Investment Services Regulatory Update

January 2021

Monthly Version

VedderPrice

New Rules, Proposed Rules, Guidance and Alerts

NEW RULES

SEC Finalizes Updates to Advertising and Cash Solicitation Rules

On December 22, 2020, the U.S. Securities and Exchange Commission finalized a new "Marketing Rule" under the Investment Advisers Act of 1940 that overhauls the traditional Advertising Rule under Rule 206(4)-1 and the Cash Solicitation Rule under Rule 206(4)-3. The new Marketing Rule represents a significant change to how investment advisers can market themselves and their products, including how advisers to private funds such as private equity, venture capital and hedge funds can present their performance information. The SEC also has made related amendments to Form ADV, the investment adviser registration form, and Rule 204-2, the books and records rule.

As summarized in the corresponding press release (found here), the new rule merges the Advertising Rule and the Cash Solicitation Rule and replaces the traditional broadly drawn limitations with principles-based provisions designed to accommodate the continual evolution and interplay of technology and advice. The staff of the Division of Investment Management will withdraw decades of no-action letters and other guidance addressing the application of the Advertising and Cash Solicitation Rules, as those positions are either incorporated into the final rule or will no longer apply. A list of such letters will be available on the SEC's website.

The new Marketing Rule was adopted with a number of modifications from the proposed rule published in November 2019. Important differences from the proposal include:

- not expanding the definition of advertisements to one-on-one communications

  internal review and written approval of advertisements is not required prior to dissemination

- no separate requirement for performance advertisements used with retail versus non-retail clients, and
- loosening of the requirements for advertisements to display predecessor performance

The Marketing Rule, amended books and records rule, and related Form ADV amendments will be effective 60 days after publication in the Federal Register. The SEC has adopted a compliance date that is 18 months after the effective date to provide a transition period to comply with the amendments.

Attorneys in Vedder Price's Investment Services Group have prepared a more detailed summary of the Marketing Rule, which is available here.

SEC Adopts New Framework for Fund Valuation

On December 3, 2020, the U.S. Securities and Exchange Commission adopted new Rule 2a-5 under the Investment Company Act of 1940, providing a new framework for fund valuation practices and clarity on how fund boards may satisfy their statutory obligation to determine the fair value of fund investments. In particular, new Rule 2a-5:

- permits fund boards to designate the fund's investment adviser (or, for internally managed funds, a fund officer) as the party that performs determinations of fair values of fund investments (in this capacity, the "valuation designee"), subject to board oversight, without any requirement that boards subsequently ratify any fair values so determined by the valuation designee;
- establishes a principles-based framework for determining fair values of fund investments that incorporates the assessment and management of material valuation risks, the establishment, application

- and testing of fair valuation methodologies, and enhanced oversight of pricing services;
- requires periodic reporting by the valuation designee to facilitate board oversight; and
- formally defines when market quotations are "readily available" for purposes of the 1940 Act.

In addition, the SEC issued significant new guidance concerning various aspects of Rule 2a-5, including, among other things, examples of specific sources of valuation risk. The SEC also set forth its expectations regarding fund directors' oversight responsibilities with respect to valuation matters. Finally, the SEC also adopted new Rule 31a-4, which establishes certain recordkeeping requirements associated with fair value determinations under Rule 2a-5.

Rule 2a-5 applies to all investment companies registered under the 1940 Act, including investment companies structured as unit investment trusts, and business development companies. While Rule 2a-5 and the related recordkeeping requirements of Rule 31a-4 will become effective 60 days from publication in the Federal Register (anticipated in early 2021), compliance with the new rules will not be required until 18 months after the effective date.

Attorneys in Vedder Price's Investment Services Group have prepared a more detailed summary of new Rule 2a-5, which is available here.

SEC Adopts Rule Amendments to Permit Electronic Signatures to Authenticate SEC Filings

On November 17, 2020, the SEC adopted amendments to Rule 302(b) of Regulation S-T to permit the use of electronic signatures in authentication documents required for SEC filings on EDGAR. In addition, the SEC adopted amendments to certain rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940 to permit the use of electronic signatures in authentication documents for certain other filings when these filings contain typed, rather than manual, signatures, under generally the same conditions available under Rule 302(b). The amendments to Rule 302(b) and related amendments to other rules and forms took effect upon their publication in the Federal Register on December 4, 2020.

Rule 302(b) of Regulation S-T previously required that each signatory to an electronic filing made with the SEC under the federal securities laws, before or at the time the electronic filing is made, manually sign a signature page or other document to authenticate, acknowledge or otherwise adopt his or her signature appearing in typed form within the electronic filing. Further, electronic filers were required to retain the paper originals of these authentication documents for five years and furnish copies to the SEC or its staff upon request.

In March 2020, the staff of the SEC's Division of Corporation Finance, Division of Investment Management and Division of Trading and Markets issued a statement regarding compliance with the authentication requirements under Rule 302(b) in light of the public health and safety concerns related to COVID-19. The staff stated that it would not recommend the SEC take enforcement action with respect to Rule 302(b) if the signatory retained the manually signed signature page or other authentication document and provided such document, as promptly as reasonably practicable, to the electronic filer in the ordinary course (e.g., if a signatory was working remotely, he or she could retain the paper original until the signatory could return to his or her place of work and deliver the document to the electronic filer), and complied with certain other conditions. In April 2020, the SEC received a rulemaking petition requesting that it generally permit the use of electronic signatures in authentication documents under Rule 302(b). The petition noted that obtaining and retaining manual signatures in compliance with the staff's March 2020 statement remained a significant logistical burden due to COVID-19 and highlighted the widespread use of electronic signatures and improvements in electronic signature software technology. In June 2020, nearly 100 public companies jointly submitted a letter in support of the rulemaking petition.

Recognizing the widespread use of electronic signatures and technological developments in the authentication and security of electronic signatures, as well as the continuing need to support remote workforces, the SEC adopted amendments to Rule 302(b) to permit a signatory to an electronic filing made with the SEC to sign an authentication document through an electronic signature that meets certain requirements set forth in the EDGAR Filer Manual. Specifically, the electronic signature signing process must, at minimum:

- require the signatory to present a physical, logical or digital credential that authenticates the signatory's individual identity;
- reasonably provide for non-repudiation of the signature;
- provide that the signature be attached, affixed or otherwise logically associated with the signature page or document being signed; and
- include a timestamp to record the date and time of the signature.

In addition, the amendments to Rule 302(b) provide that, before a signatory first uses an electronic signature to sign an authentication document, the signatory must manually sign a document to attest that he or she agrees that the use of the electronic signature in any authentication document serves as the legal equivalent of hjs or her manual signature for purposes of authenticating the signature to any filing for which it is provided. The filer must retain the initial electronic signature authentication document for as long as the signatory uses an electronic signature to sign authentication documents and for a minimum of seven years after the date of the most recent electronically signed authentication document, and must furnish this document to the SEC or its staff upon request. The amendments also provide that manually signed documents under Rule 302(b), including an initial electronic signature authentication document, may be retained and stored by electronic means.

The SEC's adopting release is available here.

GUIDANCE AND ALERTS

OCIE Risk Alert Cautions Firms to Comply with Large Trader Obligations

A December 16, 2020 risk alert issued by the SEC's Office of Compliance Inspections and Examinations (OCIE) cautions investment advisers and broker-dealers to review and, as necessary, enhance their compliance programs with respect to "Large Trader" obligations pursuant to Rule 13h-1 under the Securities Exchange Act of 1934. Compliance with Rule 13h-1 enables the SEC to identify and obtain information on market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in national market system (NMS) securities—i.e., "Large Traders."

Rule 13h-1 requires entities and individuals, such as investment advisers, whose transactions in NMS securities meet or exceed the daily or monthly thresholds identified by the rule to self-identify to the SEC on Form 13H, and also requires certain recordkeeping, reporting and monitoring responsibilities for broker-dealers.

During examinations, OCIE observed "numerous instances of potential non-compliance" with Rule 13h-1, including some firms that were either not aware of Rule 13h-1 or were not familiar with certain requirements. Consequently, OCIE encouraged firms to thoroughly review their written supervisory procedures to ensure compliance with the rule, and provided the following specific recommendations:

For Investment Advisers

- Identify situations that could lead the firm to become a Large Trader (e.g., if an adviser enters into a new discretionary client agreement, trading activity may meet the transaction thresholds of the Rule resulting in the investment adviser being deemed a Large Trader).
- Timely file Form 13H, with respect to both the annual filing requirement and obligations to provide amended filings, as applicable.

- Promptly following the end of a calendar quarter, amend Form 13H if the information contained within the filing becomes inaccurate, including the list of broker-dealers effecting transactions in eligible securities by the adviser, or the adviser's affiliates.
- Notify any broker-dealers through which the adviser executes transactions of its Large Trader status.

For Broker-Dealers

- Assess applicability of Rule 13h-1 to the firm and its affiliates and make any necessary changes to its supervisory and compliance policies and procedures.
- Timely file Form 13H, with respect to both the annual filing requirement and amended filings, as applicable.
- Assess compliance policies and procedures and address reporting requirements under Electronic Blue Sheets and upcoming requirements under the Consolidated Audit Trail, as well as applicable FINRA rules.
- Monitor customer activity to identify customers that may be Large Traders but have not provided their Large Trader identification number, and ensure that compliance procedures include a process to contact such customers.
- Ensure that compliance policies and procedures address how the firm identifies and associates new accounts for existing Large Traders.

The OCIE risk alert is available here.

SEC Staff Issues ADI Regarding Risk Disclosures for Registered Funds Investing in Emerging Markets

On December 14, 2020, the staff of the SEC's Division of Investment Management issued guidance, in the form of an Accounting and Disclosure Information (ADI), regarding the adequacy of the risks disclosed by registered funds with significant exposure to emerging markets. In light of registered funds' increased exposure to emerging markets, the ADI highlights the staff's ongoing review of emerging markets risk disclosures and the importance of tailored communication to investors.

A few notable factors from the ADI for funds to consider when drafting their emerging markets risk disclosures are as follows:

- **Foreign Market Risks.** Funds should consider the particular risks related to the emerging markets in which they invest and tailor disclosures accordingly. In drafting risk disclosure, the staff states that funds should consider factors such as lack of liquidity, concerns about market manipulation, limited reliable access to capital, political risks and foreign investment structures.
- **Impact of Regulation and Financial Reporting Standards.** Funds should consider whether and to what extent local regulatory, accounting, auditing and financial reporting and recordkeeping standards in emerging markets may limit an adviser's ability to evaluate investments or affect fund performance.
- **Limitations on Shareholder Rights.** Funds also should consider any limitations on their rights and remedies against portfolio companies.
- **Concerns for Index Funds.** Funds tracking indices with significant exposure to emerging markets should consider the reliability of an index provider's information and evaluate any concerns regarding the diligence process used to gather data.
- **Restrictions on PCAOB Audits.** Unlike U.S.-listed issuers, issuers listed in certain emerging markets may not be required to comply with Public Company Accounting Oversight Board (PCAOB) audit requirements. Funds should consider that certain jurisdictions do not allow the PCAOB sufficient access to inspect public audit firms or other audit materials. Accordingly, funds should carefully assess the regulatory framework in place in the emerging markets

in which they invest and reflect material concerns in risk disclosures.

The ADI is available here.

SEC Articulates Standards for Relief Under Section 26(c) for Variable Insurance Product Substitution Orders

On December 4, 2020, the SEC granted a substitution order under Section 26(c) of the Investment Company Act of 1940 to Allianz Life Insurance Company of North America and Allianz Life Insurance Company of New York, together with their respective separate accounts (collectively, Allianz). Section 26(c) of the 1940 Act prohibits the substitution of shares of mutual funds offered as an investment option to variable annuity and variable life insurance contracts with shares of a different mutual fund (a Substitution) unless the SEC determines that the evidence establishes that the Substitution is consistent with the protection of investors and the purposes of the 1940 Act.

Following Allianz's application for a Substitution, a fund company raised several issues relating to Allianz's proposed Substitution, and requested that the SEC consider such issues in a hearing. The objecting party made the following assertions in challenging the application for a Substitution order:

- Prior Substitutions dealt primarily with single-fund Substitutions, instead of "slate-clearing" Substitutions. Accordingly, the SEC should analyze the effects and harm of slate-clearing Substitutions differently than single-fund Substitutions and require different terms and conditions for the proposed Substitutions.
- A Substitution should only be permitted where affected investors would demonstrably benefit from the modifications.
- Contract holders and their financial advisers may incur additional expenses due to contract holders seeking advice on the Substitutions.
- The effects of the proposed Substitutions on the contractual benefits and guarantees of the contracts should be considered.
- Contract holders will experience a loss of economies of scale from the transfer of their assets from the funds being replaced (or Target Funds) to the much smaller replacement funds (or Destination Funds).
- The proposed Substitutions arise from the commercial objectives and not from necessity.
- Instead of replacing the Target Funds with the Destination Funds, Allianz should add the Destination Funds as additional investment options.
- The Destination Funds have investment strategies that are insufficiently similar to the Target Funds and thus, the Substitutions will adversely affect the investment choices available to contract holders.
- After the assets are transferred from the Target Funds to the Destination Funds, the remaining shareholders of the Target Funds may be adversely affected.

In granting a Substitution order to Allianz, the SEC responded to the objecting party's assertions as follows:

- A slate-clearing Substitution should not be treated differently than a single-fund Substitution, and the SEC has granted similar Substitutions in the past to other applicants. Accordingly, the SEC declined to require different terms or conditions.
- Section 26(c) requires that a Substitution be consistent with the protection of investors; it does not require a demonstrable benefit to investors, but rather the absence of harm.
- Section 26(c) is concerned with the protection of investors, not the burden on an investor's financial adviser and does not take into account the cost of personal financial advice that an investor may seek. In fact, the legislative history indicates that the purpose of Section 26(c) was to protect shareholders from being subject to a new sales load.

- Section 26(c) does not require consideration of the impact on the value of contract guarantees or economies of scale because such analysis would be speculative, complex and rely on numerous assumptions and would be of limited use in determining whether a Substitution is consistent with the protection of investors.
- Section 26(c) does not require exceptional or exigent circumstances in order for an insurance company to engage in a Substitution.
- Section 26(c) does not require the applicants or the SEC to analyze alternative actions to a Substitution.
- The relevant variable annuity and variable life insurance contracts offer numerous investment options with the understanding that the insurance company will have the ability to make changes among the investment options in appropriate circumstances, and such contracts expressly permit Substitutions.
- The objecting party's assertion that the Destination Funds must have substantially similar investment strategies to the Target Funds is not a requirement under Section 26(c); however, Allianz agreed to analyze the comparability of the funds as one of the conditions to being granted a Substitution order. In addition, the protection of investor choice was not a fundamental purpose of Section 26(c), but rather the protection of investors from incurring certain costs.
- Consideration of the effects that a Substitution will have on third-party investors is inconsistent with the text and purpose of Section 26(c) and, accordingly, the extension of such a determination under Section 26(c) is not required.

Accordingly, the SEC found that the Substitutions were consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act and granted the Substitution order under Section 26(c) to Allianz.

The SEC order is available here.

OCIE Risk Alert Highlights Compliance Rule Deficiencies Observed During Recent Adviser Exams

On November 19, 2020, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a Risk Alert summarizing common deficiencies related to registered investment adviser compliance programs identified by OCIE staff during recent adviser exams. Rule 206(4)-7 of the Advisers Act—the Compliance Rule—requires registered investment advisers to adopt written policies and procedures designed to prevent violations of the Advisers Act, review the adequacy and effectiveness of such policies and procedures no less frequently than annually and appoint a chief compliance officer (CCO) empowered to administer the compliance program.

OCIE identified the following categories of Compliance Rule deficiencies and weaknesses:

- **Inadequate Compliance Resources.** Failure to devote adequate resources, such as information technology, staff and training, to compliance programs, including, for example, by (1) allowing or directing CCOs to assume various other professional responsibilities, leaving CCOs with insufficient time to devote to their compliance oversight responsibilities and/or to develop their knowledge of the Advisers Act; and (2) not hiring additional compliance staff or enhancing information technology capabilities despite having experienced significant growth in the firm's size or complexity, leading to compliance program implementation failures;
- **Insufficient Authority of CCOs.** Failure to empower CCOs to develop and enforce compliance programs, including, for example, by (1) restricting CCOs' access to critical compliance information, such as trading exception reports and advisory agreements with key clients; (2) not consulting CCOs regarding matters that had potential compliance implications; and (3) not

prioritizing senior management engagement with CCOs, leading to CCOs having limited knowledge about the firm's leadership, strategy, transactions, and business operations;

- **Annual Review Deficiencies.** Inability to demonstrate that an annual review was performed or annual reviews that failed to identify significant existing compliance or regulatory problems, including, for example, by (1) failing to identify or review key risk areas applicable to the adviser, such as conflicts and protection of client assets; and (2) failing to review significant areas of the adviser's business, such as policies and procedures concerning cybersecurity and the calculation of fees and allocation of expenses;

- **No Implementation of Compliance Program.** Failure to implement or perform actions required by written policies and procedures, including, for example, by failing to (1) train employees; (2) implement compliance procedures regarding trade errors, advertising, best execution, conflicts, disclosure and other requirements; (3) review advertising materials; (4) follow compliance checklists and other processes, including backtesting fee calculations and testing business continuity plans; and (5) review client accounts, e.g., to assess consistency of portfolios with clients' investment objectives, on a periodic basis or on a schedule required in the adviser's policies;

- **Inaccurate and Incomplete Information in Policies and Procedures.** Inclusion of outdated or inaccurate information about the adviser in policies and procedures, including through the use of off-the-shelf policies;

- **Insufficient Policies and Procedures.** Failure to maintain, establish or implement appropriately tailored written policies and procedures reasonably designed to prevent violations of the Advisers Act, including, for example, by (1) claiming to rely on cursory or informal processes instead of maintaining written policies and procedures; and (2) using policies of an affiliated entity, such as a broker-dealer, that were not tailored to the adviser's business.

OCIE encourages advisers to review their written policies and procedures, including implementation of those policies and procedures, to ensure that they are tailored to the advisers' business and adequately reviewed and implemented.

The Risk Alert is available here.

Enforcement and Litigation Matters

LITIGATION MATTERS

Parties Stipulate to Dismissal of Last Pending Section 36(b) Excessive Fee Suit

On December 30, 2020, the parties to the last pending excessive fee suit brought against a mutual fund's investment adviser under Section 36(b) of the Investment Company Act of 1940 submitted to the U.S. District Court for the District of Maryland a joint stipulation of dismissal with prejudice. On January 4, 2021, the court entered an order on the stipulation, resulting in the closure of the case. The litigation began in April 2016, when the plaintiffs, investors in eight mutual funds managed by T. Rowe Price Associates, Inc., filed a complaint in the U.S. District Court for the Northern District of California alleging that T. Rowe Price received excessive advisory fees from the funds in violation of the firm's fiduciary duty because the firm provided substantially similar services for a lower fee as a sub-adviser to unaffiliated funds. The case was transferred to the Maryland District Court in August 2016, and claims with respect to one of the eight funds named in the original complaint were voluntarily dismissed in March 2018. In the stipulation, the parties stated that the dismissal of the suit was not the result of a settlement, compromise or payment of any consideration to the plaintiffs, and each side agreed to bear its own costs and attorneys' fees.

Following the dismissal of this case, there are no Section 36(b) excessive fee suits currently pending in federal court.

The stipulation was submitted under the caption *Zoidis v. T. Rowe Price Assocs., Inc*., case no. 1:16-cv-02786-GLR.

Public Statements, Press Releases and Testimony

PUBLIC STATEMENTS

Recent SEC Leadership and Organizational Changes

In December 2020, the SEC announced multiple leadership and organizational changes, including the departures of the Directors of the Divisions of Investment Management, Enforcement and Corporation Finance and the departure of SEC Chairman Jay Clayton. On January 21, 2021, the SEC announced that Commissioner Allison Herren Lee had been designated Acting Chair of the SEC. On January 22, 2021, the SEC announced that Melissa Hodgman had been named Acting Director of the Division of Enforcement.

Departures of Division Directors and SEC Chairman

The Director of the Division of Corporation Finance, William Hinman, the Director of the Division of Enforcement, Stephanie Avakian, and SEC Chairman Jay Clayton each stepped down in December 2020. On December 22, 2020, the SEC announced that the Director of the Division of Investment Management, Dalia Blass, would step down in January 2021. On December 28, 2020, the SEC announced that Commissioner Elad Roisman had been appointed Acting SEC Chairman.

FinHub to Become Stand-Alone Office

On December 3, 2020, the SEC announced that its Strategic Hub for Innovation and Financial Technology (commonly referred to as FinHub) would become a stand-alone office, and that Valerie A. Szczepanik would continue to lead FinHub as its first director and report directly to the SEC Chairman. FinHub was established within the Division of Corporation Finance in 2018 to encourage responsible innovation in the financial sector, including in evolving areas such as distributed ledger technology (i.e., blockchain), digital assets (e.g., cryptocurrencies), automated investment advice (e.g., robo-advisors) and artificial intelligence and machine learning. Ms. Szczepanik stated that the "organizational shift will facilitate the agency's agility and flexibility to work with market participants and regulators worldwide, and to encourage leading-edge innovation that will shape the intersection between the federal securities laws and technology."

Division of Examinations

In a public statement issued on December 17, 2020, the SEC announced that it was renaming the Office of Compliance Inspections and Examinations (commonly referred to as OCIE) as the Division of Examinations, noting the office's growth and the increased breadth and complexity of its responsibilities. OCIE, now the Division of Examinations, is the second largest division at the SEC, with over 1,000 employees, and is primarily responsible for conducting risk-based examinations of SEC-registered entities, is often the first point of contact at the SEC for small registrants, and conducts significant outreach to market participants.

Legislative Developments and Executive Orders

Biden Administration Issues "Regulatory Freeze" Memo

On January 20, 2021, the administration of President Joseph R. Biden, Jr. issued a "regulatory freeze" memorandum for the heads of executive departments and agencies to ensure that President Biden's appointees or designees have an opportunity to review any new or pending rules.

Pursuant to the memo, rules that have been sent to the Office of the Federal Register but that have not yet been published must not be published until a department or agency head appointed or designated by the new administration reviews and approves the rule. In addition, the memo directs department and agency heads to consider postponing rules that have been published in the Federal Register but that have not yet taken effect to seek additional public comment on issues of fact, law and policy raised by the rules and thereafter to take appropriate action.

Although the SEC is not an executive department or agency, but rather an independent regulatory agency of the U.S. federal government, there is some ambiguity about whether the memo applies to SEC rules. In addition, the SEC may choose to voluntarily follow the memo's directives and recommendations.

We will keep clients abreast of any impact on new or pending rules resulting from this regulatory freeze.

The regulatory freeze memo is available here.

President Trump Issues Executive Order Prohibiting Transactions Involving "Communist Chinese Military Companies," Signs Holding Foreign Companies Accountable Act

This article summarizes two recent developments relevant to China-based issuers whose securities are publicly traded in the United States. These developments may have a significant impact on U.S. persons that invest in those securities, including U.S. investment funds and their managers.

Executive Order 13959 and Subsequent Developments

On November 12, 2020, then-President Donald J. Trump issued Executive Order 13959, *Addressing the Threat from Securities Investments That Finance Communist Chinese Military Companies*. Under existing statutory authority, the U.S. Department of Defense (DOD), acting in coordination with the U.S. Department of the Treasury, identifies and publishes a list of "Communist Chinese military companies" (CCMCs) that operate directly or indirectly in the United States or its territories or possessions. Executive Order 13959 prohibits U.S. persons from purchasing securities of issuers so identified as CCMCs, as well as securities of other issuers identified by the Secretary of the Treasury as meeting the criteria of a CCMC or of a publicly listed subsidiary of a CCMC. The executive order applies to investments in publicly traded securities of identified CCMCs and any securities that are derivative of, or that are designed to provide investment exposure to, those securities. An annex to the executive order listed 31 companies identified as CCMCs, investments in which would be subject to the executive order. Following the issuance of the executive order, additional CCMCs have been identified, including nine additional CCMCs named by DOD on January 14, 2021.

The sanctions against trading in CCMC securities took effect on January 11, 2021 with respect to CCMCs initially designated on November 12, 2020. For additional CCMCs designated after November 12, 2020, the trading ban takes effect 60 days after the date of designation.

After the issuance of the executive order, the Department of the Treasury's Office of Foreign Assets Control (OFAC) issued guidance in the form of Frequently Asked Questions to clarify various provisions of the order. Importantly, the FAQs make it clear that the executive order would apply to derivatives (including futures, options and swaps), warrants, depositary receipts, mutual funds, exchange-traded funds and index funds that hold or otherwise provide exposure to publicly traded securities of CCMCs, noting that transactions in those securities are "prohibited regardless of such securities' share of the underlying index fund, ETF, or derivative thereof."

On January 6, 2021, the SEC's Division of Examinations issued a risk alert regarding the executive order. In the risk alert, the Division encouraged investment advisers, broker-dealers and other market participants to review and assess the impact of the executive order on their own investments as well as on the investments their investors and clients, and to evaluate related processes. On January 13, 2021, then-President Trump issued Executive Order 13974, amending certain provisions of the original November 12, 2020 executive order, including, notably, adding a provision prohibiting "possession" by U.S. persons of CCMC securities as of 11:59 p.m. ET on the date 365 days after the CCMC was designated as such. Following the amended executive order, OFAC issued additional guidance expressly stating that U.S. persons are required to divest their holdings of CCMC securities by the end of the applicable wind-down period and are "prohibited from holding covered securities after the relevant deadline."

In the latest development, on January 27, 2021, OFAC issued General License No. 1A to Executive Order 13959, authorizing, until 9:30 a.m. ET on May 27, 2021, transactions in securities of any entity "whose name closely matches, but does not exactly match, the name of a [CCMC]." The Biden administration could further modify or repeal the executive orders.

The November 12, 2020 executive order is available here; the January 13, 2021 executive order is available here.

The OFAC FAQs relating to the executive order, as well as the current list of prohibited companies published by OFAC, are available here.

The SEC Division of Examinations risk alert relating to the initial executive order is available here.

Holding Foreign Companies Accountable Act

On December 18, 2020, then-President Donald J. Trump signed the Holding Foreign Companies Accountable Act (HFCA Act) into law. The HFCA Act, an amendment to the Sarbanes-Oxley Act of 2002 that garnered bipartisan support in the House and the Senate, is intended to address rising concerns over audit inspections of China-based issuers. The HFCA Act requires auditors of foreign public companies to allow the Public Company Accounting Oversight Board (PCAOB) to inspect their audit work papers; issuers whose foreign auditors go three years without a PCAOB inspection will be prohibited from having their securities publicly traded in the United States. Although the HFCA Act as drafted is not specific to China-based issuers, authorities in China have historically prohibited audit firms located in China and Hong Kong from providing the PCAOB access to audit work papers.

Under the HFCA Act, the SEC is required to identify all issuers subject to the periodic reporting requirements of the Securities Exchange Act of 1934 whose audited financial reports are prepared by an accounting firm located in a foreign jurisdiction and that the PCAOB is unable to inspect due to a position taken by an authority in that jurisdiction. If the PCAOB is unable to inspect the issuer's auditor for three consecutive years, the issuer will be prohibited from having its securities listed for trading on a U.S. exchange or otherwise traded in over-the-counter markets subject to the jurisdiction of the SEC. The HFCA Act contains cure provisions for companies whose securities have been delisted pursuant to the provisions of the HFCA Act but that later take actions to engage auditors that submit to PCAOB inspections. However, if the trading prohibition is so removed and the issuer's auditor has a recurrence of non-inspection during the same year, the issuer's securities will be subject to a minimum five-year trading prohibition. The HFCA Act contains additional disclosure requirements for issuers identified by the SEC as having auditors that the PCAOB is unable to inspect, including, among others, the percentage of the shares of the issuer owned by governmental entities in the jurisdiction in which the issuer is organized and the name of any official of the Chinese Communist Party on the issuer's board of directors.

After the HFCA Act was signed into law, SEC Chairman Jay Clayton issued a statement noting that he was "pleased with the bipartisan, multi-agency approach to addressing these critical investor protection issues," while noting that the HFCA Act "requires significant Commission action to implement." Mr. Clayton stated that prior to passage of the HFCA Act, the SEC was finalizing recommendations for proposed rules regarding the same matter. Due to overlap between the HFCA Act and the SEC's proposal, Mr. Clayton stated that he directed the SEC staff to consider providing a single consolidated proposal on issues related to PCAOB's access to audit work papers, exchange listing standards and trading prohibitions, and noted that the SEC would likely consider the proposal following his departure from the agency.

The text of the HFCA Act is available here.

Mr. Clayton's statement regarding the HFCA Act is available here.

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2020 THE NATIONAL LAW REVIEW Go To Thought Leader

Vedder Price's Investment Services Group has received a 2020 Go-To Thought Leadership Award from the National Law Review in recognition of the Group's regular securities law thought leadership contributions and outstanding analysis of issues affecting the asset management industry.

VedderPrice

Investment Services Group

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.