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Compliance Rules Turn Twenty: Reflecting on Two Decades of the Registered Fund and Adviser Compliance Rules

By George Raine and James McGinnis

As this article goes to print, compliance departments will be taking down the streamers and sweeping up the confetti from the 20th birthday parties they will have been throwing for the Securities and Exchange Commission's (SEC) landmark rules that created the formal role of the chief compliance officer (CCO). October 5, 2004 was the compliance date for two rules centered on the adoption and implementation of compliance programs for registered funds and registered advisers: Rule 38a-1 under the Investment Company Act of 1940 (Company Act) and Rule 206(4)-7 under the Investment Advisers Act of 1940 (Advisers Act).[1] Rule 38a-1 and Rule 206(4)-7 (collectively, the Compliance Rules or the Rules) required investment companies and their advisers to adopt compliance programs, review their programs, and appoint a CCO to administer and oversee these programs (at the registered fund level and the adviser level).[2] This article reflects on the novel importance of the Compliance Rules, the impacts those Rules have had on the asset management industry, and their evolution over the past two decades.

To fully understand the Compliance Rules and the regulatory intent underlying their adoption, this article begins with general background information that discusses the national conditions that gave rise to the SEC's adoption of the Compliance Rules, as well as the basic requirements of both Rule 38a-1 and Rule 206(4)-7. Next, the evolution of the Compliance Rules is discussed with a focus on the SEC's use of the Rules in enforcement actions. This article then analyzes the legacy of the Compliance Rules, focusing on other SEC rules that adapt the framework of the Compliance Rules as a foundation, as well as some of the major criticisms of the Rules. Finally, the discussion concludes by peering into possibilities for the future of the Compliance Rules. In short, we seek to take stock of where the Rules came from, where they have gone, and where they are going.

Background

The Market Timing Scandal

The SEC's Compliance Rules came of age in a time of significant concern regarding regulatory compliance in the asset management industry. In late 2003, the fund industry became the face of very public scandals around "market timing" of mutual fund pricing mechanisms and "late trading" in fund shares. These were dramatic blemishes on the public image of the funds industry at the time. While the development of the Rules had begun before these scandals unfolded, the SEC found confidence and inspiration in the scandals when it adopted the Final Rules, even referencing them in the Final Release.[3]

The market timing scandal made headlines several months after the SEC proposed the Compliance Rules. The then-Attorney General of New York, Eliot Spitzer, filed a complaint against Canary Capital Partners for engaging in the fraudulent schemes of "late trading" and "timing" of funds.[4] "Late trading" occurs where an investor places an order after the 4:00pm EST closing, but the fund processes the order as if it were made before the closing, allowing the investor to benefit from post-closing information that other investors could not.[5] "Timing" is a short-term investment technique that exploits inefficiencies in the way mutual funds price their shares.[6] While timing in and of itself is not illegal, the Attorney General alleged that the mutual fund misled long-term investors by creating the impression that it protected against timing, where in reality, a fund sold the right to "time" their funds to Canary.[7] What started with a complaint against a single hedge fund erupted into a major scandal, as several investors and funds were charged for similar violations, company executives resigned, and funds paid billions in penalties.[8]

Just a few months later, the market timing scandal played an important role in the SEC's final Compliance Rules release. Not only did the SEC reference the scandal and its harmful effects on funds, management, and investors, but they also used it to underpin the importance of the Rules as a deterrent for future violations. More specifically, the SEC stated that the Compliance Rules served as a regulatory action "designed to curb the abusive practices recently uncovered and to prevent their recurrence."[9]

The Compliance Rules' Adoption

When the SEC first proposed the Compliance Rules in February of 2003, it framed the Compliance Rules as a means for funds and advisors to keep themselves accountable. After all, the broader financial services industries had been answering for several years for the control failures and oversight shortcomings highlighted in the prior scandals around Enron and WorldCom, which had already spurred passage of the Sarbanes Oxley Act and related rulemaking. The SEC stated that they crafted the Rules to "prevent violations of the federal securities laws and to protect the interests of shareholders and clients."[10] The SEC emphasized its limited resources, stating that "like police officers," its examiners "cannot be everywhere at all times."[11] Because of the limited nature of the SEC's resources, the SEC's compliance examinations focused on the internal methods the funds or advisers used to "prevent and detect violations of the federal securities laws," rather than specific transactions.[12] The SEC backed this methodology by stating that funds and advisers with "effective" internal compliance systems are less likely to violate securities laws.[13] In effect, the establishment of the Compliance Rules was intended to promote self-policing by funds and advisers that could reduce both harm to investors and prevent securities violations.

The Compliance Rules: In a Nutshell

The Compliance Rules instituted several then-novel requirements for investment funds and advisers. Both Rules 38a-1 and 206(4)-7 require the fund and adviser to "adopt and implement written policies and procedures reasonably designed to prevent violation" of the securities laws.[14] The Rules also demand that the funds and advisers annually review their policies and procedures.[15] In the case of a fund, the fund's board must approve, and the fund's CCO must annually review, the policies and procedures of its "advisers, principal underwriters, administrators, and transfer agents" (collectively, service providers).[16] Next, the Compliance Rules require the designation of a CCO responsible for administering the fund's and adviser's compliance policies and procedures (as applicable).[17] Finally, Rule 38a-1 requires funds to maintain certain documents related to their policy and procedure records for at least five years.[18] While Rule 206(4)-7 itself is silent on this requirement, Rule 204-2 references the Compliance Rule and calls for the maintenance of the same compliance-related documents.[19]

Two components of the Rules were particularly novel at the time of the Rules' adoption. First, the Rules built in a new recordkeeping component by requiring the policies and procedures to be written down. While certainly an industry practice to maintain extensive compliance policies, the comprehensive nature of having to catalogue all legal requirements, and then to implement precisely corresponding policies, was novel. Second, the Rules further built in an oversight mechanism by requiring a specific party be designated to administer the policies and procedures, the CCO.

Rule 38a-1 contains additional requirements for registered funds that are not applicable to investment advisers. For instance, a fund must obtain approval from a majority of the fund's disinterested directors for its own compliance policies and procedures, as well as those of its enumerated service providers.[20] Additionally, Rule 38a-1 contains a provision prohibiting any direct or indirect actions that may cause undue influence over the fund's CCO.[21] There are several other detailed additions to Rule 38a-1 that are absent in 206(4)-7.[22]

Evolution

Development of the Rules

The Compliance Rules appear purposefully to leave wide room for interpretation for each CCO. Prior to passage of the Rules, commentors shared many concerns that the SEC believed to stem from incorrect perceptions that the Rules required "one-size-fits-all compliance programs."[23] However, this was not the case. The Rules were always meant to be flexible, because "funds and advisers are too varied in their operations for the rules to impose a single set of universally applicable required elements." [24] This leaves room for changing considerations as new regulations are added to the securities laws, and as existing regulations evolve over time. The SEC provided a minimum list of universally required elements for consideration for both Rules, leaving room for additional risk assessment and compliance elements depending on the needs of the specific adviser or fund.[25] This approach made it necessary for each CCO to first identify the risks and compliance considerations relevant to the specific adviser or fund. Then the CCO was expected to move on to design a compliance program that best suited those needs.

The Role of the CCO in a Fund Complex

Today, as a result of the Rules and the programs they require to be in place, CCOs are responsible for keeping up with changes to the securities laws to ensure compliance is maintained. As the SEC anticipated in its proposing and adopting releases of the Rules, this looks different depending on the adviser firm, or the fund complex, as each has different needs and faces different risks or challenges. Further, Rule 206(4)-7 applies to all advisers, whether or not the funds they manage are registered or private. It also could depend on the type of CCO model employed by a fund complex. Some may choose to have the same CCO for both adviser compliance and fund compliance. Whereas others may wish to have separate CCOs. One way is not necessarily better, or more popular than the other.[26] Rather, like all other compliance considerations, it simply depends on the wants and needs of the advisers and funds, as well as the expertise of the CCOs employed.[27]

Love and Marriage: Two Decades of Enforcement Actions

Over the past 20 years of SEC enforcement, it has become apparent that, in the eyes of the SEC Staff as evidenced by their settlements and charges they have filed in federal court, a Compliance Rule violation does not necessarily mean the respondent violated any other securities laws, and vice versa. With the enactment of the Compliance Rules, it became possible for the SEC to bring an enforcement action for "failure to have adequate compliance policies and procedures in place," without any other substantive securities law violation cited.[28] Within this 20-year time period, the SEC has brought enforcement actions for violating only the Compliance Rules, as well as violations of the Company Act or the Advisers Act without any mention of violation of the Compliance Rules.

By way of example, in 2023, the SEC instituted an enforcement settlement with DWS Investment Management Americas, Inc. (DIMA) for an alleged failure "to develop and implement a reasonably designed anti-money laundering (AML) program."[29] In this enforcement action, the SEC cites only an alleged violation of Rule 38a-1 for this failure.[30] While this is one of the first times the SEC has settled for an alleged violation of Rule 38a-1 without charging or settling with additional substantive violations, it has become increasingly common in recent years for the SEC to threaten or bring enforcement action against advisers where the only violations relate to their shortcomings under Rule 206(4)-7 under the Advisers Act. For example, the SEC has instituted several enforcement settlements citing only Rule 206(4)-7 violations. Some violations include allegations of failure to implement policies and procedures for valuations,[31] outside business activity reporting,[32] volatility-linked products,[33]as well as alleged failure to review existing policies and procedures and their adequacy.[34]

However, as current SEC Commissioner Hester Peirce has noted, "a firm that has reasonably designed policies and procedures nevertheless can experience a securities violation."[35] Indeed the SEC has brought more than a few enforcement actions for violations of the Company Act and the Advisers Act with no mention whatsoever of the Compliance Rules. For example, there are several instances where enforcement actions cite Adviser Act violations for misrepresentations or fraud[36] and pay-to-play violations[37] without also citing a Rule 206(4)-7 violation. Additionally, there are several actions that charge for violations of both the Company Act and the Advisers Act without any mention of either of the Compliance Rules.[38]

Finally, from our research it appears that that the SEC is far more likely to bring an enforcement action for a violation of Rule 206(4)-7 under the Advisers Act than it is for a violation of Rule 38a-1 under the Company Act. Statistically this is unsurprising, given that the number of investment advisory firms registered with the SEC vastly outweighs the number of registered fund complexes, which means the sheer number of examinations conducted to review investment advisers significantly outpaces the examinations of fund complexes, with the latter being more time consuming. Furthermore, managers unattached to fund complexes tend to have fewer resources devoted to regulatory compliance and, accordingly, are at greater risk of offering low-hanging fruit for referrals to the Division of Enforcement. But the deeper point is one of balancing blame: by bringing actions under the Advisers Act, the public message is one of policing the regulated professional business of an investment adviser; by contrast, finding violations of Rule 38a-1 introduces the further complication of potentially questioning the fund board's oversight of CCO resources for the protection of retail investors, and absent egregious derelictions of duty the SEC has historically been slower to point the finger at fund boards.

Legacy of the Compliance Rules and Their Use As a Blueprint

The Compliance Rules as a Foundational SEC Regulation

Over 20 years later, the Compliance Rules command a perhaps initially unforeseen legacy over SEC rulemaking in the asset management field, as in no small part the Rules have served as a blueprint and a foundation for subsequent SEC rulemaking innovations. In particular, regulations such as the Good Faith Determinations of Fair Value rule (Fair Value Rule), the Use of Derivatives by Registered Investment Companies rule (Derivatives Rule), and the Open-End Fund Liquidity Risk Management Programs rule (Liquidity Risk Management Rule) all demonstrate the importance and impact the Compliance Rules maintain 20 years later.

The Compliance Rules, more particularly Rule 38a-1, played a major influence in the development and support of the Fair Value Rule, Rule 2a-5 under the Company Act.[39] Adopted in December of 2020, the Fair Value Rule established requirements for determining fair value in good faith under the Company Act.[40] In the Fair Value Rule's proposed release, it included language requiring the adoption of written policies and procedures "reasonably designed to achieve compliance" under Rule 2a-5; however, the SEC determined that Rule 38a-1 precluded the need for this language.[41] More specifically, Rule 38a-1 serves as a specified mechanism to ensure compliance with the requirements of the Fair Value Rule, where the fair value policies and procedures must be approved by the board in accordance with Rule 38a-1.[42] Additionally, Rule 2a-5 includes a requirement of an annual assessment of the fund's policies for fair valuation, mimicking the requirement of the Compliance Rules.[43] Finally, much like the Compliance Rules system, Rule 2a-5 demands board oversight of the fair valuation procedures, where a board appointed "valuation designee" performs the valuations and reports directly to the board.[44]

The Derivatives Rule, Rule 18f-4 under the Company Act, also intertwines with the procedures of Rule 38a-1 to ensure compliance.[45] This rule provides a comprehensive approach to the regulation of registered funds' use of derivatives.[46] Importantly, it contains its own reporting requirements that serve to enhance compliance with the rule.[47] In the Derivatives Rule release, the SEC explicitly states that Rule 38a-1 "encompasses" fund compliance obligations under the Registered Derivatives Rule.[48] In particular, the rule requires the use of a derivative risk manager who must provide written reports to the board on an annual basis, governed by specific reporting requirements under the rule, a system almost identical to that of the Compliance Rules.[49] The SEC emphasized upon adoption of the Derivatives Rule several times that its many reporting requirements are "designed to facilitate the board's oversight role, including its role under rule 38a-1."[50]

The Liquidity Risk Management Rule, or Rule 22e-4, similarly builds upon the compliance requirements of Rule 38a-1.[51] This rule establishes a liquidity risk management program, as well as requirements that underwriters and depositors of unit investment trusts engage in limited liquidity reviews.[52] Rule 22e-4 mimics Rule 38a-1's compliance framework even further through its requirement of "reasonably designed" policies and procedures.[53] The Liquidity Risk Management Rule also adds an additional layer of compliance obligations for registered funds. The SEC expressed in its final release that the liquidity risk management program "in effect will provide more specific and enhanced requirements in certain areas already generally covered by the compliance program rules."[54] In response to commenters on the proposed rule, the SEC even tailored some of the rule's requirements to mirror those of Rule 38a-1. For example, the SEC changed the proposed liquidity rule's requirement of prior board approval for any material changes to the program, and instead mirrored Rule 38a-1's requirement that the managers simply explain any material changes made to the board after the fact.[55]

Criticisms of the Rule

The Compliance Rules are not without faults and controversy. In fact, Commissioner Peirce has pointed to what she perceives as structural flaws in the Compliance Rules. And Commissioner Peirce has intimate familiarity with the relevant regulations, given that she was listed on the Final Release of the Compliance Rules over 20 years ago as a point of contact—an indication that she was one of the primary SEC Staffers at the time involved in drafting the Rules.[56]

One criticism of the Compliance Rules concerns the framework upon which Rule 206(4)-7 is built. Section 206 of the Advisers Act makes it unlawful for an investment adviser "to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative."[57] Despite being based on an antifraud provision, the 206(4)-7 framework allows for the SEC to bring compliance violations against advisers who have committed no fraud. In fact, as noted above, there are several enforcement actions where the SEC has brought an action simply for a Compliance Rule violation, with no substantive fraud violation attached to it. Commissioner Peirce herself stated in August of 2023 that Section 206(4) "is an uncomfortable home for routine compliance obligations" because it can turn mere compliance "foot-faults" into full enforcement actions under an antifraud provision.[58]

The Compliance Rules also draw criticism from some quarters for introducing the possibility of CCO liability.[59] Occasionally enforcement actions brought by the SEC have pinned personal liability on CCOs for lack of oversight resulting in an adviser's violation of 206(4)-7. For example, *In the Matter of Hamilton Investment Counsel, LLC,* found the advisor's CCO to have "willfully aided and abetted and caused" the adviser to violate Rule 206(4)-7.[60] As a result, Kirkpatrick's future activities in a "supervisory" or "compliance" capacity were prohibited by the SEC for at least five years.[61] SEC Director of the Division of Enforcement Gurbir Grewal addressed the issue of CCO liability in 2023, noting that "we do not second-guess good faith judgments of compliance personnel made after reasonable inquiry and analysis."[62] Commissioner Peirce, in a statement to the National Society of Compliance Professionals, criticized Rule 206(4)-7's role in CCO liability, stating that it "exacerbates the problem" by supporting "negligence-based charges" against CCOs, that in practice, look "more like strict liability."[63] For example, former Commissioner Dan Gallagher noted in 2015 that two prior SEC actions holding the CCOs responsible for the "implementation of the firm's policies and procedures" made them responsible for conduct that should be the responsibility of the adviser itself.[64] While this merely gives a brief glimpse into the CCO personal liability issue, it is important to understand the basics of the issue.

One final criticism of the Compliance Rules implicates a fundamental question: whether one can violate a securities law without violating the Compliance Rules and whether, conversely, the Compliance Rules simply serve as another charge for the SEC to tack on to substantive violations of the federal securities laws. Commissioner Peirce has noted her concern that the SEC "appear[s] to assume that every securities violation we find indicates a problem with the firm's compliance program."[65] As discussed above, this isn't uniformly the case in practice, as there are several instances where the SEC found substantive violations of securities laws without any compliance violations. Commissioner Peirce affirmed these findings with her belief that a firm with "reasonably designed policies and procedures nevertheless can experience a securities violation."[66]

Future of the Rules

For decades, the SEC has consistently emphasized the need for a strong "culture of compliance."[67] This "culture of compliance," refers to the need to establish, "from the top of the organization down, an overall environment that fosters ethical behavior and decision-making."[68] The adoption of the Compliance Rules is perhaps the clearest articulation of the Commission's structural approach around facilitating and encouraging a "culture of compliance." As noted above, the SEC possesses limited resources, meaning examiners already frequently relied on examining compliance methods of a fund or adviser, rather than specific transactions, when looking for violations prior to the adoption of the Rules.[69] From this vantage point, the Rules seem to provide an appropriate framework for efficiency among regulated entities and their services providers, and the rules provide for the possibility of earlier detection of potential violations of the federal securities laws. Furthermore, Director Grewal may have extended the "culture of compliance" framing by recently emphasizing the need for a "culture of proactive compliance" at firms, noting the need specifically for education, engagement, and execution.[70] This push for "proactive" compliance could signal an intensification of expectations by the current Staff and SEC with respect to the level of involvement by CCOs and compliance personnel in broad engagement through the broader businesses of their firms.

Is Section 206 an "Uncomfortable Home for Routine Compliance Obligations"?

Perhaps the most pertinent question relating to the future of the Compliance Rules follows from a recent Fifth Circuit decision that implicated Section 206 of the Advisers Act, which could bring into question whether the SEC had the statutory authority to enact Rule 206(4)-7.

As part of its rulemaking practice increasing substantive regulation on private fund advisers, in August 2023, the SEC relied in part on Section 206(4) of the Advisers Act, stating that "206(4) permits the Commission to adopt prophylactic rules against conduct that is not itself necessarily fraudulent."[71] In *National Association of Private Fund Managers v. SEC*, on June 4, 2024, the Fifth Circuit held that the Commission "exceeded its statutory authority in adopting the Final Rule," including through its reliance on Section 206(4) of the Advisers Act.[72]

The Court noted that Rule 206(4) "specifically requires the Commission to 'define' an act, practice, or course of business that is 'fraudulent, deceptive, or manipulative' before the Commission can prescribe 'means reasonably designed to prevent' 'such' act, practice or course of business."[73] The Court went on to state that "the Final Rule's 'anti-fraud' measure is pretextual" and note the argument by the Private Fund managers claiming that the Commission failed to articulate "a 'rational connection' between fraud and any part of the Final Rule."[74] This draws into question whether the Commission articulated a rational connection to fraud, deception, or manipulation in passing Rule 206(4)-7.

On the one hand, the actual wording in Rule 206(4)-7 differs from the other regulations promulgated under Section 206(4). Take the introductory wording of Rules 206(4)-1 and 206(4)-5,—"as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts, practices or course of business within the meaning of Section 206(4) of the Act,"—or Rule 206(4)-6—"it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act,"—as examples.[75] By contrast, the text of Rule 206(4)-7 does not reference fraud, deception, or manipulation at all.[76] Originally, the text of Rule 206(4)-7 did follow the general section 206(4) formula in the original proposal of the Rules. The wording would have read, "it is a fraudulent, deceptive or manipulative act, practice or course of business" for an adviser to advise clients without complying with Rule 206(4)-7 requirements.[77]

However, in response to "commenter's concerns regarding the optics of the rule" the Commission "revised the text of the rule so that a violation of the rule would be deemed to be 'unlawful' rather than 'a fraudulent, deceptive, or manipulative act, practice or course of business.'"[78] The concerns included objections "to the adoption of the adviser's compliance rule under the Commission's anti-fraud authority in section 206(4)," as well as contentions that this rule "would mislead investors and others by causing even minor compliance infractions to look like serious violations" if it were to be adopted as an anti-fraud rule.[79] Further, in the original proposal of the Compliance Rules, the SEC's reasoning encompassed a more broad need to prevent violations of the securities laws and the limited resources of its examiners, rather than fraud, deception, or manipulation.[80] Rule 206(4)-7 was not tied to anti-fraud at all in the body of either the proposal or the final adopting release of the Rules.[81]

On the other hand, in the footnotes of the adoption of the Compliance Rules the Commission did refer to a number of settlements reached by the SEC between the proposal of the Rules and the adoption of the Rules, relating to alleged fraudulent activities of investment advisers.[82] It is possible that these types of violations would not be considered "pretextual" as the Fifth Circuit found the amendment to Rule 206(4)-7(b) passed with respect to the Final Rule adoption further regulating private fund advisers specifically. Distinctions may be drawn in this respect too, as the Court noted specifically that "private funds are exempt from federal regulation of their internal 'governance structure,'" and that private fund advisers were only brought into the fold of regulation by the Dodd-Frank Act to regulate "the relationship between the advisers and the private funds they advise."[83] Perhaps, then, Rule 206(4)-7 is relatively safe from a carbon-copy regulatory challenge, at least based on the specific arguments used with the Fifth Circuit to nullify the private fund rule, in that it does not specifically target private fund advisers. However, it is worth nothing that, due to its lack of connection to fraud, 206(4)-7 could be vulnerable if challenged similarly to the recent Fifth Circuit Case.[84]

Is There Potential for a CCO Liability Framework?

Another frequent topic of concern revolves around when an enforcement action might be brought against a CCO. After an administrative proceeding involving the CCO of Hamilton Investment Counsel LLC, Commissioner Hester Peirce noted that "the SEC's determinations about whether to charge a compliance officer are consequential not only for the particular compliance officer, but more generally for the profession."[85] CCOs are undoubtedly an integral piece of the Compliance Rules, as well as a vital piece of the compliance programs adopted over the past 20 years. The New York City Bar Association Compliance Committee has gone so far as to suggest the adoption of a specific framework to assess CCO liability.[86] This is clearly still on the minds of CCOs, as Director Grewal referred to CCO liability as "the proverbial elephant" in the room in a speech in 2023.[87] While there is no indication that the Commission is considering new rulemaking establishing a formal framework for CCO liability, Director Grewal did list three situations in which a CCO might be subject to an enforcement action. These include: (1) CCOs who affirmatively participate in misconduct unrelated to compliance; (2) CCOs who mislead regulators; and (3) a CCO's wholesale failure to carry out their compliance responsibilities. Looking at these situations, the liability of a CCO does not necessarily hinge on a violation of the Compliance Rules, but as a natural result of the Rules, there are a larger number of CCOs. However, if there isn't a formal framework 20 years after the implementation of required CCOs via the Compliance Rules, it may be unlikely one is forthcoming.

Conclusion

As this discussion exemplifies, the past 20 years have served to strengthen and expand the impact of the Compliance Rules. They came of age amidst existential scandal affecting the mutual fund industry, intended to rehabilitate the reputation of investment advisers as stewards of strong compliance. They appear to have delivered on this expectation and, furthermore, have provided the blueprint for a series of further innovations in specific rulemaking (that is, valuation, derivatives risk, liquidity). By the same token, the Compliance Rules have supported some enforcement activity that arguably stretched the scope of policing for bad behavior. This trend in increasing expansion could well continue; equally, the current pressures pushing back on the reach of the regulatory state could potentially contain any overexpansive tendencies. Time will tell. Here's to toasting the Compliance Rules when they ring in their 30th birthday!

Mr. Raine is a partner at Ropes & Gray LLP in Boston, MA. **Mr. McGinnis** is counsel at Ropes & Gray LLP in Washington, DC. The authors would like to extend their hearty thanks to Rheise Berro and Jessica Lawson, summer

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NOTES

1 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003).

2 *Id.*

3 *Id.* (referencing the market timing scandal and stating that it "confirms the need for these rules").

4 Complaint, New York v. Canary Capital Partners, LLC (Sept. 3, 2003), *https://ag.ny.gov/sites/default/files/court-filings/canary_complaint.pdf*.

5 *Id*. at 9.

6 *Id*. at 11.

7 *Id*. at 13.

8 Gabriel Denis, "Why the Mutual Fund Trading Scandal Still Matters Today" (Aug. 31, 2023).

9 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003).

10 *Id.* ("We proposed the rules because it is critically important for funds and advisers to have strong systems of controls in place to prevent violations of the federal securities laws and to protect the interests of shareholders and clients.").

11 Proposed Rule, *Compliance Programs of Investment Companies and Investment Advisers,* Investment Co. Rel. No. 25925 (Feb. 10, 2003).

12 *Id.*

13 *Id.*

14 17 CFR § 270.38a-1(a)(1); 17 CFR § 275.206(4)-7(a).

15 17 CFR § 270.38a-1(a)(2); 17 CFR § 275.206(4)-7(b).

16 17 CFR § 270.38a-1(a)(2); Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003) (defining the fund's "advisers, principal underwriters, administrators, and transfer agents" as "service providers").

17 17 CFR § 270.38a-1(a)(3); 17 CFR § 275.206(4)-7(c).

18 17 CFR § 270.38a-1(d).

19 17 CFR § 275.204-2(a)(17) (requiring advisers to maintain documents related to their "policies and procedures formulated pursuant to § 275.206(4)-7(a) of this chapter").

20 17 CFR § 270.38a-1(a)(2).

21 17 CFR § 270.38a-1(c) (prohibiting any fund officer, director, or employee from taking any action to "coerce, manipulate, mislead, or fraudulently influence" the CCO).

22 Rule 38a-1 goes into great detail on the appointment, removal, and compensation of the CCO, while Rule 206(4)-7 does not. 17 CFR § 270.38a-1(a)(4) (detailing the designation, compensation, removal, and responsibilities of the CCO). Additionally, Rule 38a-1 contains specific rules on unit investment trusts, requiring the fund's principal underwriter or depositor to oversee the policies and procedures of the fund, as well as the CCO. 17 CFR § 270.38a-1(b) (requiring unit investment trust principal underwriters or depositors to "approve the fund's policies and procedures and chief compliance officer", "receive all annual reports", and "approve the removal of the chief compliance officer from his or her responsibilities").

23 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713, n.103 (Dec. 17, 2003).

24 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003).

25 *Id.*

26 Mary Ann Picciotto, Speaker: IDC Webinar: The Fund Compliance Rule at 20 (Feb. 28, 2004) (available at *https://www.idc.org/events/24-idc-webinar-0228*).

27 *Id.*

28 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003) ("Failure of an adviser or fund to have adequate compliance policies and procedures in place will constitute a violation of our rules independent of any other securities law violations.").

29 *In the Matter of DWS Investment Management Americas, Inc.,* Rel. No. IA 6431(Sept. 25, 2023) (available at *https://www.sec.gov/files/litigation/admin/2023/ia-6431.pdf*).

30 *Id.*

31 *In the Matter of OEP Capital Advisors, L.P.,* Rel. No. 6514 (Dec. 26, 2023) (available at *https://www.sec.gov/files/litigation/admin/2023/ia-6514.pdf*); *In the Matter of Sciens Investment Management, LLC and Sciens Diversified Managers, LLC,* Rel. No. 6315 (May 24, 2023) (available at *https://www.sec.gov/files/litigation/admin/2023/ia-6315.pdf*).

32 *In the Matter of Hamilton Investment Counsel, LLC and Jeffrey Kirkpatrick,* Rel. No. 6061 (Jun. 30, 2022) (available at *https://www.sec.gov/files/litigation/admin/2022/34-95189.pdf*).

33 *In the Matter of UBS Financial Services Inc.,* Rel. No. 5781 (Jul. 19, 2021) (available at *https://www.sec.gov/files/litigation/admin/2021/ia-5781.pdf*).

34 *In the Matter of Kevin A. Giles,* Rel. No. 4998, (Aug. 27, 2018) (available at *https://www.sec.gov/files/litigation/admin/2018/ia-4998.pdf*).

35 Hester Peirce, Commissioner, Speech: When the Nail Fails; Remarks before the National Society of Compliance Professionals (Oct. 19, 2020) (available at *https://www.sec.gov/newsroom/speeches-statements/peirce-nscp-2020-10-19*).

36 *SEC v. JAG Capital Advisers, Litig.* Rel. No. 26082 (Jun. 14, 2024) (available at *https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26028*); *In the Matter of David Sheldon Wells,* Rel. No. 100351 (Jun. 17, 2024) (available at *https://www.sec.gov/files/litigation/admin/2024/34-100351.pdf*); *In the Matter of Hai Khoa Dang,* Rel. No. 6464 (Oct. 17, 2023) (available at *https://www.sec.gov/files/litigation/opinions/2023/ia-6464.pdf*); *In the Matter of Geluk Capital Management Ltd. And Douglas Gerald Fathers,* Rel. No. 11077 (June. 24, 2022).

37 *In the Matter of Wayzata Investment Partners LLC,* Rel. No. 6590 (Apr. 15, 2024) (available at *https://www.sec.gov/files/litigation/admin/2024/ia-6590.pdf*); *In the Matter of Highland Capital Partners LLC,* Rel. No. 6128 (Sept. 15, 2022) (available at *https://www.sec.gov/files/litigation/admin/2022/ia-6128.pdf*); *In the Matter of Asset Management Group of Bank of Hawaii,* Rel. No. 6127 (Sept. 15, 2022) (available at *https://www.sec.gov/files/litigation/admin/2022/ia-6127.pdf*).

38 *In the Matter of Catalyst Capital Advisors, LLC,* Rel. No. 6597 (Apr. 29, 2024 (available at *https://www.sec.gov/files/litigation/admin/2024/ia-6597.pdf*); *In the Matter of Exchange Traded Managers Group LLC, ETF Managers Group LLC, and Samuel R. Masucci,* Rel. No. 98034, (Aug. 1, 2023) (available at *https://www.sec.gov/files/litigation/admin/2023/34-98034.pdf*); *In the Matter of Chatham Asset Management, LLC, and Anthony Melchiorre,* Rel. No. 6270 (Apr. 3, 2023) (available at *https://www.sec.gov/files/litigation/admin/2023/ia-6270.pdf*).

39 17 CFR § 270.2a-5

40 Final Rule, *Good Faith Determinations of Fair Value,* 86 Fed. Reg. 748 (Jan. 6, 2021) ("The rule will provide requirements for determining fair value in good faith for purposes of the Act.").

41 *Id.* (stating that "policies and procedures required by the proposed rule are already required by the compliance rule").

42 *Id.* (noting that "the fair value policies and procedures must be approved by the board pursuant to rule 38a-1").

43 17 CFR § 270.2a-5(b)(1)(B).

44 17 CFR § 270.2a-5(b)(1).

45 17 CFR § 270.18f-4.

46 Final Rule, Use of Derivatives by Registered Investment Companies and Business Development Companies (Nov. 2, 2020) (stating that Rule 18f-4 "provide[s] an updated and more comprehensive approach to the regulation of funds' use of derivatives and the other transactions the new rule addresses").

47 *Id.* ("[T]he Commission is adopting new reporting requirements designed to enhance the Commission's ability to effectively oversee funds' use of and compliance with the new rule, and to provide the Commission and the public additional information regarding funds' use of derivatives.").

48 *Id.*

49 *Id.* ("The rule will require the derivatives risk manager to provide a written report on the effectiveness of the program to the board at least annually.").

50 *Id.*

51 17 CFR §270.22e-4.

52 Final Rule, Investment Company Liquidity Risk Management Programs (Oct. 13, 2016) (summarizing the requirements of rule 22e-4).

53 17 CFR § 270.22e-4(b)(1).

54 Final Rule, Investment Company Liquidity Risk Management Programs (Oct. 13, 2016).

55 *Id.* ("We agree with commenters that requiring funds to obtain approval from fund boards before making material changes to a liquidity risk management program risks the program becoming stale and outdated as market changes occur, and is not consistent with the approach taken under rule 38a-1.").

56 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003) ("For Further Information Contact: Hester Peirce, Senior Counsel, Office of Regulatory Policy").

57 15 USC § 80b-6(4).

58 Hester Peirce, Commissioner, Statement: Uprooted: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (Aug. 23, 2023), *https://www.sec.gov/newsroom/speeches-statements/peirce-statement-doc-registered-investment-adviser-compliance-reviews-08232023*.

59 *See, e.g.,* New York City Bar Association Compliance Committee, Framework for Chief Compliance Officer Liability in the Financial Sector, (noting the concern among CCOs in the financial sector due to "increased enforcement actions holding CCOs personally liable, in particular for actions that do not result from fraud or obstruction on their part") (available at *https://s3.amazonaws.com/documents.nycbar.org/files/NYC_Bar_CCO_Framework.pdf*).

60 *In the Matter of Hamilton Inv. Counsel, LLC and Jeffrey Kirkpatrick,* Rel. No. 34-95189 (June 30, 2022), available at *https://www.sec.gov/litigation/admin/2022/34-95189.pdf*.

61 *In the Matter of Hamilton Inv. Counsel, LLC and Jeffrey Kirkpatrick,* Rel. No. 34-95189 (June 30, 2022), available at *https://www.sec.gov/litigation/admin/2022/34-95189.pdf*.

62 Gurbir Grewal, Director, SEC Division of Enforcement, Remarks at New York City Bar Association Compliance Institute (Oct. 24, 2023) (transcript available at *https://www.sec.gov/newsroom/speeches-statements/grewal-remarks-nyc-bar-association-compliance-institute-102423*).

63 Hester Peirce, Commissioner, SEC, When the Nail Fails; Remarks before the National Society of Compliance Professionals (Oct. 19, 2020) (transcript available *https://www.sec.gov/newsroom/speeches-statements/peirce-nscp-2020-10-19#_ftn5*).

64 Daniel M. Gallagher, Statement on Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7 (June 18, 2015) (transcript available *https://www.sec.gov/newsroom/speeches-statements/sec-cco-settlements-iaa-rule-206-4-7*) ("Both settlements illustrate a Commission trend toward strict liability for CCOs under Rule 206(4)-7.").

65 Hester Peirce, Commissioner, SEC, When the Nail Fails; Remarks before the National Society of Compliance Professionals (Oct. 19, 2020) (transcript available *https://www.sec.gov/newsroom/speeches-statements/peirce-nscp-2020-10-19#_ftn5*).

66 *Id.* (transcript available *https://www.sec.gov/newsroom/speeches-statements/peirce-nscp-2020-10-19#_ftn5*).

67 Lori Richards, Director, SEC Off. of Compliance Inspections and Examinations, Speech by SEC Staff: The Culture of Compliance (Apr. 23, 2003) (transcript available *https://www.sec.gov/news/speech/spch042303lar.htm*) ("We at the SEC have been emphasizing that firms need to create a culture of compliance for many years").

68 Lori Richards, Director, SEC Off. of Compliance Inspections and Examinations, Speech by SEC Staff: The Process of Compliance (Oct. 19, 2006) (transcript available *https://www.sec.gov/news/speech/2006/spch101906lar.htm#:~:text=The%20*

%22Culture%20of%20Compliance%22,ethical%20behavior%20and%20decision%2Dmaking).

69 Proposed Rule, *Compliance Programs of Investment Companies and Investment Advisers,* Release Nos. IC-25925, IA-2107 (available at *https://www.sec.gov/files/rules/proposed/ic-25925.htm#back*).

70 Gurbir Grewal, SEC Director, Division of Enforcement, Remarks at New York City Bar Association Compliance Institute (Oct. 24, 2023) (transcript available at *https://www.sec.gov/news/speech/grewal-remarks-nyc-bar-association-compliance-institute-102423*).

71 Final Rule, *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews,* 88 Fed. Reg. 63206, at 63213.

72 Nat'l Ass'n of Priv. Fund Managers v. SEC, No. 23-6041,1, 25 (5th Cir. 2024) (available at *https://www.ca5.uscourts.gov/opinions/pub/23/23-60471CV0.pdf*).

73 *Id.* at 23 (*quoting* 17 CFR § 275.206(4)) ("The Commission shall, for purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and course of business as are fraudulent, deceptive, or manipulative").

74 *Id.* at 23.

75 17 CFR §§ 275.206(4)-1, 275.206(4)-5, 275.206(4)-6.

76 17 CFR § 275.206(4)-7. ("If you are an investment adviser registered or required to be registered under section 203 of the Investment Advisers Act of 1940, it shall be unlawful within the meaning of Section 206 of the Act for you to provide investment advice to client unless you . . . .").

77 Proposed Rule, *Compliance Programs of Investment Companies and Investment Advisers,* Release Nos. IC-25925, IA-2107 (available at *https://www.sec.gov/files/rules/proposed/ic-25925.htm#back*) (" . . . it is a fraudulent, deceptive or manipulative act, practice or course of business within the meaning of Section 206(4) of the Act").

78 Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003).

79 Hester Peirce, SEC, Division of Investment Management, Compliance Programs of Investment Companies and Investment Advisers: Summary of Comments, (Nov. 20, 2003) (available at *https://www.sec.gov/files/rules/extra/s70303summary.pdf*).

80 Proposed Rule, *Compliance Programs of Investment Companies and Investment Advisers,* Release Nos. IC-25925, IA-2107 (available at *https://www.sec.gov/files/rules/proposed/ic-25925.htm#back*).

81 *Id.*; Final Rule, *Compliance Programs of Investment Companies and Investment Advisers,* 68 Fed. Reg. 74713 (Dec. 17, 2003).

82 Proposed Rule, *Compliance Programs of Investment Companies and Investment Advisers,* Release Nos. IC-25925, IA-2107, n.6 (available at *https://www.sec.gov/files/rules/proposed/ic-25925.htm#back*).

83 Nat'l Ass'n of Priv. Fund Managers v. SEC, No. 23-6041at 20.

84 We note that it is quite possible that there are various procedural hurdles or other various issues of administrative law that may also preclude a challenge of the rules (for example, Section 43 of the Company Act and Section 213 of the Advisers Act generally require persons seeking review of Commission orders to file their petitions or lawsuits within 60 days of the Commission's entry of the order). The applicability of such issues is beyond the scope of this article.

85 Hester Peirce, SEC Commissioner, Chief Compliance Officer Liability: Statement on In the Matter of Hamilton Investment Counsel LLC and Jeffrey Kirkpatrick (available at *https://www.sec.gov/news/statement/peirce-statement-hamilton-investment-counsel-070122#_ftnref2*).

86 New York City Bar Association Compliance Committee, Framework for Chief Compliance Officer Liability in the Financial Sector, (available at *https://s3.amazonaws.com/documents.nycbar.org/files/NYC_Bar_CCO_Framework.pdf*).

87 Gurbir Grewal, SEC Director, Division of Enforcement, Remarks at New York City Bar Association Compliance Institute (Oct. 24, 2023) (transcript available *https://www.sec.gov/news/speech/grewal-remarks-nyc-bar-association-compliance-institute-102423*).

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