Simpson Thacher

Registered Funds Regulatory Update

July 7, 2023

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SEC Rulemaking

SEC Announces Spring 2023 Regulatory Agenda

The Office of Information and Regulatory Affairs recently released the SEC's Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions, which identifies the most significant regulatory actions that the SEC reasonably expects to issue in proposed or final form and the broad targeted time frame to issue such rules. The Agenda indicates that the SEC expects to continue carrying out its expansive rulemaking agenda at a rapid pace with respect to investment advisers, private funds and registered funds, with several major rule proposals slated for adoption in the second half of 2023. Below is a breakdown of the target time frames for final action on previously proposed rules concerning investment advisers and funds, and descriptions of a few notable contemplated rule proposals concerning investment advisers and funds.

Previously Proposed Rules—Final Action Contemplated for October 2023

- ***Enhanced Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices and Investment Company Names***: The proposal for enhanced disclosure would require investment companies and investment advisers to provide more specific disclosures in fund filings and investment adviser brochures regarding the ESG strategies that they pursue and the specific ESG impact(s) they seek to achieve, and require additional disclosures by funds that use proxy voting or other issuer engagements to implement their ESG strategy. The fund names rule proposal would, among other measures, expand the current requirement of the names rule for certain registered funds to adopt a policy related to the 80 percent investment requirement.
- ***Cybersecurity Risk Management for Investment Advisers, Investment Companies and BDCs***: This proposed rule would require SEC-registered advisers and funds to adopt and implement written policies and procedures that are reasonably designed to address cybersecurity risks and to provide additional disclosures related to cybersecurity risks and incidents in investment adviser brochures and fund filings. It would also require SEC-registered investment advisers to report significant cybersecurity incidents to the SEC within 48 hours of the incident's occurrence.
- ***Open-End Liquidity Risk Management Programs and Swing Pricing***: These proposed amendments would require most open-end funds to use swing pricing to adjust their NAV per share, in order to pass on costs stemming from material shareholder purchase or redemption activity to the purchasing or redeeming shareholders. The proposed amendments would also require additional disclosures on Forms N-PORT, N-1A and N-CEN for certain registered investment companies, and require more frequent reporting of monthly portfolio holdings and information about liquidity risk management and swing pricing to the SEC and the public.

- ***Modernization of Beneficial Ownership Reporting***: This proposal would accelerate the filing deadlines for Schedules 13D and 13G beneficial ownership reports, expand the application of Regulation 13D and 13G to certain derivative securities, expand the circumstances under which two or more persons will be deemed to have formed a "group" that would be subject to beneficial ownership reporting obligations, and require that Schedules 13D and 13G be filed using a structured, machine-readable data language.
- ***Safeguarding Rule***: This dramatic set of amendments to the Advisers Act custody rule would require registered investment advisers to enter into written agreements with clients' qualified custodians that contain certain assurances, and require that qualified custodians have possession or control of the client assets for which investment advisors have historically had custody. In addition, the proposal would require, for privately-offered securities not maintained at a qualified custodian, that the investment adviser document that such securities cannot be maintained at a qualified custodian and that an independent public accountant promptly verify any purchase, sale or transfer of such a security. The proposal would expand the custody rule to apply to all client assets, including non-security assets such as digital assets and real estate.

Previously Proposed Rules—Final Action Contemplated for April 2024

- ***Outsourcing by Investment Advisers***: This proposal would, among other things, require registered investment advisers to conduct due diligence before outsourcing various functions, monitor and reassess service providers' performance, and make and keep books and records related to such due diligence and monitoring.
- ***Regulation S-P***: This proposal would amend regulation S-P to create a federal minimum standard for covered institutions (broker-dealers, registered investment companies including BDCs, registered investment advisers and transfer agents) for preventing and responding to data breaches, including providing notice to certain affected stakeholders, and require covered institutions' contracts with service providers to include measures to protect against data breaches.

Contemplated Rule Proposals

- ***Prohibition of Conflicted Practices for Investment Advisers and Broker-Dealers That Use Certain Covered Technologies***: The SEC is considering recommending separate proposed rules related to investment advisers' and broker-dealers' conflicts of interest in the use of predictive data analytics, artificial intelligence, machine learning and similar technologies in connection with certain investor interactions.
- ***Fund Fee Disclosure and Reform***: The SEC is considering recommending changes to regulatory requirements relating to registered investment companies' fees and fee disclosure.

Agency Rule List – Spring 2023 (June 13, 2023), available at: https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=ABBAA84824C29E01B566B0472A6E99E59C730916821A14613C79DE7F48AC8EAEF4CA3A7C929E9B10E667F119BAA4958D5293.

SEC Requires More Share Repurchase Disclosure

On May 3, 2023, the SEC adopted amendments to its issuer share repurchase disclosure rules in an effort to modernize and improve disclosure and provide investors with enhanced information to assess the purposes and effects of share repurchases. Both U.S. and foreign reporting companies, as well as registered closed-end management investment companies that are exchange traded ("listed closed-end funds") and business development companies (listed or non-listed), will now be required to provide more public disclosure regarding their share repurchases.

The new rule requires issuers to file daily quantitative share repurchase data on a quarterly basis (semi-annually for listed closed-end funds). The required disclosures include, for each day on which a repurchase was conducted, the number of shares repurchased that day and the average price paid, among other things. Issuers must also disclose with this quarterly reporting whether any director or officer made trades in the issuer's shares within four business days before or after the announcement of a new or amended share repurchase plan. The new disclosure requirements may allow the market to estimate the specifics of an issuer's 10b5-1 repurchase plan, including maximum/minimum purchase prices and quantities on any given day.

The SEC will also now require issuers to disclose narratively in their periodic reports their objectives for share repurchases, criteria for determining repurchase amounts and policies for director and officer trades during a repurchase program.

Finally, domestic issuers will be required to disclose quarterly whether they adopted or terminated any Rule 10b5-1 repurchase plans.

Domestic corporate issuers, including business development companies, will be required to comply with the new disclosure requirements in their first Form 10-Q or Form 10-K covering the quarter beginning on or after October 1, 2023.

Listed closed-end funds will be required to comply with the new disclosure requirements in their first Form N-CSR covering the six-month period beginning on or after January 1, 2024.

Share Repurchase Disclosure Modernization, SEC Release No. IC-34906 (May 3, 2023), available at: https://www.sec.gov/rules/final/2023/34-97424.pdf.

SEC Enforcement

Adviser Agrees to Pay $9 Million for Disclosure and Policies and Procedures Failures

The SEC recently settled charges against a registered investment adviser related to disclosure and policies and procedures violations involving two of the funds it advises.

In the first action, the Order found that, from April 2011 to November 2017, the adviser failed to waive approximately $27 million in advisory fees for a fund that primarily invested in other funds managed by the same adviser to avoid duplicative fees, as required by the advisory agreement, due to a formula error used to calculate the fee waiver amount. The Order noted that the adviser's fee waiver calculations did not properly consider the fund's use of leverage. Additionally, until at least 2018, the fund did not have adequate written policies and procedures to oversee advisory fee calculations and related fee waivers. The adviser has since disbursed to investors $27 million in fees that should have been waived, plus interest and a performance adjustment.

In the second action, the Order found that, from September 2014 to August 2016, the adviser failed to disclose material information to investors about its use of interest swaps for a listed closed-end fund it advised and the material impact of the swaps on the fund's dividend. The adviser inadequately disclosed that certain paired interest rate swaps in the fund's portfolio had become a material source of distributable income (no less than 24% of the fund's distributions paid to shareholders in each month), which allowed the adviser to maintain the fund's dividend rate. However, the continued use of interest rate swaps contributed to a decline in the fund's NAV. According to the Order, the adviser failed to inform shareholders that a significant portion of the fund's distributions came from the paired swap transactions, and that these transactions not only had a substantial risk of capital loss but also a negative effect on the fund's NAV.

For the first action, the Order found that the adviser violated the anti-fraud and compliance provisions of the Advisers Act. In the second action, the Order found that the adviser violated the anti-fraud provisions of the Advisers Act and Section 34(b) of the Investment Company Act, which makes it unlawful for any person to make untrue statements of material fact, or omit material information necessary to make other statements not misleading, in any report or document filed under the Investment Company Act.

Without admitting or denying the SEC's findings, the adviser agreed to a cease-and-desist order and censure in each action as well as a combined $9 million civil monetary penalty from both actions.

In the Matter of Pacific Investment Management Company LLC, SEC Admin. File No. 3-21489 (June 16, 2023), available at: https://www.sec.gov/litigation/admin/2023/ia-6328.pdf.

In the Matter of Pacific Investment Management Company LLC, SEC Admin. File No. 3-21490 (June 16, 2023), available at: https://www.sec.gov/litigation/admin/2023/ia-6329.pdf.

SEC Enforces First Liquidity Rule Case Against Investment Adviser and Fund Trustees

The SEC charged Pinnacle Advisors LLC, a registered investment adviser, for aiding and abetting Liquidity Rule violations by a mutual fund it advised and whose Liquidity Risk Management Program it administered. The SEC also charged the fund's two independent trustees, Mark Wadach and Lawton Williamson, and two officers of both Pinnacle Advisors and of the fund it advised, Robert Cuculich and Benjamin Quilty, with aiding and abetting Liquidity Rule violations by the fund. A third trustee, Joseph Masella, agreed to settle charges that he caused and willfully counseled the fund's violations.

The action is the first-ever case enforcing the Liquidity Rule, which prohibits mutual funds from investing more than 15 percent of their net assets in illiquid investments, requires funds to take certain prompt remedial steps if they hold illiquid investments above this percentage limit, and requires funds to adopt a liquidity risk management program to assess their liquidity risk.

The SEC's Complaint alleges that, from June 2019 to June 2020, the fund held approximately 21 to 26 percent of its net assets in illiquid investments. According to the Complaint, Pinnacle Advisors and its officers, Cuculich and Quilty, classified the fund's largest illiquid investment as a "less liquid" investment, ignoring restrictions, transfer limitations, and the absence of any market for the shares, and disregarding the advice of fund counsel and auditors. The SEC alleges that Pinnacle Advisors and its officers did not present the fund's board with a plan to reduce the fund's illiquid investments to 15 percent or lower or make required filings with the SEC, as required by the Liquidity Rule. The Complaint also states that Cuculich, Quilty, and Masella misled the SEC's Division of Investment Management about the basis for the fund's liquidity classifications. According to the Complaint, the fund's board had oversight responsibilities regarding the fund's Liquidity Risk Management Program, and Wadach and Williamson, who knew that the shares were restricted and illiquid, aided and abetted the fund's violation by recklessly failing to exercise reasonable oversight of the fund's program.

The Complaint seeks permanent injunctions and civil money penalties. The fund is now a liquidating trust and is not separately charged.

Without admitting or denying the SEC's findings, Masella consented to an order requiring him to cease and desist from violations of the Liquidity Rule and pay a civil penalty of $20,000, and suspending him from association with any investment adviser, registered investment company, and others for six months.

The SEC also announced charges against Pinnacle Investments LLC, an affiliate of Pinnacle Advisors, for making false and misleading statements in its Form ADV brochure regarding reviews of advisory client accounts and

failing to disclose certain conflicts of interests, adopt and implement related policies and procedures, and deliver to clients required information about advisory personnel. Without admitting or denying the SEC's findings, Pinnacle Investments consented to an order requiring it to cease and desist from violations of the antifraud and other provisions of the Investment Advisers Act of 1940, a censure, and disgorgement and a civil penalty totaling approximately $476,000.

Complaint, *SEC v. Pinnacle Advisors, LLC, et al.*, Civil 5:23-cv-547-FJS-ATB (N.D. NY. May 5, 2023) , available at: https://www.sec.gov/litigation/complaints/2023/comp-pr2023-90.pdf.

In the Matter of Joseph Masella, SEC Admin Proc. File No. 3-21406 (May 5, 2023), available at: https://www.sec.gov/litigation/admin/2023/ia-6303.pdf.

In the Matter of Pinnacle Investments, LLC, SEC Admin Proc. File No. 3-21405 (May 5, 2023), available at: https://www.sec.gov/litigation/admin/2023/34-97448.pdf.

SEC Settles With Adviser and Its Founder for Improper Trading

The SEC recently settled charges against Chatham Asset Management, LLC, a registered investment adviser, and its founder, Anthony Melchiorre, for improper trading.

The Order found that in 2014, Chatham acquired 78% of AMI Parent Holdings, LLC's equity, which gave it effective control of the publisher. From 2016 through 2018, Chatham and Melchiorre traded, on behalf of their private fund clients, in three high-yield debt securities issued by American Media Inc., a wholly-owned subsidiary of AMI Parent Holdings. Chatham and Melchiorre acquired substantial positions in these AMI bonds. On average, the AMI bonds comprised 11 percent of client portfolios and its clients collectively owned 83 percent of the bonds issued by AMI. During this period, Chatham and Melchiorre engaged in rebalancing trades between funds they managed in the AMI bonds through various broker-dealers to meet portfolio constraints. These trades were executed at prices proposed by Chatham and Melchiorre instead of market prices. Chatham and Melchiorre executed more than 100 of such trades from 2016 to 2018, accounting for approximately 81 percent of Chatham's overall trading. Over time, the prices Chatham and Melchiorre traded the bonds increased at a materially higher rate compared to the prices of similar securities because their trading accounted for the vast majority of the trading in the bonds.

The Order also found that Chatham and Melchiorre calculated the NAVs of their client funds' holdings using pricing data that was based partly on the trading prices of the securities. As a result, the NAVs of Chatham's clients were higher than they would have been if Chatham's trades in the bonds had been removed from the market, resulting in higher fees being charged to Chatham's clients. Furthermore, Chatham was compensated for its advisory services with a management fee and, for certain clients, an additional performance fee. Chatham's

clients paid an estimated $11 million in management and/or performance fees that they would not have in the absence of these trades. Chatham in turn paid approximately 55% of such fees to Melchiorre.

The SEC charged Chatham and Melchiorre with violating the anti-fraud provisions of the Advisers Act. Additionally, many of the trades involved mutual funds, for which Chatham acted as subadviser, and in those cases, Chatham and Melchiorre caused the funds to enter into prohibited affiliated transactions under the Investment Company Act.

Without admitting or denying the findings, Chatham and Melchiorre agreed to cease-and-desist orders, censures, disgorgement of $11 million, and prejudgment interest of $3,375,072. Chatham and Melchiorre also agreed to pay civil monetary penalties of $4.4 million and $600,000, respectively. In addition, Melchiorre was permanently barred from the industry.

In the Matter of Chatham Asset Management, LLC, and Anthony Melchiorre, SEC Admin. File No. 3-21355 (Apr. 3, 2023), available at: https://www.sec.gov/litigation/admin/2023/ia-6270.pdf.

Commonwealth Found Liable for Failing to Adequately Disclose Revenue Sharing Arrangement

On April 7, 2023, a Massachusetts District Court ruled that Commonwealth Financial Network negligently breached its fiduciary duties to its advisory clients for failing to disclose material conflicts of interest relating to a revenue sharing agreement in violation of the anti-fraud provisions of the Advisers Act. In 2014, Commonwealth and National Financial Services, a clearinghouse affiliate of Fidelity Investments, agreed that NFS would pay Commonwealth 80% of NFS's received mutual fund revenue as long as Commonwealth invested client assets in specific mutual fund share classes for which NFS shared revenue. Between 2014 and 2018, Commonwealth received around $135 million from NFS as part of this revenue sharing agreement. The SEC brought an enforcement action against Commonwealth in August 2019, alleging that while Commonwealth did disclose a revenue sharing arrangement with a clearing broker in a "no-transaction fee" program, it did not adequately disclose that the arrangement incentivized Commonwealth to select more expensive investments for its advisory clients. In its Complaint, the SEC focused on three main facts: (i) in some instances, the mutual fund shares classes purchased by Commonwealth's clients had at least one lower-cost share class available that Commonwealth received less or no revenue sharing; (ii) in some instances, Commonwealth purchased transaction fee mutual fund share classes for its clients, NFS charged a transaction fee on the purchase and sale of such shares, and the mutual funds paid a portion of the ongoing fees to NFS that it then shared with Commonwealth; and (iii) there were certain mutual funds that Commonwealth had no incentive to select because it did not receive any revenue sharing. In response, Commonwealth argued that the SEC failed to allege facts showing a conflict of interest, insufficient disclosure, and deception and also did not provide Commonwealth with fair notice of its disclosure obligations.

The Court agreed with the SEC, taking particular issue with Commonwealth's use of "may" in its disclosure of potential conflicts of interest. Specifically, it noted that Commonwealth presented the revenue sharing payments as hypothetical payments it may receive and that Commonwealth may have an incentive to select investments for which it received compensation when both should have been presented to investors as "as a matter of fact." Furthermore, without having more information regarding the cost differences between share classes, Commonwealth's clients did not have access to the 'total mix of information' necessary to make informed investment decisions. As such, the Court determined that Commonwealth's disclosures were inadequate under the Advisers Act.

SEC v. Commonwealth Equity Services, No. 1:19-cv-11655 (D. Mass. Apr. 7, 2023).

Industry Developments

Republican AGs Threaten Major Asset Managers With Legal Action Over ESG

Republican Attorneys General from 21 U.S. states threatened to take legal action against major asset managers for prioritizing ESG factors when making investment decisions, thereby signaling their intent to scrutinize the industry during its upcoming proxy season. In a letter provided by the office of Montana Attorney General Austin Knudsen sent to 53 major asset managers, the AGs raised concerns that asset managers are effectively breaching their fiduciary duties by joining organizations, such as the Net Zero Asset Managers Initiative and Climate Action 100+, that encourage members to reduce global emissions. The letter states that the AGs intend to watch fund company votes on proxy proposals related to the environment, abortion, political spending, race, and gender, which would "prioritize political goals over financial interests." The letter goes on to state that asset managers' support of coordinated proxy voting motions by organizations, including As You Sow, may run the risk of violating antitrust protections.

The letter was sent to asset managers with $40 billion or more in assets, including BlackRock, Capital Group, Franklin Templeton, Goldman Sachs, Invesco, JPMorgan Asset Management, PIMCO, State Street Global Advisors, and T. Rowe Price. Notably, a spokesperson for Knudsen said Vanguard was excluded because it withdrew from the Net Zero Asset Managers Initiative last December.

The approach for companies and investors to increasingly consider ESG factors has been supported by Democratic leaders, including President Biden, who recently used his first veto to defend a rule on ESG investing. On the other hand, Republicans, many from energy-producing states, have increasingly raised challenges on ESG investing.

Republican Attorneys General Letter (Mar. 30, 2023), available at: https://content.govdelivery.com/attachments/MTAG/2023/03/30/file_attachments/2453301/2023-03-30%20Asset%20Manager%20letter%20Press%20FINAL.pdf.

Litigation

Class Action Suit Filed Over ESG in 401(k) Plans

A pilot, on behalf of two American Airlines 401(k) Plans (collectively, the "Plan"), filed a class action lawsuit against, among others, the company and Fidelity Investments Institutional for breach of fiduciary duty in violation of ERISA for making a variety of ESG funds available to Plan participants. Fidelity, as the Plan administrator, is responsible for selecting, monitoring and removing the Plan's designated investment options.

The Complaint stated that ERISA imposes strict fiduciary duties of loyalty and prudence upon employers and other ERISA fiduciaries and mandates that the exclusive purpose of Plan investments is to maximize financial benefits for participants and beneficiaries. Therefore, Defendants violated their fiduciary duties by including numerous ESG funds as well as other funds managed by investment companies who voted for ESG policy mandates. The Complaint alleges that many ESG funds are (i) more expensive for Plan participants to own; (ii) underperform financially; and (iii) engage in shareholder activism to achieve ESG policy agendas rather than maximize risk-adjusted financial returns for Plan participants, and that such ESG funds and managers pursue nonfinancial or nonpecuniary objectives such as ESG social policy objectives, rather than investment funds that exclusively aim to maximize financial returns for investors.

This Complaint seeks, among other things, reimbursement for ESG losses and permanent injunctive relief enjoining Defendants from including ESG investment funds and funds by pro-ESG managers in the Plan. Although the lawsuit faces many headwinds, if successful, it could impact the current ESG debate and open the door for a wave of copycat litigation.

Bryan P. Spence, et al. v. American Airlines, Inc. et al., Case No. 4:23-cv-00552-O (N.D. Tex. June 2, 2023), available at: https://www.dandodiary.com/wp-content/uploads/sites/893/2023/06/American-Airlines-ERISA-complaint.pdf.

Collapse of Infinity Q Funds: Insurance Dispute for Infinity Q Underscores Significance of Warranty Statements

In July 2021, Infinity Q Capital Management LLC and its officers filed a complaint in the Delaware Superior Court against three of its insurance providers for breach of contract for failing to advance defense costs incurred by Infinity Q. In August 2022, the Court granted summary judgment to the insurance providers, stating that Infinity Q had executed a warranty statement without disclosing an ongoing SEC inquiry. The Infinity Q parties appealed to the Delaware Supreme Court.

According to the Court's recitation of facts, from 2014 through August 2020, Infinity Q maintained $5 million in professional liability insurance through a primary insurance policy. In August 2020, Infinity Q added three separate excess liability policies underwritten for claims made during the period from August 2020 through August 2021. Each such insurance provider issued policies with a limit of liability of $5 million.

Prior to the excess policies being binded, Infinity Q executed a required warranty statement attesting that it did not have any knowledge of any facts or circumstances that would give rise to a future claim and that a violation of the knowledge exclusion would void coverage. However, in May 2020, the SEC had notified Infinity Q's officers of an inquiry regarding potential federal securities law violations. Furthermore, it was revealed that James Velissaris, Founder and former Chief Investment Officer of Infinity Q, had pressed to increase insurance after learning about the SEC investigation. After Infinity Q began facing shareholder complaints and suspended redemptions in February 2021, Infinity Q subsequently claimed on the primary policy, which was paid in full in May 2021, and attempted to claim on the three additional policies. However, those insurance providers refused coverage, citing the failure to disclose the SEC investigation from the warranty statements and a subsequent shareholder complaint as basis for the belief that Velissaris had prior knowledge of the circumstances that may have caused a claim. The Infinity Q officers contended that the insurance providers could not prove the warranty statements prohibited coverage and that they should still be ruled severable with defense costs paid to the innocent insureds, including Infinity Q's board members who joined the case after the dispute began. The Court held that the prior knowledge exclusions in the warranty statements barred coverage for the claims in dispute and granted summary judgment to the insurance providers.

On a related note, Infinity Q recently settled with the SEC for mispricing the NAV of Infinity Q Diversified Alpha Fund and its parallel hedge fund, the Infinity Q Volatility Alpha Fund, L.P. The Complaint stated that, from at least February 2017 through February 2021, the funds' reported NAVs were materially and falsely inflated due to a fraudulent mismarking scheme conducted by Infinity Q through Velissaris. Infinity Q agreed to settle the charges and consent to the appointment of a monitor to oversee the return of the remaining funds to harmed private fund investors. The settlement, which permanently enjoined Infinity Q from violating the federal securities laws charged in the Complaint, and the appointed monitor, are subject to Court approval. The SEC previously charged the mutual fund with mispricing its NAV, and the Court appointed a special master to oversee the distribution of the mutual fund's remaining funds to its harmed investors. Velissaris was sentenced to 15 years in prison for his participation in the fraudulent scheme. Separate settlements were reached with the SEC and other investors in September and November 2022. In November 2022, Velissaris pled guilty to securities fraud charges brought by the Southern District of New York but more recently attempted to retract his plea.

Infinity Q Capital Management, LLC, et al. v. Travelers Casualty and Surety Company, et al., C.A. No. N21C-07-158 EMD CCLD (Aug. 15, 2022), available at: https://www.dandodiary.com/wp-content/uploads/sites/893/2022/08/Infinity-Q-coverage-opinion-Del-Superior-Court-8.15.2022.pdf.

Complaint, *SEC v. Infinity Q Capital Management, LLC et al.*, Case 1:23-cv-05081 (S.D.N.Y. June 16, 2023), available at: https://www.sec.gov/litigation/complaints/2023/comp25750.pdf.

SEC to Submit Amicus Brief on Whether Syndicated Term Loans are Securities

On March 16, 2023, the United States Court of Appeals for the Second Circuit requested that the SEC file an amicus brief presenting its views on whether broadly syndicated term loans should be considered securities for purposes of the federal securities laws. The amicus brief will be submitted in the *Kirschner v. JPMorgan Chase Bank* litigation, which resulted from a 2014-syndicated loan transaction involving institutional investors purchasing $1.775 billion of Millennium Health LLC's debt obligations from a syndicate of banks, including JPMorgan Chase Bank. Between 2014 and 2015, Millennium faced multiple challenges that culminated in Millennium defaulting on its term loan and filing for bankruptcy.

In 2017, Marc S. Kirschner, as trustee for the investors in the Millennium debt obligations, sued the banks, claiming that they violated securities laws by misrepresenting or omitting material facts in their offering materials. In May 2020, the U.S. District Court of the Southern District of New York held that the underlying syndicated term loan was not a security, and therefore not subject to federal and state securities laws, and granted the banks' motion to dismiss. Kirschner filed an appeal in October 2021, and the Second Circuit heard oral arguments on March 9, 2023. The parties argued whether broadly syndicated term loans should be considered securities under *Reves v. Ernst & Young*, a 1990 U.S. Supreme Court case that created the "family-resemblance test" for determining whether notes are securities. Under the test, an instrument is presumed to be a security unless it bears a strong resemblance to one of a judicially crafted list of categories of instruments determined not to be securities. If the instrument does not bear a strong resemblance to a listed security, a court must determine whether another category should be added by reviewing the same factors. The Second Circuit requested the amicus brief from the SEC given the policy implications of the Court's conclusion as to whether syndicated term loans are securities.

Those that oppose classifying syndicated loans as securities generally argue that such classification would result in increased costs and reduced access to capital. Additionally, the CLO market could be impacted because CLOs have a limit on how many securities they may hold in their portfolios. Those in favor of classifying syndicated loans as securities argue that the *Reyes* family resemblance test is outdated and the $1.4 trillion syndicated loan market should be subject to the stronger protections afforded by the federal securities laws.

Kirschner v. JP Morgan Chase Bank, Docket No. 21-2726 (2d Cir. 2023).

SEC Obtains Judgments Against Former Trader and Portfolio Manager for Hedge Fund Valuation Fraud

The U.S. District Court for the Southern District of New York recently entered final consent judgments against Ashish Dole and Amin Majidi, a former trader and former portfolio manager, respectively, at now-defunct registered investment adviser Premium Point Investments L.P., for violating, among other things, the insider trading and antifraud provisions of the federal securities law.

The SEC's Complaint alleged that, from at least September 2015 through March 2016, Premium Point entered into a secret deal where in exchange for sending trades to a broker-dealer, it received inflated broker quotes on securities in private funds managed by Premium Point. Premium Point also allegedly utilized "imputed" mid-point valuations, which were applied to further inflate the value of the securities involved. This arrangement allegedly led to Premium Point materially overstating the funds' reported NAVs by more than $100 million and reporting inflated month-end and annual performance for its funds to existing and potential investors. The arrangement also hid the funds' poor performance to deter redemptions and allowed Premium Point to receive excess management and performance fees.

The Complaint charged Dole and Majidi with insider trading violations under the Exchange Act as well as with aiding and abetting violations of the anti-fraud provisions under the Advisers Act. Previously, the SEC charged Premium Point, along with Majidi, Anilesh Ahuja, Premium Point's CEO and CIO, and another trader, with fraud in 2018 and later amended its Compliant to add Dole as a defendant. In 2022, the SEC obtained a final judgment on consent against Ahuja from violating the antifraud and other provisions of the federal securities laws and ordered Ahuja to pay a civil penalty of $450,000. Ahuja was also permanently barred from the industry.

Final Judgment as to Defendant Ashish Dole (Apr. 11, 2023), available at: https://www.sec.gov/litigation/litreleases/2023/judg25698-dole.pdf.

Final Judgment as to Defendant Amin Majidi (Apr. 11, 2023), available at: https://www.sec.gov/litigation/litreleases/2023/judg25698-majidi.pdf.

SEC Remarks

Chair Gensler Emphasizes Need for Crypto Regulation

In a June 8, 2023 speech, SEC Chair Gary Gensler reiterated his belief that cryptocurrencies are investment contracts and crypto security issuers and intermediaries must register with the SEC or meet the requirements for an exemption. His comments were made days after the SEC filed lawsuits against Binance and Coinbase for, among other things, operating as unregistered securities exchanges, brokers and clearing agencies.

Gensler stated that cryptocurrency meets the definition of an investment contract under the so-called "Howey test," which refers to the U.S. Supreme Court case for determining whether a transaction qualifies as an "investment contract." The Supreme Court has held that an investment contract exists when there is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others. He opined that the digital nature of cryptocurrencies does not change the way in which they should be regulated and thus, issuers of cryptocurrencies should register with the SEC. Gensler rejected claims by crypto asset issuers that they lacked fair notice that their conduct could be illegal. Gensler went on to state that investors are deprived of critical protections when crypto asset intermediaries fail to register and disagreed with industry claims that it is impossible for crypto platforms to register with the SEC and comply with SEC regulations, asserting that failing to implement separate lines of business or put in place appropriate safeguards against fraud does not provide intermediaries with "a free pass to put investors at risk."

With regards to the risks and uncertainties related to crypto assets, Gensler identified several measures taken by the SEC, including (i) reissuing a release stating the applicability of existing rules to crypto asset trading platforms; (ii) proposing amendments to qualified custodian requirements that would cover all crypto assets; and (iii) SEC staff statements on public company accounting and disclosures relating to crypto assets.

Gary Gensler, SEC Chair, Speech, *"We've Seen This Story Before" Remarks before the Piper Sandler Global Exchange & Fintech Conference* (June 8, 2023), available at: https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-060823.

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