

less frequently than annually and modify as needed, the cybersecurity policies and procedures.

Lastly, in 2017 NASAA released a practical checklist¹ that includes 89 assessment areas to help state-registered investment advisers detect, identify, protect and to recover from cyber events.

The five policy components of NASAA's 2019 model rule was built from the checklist. Therefore, reviewing the two documents in unison may be sensible.

For example, to address the identification portion of the model rule, the NASAA checklist offers “yes” or “no” statements in an attempt to assist in creating a policy. The nine statements include:

1. Cybersecurity is included in the risk assessment.
2. Risk assessments are conducted frequently (*e.g.*, annually, quarterly).
3. The risk assessment includes an examination of the data its business collects and creates, where it is stored and whether or not it is encrypted.
4. Internal “insider” risk (*e.g.*, disgruntled employees) and external risks are included in the risk assessment.
5. The risk assessment includes relationships with third parties.
6. Adequate policies and procedures demonstrate expectations of employees regarding cybersecurity practices (*e.g.*, frequent password changes, locking of devices, reporting of lost or stolen devices, etc.).
7. Primary and secondary person(s) are assigned as the central point of contact in the event of a cybersecurity incident.
8. Specific roles and responsibilities are tasked to the primary and secondary person(s) regarding a cybersecurity incident.
9. The firm has an inventory of all hardware and software.

ENDNOTES:

¹ <https://www.nasaa.org/wp-content/uploads/2020/04/Cybersecurity-Checklist-Update-3-19-20.pdf>.

SEC/SRO UPDATE: SEC ADOPTS AMENDMENTS TO REDUCE UNNECESSARY BURDENS ON SMALLER ISSUERS BY MORE APPROPRIATELY TAILORING THE ACCELERATED AND LARGE ACCELERATED FILER DEFINITIONS; SEC PROPOSES TO MODERNIZE FRAMEWORK FOR FUND VALUATION PRACTICES; SEC ENHANCES STANDARDS FOR CRITICAL MARKET INFRASTRUCTURE; FOREIGN NATIONAL AND AMERICAN TRADER SETTLE FRAUD CHARGES IN EDGAR HACKING CASE

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SEC Adopts Amendments to Reduce Unnecessary Burdens on Smaller Issuers by More Appropriately Tailoring the Accelerated and Large Accelerated Filer Definitions

On March 12, the Securities and Exchange Commission (the “SEC” or “Commission”) adopted amendments

to the definitions of “accelerated filer” and “large accelerated filer” under Rule 12b-2 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).¹ The revised definitions expand the number of issuers that may qualify as non-accelerated filers and are intended to seek to promote capital formation, preserve capital, and reduce unnecessary burdens on smaller issuers while still maintaining investor protections.²

Background

On June 28, 2018, the SEC expanded the scope of smaller issuers that qualify for scaled disclosures (*i.e.*, less extensive narrative and financial disclosures in the issuer’s quarterly and annual reports) under Regulation S-K and Regulation S-X.³ The SEC revised the definition of “smaller reporting company” to enable (1) a company with less than \$250 million of public float (compared to the previous threshold of \$75 million) or (2) a company with less than \$700 million of public float *and* less than \$100 million in annual revenues, to provide scaled disclosures. The amendments did not change the thresholds contained in the definitions of “accelerated filer” or “large accelerated filer.” As a result, some issuers that qualified as smaller reporting companies also continued to be classified as accelerated filers. The recent final amendments address this issue by classifying each issuer into a single category.

Final Amendments

The final amendments would, among other things:⁴

- Exclude from the definitions of “accelerated filer” and “large accelerated filer” an issuer that is eligible to be a smaller reporting company and that had annual revenues of less than \$100 million in the most recent fiscal year for which audited financials are available and exclude business development companies in analogous circumstances;
- Increase the transition thresholds for accelerated and large accelerated filers becoming non-accelerated filers from \$50 million to \$60 million of public float, and for exiting large accelerated filer status from \$500 million to \$560 million of public float;
- Add a revenue test to the transition thresholds for exiting from both accelerated and large accelerated filer status; and
- Add a check box to the cover pages of Form 10-K, 20-F, and 40-F to indicate whether an internal control over financial reporting auditor attestation is included in the filing.

The table below summarizes the relationship between smaller reporting companies and non-accelerated, accelerated, and large accelerated filers under the final amendments. As the table shows, not all smaller reporting companies will become non-accelerated filers under the final amendments.

Status	Public Float	Annual Revenues
Smaller Reporting Company and Non-Accelerated Filer	Less than \$75 million	N/A
	\$75 million to less than \$700 million AND	Less than \$100 million
Smaller Reporting Company and Accelerated Filer	\$75 million to less than \$250 million AND	\$100 million or more
Accelerated Filer (not a Smaller Reporting Company)	\$250 million to less than \$700 million AND	\$100 million or more
Large Accelerated Filer (not a Smaller Reporting Company)	\$700 million or more	N/A

The final amendments became effective on April 27, and apply to each annual report filing due on or after the effective date.

SEC Proposed to Modernize Framework for Fund Valuation Practices

On April 21, the SEC announced a proposed new rule that would establish a framework for fund valuation practices (the “Proposed Rule”).⁵ According to the press release, the Proposed Rule, to be added as Rule 2a-5 under the Investment Company Act of 1940, as amended (the “1940 Act”), seeks to “clarify how fund boards can satisfy their valuation obligations in light of market developments, including an increase in the variety of asset classes held by funds and an increase in both the volume and type of data used in valuation determinations.”

The SEC last addressed valuation practices under the 1940 Act in a comprehensive manner in a pair of releases issued in 1969 and 1970. Since then, markets and fund

investment practices have evolved considerably. For example, many funds now engage third-party pricing services to provide pricing information, particularly for thinly traded or more complex assets. In addition, significant regulatory developments have altered how boards, investment advisers, independent auditors, and other market participants address valuation under the federal securities laws.

The Proposed Rule would establish requirements for satisfying a fund board's obligation to determine fair value in "good faith" for purposes of the 1940 Act. The Proposed Rule would require a board to assess and manage material risks associated with fair value determinations; select, apply and test fair value methodologies; oversee and evaluate any pricing services used; adopt and implement policies and procedures; and maintain certain records.

Recognizing that most fund boards do not play a day-to-day role in the pricing of fund investments, the Proposed Rule would permit a fund's board to assign the determination of fair value to the fund's investment adviser, subject to additional conditions and oversight requirements. These detailed conditions include specific reporting by the adviser both periodically and promptly; clear specification of responsibilities and reasonable segregation of duties among the adviser's personnel; and additional recordkeeping.

The Proposed Rule would also define "readily available" market quotations for purposes of the Act. Under the Act, fund investments must be fair valued where market quotations are not "readily available." The Proposed Rule would treat a market quotation as readily available only when that quotation is a quoted price (unadjusted) in active markets for identical investments that the fund can access at the measurement date. The Proposed Rule would also provide that a quotation is not readily available if it is not reliable.

In view of the Proposed Rule, the SEC also proposed to rescind two releases, Accounting Series Release 113 (ASR 113) and Accounting Series Release 118 (ASR 118), which provide SEC guidance on, among other

things, how to determine fair value for restricted securities. In addition, the proposal stated that certain staff letters and other staff guidance addressing fund valuation matters covered by the Proposed Rule would be rescinded or withdrawn in connection with any adoption of the rule.

The comment period for the Proposed Rule will be open until July 21, 2020.

SEC Enhances Standards for Critical Market Infrastructure

On April 9, the SEC adopted a set of rule amendments for securities clearing agencies to apply enhanced standards to all SEC-registered central counterparties and central securities depositories.⁶

Background

In 2012, the SEC adopted Rule 17Ad-22 under the Exchange Act to strengthen substantive regulation of registered clearing agencies and seek to promote their safe and reliable operation.⁷ In 2016, the SEC adopted certain rule amendments establishing enhanced requirements for an initial group of registered clearing agencies, including policies and procedures for transparency, governance, and financial and operational risk management.⁸

Final Amendments

The final rule amendments adopted by the SEC enhance and clarify the definitions of "covered clearing agency," "central securities depository services," and "sensitivity analysis" under Rule 17Ad-22.⁹

Covered Clearing Agency (Rule 17Ad-22(a)(5) of the Exchange Act)

- Current definition: a designated clearing agency or a clearing agency involved in activities with a more complex risk profile for which the Commodity Futures Trading Commission is not the Supervisory Agency as defined in Section 803(8) of the Payment, Clearing, and Settlement Supervision Act of 2010.

- Amended definition: a registered clearing agency that provides the services of a central counterparty or central securities depository.

Central Securities Depository Services (Rule 17Ad-22(a)(3) of the Exchange Act)

- Current definition: services of a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act.
- Amended definition (which will include the deletion of the word “services” from the defined term): a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act.

Sensitivity Analysis (Rule 17Ad-22(a)(16) of the Exchange Act). Current definition: an analysis that involves analyzing the sensitivity of a model to its assumptions, parameters, and inputs that:

- Considers the impact on the model of both moderate and extreme changes in a wide range of inputs, parameters, and assumptions, including correlations of price movements or returns if relevant, which reflect a variety of historical and hypothetical market conditions. Sensitivity analysis must use actual portfolios and, where applicable, hypothetical portfolios that reflect the characteristics of proprietary positions and customer positions;
- When performed by or on behalf of a covered clearing agency involved in activities with a more complex risk profile, considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency; and
- Tests the sensitivity of the model to stressed market conditions, including the market conditions that may ensue after the default of a member and other extreme but plausible conditions as defined in a covered clearing agency’s risk policies.

Amended definition: an analysis that involves analyzing

the sensitivity of a model to its assumptions, parameters, and inputs that:

- Considers the impact on the model of both moderate and extreme changes in a wide range of inputs, parameters, and assumptions, including correlations of price movements or returns if relevant, which reflect a variety of historical and hypothetical market conditions;
- Uses actual portfolios and, where applicable, hypothetical portfolios that reflect the characteristics of proprietary positions and customer positions;
- Considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency; and
- Tests the sensitivity of the model to stressed market conditions, including the market conditions that may ensue after the default of a member and other extreme but plausible conditions as defined in a covered clearing agency’s risk policies.

The final amendments will become effective on July 13.

Foreign National and American Trader Settle Fraud Charges in EDGAR Hacking Case

On April 9, the SEC announced settlements with two traders who allegedly profited from trading on nonpublic corporate earnings information hacked from the SEC’s EDGAR system.¹⁰ The settlement agreements are subject to court approval.

According to the SEC’s complaint, the two traders and seven other defendants participated in a scheme to hack into EDGAR and extract material, nonpublic information to use for illegal trading. The complaint alleged that one hacker extracted EDGAR files containing nonpublic earnings results. The traders then allegedly traded on the basis of this hacked information in the narrow window of time between when the files were extracted from EDGAR and when the information was released to the public. One of them also allegedly previously traded

based on material nonpublic information obtained through the hack of at least two newswire services.

The traders consented to the entry of final judgments that would permanently enjoin them from violating the antifraud provisions of the securities laws. One agreed to pay \$165,474 in disgorgement, representing the profits from his illegal trades, and \$16,254 in prejudgment interest. The settlement reserves the issue of a civil penalty for that trader for further determination by the court upon a motion of the SEC. The other trader agreed to disgorge \$148,804 in profits from his illegal trades, including trades he conducted in the account of his wife, with prejudgment interest of \$20,945. The other trader also agreed to pay a civil penalty of \$148,804. The SEC stated that it would move to dismiss the charges it had filed against his wife.

ENDNOTES:

¹See SEC Press Rel. No. 2020-58 (March 12, 2020), available at <https://www.sec.gov/news/press-release/2020-58>.

²See SEC Rel. No. 34-88365 (March 12, 2020) at 1, available at <https://www.sec.gov/rules/final/2020/34-88365.pdf>.

³See SEC Rel. Nos. 34-10513 and 34-83550 (June 28, 2018) at 1, available at <https://www.sec.gov/rules/final/2018/33-10513.pdf>.

⁴See SEC Press Rel. No. 2020-58 (March 12, 2020), available at <https://www.sec.gov/news/press-release/2020-58>.

⁵See SEC Press Rel. No. 2020-93 (Apr. 21, 2020), available at <https://www.sec.gov/news/press-release/2020-93>. See also 85 Fed. Reg. 28734 (May 13, 2020).

⁶See SEC Press Rel. No. 2020-86 (Apr. 9, 2020), available at <https://www.sec.gov/news/press-release/2020-86>.

⁷See Rel. No. 34-88616 (Apr. 9, 2020) at 3, available at <https://www.sec.gov/rules/final/2020/34-88616.pdf>.

⁸Rel. No. 34-88616 at 3-4.

⁹Rel. No. 34-88616 at 5-15.

¹⁰See SEC Press Rel. No. 2020-85 (Apr. 9, 2020), available at <https://www.sec.gov/news/press-release/2020-85>.