

Investment Management Regulatory Update

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Regulatory Action

SEC Announces Spring Regulatory Agenda

Registered Funds | Investment Advisers | Private Funds | Broker-Dealers | Other Market Entities

The SEC announced its spring regulatory agenda in June 2023. Among the proposed regulations slated for adoption in October 2023 are: (1) open-end fund liquidity risk management programs and swing pricing reform; (2) expansion of the investment adviser custody rule; (3) investment company names rule amendments; (4) enhanced environmental, social, and governance (“ESG”) disclosures by advisers and investment companies; and (5) cybersecurity risk management for investment advisers, registered investment companies, and business development companies.

The SEC’s complete regulatory agenda is available [here](#).

SEC Adopts Form PF Amendments

Private Funds | Hedge Funds

The SEC approved amendments to Form PF in May 2023. Form PF is required to be filed by registered investment advisers that manage one or more private funds and have at least \$150 million in private fund assets under management as of most recently completed fiscal year. The amendments apply to: (i) large hedge fund advisers (those with at least \$1.5 billion in hedge fund assets under management); (ii) private equity fund advisers (those with at least \$150 million private fund assets under management); and (iii) large private equity fund advisers (those with at least \$2 billion private equity fund assets under management).

The amendments require:

- 1) large hedge fund advisers to report certain current events, such as extraordinary investment losses, significant margin and default events, and large withdrawal and redemption requests, as soon as practicable, but no later than 72 hours after the occurrence of such event;
- 2) all private equity fund advisers reporting on Form PF to report the occurrence of any of the following events within 60 days of the relevant fiscal quarter end: (a) completion of an adviser-led secondary transaction; (b) the removal of a fund's general partner; and (c) an election to terminate a fund or a fund's investment period by the limited partners; and
- 3) large private equity fund advisers to report certain events in their annual reporting, including general partner or limited partner clawbacks, fund-level borrowing, events of default, information about a fund's investment strategies, and information about bridge financing arrangements.

The amendments to Form PF will take effect on two compliance dates. The first compliance date for the new "current events reporting" for hedge funds and quarterly reporting for private equity funds will be December 11, 2023. The second compliance date for annual reporting for private equity funds will be June 11, 2024.

The adopting release is available [here](#).

NFA Adopts Digital Asset Compliance Rule

Registered Funds | Investment Advisers | Private Funds | Other Market Entities

Near the end of March, the National Futures Association (the "NFA") issued a notice indicating that it has adopted Compliance Rule 2-51, which imposes anti-fraud, just and equitable principles of trade, and supervision requirements on NFA members that engage in digital asset commodity activities. The NFA currently limited the definition of "digital asset commodities" for purposes of this rule to Bitcoin and Ether. Rule 2-51 also codifies the NFA's Interpretive Notice 9073, which requires certain disclosures to investors regarding virtual currencies, virtual currency derivatives, and associated risks. The NFA will have the ability to discipline a member or take other action to protect the public if a member commits fraud or similar misconduct with respect to its spot digital asset commodity activities. The rule became effective May 31, 2023.

The text of the Final Rule is available [here](#).

SEC Adopts Anti-Fraud Rules for Security-Based Swaps

Registered Funds | Investment Advisers | Private Funds | Other Market Entities

On June 7, the SEC adopted rules to implement the Exchange Act's prohibition on fraud, manipulation, and deception in connection with securities-based swap transactions and to prevent undue influence over the chief compliance officer ("CCO") of a security-based swap dealer or a major security-based swap participant (each, an "SBS Entity").

New Rule 9j-1 implements the antifraud language of Section 9(j) of the Exchange Act to prohibit the use of fraud, manipulation, or deceit in connection with effecting any transaction in, or attempting to effect any transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, securities-based swaps.

The adopting release clarifies that the new rule's application of antifraud protections to various steps in a security-based swap transaction, including those changing "any rights or obligations" under a security-based swap, align with the broad definitions of purchase and sale under the Exchange Act. The release details the SEC's view that this expansive definition is necessary, for example, to prevent opportunistic strategies used to manipulate prices and obligations in relation to swaps, such as manufactured credit events in the credit default swap market.

New Rule 15fh-4(c) prohibits personnel of an SBS Entity from exerting undue influence over its CCO. Rule 15fh-4(c) also prohibits any person acting under the direction of personnel of an SBS Entity from taking any action to coerce, manipulate, mislead, or fraudulently induce the SBS Entity's CCO in the performance of its duties.

The new rules will become effective 60 days after the date of publication of the adopting release in the Federal Register.

The adopting release can be found [here](#).

SEC Adopts Amendments to Modernize Share Repurchase Disclosure

Corporate Issuers | Closed-End Funds | Foreign Private Issuers

In May 2023, the SEC adopted amendments to the disclosure requirements relating to issuers' repurchases of their equity securities. The amendments will require issuers to (1) disclose daily repurchase data in a new table filed as an exhibit to Form N-CSR for closed-end funds, Forms 10-Q and 10-K for corporate issuers, and a new Form F-SR for Foreign Private Issuers ("FPIs"), (2) indicate by a checkbox whether the issuer's executives or directors traded in the issuer's equity securities within four business days before or after the public announcement of a repurchase plan or program, or the announcement of an increase of an existing share repurchase plan or program, (3) provide narrative disclosure about repurchase programs, including the objectives and rationale behind such repurchase programs, and (4) provide disclosure regarding the company's adoption or termination of any Rule 10b5-1 trading arrangements.

Listed closed-end funds will be required to provide the disclosures under the new amendments beginning with the Form N-CSR that covers the first six-month period that begins on or after January 1, 2024. FPIs will be required to provide the disclosures on Form F-SR beginning with the first full fiscal quarter which begins on or after April 1, 2024. All other domestic corporate issuers will be required to comply with the new requirements in their Form 10-Q and 10-K filings beginning with the first filing that covers the first full fiscal quarter that begins on or after October 1, 2023.

The adopting release is available [here](#).

SEC Proposes Cybersecurity Program Requirements

Investment Advisers | Investment Companies | Broker-Dealers | Other Market Entities

On March 15, 2023, the SEC issued a series of proposals designed to improve firms' preparedness and responses to cyber incidents. The proposals, which would impact many of the financial services industry participants regulated by the SEC, generally require that firms establish policies and procedures to better prevent and detect cyber incidents and disclose certain cyber incidents to clients and the SEC within specified time periods. The proposals take the form of amendments to Regulation S-P and Regulation SCI and new rules under the Investment Advisers Act, the Investment Company Act, and the Exchange Act, as well as related form changes. If the proposals are adopted, their impact would be twofold: the proposals would (1) expand the SEC's oversight of firms' handling of cybersecurity and cyber incidents, including with respect to examinations and enforcements, and (2) create new obligations on behalf of industry participants to generate client disclosures and/or regulatory filings in the event of a cyber incident.

Chapman's client alert outlining the proposals is available [here](#).

SEC Proposes Action on Covered Clearing Agencies

Clearing Agencies

On May 17, 2023, the SEC issued a proposal that would amend the existing rules regarding intraday margin and the use of substantive inputs to a covered clearing agency's ("CCA") risk-based margin system. The proposal would also add a new rule establishing requirements for a CCA's recovery and wind-down plan. The rule amendments would, among other things, require CCAs to implement policies and procedures to monitor intraday credit exposure on an ongoing basis, including a risk-based margin system that includes the authority and operational capacity to make intraday margin calls as frequently as necessary. The amendments would also require that such policies and procedures address the use of substantive inputs in a CCA's risk-based margin system, specifically, how the CCA will address situations when such inputs are not readily available or reliable. Current regulations require that a CCA establish a recovery and wind-down plan; the proposed new rule specifies that such plan include provisions addressing nine elements intended to ensure a CCA is prepared for an orderly wind-down.

The proposing release is available [here](#).

SEC Investor Advisory Committee Issues Recommendation on Single Stock and Leveraged ETFs

Exchange-Traded Funds

On June 22, 2023, the SEC's Investor Advisory Committee (the "Committee") issued a recommendation that the SEC consider future amendments to Rule 6c-11 under the Investment Company Act (the "ETF Rule") to clarify which ETFs and other exchange traded products should qualify for exemptive relief and which should require approval from the SEC. In addition, the Committee also recommended consideration of rule changes that would require that single stock and leveraged ETFs be renamed to differentiate them from more diversified, traditional ETFs. The Committee also recommended consideration of a requirement for a single stock ETF's disclosure document to include a graphical representation of divergent long-term performance compared to its underlying reference asset. Finally, the Committee called on SEC and FINRA staff to continue their scrutiny of investment advisors and broker-dealers involved in the recommendation and sale of single stock and leveraged ETFs to investors. The Committee's recommendations arise from concerns that retail investors, which hold approximately 92% of the most popular single stock ETFs, may fail to understand the payouts and risks of single stock and leveraged ETFs, due in part to their close association with more standard, diversified products. Chapman served as adviser counsel in connection with the first single stock ETFs and continues to represent a significant number of funds with inverse, leveraged, covered call and hedged investment strategies.

The text of the Committee's recommendation is available [here](#).

Market Happenings

Perpetual Applies for ETF Share Class Relief

Exchange-Traded Funds | Mutual Funds

In February 2023, Chapman represented Perpetual U.S. Services, the U.S. arm of Australia's Perpetual Group, in filing for exemptive relief that would allow Perpetual to issue ETF shares as a separate class of shares for its existing mutual funds. Vanguard was issued this relief in 2000 and would go on to receive a patent on the structure in 2003. Vanguard now offers over 70 mutual funds with nearly \$5 trillion in assets that utilize an ETF share class. However, Vanguard's patent expired in May 2023, allowing industry participants to seek relief to implement a similar structure. Although the SEC issued the relief to Vanguard nearly 25 years ago, staffers at the agency have expressed concern with regard to the structure, specifically with regard to "class subsidization," whereby the operation of an ETF share class alongside a mutual fund share class would cause one class to incur expenses it would not otherwise have incurred.

Perpetual's application, available [here](#), sets forth Perpetual's proposed solutions to those concerns.

iShares Filing for Bitcoin ETF Reheats Race

Exchange Traded Funds | Crypto Currencies

The next chapter in the now-infamous saga to offer a bitcoin ETF in the United States began on June 15, 2023, with iShares filing a registration statement and application to list shares of a bitcoin ETF on Nasdaq. This marked the first time iShares has sought to offer such a product and is interpreted as a sign of the increasing institutional comfort with bitcoin. U.S. market participants have been doggedly seeking regulatory approval to offer and list such a product since 2013 when Cameron and Tyler Winklevoss sought SEC approval for the Winklevoss Bitcoin Trust. The SEC has repeatedly denied such applications from numerous applicants, as described in detail in a 2022 report produced by the Chamber of Digital Commerce. The iShares filing motivated numerous other issuers to refile their applications, with Bitwise, Valkyrie Investments, and Invesco all seeking similar relief. The SEC's decision on these applications is not expected until February 2024.

For more information see the article from the Chamber of Digital Commerce available [here](#).

Litigation and Enforcement

2023 SEC Examination Priorities

Investment Advisers | Investment Companies | Private Funds | Broker-Dealers

The SEC's Division of Examinations issued its annual list of exam priorities in March 2023. The staff will focus on, among other things, compliance with recently enacted Advisers Act and Investment Company Act rules, including the adviser advertising rule, the derivatives rule, and the fair valuation rule. In addition, the staff will continue its perennial focus on standards of conduct for broker-dealers and registered investment advisers (including Regulation Best Interest, fiduciary duty, and Form CRS); information security; ESG investing; and cyber and digital assets.

Focus areas for registered investment advisers include: (1) the calculation of fees; (2) bank deposit sweep programs; (3) excessive fees; (4) policies and procedures for retaining and monitoring electronic communications; and (5) selection and monitoring of third-party service providers.

Focus areas for investment companies include: (1) turn-key funds; (2) mutual fund to ETF conversions; (3) non-transparent ETFs; (4) loan-focused funds; (5) small- and medium-sized fund complexes; (6) board 15(c) processes, especially for funds with weaker performance records; and (7) derivatives and liquidity risk management programs.

The SEC's 2023 Examination Priorities Report is available [here](#).

SEC Issues Risk Alert Regarding the Safeguarding of Customer Records and Information at Branch Offices

Investment Advisers | Broker-Dealers

The SEC's Division of Examinations issued a risk alert highlighting the importance of establishing written policies and procedures for safeguarding customer records and information at branch offices. The risk alert indicated that while firms have implemented safeguarding policies and procedures at their main office, some firms did not adopt or implement similar policies for their branch offices, resulting in cybersecurity and data breaches. The risk alert highlighted several notable risk areas including: (1) improper due diligence and oversight of branch offices' vendors despite policies at the main office that required such diligence; (2) weakness in email configuration, data access management, and assessments of technology risks; and (3) improper data classification at branch offices resulting in a failure to identify and control customer records and information. The staff cautioned firms to consider their entire organization, including branch offices, when implementing written policies and procedures for the safeguarding of customer records and information to ensure they are compliant with Regulation S-P.

The Risk Alert is available [here](#).

SEC Charges Adviser and Fund Trustees with Liquidity Rule Violations

Investment Advisers | Fund Boards | Investment Companies

In May 2023, the SEC brought its first case enforcing its liquidity risk management rule in connection with a mutual fund's failure to classify certain securities as "illiquid investments" when the underlying restrictions, transfer limitations, and lack of market for the shares required that classification. The SEC brought charges against the fund's adviser, who administered the fund's liquidity risk management program, for aiding and abetting liquidity rule violations by the fund. The SEC also brought similar charges against certain of the fund's independent trustees and two of the fund's officers for recklessly failing to exercise reasonable oversight of the fund's liquidity program. The SEC's complaint alleges the parties disregarded the advice of the fund's counsel, who resigned over the issue, as well as the advice of the fund's auditors, who raised questions about the securities' liquidity classification. In addition, the complaint alleges that representatives of the fund's adviser made false and misleading statements and omissions about the basis for their improper classification to SEC staff.

The SEC's press release is available [here](#).

SEC Charges Adviser for Disclosure and Advisory Fee Waiver Failures

Investment Advisers | Fund Boards | Investment Companies

In June 2023, the SEC announced it had settled two enforcement actions against a registered investment adviser. The first action resulted from the adviser's failure to disclose material information to investors concerning a fund's use of interest rate swaps, which had become a material source of distributable income and contributed to a decline in the net asset value of the fund. The second enforcement action related to the adviser's failure to waive approximately \$27 million in advisory fees over a six-year period and failure to maintain adequate policies and procedures to verify that the fund's waivers were being implemented. The error was identified internally by the adviser and fund administrator, and the adviser took steps to remediate the error, including repaying the funds the incorrectly charged advisory fees as well as an additional performance adjustment. Without admitting or denying the SEC's findings, the adviser agreed to a cease-and-desist order and a censure in each action and to pay a combined \$9 million penalty.

The SEC's press release is available [here](#).

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If you would like further information concerning the matters discussed in this article, please contact a member of Chapman's Corporate and Securities Department or the Investment Management Group or visit us online at chapman.com.

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