



Investment Services Regulatory Update

September 2020

Monthly Version

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New Rules, Proposed Rules, Guidance and Alerts

GUIDANCE AND ALERTS

SEC Issues Cybersecurity Risk Alert on Safeguarding Client Accounts against “Credential Stuffing”

On September 15, 2020, the SEC’s Office of Compliance Inspections and Examinations (OCIE) issued a Risk Alert highlighting the staff’s concerns with an apparent increase in “credential stuffing” attacks against SEC-registered investment advisers and broker-dealers. Credential stuffing is a type of cyberattack where bad actors use compromised client login credentials obtained from the dark web to seek unauthorized access to customer assets, confidential customer information and firm systems. OCIE warned that firms’ information systems, particularly Internet-facing websites, including those hosted by third-party vendors, face an increased risk of a credential stuffing attack. OCIE observed that successful attacks occur more often when individuals use (1) the same or similar passwords for multiple accounts, and/or (2) easily guessed usernames, such as email addresses or full names.

OCIE observed certain practices that firms have implemented to seek to safeguard client accounts, including:

- **Reviewing and updating policies and procedures.** Conducting periodic reviews of and, as necessary, updating policies and procedures to incorporate password standards consistent with industry standards for length, complexity and duration;
- **Employing multi-factor authentication (MFA).** Requiring use of properly implemented MFA to authenticate the user seeking to access an account;
- **Using Completely Automated Public Turing test to tell Computers and Humans Apart (CAPTCHA).** Requiring use of CAPTCHA (e.g., identifying pictures of

a particular object within a grid of pictures) to combat automated scripts or bots;

- **Implementing detection and prevention controls.** Implementing controls to detect and prevent credential stuffing attacks; including, for instance, monitoring for a higher-than-usual number of login attempts or failed attempts, using a Web Application Firewall (WAF), and enabling additional controls to mitigate damage if an account is taken over by an unauthorized user; and
- **Monitoring the dark web.** Surveilling the dark web for lists of leaked user IDs and passwords and performing tests to assess whether current user accounts are susceptible to credential stuffing attacks.

OCIE advised firms to review and evaluate the sufficiency of their customer account protection safeguards and identity theft prevention programs. OCIE also encouraged firms to consider customer outreach regarding the implementation of safeguard measures.

The Risk Alert is available [here](#).

FINAL RULES

SEC Adopts Expanded “Accredited Investor” Definition

On August 26, 2020, the SEC adopted amendments to Rule 501, Rule 144A and other related rules to expand the definition of “accredited investor” under the Securities Act of 1933. The amendments were adopted largely as proposed and broaden the scope of natural persons and entities that may qualify to participate in private offerings of securities that are exempt from registration under the Securities Act.

In particular, the “accredited investor” designation will now include the following:

- **Natural persons holding certain professional certifications and designations.** The SEC will periodically issue orders designating those professional certificates, designations or credentials that, when held by a natural person, would qualify such person as an accredited investor. Contemporaneously with the

amendments, the SEC designated holders in good standing of the Series 7, Series 65 and Series 82 licenses as qualifying for accredited investor status. In evaluating additional professional designations for qualifying status, the SEC will consider a non-exhaustive list of attributes established by the amendments.

- **“Knowledgeable Employees”** of private funds as defined under the Investment Company Act, but only with respect to investment in such private fund. A Knowledgeable Employee’s spouse will also be considered an accredited investor with respect to joint investments in the private fund.
- **Certain enumerated entities**, including,
 - federal- or state-registered investment advisers and exempt reporting advisers, regardless of the level of assets under management,
 - rural business investment companies (RBICs), as defined in Section 384A of the Consolidated Farm and Rural Development Act,
 - limited liability companies that have total assets in excess of
 - \$5 million and were not formed for the purpose of acquiring the securities offered,¹ and
 - any entity with at least \$5 million in investments (as defined under the Investment Company Act) that has not been formed for the purpose of investing in the securities offered, in order to encompass entities such as Native American tribes, foreign entities and local government bodies that were not previously covered by Rule 501.
- **“Family offices” and their “family clients,”** each as defined under the Advisers Act, provided the family office has at least \$5 million in assets under management, was not formed for the purpose of acquiring the securities offered and was directed to make the investment by a person who has such knowledge and experience in financial and business matters such that the family office is capable of evaluating the merits and risks of the investments.

The amendments also clarify that spousal equivalents can pool finances when determining qualification as an accredited investor and update the definition of “qualified institutional buyer” under the Securities Act to conform with the new accredited investor definition.

The expansion of the accredited investor definition has many implications for asset managers, including updates to offering and subscription documents and questionnaires, consideration of expanded options for funding general partner commitments via the expanded pool of knowledgeable employees and affiliated professionals and evaluation of fundraising opportunities. Commissioners adopted the amendments on a 3-2 vote, with commenters disagreeing with the SEC’s decision not to index the wealth thresholds, which were initially adopted in 1982, for inflation.

The amendments will be effective 60 days after publication in the Federal Register.

The SEC’s adopting release is available [here](#).

¹ While Rule 501 did not explicitly include LLCs meeting these requirements prior to the amendments, the SEC historically has taken the position that such LLCs qualify as accredited investors.

Public Statements, Press Releases and Testimony

PUBLIC STATEMENTS

SEC Issues Statement in Response to the Report of the President’s Working Group on Financial Markets

On August 6, 2020, the President’s Working Group on Financial Markets released its *Report on Protecting United States Investors from Significant Risks from Chinese Companies*, which included certain recommendations for the SEC regarding the need to strengthen investor protections and to promote the integrity of U.S. capital markets by (1) leveling the playing field for all companies listed on U.S.

exchanges, and (2) improving disclosure regarding, and consideration by fiduciaries and other market professionals of, the risks of investing in emerging markets, including China. On August 10, 2020, the SEC issued a statement in response to the report. The statement highlighted various SEC initiatives to bring attention to the risks of investing in emerging markets countries; noted that SEC Chairman Jay Clayton had directed the SEC staff to prepare proposals in response to the recommendations in the report; noted the SEC staff's emerging markets roundtable held in July 2020 at which investors, regulators and other industry participants and experts discussed issues relating to investing in emerging markets, including China; and encouraged the public to provide comments or other information for the SEC to consider as it develops responses to the report.

The SEC's statement is available [here](#), and the report of the President's Working Group on Financial Markets is available [here](#).

SPEECHES

Remarks of Dalia Blass, Director of the SEC's Division of Investment Management, at the SEC Regulation Think-In 2020 Conference

Dalia Blass, Director of the SEC's Division of Investment Management, provided remarks at the SEC's Regulation Think-In 2020 Conference that was held online on September 16, 2020. Her remarks focused on international policy, including the Division staff's collaboration with international organizations and regulators and monitoring of the effects of foreign policy on SEC-regulated entities, particularly in light of the COVID-19 pandemic. As an example, she noted that information on the use of swing pricing by certain European funds as a liquidity risk management tool could help the Division determine the potential benefits of implementing swing pricing in the United States. Ms. Blass discussed recent MiFID II rule amendments in response to COVID-19 pertaining to

research on small- and mid-cap European companies and European fixed-income instruments that would permit investment firms to make joint payments for research and execution under certain conditions.

Ms. Blass encouraged asset managers and other industry participants to engage with the Division or their local regulators, citing the benefits of having a wide range of perspectives when the Division staff engages with international regulators. She stated that the Division staff has engaged extensively with asset managers and broker-dealers regarding the impact of regulatory changes on research coverage and quality, and has encouraged those firms to reach out to the staff if their views have changed in light of the no-action letter issued on November 4, 2019 that extended certain temporary relief previously issued to investment managers subject to MiFID II or in light of other developments in market practice. Ms. Blass concluded by renewing the Division's request for data and other information concerning how MiFID II's research provisions are affecting various market participants, stating that more hard data allows the Division staff to better assess policy options.

A transcript of Ms. Blass's remarks is available [here](#).

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With significant experience in all matters related to design, organization and distribution of investment products, Vedder Price can assist with all aspects of investment company and investment adviser securities regulations, compliance issues, derivatives and financial product transactions, and ERISA and tax inquiries. Our highly experienced team has extensive knowledge in structural, operational and regulatory areas, coupled with a dedication to quality, responsive and efficient service.