

# SEC Settles Compliance Rule Violations with ICE Subsidiary

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On December 9, 2020, the Securities and Exchange Commission (SEC) settled an enforcement action against ICE Data Pricing & Reference Data LLC (PRD), a global securities pricing service and registered investment adviser, for compliance deficiencies relating to its client delivery of prices based on quotes it received from a single market participant, also known as single broker quotes. PRD agreed to pay \$8 million to settle the charges.

According to the SEC's order, from at least 2015 through September 2020, PRD delivered prices based on single broker quotes to its clients, while failing to adopt and implement policies and procedures reasonably designed to address the risk that these prices would not reasonably reflect the value of the securities.

Certain investment advisers must provide daily, monthly, and/or annual valuations to clients. For example, mutual funds must determine the net asset value of their portfolios on a daily basis, which determines the price at which investors can purchase and redeem shares. In certain circumstances, the value of a security may be readily ascertainable (e.g., quoted prices in active markets for identical assets or liabilities). In other instances, the value of a security may be difficult to ascertain for reasons, including illiquidity or lack of readily ascertainable inputs. In such instances, investment advisers may turn to pricing services, such as PRD.

PRD provides institutions, investment funds, and other types of financial services customers with securities pricing, evaluations, reference data, analytics data, and corporate actions data. Where observable market-based inputs are available, PRD provides independent pricing evaluations to assess what the holder of a particular security may receive in an orderly sale under current market conditions. PRD provides such evaluations for the majority of the 2.8 million fixed-income securities for which it provides pricing information. Observable market-based inputs used by PRD in its evaluation process may include benchmark yields, reported trades, bids, offers, and two-way markets.

But for approximately 46,000 securities, where observable market-based inputs were unavailable, PRD provided customers only a single broker-quoted price.

The SEC found that PRD did not adopt or implement reasonably designed policies or procedures concerning the provision of single broker-quoted prices. PRD did not have policies or procedures to address the risk that a quote it received from a market participant would not reasonably reflect a security's value, and its quality controls were not effectively or consistently implemented.

For example, PRD's policies and procedures did not allow PRD to detect that it had received unchanged prices

for a specific fixed-income security for more than 18 months from a market maker in such security. Additionally, PRD did not consider other market information for broker-quoted securities, even when clients presented PRD with trades or other market information that suggested the broker-quoted price may not reasonably reflect a security's value.

The SEC stopped short of finding that PRD's quotes were inaccurate. Nonetheless, misquotes have many downstream effects. For example, mispriced securities may affect trading decisions by portfolio managers, net asset value calculations, asset management fees, and ultimately the returns of end investors.

The SEC found that PRD's failure to adopt and implement reasonably designed policies and procedures for broker quotes resulted in PRD delivering single broker-quoted prices to clients that may not have reasonably reflected the security's value.

As a result of these infractions, the SEC said that PRD willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require registered investment advisers to, among other things, adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules adopted thereunder.

This enforcement action underscores the importance of data providers in the financial system and illustrates the reach of securities laws. PRD is not a traditional investment adviser, but it falls within the scope of the definition of "investment adviser" due to its provision of advice about the value of securities. All investment advisers — data providers and asset managers alike — should have policies and procedures carefully tailored to their actual business to prevent violations of the securities laws.

For example, asset managers should have policies and procedures in place, which provide for challenging price quotes that do not appear accurate. Asset managers may also consider engaging secondary or tertiary data providers to avoid relying on a single source of information.

Valuation is a recent area of focus for the SEC. The SEC recently adopted Rule 2a-5 under the Investment Company Act of 1940, which provides a framework for a registered investment company's fair valuation process. Investment advisers and investment company boards would do well to evaluate their compliance policies and procedures and fair valuation processes in light of the SEC's focus on this space.

Troutman Pepper brings deep experience in counseling asset managers and other financial industry participants. For questions, please contact any of the authors of this advisory.

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