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Regulatory Update

Investment Management Regulatory Update

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Third Quarter 2024

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SEC Adopts Form Amendments and Liquidity Rule Guidance

Investment Advisers | Investment Companies

On August 28, 2024, the SEC adopted amendments to Forms N-PORT and N-CEN and provided guidance regarding Rule 22e-4 under the Investment Company Act (the *"Liquidity Rule"*). Importantly, the SEC declined to adopt the portions of its proposal that would have required mutual funds to implement "swing pricing" and a hard close when net purchases or redemptions exceeded set thresholds. The amendments, among other things, will require mutual funds, ETFs, and closed-end funds to file monthly portfolio disclosures on Form N-PORT within 30 days after the end of each month. Such reports will become publicly available 60 days after the month's end. Funds are currently required to prepare monthly Form N-PORT reports, which are filed with the SEC on a quarterly basis. The SEC also adopted amendments to Form N-CEN requiring funds to report certain information about service providers used to fulfill the requirements of the Liquidity Rule. Compliance with the form amendments will be required as of November 17, 2025, for larger entities and May 18, 2026, for smaller entities.

The Liquidity Rule guidance included: (1) adding examples of instances where intramonth liquidity evaluations may be required; (2) cautioning funds to consider the time it would take to convert foreign currencies to U.S. dollars in its liquidity determination; and (3) reiterating requirements for funds to adopt and review highly liquid investment minimums.

For more information, see the SEC adopting release available here.

Financial Regulatory Agencies Propose "Data Standards" for Financial Disclosures

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

A new rule prescribing the way financial information is presented in disclosure filings was jointly proposed by nine federal financial regulators, including the SEC. The rule is mandated by the Financial Data Transparency Act (the *"FDTA"*), which is intended to modernize and standardize financial information disclosed to investors, including financial information disclosures made by issuers. Among other things, the proposal would require regulated entities to obtain common legal identifiers for use across the covered regulators and that data collection, transmission, or presentation programs adopted by the covered agency abide by established principles that allow for increased availability, searchability, and analytics.

For more information, see our Client Alert available here.

SEC Issues Spring 2024 Regulatory Agenda

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

In July 2024, the SEC released its Spring 2024 Regulatory Agenda, which outlines its rulemaking agenda for the next 12 months. Below are updates on the SEC's expected timing with respect to certain rulemaking that may impact the investment management industry:

Rulemaking	Expected Timing
Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices	To be finalized by October 2024
Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies	To be finalized by October 2024
Outsourcing by Investment Advisers	To be finalized by October 2024
Reporting of Security-Based Swap Positions	To be finalized by October 2024
Rule 14a-8 Amendments	To be finalized by April 2025
Safeguarding Advisory Client Assets	To be reproposed by October 2024
Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers	To be reproposed by October 2024
Fund Fee Disclosure and Reform	To be proposed by April 2025
Exchange-Traded Products	To be proposed by April 2025
Regulation D and Form D Improvements	To be proposed by April 2025
Revisions to Definition of Securities Held of Record	To be proposed by April 2025

For more information, see the SEC's complete regulatory agenda, available here.

NYSE Proposes to Exempt Registered Closed-End Funds from Annual Meeting Requirements

Closed-End Funds | Investment Advisers

In June 2024, the NYSE filed an application with the SEC pursuant to Section 19 of the Securities Exchange Act and Rule 19b-4 thereunder, in which it proposed to amend its rules and exempt closed-end funds (CEFs) registered under the Investment Company Act from the requirement to hold annual shareholder meetings. In its application, NYSE

noted that significant differences between CEFs and listed operating companies justify exempting CEFs from NYSE's annual shareholder meeting requirement, in particular significant statutory protections under the Investment Company Act, such as: specific requirements with respect to the election of directors by CEF shareholders; the requirement that disinterested directors must comprise at least 40% of the CEF's board; the requirement that a majority of the disinterested directors approve significant actions; and shareholder approval requirements for a number of material matters. NYSE further noted that all of the categories of investment companies for which the NYSE has listing standards other than CEFs are already explicitly exempt from the annual shareholder meeting requirement.

Under the Exchange Act, the SEC has 180 days (until December 2024) to issue an order either approving or disapproving the proposed rule change. If approved, the rule change could help alleviate the pressure on CEFs from activist investors that have been utilizing the annual shareholder meetings to submit proposals aligned with their views.

NYSE's application is available here.

FTC Bans Use of Fake Consumer Reviews and Testimonials

Investment Advisers | Other Market Entitles

In August 2024, the Federal Trade Commission (FTC) issued a final rule that prohibits certain deceptive or unfair acts and practices involving consumer reviews and testimonials. The final rule prohibits: (i) selling or purchasing fake consumer reviews or testimonials; (ii) buying positive or negative reviews; (iii) certain insider reviews and testimonials; (iv) using company-controlled review websites and entities that falsely purport to provide independent reviews; (v) certain review suppression practices; and (vi) misuse of fake social media indicators.

The rule is scheduled to become effective 60 days after publication in the Federal Register. The violation of a trade regulation rule entitles the FTC to seek significant penalties, as well as consumer redress and other remedial measures.

The FTC's adopting release is available here.

Market Happenings

Chapman Issues White Paper on Interval and Tender Offer Closed-End Funds

Investment Advisers | Investment Companies | Closed-End Funds

Chapman attorneys have authored a white paper summarizing the frameworks, explaining the funds' distribution and redemption qualities, and comparing the funds to each other and to other types of investment companies. Interval funds and tender offer funds are increasingly popular closed-end funds that provide sponsors with greater flexibility in liquidity, pricing, and investment strategies than open-end mutual funds, ETFs, and traditional closed-end funds.

Both interval funds and tender offer funds serve as a bridge between open-end mutual funds and traditional closed-end funds. While some open-end funds and ETFs are subject to the SEC's liquidity risk management program rule, interval funds and tender offer funds are not restricted in their liquidity profiles, allowing fund sponsors to manage their portfolios more effectively. Additionally, unlike traditional closed-end funds that typically trade on exchanges at a discount to their net asset value (NAV), interval funds and tender offer funds can offer shares based on their actual NAV.

For more information, see the full white paper available here.

Chapman Issues Investment Adviser Registration Guide

Investment Advisers

Chapman attorneys have prepared a guide to assist investment professionals in determining when (and whether) they are required to register with the SEC or applicable state authorities. This guide simplifies the SEC investment adviser registration analysis, clearly explains key rules, concepts, and registration exemptions, and discusses registered investment advisers' ongoing compliance obligations.

See the full guide available here.

Litigation, Enforcement, and Examinations

SEC Charges Adviser for Overvaluation of Assets and Cross Trade Violations

Investment Advisers | Investment Companies

In September 2024, the SEC announced it had settled charges against a registered investment adviser for overvaluing largely illiquid collateralized mortgage obligations (CMOs) held in 20 advisory accounts, including private funds and mutual funds, and for executing hundreds of cross trades between advisory clients that favored certain clients over others. According to the SEC, from January 2017, through April 2021, the adviser valued the odd lot CMO positions, which traded at a discount to institutional, larger sized positions, using prices obtained from a third-party pricing service that were intended for institutional lots only. The SEC alleged the CMOs were valued at inflated prices, which resulted in the adviser overstating the performance of client accounts holding these assets. The SEC further alleged the adviser attempted to minimize losses to redeeming investors by effectuating cross trades with affiliated accounts at above independent market prices. Per the settlement, the adviser agreed, among other things, to pay a $70 million penalty plus $9.8 million in disgorgement and prejudgment interest and to retain a compliance consultant to conduct a comprehensive review of its policies and procedures relating to, among other things, valuation of CMOs (and associated liquidity risks) and cross trading.

The SEC's press release is available here.

SEC Charges Adviser with Misleading Investors Regarding Its ESG Investment Strategy

Investment Advisers | Investment Companies

In September 2024, the SEC announced charges against a registered investment adviser for making misleading statements and compliance failures related to the execution of its "biblically responsible investing" strategy. According to the SEC order, the adviser represented in its Form ADV and prospectuses that the ETFs and separately managed accounts it advised would not invest in companies that have "any degree of participation in" certain enumerated activities or products. The SEC found that, in practice, the adviser "misrepresented its research process, did not apply its investment criteria consistently, invested in companies that should have been excluded based on [its] stated investment criteria, and had a research process that failed to prevent departures from its stated investment criteria." The SEC further found that the adviser failed to adopt "written policies and procedures establishing a due diligence process that would support representations made to investors and clients" and "written policies and procedures setting forth a process for evaluating companies' activities as part of its investment process." Without admitting or denying the SEC's findings, the adviser consented to receive a censure and cease-and-desist order, agreed to pay a $300,000 penalty, and to retain an independent compliance consultant.

The SEC's press release is available here.

SEC Declines to Appeal Decision to Vacate Private Fund Advisers Rule

Investment Advisers | Investment Companies

The SEC determined not to appeal the U.S. Court of Appeals for the Fifth Circuit's decision to vacate its recently adopted rules increasing the regulation of private fund advisers (the "*Private Fund Advisers Rule*"). The Private Fund Advisers Rule, among other things, would have required investment advisers to private investment funds to provide additional disclosures to investors and produce quarterly fee and performance reports. On June 5, 2024, the Fifth Circuit unanimously vacated the Private Fund Advisers Rule, reasoning that the SEC had exceeded the statutory authority granted under the provisions of the Investment Advisers Act of 1940 cited by the SEC in its rulemaking. Specifically, the court found that the word "investors," as used in Section 211(h), applied only to "retail customers" and that the SEC's reliance on Section 206(4) in adopting the Private Fund Advisers Rule was "pretextual" and lacked a "rational connection" to fraud. The 90-day deadline for the SEC to seek review of the court's decision by the U.S. Supreme Court passed in early September, with the SEC declining to appeal. Although the Private Fund Advisers Rule now has no legal effect, it is possible that the SEC reproposes the rules on a more limited scope in the future.

For more information, see our Client Alert regarding the Fifth Circuit's decision available here.

SEC Charges Nine Investment Advisers in Ongoing Marketing Rule Sweep Exam

Investment Advisers

On September 9, 2024, the SEC charged nine investment advisers for making untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures. The charges resulted from the SEC's ongoing sweep examination focused on the recently amended Rule 206(4)-1 under the Investment Advisers Act of 1940 (the "*Marketing Rule*"). The materials at issue included: (i) claims that an adviser was a member of an organization that did not exist; (ii) claims that certain firms provide conflict-free advisory services (which the firms were unable to substantiate); (iii) testimonials, which did not come from current clients; and (iv) endorsements that did not contain accompanying disclosure that the endorser was a paid, non-client of the firm. Other advisers were found to have used third-party ratings that were more than five years old in their advertisements, without disclosing relevant information about the timing of the ratings. The firms, without admitting to the SEC's findings, agreed to the orders requiring them to be censured, to cease and desist from any ongoing violations, and to pay civil penalties ranging from $60,000 to $325,000.

For more information, see the SEC's press release available here. For more information on amendments to the marketing rule, see our Client Alert available here.

SEC Charges Crypto-Focused Advisory Firm for Custody Failures

Investment Advisers | Crypto Firms | Other Market Entities

On September 3, 2024, the SEC charged crypto-focused investment adviser, Galois Capital Management LLC, for its failure to comply with requirements related to the safeguarding of client assets under Rule 206(4)-2 of the Investment Advisers Act (the "*Custody Rule*"). In the order, the SEC found that Galois Capital had failed to ensure that its private fund client's crypto assets were held by a qualified custodian in violation of the Custody Rule. Instead, Galois Capital held certain of its client's crypto assets on digital asset trading platforms, including FTX Trading Ltd. When FTX collapsed in November 2022, approximately half of the private fund client's assets were lost. In addition, Galois Capital misled investors about the notice period required for redemptions. While Galois Capital told certain investors that redemptions required at least five days' written notice, they permitted other investors to redeem out of the fund with less than five days' written notice. Galois Capital, without admitting to any wrongdoing, consented to receiving a cease and desist order prohibiting further violations of the Advisers Act, a censure, and a civil penalty of $225,000.

For more information, see the SEC's press release available here. For more information on recent proposed expansions to the Investment Adviser Custody Rule, see our Client Alert available here.

SEC Disbands ESG Task Force

Investment Advisers | Investment Companies | Other Market Entities

The SEC recently dissolved its Climate and ESG Enforcement Task Force (the *"ESG Task Force"*). The ESG Task Force was created in March 2021, within the SEC's Division of Enforcement with a stated goal of developing initiatives to proactively identify ESG-related misconduct, including analyzing disclosure and compliance issues relating to investment advisers' and funds' ESG strategies, and to evaluate ESG-related whistleblower complaints. The ESG Task Force actions included cases against investment advisers for making misleading statements on ESG and violations of related policies and procedures. According to an SEC spokesperson, the "expertise developed by the task force now resides across the Division." The proposed rule on "Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices" remains on the SEC's rulemaking agenda.

Recent and Upcoming Compliance Dates

Below is a list of recent and upcoming compliance dates impacting the investment management industry:

Compliance Requirement	Date
Form N-PX: Enhanced Proxy Voting Disclosures	7/1/2024
Tailored Shareholder Reports for ETFs & Mutual Funds	7/24/2024
Modernization of Beneficial Ownership Reporting	
Compliance with the revised Schedule 13G filing deadlines	9/30/2024
Compliance with the structured data requirement for Schedules 13D and 13G	12/18/2024
Short Position and Activity Reporting by Institutional Investment Managers	1/2/2025
Reg S-P Amendments: Privacy of Consumer Information	
Larger Entities	12/3/2025
Smaller Entities	6/3/2026
Fund Names Rule	
Larger Entities	12/11/2025
Smaller Entities	6/11/2026

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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.