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THE JOURNAL OF FEDERAL AGENCY ACTION

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Editor's Note

A Lot Is Happening (Still)

Victoria Prussen Spears*

Although the Supreme Court's *Loper* decision continues to unsettle federal agencies and those who seek, challenge, or litigate their decisions and proposals, much continues to come forth from Washington, as you can see in the articles in this issue of *The Journal of Federal Agency Action*.

Justice

The lead article in this issue, titled "Department of Justice Launches Pilot Program to Reward Corporate Whistleblowers," is by Steven E. Fagell, Adam M. Studner, Addison B. Thompson, and Brendan C. Woods of Covington & Burling LLP.

In this article, the authors review the three-year Corporate Whistleblower Awards Pilot Program launched recently by the Department of Justice to incentivize and reward certain individuals who report corporate wrongdoing.

Agriculture

Next, in the article titled "Department of Agriculture Food Safety and Inspection Service Announces Proposed Rule Under Salmonella Framework for Raw Poultry Products," Peter Tabor and Patrick G. Selwood of Holland & Knight LLP discuss the latest effort by the U.S. Department of Agriculture to reduce salmonella in poultry products, which effectively acknowledges that efforts to encourage consumers to eliminate salmonella through proper handling and cooking have not appreciably reduced salmonella-related illness associated with raw chicken and turkey products.

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Treasury

Darshak S. Dholakia, Thomas C. Bogle, Meagan Cox, and Emily Towill of Dechert LLP are the authors of the piece titled "Treasury Department Issues Final Investment Advisers AML/CFT Program Rule."

Here, the authors discuss a final rule issued by the Financial Crimes Enforcement Network requiring certain investment advisers to establish an anti–money laundering/counter-terrorism financial program pursuant to the Bank Secrecy Act.

FTC

The article that follows is titled "Federal Trade Commission's Enforcement Action Against Avast Signals Increased Focus on Consumer Web Data."

In this article, Kirk J. Nahra, Ali A. Jessani, and Amy Olivero of Wilmer Cutler Pickering Hale and Dorr LLP summarize the Federal Trade Commission's complaint and final order against Avast Limited and provide some key takeaways from the decision.

SEC

In the article titled "Securities and Exchange Commission Adopts New Regulation NMS Rules on Tick Sizes, Access Fees, and Market Data," Andre E. Owens, Bruce H. Newman, Stephanie Nicolas, Tiffany J. Smith, and Kyle P. Swan of Wilmer Cutler Pickering Hale and Dorr LLP examine new amendments recently approved by the Securities and Exchange Commission to Regulation NMS.

GWE

Next, Kenneth W. Parsons and Rachel T. Provencher of Holland & Knight LLP discuss long-awaited proposed regulations on the Tribal General Welfare Exclusion Act of 2014 released recently by the U.S. Department of the Treasury and Internal Revenue Service, which reflect many priorities of Indian Country, including substantial deference to Tribes as they create and implement general welfare exclusion programs. However, the authors add, work

remains to improve clarity of the guidance and address unresolved issues. The title of their article: "Tribal General Welfare Exclusion Proposed Regulations Are an Overdue Win for Indian Country."

Financial Data

Michael Nonaka, David H. Engvall, David Fredrickson, and David B.H. Martin of Covington & Burling LLP submitted their piece, titled "Federal Agencies Begin to Implement the Financial Data Transparency Act."

In this article, the authors explain that the Financial Data Transparency Act specifies a timeline for a series of rulemakings by the federal financial regulators over the next two-and-one-half years, and that affected entities may want to start paying attention now.

PFAS

In the article titled "The End of *Chevron* Deference Could Spell Trouble for the Environmental Protection Agency PFAS 'Hazardous Substance' Rule," Reza Zarghamee and Steve R. Brenner of Pillsbury Winthrop Shaw Pittman LLP explain how a recent decision by the U.S. Supreme Court could affect the Environmental Protection Agency's PFAS hazardous substance designation.

What's Next?

In their article, titled "What's Next After the Private Fund Adviser Rules?," Robin Bergen and Rachel Gerwin of Cleary Gottlieb Steen & Hamilton LLP explore the implications of a recent decision by a federal circuit court of appeals vacating all of the Private Fund Adviser rules issued by the Securities and Exchange Commission.

Enjoy the issue!

Note

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attorney at a leading New York City law firm before joining Meyerowitz Communications. Ms. Spears, who also is Editor of *The Journal of Robotics, Artificial Intelligence & Law*, *The Global Trade Law Journal*, and *The Global Regulatory Developments Journal*, may be contacted at vpspears@meyerowitz communications.com.

Department of Justice Launches Pilot Program to Reward Corporate Whistleblowers

Steven E. Fagell, Adam M. Studner, Addison B. Thompson, and Brendan C. Woods*

In this article, the authors review the three-year Corporate Whistleblower Awards Pilot Program launched recently by the Department of Justice to incentivize and reward certain individuals who report corporate wrongdoing.

The Department of Justice (Department or DOJ) has launched a three-year, Department-wide Corporate Whistleblower Awards Pilot Program (the Pilot Program)[1] to incentivize and reward certain individuals who report corporate wrongdoing. The Pilot Program, which will be managed by the Criminal Division's Money Laundering and Asset Recovery Section, took effect on August 1, 2024, and is DOJ's first whistleblower rewards program.

Deputy Attorney General (DAG) Lisa Monaco and then-Acting Assistant Attorney General (Acting AAG) Nicole Argentieri previewed the Pilot Program in March.[2] The finalized Pilot Program reflects a significant evolution of the outline set out by the DAG and the Acting AAG, likely in response, at least in part, to questions and concerns raised by the whistleblower and defense bars.

Under the Pilot Program, eligible whistleblowers may receive a portion of the "net proceeds forfeited" as a result of "original" information provided. The award amount is at DOJ's discretion and is only available if the report:

1. Relates to specific subject matter areas identified by the Department and not covered by other federal whistleblower or qui tam programs;
2. Leads to the successful forfeiture of more than $1 million in net proceeds; and
3. Meets a number of other criteria (e.g., the whistleblower did not "meaningfully participate[]" in the criminal activity and the report is truthful and complete).

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The Pilot Program thus fills certain eligibility and subject matter gaps in existing federal whistleblower and qui tam regimes, which may necessitate enhancements to corporate compliance programs in the face of potentially heightened risks. For example, in the Foreign Corrupt Practices Act (FCPA) context, the Pilot Program expands the reach of whistleblower awards to reported conduct committed by a private company that qualifies as a U.S. "domestic concern" (but not as an "Issuer"), as the Securities and Exchange Commission's (SEC's) existing whistleblower program necessarily applies to Issuers but not to domestic concerns given limitations to the SEC's enforcement authority under the FCPA.

DOJ attempted to carve out space so that the Pilot Program does not undermine companies' internal reporting and investigative functions. For example:

- Personnel in compliance and legal functions—or personnel to whom information related to potential violations of law is reported—are generally ineligible to receive awards, although there are certain exceptions discussed below.
- The Pilot Program encourages internal reporting through existing channels by providing higher awards in cases where the whistleblower reports misconduct internally first and cooperates with the internal investigation.

Likewise, the Pilot Program ties in with the Criminal Division's voluntary self-disclosure initiative.

In particular, in parallel with announcing the Pilot Program, DOJ's Criminal Division temporarily amended[3] its recently revamped Corporate Enforcement and Voluntary Self-Disclosure Policy (the CEP)[4] to enable companies to obtain voluntary disclosure credit, in the form of a presumptive declination with disgorgement, even if the whistleblower provides information to the Department before the company does. Such an outcome would have been precluded under the prior version of the CEP. To remain eligible for a declination, a company must self-report misconduct to the "Department" within 120 days of receiving a whistleblower report, as well as meet other generally applicable criteria for receiving a declination (e.g., full cooperation and timely and appropriate remediation).

As with the CEP in general, this change applies only to matters involving the Criminal Division and does not apply to cases that

are prosecuted by other components, such as the National Security Division, the Civil Division's Consumer Protection Branch, and U.S. Attorneys' Offices. Whether those other DOJ components with their own voluntary self-disclosure policies will create similar safe harbor periods for companies remains an open question.

This 120-day clock creates a further incentive for companies to establish effective and nimble reporting and investigative mechanisms so they can consider timely disclosing misconduct to remain eligible for a potential declination with disgorgement. It will be important to watch to see if this 120-day clock becomes the new standard for meeting the Criminal Division's requirement of "reasonably prompt disclosure" for voluntary self-disclosure outside of the whistleblower context.

For companies weighing whether to disclose misconduct to DOJ, the Pilot Program raises the stakes, in the sense that it financially motivates whistleblowers to make disclosures to the Department. At the same time, it provides welcome breathing room to companies to investigate compliance reports without foreclosing the availability of benefits afforded to companies by the Criminal Division under the CEP.

The impact of the Pilot Program—particularly on companies—remains to be seen, but the Pilot Program, like all of DOJ's other voluntary disclosure frameworks, vests considerable discretion in the Department to determine how it will be implemented and applied. Nonetheless, the Pilot Program continues to incentivize companies to build compliance and investigations capabilities to promptly investigate allegations of corporate misconduct and quickly reach voluntary disclosure decisions.

The Corporate Whistleblower Awards Pilot Program

When Is an Award Available?

The Pilot Program includes a detailed set of criteria that whistleblowers must meet to receive a portion of the forfeiture amount. But even if these criteria are met, the decision to issue an award, and the award amount, remain within DOJ's sole discretion.

Who Is Eligible?

The Pilot Program imposes a number of eligibility requirements, which have generated significant commentary and controversy. Certain requirements are straightforward and obvious—for example, DOJ employees and other members of law enforcement are ineligible, as are elected officials and individuals who "meaningfully participated" in the activity that they are reporting, even if there will be questions about what that phrase actually means (i.e., what level of participation will be considered meaningful?).

Other requirements are more nuanced. For example, eligibility extends only to individuals who are not also eligible for an award through another U.S. federal whistleblower or qui tam program—a factor that may trip up whistleblowers who do not do their diligence and make disclosures to the right agencies. This factor may make the Pilot Program more obviously attractive to individuals with information about foreign and private companies that are outside of the jurisdiction of the SEC, as individuals reporting information that would be eligible under the SEC's Dodd-Frank whistleblower program, which generally provides for more lucrative awards, would be ineligible under the Pilot Program. Potential whistleblowers also must have provided their information on or after the Pilot Program's effective date of August 1, 2024 (and while the program is still in effect).

What Type of Information Qualifies?

Qualifying information must be "original," meaning non-public information based on the reporter's independent knowledge or analysis, not known to the Department, and not obtained through a communication that was subject to the attorney-client privilege or as part of a legal representation. The information may relate to a matter unknown to DOJ or to a subject that DOJ already possesses some information about, so long as the whistleblower's information "materially adds" to DOJ's information on the matter.

Significantly, information disclosed by certain categories of employees is deemed not to be original in certain circumstances. For example, information learned through the purported whistleblower's position as a company officer, director, trustee, or partner is not original if it was learned from another person or through the employer's processes for identifying, reporting, and addressing potentially illegal conduct. Similarly, information disclosed by

compliance professionals and internal audit employees is deemed not original if it relates to or is derived from their compliance or audit duties.

However, there is a potentially significant exception to these exclusion criteria, as reports from the above individuals can qualify as original information if the employee "has a reasonable basis to believe" that disclosure is necessary to prevent certain future misconduct, including conduct that may lead to "imminent financial harm." It remains to be seen whether this carveout will be interpreted by DOJ expansively or applied only in the most extraordinary circumstances.

What Crimes Are Covered?

In keeping with Acting AAG Argentieri's goal[5] to "fill gaps in the existing framework of federal whistleblower programs," qualifying information submitted through the Pilot Program must pertain to certain statutory subject areas—including money laundering, fraud, corruption and bribery (including under the FCPA and domestic bribery laws), and certain healthcare offenses—that are not otherwise subject to existing federal qui tam and whistleblower programs. Excluded from this list—and, presumably, from the Pilot Program—are offenses in other major areas of corporate enforcement, such as export controls, sanctions, and other fraud-based offenses.

What Is "Voluntary" Information?

A submission is eligible for an award only if it occurs prior to a request, inquiry, or demand from DOJ and the individual has no preexisting duty to disclose. In an apparent internal contradiction, the Pilot Program further defines "voluntary" to require that the submission be made "in the absence of any government investigation." This requirement seemingly contradicts the discussion of "original information" in the Pilot Program's policy guidance, which indicates that a submission may be successful "regardless of whether the Department did or did not already have an investigation open related to the information provided."

What Other Requirements Exist?

There are numerous other requirements embedded in the Pilot Program. Of note, qualifying information must represent the entirety of the individual's knowledge of the subject disclosed. In addition, to retain eligibility for an award, the individual must agree to cooperate with the Department in its related civil and criminal investigations, including potentially serving as a witness in a grand jury, trial, or other proceeding. This criterion goes beyond the level of assistance contemplated under the SEC's whistleblower program, which does not explicitly require in-court testimony by potential whistleblowers. This criterion also creates the possibility that a company's employees may be actively testifying in grand jury proceedings with the hope of a whistleblower award, before the company even becomes aware of the alleged misconduct.

What Outcome Must Result?

The whistleblower's information must lead to successful criminal or civil forfeiture exceeding $1 million in net proceeds to qualify for a potential award. "Net proceeds" is defined as the forfeited funds less the costs and expenses of forfeiture and any victim compensation. Notably, criminal and civil fines and restitution amounts do not count toward the $1 million threshold, nor are they considered in the calculation of the whistleblower award. Thus, the Pilot Program seems likely to pay out smaller awards than the SEC's and the Commodity Futures Trading Commission's (CFTC's) whistleblower programs, which also consider civil fines and other penalties in their award decisions. Moreover, although DOJ's statutory authority for granting awards only extends to information leading to forfeiture, many corporate enforcement resolutions with DOJ involve no or minimal forfeiture, potentially leaving whistleblowers with little or no actual award. It is important to watch to see if DOJ augments which monetary sanctions it seeks to impose in matters involving the prospect of a whistleblower reward. In addition, in cases involving a large number of victims who are entitled to compensation, there may be little leftover for whistleblowers.

What Is the Award Amount?

The decision to issue an award and the amount of the award are within DOJ's sole discretion, and the factors that DOJ says it

will use are fairly subjective. However, the Pilot Program guidance states a "presumption" that DOJ will award to the whistleblower 30 percent of the first $10 million in net proceeds forfeited, if it determines that an award is appropriate and none of the factors that may decrease an award (such as an individual's involvement in the conduct, unreasonable delay in reporting, or interference in an internal investigation) are present.

At the same time, the awards calculation appears likely to result in less lucrative awards than the whistleblower awards offered by other agencies. For instance, the policy makes clear that DOJ will fully compensate victims before paying a whistleblower award, meaning that whistleblowers may not see any reward at all in cases involving many victims or that result in the dissolution of the company. The Pilot Program also caps the award at 30 percent of the first $100 million forfeited and 5 percent of the next $400 million, for a maximum award of $50 million—a fraction of the largest awards that have been disbursed under the SEC's and the CFTC's whistleblower programs. And the Pilot Program uses a "net proceeds forfeited" amount to both determine eligibility for an award and to calculate the amount of the award, whereas the SEC and the CFTC use a total monetary sanctions amount that includes any civil penalty.

Discretionary Awards Scheme with Incentives—But No Requirements—for Internal Reporting to a Company

The Pilot Program identifies factors that may increase or decrease the award amount. Perhaps most relevant to companies, the Pilot Program embeds factors meant to encourage internal reporting to companies' compliance functions before or in parallel with reporting to DOJ. For instance, as part of its determination of the award amount, the Department will assess whether the conduct was reported to the company and whether the whistleblower, or the whistleblower's attorney, participated in internal compliance systems. This includes whether the whistleblower timely reported the conduct through the company's internal reporting mechanisms and whether the whistleblower assisted in any internal investigation concerning the reported conduct. On the other side of the ledger, the award may be decreased if the whistleblower interfered in any internal investigation of the issue.

These factors, while clearly intended to incentivize whistleblowers to work through internal compliance processes, apply only to a potential award increase or decrease and are not used to determine whether the whistleblower receives an award. In other words, under the Pilot Program's terms, whistleblowers may still receive an award if they do not report or cooperate through the companies' internal mechanisms. Whether DOJ's suggestion that it will increase the award size for whistleblowers who internally report is enough to influence reporter behavior is an open question, as the Pilot Program does not quantify how much of an impact internal reporting or cooperation in an internal investigation will have on the award. But these factors reflect an apparent effort to structure the Pilot Program in a way that does not completely undermine internal reporting and participation in companies' internal investigations and adds a measure of deference by DOJ to companies' internal reporting mechanisms and compliance functions.

One Hundred Twenty–Day Window for Companies to Disclose Internal Reports and Retain Eligibility for Voluntary Self-Disclosure Credit Under the Criminal Division's CEP

Complementing the Pilot Program, the Criminal Division also announced a safe harbor of sorts for companies receiving allegations from a whistleblower through its internal reporting channels. Specifically, a new Temporary Amendment to the Criminal Division's CEP (the Temporary Amendment) provides a 120-day window for companies to disclose whistleblower reports to the "Department" and still qualify for a presumption of a declination with disgorgement, even if the whistleblower has already gone to the Department. This policy shift allows companies to disclose to the Department conduct that the company learned from a whistleblower without having to be overly concerned that a whistleblower front-ran the disclosure to DOJ and thereby jeopardized the company's ability to qualify for voluntary self-disclosure credit from the Criminal Division. The Temporary Amendment did not amend the CEP's requirement that companies "pay all disgorgement/forfeiture" to qualify for a declination.

The Temporary Amendment represents a significant revision to the CEP, which previously provided for a presumed declination with

disgorgement only if companies voluntarily self-disclosed criminal conduct to the Criminal Division, the disclosure was "reasonably prompt," and the disclosure occurred prior to an imminent threat of disclosure or government investigation. Implicitly, companies had to be first in the door, without a risk of disclosure pushing them through the door. Now, companies that receive a whistleblower report may still receive voluntary self-disclosure credit from the Criminal Division if they disclose the allegation to the Department within 120 days of learning it, even if the whistleblower has already shared the allegation with the Department, and even if additional whistleblowers have come forward in the meantime. The upshot for companies is that, in connection with matters that might be disclosed to the Department and fall under the Criminal Division's purview, they have some degree of breathing room to investigate allegations and make a disclosure decision without worrying about being front run by reporters or worrying about additional whistleblowers coming forward, including those who might learn of the allegations through the company's investigation.

At the same time, the Criminal Division's Temporary Amendment creates some ambiguity in requiring that a company "meets the other requirements for voluntary self-disclosure and presumption of a declination under the [CEP]" in order to qualify for a presumption of a declination. As a threshold matter, the CEP required that disclosures be made to the Criminal Division to qualify for the benefits afforded by the CEP, while the Temporary Amendment will count as qualifying any self-disclosure to the Department that otherwise meets the Temporary Amendment's requirements. It is unclear what policy prerogatives would justify this apparent dissonance between the CEP and the Temporary Amendment. The upshot is that companies relying on the Temporary Amendment apparently should not be precluded from obtaining voluntary self-disclosure credit from the Criminal Division if they first disclose a matter to another DOJ component, removing the chance of a foot fault in this one circumstance.

It does seem clear that the 120-day window supplants the CEP's requirement for companies to disclose conduct to the Criminal Division within a "reasonably prompt time" after learning of it and removes or reduces the "burden ... on the company to demonstrate timeliness." But does a disclosure by the company to DOJ within 120 days of receiving a whistleblower report also replace the separate requirement that the voluntary disclosure occur "prior

to an imminent threat of disclosure or government investigation," potentially including disclosure to the press? And if not, does an internal whistleblower report indicating that the whistleblower will go to DOJ or the media concurrently with the internal disclosure, or on a date soon thereafter, constitute an "imminent threat of disclosure"?

Separately, the Criminal Division's Temporary Amendment states that the 120-day window relates to cases otherwise qualifying for a presumption of a declination. But what about cases that do not qualify for the presumption for other reasons, such as the presence of aggravating circumstances? Can disclosure within 120 days also qualify as "immediate" disclosure necessary to receive a discretionary declination from the Criminal Division if aggravating circumstances are present, or is some shorter window expected or required?[6]

Time will tell how the Criminal Division resolves these nuances, ambiguities, and related questions, but the policy prerogatives behind creating the 120-day safe harbor suggest that DOJ should credit companies that timely come forward in response to whistleblower allegations.

So far, the Criminal Division is the only DOJ component to amend its voluntary self-disclosure policy in light of the Pilot Program. The Criminal Division being at the leading edge here is perhaps not surprising given that it has been at the forefront of Department policymaking in the voluntary self-disclosure space and has the most mature voluntary self-disclosure program. But other components may want to consider how their programs overlap with the Pilot Program.

The United States Attorneys' Offices Voluntary Self-Disclosure Policy,[7] in particular, deems a company's report to be a voluntary self-disclosure only if it occurred "prior to the misconduct being . . . known to the government." And the Civil Division's Consumer Protection Branch, which prosecutes several of the healthcare offenses covered by the Pilot Program, has not amended its Voluntary Self-Disclosure Policy for Business Organizations following the release of the Pilot Program.[8] The upshot is that companies confronted with whistleblower concerns may face drastically different enforcement outcomes related to conduct raised by whistleblowers depending on which component of DOJ is prosecuting the case. In creating this disparity, the Pilot Program and the Criminal Division's Temporary Amendment threaten to thwart the consistency that DOJ had been

seeking in its push for all Department components to implement voluntary self-disclosure policies.

A Race Against the Clock, But Not to Be "First in the Door"

The incentives for whistleblowers to report internally and the 120-day window for companies to disclose reported misconduct to the Department and still qualify for a presumption of a declination with disgorgement represent significant changes relative to the Pilot Program outline that DAG Monaco laid out in March. In her preview of the Pilot Program, DAG Monaco articulated a "first in the door" paradigm whereby corporate defendants and whistleblowers alike would have to "tell us something we didn't already know" in order to receive some benefit. The finalized Pilot Program departs from that principle and creates "room for credit to be shared," which many hoped would be the case, if both the whistleblower and company bring the allegations to DOJ. Still, the fact remains that internal reporters are now financially incentivized to also report potential misconduct to DOJ. Likewise, companies facing a weighty self-disclosure decision must consider the possibility that reporters have concurrently disclosed the misconduct to DOJ in light of the Pilot Program's incentives, potentially raising the stakes for a decision not to disclose.

Beyond its particular applicability in relation to the Pilot Program, the 120-day safe harbor feature in the Criminal Division's Temporary Amendment could set a standard—at least informally—for what constitutes "prompt" disclosure within the Criminal Division and potentially across the Department. The Department's enforcement programs and voluntary self-disclosure policies set various timeframes for companies to disclose, and address, wrongdoing.

For example, the Mergers and Acquisitions (M&A) Safe Harbor Policy[9] sets a 180-day window to self-disclose wrongdoing at an acquired company; the Justice Manual defines[10] "voluntary self-disclosure" for all components to require "promptly" disclosing misconduct; and the CEP calls for "reasonably prompt" disclosure after a company learns of wrongdoing. In cases involving whistleblowers, at least, the latter requirement has now been defined within the Criminal Division as within 120 days. But what of cases not

involving whistleblowers? The Department has not changed the "reasonably prompt disclosure" requirement for non-whistleblower cases, but companies and counsel may reasonably view 120 days as the standard there as well. And it stands to reason that the Criminal Division imposed a more stringent standard here than in the M&A Safe Harbor Policy because companies do not always have the same ready access to information in the acquisition context.

Looking Ahead

The Pilot Program follows in the footsteps of robust whistleblower award programs at other enforcement agencies and in other statutory contexts, and it signals DOJ's openness to making such a program a permanent part of its enforcement strategy.

The next three years may provide answers to a number of questions that remain with respect to the Pilot Program's design and function, including:

- How the Pilot Program's details—which, as mentioned, differ somewhat from other whistleblower programs'—will affect DOJ's ability to attract new tips, and whether DOJ, which currently lacks a dedicated Office of the Whistleblower, will devote the necessary resources to process, investigate, and prosecute a potential influx of new tips;
- Whether the Pilot Program's award calculation—which is discretionary, calculated based on the "net proceeds forfeited," only paid out after DOJ has fully compensated victims, and, unlike the SEC's and CFTC's programs, capped at $50 million—will provide sufficient incentives to attract whistleblowers;
- Whether the Pilot Program and the Temporary Amendment—which are the latest in a long run of new corporate enforcement policies and programs from DOJ and the Criminal Division over the past several years and introduce a further degree of inconsistency in DOJ components' treatment of voluntary self-disclosures—will risk policy fatigue and confusion; and
- Whether companies will receive voluntary self-disclosure credit under the Temporary Amendment for disclosures made prior to August 1, 2024, in light of the relevant policy

> prerogatives and the Criminal Division's history of issuing declinations to companies that voluntarily self-disclosed before a voluntary self-disclosure program went into effect.

Still, a couple of points are clear. First, companies are more incentivized than ever to build out their compliance and investigations capabilities to promptly conduct an initial investigation of inbound reports of wrongdoing and consider whether to disclose them to DOJ—and to do so within 120 days. The newly increased risk that an internal reporter may have disclosed the allegations to the Department adds additional considerations to the self-disclosure calculus, even if the 120-day window provides some breathing room, for matters that would be within the Criminal Division's purview, to conduct a preliminary investigation of the issues. And second, companies have an even greater incentive to ensure that their internal reporting systems are known and accessible to employees, in order to give whistleblowers every opportunity to disclose issues internally before or at least concurrently with going to the government. By doing so, companies will maximize their chances of positioning themselves to obtain a presumption of a declination if they choose to self-disclose.

Notes

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1. https://www.justice.gov/criminal/media/1362321/dl.

2. https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-monaco-delivers-keynote-remarks-american-bar-associations.

3. https://www.justice.gov/criminal/media/1362316/dl?inline.

4. https://www.justice.gov/criminal/criminal-fraud/file/1562831/dl?inline.

5. https://www.justice.gov/opa/speech/acting-assistant-attorney-general-nicole-m-argentieri-delivers-keynote-speech-american.

6. Under the CEP, cases that do not qualify for a presumption of a declination with disgorgement due to aggravating factors, such as involvement by company executives in the misconduct, significant profits from the misconduct, or recidivism, may still, at the Criminal Division's discretion, result in a discretionary declination with disgorgement if the company demonstrates that it: (1) "immediately" voluntarily self-disclosed upon becoming aware of the allegation of misconduct; (2) at the time of the misconduct and the

voluntary self-disclosure, had an effective compliance program and system of internal accounting controls, which enabled identification of misconduct and led to the voluntary self-disclosure; and (3) engaged in "extraordinary" cooperation and remediation. Other DOJ components' self-disclosure policies, do not articulate a presumptive path to receiving a declination or specific criteria making companies eligible for either a presumptive or discretionary declination with disgorgement.

7. https://www.justice.gov/usao-edny/press-release/file/1569406/dl.

8. https://www.justice.gov/civil/media/1277181/dl.

9. https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-announces-new-safe-harbor-policy-voluntary-self.

10. https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations#9-28.900.

Department of Agriculture Food Safety and Inspection Service Announces Proposed Rule Under Salmonella Framework for Raw Poultry Products

Peter Tabor and Patrick G. Selwood*

In this article, the authors discuss the latest effort by the U.S. Department of Agriculture to reduce salmonella in poultry products, which effectively acknowledges that efforts to encourage consumers to eliminate salmonella through proper handling and cooking have not appreciably reduced salmonella-related illness associated with raw chicken and turkey products.

The U.S. Department of Agriculture's (USDA) Food Safety and Inspection Service (FSIS) (collectively, the Agency)[1] recently issued a proposed rule[2] aimed at reducing salmonella contamination in raw poultry products destined for human consumption.[3]

The proposed rule comes on the heels of the Agency's final rule,[4] published in May 2024, declaring salmonella an "adulterant" when present in certain quantities in breaded, stuffed, not-ready-to-eat (NRTE) chicken products.[5] Under the proposed rule issued on July 29, 2024, raw chicken and turkey products containing certain salmonella serotypes and levels would be considered adulterated within the meaning of the Poultry Products Inspection Act.[6] The Agency's proposal would also require poultry slaughter and processing establishments to implement internal procedures—including the use of monitoring and sampling programs—aimed at reducing these adulterants to prescribed regulatory limits and otherwise ensuring compliance with Agency standards. The Agency indicates it is taking these steps because, while current salmonella pathogen-reduction standards have yielded positive results in terms of reduced salmonella levels in raw poultry products, "these measures have yet to have an impact on human illness rates."

If finalized as proposed, the rule is likely to impose considerable financial and operational burdens on producers in America's

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poultry industry, many of whom indicated their opposition to contemplated changes during the stakeholder engagement process prior to rulemaking and in response to this proposed rule when it was announced in late July 2024.

Background

Motivation

Salmonella is a significant contributor to food safety and human health concerns. According to the U.S. Centers for Disease Control and Prevention (CDC), food is the leading source of salmonella infections, and poultry is among the leading sources of foodborne salmonella illnesses. The CDC estimates that salmonella from all sources is responsible for 1.3 million illnesses, 26,500 hospitalizations, and 420 deaths each year. The Agency estimates that of the annual number of salmonella illnesses from poultry, 42,000 are associated with turkey, while 125,000 come from chicken products—the latter is estimated to cost the United States more than $2.8 billion in economic losses annually.[7]

The Agency's efforts to curb rates of salmonella illness date back decades. With its "Pathogen Reduction; Hazard Analysis and Critical Control Point" (PR/HACCP) final rule, published in July 1996, the Agency began its salmonella-verification testing program.[8] The PR/HACCP rule established salmonella pathogen reduction performance standards for establishments that slaughter or process certain classes of animals and raw ground meat products. Although these performance standards, which were regularly updated, achieved reductions in salmonella detections in poultry, there was no observable reduction in human illness.

Latest Development in Biden Administration's Trend of Increased Agency Regulation of the Poultry Industry

The USDA's approach[9] under the Biden administration to addressing foodborne illness has been to place a greater onus on producers and processors to reduce the presence of the pathogen in food, including raw or NRTE poultry products. This is in part an acknowledgment that consumer behavior has not reduced incidents of foodborne illness associated with raw poultry products.

In early 2020, the Agency began receiving petitions from consumer advocacy organizations and other stakeholders, noting the failure of the Healthy People 2030 initiative[10] to meet its salmonella reduction targets and requesting that USDA revise its approach to reducing salmonella illnesses associated with poultry products. Over the next three years, USDA continued to receive comments urging the department to take various steps to reduce the number of cases of salmonella illness in humans associated with poultry. In particular, a 2021 petition[11] submitted by the Center for Science in the Public Interest urged the Agency to take action against the salmonella strains that posed the greatest risks to human health risk by requiring that poultry establishments identify and control foodborne hazards within their supply chains.

In late 2021, the Agency announced it would begin gathering data in an effort to identify new steps to meet its goal of reducing salmonella human illness associated with poultry—a goal consistent with the Healthy People 2030 goal of a 25 percent reduction in salmonella illnesses. Through extensive stakeholder engagement, data gathering, and analysis, including industry pilot projects to evaluate different control strategies for salmonella in poultry products, the Agency took steps to identify the salmonella serotypes of greatest concern to human health and evaluated supply chain risks. In August 2022, in part based on its data collection, FSIS announced[12] that it would declare salmonella an adulterant in breaded and stuffed NRTE chicken products. The rule was finalized in May 2024.

The Proposed Rule

In announcing its proposed rule, the Agency noted that the "proposed framework is a systematic approach to addressing salmonella contamination at poultry slaughter and processing, which includes enforceable standards that will result in safer food for consumers and fewer illnesses." The Agency assesses three main components of the framework in reverse order in the proposed rule, in terms of their effectiveness and the Agency's intention to propose new requirements.

First and most significantly, the rule sets new limits for certain levels and serotypes of salmonella in raw chicken and ground turkey products.[13] Violative products would be considered adulterated and

prevented from entering commerce. Specifically, the final framework states that raw chicken carcasses, chicken parts, comminuted chicken, and comminuted turkey are adulterated if they contain any type of salmonella at or above 10 colony forming units (CFU) per milliliter or gram in analytical portion (i.e., milliliter of rinsate or gram of product) and contain any detectable level of at least one of the salmonella serotypes of public health significance identified for that commodity. The proposed rule identifies the salmonella serotypes Enteritidis, Typhimurium, and I 4,[5],12:i:- for raw chicken carcasses, chicken parts, and comminuted chicken. The proposed rule identifies salmonella serotypes Hadar, Typhimurium, and Muenchen for raw comminuted turkey. These are the most highly virulent salmonella serotypes associated with these products identified in the FSIS chicken and turkey risk assessments. FSIS indicates the "salmonella serotypes of public health significance will likely change over time as the serotypes commonly associated with human illnesses change." The Agency intends to reevaluate the salmonella serotypes of public health significance at least every three to five years and whenever new information becomes available.

Second, the proposed rule seeks to enhance industry control by updating the requirements in 9 C.F.R. 381.65(g) and (h) for poultry establishments to develop and implement a microbial monitoring program to prevent pathogen contamination throughout the slaughter system. Specifically, establishments would be required to "incorporate statistical process control (SPC) monitoring principles into their microbial monitoring programs (MMPs)." Notably, testing of product to ensure effectiveness of controls would require that sampled and tested product be held until test results were obtained and evaluated, with establishments required to have written plans for responding to circumstances where violations of the regulation are found. Notably, the Agency states it will make resources available to very small and very low-volume establishments to facilitate compliance with this requirement. Finally, FSIS proposes that establishments would be required to submit their microbial monitoring data to the Agency electronically.

Third, the Agency evaluated the need for more stringent preharvest measures for incoming chicken and turkey to reduce the pathogen load establishments would have to address in order to meet proposed limits for pathogen presence in products entering commerce.[14] Notably, the draft framework under which this proposed rule was developed examined the role that preharvest

measures such as testing live birds for salmonella prior to receiving might have on reducing the incidence of salmonella in raw chicken and turkey. After evaluating both the cost and effectiveness of such measures, including the burden on small establishments, "FSIS has decided at this time not to establish a regulatory requirement that establishments characterize salmonella as a hazard reasonably likely to occur at receiving or that incoming flocks be tested for salmonella before entering an establishment."

Agency's Predicted Outcomes, Public Reception and Possible Implications

One of the main costs associated with the rule, if finalized as proposed, relates to holding product during testing. Specifically, the proposed rule would require that "establishments subject to FSIS verification sampling for adulterants maintain control of sampled product pending test results." FSIS estimates the total costs to U.S. producers at between $3.31 million and $32.25 million.

According to the Agency, the proposed rule would save $20.5 million annually—an estimate that includes benefits to consumers from lower illness rates and avoided costs from reducing the risk of outbreak-related recalls for poultry products.

In anticipation of legal challenges to this rule if finalized, the Agency indicates that, "if any of [its provisions] were to be set aside by a reviewing court, FSIS would intend for the remainder of this action to remain in effect." In light of the U.S. Supreme Court's decision in *Loper Bright Enterprises v. Raimondo*[15] (effectively eliminating the deference courts must show to agency interpretations of vague statutory language), the Agency is preparing for this regulation to be challenged by stakeholders who disagree with its approach.

Conclusion

This FSIS proposed rule is a significant step by the Agency under the Biden administration to place more responsibility for product safety on establishments, effectively acknowledging that consumer behavior and practices are insufficient to reduce salmonella-related foodborne illnesses associated with raw chicken

and turkey products. This proposed rule's fate is uncertain with President-elect Trump set to move back into the White House in January. Both his views and those of his U.S. Department of Agriculture appointees (if/when confirmed), will impact the path forward, if any, for rulemaking.

Notes

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1. USDA is charged with implementing several acts of Congress, including the Poultry Products Inspection Act (PPIA), 21 U.S.C. § 451 et seq. Through the PPIA, Congress authorized the Secretary of Agriculture "to promulgate regulations 'to protect the health and welfare of consumers.'" Dawkins ex rel. Est. of Dawkins v. United States, 226 F. Supp. 2d 750, 752 (M.D.N.C. 2002) (21 U.S.C. § 451); see also 21 U.S.C. §§ 456, 463. The Secretary of Agriculture has delegated the task of administering the PPIA to FSIS, a sub-agency or branch of "[USDA] that focuses on … food safety and inspection. Dawkins, 226 F. Supp. 2d at 751 (citing 9 C.F.R. § 300.2); id. ("Implementation of the PPIA is one of the 'primary regulatory responsibilities' of the FSIS.") (quoting 9 C.F.R. § 300.3(a)); see also 7 C.F.R. §§ 2.18(a)(1)(ii)(A), 2.53(a)(2)(i). This delegation includes, inter alia, implementing USDA's detailed regulations, many of which relate to poultry inspection and sanitation at processing plants. Dawkins, 226 F. Supp. at 752 (citing 9 C.F.R. § 381.1 et seq.). FSIS's principal means for carrying out these regulatory requirements is through conducting inspections of poultry-processing plants. Dawkins, 226 F. Supp. 2d at 752 ("The purpose of these inspections, consistent with the purpose of the PPIA, is to protect the 'health and welfare of consumers' 'by assuring that poultry products distributed to them are wholesome, not adulterated.'") (quoting 21 U.S.C. § 451).

2. https://www.fsis.usda.gov/sites/default/files/media_file/documents/FSIS-2023-0028.pdf.

3. See "USDA Proposes New Policy to Reduce Salmonella in Raw Poultry Products," USDA Press Release No. 0148.24, July 29, 2024; see also "Salmonella Framework for Raw Poultry Products," 89 FR 64678-01, 2024 WL 3673417(F.R.) (Aug. 7, 2024) (noting, inter alia, the Agency is proposing to revise the current regulations in 9 C.F.R. § 381.65 ("Poultry Products Inspection Regulations. Operating Procedures.") to include the requirements and policies set forth in the proposed rule).

4. https://www.fsis.usda.gov/sites/default/files/media_file/documents/FSIS-2022-0013F.pdf.

5. See "USDA Finalizes Policy to Protect Consumers from salmonella in Raw Breaded Stuffed Chicken Products," USDA Press Release No. 0072.24, April 26, 2024.

6. https://www.fsis.usda.gov/policy/food-safety-acts/poultry-products-inspection-act. "The Poultry Products Inspection Act (PPIA), 21 U.S.C. §§ 451-472, was born out of a Congressional interest in protecting consumer health and welfare by enabling the Secretary of Agriculture to ensure that poultry products were 'wholesome, not adulterated, and properly marked, labeled, and packaged.'" Food & Water Watch, Inc. v. Vilsack, 808 F.3d 905, 909 (D.C. Cir. 2015) (quoting 21 U.S.C. § 451). The legislation achieves these goals in various ways, such as by requiring the Agency to ensure "that inspectors conduct a post-mortem inspection of all poultry processed for human consumption," as well as by mandating Id. § 455(b). The PPIA also requires "condemnation and destruction for human food purposes of all poultry that is found to be adulterated, unless the poultry can be reprocessed under an inspector's supervision so that it is found to be not adulterated." Food & Water Watch, 808 F.3d at 909-10 (citing 21 U.S.C. § 455(b), (c)).

7. "Food Attribution and Economic Cost Estimates for Meat and Poultry-Related Illnesses," Robert L. Scharff, Journal of Food Protection, 2020; 83(6): 959-967.

8. 61 FR 38806.

9. https://www.usda.gov/media/press-releases/2021/10/19/usda-launches-new-effort-reduce-salmonella-illnesses-linked-poultry.

10. A national program developed by the U.S. Department of Health and Human Services with the purpose of providing data-driven recommendations for achieving health-promotion and disease-prevention goals; https://odphp.health.gov/our-work/national-health-initiatives/healthy-people/healthy-people-2030.

11. https://www.fsis.usda.gov/policy/petitions/petition-submitted-center-science-public-interest.

12. https://www.usda.gov/media/press-releases/2022/08/01/usda-announces-action-declare-salmonella-adulterant-breaded-stuffed.

13. The proposed salmonella serotypes of public health significance identified for raw chicken include Enteritidis, Typhimurium and I 4,[5],12:i:- ; and for raw turkey include Hadar, Typhimurium, and Muenchen.

14. The proposed rule does not require poultry producers to test live chickens they receive.

15. Loper Bright Enterprises v. Raimondo, No. 22-451, 603 U.S. ___ (June 28, 2024).

Treasury Department Issues Final Investment Advisers AML/CFT Program Rule

Darshak S. Dholakia, Thomas C. Bogle, Meagan Cox, and Emily Towill*

In this article, the authors discuss a final rule issued by the Financial Crimes Enforcement Network requiring certain investment advisers to establish an anti-money laundering/counter-terrorism financial program pursuant to the Bank Secrecy Act.

The U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) has issued a final rule (Final Rule) requiring certain investment advisers to establish an anti–money laundering/counter-terrorism financing program (AML/CFT Program) pursuant to the Bank Secrecy Act (BSA).[1] U.S. Secretary of the Treasury Janet L. Yellen stated that the Final Rule will "close critical loopholes in the U.S. financial system that bad actors use to facilitate serious crimes like corruption, narcotrafficking, and fraud."

FinCEN issued a notice of proposed rulemaking on February 13, 2024 (Proposed Rule) and accepted public comments through April 15, 2024. The Final Rule largely adopts the requirements of the Proposed Rule, with a few key differences, as described below.

Final Rule Requirements

AML/CFT Program Requirement

The Final Rule requires certain registered investment advisers (RIAs) and exempt reporting advisers (ERAs) (together with RIAs, Investment Advisers) to adopt a reasonably designed, risk-based AML/CFT Program to combat the laundering of money and financing of terrorism through the institution, as required by the BSA.

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The AML/CFT Program must, at a minimum:

- Establish and implement internal policies, procedures, and controls reasonably designed to prevent the adviser from being used for money laundering, terrorist financing, and other illicit finance activities and to comply with applicable provisions of the BSA and implementing regulations.
- Provide for independent testing of the AML/CFT Program by the adviser's personnel or a qualified outside party.
- Designate a person or persons to be responsible for implementing and monitoring the internal policies, procedures, and controls of the AML/CFT Program.
- Provide for ongoing training of appropriate persons.
- Implement appropriate risk-based procedures for conducting ongoing customer due diligence (CDD) that includes:
    - Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile.
    - Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

The AML/CFT Program must be approved in writing by the Investment Adviser's board of directors or trustees, or if it does not have a board, by its sole proprietor, general partner, trustee, or other persons that have functions similar to a board of directors and are able to approve the AML/CFT Program. The Final Rule also allows Investment Advisers to delegate the implementation and operation of some or all aspects of their AML/CFT Programs to a third party, such as a fund administrator, if certain criteria are met. The Investment Adviser still, however, would remain fully responsible and legally liable for compliance with the requirements of the Final Rule.

Reports of Suspicious Transactions

The Final Rule requires Investment Advisers to file Suspicious Activity Reports (SARs) with FinCEN for a transaction that involves or aggregates at least $5,000 in funds or other assets, if it knows, suspects, or has reason to suspect that the transaction meets any of the following criteria:

- The transaction involves funds derived from illegal activity or is intended or conducted to hide or disguise funds or assets derived from illegal activity.
- The transaction is designed, whether through structuring or other means, to evade the requirements of the BSA.
- The transaction has no business or apparent lawful purpose, and the Investment Adviser knows of no reasonable explanation for the transaction after examining the available facts.
- The transaction involves the use of the Investment Adviser to facilitate criminal activity.

The Final Rule requires Investment Advisers to maintain records of SARs filed.

Other Requirements

In addition, certain other filing and recordkeeping rules are applicable to Investment Advisers under the Final Rule. For example, Investment Advisers are required to comply with the requirements of the Recordkeeping and Travel Rules, which require financial institutions to create and retain records for transmittals of funds that equal or exceed $3,000 and to ensure that certain information pertaining to the transmittal of funds "travels" with the transmittal to the next financial institution in the payment chain.

Additionally, Investment Advisers are required to file Currency Transaction Reports (rather than filing on joint FinCEN/Internal Revenue Service Form 8300, as they do currently), upon the receipt of more than $10,000 in currency and certain negotiable instruments. Investment Advisers are also subject to the information-sharing provisions of the BSA and "special measures" imposed by FinCEN pursuant to Section 311 of the USA PATRIOT Act. The Final Rule clarifies that, with respect to such "special measures," Investment Advisers may deem the AML/CFT Program requirements satisfied for any mutual fund, bank- and trust company-sponsored collective investment fund or any other investment adviser they advise subject to the Final Rule that is already subject to AML/CFT Program requirements.

Differences from Proposed Rule Requirements

Scope of the Final Rule

The Final Rule adopts a narrower definition of "investment adviser" than the Proposed Rule, excluding (1) RIAs that register with the SEC solely because they are (a) mid-sized advisers, (b) multistate advisers, or (c) pension consultants; and (2) RIAs that are not required to report any assets under management to the SEC on Form ADV.

The Final Rule also addressed comments regarding applicability of the Proposed Rule to RIAs or ERAs that have a principal office and place of business outside the United States (foreign-located investment advisers). The Final Rule applies solely to foreign-located investment advisers' advisory activities that (1) take place within the United States (including through the adviser's U.S. personnel), or (ii) provide advisory services to a U.S. person or a foreign-located private fund with an investor that is a U.S. person.

Duty Provision

In the Final Rule, FinCEN removed the Proposed Rule's provision requiring that the duty to establish, maintain, and enforce an adviser's AML/CFT Program fall within the responsibility of and be performed by persons in the United States who are accessible to and subject to oversight and supervision of the Secretary of the Treasury and the relevant federal regulator.

Extended Compliance Date

The Proposed Rule contained a compliance deadline of 12 months after the effective date of the regulation. FinCEN extended the compliance date in the Final Rule to January 1, 2026.

Customer Identification Program Proposed Rule

In a separate effort to address money laundering and counter-terrorism financing concerns, on May 13, 2024, FinCEN and the SEC jointly proposed a new rule that would require certain RIAs

and ERAs to establish, document and maintain written Customer Identification Programs (CIP Proposed Rule).[2] The comment period for the CIP Proposed Rule closed on July 22, 2024.

In Summary

- Treasury issued a Final Rule requiring certain investment advisers to establish an AML/CFT Program and file certain reports, such as SARs, with FinCEN.
- The Final Rule applies to RIAs and exempt reporting advisers, but excludes certain RIAs from its scope.
- The compliance date for the Final Rule has been extended to January 1, 2026, but covered investment advisers should start making preparations now even if they already maintain some form of a voluntary AML/CFT Program.

Conclusion

The Final Rule represents the culmination of a two-decade long effort to apply AML obligations to investment advisers. Investment Advisers subject to the Final Rule should begin to calibrate existing programs or implement new programs to comply with the Final Rule.

Notes

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1. See Anti–Money Laundering/Countering the Financing of Terrorism Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers (Sept. 4, 2024), https://www.federalregister.gov/documents/2024/09/04/2024-19260/financial-crimes-enforcement-network-anti-money-launderingcountering-the-financing-of-terrorism.

2. See Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers (May 21, 2024), https://www.federalregister.gov/documents/2024/05/21/2024-10738/customer-identification-programs-for-registered-investment-advisers-and-exempt-reporting-advisers.

Federal Trade Commission's Enforcement Action Against Avast Signals Increased Focus on Consumer Web Data

Kirk J. Nahra, Ali A. Jessani, and Amy Olivero*

In this article, the authors summarize the Federal Trade Commission's complaint and final order against Avast Limited and provide some key takeaways from the decision.

The Federal Trade Commission (FTC) has been actively flexing its authority as a privacy regulator in recent months. The agency has been especially focused on identifying data practices it views to be "unfair," thereby essentially creating substantive obligations for how companies are permitted to use data. The FTC's recent enforcement action and order against Avast Limited is one example of this trend.

The FTC recently announced its finalized order prohibiting the sale or licensing of any web browsing data for advertising purposes against Avast and two of its subsidiaries, including Jumpshot Inc. The FTC's case against Avast focused primarily on allegations of misrepresentations about the company's collection, retention, and sale of its consumers' browsing information and insufficient consumer notice regarding the disclosure of consumer data to over 100 third parties.

Through this action, the FTC established that it considers re-identifiable browsing information to be sensitive data. This browsing information can include data such as a user's search queries; the URLs of web pages visited; domains of third-party cookies embedded in ads, videos, or web banners of a user's visited URL; domains of images pulled from visited URLs, and the value of cookies placed on consumers' devices by third parties. In its complaint against Avast, the FTC stated that this browsing information "reveal[s] consumers' religious beliefs, health concerns, political leanings, location, financial status, visits to child-directed content, and interest in prurient content." Here, the agency asserted that this

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information should not have been sold, transferred, or disclosed to third parties without first obtaining affirmative consent from consumers and was thus an "unfair" practice.

This article summarizes the FTC's complaint and final order against Avast and provides some key takeaways from the decision.

Summary of the Complaint

Avast develops and produces cybersecurity software designed to limit and prevent third-party tracking on users' devices. According to the FTC, however, Avast's browser extensions and software also enable it to track users' browsing information with greater detail than ordinary third-party tracking. The FTC alleged three primary violations stemming from Avast's handling of consumers' browsing information and the associated statements, policies, and practices.

Specifically, the FTC stated the following to be an unfair or deceptive practices in violation of Section 5 of the FTC Act.

- *Unfair Collection, Retention, and Sale of Consumers' Browsing Information*

The complaint explained that some of Avast's main products, such as software and browser extensions—which were designed to identify and address potential risks to consumers' privacy and security—also collected eight petabytes of consumer data over a period of approximately six years. The FTC alleges that from 2014 to 2020, Avast, through its subsidiary, Jumpshot, sold large quantities of this data to over 100 third parties via Jumpshot products called "data feeds." These data feeds "provided third-party data buyers with extraordinary detail regarding how consumers navigated the Internet, including each webpage visited, precise timestamp, the type of device and browser, and the city, state, and country." According to the FTC, although Avast sold data feeds in non-aggregate form, many of these feeds included a unique and persistent device identifier that some third parties later used to trace identifiable individuals' browsing activity. Some of the agreements with these third parties allegedly stated directly the recipient's intention to reidentify individuals through re-association while others contained some contractual limitations but were not monitored or assessed for compliance.

- *Inadequate Disclosure of Consumer Tracking*

The FTC's complaint noted a significant discrepancy between Avast's "marketing hook," which was primarily based on protecting users' privacy and security, and its actual tracking of consumer data and associated privacy statements, for the 2014-2020 period. Moreover, Avast allegedly continued to profit off sales of consumer data (through the sale of Jumpshot data products) without sufficiently informing its users that numerous third parties could "track and target consumers across multiple devices." This included data such as the web pages consumers visited; precise time stamps of the visits; the type of device and browser used; and the city, state, and country of the user. Furthermore, Avast's disclosures were not always triggered by consumer action (e.g., users could download certain Avast products without ever receiving a pop-up notification pertaining to the collection, use, sale, or disclosure of their data of third-party tracking) and/or these disclosures were allegedly hard to find and hard to understand.

- *Misrepresentations Regarding Aggregation and Anonymization of Data*

The FTC's complaint alleges that even where Avast described potential disclosures of consumers' browsing information to third parties, the company misrepresented how it would disclose such data. Until 2018, Avast's privacy policy failed to inform consumers that third parties would have any access to their browsing information outside the law enforcement or service provider context. In its own web forum, Avast even claimed that their aggregation of data prevented the reverse-engineering capable of tracing data back to specific users. Although Avast described certain privacy policies on its own forum, the FTC depicted the forum as a technical-oriented informational site that individuals had to seek out to learn more. The agency also claims Avast's forum made numerous false statements, including that they aggregated all user data when the company allegedly provided Jumpshot with non-aggregate data, which was later re-packaged and sold to additional third parties.

Key Provisions from the Final Consent Order

In addition to the $16.5 million fine, the highest monetary remedy for a de novo privacy violation under Section 5(a) of the FTC Act, the FTC imposed several other mandates on Avast, such as the following.

- *A Prohibition on the Sale or Disclosure of Browsing Information*

Avast faces restrictions around the sale, license, transfer, share, and disclosure of browsing information. Avast can no longer engage in disclosure of browsing information derived from any Avast product, even after obtaining consumer consent.

However, the FTC has not completely banned Avast's use or disclosure of browsing information in certain contexts. Avast may disclose browsing information from non-Avast products for advertising purposes upon obtaining affirmative express consent from the consumer. Additionally, the mere use of any browsing information by Avast for advertising purposes cannot be done until after the data subject has given affirmative express consent. The FTC opted for a rather broad definition of "advertising purposes," which further restricted potential Avast efforts to utilize consumer data as a corporate asset. The process of obtaining affirmative express consent may also restrict Avast's ability to profit from browsing information. Avast must provide clear and conspicuous notice detailing if and how browsing information will be used, sold, or otherwise disclosed by both Avast and any third party involved before a user can consent to such action.

- *Data and Model Deletion*

The prohibition on disclosure of browsing information from Avast products applies not only to the data itself but also to the products and services incorporating that information, such as any models or algorithms. The Final Order instructs Avast to delete "the Jumpshot Data and any models, algorithms, or software developed by Jumpshot based on the [their data]." The FTC has recently made efforts for complete disgorgement by requiring companies to destroy any artificial intelligence models that were created using allegedly improperly collected data. To ensure this data can no longer be used for profit, the agency also required Avast to instruct

third parties in possession of Jumpshot data or its by-products to delete or destroy such information. Jumpshot data may only be retained for purposes required by the government or otherwise by law and must be deleted within 30 days after the obligation's expiration.

- *Notice to Consumers*

Avast, a company that once marketed itself primarily based on consumer privacy and security, must provide clear and conspicuous notice to those same consumers that Avast sold their data, without consent, to third parties. The FTC has also required Avast to inform those same consumers of this action against the company. This requirement entails directing consumers to a prewritten notice by providing the linked notice:

1. On the Avast website,
2. On Avast products involved in the collection of browsing information from 2014 to 2020, and
3. In emails sent to any user who purchased an Avast product prior to January 30, 2020.

- *Implement Comprehensive Privacy Program*

Similar to other previous FTC Final Orders, Avast must implement a comprehensive privacy program with biennial third-party assessments for 20 years. The program must be documented in writing, provided to the Avast board of directors or equivalent governing body, and overseen by a designated qualified employee. This provision also requires the installation of safeguards designed to protect covered information based on the amount and sensitivity of covered information at risk.

Key Takeaways

Treat Browsing Information as Sensitive Data and Consider Establishing an Affirmative Express Consent Model Before Collecting

The action against Avast illustrates the FTC's heightened concern around web browsing information and its emphasis that this

data can reveal a great deal of highly sensitive information about a consumer. Under this understanding, browsing information, when aggregated and combined with other data sources, may result in reidentification of the individual consumer. Through the Avast enforcement action, the FTC adds web browsing information to a growing list of what it considers sensitive information that merits heightened protection. (In early 2024, the FTC's enforcement actions against X-Mode and InMarket added health and geolocation data to this list.) Companies should consider obtaining the affirmative express consent from any consumers prior to the disclosure of their browsing information to any third party.

Review Consumer Privacy and Security Claims to Ensure They Accurately Reflect Data Practices and Operations

The FTC's complaint took significant issue with Avast's "marketing hook," which claimed to prevent the exact type of third-party tracking Avast enabled through Jumpshot's sale of data feeds. This focus in the enforcement action illustrates the important of disclosures that accurately inform users how products collect, retain, and use their data. Companies should consistently ensure that any privacy policies, marketing materials, and public statements are in line with the business' legitimate efforts to support privacy and security-related claims.

Exercise Stronger Oversight Over Contractual Provisions Limiting Third Parties' Use of Disclosed Data

Companies should consider performing due diligence assessments to determine whether the third-party companies they enter into contracts with have the capabilities and intentions to comply with any data use limitations written into contracts. Through the Avast action, the FTC has put companies on notice that the agency will hold them accountable for failures to vet third parties who may seek to use a company's data for purposes prohibited by the contract, such as re-identifying users for targeted advertising.

Monitor the FTC's Increasing Fines Against Companies for Privacy Violations

Deceiving consumers by selling their sensitive data without affirmative express consent or sufficient disclosures of the company's intent to sell data may result in significant monetary liability. The agency will seek to provide redress to consumers, especially in situations where it believes companies have viewed consumer data as a windfall for their business. Although certain sensitive data transfers may seem profitable, settlement payments, reputational harm, and mandatory privacy obligations will likely outweigh any short-term gains for your business.

The FTC Will Use Its Enforcement Authority Against Domestic And International Companies for Privacy Violations

The FTC's complaint charges that UK-based Avast and two of its subsidiaries, Czech Republic-based Avast Software and U.S.-based Jumpshot operated as a common enterprise that was subject to FTC authority. Significantly, Jumpshot operations were shut down in 2020, so the current FTC privacy obligations for Avast target its operations outside of the United States. Multinational companies should be aware that data practices outside the United States could still fall within FTC authority.

Note

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Securities and Exchange Commission Adopts New Regulation NMS Rules on Tick Sizes, Access Fees, and Market Data

Andre E. Owens, Bruce H. Newman, Stephanie Nicolas, Tiffany J. Smith, and Kyle P. Swan*

In this article, the authors examine new amendments recently approved by the Securities and Exchange Commission to Regulation NMS.

The Securities and Exchange Commission (SEC or Commission) has approved amendments to Regulation NMS (National Market System) (the Amendments)[1] that take several steps intended to narrow bid-ask spreads, reduce transaction costs for investors, and enhance market transparency. Opinions among market participants on how best to achieve these goals—and whether the SEC's adopted approach will realize them—have differed as the Amendments have worked their way through the rulemaking process.

The Amendments will:

- Establish a second minimum pricing increment (or tick size) of $0.005 under Rule 612 of Regulation NMS for quoting "tick-constrained" NMS stocks;
- Reduce the access fee caps under Rule 610 of Regulation NMS from $0.003 (30 mils) per share to $0.001 (10 mils) per share for NMS stocks quoting at or above $1.00 (and from 0.3 percent to 0.1 percent of the quotation price per share for NMS stocks quoting at less than $1.00) and require national securities exchanges to make the amounts of all fees and rebates determinable by market participants at the time of execution; and
- Accelerate the implementation of the "round lot" and "odd-lot information" definitions adopted under the Market Data Infrastructure Rules (MDI Rules)[2] and add information

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about the "best odd-lot orders" (or BOLO) to the definition of "odd-lot information."

For Rule 612, Rule 610, and the "round lot" definition, the compliance date will be the first business day of November 2025. For the "odd-lot information" definition, the compliance date will be the first business day of May 2026.

The Amendments are part of the SEC's ambitious equity market structure overhaul that includes now-adopted amendments to Rule 605 of Regulation NMS as well as proposals for Regulation Best Execution, the Order Competition Rule, and Volume-Based Exchange Transaction Pricing.[3] While many aspects remain unchanged from the SEC's original 2022 proposal,[4] the Amendments largely simplify the proposed rules and depart from them in several key ways, discussed below.

Rule 612: Minimum Pricing Increments

Rule 612 currently requires quotations in NMS stocks priced equal to or greater than $1.00 to have a minimum pricing increment of $0.01. While trades can be executed in finer increments, quotations in NMS stocks generally can be displayed, ranked, or accepted only in increments of $0.01 or greater.

The Amendments simplify the complex framework for Rule 612 that the SEC initially proposed. The SEC's proposed regime would have created four separate tick sizes ($0.01, $0.005, $0.002, and $0.001) for quoting NMS stocks at or above $1.00 based on the time-weighted average quoted spread (TWAQS) over a prescribed one-month "Evaluation Period" where the tick sizes would be reevaluated every three months.

The Amendments will create only one new minimum increment for quoting NMS stocks at or above $1.00, so those stocks will be quoted at minimum increments of either $0.01 or $0.005.[5] Tick sizes still will be determined based on the TWAQS over a prescribed Evaluation Period—any NMS stock with a TWAQS of $0.015 or less will have a minimum quoting increment of $0.005. However, the SEC modified how and how often tick sizes will be reevaluated under the Amendments. The duration of the Evaluation Period used to determine tick sizes was adjusted to three

months instead of one month, and tick sizes will be adjusted every six months instead of every three months.

Notably, the Amendments abandon the controversial notion of a universal trading increment that would have required all trading in NMS stocks (on-exchange or off-exchange) to occur at the same minimum pricing increments as the stock is quoted, subject to limited exceptions. In the Proposing Release, the SEC identified that this proposed change was intended to "level the competitive playing field" between market participants trading on exchanges—where, absent limited exceptions, orders are executed at the same increment at which they are quoted—and off-exchange dealers, which can provide price improvement by executing trades in smaller increments than are available on an exchange.[6] The minimum trading increment would have restricted off-exchange dealers from executing trades in smaller increments than are available through ordinary trading on an exchange, removing an incentive to route orders to off-exchange dealers.

The SEC regards the amended Rule 612 as "only partially address[ing] the competitive dynamic between OTC [over-the-counter] market makers and exchanges and ATSs [alternative trading systems]."[7] As a result, the SEC noted that "Commission staff will continue to monitor sub-penny trading to evaluate whether further action is appropriate for the protection of investors and to assure 'fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets' in the national market system."[8]

Rule 610: Access Fee Caps and Exchange Fee/Rebate Structures

Rule 610 currently sets the maximum fee that a trading center can charge to execute an order against a protected quotation at $0.003 (30 mils) per share for NMS stocks quoted at or above $1.00 (or 0.3 percent of the quotation price per share for NMS stocks under $1.00). The proposal would have lowered access fee caps dependent on the applicable minimum pricing increment—either to $0.001 (10 mils) or $0.0005 (5 mils) per share for NMS stocks quoting at or above $1.00.

The Amendments adopt a $0.001 (10 mils) per share access fee cap for NMS stocks at or above $1.00 regardless of the applicable

minimum pricing increment. The adopted access fee caps are consistent with the proposal, which used a $0.001 (10 mils) per share access fee cap at the $0.01 and $0.005 minimum pricing increments.

Similarly, the Amendments would reduce the access fee caps for NMS stocks quoting at less than $1.00 from 0.3 percent to 0.1 percent of the quotation price per share, which is higher than the proposed access fee cap of 0.05 percent of the quotation price per share. The access fee cap decision was controversial and the subject of debate among the Commission, as Commissioners Hester Peirce and Mark Uyeda expressed concerns about whether a 10 mils access fee cap was optimal or whether another cap (or no cap) might be more appropriate.[9]

The prohibition on national securities exchanges enacting fees, rebates, or other remuneration unless they are determinable at the time of execution remains unchanged from the proposal. While the Amendments would not broadly prohibit volume-based transaction pricing, as the SEC has proposed elsewhere,[10] they will change the way in which many exchanges calculate fees and rebates today. For example, to be determinable at the time of execution, a fee and rebate structure that relies on trading volume would have to rely on historical trading volume or other contemporaneously ascertainable metrics instead of future trading volume.[11]

Acceleration of MDI Rules Implementation

The parts of the MDI Rules implementation that were accelerated under the Amendments will result in the exclusive securities information processors (SIPs) collecting, consolidating, and disseminating new and additional data within the national market system. The accelerated MDI Rules define “round lot” (which today is typically 100 shares) with respect to NMS stocks as 1, 10, 40, or 100 shares based on the stock’s average closing price and incorporate into core data disseminated by the exclusive SIPs information about odd-lot orders (orders smaller than a round lot), including odd-lot orders at or better than the national best bid/offer (NBBO) and BOLO.

The MDI Rules implementation is proceeding largely as proposed, with some minor modifications intended to facilitate the implementation process by the exchanges and the SIPs. In particular, the SEC modified the proposed implementation schedule

for the definitions of "round lot" and "odd-lot information" by extending the compliance deadlines to the first business days of November 2025 and May 2026, respectively, to provide more time to operationalize the changes than in the 2022 proposal, which provided a substantially shorter time frame.[12]

Additionally, the Amendments revise the "round lot" definition to require semiannual rather than monthly adjustments to a stock's round lot size by defining a round lot Evaluation Period and by specifying an operative period for that size that aligns the dates for assigning round lots to the dates for assigning minimum pricing increments under Rule 612.

Dissemination of odd-lot information will provide the market with new data points on smaller orders that could inform trading and order routing decisions. However, reiterating a point from the adoption of the MDI Rules, the SEC clarified that while odd-lot information "may be relevant to broker-dealers' best execution analyses and, in many cases, will facilitate the ability of broker-dealers to achieve best execution for their customer orders, the Commission . . . is not setting forth minimum data elements needed to achieve best execution[.]"[13]

Conclusion

While the Amendments are in many ways a scaled-back version of what the SEC described in the Proposing Release, many facets of the original proposal remain that represent a considerable departure from the existing market structure. These changes will likely impact market liquidity within the NBBO, will change the economics of market participants' businesses, and may alter the existing balance between on-exchange and off-exchange trading. Market participants should keep an eye out for further changes to market structure remaining on the SEC's rulemaking agenda, including further consideration and potential adoption of the Order Competition Rule, Regulation Best Execution, and Volume-Based Exchange Transaction Pricing for NMS Stocks.[14]

Notes

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wilmerhale.com, stephanie.nicolas@wilmerhale.com, tiffany.smith@wilmerhale.com, and kyle.swan@wilmerhale.com, respectively.

1. See Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, (Sept. 18, 2024), https://www.sec.gov/files/rules/final/2024/34-101070.pdf (Adopting Release).

2. Market Data Infrastructure, 86 Fed. Reg. 18596 (Apr. 9, 2021).

3. See Volume-Based Exchange Transaction Pricing for NMS Stocks, 88 Fed. Reg. 76282 (Nov. 6, 2023).

4. See Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, 87 Fed. Reg. 80266 (Dec. 29, 2022) (Proposing Release).

5. The minimum pricing increment for NMS stocks priced at below $1.00 remains unchanged.

6. Proposing Release at 80273.

7. Adopting Release at p. 85.

8. Id. The Adopting Release also mentions exchange retail liquidity programs that permit on-exchange trading at increments as small as $0.001 but acknowledges that they have not attracted significant volume. See Adopting Release at p. 251.

9. See Comm'r Hester M. Peirce, "My Take on Tick: Statement on Adoption of Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders" (Sept. 18, 2024), https://www.sec.gov/newsroom/speeches-statements/peirce-statement-regulation-nms-091824; see also Comm'r Mark T. Uyeda, "Statement on Adoption of Rule Regarding Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders" (Sept. 18, 2024), https://www.sec.gov/newsroom/speeches-statements/uyeda-statement-regulation-nms-091824.

10. See Volume-Based Exchange Transaction Pricing for NMS Stocks, 88 Fed. Reg. 76282 (Nov. 6, 2023).

11. See Adopting Release at pp. 156-57.

12. See Adopting Release at p. 23.

13. See Adopting Release at p. 209.

14. See SEC, Agency Rule List—Spring 2024, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode&showStage=active&agencyCd=3235.

Tribal General Welfare Exclusion Proposed Regulations Are an Overdue Win for Indian Country

Kenneth W. Parsons and Rachel T. Provencher*

In this article, the authors discuss long-awaited proposed regulations on the Tribal General Welfare Exclusion Act of 2014 released recently by the U.S. Department of the Treasury and Internal Revenue Service, which reflect many priorities of Indian Country, including substantial deference to Tribes as they create and implement general welfare exclusion programs. However, the authors add, work remains to improve clarity of the guidance and address unresolved issues.

The U.S. Department of the Treasury and the Internal Revenue Service (IRS) have issued Proposed Regulations on the Tribal General Welfare Exclusion Act of 2014 (the Act).[1] The Proposed Regulations are an overdue win for Indian Country, demonstrating the value of meaningful Tribal consultation and the importance of the work of the Treasury Tribal Advisory Committee (TTAC), for which general welfare exclusion (GWE) guidance was a key issue. The Proposed Regulations are one of several Tribal tax guidance projects prioritized during the impactful tenure of the first Native American Treasurer of the United States, Chief Lynn Malerba, and the first director of the Treasury Department's recently established Office of Tribal and Native Affairs, Fatima Abbas.

Throughout the Proposed Regulations and Preamble, the Treasury Department and IRS express a willingness to largely defer to Tribes in their formation and implementation of GWE programs. The Treasury Department and IRS also incorporated several of the recommendations they received from the TTAC, as well as feedback from Tribes on how the Act should be implemented through regulations.

However, as further discussed below, there is still work to be done. The Treasury Department and IRS did not agree with all of the recommendations they received from the TTAC and Tribes and

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left ambiguities in the Proposed Regulations that Tribes should help resolve before the guidance is finalized.

What Is the GWE?

Although taxpayers must generally include all items of income when computing gross income, the IRS has long recognized an exception for Tribal members who receive Tribal government program benefits for the promotion of general welfare and not as compensation for services. However, questions as to where the line was between taxable distributions and nontaxable general welfare benefits led to disputes between Tribal governments and the IRS. In order to minimize controversies, the IRS agreed to consult with Tribal governments and issue more tailored guidance, which culminated with Revenue Procedure 2014-35,[2] also known as the IRS Safe Harbor, in June 2014.

The Revenue Procedure offers a series of safe harbors applicable to specific types of Tribal programs under which the IRS will presume that the program is "for the promotion of the general welfare." In addition, the Revenue Procedure describes specific types of qualifying benefits, including elder and disabled programs, education programs, housing programs, burial and funeral assistance, and certain other qualifying assistance programs.

The Act created Internal Revenue Code Section 139E (Section 139E), which includes similar requirements to those found in the Revenue Procedure, although the Act was intended to be broader than the IRS Safe Harbor and applies to any Tribal benefit for the promotion of general welfare.

Under both the IRS Safe Harbor and the Act, benefits are excluded from income—and tribes do not issue Form 1099s—if a program meets certain requirements, including:

- The benefits provided are available to all Tribal members who meet the eligibility requirements in the program's guidelines,
- Distribution of benefits does not discriminate in favor of the Tribe's governing body,
- The benefits are not compensation for services, and
- The benefits are not lavish or extravagant.

The Act imposed a moratorium on IRS audits of GWE issues. Prior to resuming audits, the Treasury Department must issue final guidance, as well as provide training and education on the guidance to IRS field agents and Tribal finance officers. The Act requires this training and education to be done in consultation with the TTAC.

What Has Happened Since the Act Was Passed?

Over the past decade, several steps have been taken toward the issuance of these Proposed Regulations, including soliciting and receiving feedback from Tribes and Tribal leaders:

- *Treasury Tribal Advisory Committee*. Establishment of the TTAC was mandated by the Tribal General Welfare Exclusion Act of 2014. The purpose of the TTAC is to advise the Treasury Secretary and IRS on matters relating to the taxation of Indians, training of IRS field agents, and provision of training and technical assistance to Tribal financial officers. The TTAC held its first public meeting on June 20, 2019.
- *IRS Notice 2015-34*. On April 16, 2015, the IRS issued Notice 2015-34,[3] which states that Section 139E of the Internal Revenue Code codifies, but does not supplant, the GWE and that taxpayers may continue to rely on the Revenue Procedure. The IRS also notes that the Revenue Procedure is broader than Section 139E in some respects and, for benefits described in the safe harbors, provides certainty that the "need requirement" of the GWE is satisfied.
- *TTAC's Tribal GWE Subcommittee*. In 2019, the TTAC established the GWE Subcommittee, which is charged with providing the TTAC recommendations on (1) implementation of the substantive provisions of the Act, and (2) implementation of the training provisions set forth in the Act.
- *Subcommittee Report*. The GWE Subcommittee solicited feedback from Tribes on an initial set of core principles for the GWE and surveyed Tribes on their general welfare programs. The GWE Subcommittee then prepared a GWE Subcommittee Report[4] and its version of proposed regulations (TTAC Proposed Regulations). These documents

contain recommended guidance to the Treasury Department and IRS on various aspects of the interpretation and implementation of the GWE. On June 16, 2021, the GWE Subcommittee submitted the GWE Subcommittee Report and TTAC Proposed Regulations to the Treasury Department. The TTAC referred these documents to the Treasury Department on October 26, 2022, for Tribal consultation and comment.

- *Dear Tribal Leader Letter*. On October 27, 2022, the Treasury Department issued a Dear Tribal Leader Letter[5] announcing consultations and soliciting comments on the Act, GWE Subcommittee Report, and TTAC Proposed Regulations. The Dear Tribal Leader Letter also requested responses to certain questions related to the interpretation of particular provisions of Section 139E. In response to the Dear Tribal Leader Letter, the Treasury Department received 65 written comments from Tribes and two Tribal organizations (Tribal Comments).
- *Consultation Process*. On December 14-16, 2022, the Treasury Department hosted Tribal consultations on the Act, the GWE Subcommittee Report and TTAC Proposed Regulations. The Treasury Department and IRS also consulted with the TTAC and GWE Subcommittee throughout 2023 and 2024.

What Are Key Features of the Proposed Regulations?

- *Benefits Must Be for the Promotion of the General Welfare*. The Preamble provides that an Indian Tribal government is in the best position to determine which general welfare benefits are best suited to meet the needs of its Tribal members and other eligible individuals. The Proposed Regulations would provide that an Indian Tribal government has sole discretion to determine whether a benefit is for the promotion of general welfare and that the IRS will defer to the Indian Tribal government's determination that a benefit meets this requirement.
- *Definition of Tribal Program Participant*. The Preamble states that the Treasury Department and IRS agreed with

the GWE Subcommittee report and Tribal Comments that an expansive definition of eligible individuals to receive Tribal general welfare benefits is appropriate. The definition in Proposed Regulation Section 1.139E-1(b)(8) is intended to encompass the categories of "qualified nonmember" that are covered by Revenue Procedure 2014-35, with the clarification that a spouse may be a spouse under applicable Tribal law.

- *Program Must Be Established Under Specified Guidelines*. The Proposed Regulations would provide that a GWE program must include, at a minimum:
    1. A description of the program to provide Tribal general welfare benefits,
    2. The benefits provided by the program, including how benefits are determined,
    3. The eligibility requirements for the program, and
    4. The process for receiving benefits under the program.

  The Treasury Department and IRS agreed with the GWE Subcommittee Report and Tribal Comments that Section 139E does not require the specified guidelines of the program to be memorialized in a written document. However, several features in the Proposed Regulations incentivize Tribal governments to put their GWE programs in writing.
- *No Limitation on Source of Funds*. The Preamble confirms that the Treasury Department and IRS agree with the GWE Subcommittee Report and Tribal Comments that Section 139E does not prohibit an Indian Tribal government from funding a general welfare program with net gaming revenues or revenues from any other particular source. Proposed Regulation Section 1.139E-1(c)(5) would provide that benefits under the Indian Tribal government program may be funded by any source of revenue or funds, including net gaming revenues. However, gaming Tribes with a Revenue Allocation Plan (RAP) should ensure that their GWE programs are consistent with the terms of their RAP. Under the Indian Gaming Regulatory Act (IGRA), per capita distributions of gaming revenue are subject to tax. The Proposed Regulations do not change this rule.
- *Benefits Cannot Be Lavish or Extravagant*. The Proposed Regulations offer deference to Tribes and incorporate

a presumption that a written GWE program is not lavish or extravagant. Under Proposed Regulation Section 1.139E-1(d)(4), whether a benefit is lavish or extravagant would be based on the facts and circumstances at the time the benefit is provided. Relevant facts and circumstances would include a Tribe's culture and cultural practices, history, geographic area, traditions, resources, and economic conditions or factors.

- *Participation in Cultural or Ceremonial Activities*. The Treasury Department and IRS generally agreed with Tribal Comments regarding ceremonial activities under Section 139E(c)(5). Proposed Regulation Section 1.139E-1(e) would provide deference to Indian Tribal governments on whether an activity is a cultural or ceremonial activity for the transmission of Tribal culture.

Although recommend by the GWE Subcommittee Report and Tribal Comments, the Proposed Regulations do not address grants to Indian-owned enterprises or trust arrangements (such as minor's trusts) with deferred benefits.

Public Comments

The Treasury Department and IRS requested comments on all aspects of the Proposed Regulations and specifically the following four issues:

1. Should additional examples be included in the final regulations and, if so, what specific fact patterns or rules should be addressed by the additional examples?
2. Should Revenue Procedure 2014-35 be obsoleted when the final regulations become applicable? If not, why is there a continuing need for it after the publication of final regulations?
3. Do Indian Tribal governments anticipate needing any transition relief to adjust existing general welfare programs to satisfy these Proposed Regulations before they are finalized? If yes, please explain the nature of the transition relief needed and provide recommendations as to what relief would be helpful to Indian Tribal governments.

4. Is additional guidance needed under Section 139E or other Internal Revenue Code sections to address the tax treatment of deferred benefits or benefits paid from trust arrangements and, if so, what specific fact patterns should be addressed?

Next Steps

The GWE offers a unique opportunity for Tribes to provide important benefits to members without creating a tax liability. Tribes should consider developing new GWE programs or revising existing ones to incorporate the flexibility and other favorable features of the Proposed Regulations. Although the guidance is not final, Tribal governments are free to utilize aspects of the Proposed Regulations that they find helpful.

Takeaways

- In the absence of GWE guidance, over the past 10 years, many Tribes have charted their own path by creating and administering GWE programs through various approaches. These approaches have included application-based programs such as housing, equal GWE distributions, and hybrid programs that combine elements of both. The Proposed Regulations largely validate these approaches.
- The Treasury Department and IRS have substantially improved on elements of the IRS Safe Harbor such as by providing complete deference to Tribes for the determination of whether a program "promotes the general welfare." This provides clear flexibility for Tribal governments to establish programs outside of the IRS Safe Harbor.
- Since 2014, arguably the most significant question on GWE implementation has been how the Treasury Department would handle the "lavish or extravagant" requirement. Tribal governments were adamant in their comments that the standard needs to be flexible and provide great deference to Tribal governments. In response to these comments, the Proposed Regulations create a presumption that a written GWE program is not lavish or extravagant. This is a standard very favorable to Tribal governments.

However, the Proposed Regulations are unclear how—if at all—the Treasury Department and IRS could rebut this presumption. This will be a critical issue to be resolved in the final regulations and in the training of IRS agents.

- Although the Proposed Regulations represent a positive development for Indian Country, issues remain. For instance, the substantiation requirements are unclear. The Proposed Regulations also do not address trusts. Guidance on trusts is critical as Tribes move away from distribution structures that are solely focused on per capita payments. For example, the most recent public guidance on minor's trusts is Revenue Procedure 2011-56,[6] which addresses only IGRA trusts. This guidance is in need of modernization not only due to GWE but because of the diversification of Tribal economies beyond gaming.
- The TTAC and GWE Subcommittee will work with the Treasury Department and IRS to improve the guidance before it is finalized.
- The Proposed Regulations do not change the federal income tax treatment of per capita distributions of gaming revenue. Tribal governments may need to explore RAP amendments to help ensure that their GWE programs comply with IGRA.
- The Proposed Regulations also do not address the treatment of GWE benefits for Supplemental Security Income, Medicaid, Supplemental Nutrition Assistance Program, and other public benefits such as those administered by the U.S. Department of Housing and Urban Development and U.S. Department of Veterans Affairs. These programs often determine eligibility using income tests that do not exclude GWE. Although workaround solutions may be available, they are imperfect and impermanent. A legislative solution[7] may be required.

Notes

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2. https://www.irs.gov/pub/irs-drop/rp-14-35.pdf.
3. https://www.irs.gov/pub/irs-drop/n-15-34.pdf.

4. https://home.treasury.gov/system/files/226/GWE_Subcommittee_Report_October2022.pdf.

5. https://home.treasury.gov/system/files/226/DTLL-GWE-Tribal-Consultation-Notice.pdf.

6. https://www.irs.gov/pub/irs-drop/rp-11-56.pdf.

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Federal Agencies Begin to Implement the Financial Data Transparency Act

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In this article, the authors explain that the Financial Data Transparency Act specifies a timeline for a series of rulemakings by the federal financial regulators over the next two-and-one-half years, and that affected entities may want to start paying attention now.

As directed by Congress in the Financial Data Transparency Act (FDTA or the Act), nine federal financial regulators[1] have proposed standards for making the data they collect "machine readable"; that is, specially coded so a computer can process it without human intervention.[2] The agencies are further directed to "seek to promote inter-operability" of the data; that is, make it capable of being collated and analyzed across agencies.

Once fully implemented, the data standards will affect publicly traded companies, regulated financial institutions, and other entities that file reports with or otherwise submit information to the federal financial regulators and, in some cases, self-regulatory organizations.

Depending on the standards ultimately chosen, the resulting reporting burden will increase, potentially substantially, for some entities. And, if the Securities and Exchange Commission's (SEC) machine-readable data project is any guide, there will likely be lingering data quality issues.

The Act specifies a timeline for a series of rulemakings over the next two-and-one-half years; affected entities may want to start paying attention now.

The Financial Data Transparency Act

Congress passed the FDTA as part of a much larger defense funding bill in December 2022.[3] The FDTA amends the Financial

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Stability Act of 2010 (Title I of the Dodd-Frank Act) to improve data collection and use for the Financial Stability Oversight Council by requiring the agencies to jointly adopt data standards. It also amends the organic statutes of the respective agencies, directing them to implement the joint data standards for their own "collections of information."

Although some agencies, like the SEC, have already begun to require some data they collect to be machine readable, the Act directs the SEC to vastly expand the universe of such data, including information submitted to the Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board.

Finally, to the extent an agency has identified "open data assets"—data it collects and makes available to the public—the Act directs each agency to make that information freely downloadable, rendered in human-readable format, and accessible in a form that enables two or more software programs to use the data.

What's in the Current Joint Rulemaking?

The current rulemaking has two components. First, the agencies propose "common identifiers" for commonly used critical data—legal entities, financial instruments, dates, locations, and currency. These are the digital building blocks for identifying relationships in the financial regulatory ecosystem and, hopefully, risks.

Second, the agencies propose four principles to guide the adoption of any data standard. Those principles are:

1. Data should be fully searchable and machine readable,
2. The standard should clearly define the data element and its relationship to other data elements,
3. Data should be consistently identified in accordance with its regulatory requirement, and
4. The data standard should be non-proprietary or available under an open license.

The joint rulemaking will not create any new reporting requirements. (Indeed, the Act specifies that it does not create any obligation to collect more information than was collected before the Act passed.) However, any entity subject to these requirements will want to pay attention to how the rulemaking develops, as new data

standards will likely change how such entities collect and report data to their regulators.

What Happens After This Rulemaking?

Once the nine agencies settle on joint data standards, each agency is directed to "incorporate, and ensure compatibility with (to the extent feasible)" the joint data standards for the information it collects under its regulatory regime. The Act gives agencies some flexibility to tailor their own rules to scale them for smaller entities and minimize disruptive changes.

These agency-specific rules must take effect within two years of the joint agency standards being finalized. This two-year period will require entities that submit information to financial regulators to monitor the rulemakings, participate as appropriate, and begin the process of evaluating and modifying their reporting systems as necessary.

Notes

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1. The nine agencies are Commodity Futures Trading Commission, Office of the Comptroller of the Currency, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Board of Governors of the Federal Reserve System, National Credit Union Administration, Securities and Exchange Commission, and Department of the Treasury.

2. Financial Data Transparency Act Joint Data Standards, 89 Fed. Reg. 67890 (Aug. 22, 2024), https://www.govinfo.gov/content/pkg/FR-2024-08-22/pdf/2024-18415.pdf.

3. Pub. L. No. 117-263, 136 Stat. 3421 (2022).

The End of *Chevron* Deference Could Spell Trouble for the Environmental Protection Agency PFAS "Hazardous Substance" Rule

Reza Zarghamee and Steve R. Brenner*

In this article, the authors explain how a recent decision by the U.S. Supreme Court could affect the Environmental Protection Agency's PFAS hazardous substance designation.

A recent Supreme Court ruling could further jeopardize the Environmental Protection Agency's (EPA's) per- and polyfluoroalkyl substances (PFAS) hazardous substance designation, as the agency is attempting to advance a novel use of delegated legislative authority to further regulate PFAS chemicals.

On June 28, 2024, the Supreme Court issued its opinion in *Loper Bright Enterprises v. Raimondo*,[1] overturning the long-standing doctrine known as "*Chevron* deference." *Loper Bright* substantially expands the ability of federal courts to review and reject federal agencies' interpretation of statutes.

Not two months before the Court issued its decision in *Loper Bright*, the EPA published its long-awaited rule (the Final Rule) designating two PFAS compounds, perfluorooctanoic acid (PFOA) and perfluorooctanesulfonic acid (PFOS), as "hazardous substances" under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

The Final Rule has significant immediate impacts, but is also novel in a legal sense: The Final Rule marks the first time that the agency has designated a hazardous substance using its authority under Section 102(a) of CERCLA.

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Chevron Deference and *Loper Bright*, Explained

The principle of agency deference overturned by *Loper Bright* originated 40 years ago in *Chevron USA, Inc. v. Natural Resource Defense Council*.[2] In attempting to resolve statutory ambiguity concerning the meaning of a regulated "source" under the Clean Air Act, the Supreme Court created a simple, two-step test for federal courts reviewing agency interpretations of statutes.

First, courts should assess whether the text of the statute reveals that Congress has explicitly and unambiguously addressed the question at issue. If not, and the statute is ambiguous, courts must defer to the agency's interpretation so long as the agency's interpretation is reasonable. The Supreme Court reasoned that federal judges are not experts in the technical regulatory matters that face administrative agencies, nor are judges as accountable to the public as agencies that are part of the executive branch.

Since the Supreme Court issued this opinion in 1984, *Chevron* deference has allowed administrative agencies to consider the scope of their delegated powers from Congress with greater flexibility. *Chevron* has been cited by federal courts very often and has served as a basis for upholding countless federal regulatory efforts, ranging from cases involving the Social Security Administration,[3] to the Immigration and Naturalization Service,[4] to, of course, EPA.[5]

Writing for the majority in *Loper Bright*, Chief Justice John Roberts characterized *Chevron* as "fundamentally misguided" and "unworkable," primarily because federal courts have long struggled to assess what exactly constitutes "ambiguity" and thus preventing the judiciary from adequately interpreting federal law. The Court also rejected the idea that the technical expertise of agencies requires deference in interpreting ambiguous statutes, finding instead that federal courts are best suited to this task because it is the fundamental job of the courts to decide legal questions by applying their own independent judgment.

The Court also instructed federal courts to return pre-*Chevron* framework: *Skidmore* respect. Based on *Skidmore v. Swift & Co.*,[6] *Skidmore* instructs federal courts to give weight and consideration to the reasoned, technical judgments of agencies. Federal courts, however, are still free to reject an agency's interpretation if, in the court's view, that interpretation is not the best interpretation of the statute at issue.

Implications for PFAS Regulations

EPA's designation of PFOA and PFOS as hazardous substances under CERCLA is already facing a challenge from industry trade associations at the U.S. Court of Appeals for the District of Columbia Circuit.[7] In a non-binding statement of issues for the Court to consider, petitioners indicated their intent to press the statutory interpretation question of "[w]hether EPA erroneously interpreted CERCLA when designating PFOA and PFOS as hazardous substances."

Comments to EPA's proposed rule indicate the precise subjects of these rulemaking challenges. For example, a conglomeration of oil and gas trade groups contested EPA's interpretation of Section 102(a), which authorizes EPA to "promulgate and revise as may be appropriate, regulations designating as hazardous substances . . . elements, compounds, mixtures, solutions, and substances which, when released into the environment may present substantial danger to the public health or welfare or the environment."

Specifically, commenters argued that EPA's criteria for evaluating whether a chemical or substance poses a "substantial danger to public health or welfare" was vague and not adequately defined in the Final Rule.

EPA's response to these comments reveal that the agency believes it is entitled to a degree of deference in making hazardous substance designations. In the preamble to the Final Rule, the agency defended its interpretation by noting that "EPA is taking final action . . . after considering the available scientific and technical information and after considering comments on the proposed determination. Available information indicates that human exposure to PFOA and/or PFOS is linked to a broad range of adverse health effects."[8] The groups challenging the rule will likely argue in response that EPA is making the same error that the Supreme Court observed from federal agencies in Loper Bright; EPA has not promulgated judicially manageable or anything resembling a firm standard to support its interpretation of the phrase "may present substantial danger to public health or welfare of the environment." A court reviewing the Final Rule could very well still defer to EPA's understanding of the scientific and public health literature on the impacts of PFAS chemicals and uphold the rule. But in a post-*Chevron* landscape, the reviewing court is also more likely to invalidate EPA's approach and vacate the Final Rule.

It remains to be seen how the District of Columbia Circuit Court, or other reviewing courts, will review EPA's interpretation of CERCLA and other environmental statutes in light of *Loper Bright*. Regardless, EPA stands to continue its push to further regulate PFAS chemicals, in keeping with the Biden Administration's PFAS Strategic Roadmap.[9]

Notes

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1. Loper Bright Enterprises v. Raimondo, 603 U.S. ___ (2024).
2. Chevron USA, Inc. v. Natural Resource Defense Council, 467 U.S. 839 (1984).
3. Barnhart, Commissioner of Social Security v. Walton, 535 U.S. 212 (2002).
4. Immigration and Naturalization Service v. Cardoza-Fonseca, 480 U.S. 421 (1987).
5. Entergy Corp. v. Riverkeeper, Inc., 556 U.S. 208 (2009).
6. Skidmore v. Swift & Co., 323 U. S. 134 (1944).
7. See Chamber of Com. et al. v. EPA, D.C. Cir., No. 24-01193 (Filed Jun. 10, 2024).
8. 89 Fed. Reg. 39125.
9. https://www.epa.gov/pfas/pfas-strategic-roadmap-epas-commitments-action-2021-2024.

What's Next After the Private Fund Adviser Rules?

Robin Bergen and Rachel Gerwin*

In this article, the authors explore the implications of a recent decision by a federal circuit court of appeals vacating all of the Private Fund Adviser rules issued by the Securities and Exchange Commission.

In a highly awaited opinion,[1] the U.S. Court of Appeals for the Fifth Circuit vacated all of the Securities and Exchange Commission's (SEC) Private Fund Adviser Rules (PFAR), agreeing with industry trade associations that the SEC lacked the necessary statutory authority to adopt PFAR.

The initial question following the opinion was whether the SEC would appeal or seek judicial review of the Fifth Circuit's panel decision, particularly given the priority SEC Chair Gary Gensler placed on PFAR and the considerable resources the SEC devoted to it. The SEC, however, did not appeal the decision.

What Questions Still Remain?

Since PFAR's adoption in August 2023 and the filing of the lawsuit, many private fund sponsors had been focused on the two looming questions: What would be the outcome of the litigation? And how should firms go about preparing for compliance in light of the litigation?

The Fifth Circuit's decision has reshaped the most salient questions for the industry, which we now think of as:

- What aspects of PFAR may survive the outcome, even with the rules themselves vacated?
- What might the Fifth Circuit's decision mean for other pending and effective SEC rules?

In considering the second question in particular, it is worth exploring the issue of statutory authority and its direct effects on SEC rulemaking.

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Statutory Authority: A Closer Look

When the SEC proposed and adopted PFAR, it identified two sources of statutory authority for its rulemaking:

1. The Advisers Act Section 206(4)—the anti-fraud provision; and
2. Dodd-Frank Section 913—focusing on the SEC's authority to enact rules for the protection of customers and investors. (Section 211(h) of the Advisers Act was added pursuant to Section 913 of Dodd-Frank.)

One of the industry associations' central arguments in the litigation was that neither of these statutes in fact gave the SEC the requisite authority to adopt PFAR.

Statutory Authority: The Fifth Circuit's View

The Fifth Circuit agreed with the industry associations, and vacated PFAR in full based on its determination that the SEC lacked authority under either statute to adopt PFAR.

- The court stated that Section 913 "of Dodd-Frank . . . applies to 'retail customers,' not private fund investors. It has nothing to do with private funds."
  - As a result, the SEC cannot promulgate rules under Section 211(h) of the Advisers Act that would regulate the activities of private funds and the relationships between advisers and those funds.
- The Fifth Circuit noted that Section 206(4) of the Advisers Act "specifically requires the [SEC] to 'define' an act, practice, or course of business that is 'fraudulent, deceptive, or manipulative' before the [SEC] can prescribe 'means reasonably designed to prevent' such act, practice, or course of business."
  - Because the SEC "fail[ed] to explain how the Final Rule would prevent fraud," its "vague assertions" regarding observations of fraudulent adviser misconduct "[fell] short of the definitional specificity that Congress has required."

Statutory Authority: Implications for Other Rules

The Fifth Circuit's broad and strongly worded language on the limits of the SEC's statutory authority may present challenges for some pending Advisers Act rules absent of major changes from the versions that the SEC proposed.

In particular:

- The Fifth Circuit's determination that Section 211(h) of the Advisers Act was intended by Congress for the protection of retail and not private fund investors directly undercuts the statutory authority cited by the SEC in recent proposals; and
- Section 206(4) anti-fraud is a source of authority frequently cited by the SEC in Advisers Act rules, and the Court specifically held that the SEC cannot use anti-fraud as a mere "pretext" for rulemaking.

Reviewing the pending Advisers Act rules that remain on the SEC's agenda (as outlined in Table 1), we note that four proposals cite to these same subsections (211(h) and 206(4)), and therefore appear susceptible to the same challenges brought by the industry and defects identified by the Fifth Circuit.

Table 1. Pending Advisers Act Rules

Rule	Statutory Authority (Advisers Act)	Proposal Date	Proposal Components
Predictive Data Analytics	Sections 204, 211(a), 211(h)	July 2023	• New Rule 211(h)(2)-4 (conflicts of interest), and • Amendments to Rule 204-2 (Books and Records)
Safeguarding	Sections 203, 204, 206(4), 211(a), 223	February 2023	• Proposed new Rule 223-1, redesignates existing Rule 206(4)-2 (Custody Rule)
Outsourcing	Sections 203, 204, 206(4), 211(a), 211(h)	October 2022	• New Rule 206(4)-11 (service providers), • Amendments to Rule 204-2 (Books and Records), and • Amendments to Form ADV
Adviser ESG Disclosure	Sections 203, 204, 211	May 2022	• Amendments to Form ADV
Adviser Cybersecurity	Sections 203, 204, 206(4), 211(a), 211(h)	February 2022	• New Rule 206(4)-9 (cybersecurity policies and procedures), • New Rule 204-6 and Form ADV-C (reporting “significant” cybersecurity incidents to SEC), and • Amendments to Rules 204-2 (Books and Records) and 204-3 (Brochure Rule)

Predictive Data Analytics and Safeguarding Will Be Re-Proposed

Predictive Data Analytics

The SEC's proposal relied on Section 211(h) as authority for a new conflicts rule that would apply to private fund (and other registered) advisers.[2] This rule likely will be the most difficult for the SEC to justify in the wake of the PFAR decision.

That said, Chair Gensler emphasized repeatedly during his tenure that the regulation of artificial intelligence usage in capital markets—and addressing the threat that conflicts of interest relating to digital engagement practices pose to investors—are essential. Shortly following the PFAR decision, he suggested that the SEC plans to re-propose Predictive Data Analytics rather than move right to a final version.[3]

What might the new version look like? The new proposal could rely on Section 211(h) but apply only to advisers' interactions with retail customers—not to private funds themselves or to investors in such funds. The new proposal could also include amendments to, or rules under, the recordkeeping and/or anti-fraud provisions that apply to all registered advisers (for recordkeeping rules) and all advisers (for 206(4) rules). For a new rule under 206(4), the SEC would need to include clear descriptions of a well-defined fraud that the rule is meant to address.

The SEC may also take the opportunity to fix other widely noted concerns with the original proposal, including the overbroad definition of "covered technology" and the novel, undefined concept of "neutralizing" a conflict of interest.

Safeguarding

The Safeguarding Rule, by contrast, is one that we think would be able to move forward under the same statutory authority (Sections 203, 204, 206(4), 211(a), and 223) as the original proposal. But because other aspects of the proposal—including numerous practical issues that commenters identified—are likely to require substantive changes, Chair Gensler has previewed that the SEC plans to re-open the comment period or re-propose the rule.

The Safeguarding Rule is intended to replace the existing Advisers Act Custody Rule, a well-established anti-fraud rule

under Section 206(4). In the proposing release, the SEC included a substantial amount of discussion and examples of fraudulent conduct—including references to Madoff—to support continued authority under Section 206(4).[4]

To strengthen the nexus between the existing Custody Rule and the new Safeguarding Rule, the SEC may drop its plans to renumber the Rule (as Rule 223-1) and move it forward as an amended version of the existing Custody Rule (206(4)-2).

Outsourcing, Adviser ESG Disclosure, and Cybersecurity

Outsourcing

The Outsourcing Rule was also proposed under Section 206(4) and prohibits advisers from retaining service providers to perform certain functions without conducting prescribed due diligence and ongoing monitoring.[5] But unlike the Safeguarding Rule, the SEC seemed to struggle in the Outsourcing Rule's proposing release to articulate and provide substantial evidence of the fraud that the proposal was designed to address.

With the Fifth Circuit so clearly denouncing "vague assertions" from the SEC regarding fraudulent adviser conduct as justification for anti-fraud rulemaking, the SEC would need to demonstrate that reliance on Section 206(4) for the Outsourcing Rule is not merely a pretext to introduce substantive diligence and monitoring requirements that the SEC thinks would constitute better business practices.

Some alternatives the SEC could consider would be to shift from new conduct requirements to investor disclosure requirements regarding risks associated with the use of service providers, including concentration risk and the possibility of operational or compliance gaps, or to focus on books and records relating to the use and ongoing oversight of service providers.

Adviser ESG Disclosure

As the name suggests, the Adviser ESG (environmental, social, and governance) Disclosure proposal would create new disclosure

obligations for registered advisers on their Form ADV filings and brochures.[6]

Although Chair Gensler has often stated his desire to combat "greenwashing" in the investment management industry, Adviser ESG Disclosure was not proposed as an anti-fraud rule. The SEC relied on Sections 203 and 204 (along with Section 211, but not 211(h)), which provide broad authority to require disclosure of business practices—authority that remains intact.

The proposal has been criticized by commenters for the over-inclusive ESG product characterization framework that it would create, but this may be a relatively straightforward issue for the SEC to address in a final version.

Cybersecurity

The Fifth Circuit's opinion in PFAR may also pose less of an obstacle to the SEC's ability to finalize the Adviser Cybersecurity rules.

The Adviser Cybersecurity proposal includes a new Rule 206(4)-9 requiring advisers to adopt and maintain cybersecurity policies and procedures as well as a series of disclosure requirement rules under Section 204 and a new "Form ADV-C" for reporting to the SEC (but not the public) any significant cybersecurity event.[7]

If the SEC moves to finalize these rules, it will likely focus on defining more precisely what the fraud is—as opposed to what external threats from third-party bad actors may exist—that the Rule is designed to address.

The SEC finalized a set of cybersecurity disclosure rules for public companies in July 2023, and so the SEC may decide to narrow the set of final Adviser Cybersecurity rules to ones mandating disclosure and reporting.

Statutory Authority: What About the Marketing Rule?

The Marketing Rule was adopted under 206(4) and has some similar concepts to PFAR, such as granular requirements for performance presentations. However, a successful challenge seems unlikely as:

- The Marketing Rule's adopting release cited evidence of allegedly fraudulent misconduct by advisers in the advertising context.
- The Rule was adopted as a new, combined version of the preexisting Advertising Rule and Cash Solicitation Rule, both of which had been in effect for decades and were established parts of adviser compliance programs.

We expect to see a continued focus by the SEC staff on compliance with the Marketing Rule, as suggested by a recent Risk Alert from the Division of Examinations and staff guidance in the form of FAQs. The Risk Alert highlighted observations from SEC examination staff on advisers' compliance with the Marketing Rule-related items of Form ADV, Rule 206(4)-7 (the Compliance Rule), and Rule 204-2 (the Books and Records Rule), as well as the Marketing Rule's prohibitions and requirements relating to the substance of advertisements. In other words, the SEC took the opportunity to note adviser compliance issues relating to disclosure, policies and procedures, recordkeeping, and fraud (such as performance presentations that misled investors), thereby supporting its ongoing justification for the rule.

Notes

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1. National Association of Private Fund Managers et al. v. Securities and Exchange Commission (June 5, 2024).

2. See Release No. IA-6353, Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (Aug. 9, 2023).

3. See, e.g., "SEC's Gensler Rethinking AI Advising, Crypto Custody Regs" (June 13, 2024), https://www.law360.com/securities/articles/1847615.

4. See Release No. IA-6240, Safeguarding of Client Assets (Mar. 9, 2023).

5. See Release No. IA-6176, Outsourcing by Investment Advisers (Nov. 16, 2022).

6. See Release No. IA-6034, Enhanced Disclosure by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (June 17, 2022).

7. See Release No. IA-5956, Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies (Mar. 9, 2022).

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