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Investment Management Update

May 2024

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In This Update

Covering legal developments and regulatory news for funds, their advisers, and industry participants for the quarter ended March 31.

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RULEMAKING AND GUIDANCE

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

03.27.24

On March 27, the U.S. Securities and Exchange Commission (the SEC) adopted amendments to modernize Rule 203A-2(e) (the Internet Adviser Exemption) under the Investment Advisers Act of 1940. This new rule takes into account the evolution in technology and the investment advisory industry since the initial adoption of the rule in 2002. The amended Internet Adviser Exemption will (i) require an internet investment adviser to provide advice to all its clients exclusively through the internet (eliminating the *de minimis* exception for providing advice to a limited number of clients by other means); and (ii) replace the term “interactive website” with a new defined term, “operational interactive website,” which, among other things, is intended to pick up digital platforms and other future technology in addition to traditional websites.

Background:

In 2002, the SEC adopted what were intended to be narrow exemptions to address the registration burden placed on internet-based advisers. The Internet Adviser Exemption permitted SEC registration for advisers that provide investment advice to all of their clients exclusively through an interactive website. The rule also provided an exemption for internet-based advisers that served fewer than 15 noninternet clients within the previous 12 months. Since the implementation of the 2002 rules, the SEC staff has observed significant gaps in compliance, and the technology for providing internet-based services has advanced. The SEC staff recently noted that nearly half of those advisers relying on the internet adviser exemption were ineligible and that the SEC has cancelled registration in such instances of noncompliance. Moreover, advisers have increasingly used a variety of technologies, from mobile applications to artificial intelligence (AI), to offer and provide their services in a manner not contemplated in 2002.

2024 Amendments:

Accordingly, the SEC adopted the following amendments to the Internet Adviser Exemption:

1. **Operational Interactive Website**: The rule now requires an internet investment adviser to provide investment advice to all of its clients exclusively through an "operational" interactive website at all times during which it relies on the Internet Adviser Exemption.
2. **Digital Investment Advisory Service**: The amendments introduce the term "digital investment advisory service," which means investment advice to clients that is generated by the operational interactive website’s software-based models, algorithms, or applications based on personal information each client supplies through the operational interactive website.
3. **Form ADV**: The amendments require an investment adviser relying on the exemption as a basis for registration to represent on Schedule D of its Form ADV that, among other things, it has an operational interactive website.

The rule is effective July 8. An adviser relying on the exemption must comply with the amended rules, including the requirement to amend its Form ADV to include the required representations, by March 31, 2025. An adviser that is no longer eligible for the exemption and otherwise ineligible for SEC registration must register in one or more states and withdraw its SEC registration by filing a Form ADV-W by June 29, 2025.

A copy of the SEC's Rule Amendments can be found at: https://www.sec.gov/files/rules/final/2024/ia-6578.pdf.

02.23.24

Introduction

On February 13, the Financial Crimes Enforcement Network (FinCEN) proposed a new rule (the Proposed Rule), that, if adopted, would add certain investment advisers to the definition of "financial institution" under the Bank Secrecy Act of 1970 (BSA) and require those advisers to:

- Establish Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) programs, including risk-based procedures for conducting ongoing customer due diligence (CDD);
- Report suspicious activity to FinCEN by filing Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs);
- Maintain records of originator and beneficiary information for certain transactions;
- Apply information-sharing provisions between and among FinCEN, law enforcement, agencies, and certain financial institutions; and
- Implement special due diligence requirements for correspondent and private banking accounts, and special measures under Section 311 of the USA PATRIOT Act.[1]

Unlike banks, mutual funds, and broker dealers, which are currently "financial institutions" under the BSA, investment advisers are not required to maintain AML/CFT programs or records under the BSA. Notably, the Proposed Rule would not permit advisers to exempt mutual funds that they advise from the proposed information sharing, special standards, prohibitions, and other requirements, which are discussed below.

Many larger advisers implement AML policies and procedures as a matter of best practice and comply with Treasury's sanctions regulations,[2] but not all of those advisers are subject to regular examinations to test the adequacy of their programs.[3] FinCEN is hoping the Proposed Rule, if adopted, would close this gap and, among other things, help identify, prevent, and deter bad actors from using investment advisers to further illicit financial activity. If adopted as proposed, the

[1] Pub. L. 107-56, Section 312 (Oct. 26, 2011), codified as 31 U.S.C. 5318(i).

[2] All U.S. persons must comply with the regulations of Office of Foreign Assets Control (OFAC), including all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, and all U.S. incorporated entities and their foreign branches. OFAC is an office of the U.S. Treasury that administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against entities such as targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. OFAC regulations generally require blocking accounts and other property of specified countries, entities, and individuals; and prohibiting or rejecting unlicensed trade and financial transactions with specified countries, entities, and individuals. Many advisers maintain policies prohibiting business dealings with countries, entities, and individuals specified on the OFAC lists of "Specially Designated Nationals, Blocked Persons or Sanctioned Countries," which are available at http://www.treas.gov/offices/enforcement/ofac/sdn/.

[3] Per rule 206(4)-7, investment advisers registered with the SEC must implement and maintain policies and procedures reasonably designed to prevent and detect violations of the Investment Advisers Act of 1940, as amended (Advisers Act). SEC-registered investment advisers must maintain books and records, including those regarding their compliance programs, which are subject to regular SEC exam.

rule would apply to both SEC registered investment advisers (RIAs) and SEC exempt reporting advisers (ERAs).[4]

Notably, FinCEN is proposing to delegate examination authority for this rule to the Securities and Exchange Commission (SEC) given the SEC's expertise in the regulation of investment advisers and experience in examining other financial institutions with respect to AML/CFT responsibilities. Both RIAs and ERAs would be subject to SEC examination for compliance with the final version of the Proposed Rule.

The Proposed Rule is the latest in a series of moves by state and federal regulators attempting to combat money laundering and illicit finance activities by increasing reporting requirements for certain entities.[5] FinCEN believes the Proposed Rule would also bring the investment adviser industry more in line with its counterparts in the U.S. financial sector and around the world. FinCEN is hoping the Proposed Rule also will improve the U.S. government's understanding of priority national security threats, including funds moving through the U.S. financial system that may be associated with Russian oligarchs and investment activity that may be tied to foreign-state efforts to invest in early-stage companies developing critical or emerging technologies with national security implications.

Déjà Vu? FinCEN's Third Attempt to Issue Investment Adviser AML/CFT Rule

The BSA authorizes the Secretary of the Treasury, to define a business or agency as a "financial institution" under the BSA if it engages in any activity determined by regulation "to be an activity which is similar to, related to, or a substitute for any activity" in which a "financial institution," as defined by the BSA, is authorized to engage. The Proposed Rule is FinCEN's third attempt to define investment advisers as such. FinCEN first proposed rules in 2003, which were subsequently withdrawn in 2008.[6] Then, in 2015, FinCEN reproposed its rule, but it was never finalized. In March 2022, a group of six Senate committee chairs, including Senator Mark Warner (D-VA), chair of the Senate Intelligence Committee, sent a letter to the Treasury Department urging the agency to take up its 2015 proposal.[7] In December 2022, the U.S. Senate also tried but failed to amend the statutory definition of "financial institutions" through the proposed ENABLERS Act.[8] According to the Proposed Rule release, FinCEN will withdraw its 2015 proposal and issue

[4] ERAs are investment advisers relying on exemptions from SEC registration under sections 203(l) and 203(m) of the Advisers Act and 17 CFR 275.203(l)-1 and 275.203(m)-1. While the Proposed Rule does not apply to State-registered investment advisers, FinCEN will continue to monitor their activity for indicia of money laundering, terrorist financing, or other illicit finance activities, and may action to mitigate any such activity.

[5] Earlier this year, FinCEN's Beneficial Ownership Information Reporting Requirements went into effect, implementing Section 6403 of the Corporate Transparency Act (CTA), see our client alert here. Also, New York State passed the New York LLC Transparency Act (NYLTA), which largely mirrors the CTA and requires nonexempt LLCs in New York to disclose beneficial owner information to the New York Department of State. For more information on the NYLTA, see our client alert here.

[6] FinCEN, Anti-Money Laundering Programs for Investment Advisers, 68 FR 23646 (May 5, 2003); FinCEN, Withdrawal of the Notice of Proposed Rulemaking; Anti-Money Laundering Programs for Unregistered Investment Companies, 73 FR 65569 (Nov. 4, 2008).

[7] See Letter dated March 30, 2022, to Hon. Janet Yellen, Secretary, U.S. Department of the Treasury, from Senators Jack Reed, Richard J. Durbin, Sherrod Brown, Ron Wyden, Robert Menendez and Mark R. Warner, available at: 4B993E920232BF5068BCA4EFA3A5F5C1.money-laundering.pdf (senate.gov).

[8] See H. R. 5525, 117th Congress (2021-2022) at https://www.congress.gov/bill/117th-congress/house-bill/5525/text.

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the new Proposed Rule to ensure that changes in the risk and factual context since 2015 are taken into account.

Key Requirements of the Proposed Rule

Implementation of an AML/CFT Program

The Proposed Rule would require advisers to establish an AML/CFT program that includes:

- **Internal Policies, Procedures, and Controls**: The adviser must develop and implement internal policies, procedures, and controls to prevent the investment adviser from being used for illicit finance activities and to comply with the Bank Secrecy Act and associated regulations.
- **Designation of Responsible Person**: The adviser must designate a qualified individual (or individuals) responsible for implementing and maintaining the day-to-day operation of the AML/CFT program.
- **Ongoing Training**: The adviser must provide ongoing training in AML/CFT requirements pertinent to their roles and in identifying potential indicators of money laundering, terrorist financing, and other illicit financial activities that may occur during their responsibilities.
- **Independent Compliance Testing**: The adviser must arrange for independent compliance testing to be conducted by a qualified third party or the investment adviser's personnel.
- **Ongoing Customer Due Diligence (CDD)**: The adviser must implement risk-based procedures for ongoing customer due diligence. This includes understanding the nature and purpose of customer relationships to develop a customer risk profile, conducting ongoing monitoring to identify and report suspicious transactions, and maintaining and updating customer information based on risk.[9]

In developing their programs, advisers would not be required to adopt a one-size-fits-all approach. The Proposed Rule would give advisers the flexibility to take a risk-based approach in designing their programs by tailoring them to the specific risks of the advisory services they provide and the customers they advise.[10] FinCEN contemplates that advisers would be able to build upon existing policies, procedures, and internal controls (or the processes undertaken to establish the same) to comply with the proposed AML/CFT requirements.

[9] The proposed customer due diligence requirements incorporate two out of four core elements of the FinCEN rule titled "Customer Due Diligence Requirements for Financial Institutions," (81 Fed. Reg. 29397 (May 11, 2016) (the CDD Rule). FinCEN is not proposing to require advisers to identify and verify the identity of customers at this time (*i.e.*, a customer identification program (CIP) requirement), but according to the adopting release FinCEN anticipates addressing that requirement the future joint rulemaking with the SEC. FinCEN also is not proposing to require advisers to identify and verify the beneficial owners of legal entity customer accounts at this time because that requirement is predicated on the CIP requirement. According to the adopting release, FinCEN will not impose beneficial ownership identification and verification on advisers until the effective date of the expected revisions to the CDD Rule to bring it into conformance with the CTA. The CDD Rule must be revised for conformance no later than January 1, 2025.

[10] Since mutual funds are already defined as "financial institutions" under the BSA, the Proposed Rule would not require advisers to apply the AML/CFT program or SAR reporting requirements to mutual funds they advise. However, FinCEN did not propose to permit advisers to exempt mutual funds that they advise from the proposed information sharing, special standards, prohibitions, and other requirements, which are discussed below.

Suspicious Activity and Currency Transaction Reporting

Under the Proposed Rule, advisers would be required to file a SAR for any transaction that involves or aggregates to $5,000 or more and the financial institution knows, suspects, or has reason to suspect that the transaction:

- Involves funds derived from illegal activities or is intended or conducted to hide or disguise funds or assets derived from illegal activities;
- Is designed to evade the BSA's requirements; or
- Has no business or apparent lawful purpose or is not the type of transaction that the particular customer would normally be expected to engage in, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts.

Advisers will also be required to file a SAR if:

- The adviser suspects or has reason to suspect that an insider (such as an employee, director, officer, or controlling shareholder) is involved in a suspicious transaction, regardless of the amount involved in the transaction; or
- The adviser suspects or has reason to suspect that a suspicious transaction involves potential money laundering or violations of the BSA that require immediate attention, such as ongoing money laundering schemes.

The reporting should occur within 30 days from the initial detection of the suspicious activity. Noncompliance with this rule could lead to penalties imposed by FinCEN under the BSA. The Proposed Rule also mandates the retention of records related to SARs reporting and ensures confidentiality for firms reporting a SAR, attempting to safeguard them from liability. The proposal exempts mutual fund advisers and nonadvisory services like private equity fund advisers operating as part of a management team at a portfolio company.

To satisfy their existing obligations to report currency transactions over $10,000 in cash and negotiable instruments, the Proposed Rule would require advisers to use the Currency Transaction Report (CTR instead of the joint FinCEN/Internal Revenue Service Form 8300 (Form 8300).[11]

Recordkeeping and Travel Rule

Under the Proposed Rule, advisers would be required to comply with the Record Keeping and Travel Rule regulations of the BSA. This would mean advisers must:

- Retain records for funds transfers and transmittals of funds that equal or exceed $3,000;
- Ensure the records include the name and address of the transmitter and recipient, the amount of the transaction, the execution date, and any payment instructions received from the transmitter;

[11] See FinCEN, Proposed Renewal: Renewal Without Change of the Bank Secrecy Act Reports of Transactions in Currency Regulations at 31 CFR 1010.310 Through 1010.314, 31 CFR 1021.311, and 31 CFR 1021.313, and FinCEN Report 112-Currency Transaction Report, 85 FR 29022 (July 13, 2020).

- Retain these records for five years.
- Include certain information in transmittal orders, such as the name of the transmitter and recipient, their account numbers, and their addresses; and
- Ensure that the information "travels" with the transmittal order through each phase of the payment chain.

Information-Sharing

FinCEN's regulations under Section 314(a) of the USA PATRIOT Act enable law enforcement agencies, through FinCEN, to request information from financial institutions to locate accounts and transactions of persons that may be involved in terrorism or money laundering. The Proposed Rule would authorize law to request from advisers, where there is reasonable suspicion and credible evidence, potential lead information that might otherwise never be uncovered. Upon such a request from FinCEN, the adviser would be required to "expeditiously search its records for specified information to determine whether it maintains or has maintained any account for, or has engaged in any transaction with, an individual, entity, or organization named in FinCEN's request." An investment adviser would then be required to report any such identified information to FinCEN. Section 314(b) of the USA PATRIOT Act provides financial institutions with the ability to voluntarily share information regarding parties suspected of possible terrorist or money laundering activities with another financial institution upon notice to the Treasury under a safe harbor that offers protections from liability.

Special Standards of Diligence; Prohibitions; and Special Measures

The Proposed Rule, if adopted, would subject advisers to special due diligence standards consistent with the special due diligence standards applied to similarly situated financial institutions under the BSA. Section 312 of the USA PATRIOT Act establishes special due diligence requirements for private banking and correspondent bank accounts involving foreign persons. Specifically, advisers would be required to maintain due diligence programs for correspondent accounts for foreign financial institutions and for private banking accounts that include policies, procedures, and controls that are reasonably designed to detect and report any known or suspected money laundering or suspicious activity conducted through or involving any such correspondent or private banking accounts. In addition to meeting required minimum standards for such due diligence programs, advisers would be required to have procedures for enhanced due diligence for correspondent accounts for foreign banks and private banking accounts for senior foreign political figures.

The Proposed Rule would also require advisers to comply with special measures provisions of Section 311 of the USA PATRIOT Act and Section 9714(a) of the Combatting Russian Money Laundering Act. Section 311 requires U.S. financial institutions to implement certain "special measures" if the Secretary finds that reasonable grounds exist to conclude that a foreign jurisdiction, institution, class of transaction, or type of account is a "primary money laundering concern." Special measures range from requiring additional due diligence, recordkeeping, and reporting concerning particular account transactions, to prohibiting the opening or maintenance of

any correspondent or payable-through accounts. Section 9714(a) provides for similar special measures, but specifically in the context of Russian illicit finance.

Next Steps

The comment period for the Proposed Rule will remain open until 60 days after its publication in the Federal Register, which is April 15. If adopted, RIAs and ERAs would be required to comply with the Proposed Rule on or before 12 months from the final rule's effective date.

SEC Adopts Amendments to Enhance Private Fund Reporting

02.08.24

On February 8, the SEC and the Commodity Futures Trading Commission (CFTC) jointly adopted various amendments to Form PF, which is the regulatory filing form for certain SEC-registered investment advisers to private funds. Specifically, Form PF provides the SEC, the CFTC, and the Financial Stability Oversight Council (FSOC) with important, confidential information regarding the basic operations and strategies of private funds and their advisers. The information from Form PFs helps these government entities better understand the current state of the private fund industry and assist with assessing systemic risks in the industry.

Goals of the Form PF Amendments

The SEC and the CFTC (together, the Commissions) adopted the amendments to Form PF to further the Commissions' various initiatives for the private fund industry, which include the following:

- Improve the reporting by large hedge fund advisers on qualifying hedge funds to provide greater insight into the operations and strategies of these funds and their advisers, and also improve data quality and comparability.
- Enhance reporting of hedge funds to develop a better understanding into hedge funds' operations and strategies, identify trends, and improve data quality and comparability.
- Amend how advisers report complex structures to improve the FSOC's ability to monitor and assess systemic risk and to provide greater visibility for both the FSOC and the Commissions into these types of arrangements.
- Remove aggregate reporting for large hedge fund advisers to reduce the burden on advisers and to focus Form PF reporting on more valuable information that better assists with systemic risk assessments.

Application of the Form PF Amendments

Enhance Reporting by Large Hedge Fund Advisers on Qualifying Hedge Funds

The Form PF amendments aim to improve the reporting by large fund advisers on qualifying hedge funds, which are funds with a net value of at least $500 million. The enhanced reporting aims to provide better insights into how large hedge fund advisers report investment exposures, borrowing and counterparty exposures, market factor effects, currency exposure, turnover, country and industry exposure, central clearing counterparty reporting, risk metrics, investment performance by strategy, portfolio liquidity, and financing and investor liquidity.

Enhance Reporting on Basic Information About Advisers and the Private Funds They Advise

The Form PF amendments will also require hedge fund advisers to report additional information about themselves and their private funds. The increased reporting includes sharing identifying information, assets under management, withdrawal and redemption

rights, gross asset value and net asset value, inflows and outflows, base currency, borrowings and types of creditors, fair value hierarchy, beneficial ownership, and overall fund performance. This increased reporting aims to enhance data quality and comparability, reduce reporting errors, and assist in identifying trends, especially trends that could result in systemic risk.

Enhance Reporting Concerning Hedge Funds

The amendments will require more detailed reporting on Form PFs regarding hedge fund investment strategies, counterparty exposures, and trading and clearing mechanisms employed by hedge funds. They will also remove duplicative questions on the Form PF. The reporting improvements on Form PFs are designed to lead to greater insight into hedge funds' operations and strategies, assist in identifying trends, and improve data quality and comparability.

Amend How Advisers Report Complex Structures

For more complex fund structures, specifically master-feeder arrangements and parallel fund structures, the Form PF amendments will require separate reporting for each component fund of the given fund structure. The amendments will also require advisers to identify trading vehicles used by the reporting funds, and then report on them on an aggregated basis to provide the Commissions and the FSOC with better visibility into trading vehicles. The enhanced reporting will assist the Commissions with identifying areas in need of outreach, examination, or investigation, which will improve the Commissions' efforts to protect investors.

Remove Aggregate Reporting for Large Hedge Fund Advisers

Currently, Form PF requires large hedge fund advisers to report specific aggregated information about the particular hedge funds they advise. The aggregated information, however, can often obscure data about the hedge funds. For instance, the aggregated information could conceal the directional exposure of individual funds. The Form PF amendments will remove this aggregate reporting requirement so that Form PF reporting can produce more beneficial information on trends and risks to hedge funds.

In sum, these Form PF amendments aim to provide greater insights in the operations and strategies of private funds, help identify trends in the industry, especially those that could create systemic risk, enhance data quality and comparability, and limit reporting errors.

The final amendments will become effective on March 12, 2025. This effective date will also serve as the compliance date for the amendments.

A copy of the SEC Amendments to Enhance Private Fund Reporting can be found at: https://www.sec.gov/files/ia-6546-fact-sheet.pdf.

SEC Releases New Guidance on Tailored Shareholder Reports

01.23.24

On January 19, the Division of Investment Management staff at the Securities and Exchange Commission (SEC), released several responses to frequently asked questions (FAQs) related to the adoption of rules and form amendments for registered open-end funds (*i.e.*, mutual funds and ETFs) that will substantially alter the form and content of fund shareholder reports. In October 2022, the SEC adopted amendments (Adopting Release) to rules under the Securities Act of 1933 and Investment Company Act of 1940, as well as Forms N-1A and N-CSR, in an effort to require funds to, among other things, transmit "concise and visually engaging" shareholder reports.

The FAQs address what an appropriate broad-based securities market index is, Form N-CSR and website availability requirements, binding individual shareholder reports of multiple funds, electronically provided shareholder reports, and compliance date and Inline XBRL issues. The full text of the new FAQs can be found here: https://www.sec.gov/investment/tailored-shareholder-reports-faqs.

APPROPRIATE BROAD-BASED SECURITIES MARKET INDEX

- The final rules require a fund to show its performance against an "appropriate broad-based securities market index," which is defined as "the overall applicable domestic or international equity or debt markets, as appropriate." In the Adopting Release, the SEC stated that a fund must select an index that "reasonably represents" the applicable market, and provided examples that pertain to funds that invest primarily in equity securities, which left open questions for funds that primarily invest in fixed income securities.
- The staff clarifies that a fund that invests primarily in tax-exempt municipal securities, including a fund that invests primarily in the municipal income securities of a single state, may use an index that reflects the national ***municipal*** securities market as its appropriate broad-based securities market index, rather than an index that reflects the national ***aggregate*** fixed income securities market (emphasis added). The staff stated that, in their view, because tax-exempt municipal bonds are distinct from other types of securities, the national municipal securities market may be understood as a standalone overall market as opposed to a mere subset of the fixed income market. *(FAQ #2)*
- The staff's omission of a FAQ related to other types of funds that invest primarily in fixed income securities (*e.g.*, high yield bond funds) may draw the negative implication that such funds do *not* warrant the special consideration seemingly paid to municipal fixed income funds, and, accordingly, may not use an index that reflects their related national fixed income securities market (*e.g.*, the national high yield bond market). Accordingly, absent further guidance, a prudent approach for fixed income funds (other than tax-exempt municipal securities funds) would be to select an index that reflects the national aggregate fixed income securities market.

FORM N-CSR AND WEBSITE AVAILABILITY REQUIREMENTS

- In connection with each shareholder report, the final rules (rule 30e-1) require a fund to make certain disclosures required by Form N-CSR (Items 7 through 11) publicly available, free of charge, on the fund's website. Alternatively, the fund may post the complete Form N-CSR. For funds that are registered under the Investment Company Act of 1940, as amended (1940 Act), but that offer and sell their securities without registration under the Securities Act of 1933, as amended (Securities Act), the new regulatory requirement to disclose fund information raised questions regarding whether such disclosure would violate the prohibition on general solicitation and advertising in Regulation D under the 1933 Act.
- The staff clarifies that compliance with the requirement to post Form N-CSR information online under amended rule 30e-1 would not be a violation of rule 502(c) of Regulation D, so long as the fund posts only the information required by the rule and does not use its website to offer or sell securities or in a manner that is deemed to be general solicitation or advertising for offers or sales of its securities. *(FAQ #5)*

BINDING INDIVIDUAL SHAREHOLDER REPORTS OF MULTIPLE FUNDS

- New Instruction 4 to Item 27A(a) provides that a fund must prepare a separate shareholder report for each series of a fund, and if a series has multiple classes, to prepare a separate shareholder report for each class within the series. In the Adopting Release, the SEC stated that such requirement is intended to address circumstances where (1) one shareholder report addresses multiple funds and/or share classes; and/or (2) an investor receives information about multiple funds, but the investor is not actually invested in all of these funds.
- The staff clarifies that where an investor has invested in multiple funds (or in multiple share classes of funds), the individual shareholder reports of each of such funds (or, as applicable, share classes) may be bound, stapled, or stitched together for transmission to the investor because such practice does not raise the same concerns about multiseries shareholder reports that the SEC discussed in the Adopting Release. The staff notes that a fund should consider including a table of contents to any bound, stapled, or stitched shareholder report for investors' ease of use. *(FAQ #6)*

ELECTRONICALLY PROVIDED SHAREHOLDER REPORTS

- In FAQ #9, the staff clarifies that there is more than one approach that would be consistent with the requirements of Instruction 4 to Item 27A(a) of Form N-1A for a fund to deliver their fund and share-class specific shareholder report directly to an investor, including delivering an email, or otherwise electronically transmitting a notification to investors, that (i) includes direct links to the shareholder report(s) of the fund(s) and share class(es) that the investor owns, and (ii) specifies the investor's fund(s) and share-class(es) and includes a link directing the investor to a website landing page that includes direct links that are limited to the shareholder report(s) for the fund(s) and share class(es) that the investor owns. *(FAQ #9)*

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COMPLIANCE DATE AND INLINE XBRL ISSUES

- In FAQ #10, the staff clarifies that funds should include the shareholder report that was actually transmitted to shareholders in the respective Form N-CSR, regardless of whether the Form N-CSR is filed before or after the compliance date, *i.e.*, July 24, 2024. *(FAQ #10)*

We are available to discuss these updates and other considerations related to the new Tailored Shareholder Reports requirements. Please do not hesitate to contact us with any questions.

A copy of the SEC's Guidance is available here: https://www.sec.gov/investment/tailored-shareholder-reports-faqs.

LITIGATION AND ENFORCEMENT

SEC Charges Van Eck Associates for Failing to Disclose Influencer's Role in Connection With ETF Launch

02.16.24

On February 16, the SEC entered a cease and desist order and imposed remedial sanctions alongside a $1.75 million fine against Van Eck Associates Corporation (VEAC), a registered investment adviser, for disclosure failures in connection with the high-profile launch of its new exchange traded fund (EFT), the VanEck Social Sentiment EFT (BUZZ EFT), in March 2021.

According to the SEC, VEAC failed to disclose to the independent trustees of the VanEck EFT Trust (board) a prominent social media influencer's, well-known for his controversial commentary on sports, investing, and other topics (influencer), planned involvement and the details of the influencer's anticipated licensing arrangement during its review and approval of the fund launch, the management fee, and the renewal of the VEAC advisory contract for the BUZZ EFT.

At the outset of the BUZZ ETF launch, VEAC offered economic terms for an exclusive license to use the BUZZ NextGen AI US Sentiment Leaders Index (BUZZ Index) from the index provider. The BUZZ Index identifies U.S. stocks based on "positive insights" from social media and other data. The index provider, in response, planned to partner with the influencer to market and promote the BUZZ Index in tandem with the BUZZ ETF launch. The provider also suggested a new licensing fee structure, which included an ownership stake for the influencer and a sliding scale fee that would increase their compensation if the BUZZ ETF's assets reached certain levels. Importantly, VEAC had no prior experience working with the influencer to promote an ETF or an index used by a VEAC-advised ETF; yet still agreed to, and later executed, the agreement.

In the board meeting materials, VEAC misrepresented the expected licensing fee terms to be paid to the index provider and the influencer, disclosing only the 20% net management fee and omitting the sliding scale. The materials did not disclose VEAC's projected profitability from the BUZZ ETF, the expected economies of scale, the influencer's promotional role and compensation, or the potential brand risk due to the influencer's controversies. Despite the limited information, the board approved the advisory contract and the BUZZ ETF launch. However, the minutes do not show that the board was informed about the economic terms of the licensing agreement or the influencer's role, compensation, and controversies.

Thus, the SEC determined that VEAC both misrepresented and failed to disclose crucial details to the board regarding: (a) the licensing agreement with the index provider, and (b) the influencer's involvement, compensation, and associated controversies. Furthermore, VEAC did not establish and enforce policies and procedures neither to adequately prevent violations of the Advisers Act and its rules, nor to furnish the board with accurate information reasonably necessary to properly access and evaluate the terms of the advisory contract.

Andrew Dean, co-chief of the Enforcement Division's Asset Management Unit, emphasized the importance of accurate disclosures, stating, "Fund boards rely on advisers to provide accurate disclosures, especially when involving issues that can impact the advisory contract, known as the

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15(c) process." He added that VEAC's disclosure failures limited the board's ability to consider the economic impact of the licensing arrangement for the Fund and the involvement of a prominent social media influencer.

As a result of its conduct, the SEC found that VEAC willfully violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and violated Section 15(c) of the Investment Company Act.

Due in part to VEAC's prompt correction of their policies and processes, and cooperation with the investigation, the SEC and VEAC reached a settlement in which (1) VEAC must cease and desist from committing or causing any violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 thereunder, and Section 15(c) of the Investment Company Act; (2) VEAC is censured; and (3) VEAC will pay a fine of $1,750,000 to the SEC.

For a copy of the SEC's Administrative Order, click https://www.sec.gov/files/litigation/admin/2024/ic-35132.pdf.

The SEC Press Release is available at https://www.sec.gov/news/press-release/2024-20.

SEC AND SRO NEWS

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

02.28.24

The SEC has announced that William Birdthistle, the Director of the SEC's Division of Investment Management, left the agency effective March 8, and is succeeded by Natasha Vij Greiner, who previously served as the Deputy Director of the Division of Examinations. The Division of Investment Management is responsible for regulatory policy oversight for investment advisers and investment companies, including mutual funds and other investment products and services relied upon by retail investors.

Birdthistle, who joined the SEC in December 2021, was instrumental in strengthening oversight of investment companies and investment advisers. His tenure saw the adoption of significant rulemakings related to private fund advisers and their reporting on Form PF, as well as to public funds, including money market fund reforms, tailored shareholder reports, and revisions to the Fund Names Rule. He also initiated the SEC's annual Conference on Emerging Trends in Asset Management. Following his departure, Birdthistle plans to return to academia.

SEC Chair Gary Gensler expressed his gratitude to Birdthistle for his service. Gensler also welcomed Greiner to her new role, praising her deep and broad expertise gained from leading the agency's Investment Adviser/Investment Company (IA/IC) examination program and serving in other key leadership roles over her more than two-decade tenure at the SEC.

Greiner's extensive experience at the SEC includes serving as the national associate director of the IA/IC examination program, which includes the Private Funds Unit, and as the associate director of the Home Office IA/IC examination program. She has also served as Acting Chief Counsel and Assistant Chief Counsel in the Division of Trading and Markets, and worked in the Division of Enforcement, including in its Asset Management Unit.

A copy of the SEC's press release is available at https://www.sec.gov/news/press-release/2024-27.

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