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Investment Management Regulatory Update

In This Issue

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Regulatory Happenings

- Trump Administration Halts Pending Rulemaking Activity
- SEC Issues Names Rule FAQs
- SEC Issues Risk Alert for Registered Investment Companies
- SEC Identifies Common Issues with Tailored Shareholder Reports

Market Happenings

- President Trump Selects Paul Atkins to Lead SEC
- SEC Announces New Crypto Task Force

Litigation, Enforcement, and Examinations

- SEC Issues 2025 Exam Priorities
- Court Upholds Closed-End Fund Majority Vote Standard for Contested Elections
- Court Reinstates Preliminary Injunction of Corporate Transparency Act
- SEC Enforcement Roundup

Upcoming and Recent Compliance Dates

Regulatory Happenings

Trump Administration Halts Pending Rulemaking Activity

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

On January 20, 2025, shortly following his inauguration, President Trump issued an executive order preventing all federal agencies from sending new regulations for publication in the Federal Register and withdrawing submitted regulations that had not yet been published. The order also requests that agencies "consider postponing for 60 days from the date of [the order] the effective date for any rules that have been published in the Federal Register, or any rules that have been issued in any manner but have not taken effect." Among the SEC regulations subject to reconsideration are recently adopted amendments to the Investment Company Names Rule (Rule 35d-1 under the Investment Company Act), which has an initial compliance date of December 11, 2025, for larger entities.

For more information, see the Executive Order available here.

SEC Issues Names Rule FAQs

Investment Advisers | *Investment Companies*

On January 8, 2025, the SEC issued frequently asked questions guidance on the recently adopted amendments to the Investment Company Names Rule (Rule 35d-1 under the Investment Company Act). The guidance includes the following:

- **Single-State Municipal Funds:** A single-state tax-exempt fund may include a security of an issuer located outside of the named state in the fund's 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, *provided* that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state.
- **Use of "Municipal" vs. "Tax-Exempt" in a Fund's Name:** Funds that use the term "municipal" rather than "tax-exempt" may count securities that generate income subject to the alternative minimum tax toward the 80% investment requirement, while funds that use the term "tax-exempt" may not.

- **Use of "Income" in a Fund's Name:** When the term "income" in the name of a fund does not refer to fixed income securities, the term "income" in a fund's name generally suggests that the fund emphasizes the achievement of current income as a "portfolio-wide result to be achieved" and thus would not be subject to the Names Rule.
- **Use of "High Yield" in a Fund's Name:** The staff believes "high yield" to be generally understood to describe corporate bonds with particular characteristics (namely having been assigned a below investment grade credit rating). Accordingly, the staff believes "high yield" in a fund's name triggers application of the Names Rule and requires an 80% investment test in such bonds. However, for historical reasons, the staff said that when "high yield" is paired with "municipal" or "tax-exempt" in a fund's name, such fund need not necessarily adopt an investment test to invest at least 80% of its assets in high yield securities but will of course need to invest at least 80% of its assets in municipal securities.

For more information, see the SEC's guidance, available here.

SEC Issues Risk Alert for Registered Investment Companies

Investment Advisers | Investment Companies

On November 4, 2024, the SEC's Division of Examinations issued a risk alert summarizing findings from the past four years of investment company examinations. The risk alert summarized common deficiencies in three areas:

- **Fund Compliance Programs:** Funds failed to adopt, implement, update, and/or enforce complete and accurate policies and procedures that were tailored to the fund's business model (specifically with respect to custody requirements, fee billing, derivatives and liquidity risk management programs, valuation of portfolio assets, portfolio management, shareholder complaints, distribution of fund shares, trade allocations and errors, affiliated transactions, and execution capabilities of certain broker-dealers). Other deficiencies noted by the staff include: failure to exercise effective oversight of compliance policies and procedures (including assessing the effectiveness thereof), failure to adopt, implement, or enforce a code of ethics and failure by fund CCOs to provide requisite written annual compliance reports to the fund's board.
- **Fund Disclosures and Filings:** Fund registration statements, reports, or sales literature contained untrue or potentially misleading statements regarding investment practices (including use of environmental, social, and governance factors in investment decision-making processes). The staff also noted instances of funds repeatedly exceeding stated asset investment thresholds and failing to timely make required fund filings.
- **Fund Governance Practices:** Fund board approvals of advisory agreements appeared to be inconsistent with the Investment Company Act and/or the funds' written compliance procedures. Fund boards did not receive certain information to effectively oversee fund practices (including illiquid investments). Fund boards did not perform required responsibilities (*e.g.,* determinations with respect to joint liability insurance policies) or failed to adopt required policies (*e.g.,* liquidity risk management program, anti-money laundering program, or Rule 12b-1 plans). Fund board minutes did not fully document board actions.

For more information, see the SEC's Risk Alert, available here.

SEC Identifies Common Issues with Tailored Shareholder Reports

Investment Advisers | Mutual Funds | Exchange-Traded Funds

In November 2024, the SEC's Division of Investment Management's Disclosure Review and Accounting Office issued an Accounting and Disclosure Information (ADI) summarizing common issues the staff has identified with Tailored Shareholder Reports (TSRs). Among the issues identified are the following:

- **Annualizing Fund Expenses:** Certain funds were inappropriately annualizing the expenses in dollars paid on a $10,000 investment in their semi-annual shareholder report (such expenses should reflect the dollar cost over the period). However, expenses as a percentage of a $10,000 investment may be annualized in the semi-annual report. The staff suggested that, to further assist investors, funds consider noting in their semi-annual reports that costs paid as a percentage of a $10,000 investment is an annualized figure.
- **Calculating Fund Expenses:** Several funds incorrectly calculated the expenses in dollars paid on a $10,000 investment by multiplying the "[c]osts paid as a percentage of your investment" by $10,000. Funds should

multiply "[c]ost paid as a percentage of your investment" by the average account value over the period based on an investment of $10,000 at the beginning of the period.

- **ETF Performance:** ETFs are not permitted to disclose market value performance. Only net asset value performance may be shown.
- **Broad-Based Securities Index:** The staff reminded funds that industry-specific indexes (such as indexes with characteristics such as "growth," "value," or "small- or mid-cap") are not broad-based securities indexes that satisfy the performance comparison requirements of Form N-1A. The staff also reminded funds that reports are required to be tagged using Inline XBRL structured data format and that a fund's optional secondary performance benchmark should not be XBRL tagged as a broad-based index.
- **Fund Statistics:** Certain funds include portfolio-level statistics, such as average maturity or average credit rating, under the heading "Graphical Representation of Holdings." These holdings-based statistics should instead be disclosed under the heading "Fund Statistics."
- **Graphical Representation of Holdings:** The staff reminded funds to, as applicable: specify whether the percentage of fund holdings shown in the report is based on net asset value, total investments, or total or net exposure and include a brief description of how the credit quality of the holdings were determined. The staff suggested that funds consider selecting categories that are most helpful for investors to assess and monitor their fund investments.
- **Material Changes:** Certain funds failed to include required cover page disclosure for the material changes contained within a report.
- **Availability of Additional Information Online:** The staff noted several instances where links included within reports were broken or led to a central site or landing page that was not specific to the specific item required by the form. The staff also suggested that funds consider referring to the additional information required by Form N-CSR to be provided on a fund's website by a term that is more descriptive of that information (*e.g.*, "Annual Financial Statements and Additional Information") rather than using descriptors such as "N-CSR" or "Financial Statements."

For more information, see the SEC's ADI, which is available here.

Market Happenings

President Trump Selects Paul Atkins to Lead SEC

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

President Trump announced Paul Atkins, former SEC commissioner from 2002 to 2008, to succeed Gary Gensler as chairman of the SEC. Mr. Atkins is expected to focus on paring back financial industry regulation and lowering economic penalties for violators. Since leaving the SEC in 2008, Mr. Atkins has represented cryptocurrency and digital asset market participants in various contexts and is expected to take a looser regulatory approach to such assets than his predecessor.

SEC Announces New Crypto Task Force

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

On January 21, 2025, acting SEC Chairman Mark T. Uyeda announced the creation of a new cryptocurrency task force dedicated to "developing a comprehensive and clear regulatory framework for crypto assets." The task force signals a departure from the former administration's enforcement-focused approach to the crypto industry and is in line with the Trump administration's perceived support for crypto-friendly regulation. The task force, led by Commissioner Hester Peirce, will coordinate across Congress, the SEC, and other international, federal, and state regulatory agencies to, among other things, "provide realistic paths to registration" and "craft sensible disclosure frameworks." Commissioner Peirce has been publicly supportive of crypto innovation and critical of enforcement actions targeting crypto industry participants.

For more information, see the SEC's press release, available here.

Litigation, Enforcement, and Examinations

SEC Issues 2025 Exam Priorities

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

In October 2024, the Division of Examinations of the SEC published its examination priorities for fiscal year 2025, reflecting practices, products, and services the Division believes present heightened risks to investors and the U.S. capital markets. The Division highlighted the following focus areas, among others:

- Investment adviser adherence to fiduciary duty standards;
- Private fund investment advisers;
- Investment company fund fees and expenses, and any associated waivers and reimbursements;
- Investment company oversight of affiliated and unaffiliated service providers;
- Investment company portfolio management practices and disclosures, including consistency with investment strategies disclosures, fund filings, and marketing materials;
- Broker-dealer compliance with Regulation Best Interest;
- Content of broker-dealer Form CRS;
- Broker-dealer compliance with the net capital rule, the customer protection rule, and related policies and procedures;
- Broker-dealer trading-related practices and services, including structure, marketing, fees, and potential conflicts associated with offerings to retail customers; and
- General focus areas of cybersecurity, privacy, fin-tech, crypto-assets, and anti-money laundering.

It should be noted, however, that the Trump administration and the incoming SEC chairman may redirect the Division's enforcement efforts. For more information on the SEC's exam priorities, see our Client Alert available here.

Court Upholds Closed-End Fund Majority Vote Standard for Contested Elections

Closed-End Funds

On October 21, 2024, the Massachusetts Superior Court affirmed a lower court's ruling that the Eaton Vance Closed-End Funds' bylaw provision instituting a majority voting standard in the event of a contested election was consistent with applicable state law and the equal voting rights provision of Section 18(i) of the Investment Company Act. The majority rule provision also allowed current fund trustees to remain in place until new trustees could be elected. The Court's decision represents a win for the closed-end fund industry and enhances such fund's ability to defend against activist shareholders.

Court Reinstates Preliminary Injunction of Corporate Transparency Act

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

As reported in our recent series of Client Alerts, federal courts have considered and reconsidered the enforceability of a preliminary injunction blocking enforcement of the Corporate Transparency Act ("*CTA*"). On December 3, 2024, the U.S. District Court for the Eastern District of Texas (the "*district court*") issued a nationwide preliminary injunction that temporarily blocked enforcement of the CTA and the U.S. Department of the Treasury's Financial Crimes Enforcement Network's ("*FinCEN*") related beneficial ownership information ("*BOI*") reporting rules. On January 23, 2025, the Supreme Court granted a stay of a district court's nationwide injunction pending any further appeals. However, a different judge in the same district court recently issued an order in a separate case (*Smith v. U.S. Department of Treasury*) which enjoined FinCEN from enforcing the CTA against the plaintiffs in the case and, notably, stayed the effective date of the BOI reporting rules. Any questions as to the scope and continued effectiveness of this ruling in light of the Supreme Court's order were quickly put to rest by FinCEN, which issued a statement containing the following: "Reporting companies also are not subject to liability if they fail to file this

information while the *Smith* order remains in force. However, reporting companies may continue to voluntarily submit beneficial ownership information reports." For now, it appears the CTA continues to not be enforceable. We will continue to monitor developments in this rapidly changing area and will continue to provide updates.

For more information, please see our most recent Client Alert on this topic, available here.

SEC Enforcement Roundup

Investment Advisers | Investment Companies

During the fourth quarter of 2024 and early 2025, the SEC pursued several enforcement actions against registered investment advisers centered mainly around fraudulent or misleading statements, disclosures, and investment practices, and violations of the compliance policies and procedures and recordkeeping requirements of the federal securities laws. It is anticipated that, under the new administration, the SEC would pursue a narrower set of enforcement priorities, including a lighter touch of cryptocurrency and environmental, social, and governance ("*ESG*") enforcement. A few examples of SEC actions during the fourth quarter and early 2025 are highlighted below:

- **Adviser's Failure to Supervise and Whistleblower Violations:** On January 16, 2025, the SEC announced it had settled charges against a registered investment adviser for "breaching their fiduciary duties by failing to reasonably address known vulnerabilities in their investment models and for related compliance and supervisory failures, which resulted in persons making unauthorized changes to the funds' investment models." The adviser had also violated a federal whistleblower protection rule by requiring departing individuals, in separation agreements, to state that they had not filed a complaint with any governmental agency. The SEC press release is available here.
- **Marketing Rule Violations by Adviser:** On December 20, 2024, the SEC announced it settled charges against an adviser for failure to comply with amended Rule 206(4)-1 ("*Marketing Rule*") under the Advisers Act. The SEC found the adviser "made false and misleading claims about its investment strategies and their performance, failed to present net performance information alongside gross performance, was unable to substantiate performance claims upon demand by the Commission, and advertised hypothetical performance on its public website without adopting and implementing required policies and procedures." The SEC found the adviser also violated Rule 204-2(a)(16) under the Advisers Act "by not maintaining books and records sufficient to demonstrate the calculation of the performance information in its advertisements," and Rule 206(4)-7 by failing to implement certain of its compliance policies and procedures. The SEC press release is available here.
- **Failure to Disclose Conflicts of Interest:** On December 20, 2024, the SEC announced it settled charges against a registered investment adviser and its owner and managing partner for failures to disclose actual or potential conflicts of interest arising from the owner's familial and financial connections with the chief executive officer of a portfolio company in which a private fund managed by the adviser made investments. The SEC found the adviser and owner willfully violated the anti-fraud provision of Section 206(2) of the Advisers Act, and the adviser violated the anti-fraud provision and compliance rule in Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder. The SEC press release is available here.
- **Advisers' Repeated Failure to File Form PF:** The SEC settled charges against seven registered investment advisers for failure to file Form PF over multiple periods in violation of the reporting requirements of the Advisers Act. The advisers agreed, among others, to civil monetary penalties totaling $790,000. The SEC press release is available here.
- **Adviser Charged for Making Misleading ESG Claims:** On December 13, 2024, the SEC announced it sanctioned an investment adviser for making misleading statements about the percentage of company-wide assets under management that integrated ESG factors in investment decisions, in violation of the Advisers Act. The adviser agreed to a $17.5 million civil penalty to settle the charges. The SEC press release is available here.
- **Adviser's Former Co-CIO Charged with Fraud:** On November 25, 2024, the SEC announced it had filed fraud charges against the former co-chief investment officer ("*CIO*") of a registered investment adviser for "engaging in a multi-year scheme to allocate favorable trades to certain portfolios, while allocating unfavorable trades to other portfolios, a practice known as cherry-picking." The complaint, filed in the U.S. District Court for the Southern District of New York, charged the CIO with violating anti-fraud and other provisions of the federal securities laws,

and seeks permanent and conduct-based injunctions, an officer-and-director bar, disgorgement, prejudgment interest, civil penalties, and other relief. The SEC press release is available here.

- **Affiliated Broker-Dealer/Investment Advisers Sanctioned in Five Enforcement Actions:** The SEC charged broker-dealer/registered investment adviser affiliated entities in five separate enforcement actions for misleading disclosures to investors, breach of fiduciary duty, prohibited joint transactions and principal trades, and failures to make recommendations in the best interest of customers. In one of the actions, the SEC censured a broker-dealer/investment adviser for violating the care obligation and compliance obligation of Regulation Best Interest ("*Reg. BI*"). The SEC found that the broker-dealer/adviser representatives had recommended certain mutual funds to its retail brokerage customers when materially less expensive ETFs were also available on its platform, failed to consider the costs associated with the clone mutual funds as opposed to the less expensive clone ETFs, and failed to have a reasonable basis to believe the recommendations were in the best interest of the customers. In another action, the SEC found that the investment manager violated Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder by causing $4.3 billion in prohibited joint transactions that advantaged an affiliated foreign money market fund for which it served as the delegated portfolio manager over three U.S. money market mutual funds it advised. The SEC press release is available here.
- **Adviser Sanctioned for ESG Compliance Failures:** On October 21, 2024, the SEC announced it settled charges against a registered investment adviser for misstatements and compliance failures with respect to three ESG-marketed ETFs. The SEC found that the investment manager represented in the funds' prospectuses and to the board of trustees that the funds would not invest in companies involved in certain products or activities, including fossil fuels and tobacco, but used data from third-party vendors that did not screen out all such companies. The SEC further found that the investment manager did not have any policies and procedures with respect to the screening process. The SEC press release is available here.

Upcoming and Recent Compliance Dates

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

Compliance Requirement	Date
Short Position and Activity Reporting by Institutional Investment Managers	1/2/2025 (first filing due 2/14/2025)
Exemption for Certain Investment Advisers Operating Through the Internet	3/31/2025
Amended Form PF	6/12/2025
Form N-PORT and Form N-CEN Reporting	
Larger Entities	11/17/2025
Smaller Entities	5/18/2026
Reg S-P Amendments: Privacy of Consumer Information	
Smaller Entities	6/3/2026
Fund Names Rule	
Larger Entities	12/11/2025
Smaller Entities	6/11/2026

* The effective date of final rules that have not yet been implemented may be paused for 60 days or more, per Executive Order dated January 20, 2025.

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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.