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Regulatory Recap
April 30, 2024

Notable Developments:

- **SEC Staff Releases New Registered Fund Statistics Report.**
- **FTC Issues Rule Banning Noncompete Clauses.**
- **Department of Labor Adopts Final Rules to Define "Investment Advice" for Purposes of Determining "Fiduciary" Under ERISA.**

SEC Enforcement:

- **SEC Charges Investment Adviser for Illegal Expense Sharing Arrangements.**
- **SEC Settled Charges Against an Investment Adviser for Misleading Written Communications.**
- **SEC Settled Charges Against an Investment Advisor for Violations of the "Pay-to-Play" Rule.**

In Case You Missed It:

- **Crypto Industry Associations Bring Suit Against SEC.**
- **FINRA Brings Charges Against Market Maker for Inadequate Controls.**

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Notable Developments:

SEC Staff Releases New Registered Fund Statistics Report.

The SEC staff of the Division of Investment Management's Analytics Office published the first new report of *Registered Fund Statistics* based on aggregated data reported by SEC-registered funds on Form N-PORT. The report provides key industry statistics and shows trends over time, including information and trends related to portfolio holdings, flows and returns, interest rate risk, and other exposures across U.S. mutual funds, exchange-traded funds, closed-end funds, and other registered funds. It is designed to provide the public with a regular and detailed picture of the registered funds industry, with more than 12,000 funds and more than $26 trillion in total net assets under management. The new report will be updated on a quarterly basis and made available on the SEC's website here.

FTC Issues Rule Banning Noncompete Clauses.

The Federal Trade Commission issued a final rule, with 3-to-2 vote, banning noncompete clauses in employment contracts nationwide. According to the FTC, the new rules seek to protect worker freedom to change jobs and thereby increase innovation and foster new business formation.

Under the final rule, a noncompete clause is "a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from" (1) seeking or accepting work in the United States with another person, or (2) operating a business in the United States, after separation from employment with the original employer.

This definition includes, but is not limited to, restrictions in both oral and written employment policies and contractual agreements. Under the final rule, all of the following are prohibited: (1) entering into (or attempting to enter into) a noncompete clause; (2) enforcing (or attempting to enforce) a noncompete clause; and (3) representing that the worker is subject to a noncompete clause. The final rule does not apply to restrictions on competition during the worker's employment, such as outside employment or moonlighting policies. The final rule is also inapplicable to noncompete clauses entered into pursuant to a bona fide sale of a business entity, ownership interest therein, or all or substantially all of a business entity's operating assets.

Existing noncompete clauses for certain executive employees may remain in effect. Employers are prohibited from entering into or enforcing new noncompete clauses with senior executives.

Employers will have to provide clear written notice to workers bound to an existing noncompete clauses that the relevant agreement or clause will not be enforced against them in the future.

Department of Labor Adopts Final Rules to Define "Investment Advice" for Purposes of Determining "Fiduciary" Under ERISA.

The Department of Labor announced its final rules that expand the definition of "investment advice" for purposes of the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974 (Title I of ERISA). The final rule also applies for purposes of Title II of ERISA to the definition of a fiduciary of a plan defined in Internal Revenue Code, including an individual retirement account or other plan identified in the Code. Under the final rules, a person is an investment advice fiduciary if such person provides a recommendation "for a fee or other compensation" in one of the following contexts:

- The person either directly or indirectly regularly makes professional investment recommendations to investors as part of their business and the recommendations are made under circumstances that would indicate to a reasonable investor that the recommendation:
    - is based on review of the retirement investor's particular needs or individual circumstances,
    - reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances, and
    - may be relied upon by the retirement investor as intended to advance the retirement investor's best interest; or
- The person represents or acknowledges that they are acting as a fiduciary under Title I of ERISA, Title II of ERISA, or both with respect to the recommendation.

Under the final rules, investment advice providers that satisfy the definition of an investment advice fiduciary will be required to adhere to the prudence standard of care, reduce retirement investor exposure to conflicted advice that may erode investment returns, and adopt protective conflict-mitigation requirements.

On the same day, SIFMA issued a statement to express the concern that the DOL's rule conflicted with existing SEC Regulation Best Interest and have the likely effect of limiting investors' access to advice and education.

SEC Enforcement Actions:

SEC Charges an Investment Adviser for Illegal Expense Sharing Arrangements

The SEC settled charges against Catalyst Capital Advisors LLC ("CCA") for violating the prohibition of (1) an investment company's affiliated person from participating in a joint arrangement as a principal; and (2) an investment advisers' engaging in fraudulent or deceptive practices.

According to the SEC's order, CCA illegally arranged for its managed open-end fund to pay all of the legal fees and related costs resulting from certain regulatory inquiries and private lawsuits, including expenses associated with CCA's legal representation without the approval or knowledge of the fund's independent trustees, in order to maximize the amount of legal expenses covered by the fund's insurance policy. After the SEC staff opened its investigation, the fund then requested that legal counsel allocate expenses between CCA and the fund and directed CCA to reimburse the fund based on that allocation. The SEC alleged that CCA benefited from this arrangement by deferring payment on its legal costs for

multiple years and by ultimately agreeing to an allocation with the fund that was more advantageous to CCA than the final allocation determined by the fund's insurance carrier, which covered certain legal costs that the insurance carrier determined were allocable to the fund.

SEC Settled Charges Against an Investment Adviser for Misleading Written Communications.

The SEC settled charges against LM Global Investments LLC, d/b/a Fratarcangeli Wealth Management, and its representative for making misleading communications that failed to differentiate between the adviser's own models from third-party strategies and failed to make clear that the adviser managed clients' accounts in accordance with the adviser's own models. In addition, the communications provided to prospective clients included historical performance and fact sheets for third-party strategies without making it clear that the adviser's investments would differ from the strategies reflected in the materials.

SEC Settled Charges Against an Investment Advisor for Violations of the "Pay-to-Play" Rule.

The SEC settled charges against Wayzata Investment Partners LLC ("Wayzata") for violation of SEC Rule 206(4)-5, which prohibits an investment adviser from providing investment advisory services for compensation to a state or local government entity for two years after the adviser (or certain of its executives or employees who meet the definition of "covered associates") has made a political contribution to that government entity or certain elected officials.

According to the SEC's order, a covered associate of Wayzata made a $4,000 campaign contribution to a government official in Minnesota, whose office had the ability to influence the selection of investment advisers for the Minnesota State Board of Investment. As of the date of the contribution, the Minnesota State Board of Investment had already invested in the funds managed by Wayzata. During the two years after the contribution, Wayzata continued to manage the funds invested by the Minnesota State Board of Investment and received advisory fees and carried interest. The SEC alleged that Wayzata violated Rule 206(4)-5 because it continued to provide investment advisory services in the form of receiving advisory fees and carried interest with respect to the investments already made by the Minnesota State Board of Investment in the funds managed by Wayzata. The SEC did not allege any connection between the political contribution and any new investments. The SEC

Commissioner Hester Peirce issued a dissent statement criticizing the overbreadth of the pay-to-play rule.

In Case You Missed It...

Crypto Industry Associations Bring Suit against SEC.

The Blockchain Association and the Crypto Freedom Alliance of Texas, in a lawsuit filed in federal court in Texas against the SEC, seek to block the new "dealer" rule that expanded the definition of a "dealer" of securities.

The complaint alleges that the SEC exceeded its authority by adopting an unclear rule. The plaintiffs allege that the new rule, "while nominally aimed at participants in traditional financial markets, threatens to bulldoze ... innovations and potentially much of the burgeoning digital assets industry." The plaintiffs seek to vacate the rule calling it arbitrary and capricious.

The case is the second of two challenging the SEC's new interpretation filed in the Northern District of Texas, joining a prior suit by other industry groups, mentioned in prior coverage.

FINRA Brings Charges Against Market Maker for Inadequate Controls.

Flow Traders, U.S., a market maker, settled charges brought by FINRA for failing to establish satisfactory procedures to prevent the entry of orders exceeding the firm's capital.

FINRA found that the firm's written procedures did not meaningfully limit the financial exposure generated from the firm's trading activity, as the firm's position limits were unreasonable. FINRA also found that the firm failed to demonstrate how its daily maximum order size thresholds were reasonably aligned with the trading characteristics of each stock.

FINRA determined that the firm violated Exchange Act Rule 15c3-5 concerning risk management controls and FINRA Rules 3110 and 2010 for supervision and standards of ethics in trade.