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Investment Management

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Regulatory Update and Recent SEC Actions

REGULATORY UPDATES

William Birdthistle Named Director of Division of Investment Management

On December 21, 2021, the Securities and Exchange Commission ("SEC") announced the appointment of William A. Birdthistle as director of the Division of Investment Management. Prior to his appointment, Birdthistle was a professor at Chicago-Kent College of Law. Birdthistle also served as a visiting professor at the University of Chicago Law School. Prior to academia, he practiced law at Ropes & Gray.

"Professor Birdthistle will bring remarkable expertise in investment funds to the SEC," said SEC Chair Gary Gensler. "The Division of Investment Management develops regulatory policies to oversee investment companies and investment advisers so that American investors can confidently save to buy homes, pay for college, or plan for retirement. I look forward to working closely with William to execute our mission."

Other SEC Leadership Changes

On December 20, 2021, Commissioner Elad Roisman, one of two Republican commissioners, announced he will step down by the end of January 2022. Roisman, whose term was set to expire in 2023, joined the SEC in September 2018 and served briefly as acting chairman between late December 2020 and January 2021. In November 2021, the SEC announced the appointment of Nicole Creola Kelly as chief of the SEC's Office of the Whistleblower. Kelly served as senior special counsel in the Office of the General Counsel and has more than 20 years of experience with the SEC. Also in November, the SEC announced the appointment of Haoxiang Zhu, a professor of finance at the Massachusetts Institute of Technology, as director of the SEC's Division of Trading and Markets.

PCAOB Leadership Changes

In June 2021, the SEC announced that it intended to seek candidates to fill all five board positions on the Public Company Accounting Oversight Board ("PCAOB"), including those held by members whose terms had not

yet expired. In a joint statement made at the time, SEC Commissioners Hester Peirce and Elad Roisman strongly criticized the decision.

On November 8, 2021, the SEC announced the appointments of Erica Y. Williams as chairperson and Christina Ho, Kara M. Stein, and Anthony C. Thompson as board members of PCAOB. Duane DesParte will continue his service as a board member and will remain acting chairperson until Williams is sworn in.

"The PCAOB was formed in response to a crisis of confidence in the corporate disclosures of issuers after the WorldCom and Enron accounting scandals nearly 20 years ago. Finance is about trust, and the PCAOB has a critical role to play in ensuring that public company financial disclosures can be trusted by investors," said Gensler. "With these additions to the Board, the PCAOB will have the leadership to meet the mission given to it by Congress."

DOL Proposes Rule to Remove Barriers to Consideration of ESG Factors in Plan Management

On October 13, 2021, the U.S. Department of Labor ("DOL") announced a proposed rule ("Rule") that would remove barriers to plan fiduciaries' ability to consider climate change and other environmental, social, and governance ("ESG") factors when they select investments and exercise shareholder rights. The Rule, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," expressly acknowledges that issues of climate change and other ESG factors could bear directly on the financial risk and return of an investment. The Rule would roll back two rules adopted by the previous administration that were broadly seen as an attempt to restrain the consideration of ESG factors in retirement plan investment decisions by (i) holding plan fiduciaries to a "pecuniary" standard; and (ii) restricting plan fiduciaries from considering ESG factors in voting proxies. The Rule also follows Executive Order 14030, signed by President Biden on May 20, 2021, which emphasizes the administration's focus on issues related to climate change and requires federal agencies, including financial regulators, to begin to incorporate climate-risk and other ESG issues into financial regulation.

"A principal idea underlying the proposal is that climate change and other ESG factors can be financially material and when they are, considering them will inevitably lead to better long-term risk-adjusted returns, protecting the retirement savings of America's workers," Ali Khawar, the acting assistant secretary for the Employee Benefits Security Administration, said in a statement.

SEC Modernizes Filing Fee Disclosure and Payment Methods and Updates Electronic Filing Requirements

On October 13, 2021, the SEC adopted amendments to modernize filing fee disclosure and payment methods. The amendments revise most fee-bearing forms, schedules, and related rules to require operating companies and investment companies to include all required information for filing fee calculations in a structured format. The amendments also add new options for Automated Clearing House ("ACH") and debit and credit card payment of filing fees and eliminate infrequently used options for filing fee payment via paper checks and money orders. The amendments generally will be effective on January 31, 2022. The amendments that will add the options for filing fee payment via ACH and debit and credit cards and eliminate the option for filing fee payment via paper checks and money orders will be effective on May 31, 2022.

On November 4, 2021, the SEC published proposed rule and form amendments ("Amendments") to update electronic filing requirements. The Amendments would require certain forms to be submitted electronically, rather than in paper format. The Amendments would also update certain forms to require structured data reporting and remove outdated references. The SEC noted that the Amendments are intended to promote efficiency and transparency; and that electronic submissions would be more readily accessible to the public and would be available in easily searchable formats.

First Bitcoin Futures ETF Begins Trading

On October 19, 2021, the first U.S. bitcoin futures exchange-traded fund ("ETF") began trading. ProShares Bitcoin Strategy ETF ("BITO"), listed on the NYSE, invests in bitcoin futures contracts traded on the Chicago Mercantile

Exchange, rather than directly in cryptocurrency. BITO can be bought and sold through a brokerage account, eliminating the need for cryptocurrency exchanges or crypto wallets.

"This is an exciting step but not the last," Douglas Yones, head of exchange-traded products at NYSE, said in a statement to The New York Times.

SEC Issues Risk Alert on Observations from Examinations of Registered Funds

On October 26, 2021, the Division of Examinations ("Division") issued a risk alert ("Risk Alert") highlighting common compliance issues observed by the Division during its registered investment companies ("RIC") initiatives. Under the RIC initiatives, the Division examined mutual funds and exchange-traded funds ("funds") and their investment advisers that fell into one or more of the following six categories: (i) index funds that track custom-built indexes; (ii) smaller ETFs and/or ETFs with little secondary market trading volume; (iii) mutual funds with higher allocations to certain securitized investments; (iv) mutual funds with aberrational underperformance relative to their peer groups; (v) mutual funds managed by advisers that are relatively new to managing such funds; and (vi) advisers that provide advice to both mutual funds and private funds, both of which have similar strategies and/or are managed by the same portfolio managers. The RIC initiatives focused on the following:

- Effectiveness of the compliance programs of funds and their advisers, particularly in the areas of disclosure, portfolio management, and conflicts of interest;
- Disclosures by advisers to fund boards and by funds to investors regarding certain risks and conflicts of interest; and
- Fund governance practices, particularly as they relate to oversight of fund compliance programs.

The Risk Alert noted deficiencies or weaknesses in the following areas:

- Deficiencies relating to fund and adviser compliance programs and to board oversight of compliance programs, including inadequate policies and procedures relating to the oversight of investments and portfolios, valuation, trading practices, conflicts of interest, fees and expenses, and fund advertisements and sales literature;
- Inaccurate and/or omitted disclosures in fund filings, including disclosures relating to (i) principal investment strategies and risks; and (ii) fund net assets and net expense ratios, contractual expense limitations and/or operating expenses subject to the contractual expense limitations; and
- Inaccurate and/or omitted disclosures regarding investment strategies and portfolio holdings, fund expenses, and fund performance information in other shareholder communications such as fund advertising.

The Risk Alert provided a list of recommended practices to assist funds and their advisers in designing and enhancing their compliance programs, including:

- Periodic testing and review of compliance programs to ensure consistency with practices, and ensure that compliance programs adequately address the oversight of key vendors;
- Board oversight of fund compliance programs by assessing whether (i) the information the board received was accurate, specifically with respect to fund fees, expenses, performance, and investment strategies (including changes or risks associated with these strategies) and (ii) the funds were adhering to their processes for board reporting, including an annual review of fund compliance programs; and
- Adoption of policies and procedures concerning disclosure, such as those that required updating of fund websites concurrently with new or amended disclosures in filings or other shareholder communications, and review and testing of fund performance advertising for accuracy and appropriateness of presentation.

SEC Approves PCAOB Rule and Adopts Amendments Relating to the HFCAA

On November 5, 2021, the SEC announced that it had approved the PCAOB's Rule 6100, Board Determinations Under the Holding Foreign Companies Accountable Act

(the "HFCAA"). The HFCAA, which aims to address restrictions China has placed on the PCAOB's ability to inspect audit workpapers of Chinese companies, requires the SEC to ban trading on all U.S. exchanges of any company based in a foreign jurisdiction that bars the PCAOB's audit inspection for three consecutive years. Rule 6100, adopted by the PCAOB in September 2021, establishes the process for the PCAOB's determination that it is unable to inspect or investigate completely a registered public accounting firm located in a foreign jurisdiction because of a position taken by an authority in that jurisdiction. Rule6100 outlines the factors the PCAOB will evaluate and the documents and information the PCAOB will consider when assessing whether a determination is warranted; the form, public availability, effective date, and duration of such determinations; and the process by which the PCAOB will reaffirm, modify, or vacate any such determinations.

On December 2, 2021, the SEC adopted final amendments implementing the submission and disclosure requirements of the HFCAA. The amendments apply to registrants the SEC identifies as having filed an annual report with an audit report issued by a registered public accounting firm that the PCAOB is unable to inspect or investigate completely, in accordance with Rule 6100 ("Commission-Identified Issuers"). The amendments require Commission-Identified Issuers to submit documentation to the SEC establishing that, if true, it is not owned or controlled by a governmental entity in the public accounting firm's foreign jurisdiction. The amendments also require that a Commission-Identified Issuer that is a "foreign issuer," as defined in Exchange Act Rule 3b-4, provide certain additional disclosures in its annual report for itself and any of its consolidated foreign operating entities. Further, the adopting release establishes the SEC's procedures for (i) determining whether a registrant is a Commission-Identified Issuer and (ii) prohibiting the trading of a Commission-Identified Issuer's securities.

"This final rule furthers the mandate that Congress laid out and gets to the heart of the SEC's mission to protect investors. The Commission and the PCAOB will continue to work together to ensure that the auditors of foreign companies accessing U.S. capital markets play by our rules. We hope foreign governments will, working with the PCAOB, take action to make that possible," said Gensler.

SEC Issues Risk Alert on Observations from Examinations of Advisers That Provide Electronic Investment Advice

On November 9, 2021, the Division issued a risk alert ("Risk Alert") concerning deficiencies in the provision by investment advisers of advice electronically, including advisers known as "robo-advisers." The Risk Alert noted deficiencies in the areas of compliance programs, portfolio management practices (including advisers' fiduciary obligations), and marketing/performance advertising. The Risk Alert also reminded robo-advisers of the need to follow applicable registration requirements, exemptions, and safe harbors, both under (i) the Investment Advisers Act of 1940, as amended ("Advisers Act"), to be properly registered with the SEC, either as an Internet adviser relying on Advisers Act Rule 203A2(e) or another applicable provision or exemption; and (ii) the Investment Company Act of 1940, as amended ("1940 Act"), to avoid having their discretionary investment program deemed an unregistered investment company. Noting that the number of investment advisers that are providing online investment advisory services to retirement plan participants and retail investors has substantially increased, the Division expressed concern that "[m]illions of investors…now entrust their savings to advisers that provide their investment advisory services online, via mobile applications, or both."

SEC Issues Risk Alert on Investment Advisers' Fee Calculations

On November 10, 2021, the Division issued a risk alert ("Risk Alert") highlighting findings from its initiative focusing on advisory fees, predominantly those charged to retail clients. The Risk Alert identified the following deficiencies: (i) inaccurate advisory fee calculations; (ii) false, misleading, or omitted fee-related disclosures; (iii) missing or inadequate compliance programs and inaccuracy of books and records; and (iv) inaccurate financial statements.

The Risk Alert provided examples of policies and practices to assist advisers with compliance, including (i) adopting written policies and procedures addressing advisory fee billing processes and validating fee calculations; (ii) centralizing the fee billing process; (iii) ensuring that the tools established for reviewing fee calculations are utilized; and (iv) properly recording all advisory expenses and fees assessed to and received from clients, including those paid directly to advisory personnel.

SEC Adopts New Rules for Proxy Cards

On November 17, 2021, the SEC voted to adopt final rules requiring parties in a contested election to use universal proxy cards that include the names of all registrant and dissident nominees presented for election at a shareholder meeting. The rules will give shareholders the ability to vote by proxy for their preferred combination of board candidates, similar to voting in person. The rules will apply to all non-exempt solicitations for contested elections other than those involving registered investment companies and business development companies ("funds"). The SEC stated that it continues to consider any application of the rules to funds, adding that developments since 2016, along with various comments received, have led them to conclude that further consideration of the potential application of the rules to certain funds is warranted. In their statements, Commissioners Peirce and Roisman both indicated their belief that the SEC should expand the rule to include funds.

The SEC also adopted amendments that will change the form of proxy card and proxy statement disclosure requirements applicable to all director elections, including those for registered investment companies and business development companies. The amendments will (i) require proxy cards to include an "against" voting option in director elections when there is legal effect to such a vote, (ii) require that the proxy card provide shareholders with the ability to "abstain" in a director election where a majority voting standard applies, and (iii) require proxy statement disclosure about the effect of a "withhold" vote in an election of directors. The rules will apply to all applicable shareholder meetings involving director elections held after August 31, 2022.

SEC Proposes Amendments to Rules Governing Proxy Voting Advice

On November 17, 2021, the SEC voted to propose amendments to two rules adopted by the SEC in 2020 governing proxy voting advice. Specifically, the SEC proposed to rescind conditions to the availability of two exemptions from the proxy rules' informational and filing requirements. Those conditions require that: (i) registrants that are the subject of proxy voting advice have such advice made available to them in a timely manner, and (ii) clients of proxy voting advice businesses are provided with a means of becoming aware of any written responses by registrants to proxy voting advice. The SEC stated that the proposed amendments aim to address concerns expressed by investors and others that the 2020 conditions may impede the timeliness and independence of proxy voting advice and subject proxy voting advice businesses to undue litigation risks and compliance costs.

"Proxy advice voting businesses play an important role in the proxy process. Their clients deserve to receive independent proxy voting advice in a timely manner," said Gensler.

SEC Proposes Rule to Provide Transparency in the Securities Lending Market

On November 18, 2021, the SEC published proposed Exchange Act Rule 10c-1, which would require lenders of securities to provide the material terms of securities lending transactions to a registered national securities association, such as the Financial Industry Regulatory Authority. The registered national securities association would then make the material terms of the securities lending transaction available to the public. The SEC noted that the proposed rule is consistent with Congress' mandate in the Dodd-Frank Act that the SEC increase transparency regarding the loan or borrowing of securities for brokers, dealers, and investors by ensuring that market participants, the public, and regulators have access to timely and comprehensive information about the market for securities lending.

"Securities lending and borrowing is an important part of our market structure. Currently, though, the securities lending market is opaque," said Gensler. "In today's fast-moving financial markets, it's important that market participants have access to fair, accurate, and timely information. I believe this proposal would bring securities lending out of the dark."

SEC Proposes Updates to Electronic Recordkeeping Requirements

On November 18, 2021, the SEC published proposed amendments to the electronic recordkeeping and prompt production of records requirements applicable to broker-dealers, security-based swap dealers ("SBSDs"), and major security-based swap participants ("MSBSPs"). The SEC's electronic recordkeeping rule requires firms to preserve electronic records exclusively in a non-rewriteable, non-erasable format. The proposed amendments would add an audit-trail alternative, under which electronic records could be preserved in a manner that permits the recreation of an original record if it is altered, over-written, or erased. The proposed amendments would require nonbank SBSDs and MSBSPs to preserve electronic records using either of the above alternatives that would be available to broker-dealers. The amendments also would require broker-dealers and all types of SBSDs and MSBSPs to produce electronic records to securities regulators in a reasonably usable electronic format.

SEC Issues Guidance on Key LIBOR Transition Considerations

On December 7, 2021, the SEC issued guidance ("Guidance") on key LIBOR transition considerations, including general considerations for all market participants as well as specific guidance for registered investment companies and investment advisers. The Guidance reminds market participants to consider their disclosure obligations and cautions investment professionals to consider their standards of care when recommending LIBOR-linked securities or investment strategies. Highlights are as follows:

General Considerations for Market Participants

- Fallback language: The Guidance notes that many transaction documents that contemplate only a temporary cessation of LIBOR, or contain no fallback language applicable to providing an alternative reference rate, will likely experience material changes in their investment returns when LIBOR is discontinued. Newer issuances that contain fallback language may also experience a change in investment returns as no replacement rate will provide a perfect match for LIBOR. The Guidance notes that while the Alternative Reference Rates Committee ("ARRC") has published recommended fallback language, U.S. issuers are not obligated to include any particular language in transaction documents for new issuances of LIBOR-linked securities.

- Valuation: The Guidance notes the transition's potential impact on valuation measurements, including through the differences between LIBOR and alternative reference rates and through changes in market liquidity and trading volumes in all rates during the transition period.

- Operations: The Guidance notes that operational complexities as a result of the transition may require market participants to update processes and IT systems.

Registered Investment Companies

- Disclosures: The Guidance focuses on the disclosure obligations of registered investment companies, including the disclosure of any principal risks related to the potential cessation of LIBOR and the anticipated impact (and expected timing of that impact) on LIBOR-linked investments, including with respect to volatility, value, and liquidity.

- Valuation: The Guidance encourages fund boards to be mindful of any valuation risk and impacts to valuation inputs and assumptions associated with LIBOR and the transition.

- Conflicts of Interest: The Guidance notes that funds should monitor and manage any conflicts of interest associated with the transition, including, for example, by considering their disclosure and other legal obligations relating to performance fees tied to LIBOR. The Guidance states that funds should include, where applicable, disclosure that the transition to a new rate could make it easier to earn a performance fee.

Investment Advisers

- Fiduciary duty: The Guidance draws attention to advisers' fiduciary duty in providing investment advice and states that advisers should consider whether any advice regarding LIBOR-linked investments and applicable risks is consistent with their clients' goals. The Guidance recommends that advisers consider whether investments contain robust fallback language and consider any economic differences between LIBOR and an alternative replacement rate.

In remarks to the ARRC in September 2021, Gensler endorsed Secured Overnight Financing Rate as a preferable alternative rate, and cautioned against using the Bloomberg Short-Term Bank Yield Index ("BSBY"), which a number of commercial banks have promoted as a replacement. Gensler noted that BSBY has similar flaws to LIBOR, adding that both benchmarks are based upon unsecured, term, bank-to-bank lending.

SEC Proposes Amendments to Money Market Fund Rules

On December 15, 2021, the SEC proposed amendments to certain rules that govern money market funds under the 1940 Act. The SEC noted that the proposed amendments are designed, in part, to address concerns about money market funds highlighted by the events of March 2020, when the growing economic concerns about the impact of the COVID-19 pandemic led investors to reallocate their assets into cash and short-term government securities, causing prime and tax-exempt money market funds, particularly institutional funds, to experience large outflows. The amendments would increase liquidity requirements for money market funds to provide a more substantial liquidity buffer in the event of rapid redemptions. The amendments would also remove provisions in the current rule permitting or requiring a money market fund to impose liquidity fees or to suspend redemptions through a date when a fund's liquidity drops below an identified threshold. The amendments would also require institutional prime and institutional tax-exempt money market funds to implement swing pricing policies and procedures that would require redeeming investors, under certain circumstances, to bear the liquidity costs of their redemptions. Further, the amendments would implement certain reporting requirements to improve the availability of information about money market funds and enhance the SEC's monitoring and analysis of these funds. The comment period will remain open for 60 days after publication in the Federal Register.

"Together, these amendments are designed to reduce the likelihood of runs on money market funds during periods of stress," said Gensler. "They also would equip funds to better meet large redemptions, addressing concerns about redemption costs and liquidity. Given the broad reach of short-term funding markets, these proposals speak to our remit to maintain fair, orderly, and efficient markets."

SEC ENFORCEMENT ACTIONS

SEC Announces Enforcement Results for Fiscal Year 2021

On November 18, 2021, the SEC announced that it filed 697 total enforcement actions in fiscal year 2021, including 434 new actions, 120 actions against issuers who were delinquent in making required filings with the SEC, and 143 follow-on administrative proceedings seeking bars against individuals based on criminal convictions, civil injunctions, or other orders. The new actions related to a range of securities matters, including in the crypto and SPAC spaces. In fiscal year 2021, the SEC obtained judgments and orders for nearly $2.4 billion in disgorgement and more than $1.4 billion in penalties, which represented a 33 percent decrease and 33 percent increase, respectively, over amounts ordered in the prior fiscal year in these categories. Fiscal year 2021 was also a record year for whistleblower awards, with the SEC awarding a total of $564 million to 108 whistleblowers. The whistleblower program also surpassed $1 billion in awards over the life of the program.

"The SEC's Enforcement Division is the cop on the beat for America's securities laws," said Gensler. "As these results show, we go after misconduct wherever we find it in the financial system, holding individuals and companies accountable, without fear or favor, across the $100-plus trillion capital markets we oversee."

In a speech at the SEC's Securities Enforcement Forum on November 4, 2021, Gensler stated that he wants to eliminate the "unnecessary process" that he said is often initiated by defense counsel to delay settlement negotiations. "We should focus on bringing matters to resolution swiftly," he said. "We've got precious resources, we need to move the docket, and we will be bringing cases expeditiously."

SEC Charges Exchange-Traded Product and Its General Partner with Disclosure Failures

On November 8, 2021, the SEC charged United States Oil Fund LP ("USO"), an exchange-traded product, and its general partner United States Commodity Funds LLC ("USCF") with producing misleading statements about limitations imposed by its/their sole futures commission merchant and broker ("Sole Futures Broker"). According

to the SEC's order, USO's investment objective is to track the changes in the spot price of oil, as measured by the changes in prices of certain oil futures contracts. In April 2020, in the midst of oil market turmoil and the near-month futures contract closing at a negative price, the Sole Futures Broker told USO it would not execute any new oil futures positions for USO. As a result of this limitation, USO was restricted from investing the proceeds generated by the future sale of newly created shares in oil future contracts, creating the risk that USO would not be able to meet its stated investment objective. The order finds that USO did not fully disclose the character and nature of the limitation until one month after the limit was first imposed. The SEC's order finds that USO and USCF violated a negligence-based anti-fraud provision of the federal securities laws. Without admitting or denying the SEC's findings, USO and USCF agreed to cease-and-desist orders and to pay a $2.5 million penalty.

SEC Charges Private Equity Fund Adviser with Fee and Expense Disclosure Failures

On December 20, 2021, the SEC charged a registered investment adviser ("Investment Adviser") with failing to properly offset certain portfolio company fees against management fees charged to clients, as it was required to do under the offering and governing documents. The SEC's order also found that the Investment Adviser provided investors with inconsistent statements about how the Investment Adviser would calculate management fees. In addition, the SEC's order found that these violations were caused by deficiencies in the Investment Adviser's compliance program. The Investment Adviser agreed to pay a $4.5 million penalty to settle the SEC charges and voluntarily has repaid $5.4 million to its affected private fund clients.

Thomas R. Westle *and* ***Stacy H. Louizos*** *would like to thank* ***Margaret M. Murphy*** *and* ***Jennifer Patt*** *for their contributions to this update.*

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