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Regulatory Recap
August 30, 2024

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- **Merrill and BofA Fined for Failing to Monitor Manipulative Trading**

Notable Developments:

SEC Adopts Amendments to Registered Investment Companies' Reporting Requirements and Provides Guidance on Open-End Funds' Liquidity Risk Management Program Requirements

On August 28, 2024, the SEC adopted amendments to reporting requirements by registered investment companies on portfolio holdings (on Form N-Port) and liquidity risk management (on Form N-CEN). The SEC also provided related guidance on open-end fund liquidity risk management program requirements.

The amendments 1) require funds to file Form N-PORT reports for a given month within 30 days of the end of that month instead of filing these monthly reports on a quarterly basis within 60 days after quarter-end as required by the current rules; 2) make monthly Form N-PORT reports available to the public 60 days after the end of each month instead of every third month of a quarter only; and 3) require information about service providers that open-end funds use to comply with requirements under Investment Company Act Rule 22e-4.

In addition, the SEC adopted reporting amendments to Form N-CEN to require open-end funds to report certain information about service provides used to fulfill liquidity risk management program requirements to allow the SEC to track certain liquidity risk management practices. The SEC also provided guidance related to certain aspects of open-end fund liquidity risk management program requirements to address questions raised through outreach and monitoring.

The amendments to Forms N-PORT and N-CEN will become effective November 17, 2025. Funds will be required to comply with the amendments for reports filed on or after that date, except that fund groups with net assets of less than $1 billion will have until May 18, 2026, to comply with the Form N-PORT amendments.

FINRA Provides Update on Member Firms' Crypto Asset Activities

FINRA published a summary of data it collected concerning its member firms' crypto asset activities. Beginning in 2018, FINRA has asked member firms to notify their Risk Monitoring Analyst if the firm, their associated persons or affiliates engage, or plan to engage, in activities related to crypto assets. In 2023, FINRA supplemented these engagement efforts by asking nearly 600 member firms to complete a questionnaire concerning crypto asset activities.

According to FINRA, the collected data was published in an effort to help member firms develop new, or modify existing, policies and procedures to achieve compliance with a firm's current relevant regulatory obligations. The publication did not create new legal or regulatory

requirements or new interpretations of existing requirements, nor did it relieve firms of any existing obligations under federal securities laws and regulations.

Furthermore, according to FINRA, the collected data was collected to allow FINRA develop a detailed understanding of member firms' crypto asset activities to inform and enhance FINRA's regulatory operations, while also allowing FINRA to understand the ways in which member firms were connected to the broader crypto asset industry, allowing FINRA to quickly assess the impact of future crypto asset-related events on member firms.

FINRA identified the following (non-exhaustive) list of potential violations and disciplinary activities involving crypto asset-related activities that it observed as a result of collecting the data:

- Potential violations of FINRA Rule 2210 (Communications with the Public), including, for example, misrepresentations of the extent to which the protections of the federal securities laws or FINRA rules applied to crypto asset-related activities. For further detail, FINRA directed readers to its update, FINRA Provides Update on Targeted Exam: Crypto Asset Communications (January 2024).
- Potential violations of FINRA Rule 3110 (Supervision), including failures to complete reasonable due diligence on crypto asset private placements and engage in effective supervision designed to monitor crypto asset activities.
- Disciplinary actions finding violations of FINRA Rules 3270 (Outside Business Activities of Registered Persons), 3280 (Private Securities Transactions of an Associated Person), and 3110 for failures related to the disclosure of crypto asset outside business activities and the approval and supervision of private securities transactions.
- Potential violations of FINRA Rule 3310 (Anti-Money Laundering Compliance Program) related to the failure by member firms to establish AML programs reasonably designed to detect and cause the reporting of suspicious transactions in crypto assets conducted or attempted by, at or through the broker-dealer.
- Disciplinary actions finding violations of FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) related to: (i) a member firm and associated person negligently causing the dissemination of promotional materials that the member firm or associated person should have known contained material misstatements and omitting material facts related to the member firm's crypto asset business; (ii) an associated person facilitating money movements and crypto asset-related activities, even though the associated person believed funds were the proceeds of illegal activities and part of money laundering activities; and (iii) associated persons

providing false responses relating to crypto asset outside business activities or private securities transactions on a member firm's annual compliance questionnaire.

- Disciplinary action findings regarding violations of FINRA Rule 8210 (Provision of Information and Testimony and Inspection and Copying of Books) related to associated persons failing to provide records on crypto asset-related outside business activities and private securities transactions, failing to provide such records in a timely manner, or failing to appear for testimony related to crypto asset-related outside business activities and private securities transactions.
- Potential situations where individuals are seeking to take advantage of investor interest in crypto assets and blockchain technology to perpetrate pump-and-dump schemes and other forms of market abuse in the equity markets.

FINRA's publication also provided detail on trends and themes regarding the depth of use and potential breadth of activity of crypto assets across its surveyed firms generally.

FINRA cautions member firms seeking to engage in crypto asset-related activities that they "should proactively identify and address the relevant regulatory and compliance challenges and risks of such activities." FINRA suggest that such proactive activity "may include, for example, reviewing and evaluating their supervisory programs and controls, and compliance policies and procedures, in areas such as cybersecurity, AML compliance, communications with the public, manipulative trading, performing due diligence on crypto asset private placements and their associated persons' involvement in crypto asset-related OBAs and PSTs."

Federal Court Blocks FTC Ban on Noncompete

On August 20, 2024, U.S. district Judge Ada Brown for the Northern District of Texas issued a ruling that the FTC cannot enforce its recent near-total ban on noncompete agreements that was set to go into effect next month. The decision follows a partial block of the rule, previously reported here.

The ruling sides with the US Chamber of Commerce and a Texas-based tax firm that sued to block the measure. According to the ruling, the FTC lacked the authority to enact the ban, which was "unreasonably overbroad without a reasonable explanation."

The ruling divides the judiciary over the regulator's powers. A federal judge in Pennsylvania had previously sided with the FTC. The rule is therefore likely to be headed for appellate review.

SEC Enforcement:

SEC Charges Twenty-Six Firms with Recordkeeping Failures

On August 14, 2024, the SEC announced charges against 26 broker-dealers, investment advisers, and dually-registered broker-dealers and investment advisers for widespread and longstanding failures by these firms and their personnel to maintain and preserve electronic communications, following separate investigations into each firm.

According to the SEC, these firms "admitted the facts set forth in their respective SEC orders, acknowledged that their conduct violated recordkeeping provisions of the federal securities laws, agreed to pay combined civil penalties and have begun implementing improvements to their compliance policies and procedures to address these violations."

Also according to the SEC, three of the firms self-reported their violations and, as a result, will pay significantly lower civil penalties than they would have otherwise.

The firms referenced in the SEC press release include: Ameriprise Financial Services, Edward D. Jones & Co., LPL Financial, Raymond James & Associates, RBC Capital Markets, BNY Mellon Securities Corporation, together with Pershing LLC, TD Securities (USA), together with TD Private Client Wealth LLC and Epoch Investment Partners, Inc., Osaic Services, together with Osaic Wealth, Cowen and Company, together with Cowen Investment Management, Piper Sandler & Co., First Trust Portfolios L.P., Apex Clearing Corporation, Truist Securities, together with Truist Investment Services and Truist Advisory Services, Cetera Advisor Networks, together with Cetera Investment Services, Great Point Capital, Hilltop Securities, P. Schoenfeld Asset Management and Haitong International Securities (USA).

Each of the SEC's investigations uncovered pervasive and longstanding use of unapproved communication methods at these firms. As described in the SEC's orders, the firms admitted that, during the relevant periods, their personnel sent and received communications that were records required to be maintained under the securities laws. The failure to maintain and preserve required records deprives the SEC of these communications in its investigations. The failures involved personnel at multiple levels of authority, including supervisors and senior managers.

The firms were each charged with violating certain recordkeeping provisions of the Securities Exchange Act, the Investment Advisers Act, or both. The firms were also each charged with failing to reasonably supervise their personnel with a view to preventing and detecting those violations.

SEC Charges Carl Icahn and Icahn Enterprises L.P. for Failing to Disclose Pledges of Company's Securities as Collateral

On August 19, 2024, the SEC announced charges against Carl C. Icahn and his publicly traded company, Icahn Enterprises L.P. (IEP), for failing to disclose information relating to Icahn's pledges of IEP securities as collateral to secure personal margin loans under agreements with various lenders. IEP and Icahn agreed to pay civil penalties to settle the SEC's charges.

According to the SEC's orders, "from at least December 31, 2018, through the present, Icahn, who is IEP's controlling shareholder and Chairman of the board of directors of IEP's general partner, pledged approximately 51 to 82 percent of IEP's outstanding securities as collateral to secure personal margin loans worth billions of dollars under agreements with various lenders." The SEC contends that IEP failed to disclose these pledges in its Form 10K until February 25, 2022, as required. The SEC further contends that Icahn also failed to file amendments describing his personal margin loan agreements and amendments, which dated back to at least 2005, and failed to attach required guaranty agreements, which failure continued through at least 2023.

The SEC's orders find that IEP violated Section 13(a) of the Securities Exchange Act and Rule 13a-1 thereunder and that Icahn violated certain beneficial ownership reporting provisions of the Exchange Act. Without admitting or denying the findings, IEP and Icahn agreed to cease and desist from future violations and to pay the civil penalties.

SEC Charges Transfer Agent Equiniti Trust Co. with Failing to Protect Client Funds Against Cyber Intrusions

On August 20, 2024, the SEC announced settled charges against registered transfer agent Equiniti Trust Company LLC, for failing to assure that client securities and funds were protected against theft or misuse.

According to the SEC's order, an unknown actor hijacked a pre-existing email chain between what Equiniti (formerly known as American Stock Transfer) and a U.S.-based public-issuer client. The actor, pretending to be an employee at the issuer, then instructed American Stock Transfer to issue millions of new shares of the issuer, liquidate those shares, and send the proceeds to an overseas bank. The SEC's order finds that American Stock Transfer followed these instructions and transferred approximately $4.78 million to bank accounts located in Hong Kong.

In addition, the SEC's order finds that, in an unrelated incident, an unknown actor used stolen Social Security numbers of certain American Stock Transfer accountholders to create fake accounts that were automatically linked by American Stock Transfer to real client

accounts based solely on the matching Social Security numbers, even though the names and other personal information associated with the fraudulent accounts did not match those of the legitimate accounts. This allowed the actor to liquidate securities held in the legitimate accounts and transfer a total of approximately $1.9 million in proceeds to external bank accounts.

The SEC's order finds that Equiniti violated Section 17A(d) of the Securities Exchange Act of 1934 and Rule 17Ad-12 thereunder.

In Case You Missed It:

NYSE Withdraws Rule Change Permitting Listing Crypto Asset-Referenced Securities

On August 9, 2024, NYSE withdrew its proposed rule change to permit the listing and trading of options on the Bitwise Bitcoin ETF, the Grayscale Bitcoin Trust, and any trust that holds bitcoin. As previously reported, Cboe withdrew a similar rule change earlier this month, but proposed a rule change to list options referencing Ethereum ETFs.

Morgan Stanley Smith Barney Settles FINRA Charges Over Inaccurate Disclosures on Mark-Ups

Morgan Stanley Smith Barney settled FINRA charges for failing to accurately disclose mark-up and mark-down information on municipal and corporate debt securities transactions.

According to the letter of acceptance, waiver and consent, the Morgans Stanely provided non-institutional customers with confirmations that either inaccurately disclosed or failed to disclose required mark-up or mark-down information. FINRA found that the firm did not include the trade execution time and references or hyperlinks to relevant EMMA and TRACE webpages on customer confirmations. The firm self-identified these issues in June 2021 and reported them to FINRA.

FINRA further found that the firm did not have reasonably designed processes in place to test the accuracy of the information that triggered mark-up and mark-down disclosures. As a result, the firm's supervisory system was not adequately designed to ensure compliance with requirements related to the time of execution and security-specific URL disclosures.

FINRA found that the firm violated MSRB Rules G-27 and G-15 and FINRA Rules 2010, 3110 and 2232.

Merrill and BofA Fined for Failing to Monitor Manipulative Trading

Merrill Lynch, Pierce, Fenner & Smith and BofA Securities, settled FINRA charges for failing to supervise trading activities to detect and prevent potentially manipulative practices.

FINRA found that the firms relied on third-party automated surveillance systems that were not appropriately configured to capture various forms of manipulative trading activity. FINRA concluded that 1) the automated systems in place were set up with overly narrow criteria that only flagged trades executed within the same account simultaneously or within a narrow window; 2) the surveillance systems excluded certain types of securities from oversight; 3) the firms failed to review approximately 155 alerts related to potentially manipulative equity trades and about 1,000 alerts for potentially manipulative options trades; and 4) despite warnings, the firms failed to update their surveillance parameters or review processes to ensure the detection of all potentially manipulative trading.

FINRA concluded that the firms violated FINRA Rule 2010 and Rule 3110.