Katten Financial Markets and Funds *Quick Take*
November 2022

SEC Advertising Rules – Client Resource Center

November 4 was the compliance date for the new rule governing advertising and solicitation activities by investment advisers. The new rule substantially revises decades old authorities governing this activity. Katten's Investment Management and Funds group has put together a list of resources to guide clients with regard to these new rules.

- SEC Advertising Rules Placemat* (quick reference guide)
- SEC Rules for Advertising and Solicitations of Investment Advisers
- SEC Risk Alert
- Link to the full Marketing Rule Amendments

**Laminated copies available upon request. Please reach out to* jacqueline.tait@katten.com.

Tips for NYC Wage Transparency Law Compliance

By Janet R. Widmaier and Julie L. Gottshall

New York City's Wage Transparency Law took effect on November 1, 2022. The law makes it an unlawful discriminatory practice for an employer with four or more workers (including independent contractors) to advertise a job, promotion, or transfer opportunity without including the minimum and maximum salary for such position in the advertisement. The salary range may extend from the lowest to highest salary the employer in good faith believes at the time of posting it would pay for the advertised job, promotion, or transfer.

Here are some practical pointers for employers to consider when complying with this new requirement:

- Salary includes base wage or rate of pay (whether hourly or as a salary) but does not require employers to post other forms of compensation such as bonuses, commissions, stock, 401(k) plans, health insurance, or paid time off.
- The salary range can be broad, taking into account the various levels of education, special training, and experience a candidate may bring to the job, so long as it reflects actual practice.
- An "advertisement" of a position is any written description of an available job, promotion, or transfer opportunity that is publicized to a pool of potential applicants, including internal as well as external postings. An employer that does not use these forms of "advertisements" for hiring need not create and post a wage range.

- Positions that may be filled by remote employees who occasionally come to New York City, or are filled remotely but *could* be filled by someone in New York City, are likely covered by the law. If an employer operating outside New York City specifically excludes residents of New York City from applying for an open position, it may not need to comply with the law.

New SEC Electronic Recordkeeping Rule

By Susan Light

On October 12, the Securities and Exchange Commission (SEC) adopted amendments to the electronic recordkeeping requirements for broker-dealers (Rule 17a-4 under the Securities Exchange Act of 1934 sets forth the recordkeeping requirements). The amendments modernize and make more flexible the broker-dealer recordkeeping requirements.

The amendments will become effective 60 days after the date on which the adopting release is published in the *Federal Register*, which has not yet occurred, after which there will be an additional six-month compliance transition period. The new rules:

1. Provide an audit trail alternative to the current WORM — "write once, read many" format requirement, allowing electronic records to be preserved in a manner that permits the re-creation of an original record if the original record is modified or erased, provided that a complete time-stamped audit trail meeting certain requirements are met.
2. Allow broker-dealers to use cloud-based providers for recordkeeping services, provided the broker-dealer has direct access to the records and the provider files with the SEC and acknowledges the records are the broker-dealer's property; certain
3. Eliminate the safe-place WORM format "escrow" requirement but require that the electronic records are presented in a reasonably usable electronic format (i.e., are compatible with commonly used systems for accessing and reading electronic records).
4. Abolish the requirement for the broker-dealer to notify their designated examining authority (DEA), such as Financial Industry Regulatory Authority (FINRA), before implementing an electronic recordkeeping system.
5. Allow broker-dealers to designate an executive officer to execute undertakings agreeing to provide the regulatory authorities with necessary information.

SEC Proposes New Rule Governing Outsourcing by Investment Advisers

By Richard Marshall, Vlad Bulkin and Jennifer Howard

On October 26, a sharply divided Securities and Exchange Commission (SEC) proposed a new rule governing outsourcing of certain services by investment advisers. Services covered by the proposed rule include:

1. services necessary for an adviser to provide services in compliance with law; and
2. services, if not performed or performed negligently, would likely impact the adviser's clients or the ability for the adviser to provide advisory services.

An adviser would be required:

1. to conduct due diligence on the outsourced service provider and to update that due diligence periodically. Such due diligence would have to include (a) the scope of the outsourced services; (b) potential risks and mitigation of those risks; (c) the service provider's competence; (d) any subcontracting by the service provider; (e) the service provider's legal compliance efforts; and (f) plans for orderly termination of the arrangement;
2. to keep records of the adviser's due diligence;
3. to report information about outsourcing on the adviser's Form ADV; and
4. for third-party record-keepers, in addition to the above due diligence, to obtain reasonable assurances the record-keepers will meet four standards: (a) certain record-keeping; (b)

ensure records are kept in compliance with the record-keeping rules; (c) provide access to electronic records; and (d) ensure records are kept even if the record-keeper is fired by the investment adviser.

Commissioner Peirce published a dissent arguing that no need had been shown for the new rule, its costs would exceed any potential benefits, and the SEC lacks authority to adopt such a rule under a statutory grant of authority to adopt anti-fraud rules.

The comment period for the proposed rule will remain open until the later of (i) December 27, 2022; and (ii) 30 days after publication in the *Federal Register*. *Read the SEC's proposing release.*

SEC Adopts New Rules for Reporting and Advertising by Investment Companies

By Richard Marshall, Vlad Bulkin and Jennifer Howard

On October 26, the Securities and Exchange Commission (SEC) adopted new rules governing certain reporting and advertising by regulated funds.

The new rule requires the semi-annual and annual reports of open-end funds to highlight certain information in these filings to make it easier for shareholders to review. This information will have to be delivered to shareholders, repealing a rule that permitted funds merely to inform shareholders the filings are available on the fund's website. Funds will also be required to make available online and in Form N-CSR certain information about fund investments and financial information.

All investment companies (including registered closed-end funds and business development companies) will also be required to present fund fees and expenses in advertising materials in a manner that is consistent with the presentation of this information in the fund's prospectus.

The new rule becomes effective 18 months after publication in the *Federal Register*. *Read the SEC's adopting release.*

What's Up With WhatsApp? Regulators Recently Fine Firms $1.8 Billion in Aggregate for "Off-Channel" Communications

By Gary DeWaal, Carl Kennedy, Susan Light, Richard Marshall and Paul McCurdy

Recent alleged recordkeeping failures resulted in aggregate fines in excess of $1.8 billion levied against 11 Wall Street financial institutions and many of their affiliated entities by the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) (together, "the Commissions") in enforcement actions and simultaneous settlements announced by the agencies on September 27, 2022. An earlier action in December 2021 resulted in over $200 million in fines by the SEC and CFTC for the same alleged conduct.

These large settlements came shortly after the Commissions completed investigations at each of the registered defendant firms and affiliated entities regarding the alleged widespread use of personal devices and unapproved communication channels to discuss subjects that are allegedly subject to the Commissions' recordkeeping requirements.

The investigations allegedly uncovered extensive "off-channel" communications by the firms' personnel, which were gathered from personal devices. The Commissions claimed that many of the registrants' employees regularly communicated about business matters via messaging applications such as WhatsApp on their personal devices instead of using work-approved forms of communication such as work-sanctioned emails and firm-issued devices in violation of the firms' approved communications policies and procedures. The firms allegedly did not retain and supervise the "substantial majority" of these communications in violation of federal securities and commodities laws. The Commissions charged that, in some cases, supervisors and senior executives responsible for ensuring compliance with the firms' communications policies themselves violated the firms' communication policies and, in some cases, pro-actively promoted violations by employees. *Read Katten's advisory.*

Six Takeaways From FINRA's Revised Sanction Guidelines

By Susan Light and Michael J. Lohnes

The Financial Industry Regulatory Authority (FINRA) Sanction Guidelines have been significantly revised, now giving FINRA discretion to impose considerably higher fines on mid- and large-size firms. The revisions, published on September 29, also deleted 20 prior infrequently used guidelines.

The Sanction Guidelines help FINRA adjudicators determine the appropriate penalty for FINRA rules violations. The guidelines are not absolute requirements; instead, they suggest a range of appropriate penalties before considering aggravating and mitigating circumstances. Firms and individuals may equally refer to the guidelines when settling disciplinary matters.

FINRA stated that its revisions "ensure that guidelines accurately reflect the level of sanctions imposed… in disciplinary proceedings." However, FINRA's FAQs emphasize that the sanctions imposed in both litigated and settled matters may fall above or below the recommended ranges.

The new guidelines are effective immediately and are published on FINRA's website along with Regulatory Notice 22-20. Firms should review the Sanction Guidelines and assess their impact on ongoing disciplinary matters. *Read Katten's advisory.*

So Who Does Need to Register as a SEF?

By Stephen Morris

In September 2021, the Commodity Futures Trading Commission (CFTC) staff issued an advisory (Letter 21-19) "reminding entities" of swap execution facility (SEF) registration requirements. The "entities" specifically in scope of the reminder, per that advisory, were those: (1) facilitating trading or execution of swaps through one-to-many or bilateral communications; (2) facilitating trading or execution of swaps that are not subject to the trade execution requirement under the Commodity Exchange Act; (3) providing non-electronic means for the execution of swaps; or (4) falling within the SEF definition and operated by an entity currently registered with the CFTC in some other capacity, such as a commodity trading advisor or an introducing broker.

After that first step, in the last few months, other shoes have started to drop. In September the CFTC, citing Letter 21-19, settled its first enforcement action against a CTA for failure to register as a SEF. *Read about the CFTC's advisory letter.*

Fifth Circuit Declines to Reconsider Opinion that In-House SEC Enforcement Actions are Unconstitutional

By Danette Edwards and Jonathan Rotenberg

Earlier this year in *Jarkesy v. SEC*, a split panel of the Fifth Circuit Court of Appeals ruled that the Constitution prohibits in-house Securities and Exchange Commission (SEC) adjudication of securities law violations. 34 F. 4th 446 (5th Cir. 2022). The panel found three constitutional defects in the SEC's administrative proceeding mechanism: (1) a violation of the Seventh Amendment right to a jury trial in securities fraud cases where the SEC seeks monetary penalties; (2) an improper Congressional delegation of power enabling the SEC to bring securities fraud enforcement actions in-house without reference to an "intelligible principle" provided by Congress; and (3) a violation of the take care clause of Article II of the Constitution.

In response, the SEC filed a petition for rehearing en banc, which sought a review of the panel's decision before all of the judges of the Fifth Circuit.

On October 21, the Fifth Circuit denied the SEC's petition for rehearing. A circuit court may rehear a case en banc if a majority of the judges on the court vote to do so. Here, only six of sixteen judges voted to rehear the case.

Only the judges dissenting from the denial of the rehearing announced their reasoning, including concern about a shift in the law.

> "[H]aving deviated from over eighty years of settled precedent, the opinion doubtlessly merits a full review. Beyond its massive impacts on the directly involved statutes, the opinion's potential application to agency adjudication more broadly raises questions of exceptional importance." *Jarkesy v. SEC*, No. 20-61007 (5th Cir., Oct. 21, 2022) (Haynes, J., dissenting).

The original panel ruling caught the attention of many lawyers and non-lawyers alike, including comedian Jon Stewart, who devoted an entire podcast to it. Many wondered whether the case would spell a permanent end to SEC administrative proceedings, and concerns persist over the viability of this agency enforcement tool. *Read about SEC in-house proceedings.*

New CLE Requirements for New York Attorneys Effective July 1, 2023

By Trisha Sircar

Effective July 1, 2023, New York attorneys must complete 1 CLE credit hour in the new Cybersecurity, Privacy and Data Protection category of credit as part of their CLE requirement. The total number of CLE credits that must be completed in your reporting cycle does not increase.

For more information, visit the CLE website and review the Cybersecurity FAQs available at this link. *Read about the Cybersecurity CLE requirement.*

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