Wenchi Hu PLLC
Regulatory Recap
September 19, 2024

Notable Developments:

- **SEC Adopts Amendments to Reg NMS Regarding Minimum Pricing Increments and Access Fee Caps**

SEC Enforcement:

- **SEC Charges DeFi Platform and Its Founders with Misleading Investors, Acting as Unregistered Brokers and Engaging in Unregistered Offerings**
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- **SEC Charges Nine Investment Advisers with Marketing Rule Violations**
- **SEC Charges Credit Rating Agencies with Recordkeeping Failures**

In Case You Missed It:

- **CFTC Issues Order Against Uniswap Labs for Offering Illegal Digital Asset Derivatives Trading**
- **J.P. Morgan Settles FINRA Charges for Failing to Register Investment Banking Employees**

Notable Developments:

SEC Adopts Amendments to Reg NMS Regarding Minimum Pricing Increments and Access Fee Caps

On September 18, 2024, the SEC adopted final rules that amend certain rules under Regulation NMS.

First, the final rules amend Rule 612 of Regulation NMS to establish a new, additional $0.005 minimum pricing increment, or "tick size," for quotations and orders in NMS stocks that are priced at, or greater than $1.00 per share. Easing constraints on ticks by adding an additional lower minimum tick size would allow for narrower spreads, reduce transaction costs, and allow prices to be determined in a more competitive manner. The tick size for all NMS stocks will be based on the Time Weighted Average Quoted Spread for the relevant NMS stock

during a specified three-month evaluation period and thereafter assigned for a six-month period.

Second, the final rules amend Rule 610 of Regulation NMS to reflect the new $0.005 minimum pricing increment under Rule 612, address distortions associated with access fees and rebates under the existing access fee caps, address potential conflicts of interest and increase the transparency of exchange fees, rebates and other forms of remuneration. Currently, Rule 611 of Regulation NMS promotes intermarket price protection of orders by restricting the execution of transactions on one trading venue at prices that are inferior to protected quotations at another trading venue. Under Rule 610, trading venues are subject to a cap in the amount of fees they can charge market participants for access to the bids and offers protected by Rule 611. The access fee caps help to ensure that market participants have fair access to the best displayed prices. The amendments adopted by the SEC will reduce the level of the access fee caps. For protected quotations and other best bids and offers in NMS stocks priced at $1.00 or more, the access fee cap will be $0.001 per share. For protected quotations and other best bids and offers in NMS stocks priced less than $1.00, the access fee cap will be 0.1 percent of the quotation price per share.

In addition, the amendments to Rule 610 will prohibit a national securities exchange from imposing any fee or providing any rebate for the execution of an order in an NMS stock unless such fee or rebate can be determined at the time of execution. Any national securities exchange will be required to set any volume thresholds or tiers based on volume achieved for a period prior to the assessment of the fee or rebate. This will enable market participants to determine what fee or rebate level would be applicable to any submitted order at the time of execution and facilitate their best execution analysis.

Third, the final rules will amend the implementation schedule of the MDI Rules adopted in 2020 to accelerate the date by which market participants must implement the odd-lot information and round lot definitions adopted under the MDI Rules. The amendments will require the existing exclusive securities information processors (SIPs) to collect, consolidate, and disseminate odd-lot information and will require national securities exchanges and associations to provide the data necessary to generate odd-lot information to the exclusive SIPs. Finally, the amendments to the definition of odd-lot information under Rule 600(b) will add a new data element that will identify the best odd-lot orders to buy and sell across all national securities exchanges and national securities associations.

The amendments will become effective 60 days after the date of publication of the adopting release in the Federal Register. For Rule 612, Rule 610, and the round lot definition, the compliance date will be the first business day of November 2025. For odd-lot information, the compliance date will be the first business day of May 2026.

SEC Enforcement:

SEC Charges DeFi Platform and Its Founders with Misleading Investors and Acting as Unregistered Brokers and Engaging in Unregistered Offerings

On September 18, 2024, the SEC announced settled charges against Rari Capital, Inc., a decentralized finance (DeFi) protocol and its co-founders for misleading investors and engaging in unregistered broker activity and unregistered securities offering. According to the SEC's complaint, Rari Capital offered investment products that functioned like crypto asset investment funds, allowing investors to deposit crypto assets in the lending pools and earn returns from their investments. The SEC alleges that, by selling interests in these lending pools and the governance tokens, Rari Capital conducted unregistered offers and sales of securities. The complaint further alleges that Rari Capital and its co-founders misled investors by stating that the lending pools would automatically and autonomously rebalance assets, while in fact, the rebalancing mechanism required manual input and the rebalancing mechanism failed several times. In addition, the complaint also alleges that Rari Capital acted as unregistered brokers using a platform to effect transactions in investment contracts for the accounts of users.

SEC Charges a Broker-Dealer Firm with Regulation Best Interest Violations

On September 18, 2024, the SEC announced settled changes against First Horizon Advisors, Inc., a registered broker-dealer, with failure to maintain and enforce policies and procedures reasonably designed to comply with Regulation Best Interest (Reg BI). According to the SEC's order, First Horizon migrated more than 5,000 customer brokerage accounts to its system from that of a broker dealer with whom First Horizon had merged. Because of incompatibilities in the two systems First Horizon did not have accurate customer information necessary to review certain structured notes recommendations for compliance with First Horizon's Reg BI policies and procedures. In addition, the registered representatives who joined First Horizon from the merging broker-dealer did not have access to First Horizon's exception reporting site to review structured notes transactions flagged as non-compliant, as required by First Horizon's Reg BI policies and procedures. The SEC's order also finds that, in 2023, the firm approved structured note recommendations without all the documentation required by its Reg BI policies and procedures.

SEC Charges ClearPath with Custody Rule and Liability Disclaimer Violations

On September 3, 2024, the SEC announced settled charges against ClearPath Capital Partners LLC for failing to comply with requirements related to the safekeeping of client

assets and for its use of impermissible liability disclaimers in its advisory and private fund agreements.

According to the SEC's order, ClearPath failed to timely distribute annual audited financial statements to investors in certain private funds that it advised. In addition, in its advisory agreements and certain private fund partnership and operating agreements, ClearPath included liability disclaimers that could lead a client to incorrectly believe that the client had waived non-waivable causes of action against the adviser. Certain of the liability disclaimers also contained misleading statements regarding ClearPath's otherwise unwaivable fiduciary duty.

The SEC's order finds that ClearPath violated sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

SEC Brings Cease-and-Desist Orders Concerning Forfeiture of Whistleblower Claims in Employment Contracts

On September 9, 2024, the SEC announced settled changes against seven public companies concerning certain employment contracts that violated whistleblower protection rules. The employment contracts in question generally contained provisions that required certain employees to waive rights to recover monetary awards for participating in investigations by government agencies.

The SEC's orders concluded that these provisions of the employment contracts violated Exchange Act Rule 21F-17(a), which prohibits impediments to individuals communicating direction with the SEC about securities law violations. Acadia Healthcare Company, Inc., a.k.a. Brands Holding Corp., AppFolio, Inc., IDEX Corporation, LSB Industries, Smart for Life, Inc. and TransUnion each consented to the order and agreed to civil penalties and take remedial measures, including revising contract templates and contacting affected current and former employees as to the unenforceability of the relevant provisions.

SEC Charges Nine Investment Advisers with Marketing Rule Violations

On September 9, 2024, the SEC announced charges against nine registered investment advisers for violating the Marketing Rule by disseminating advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures.

The nine firms that agreed to settled the charges are: Abacus Planning Group Inc., AZ Apice Capital Management LLC, Beta Wealth Group, Inc., Droms Strauss Advisors Inc., Howard Bailey Securities LLC, Integrated Advisors Network LLC, Professional Financial Strategies Inc., Richard Bernstein Advisors LLC and TS Bank d/b/a Callahan Financial Planning.

The specific conduct alleged in the charges included publishing advertisements with untrue statements about third-party ratings, falsely claiming to be a member of an organization that did not exist, disseminating advertisements that claimed to provide conflict-free advisory services without substantiation, disseminating unsubstantiated claims concerning an award provided to a firm principal, disseminating advertisements incorrectly citing testimonials and publishing out of date third-party ratings without disclosing the dates on which the ratings were given or the periods of time upon which the ratings were based.

SEC Charges Credit Rating Agencies with Recordkeeping Failures

On September 3, 2024, the SEC announced charges against six nationally recognized statistical rating organizations for significant failures by the firms and their personnel to maintain and preserve electronic communications. Each of Moody's Investors Service, Inc., S&P Global Ratings, Fitch Ratings, Inc., HR Ratings de México, S.A. de C.V., A.M. Best Rating Services, Inc. and Demotech, Inc. admitted the facts, acknowledged that their conduct violated recordkeeping provisions of the federal securities laws and agreed to pay combined civil penalties. In addition to significant financial penalties, each credit rating agency was ordered to cease and desist from future violations of these provisions and was censured. Four of the firms ordered to retain compliance consultants have agreed to, among other things, conduct comprehensive reviews of their policies and procedures relating to the retention of electronic communications found on their personnel's personal devices and their respective frameworks for addressing non-compliance by their personnel with those policies and procedures.

In Case You Missed It:

CFTC Issues Order Against Uniswap Labs for Offering Illegal Digital Asset Derivatives Trading

On September 4, 2024, the CFTC announced its settlement with Uniswap Labs regarding charges against Uniswap Labs relating to illegal offering of leveraged or margined retail commodity transactions in digital assets via a decentralized digital asset trading protocol.

According to the CFTC's order, Uniswap Labs contributed to the development, and deployed versions of, a blockchain-based digital asset protocol that offered to non-Eligible Contract Participants and institutional users the ability to trade digital assets through use of the Ethereum blockchain. The protocol allows users to create and trade with liquidity pools, which consist of a matched pair of digital assets that are valued against each other. In order to facilitate access to the protocol, Uniswap Labs developed and maintained a web interface that it made available to users. Through the interface, users could trade in hundreds of liquidity pools on the protocol. Among the digital assets traded on the protocol and through

the interface were a limited number of leveraged tokens, which provided users leveraged exposure to digital assets such as Ether and Bitcoin.

The CFTC's order found that these leveraged tokens are leveraged or margined commodity transactions that did not result in actual delivery within 28 days and therefore can be offered to non-Eligible Contract Participants only on a board of trade that has been designated or registered by the CFTC as a contract market, which Uniswap Labs was not.

In dissent, CFTC Commissioner Summer K. Mersinger criticized the agency's approach of "regulation through enforcement" against DeFi protocols. She argued that the CEA and CFTC rules were designed for traditional market structures, not DeFi, and expressed concern that the CFTC had failed to provide clear guidance on how DeFi platforms could comply with these regulations. Among other concerns, she warned that the enforcement-first strategy risks pushing responsible DeFi developers and innovation overseas, while leaving the US vulnerable to bad actors. Ms. Mersinger also argued that the company neither profited from nor actively traded the tokens in question, and no market harm or customer losses were alleged.

Commissioner Caroline D. Pham, also dissenting, asserted that the CFTC charged the company without detailed evidence supporting its claims about the "Leveraged Tokens" involved in the case. Ms. Pham argued that the absence of specific information about these tokens in the record makes it impossible to determine whether they fall under CFTC jurisdiction. She argued that, following the commission's logic, any financed commodity transaction could be subject to the same enforcement if delivery exceeded 28 days. Such broad application of the law, she warned, could lead to "absurd" results.

J.P. Morgan Settles FINRA Charges for Failing to Register Investment Banking Employees

On September 5, 2024, J.P. Morgan Securities LLC settled FINRA charges for allowing unregistered individuals to perform investment banking activities.

According to the letter of acceptance, waiver and consent, J.P. Morgan allowed 10 individuals to engage in investment banking activities, such as advising clients on securities offerings, without being properly registered with FINRA. FINRA further found that the firm's supervisory system was insufficiently designed to monitor registration compliance. FINRA also found that the firm failed to include unregistered individuals in supervisory reports and did not prevent these employees from participating in deals, despite knowing they were not registered.