DALLAS BAR ASSOCIATION SECURITIES SECTION

Securities Compliance Town Hall: Lessons from 2024 and What to Expect in 2025

MUNSCH HARDT

Jason T. Barnes
Shareholder
Munsch Hardt Kopf & Harr, P.C.
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Program Overview

- Background and Overview of 2025 Programming
- 2024 Rulemaking and Rule Changes
- Proposed Rulemaking through Spring 2025
- 2024 Enforcement Results and 2025 Enforcement Priorities
- Practice Notes and Town Hall Discussion



Our DBA Securities Section in 2025

BACKGROUND AND OVERVIEW OF 2025 PROGRAMMING

Tentative Program Highlights

February 2025-December 2025

- **Crypto Asset Rule Changes**: Both SEC and FINRA have provided new guidance for firms engaging in crypto asset-related activities for member firms and their customers.
- **Enhanced Cybersecurity Regulations**: Both SEC and FINRA have promulgated rules that enhance requirements for protecting investor information, including measures against ransomware and insider threats.
- **FinCEN and Federal Anti-Money Laundering Developments (2024-2025)**: Updated AML and related program requirements, including suspicious activity reporting and customer onboarding procedures.
- **Managing Conflicts of Interest in Securities Engagements**: The landscape of conflicts of interest in securities engagements, the issuance of opinion letters, and other
- **Artificial Intelligence**: Anticipating the Impact of SEC Regulations on Advisers and Dealers

Rally to the Flag in 2025

Section Input and Participation; Industry Outreach

- **Program Opportunities**
  - CLEs and Speakers
  - Targeted Industry Events
  - Marketing and Development
- **Section Engagement**
  - All Members Encouraged to Participate
  - Several Dates Remain Available for Speakers and Panelists
- **Industry Outreach**
  - Regulators Will Participate and We Want More; What do you Want to Hear from Them?
  - Principals of RIAs and BDs Will Participate and We Want More; What to Hear from Them?

Some Background

Migrating to and Then Within a Hybrid Securities Practice

Where you start is never where you finish. So always try to begin with the end the mind.

- Global Syndicated Credit
- Mortgage Warehouse Lending
- Mortgage-Backed Securities
- Institutional Credit and Hedge Funds
- Private Credit Funds
- Onshore Offshore Funds
- Active Family Office Formation and Compliance
- Sponsor- and RIA-Outsourced Management of Private Placement and Ongoing Compliance Management (to 23 countries and from 51 countries)
- Products and more products: SBICs, PRIs, Social Impact Funds, PPLI, EB-5 Offerings

Rule Changes and Rulemaking

Regulatory Flexibility Agenda (Reg Flex) 2024-2025

Rule Adoption:

- The Securities and Exchange Commission (SEC) adopted or has slated for adoption 19 rules from Spring 2024 to Spring 2025, all according to SEC's Reg Flex Agenda, which applies lists planned regulatory actions by federal agencies.

Reg Flex Agenda:

- To remind those of the schedule, the Regulatory Flexibility Agenda is a semiannual agenda published by U.S. regulatory agencies, including SEC, that outlines the regulatory actions they plan to take, including proposed and final rules, and their potential impact on a substantial number of "small entities". The rulemaking agenda is updated twice a year, and the most recent update was last updated in September 2024, and details all 19 proposed rules planned for adoption through Spring 2025.

Rule Changes and Rulemaking

Regulatory Flexibility Agenda (Reg Flex) 2024-2025

SPAC Rules:

- In 2024, the SEC adopted new rules to enhance investor protections for SPACs. Key changes include enhanced disclosures about conflicts of interest, SPAC sponsor compensation, and dilution.

Regulation S-P Amendments:

- In 2024, the SEC amended Regulation S-P to enhance consumer data protection and require response programs. These amendments establish a federal minimum standard for safeguarding consumer financial information.

Documentation of RIA Compliance Reviews:

- SEC adopted new rules designed to protect investors who directly or indirectly invest in private funds, corresponding amendments to the Advisers Act books and records rule to facilitate compliance with the new rules and assist examination staff.

SEC Rule Highlights

FROM 2024 GOING INTO 2025

Enhanced SPAC and de-SPAC Disclosures

S7-13-22
January 24, 2024

Enhanced Rules:

- The SEC's rule S7-13-22 enhances investor protections in SPAC IPOs and de-SPAC transactions.
- Enhanced disclosure of sponsor compensation, conflicts of interest, dilution, and requires a minimum dissemination period for security holder communications.

Further Refinement:

- Reporting company status in de-SPAC transactions
- The safe harbor for forward-looking statements
- The rule to clarify business combinations involving reporting shell companies as sales of securities.
- Guidance regarding status of potential underwriters and the use of projections in SPAC-related filings.

A Dealer's "Regular Business"

S7-12-22
February 6, 2024

The SEC's rule S7-12-22 further defines the phrase "as a part of a regular business" in the statutory definitions of "dealer" and "government securities dealer" under the Securities Exchange Act of 1934.

- This rule aims to clarify which activities qualify an entity as a dealer or government securities dealer, ensuring consistent regulatory oversight.
- It addresses the scope of activities that constitute dealing and provides guidance on the application of these definitions to modern market practices.
- Many market participants, particularly proprietary or principal trading firms, have long relied on this distinction to conclude that they are not subject to SEC registration under previous guidance that focused on activities such as market making or underwriting and not on the impact to market liquidity.
- Final Rule: https://www.sec.gov/rules-regulations/2024/02/further-definition-part-regular-business-definition-dealer-government-securities-dealer#34-99477final

Form PF Reporting Updates

S7-22-22
February 8, 2024

The SEC's 2024 updates to Form PF under rule S7-22-22 enhance reporting requirements for private fund advisers.

- Key changes include mandatory current reports for large hedge fund advisers and event reports for private equity fund advisers upon certain events.
- These amendments aim to improve the Financial Stability Oversight Council's (FSOC) ability to monitor systemic risk and bolster the SEC's regulatory oversight and investor protection efforts.
- Final Rule: https://www.sec.gov/rules-regulations/2024/02/form-pf-reporting-requirements-all-filers-large-hedge-fund-advisers#IA-6546final

Form PF Reporting Updates

S7-22-22
February 8, 2024

Current and Event Reporting:

- Large hedge fund advisers must submit current reports for certain triggering events within 72 hours, while private equity fund advisers must file quarterly event reports within 60 days of quarter-end.

Detailed Disclosures:

- Advisers must provide more granular information on investment exposures, borrowing, counterparty exposure, market factors, currency exposure, and portfolio liquidity. This aims to improve data quality and comparability.

Master-Feeder and Parallel Fund Structures:

- The amendments impose more prescriptive requirements on reporting these structures, ensuring accurate aggregation and disaggregation of data.

Operational Adjustments:

- Advisers need to adjust their internal processes to comply with the new standards, including changes to how they report fund performance, beneficial ownership, and fair value hierarchy.

Climate Change Disclosure Standards

S7-10-22
March 6, 2024

- The final rules require a registrant to disclose, among other things: material climate-related risks; activities to mitigate or adapt to such risks; information about the registrant's board of directors' oversight of climate-related risks and management's role in managing material climate-related risks; and information on any climate-related targets or goals that are material to the registrant's business, results of operations, or financial condition.
- Further, to facilitate investors' assessment of certain climate-related risks, the final rules require disclosure of certain greenhouse gas (GHG) emissions on a phased-in basis by certain larger registrants when those emissions are material; the filing of an attestation report covering the required disclosure of such registrants' covered emissions, also on a phased-in basis; and disclosure of the financial statement effects of severe weather events and other natural conditions including, for example, costs and losses.
- The final rules include a phased-in compliance period for all registrants, with the compliance date dependent on the registrant's filer status and the content of the disclosure.

Regulation S-P: Privacy of Consumer Financial Information

S7-05-23
Corrected: June 21, 2024

Incident Response Protocols:

- The SEC's rule S7-05-23 addresses new privacy concerns relevant to RIAs, RICs, and BDCs.
- Entities must adopt and implement written cybersecurity policies and procedures. The rule requires reporting significant cybersecurity incidents to the SEC and disclosing cybersecurity risks and incidents to investors.
- Cybersecurity, the use of AI, and other related issues are very much front and center on the 2025 SEC agenda.
- **Final Rule**: Correction

Qualifying Venture Capital Funds Exemption Limits

S7-2024-01
August 21, 2024

Increasing for Inflation:

- The SEC's rule S7-2024-01 adjusts the dollar threshold for defining a "qualifying venture capital fund" under the Investment Company Act of 1940 to account for inflation.
- This adjustment, mandated by the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, ensures the threshold remains relevant over time.
- The rule allows the SEC to make inflation adjustments every five years by order, specifying the method for these adjustments. This change aims to maintain the effectiveness of regulatory exclusions for qualifying venture capital funds.
- **Final Rule**: https://www.sec.gov/files/rules/final/2024/ic-35305.pdf

Regulation NMS: Increasing Order Transparency

S7-30-22
September 18, 2024

The SEC's rule S7-30-22, issued in 2024, amends Regulation National Market System (NMS) to enhance market transparency and efficiency.

- It adjusts the minimum pricing increments for quoting certain NMS stocks, reduces access fee caps for protected quotations, and improves the transparency of better-priced orders.
- These changes aim to reduce market fragmentation and improve execution quality for investors. The rule also includes provisions to ensure fair access to market data and trading opportunities.

Documentation of RIA Compliance Reviews

S7-03-22
November 8, 2024

Increasing Transparency:

- SEC rule S7-03-22 aims to increase transparency and investor protection in private funds.
- It requires private fund advisers to disclose detailed information on fees, expenses, and performance, and mandates annual financial statement audits.
- The rule also restricts certain fee and expense arrangements and requires fairness or valuation opinions for adviser-led secondary transactions.
- Additionally, it includes amendments to the Advisers Act compliance rule to facilitate SEC examinations
- Final Rule: https://www.sec.gov/comments/s7-03-22/s70322-20131146-301343.pdf
- Examples to follow…

Documentation of RIA Compliance Reviews

S7-03-22
November 8, 2024

Annual Compliance Review Documentation:

- The SEC now requires RIAs to document their annual compliance reviews in writing. This documentation must be made available to the SEC upon request, ensuring that firms maintain thorough records of their compliance activities.

Outsourcing Oversight:

- RIAs must conduct due diligence before retaining service providers for certain advisory functions. This includes periodic monitoring of the service provider's performance and obtaining reasonable assurances regarding their compliance with regulatory requirements.

Cybersecurity Risk Management:

- RIAs are required to adopt and implement written cybersecurity policies and procedures. These policies should address the identification, protection, detection, response, and recovery from cybersecurity threats. Additionally, RIAs must report significant cybersecurity incidents and publicly disclose cybersecurity risks and incidents in their brochures and registration statements.

Safeguarding Client Assets:

- The proposed rules expand the definition of custody to include discretion over client assets, not just funds and securities. This means RIAs must implement stricter controls and oversight to protect all types of client assets.

Conflicts of Interest with Predictive Data Analytics:

- The SEC is concerned about the potential for predictive data analytics and AI systems to favor registrants over investors. The proposed rules aim to address these conflicts of interest by requiring RIAs to implement policies and procedures that ensure fair treatment of all clients.

Internet Adviser Exemption

S7-13-23
March 27, 2024

Updates from 2002 Continue:

- The SEC's rule S7-13-23 amends the Advisers Act to exempt certain investment advisers providing advisory services through the internet from the prohibition on Commission registration.
- This rule modernizes the conditions for internet investment advisers, reflecting technological advancements and industry evolution since the rule's initial adoption in 2002.
- Key changes include requirements for operational interactive websites and digital investment advisory services, and the elimination of the de minimis non-internet client exception.
- The rule also includes amendments to Form ADV to align with these updates.
- Final Rule: https://www.sec.gov/rules-regulations/2024/03/s7-13-23#IA-6578final

SECURITIES COMPLIANCE TOWN HALL

PAUSE FOR QUESTIONS & INPUT

Rulemaking in 2025

WHAT SHOULD WE EXPECT?

The Enhancement and Standardization of Climate-Related Disclosures for Investors:

- The SEC's rule S7-10-22, mandates that registrants provide detailed climate-related information in their registration statements and annual reports.
- Was stayed in April 2024, and now a late 2025 compliance target.
- These amendments aim to improve transparency and provide investors with consistent, comparable, and reliable climate-related information to better avoid greenwashing and other market manipulating tactics.
- This includes disclosures on climate-related risks that have materially impacted, or are likely to impact, the business strategy, operations, or financial condition of the registrant.
- The rule also requires information on severe weather events and other natural conditions in audited financial statements.
- Much more to follow in 2025

Climate Change Disclosure Standards

S7-10-22
March 6, 2024

Financial Data Transparency Act Bolt-On:

- The SEC's proposed rule S7-2024-05, issued under the Financial Data Transparency Act of 2022, aims to establish data standards to promote interoperability of financial regulatory data across various agencies.
- This rule involves collaboration with the Office of the Comptroller of the Currency, Federal Reserve, FDIC, NCUA, CFPB, FHFA, CFTC, and the Department of the Treasury.
- The goal is to enhance the consistency and usability of financial data, facilitating better regulatory oversight and transparency. Final standards will be adopted in separate rulemakings by the respective agencies
- **Proposed Rule**: Financial Data Transparency Act Joint Data Standards 33-11295, 34-100647, IA-6644, IC-35290

Financial Data Transparency Standards

PROPOSED: S7-2024-05
August 2, 2024

New CIPs Incoming:

- The SEC's proposed rule S7-2024-02, issued in collaboration with the Department of the Treasury, mandates Customer Identification Programs (CIPs) for registered investment advisers and exempt reporting advisers.
- This rule, under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, requires advisers to implement procedures to verify customer identities.
- The aim is to enhance anti-money laundering (AML) and counter-terrorism financing (CFT) efforts by ensuring that advisers can identify and mitigate risks associated with their clients.
- **Proposed Rule**: https://www.sec.gov/rules-regulations/2024/05/s7-2024-02

Customer Identification Programs for RIAs and Exempt Reporting Advisers

PROPOSED: S7-2024-02
May 13, 2024

2024 Enforcement Report

THE TARGETS AND THE RESULTS

The SEC's enforcement results for 2024 show a significant shift compared to 2023.

- In 2024, the SEC filed **583** total enforcement actions, a **26%** decrease from the previous year.
- Despite fewer cases, the SEC obtained a record $8.2 billion in financial remedies, including $6.1 billion in disgorgement and $2.1 billion in civil penalties.
  - *50% of the financial total was due to a major case involving Terraform Labs and Do Kwon*
  - In contrast, 2023 saw more enforcement actions but lower financial remedies.
- The SEC's focus in 2024 included significant penalties for **recordkeeping violations**, **misleading marketing practices**, and whistleblower protection

SEC Enforcement in 2024

Overall Results

Enforcement Actions Filed in Fiscal Years 2019 to 2024						
	FY 2024	FY 2023	FY 2022[1]	FY 2021	FY 2020	FY 2019
Standalone Enforcement Actions	**431**	501	463	434	405	526
Follow-On Admin. Proceedings	**93**	162	169	143	180	210
Delinquent Filings	**59**	121	129	120	130	126
Total Actions	**583**	**784**	**761**	**697**	**715**	**862**

Standalone Enforcement Actions is a combined count of Civil Actions and Standalone APs.

Total Money Ordered (in millions)						
	FY 2024	FY 2023	FY 2022	FY 2021	FY 2020	FY 2019
Penalties	**$2,102**	$1,580	$4,194	$1,456	$1,091	$1,101
Disgorgement	**$6,092**	$3,369	$2,245	$2,395	$3,588	$3,248
Total	**$8,194**	**$4,949**	**$6,439**	**$3,852**	**$4,680**	**$4,349**

Money Distributed to Harmed Investors (in millions)					
FY 2024	FY 2023	FY 2022	FY 2021	FY 2020	FY 2019
$345	$930	$937	$521	$602	$1,197

SEC Enforcement in 2024

Overall Results

Enforcement Summary Chart for FY 2024 by Primary Classification							
Primary Classification	Civil Actions	Standalone APs	Follow-On APs	Delinquent Filings	Total	% of Total Actions	% of Civil and Standalone APs
Broker Dealer	7 (13)	54 (79)	37 (37)	0 (0)	98 (129)	17%	14%
Delinquent Filings	0 (0)	0 (0)	0 (0)	59 (59)	59 (59)	10%	0%
Foreign Corrupt Practices Act	0 (0)	2 (2)	0 (0)	0 (0)	2 (2)	0%	0%
Insider Trading	16 (30)	18 (18)	1 (1)	0 (0)	35 (49)	6%	8%
Investment Advisers / Investment Companies	17 (39)	80 (91)	38 (39)	0 (0)	135 (169)	23%	23%
Issuer Reporting / Audit & Accounting	22 (49)	27 (33)	11 (12)	0 (0)	60 (94)	10%	11%
Market Manipulation	11 (45)	6 (6)	2 (2)	0 (0)	19 (53)	3%	4%
Miscellaneous	5 (8)	50 (64)	1 (1)	0 (0)	56 (73)	10%	13%
NRSRO	0 (0)	6 (6)	0 (0)	0 (0)	6 (6)	1%	1%
Public Finance Abuse	0 (0)	14 (16)	0 (0)	0 (0)	14 (16)	2%	3%
Securities Offering	80 (288)	14 (18)	3 (3)	0 (0)	97 (309)	17%	22%
SRO / Exchange	1 (2)	0 (0)	0 (0)	0 (0)	1 (2)	0%	0%
Transfer Agent	0 (0)	1 (1)	0 (0)	0 (0)	1 (1)	0%	0%
Total	**159 (474)**	**272 (334)**	**93 (95)**	**59 (59)**	**583 (962)**	**100%**	**100%**

Each action initiated has been included in only one category listed above, even though many actions may fall under more than one category. Party counts are noted in parentheses.

SEC Enforcement in 2024

Overall Results

Lots and Lots of Fraud:

- The Division's investigations led to charges alleging frauds ranging from Ponzi schemes targeting specific communities to billion dollar frauds with thousands of victims;
- The SEC charged Xue Lee (aka Sam Lee) and Brenda Chunga (aka Bitcoin Beautee) for their involvement in an allegedly fraudulent crypto asset pyramid scheme known as HyperFund that raised more than $1.7 billion from investors worldwide;
- The SEC charged Cynthia and Eddy Petion and their company, NovaTech Ltd., for allegedly operating a fraudulent scheme that raised more than $650 million in crypto assets from more than 200,000 investors worldwide;
- The SEC charged five unregistered brokers and their companies in connection with an alleged pre-IPO fraud scheme that raised at least $528 million from more than 4,000 investors around the world; and
- The SEC charged Abraham Shafi, the founder and former CEO of Get Together Inc., a privately held social media startup known as "IRL," for raising approximately $170 million from investors by allegedly fraudulently portraying IRL as a viral social media platform that organically attracted the vast majority of its purported 12 million users.

SEC Enforcement in 2024

Overall Results

Investment Advisers Breaking Bad:

- Settled charges against registered investment adviser Macquarie for overvaluing approximately 4,900 largely illiquid collateralized mortgage obligations held in 20 advisory accounts.
- Settled charges against formerly registered investment adviser Mass Ave Global for making false and misleading statements to investors concerning its flagship opportunity fund's holdings and exposures.
- An alleged $35 million fraud by real estate investment company ArciTerra and its CEO.
- Settled charges against registered investment adviser Aon Investments for misleading its client, the Pennsylvania Public School Employees' Retirement System, about the reason for a discrepancy between two different calculations of PSERS's investment returns.

SEC Enforcement in 2024

Overall Results

Sweeps and More Sweeps: The SEC continued its recent trend of undertaking several significant risk-based sweeps. This is a straightforward and clear path for SEC to find **lazy violations that lead to cash penalties**.

- Prominent sweeps in 2024 included:
- More than 12 RIAs for compliance with the Adviser Act's Marketing Rule
- A renewed focus on whistleblower protection rules
- Form-filing sweeps related to both timely reporting of stock holdings and transactions by public companies and their insiders
- Forms 13F and 13H filings by institutional investment managers
- Enhanced off-channel communications at BDs, RIAs, municipal advisors, and credit-rating agencies.

Overall SEC is quite pleased with its Sweeps as they not only collect dozens of actions that have cash penalties attached, but also generally result in an overreaction from many covered advisers seeking to avoid getting fined.

SEC Enforcement in 2024

The Sweep

Cooperation: The SEC continued to stress in speeches and enforcement actions that it will reward firms that self-report, cooperate, and remediate, highlighting specific actions that may contribute to lower—or even no—penalties or other rewards.

- In May 2024, former Director Grewal emphasized five main principles of cooperation: (1) self-policing with "appropriate safeguards" and technologically up-to-date compliance policies; (2) self-reporting without delay; (3) proactive and timely remediation; (4) "above and beyond cooperation;" and (5) "early, often, and substantive[]" collaboration with the SEC.
- The SEC specifically called out actions such as:
  - **Self-reporting before completing an internal investigation** or being certain a violation has occurred.
  - **Flagging and explaining documents** or data, particularly through forensic accountants or other experts who can explain technical or complex information.
  - Identifying key witnesses, facilitating interviews, and **presenting findings and summarizing interviews** from internal investigations.

SEC Enforcement in 2024

Cooperation as a Viable Solution

Regulate Yourself Now:

- The SEC also highlighted specific remedial actions, such as:
  - Clawing back executive bonus compensation;
  - Disciplining and/or terminating involved employees;
  - Updating employee trainings;
  - Hiring necessary personnel; and
  - Adopting new technology and/or policies.
- This year, cooperation yielded benefits including:
  - lower civil monetary penalties
  - in some cases, no penalties
  - Potentially reduced charges
  - other benefits such as not requiring admissions.
- **Key Examples**:
  - In a sweep of 11 institutional investment managers for failure to file certain forms, two firms received no financial penalty because of their timely self-reporting, cooperation, and remediation.
  - In a sweep of off-channel communications at credit-rating agencies, two of six firms received substantially lower penalties and did not have to retain a compliance consultant because of their cooperation.

Recommendations for 2025 from 2024

Proactive, Proactive, Proactive

Focus on Crypto:

- Out of many cases, SEC brought three very high-profile cases against **digital asset trading platforms** in three different jurisdictions.
  - The courts have thus far only managed to agree that digital assets themselves are not technically securities.
- Instead, the manner in which a digital asset is sold could constitute a securities transaction.
  - This angle of attached was first adopted by SEC in litigation against an enterprise crypto and blockchain technology company and two of its executives.
- The manner of sale refers to either "primary" sales, which are typically directly from an issuer to a purchaser, or "secondary" sales, which are typically between anonymous parties on a trading platform.
  - The courts also specified that the particular features of the secondary sales should be taken into account for this analysis.
- All three trading platform cases are at early stages, so the consequences of early rulings are not yet clear. **Pay close attention to these cases next year, to the extent they go forward under the next administration.**

Recommendations for 2025 from 2024 Results

Crypto and Digital Assets

(All) Off-Channel Communications:

- The SEC continued its industry sweep of regulated entities' use of "off-channel communications," assessing over $600 million in penalties in settled actions against over 70 broker-dealers, investment advisers, municipal advisors, and credit-rating agencies. Penalties this year ranged from $40,000 to **$50 million** per firm.
- This is up from the **$400 million** collected **in fiscal year 2023** and involved more firms than the past two years combined, including smaller targets and, for the first time, stand-alone registered investment advisers.
- The new administration is **likely** to **attempt** to wheel this back considerably at least in terms of the scope and scale of investigations and penalties.

Recommendations for 2025 from 2024 Results

Off-Channel Communications

Securities Compliance Town Hall

THE 2025 OUTLOOK

A Partial Pull Back From the Norm:

- The SEC will return to its traditional bread and butter cases that involve harm to retail investors, like accounting and disclosure fraud, misappropriation of funds by investment advisers, market manipulation and insider trading, and offering frauds.
- The SEC will levy smaller penalties on large entities, and penalties will need to bear a relation to a **measurable benefit the entity** received from its alleged securities law violations. The SEC will be less likely to pursue novel theories of disgorgement.
- The SEC likely will take a **less expansive approach** to materiality and will be **less likely to pursue aggressive theories** and perceived "regulation by enforcement."
- With resource constraints likely to continue, the SEC may also shy away from pursuing protracted litigation where they are not assured of success.
- With the SEC more receptive to the arguments made by public companies and regulated entities, effective, thoughtful advocacy will matter more than ever.

Enforcement Outlook for 2025

On Whom or What Will SEC Focus its Resources in 2025?

The Commissioner's Perspective:

- In his final statements as SEC Chair, Gary Gensler emphasized several key enforcement priorities for 2025.
- *Artificial Intelligence*: Gensler highlighted the importance of regulating AI in financial markets, focusing on preventing misuse and ensuring transparency in AI-driven decision-making processes.
- *Cryptocurrency and Cybersecurity*: He reiterated the SEC's commitment to addressing fraud and misconduct in the cryptocurrency space, as well as enhancing cybersecurity measures to protect investors and market integrity.
- *Investor Protection*: Gensler stressed the need for robust enforcement actions to protect retail investors, particularly against deceptive practices and conflicts of interest.
- *Market Integrity*: Ensuring fair and orderly markets remained a top priority, with a focus on preventing market manipulation and insider trading.

Enforcement Outlook for 2025

On Whom or What Will SEC Focus its Resources in 2025?

SECURITIES COMPLIANCE TOWN HALL

CASES OF NOTE

RIAs and Artificial Intelligence:

- In the investment adviser space, the SEC noted cases involving the purported use of **artificial intelligence (AI) by foreign and U.S.-based firms**.
- In an ongoing, contested case against a China-based investment adviser, the SEC has alleged that the company lied to clients and prospective clients about its use of a proprietary **software's ability to "generate extraordinary returns while promising '100%' protection for client funds."**
- The SEC also settled charges against two separate investment firms, one based in Toronto and the other in San Francisco, for misleading investors about their **respective (and allegedly nonexistent) AI and machine-learning capabilities.**

Enforcement Outlook for 2025

On Whom or What Will SEC Focus its Resources in 2025?

Alleged Reg BI Violations Involving "Clone" Mutual Funds and ETFs:

- A dual-registered RIA and BD subsidiary recommended certain mutual funds to its retail brokerage customers when the same asset management company sponsor offered a less expensive ETF with identical investment strategies to the mutual fund (Clone Funds)
- As a result of these recommendations, retail brokerage customers made approximately 17,494 purchases of more expensive mutual funds during the relevant period, resulting in such customers paying higher fees, totaling approximately $14.03 million
- Because the firm and its registered representatives allegedly failed to consider the costs associated with the mutual funds as opposed to the less expensive clone ETFs, and failed to have a reasonable basis to believe that the recommendations were in the best interest of the retail brokerage customers, the SEC found that the firm violated the care obligation of Regulation Best Interest (Reg BI).
- The firm also allegedly violated Reg BI's compliance obligation by failing to enforce its written policies and procedures reasonably designed to achieve compliance with Reg BI's care obligation.
- Among other things, the firm remediated the conduct by repaying impacted customers in full plus interest, converted impacted customers into a lower-price share class of the mutual fund, which the impacted customers were not otherwise eligible to purchase, to approximate the lower fees of the clone ETFs, and undertook an investigation to confirm that there were no other "clone pairs" of mutual funds and ETFs available for recommendation on its platform to retail brokerage customers.

Regulation BI

Another Example of Buying Your Own…

Alleged Prohibited Principal Transactions Involving Registered Funds and Other Clients.

- Over 20 months an RIA engaged in or caused 65 prohibited principal trades with a combined notional value of approximately $8.2 billion and included approximately $22,000 in spreads.
- The RIAs PM directed an unaffiliated broker-dealer to buy commercial paper or similar short-term fixed income securities from the adviser's affiliated broker-dealer and
- Thereafter the RIA purchased the paper from the unaffiliated BD on behalf of its clients.
- SEC alleged the transactions involving the registered funds did not comply with those conditions, thus causing violations of Section 17(a)(1) of the Investment Company Act.
- SEC stated, "The interpositioning of a broker-dealer in a transaction that, in absence of such party, otherwise represents a principal trade does not remove the prohibition of such transactions under Section 17(a)." As to transactions involving non-registered-fund clients, the SEC alleged that the adviser neither provided required client disclosures nor obtained client consent, thereby violating Section 206(3) of the Investment Advisers Act of 1940.
- The adviser was censured, ordered to cease and desist engaging in the alleged violations and directed to pay a civil penalty of $1 million.

Regulation BI

Another Example of Buying Your Own…

Alleged Disclosure Failures Involving Financial Incentives and Product Management Practices:

- Two 2024 administrative proceedings pertained to alleged disclosure violations by a dually registered investment adviser and broker-dealer subsidiary.
- First, a proceeding related to the firm's alleged failure to fully and fairly disclose its financial incentive to recommend its discretionary wrap fee program to clients over other advisory programs it offered that used third-party managers.
- The second related to failures to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act related to the disclosure of conflicts of interest presented by the fee structure of the programs. The foregoing proceeding resulted in the imposition of a $45 million civil penalty.
- **No Shocker**: On a related note, in a proceeding involving brokerage customers who invested in certain private fund-of-funds, to access private equity or hedge funds that customers might not be able to access directly, the SEC alleged that the firm's practices related to sales of shares of underlying portfolio companies were not consistent with the offering document and offering agreement disclosures to the brokerage customers, thus violating Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933.

A Focus on 17(a)(2) and 17(a)(3)

Don't Buy Your Own…

Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933:

- Section 17(a)(2) prohibits obtaining money or property through misstatements or omissions of material facts, making it unlawful to mislead investors.
- Section 17(a)(3) targets fraudulent practices or schemes that deceive investors, even if no misstatement is involved.
- Unlike Rule 10b-5, these sections do not require proof of intent to defraud (scienter), allowing for claims based on negligent conduct.
- These provisions are crucial for maintaining market integrity and protecting investors from deceptive practices.

17(a)(2) and 17(a)(3)

Another Example of Buying Your Own...

SECURITIES COMPLIANCE TOWN HALL

ATTENDEE QUESTIONS & PARTING THOUGHTS