

The logo for FinTech Law, featuring the words "FinTech" in a small, pink, sans-serif font above the word "Law" in a large, white, serif font. The entire logo is enclosed in a white rectangular border.The logo for Joot, featuring the word "joot" in a white, lowercase, sans-serif font. The logo is set against a pink background with a pattern of overlapping circles.

MONTHLY NEWSLETTER

DECEMBER 2022

FinTech Law is an innovative, technology-driven law firm that provides legal and consulting services to startups, crypto-related and other technology companies, investment advisers, broker-dealers, private funds, registered funds, and other financial services companies.

Joot is a technology-driven compliance company that provides services to registered investment advisers and registered investment companies, such as mutual funds, closed-end funds, and ETFs. Joot's clients include retail advisers, institutional managers, private fund managers, and mutual fund advisers.



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Highlights

If you thought you'd seen an end to more SEC rule proposals, you were wrong. Although the Derivatives Rule (Rule 18f-4) and Valuation Rule (Rule 2a-5) under the Investment Company Act took effect in August and September respectively, and the Advertising Rule (Rule 206(4)-1) under the Investment Advisers Act took effect in November, the Commission continued to crank out rule proposals for comment. On October 26, 2022, the SEC proposed a new "Outsourcing Rule" (Rule 206(4)-11) for investment advisers. A week later, on November 2, 2022, the SEC proposed changes to its Liquidity Rule (Rule 22e-4), which came into effect in 2018 for most firms. After nearly three years of gathering data under the Liquidity Rule, the SEC has decided that minimum highly liquid requirements and the optional swing pricing framework should be mandatory. Why? Because the SEC believes it will better prepare open-end funds (i.e., mutual funds and ETFs) for stressed conditions. In other words, the rule would help these funds deal with the 2023 recession that everyone is predicting, although the rule won't take effect until after the recession.

Under the proposed Outsourcing Rule (Rule 206(4)-11), investment adviser would need to adopt and implement policies and procedures that provide for the initial and ongoing due diligence of service providers who provide certain "covered functions." Advisers would need to report certain census-type information on their Form ADV. The proposed rule specifically targets index providers, and would likely cover compliance providers as covered service providers. Further, there is no explicit distinction between third-party and affiliated service providers, which means an adviser would need to conduct due diligence on its affiliated services providers. For years now the SEC's examination staff has suggested that advisers need such policies. Rather than regulate through examination, the SEC is finally proposing a rule to cover their position. If adopted, adviser will need to adopt new service provider policies, conduct initial due diligence on existing service providers, and perform ongoing due diligence on service providers.

Under the amended to the Liquidity Rule (Rule 22e-4), open-end funds would need to invest at least 10% of their portfolios in highly liquid assets, to cover redemptions during stressed conditions. Between the 15% limit on illiquid securities and the 10% requirement on highly liquid securities, funds could invest only 75% of their assets in moderately liquid securities. What about less liquid securities? Well, the SEC has decided to eliminate that bucket and go with three (Highly Liquid, Moderately Liquid, and Illiquid), presumably because no one was using the less liquid category except for bank loan funds. Funds will also need to classify their securities daily, instead of monthly. (The amendments would also remove the asset class classifications, which no one was using either.) All open-end funds except feeder fund and certain excluded funds would need to engage in swing pricing so that large redeemers would bear the expenses related to their redemptions. The SEC has also proposed a "hard close" requirement that could affect when a fund strikes its net asset value and determines the trade price for the fund's shares. Finally, the information available on Form N-PORT would become public 60 days after the reporting month, giving investors monthly portfolio data instead of



Highlights

quarterly. If passed, administrators would need to adopt new operating procedures to comply with the rule, compliance officers would need to adopt new swing pricing policies and procedures, and fund boards would need to approve the new swing pricing policies and procedures and designate the fund's swing price administrator, which presumably will be the fund's current administrator. Additionally, the board will need to review an annual swing price report from the administrator.

And then there was the enforcement data released on November 15, 2022, which showed a 9% increase in enforcement actions (760 total) and record setting civil penalties, and pre-judgement interest of \$6.439 billion, about \$2.6 billion more than 2021! While disgorgement decreased by 6%, the civil penalties increased to \$4,194 billion, another SEC record. Fiscal year 2022 was also the second highest year for whistleblower award, suggesting there is a correlation between such activity and the SEC's enforcement fines. The SEC noted in its press release that "[a] hallmark of the Enforcement Program in fiscal year 2022 was robust enforcement through resolutions that imposed penalties designed to deter future violations, establish accountability from major institutions, and order tailored undertakings that provide potential roadmaps for compliance by other firms." (Emphasis added.) The statement suggests that in addition to rulemaking, the Gensler Commission is perfectly fine regulating by enforcement. If 2023 is going to be anything like 2022, then we can expect the SEC will continue to focus on gatekeepers (auditors, lawyers, and transfer agents), crypto firms and their offerings, cybersecurity, compliance, ESG, private funds, and more.

Both the SEC's enforcement results and its ongoing rulemaking show that Chairman Gary Gensler is not going to slowdown before the next presidential election. Whatever his wish list is, he's likely going to pursue it aggressively through at least 2023.

SEC

Regulatory Activity

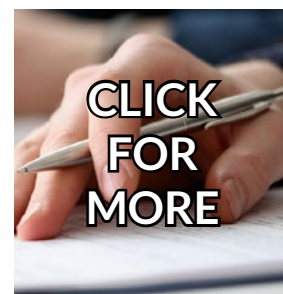


SEC Staff Issues FAQ Relating to Adviser Consideration of DEI Factors

In early October, the SEC issued guidance affirming that an investment adviser may consider diversity, equity, and inclusion (DEI) factors when referring clients to other investment advisers, so long as the use of those DEI factors is consistent with the client's objectives, the scope of the relationship, and the adviser's disclosures.
(10/13/22)

New Amendments Modernize Fund Shareholder Reports and Promote New Information in Fund Advertisements

The SEC adopted a rule in late October to require mutual funds and exchange-traded funds to transit concise and visually engaging shareholder reports, highlighting key information for shareholders. Additionally, the amendments seek to promote transparent presentations of fees and expenses in advertisements produced by the investment companies, with the aim that representations of the fees and expenses are not materially misleading.
(10/26/22)



Proposed Rule Would Update Oversight and Disclosure Requirements for Outsourced Services

The SEC proposed a new rule and amendment under the Investment Advisers Act of 1940 to prevent RIAs from outsourcing select services and functions without conducting proper due diligence. In its statement, the SEC acknowledged that outsourcing can provide great benefits to both RIAs and their clients, but proper oversight must be conducted before engaging with these third parties in order to protect clients.
(10/26/22)

SEC Adopts Rules to Enhance Proxy Voting Disclosure by Registered Investment Funds and Require Disclosure of “Say-on-Pay” Votes for Institutional Investment Managers

The SEC has adopted rules to amend Form N-PX, to expand on the information reported regarding proxy votes, as well as require institutional investment managers to disclose how they voted on executive compensation matters. The change will be used to make proxy voting records easier to use and analyze, allowing investors a greater ability to monitor and compare funds. Additionally, by requiring managers to disclose how they voted regarding “say-on-pay” matters, the amendments fulfill a mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The form amendment and rule will be effective for votes occurring on or after July 1, 2023.

(11/2/22)



SEC Proposes Enhancements to Open-End Fund Liquidity Framework

The SEC voted to propose amendments to better prepare open-end funds for stressed conditions and to mitigate dilution of shareholders' interests. The rule and form amendments would enhance how funds manage their liquidity risks, require mutual funds to implement liquidity management tools, and provide for more timely and detailed reporting of fund information.

(11/2/22)

Changes to Form 13F Filing beginning January 3, 2023

The SEC has amended Form 13F to include additional information beginning on January 3, 2023. The following information is required to be included on any 13Fs filed after January 3rd:

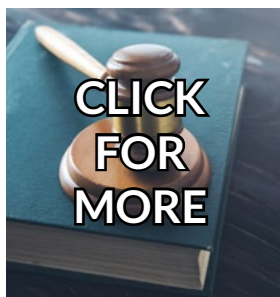
1. Filer must provide the CRD # and SEC file #
2. If the Filer reports Other Managers – must provide the CRD # and SEC file # for the Other Manager;
3. All dollar values will be rounded to the nearest dollar
4. Option to provide the security's FIGI (Financial Instrument Global Identifier) in addition to the CUSIP.
5. Adding a checkbox on the Summary Page of Form 13F report to indicate if confidential treatment is being requested. Additionally, instructions are being added to request confidential treatment electronically, instead of submitting these requests on paper. On February 28, 2023 all confidential treatment requests must be submitted, via EDGAR.

(12/13/22)



SEC

Enforcement Actions



SEC Announces Enforcement Results for FY22

The SEC announced its enforcement actions for the 2022 fiscal year. This year the SEC filed 760 enforcement actions that amounted to a 9% increase over the 2021 fiscal year. Most of these actions were “stand-alone” enforcement actions and ranged from “first-of-their-kind” actions to traditional securities law violations and charges.

(11/15/22)

SEC

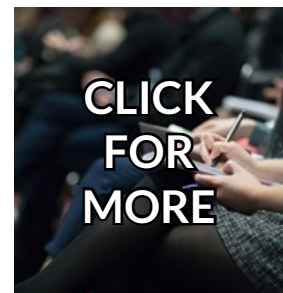
Risk Alerts

Observations from EXAMs to Prevent Identity Theft under Reg. S-ID

The SEC recently issued this risk alert to raise awareness of the most cited deficiencies and weaknesses observed related to prevention of identity theft under Regulation S-ID. The Staff observations focused on the following areas:

1. Failure to identify covered accounts, including identifying new accounts and failure to conduct risk assessment of existing accounts.
2. Failure to establish a program that is tailored to firm’s business and including all the required components of the Reg. S-ID.
3. Identification of Red Flags: Firms failed to identify red flags specific to their covered accounts; Firms did not have process to evaluate actual experiences with identity theft to consider additional red flags.
4. Detect and Respond to Red Flags: Firms relied on pre-existing policies, such as their AML procedures and procedures failed to contain relevant processes related to red flags.
5. Periodic Program Updates: Firms failed to update S-ID procedures after updating types of accounts accepted or processes for opening accounts.

(12/13/22)



Joot/FinTech Law

Blog Updates

Understanding the Regulatory Landscape of Crypto

As a part of FinTech Law & Joot's 2022 regtech blog series, Joot CEO & FinTech Managing Director Bo Howell breaks down and discusses the murky and intricate regulatory landscape of cryptocurrency and decentralized finance. This three part series looks at the landscape in both the United States and globally.

Read [Part 2](#) and [Part 3](#) here.

(11/15/22)



Slaying the Dragon: Lessons from an SEC Crypto-Enforcement Action

Recently, the SEC brought an enforcement action against three cryptocurrency entities from Dragonchain, which collectively raised \$16.5 million from about 5,000 investors in "unregistered" crypto asset securities offerings.. This became a prime example of the SEC's ever-changing policy for cryptocurrencies.

(12/1/22)

Ten Jurisdictions Adopt New IAR Continuing Education Requirements

Back in May 2022, Joot reported that Michigan adopted new continuing education requirements for Investment Adviser Representatives (IAR). Ten states and jurisdictions have now either implemented an IAR CE requirement or have informed North American Securities Administrators Association's IAR CE Committee they are planning to adopt an IAR CE requirement in 2022.

(12/5/22)



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This Week in FinTech & Compliance #1: Trouble with Two Points

In the first installment Joot & FinTech's "This Week in FinTech & Compliance" series, we discuss the SEC's recent case against Two Points Capital and what this situation can teach RIAs.

(12/8/22)