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Registered Funds Regulatory Update

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SEC Rulemaking

SEC Announces Fall 2023 Regulatory Agenda

On December 6, 2023, the SEC's Office of Information and Regulatory Affairs released the Fall 2023 Regulatory Agenda that includes the Division of Investment Management's anticipated short- and long-term regulatory actions. According to the SEC, the proposed Agenda seeks to promote the efficiency, integrity, and resiliency of the markets. The updated Agenda includes the following investment management-related rule proposals that are scheduled to be finalized in April 2024:

- rule amendments pertaining to shareholder proposals under Rule 14a-8 under the Exchange Act;
- rule amendments and/or proposed new rules under the Advisers Act to improve and modernize the regulations around the custody of assets;
- rule amendments to enhance registrant disclosures regarding issuers' climate-related risks and opportunities;
- rule amendments for open-end management investment companies regarding liquidity risk management programs and swing pricing;
- proposed rules under the Exchange Act and Advisers Act related to broker-dealer and investment adviser conflicts in the use of predictive data analytics, AI, machine learning, and similar technologies in connection with certain investor interactions;
- proposed rules under the Advisers Act requiring advisers to heighten their oversight of third-party service providers;
- proposed ESG-related rules for funds and advisers; and
- proposed rules to enhance fund and investment adviser disclosures and governance relating to cybersecurity risks.

The Agenda also indicates that the SEC now intends to propose, among others, the following proposals in October 2024:

- rule amendments to enhance registrant disclosure of board and nominee diversity; and
- changes to regulatory requirements relating to registered investment company fees and fee disclosure.

Agency Rule List – Fall 2023 (Dec. 6, 2023), available at: https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode&showStage=active&agencyCd=3235.

SEC Postpones Effective Date of Share Repurchase Disclosure Modernization

On November 22, 2023, the SEC issued an order indefinitely postponing the effective date of its Share Repurchase Disclosure Modernization Rule, initially adopted on May 3, 2023. The postponement comes after a unanimous panel of the U.S. Court of Appeals for the Fifth Circuit found the rule "arbitrary and capricious" and ordered the SEC to correct certain defects the court identified by November 30, 2023.

The Share Repurchase Disclosure Modernization Rule, a series of amendments to the SEC's existing issuer share repurchase disclosure rules, would have required greater public transparency regarding share repurchases by U.S. and foreign reporting companies, as well as registered closed-end management investment companies that are exchange traded. These enhanced requirements would have included, among other changes: (i) quarterly disclosure of daily quantitative share repurchase data; (ii) narrative disclosure regarding the objectives and rationales for each repurchase plan or program, and disclosure of the number of shares purchased other than through a publicly announced plan or program; and (iii) quarterly disclosure of whether a domestic issuer has adopted or terminated any Rule 10b5-1 trading plan and description of the material terms of any such plan.

The Share Repurchase Disclosure Modernization Rule initially became effective on July 31, 2023. Domestic issuers were initially required to comply with the amendment in the first Form 10-Q or Form 10-K covering the quarter beginning on or after October 1, 2023.

Immediately after the rule was announced, the U.S. Chamber of Commerce, among others, filed a petition for review in the Fifth Circuit. On October 31, 2023, the Fifth Circuit issued a decision agreeing with certain of the petitioners' arguments and finding that the SEC had acted arbitrarily and capriciously in violation of the Administrative Procedure Act when it adopted the rule by not considering the petitioners' comments and not conducting a proper cost-benefit analysis. The Fifth Circuit remanded the rule with a direction to the SEC to correct those defects within 30 days of its decision.

On November 22, 2023, the SEC announced the postponement of the effective date of the rule and filed a motion requesting an extension of the November 30 deadline to revise the rule, which the Fifth Circuit denied. On December 1, 2023, the SEC informed the Fifth Circuit that it was unable to the correct the rule's defects, thereby providing the Fifth Circuit the ability to vacate the rule. To move forward, the SEC will need to appeal the Fifth Circuit's decision or propose a new rule addressing the identified defects.

As the rule is stayed pending further action by the SEC, reporting companies will not be required to comply with the rule in their future periodic reports. Instead, such companies should continue to comply with existing disclosure requirements regarding share repurchases.

Announcement Regarding Share Repurchase Disclosure Modernization Rule, SEC Announcement (Nov. 22, 2023), available at: https://www.sec.gov/corpfin/announcement/announcement-repurchase-disclosure-modernization-112223.

SEC Staff Guidance

SEC Division of Examinations Announces 2024 Examination Priorities

The SEC's Division of Examinations released its 2024 Examination Priorities, aligning the release of the priorities with the start of the SEC's fiscal year to provide earlier insight to its focus areas for the upcoming year. The following sets forth an overview of the Division's 2024 examination priorities:

Investment Companies. The Division will continue to prioritize examining registered investment companies given their importance to retail investors, particularly those saving for retirement. Examination focus areas will include:

- Fees and expenses and reviewing whether the fund has adopted effective written compliance policies and procedures regarding oversight of advisory fees and implemented any associated fee waivers and reimbursements. Specifically, the SEC intends to focus on (i) funds that charge different advisory fees to different share classes; (ii) identical strategies that are offered by the same sponsor through different distribution channels but with different fee structures; (iii) funds with high advisory fees relative to peers; and (iv) funds with high fees and expenses, particularly those with poor performance relative to their peers. Notably, examinations will review the board's approval of the advisory contract and fees.
- Derivatives risk management assessments to review whether (i) funds have adopted and implemented policies and procedures reasonably designed to manage the fund's derivatives risks and prevent violations of the Investment Company Act Rule 18f-4 (Derivatives Rule); and (ii) review for compliance with Rule 18f-4, including the adoption and implementation of a derivatives risk management program, board oversight, and whether disclosures concerning the fund's use of derivatives are incomplete, inaccurate, or potentially misleading.
- Compliance with the terms of exemptive order conditions and issues involving recent market dislocations and volatility, such as whether funds in liquidation are following liquidation procedures.

Investment Advisers. The Division will continue to review a registered investment adviser's adherence to duty of care and duty of loyalty to its clients by focusing on (i) investment advice provided to certain types of clients, such as older investors and those saving for retirement; (ii) processes for determining that investment advice is provided in clients' best interests; (iii) economic incentives that an adviser and its financial professionals may have to recommend products, services, or account types, such as the source and structure of compensation, revenue, or other benefits; (iv) disclosures made to investors and whether such disclosure includes all material facts relating to conflicts of interest associated with the investment advice sufficient to allow a client to provide informed consent to the conflict.

The Division also remains focused on adviser compliance programs and compliance program reviews and will assess whether the policies and procedures are sufficient to support compliance with the adviser's fiduciary obligations. The Division's particular examination focus will include:

- marketing practice assessments, such as (i) compliance with the Advisers Act and the rules thereunder, including reforms to the Marketing Rule; (ii) appropriate disclosure or marketing-related information on Form ADV; and (iii) substantiation of processes and other required books and records;
- compensation arrangement assessments focusing on (i) fiduciary obligations of advisers to their clients; and (ii) alternative ways that advisers try to maximize revenue;
- valuation assessments regarding adviser recommendations to clients to invest in illiquid or hard to value assets, such as commercial real-estate or private placements;
- safeguarding assessments for controls protecting material non-public information; and
- disclosure assessments to review the accuracy and completeness of regulatory filings, including Form CRS.

Information Security and Operational Resiliency. The Division will continue to review broker-dealer and adviser practices to prevent interruptions to mission critical services and to protect investor information, records, and assets. The Division's exams will focus on safeguarding customer records and information (including those stored via third-party service providers), governance practices, and responses to cyber-related incidents. In addition, the Division will assess registrant preparations associated with compliance with adopted rule changes to shorten the standard settlement cycle for most broker-dealer transactions from T+2 to T+1, which has a compliance date of May 28, 2024.

Crypto-Assets and Emerging Financial Technology. Given the continued volatility of, and activity around, the crypto asset markets, the Division will continue to monitor and, when appropriate, conduct examinations of registrants focusing on the offer, sale, recommendation of, or advice regarding trading and other activities in crypto assets or related products and include whether the firm (i) met and followed its respective standards of conduct when making recommendations or providing advice to customers or clients regarding crypto assets; and (ii) routinely reviewed, updated, and enhanced its compliance practices, risk disclosures, and operational resiliency practices. The Division also will conduct examinations of broker-dealers and advisers using emerging financial technologies (*e.g.*, broker-dealer mobile apps, automated "robo-adviser" investment tools, and trading platforms) to meet compliance and marketing demands and service investor accounts. The Division will also assess whether any technological risks associated with the use of blockchain and distributed ledger technology have been addressed.

Investment Advisers to Private Funds. The Division notes a focus on ensuring adherence to contractual requirements regarding advisory boards. Sponsors should carefully review fund governing documents for notice and consent obligations and monitor, document, and test compliance with these requirements. Also included in the Examination Priorities for advisers to private funds are (i) for both private equity and venture capital firms,

adequate due diligence practices for investments in portfolio companies, including a focus on consistency with policies and disclosures on this topic; (ii) a focus on conflicts, controls, and disclosures related to affiliated service providers; and (iii) for the second consecutive year, a priority on private funds managed side-by-side with registered investment companies. Finally, the Examination Priorities include other topics, such as policies and procedures for reporting on Form PF (which was recently amended), compliance with the amended Marketing Rule—underscoring the SEC's overall focus on ensuring compliance with (and enforcing) newly adopted rules—as well as cybersecurity, AI, and anti-money laundering, among other areas.

Broker Dealers. The Division will continue to focus on standards of conduct for broker-dealers, specifically related to compliance with Regulation Best Interest. The Division's examinations will assess practices regarding review of investment alternatives, management of conflicts of interest, and consideration of investment goals and account characteristics. The Division notes the following areas of assessment for its examinations:

- recommendations with regard to products, investment strategies, and account types;
- disclosure made to investors regarding conflicts of interest;
- conflict mitigation practices;
- processes for reviewing reasonably available alternatives; and
- factors considered in light of the investor's investment profile, including investment goals and account characteristics.

Additionally, the Division's examinations will review the content of a broker-dealer's relationship summary, such as how the broker-dealer describes (i) the relationships and services that it offers to retail customers; (ii) its fees and costs; and (iii) its conflicts of interests, and whether the broker-dealer discloses any disciplinary history. The examinations will also evaluate whether broker-dealers met their obligations to file their relationship summary with the SEC and delivered it to retail customers.

2024 Examination Priorities, Division of Examinations, SEC (Oct. 16, 2023),
available at: https://www.sec.gov/files/2024-exam-priorities.pdf.

Industry Developments

SEC Exam Sweep Probes Investment Advisers' Use of AI

The SEC's Division of Examinations recently launched a sweep exam of investment advisers specifically requesting information on AI-related topics, including AI-related marketing documents, algorithmic models used to manage client portfolios, third-party providers, and compliance training, according to letters obtained within the industry. The sweep exam also requested information related to back-up plans for system failures, reports on AI-related regulatory or legal issues, and disclosures and marketing pieces specifically referencing AI. An SEC spokesperson said examinations are not made public and would not confirm or deny that a sweep exam is taking place.

The SEC recently announced its Fall 2023 Regulatory Agenda that includes a focus on regulated firms' use of AI. Additionally, the SEC in July proposed rules related to broker-dealer and investment adviser conflicts around the use of predictive data analytics, including AI, which would require firms to identify any conflicts of interest that result in broker-dealers' or investment advisers' interactions with investors that place the firm's interests ahead of investor interests and eliminate or neutralize the effects of those conflicts. SEC Chair Gary Gensler has frequently publicly commented on the emerging risks resulting from the financial industry's growing adoption of AI and warned on several occasions that the use of AI creates financial instability and could cause an economic crisis without intervention.

SEC Enforcement

SEC Announces FY 2023 Enforcement Results and Trends

On November 14, 2023, the SEC announced its enforcement results for fiscal year 2023. Over the year, the SEC filed 784 total enforcement actions, up from the 760 actions filed in the 2022 fiscal year. Penalties, disgorgement, and pre-judgment interest amounted to $4.949 billion, the second highest amount in SEC history, down from $6.439 billion in the previous year. The SEC also obtained orders barring 133 individuals from serving as officers and directors of public companies, the highest number of officer and director bars obtained in a decade.

The SEC also issued whistleblower awards totaling nearly $600 million, the most ever awarded in a single year, including a record-breaking $279 million awarded to one whistleblower. The SEC received over 18,000 whistleblower tips in fiscal year 2023, a record number exceeding more than 50 percent of the number of whistleblower tips received in fiscal year 2022. The SEC also reported it received more than 40,000 tips, complaints, and referrals in total, an increase of 13 percent compared to fiscal year 2022. It also distributed $930 million to harmed investors, marking the second year in a row the SEC distributed over $900 million.

The SEC issued enforcement actions against a wide variety of market participants, including broker-dealers, credit rating agencies, investment advisers, gatekeepers, and individuals. Notably, the SEC focused on compliance in the evolving crypto, cybersecurity, and ESG spaces, including charges against crypto companies Binance and Coinbase for noncompliance in the crypto asset intermediary space, Virtu for materially false and misleading statements and omissions regarding information barriers to prevent the misuse of sensitive customer information, and Goldman Sachs for ESG-related violations. Some of the year's largest penalties, totaling $400 million, were issued as a result of the SEC's actions against twenty-five advisory firms, broker-dealers, and/or credit rating agencies, including Wells Fargo, HSBC, and Scotia Capital, for widespread and longstanding failures to maintain and preserve work-related communications on employees' personal devices. In addition, the SEC charged ten investment advisers for noncompliance with the new Marketing Rule under the Advisers Act. The SEC also issued several enforcement actions for failing to protect whistleblowers' rights and the ability to report potential securities laws violations to the SEC.

Notably, the SEC consistently recognized meaningful cooperation with the agency to promote compliance across the securities industry, which it emphasized encourages firms to, among other things, proactively self-police, self-report, and remediate violations. The SEC rewarded public issuers, private companies, and advisers in connection with a range of violations, including material misstatement, recordkeeping, and whistleblowing violations.

SEC Announces Enforcement Results for Fiscal Year 2023, SEC Press Release (Nov. 14, 2023), available at: https://www.sec.gov/news/press-release/2023-234.

SEC Remarks

Commissioner Crenshaw Warns of Broadly Syndicated Loan Risk

In an October 11, 2023 speech to the Center for American Progress, SEC Commissioner Caroline Crenshaw called for a review to determine whether additional regulatory action is needed with respect to broadly syndicated loans, the most common form of leveraged loans, which have grown to over $1.0 trillion in assets globally. Crenshaw noted that the syndicated loan market has significantly grown and evolved far beyond traditional borrowing but is not subject to meaningful regulation.

Crenshaw stated that while syndications, loan participations, and assignments are not new investment products, these products are now “supersized and systemized.” Moreover, she noted that while investors in syndicated loans have typically been sophisticated investors, such as hedge funds, pension funds, or insurance companies, retail investors have significantly increased their exposure to syndicated loans because they have increasingly been marketed to the broader public to hedge against rising interest rates. She warned that if these products are not more closely monitored, the risks to the wider financial system will only grow and urged regulators to be vigilant with not just past risks but emerging ones too.

In March, the Second Circuit asked the SEC to weigh in as to whether syndicated term loans are securities, but the SEC ultimately declined to do so. In August, the Second Circuit ruled that leveraged loans do not qualify as securities.

Caroline A. Crenshaw, SEC Commissioner, Speech, *In-securities: What Happens When Investors in an Important Market are not Protected? Remarks to the Center for American Progress* (Oct. 11, 2023), available at: https://www.sec.gov/news/speech/crenshaw-remarks-center-american-progress-101123.

CCO Liability—Grewal Addresses the Proverbial Elephant in the Room

In a speech at the New York City Bar Association Compliance Institute, Division of Enforcement Director Gurbir Grewal stated that the SEC rarely brings enforcement actions against compliance officers because it does not second-guess their good faith judgment made after reasonable inquiry and analysis. However, it will bring enforcement actions against compliance officers for wrongdoing where there is (i) evidence that the compliance officer participated in misconduct unrelated to their compliance functions; (ii) misled a regulator; or (iii) there was a “wholesale failure” by the compliance officer to carry out their compliance obligations. Grewal noted that the SEC has filed over 1,000 standalone cases under his tenure but only a handful of those involved charges against compliance officers.

With regards to the first category, Grewal emphasized that a compliance position does not come with a "get-out-of-jail" card, meaning compliance officers will be held accountable to the same extent as anyone else when they violate the securities laws. As a recent example, he noted the SEC recently charged a CCO with insider trading for allegedly trading on material nonpublic information, and tipping it to his friends who also traded on the information, that he surreptitiously obtained from his girlfriend's laptop about an upcoming merger her employer was involved in.

The second category involves conduct obstructing or misleading regulators or providing false information to them. Grewal cited two recent actions, where in each the CCO was charged with falsifying compliance reports provided to the SEC as examples of deliberate conduct by a CCO to thwart the SEC's ability to effectively oversee compliance functions.

Finally, Grewal explained that the "wholesale failure" category involves actions where there is no education, engagement, or execution by a compliance officer. Rather, the compliance officer failed to conduct even basic inquiry and analysis. As one example, Grewal cited a recent enforcement action where the CCO to an investment adviser was charged with failing to adopt and implement a compliance program reasonably designed to prevent violations of the federal securities laws. The adviser had adopted a handbook published by a professional trade organization that was not even tailored to the adviser's actual business. In fact, the handbook did not even include the applicable federal securities laws. Moreover, the adviser failed to conduct any compliance trainings or annual reviews of its program.

Grewal also flagged in his speech three traits crucial for fostering "a culture of proactive compliance" to restore public trust in financial institutions: (i) education, or sufficient awareness of compliance responsibilities and the firm's conduct; (ii) engagement, or maintaining adequate contact with the company's staff; and (iii) execution, or implementing the right compliance policies.

Gurbir S. Grewal, SEC Division of Enforcement Director, Speech, *Remarks at New York City Bar Association Compliance Institute* (Oct. 24, 2023), available at: https://www.sec.gov/news/speech/grewal-remarks-nyc-bar-association-compliance-institute-102423.

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Registered Funds Alert

SEC Adopts Amendments to Fund "Names" Rule

October 26. 2023

On September 20, 2023, by a vote of four to one, the U.S. Securities and Exchange Commission (the "SEC") adopted amendments (the "Amended Names Rule") to Rule 35d-1 (the "Names Rule") under the Investment Company Act of 1940, as amended (the "1940 Act"), and related form and disclosure requirements.[1] The amendments aim to modernize and enhance investor protections by expanding the scope of the current requirement that 80% of the value of a registered investment company's and business development company's ("BDC," and, each, a "fund") assets be invested in the particular type of investments, or in investments in the particular industry or industries, suggested by the fund's name (for example, funds with names that suggest investments in a type of security, particular industry, geographic region or tax-free securities), to now also include funds whose name includes terms suggesting that the fund focuses in investments that have, or investments whose issuers have, particular characteristics (such as fund names with terms such as "growth" or "value," or terms indicating that the fund's investment decisions incorporate one or more environmental, social, or governance ("ESG") factors) ("80% Investment Policy"). The SEC estimates that the Amended Names Rule will result in more than 75% of existing funds having names that are subject to the Rule, an increase from 60% of funds under the current Names Rule.

The amendments were first proposed on May 25, 2022,[2] and will take effect on December 11, 2023. Fund groups with net assets of $1 billion or more will have 24 months to comply with the amendments, while fund groups with net assets of less than $1 billion will have 30 months to comply.

As discussed in more detail below, the amendments, among other things:

- **Expanded 80% Investment Policy**: Broaden the 80% Investment Policy requirement to encompass fund names that imply an emphasis on assets possessing distinct attributes, such as "growth" or "value," as well as names suggesting that the fund integrates one or more ESG factors into its investment decisions.
- **Temporary Departures**: Allow funds to temporarily deviate from their 80% Investment Policy under abnormal circumstances, with related record-keeping requirements.
- **Derivatives**: Specify how derivatives related to a fund's name and market risk factors should be considered for compliance.

[1] Investment Company Names, Release No. IC-35000 (September 20, 2023) ("Adopting Release").

[2] Investment Company Names, Release No. IC-34593 (May 25, 2022) ("Proposing Release").

- **Unlisted Closed-End Funds**: Prohibit unlisted closed-end funds and BDCs from changing their 80% Investment Policies without a shareholder vote, unless the fund conducts a tender or repurchase offer at net asset value ("NAV") per share with at least 60 days' prior notice of the policy change and the offer is not oversubscribed.
- **Materially Deceptive Names**: Codify the SEC's long-standing position that an 80% Investment Policy is not a safe harbor from materially deceptive or misleading names.
- **Enhanced Disclosure**: Require that funds with an 80% Investment Policy must define the terms used in their names using plain English meanings and/or industry standards.
- **Recordkeeping**: Provide that funds must maintain records demonstrating compliance with the 80% Investment Policy.
- **Notice Requirements**: Amend the notice requirement associated with changes to the 80% Investment Policy.
- **N-PORT Reports**: Require reporting on Form N-PORT of the fund's "80% basket," definitions of terms in fund names and declarations regarding policy compliance.

Background

Section 35(d) of the 1940 Act prohibits funds from using materially deceptive or misleading words in their names.[3] Rule 35d-1 was adopted in March 2001 and generally provides that if a fund's name suggests a focus in a particular type of investment, or in investments in a particular industry, country, or geographic region, the fund must adopt a policy to invest at least 80% of the value of its assets in the type of investment suggested by that name. Since its initial adoption, the Names Rule has been marked by difficult interpretative issues that have caused registrants and SEC staff to spend an exceptional amount of effort and resources to resolve (and sometimes agree to disagree on) fund name questions. These issues have become more complex in recent years due to new investment trends and terms, including those related to ESG, artificial intelligence and similar themes. Further, in the twenty-plus years following its adoption, the SEC has issued FAQs and other guidance interpreting the Names Rule that made clear that terms used to suggest an investment strategy, such as "growth" and "income," rather than a type of investment (such as "fixed income"), were not subject to the Names Rule. In that regard, the Amended Names Rule represents a sharp departure from decades of guidance and will encompass names suggesting a fund focus in investments that have, or investments whose issuers have, particular characteristics such as "growth" or "value." The Amended Names Rule will also directly address terms indicating that the fund's investment decisions incorporate one or more ESG factors or other terms that suggest a thematic

[3] BDCs are subject to the requirements of Section 35(d) pursuant to Section 59 of the 1940 Act.

focus. Accordingly, the SEC has stated that, in connection with the adoption of the Amended Names Rule, SEC staff are reviewing such prior guidance to determine whether portions of it should be withdrawn.[4]

Overview of the Principal Elements of the Amended Names Rule

The principal elements of the Amended Names Rule and related amendments are discussed below, as well as notable differences from the Proposing Release. Given the importance of the implications on ESG-related names, we have separately identified ESG-related considerations under each topic, if applicable.

1. Expansion of Scope of 80% Investment Policy Requirement. Broadly consistent with the proposed rule under the Proposing Release (the "Proposed Rule"), the amendments expand the scope of the Names Rule by requiring that any fund name with terms suggesting that the fund focuses in investments that have, or investments whose issuers have, particular characteristics, regardless of whether such terms connote an investment strategy, are required to adopt an 80% Investment Policy. The Amended Names Rule does not define "particular characteristics," as the SEC believes the term will be adequately understood to mean "any feature, quality, or attribute." The Amended Names Rule includes an illustrative parenthetical providing non-exclusive examples of terms that would be covered, including the terms "growth" and "value," and terms indicating that the fund's investment decisions incorporate one or more ESG factors. The SEC stated that it is adopting this approach rather than providing an enumerated list of terms included in the expanded scope "in light of the broad diversity of fund investment strategies and fund names, and to ensure that the Rule remains evergreen."[5] However, the SEC also notes that it anticipates that the *primary* types of names that the expanded scope will cover will be names that include the terms "growth" and "value," terms with ESG- or sustainability-related characteristics, or terms that reference a thematic investment focus. Acknowledging that different terms may reasonably be defined and understood differently, the Amended Names Rule allows fund managers flexibility to ascribe reasonable definitions for the terms used in a fund's name and flexibility to determine the specific criteria the fund uses to select the investments that the term describes.

   The SEC also recognized a variety of terms that would not normally require an 80% Investment Policy under the Names Rule, including certain terms that suggest a portfolio-wide result to be achieved (*e.g.*, real return, balanced, managed risk or intermediate term), a particular investment technique (*e.g.*, long/short or hedged) and names that reference asset allocation determinations that evolve over time (*e.g.*, retirement target date funds or sector rotation funds).

[4] In a footnote to the Adopting Release, the SEC also states that a fund is required to adopt and implement written compliance policies and procedures that are reasonably designed to prevent violations of the federal securities laws in general, which include Section 35(d) and the Amended Names Rule. *See* Adopting Release at n.119.

[5] Adopting Release at 30.

Changes from the Proposal: Unlike the Proposed Rule, the amendments generally will not apply to terms such as "global" or "international," as those terms describe how a fund constructs its portfolio but do not provide specific details about the composition of the portfolio (unlike terms like "Japan" or "Europe").

ESG Considerations: In order to address potential "greenwashing" concerns and investor confusion around how ESG-related terms in a fund's name are reflected in its investment policies and practices, the Adopting Release specifically identifies terms such as "sustainable," "green," and "socially responsible" as terms that will require an 80% Investment Policy. The SEC pointed to the growth in investor interest in funds that offer ESG-related investment strategies and the breadth of ESG-related terms in those funds as support for its approach.

However, in a change from the Proposed Rule, the Amended Names Rule does not categorically designate "integration funds"[6] that use ESG terms in their names as materially deceptive and misleading. The Proposed Rule's approach to integration funds was designed to address the SEC's concern that integration funds' marketing materials might be materially misleading if they indicate that ESG factors outweigh other factors in their investment selection process, when they are in practice not more important than other facts in the investment selection process. The proposed provision in the Names Rule mirrored the separate proposed definition of an integration fund in the Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices Proposal ("ESG Disclosure Proposal")[7] proposed the same day, on which the SEC has yet to take further action. In deciding not to address integration funds in the Amended Names Rule, the SEC explained that the ESG Disclosure Proposal will cover similar ground in its disclosure obligations for integration funds, so the SEC will continue to consider comments on this topic before adopting the proposed approach.[8]

2. <u>Temporary Departures from a Fund's 80% Investment Policy Requirement</u>. The Amended Names Rule retains the requirement that a fund must invest in accordance with its 80% Investment Policy "under normal circumstances." This means that a fund may temporarily depart from compliance with its 80% Investment Policy only to the extent that the fund determines that abnormal circumstances exist, which could include temporary departures that occur as a result of market fluctuations, index rebalancing, cash flows/inflows, temporary defensive positions, reorganizations or fund launches, among others. While the fund has discretion to determine when abnormal circumstances exist, the fund is required to maintain a record documenting the date of the departure and the reason for the departure.

   Funds must assess whether an investment should be included in its "80% basket" at the time of the

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[6] An integration fund is defined in the Proposing Release as "a fund that considers one or more ESG factors alongside other, non-ESG factors in its investment decisions, but [for which] such ESG factors are generally no more significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio." Proposing Release at 18.

[7] ESG Disclosure Proposal, Investment Company Act Release No. 34594 (May 25, 2022), at section II.A.1.

[8] As the Amended Names Rule was initially proposed on the same day as the ESG Disclosure Rule, many assumed the rules would be adopted together. By removing the determination that the use of an ESG term in the name of an integration fund would be materially deceptive and misleading, the SEC left the door open for a more nuanced approach in the final ESG Disclosure Rule.

investment. Under the Amended Names Rule, funds are obligated to review their portfolio investments at least quarterly to ensure compliance with the 80% Investment Policy requirement. Portfolio investments that are included in the fund's 80% basket at the time of investment will continue to be considered to be consistent with the fund's 80% Investment Policy unless the fund identifies an investment as being outside of the 80% basket as part of its required quarterly reassessments or otherwise.

If a fund falls out of compliance with its 80% Investment Policy, it must make all subsequent investments in a manner to bring it back into compliance as soon as reasonably practicable, but in any event within 90 days from the date the fund discovers the fund is out of compliance (as part of its quarterly review or otherwise) or the time the fund initially departs, in other-than-normal circumstances, from the 80% Investment Policy.[9]

Changes from the Proposal: The Proposed Rule would not have required quarterly testing but would have instead effectively required continuous compliance monitoring. In addition, under the Proposed Rule, a fund would have only been permitted to depart under certain specified circumstances, leaving less discretion to the adviser to determine when deviating from the policy is appropriate than is allowed under the "under normal circumstances policy."[10] In addition, the Proposed Rule would have required funds to come back into compliance with its 80% Investment Policy within 30 days rather than 90 days.

3. <u>Derivatives</u>. The Amended Names Rule specifies that, in addition to derivatives instruments aligned with the fund's name, to meet its 80% Investment Policy, a fund may include those offering exposure to market risk factors related to the fund's investment focus. This acknowledges that funds may use derivatives for hedging or gaining market risk factor exposure (*e.g.,* interest rate and credit spread risk) without adverse effects to a fund's compliance with its 80% Investment Policy. To help determine whether a derivatives instrument provides investment exposure to one or more of the market risk factors associated with a fund's name assets, a fund generally should consider whether the derivative provides investment exposure to any explicit input that the fund uses to value its name assets, where a change in that input would change the value of the security.

   When calculating a fund's compliance with its 80% Investment Policy, the amendments require that a fund (1) use a derivatives instrument's notional amount, rather than its market value, for the both the numerator and denominator of the calculation purpose of determining the fund's compliance with its 80%

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[9] The SEC states in the Adopting Release that it believes that "as soon as reasonably practicable" will result in funds coming back into compliance with the Amended Names Rule in less than 90 days. Further, the Amended Names Rule does not specify a time period for temporary departures associated with reorganizations, but states temporary departures with respect to fund launches cannot exceed 180 consecutive days, regardless of the fund's strategy, expressly noting that "alts funds" or illiquid funds are not permitted a longer ramp up period to come into compliance with the Names Rule.

[10] Temporary departures under the proposed amendments would have been permitted only: (1) as a result of market fluctuations, or other circumstances, where the temporary departure is not caused by the fund's purchase or sale of a security or the fund's entering into or exiting an investment; (2) to address unusually large cash inflows or unusually large redemptions; (3) to take a position in cash and cash equivalents or government securities to avoid a loss in response to adverse market, economic, political, or other conditions; or (4) to reposition or liquidate a fund's assets in connection with a reorganization, to launch the fund, or when notice of a change in the fund's 80% Investment Policy has been provided to fund shareholders at least 60 days before the change pursuant to the Names Rule.

Investment Policy;[11] (2) exclude from both the numerator and denominator of the calculation certain derivatives that hedge the currency risk associated with a fund's foreign-currency denominated investments;[12] and (3) convert interest rate derivatives to their 10-year bond equivalents and to delta adjust the notional amounts of options contracts. In addition, with respect to short positions in one or more reference assets, funds must use these derivatives instruments' notional amounts for purposes of determining compliance with their 80% Investment Policy.[13]

The final amendments will permit a fund, in determining compliance with its 80% Investment Policy, to deduct cash and cash equivalents and U.S. Treasury securities with remaining maturities of one year or less from assets (*i.e.*, the denominator in the 80% calculation), up to the notional amounts of the fund's derivatives instruments.

Changes from the Proposal: In a change from the Proposed Rule, the final amendments require a fund to exclude certain derivatives that hedge the currency risk associated with a fund's foreign-currency denominated investments in calculating its assets for purposes of assessing Names Rule compliance. In addition, the final amendments provide that a fund is permitted to exclude any closed-out derivatives positions when calculating assets for purposes of determining compliance with its 80% Investment Policy if those positions result in no credit or market exposure to the fund. The final amendments also specify that a fund must value each physical short position using the value of the asset sold short.

4. Unlisted Registered Closed-End Funds and BDCs. A registered closed-end fund or BDC that is required to adopt an 80% Investment Policy is prohibited from changing that policy without a shareholder vote, unless (1) the fund conducts a tender or repurchase offer with at least 60 days' prior notice of the policy change; (2) that offer is not oversubscribed; and (3) the fund purchases shares at its NAV per share. The SEC notes that the Amended Names Rule specifies that the fund purchase shares at its NAV per share for a tender offer but does not specify the repurchase offer price for this exception given that the 1940 Act already addresses the price (NAV per share) at which closed-end funds and BDCs conducting periodic repurchase offers are required to repurchase shares under Rule 23c-3 under the 1940 Act.[14] This limited exception to the shareholder approval requirement is designed to give investors in unlisted registered close-end funds and BDCs an opportunity to exit the fund prior to a fund's change in investment policy while also alleviating some of the operational burden of a mandated shareholder meeting on funds. If a tender or repurchase offer is oversubscribed, suggesting that the shareholders are not supportive of the change, a

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[11] The Adopting Release explains that notional amounts better reflect the investment exposure that derivative investments create because a derivative's market value may bear no relation to the investment exposure that the derivative creates. Adopting Release at 82.

[12] A fund must exclude a currency derivative if it (1) is entered into and maintained by the fund for hedging purposes; and (2) the notional amounts of the derivatives do not exceed the value of the hedged investments (or the par value thereof, in the case of fixed-income investments) by more than 10%.

[13] That is, these investments would be valued at their notional amounts in the denominator in all cases, and at their notional amounts in the numerator where the fund includes investments that provide short exposure in the numerator.

[14] It is notable that the Adopting Release therefore seems to suggest that Rule 23c-3 pricing mechanics is not just limited to repurchases conducted by interval funds but also applies to tender offers made by registered closed-end funds.

fund would then be required to conduct a shareholder vote prior to making the change to its investment policy that the notice describes.

Change from the Proposal: The Proposed Rule would have prohibited unlisted closed-end funds and BDCs from changing their 80% Investment Policy without a shareholder vote. The SEC ultimately agreed with commenters, including Simpson Thacher, that providing an exception to the shareholder vote requirement would address the SEC's concerns that shareholders would be forced to accept a policy change without a way of exiting the fund while avoiding the operational burdens that would accompany a requirement to conduct a shareholder vote for every instance in which a fund changes its 80% Investment Policy.

5. Codification of "Materially Deceptive or Misleading" and Plain English Requirement. In adopting the Amended Names Rule, the SEC codifies its long-standing position that an 80% Investment Policy is not a safe harbor from using materially deceptive or misleading names. Amended Names Rule 35d-1(c) states that a fund's name can be materially deceptive or misleading under Section 35(d) of the 1940 Act even if the fund adopts and implements an 80% Investment Policy and otherwise complies with the Rule's requirements to adopt and implement the policy. Additionally, under the Amended Names Rule, funds that are required to adopt an 80% Investment Policy are also required to ensure that any terms used in the fund's name that suggest either an investment focus or that such fund is a tax-exempt fund must be consistent with those terms' plain English meaning or established industry use.

   The SEC provides important color on this point. For example, a fund's name could be materially deceptive or misleading for purposes of Section 35(d) if the fund invests in a way such that the source of a substantial portion of the fund's risks or returns is materially different from that which an investor reasonably would expect based on the fund's name, regardless of the fund's compliance with the requirements of the Names Rule (*e.g.*, a "green energy and fossil fuel-free" fund making a substantial investment in an issuer with fossil fuel reserves, or a "conservative income bond" fund using the 20% basket to invest in highly volatile equity securities that introduce significant volatility into a fund that investors would expect to have lower levels of volatility associated with lower-yielding bonds). To the extent a fund uses its 20% basket to invest in assets that are materially inconsistent with the investment focus or risk profile reflected by the fund's name, the fund's name would be materially deceptive or misleading under Section 35(d). According to the Adopting Release, this provision is designed to codify the existing relationship between the Names Rule and Section 35(d) and is not intended to create new requirements or standards with respect to the selection of investments in a fund's 20% basket.

ESG Considerations: In the Adopting Release, the SEC notes that several commenters emphasized the importance of the codification with respect to fund names that articulate an ESG focus and one commenter even suggested that funds that use ESG terms in their name should be required to clearly and prominently states what percent of the fund is invested in securities that do not comply with the investment criteria for the 80% basket. The SEC declined to adopt those proposed changes.

6. Enhanced Prospectus Disclosure. The Amended Names Rule amends fund registration forms, such as Form N-1A and Form N-2, to require that any fund with an 80% Investment Policy must define the terms used in its name, including the specific criteria for selecting investments related to those terms, if applicable. While funds have some flexibility in defining these terms, these definitions must align with those terms' plain English meaning or established industry use. For funds utilizing Form N-1A, these definitions should be included in both the summary prospectus and statutory prospectus. Additionally, the amendments introduce a requirement for Inline XBRL tagging of new information.

7. Recordkeeping. The Amended Names Rule requires that each fund subject to an 80% Investment Policy must to keep documentation demonstrating compliance with its policy. This includes: (1) maintaining written records, at the time of each investment, that specify whether the investment falls within the 80% basket, along with the basis for its inclusion, and the value of the basket as a percentage of the fund's assets; (2) keeping written records of the fund's quarterly reviews of its portfolio; (3) in cases where a departure from the 80% Investment Policy is identified during a quarterly review or at other times, maintaining written records that note the date of identification and the reason for the departure; (4) if a departure from the 80% Investment Policy occurs under other-than-normal circumstances, maintaining written records that indicate the departure date and provide the reason for it, including an explanation of why the fund considers these circumstances as other-than-normal; and (5) archiving any notifications sent to fund shareholders under the Amended Names Rule.

Changes from the Proposal: Notably, a fund determining that it falls outside the scope of the Names Rule is not required to maintain records related to the analysis of the inapplicability of the 80% Investment Policy.

8. Notice Requirement. The Amended Names Rule continues to require that, unless a fund's 80% Investment Policy is a fundamental policy, notice must be given to shareholders of any change in the fund's 80% Investment Policy. The Amendments are designed to (1) clarify the current requirement that the notice must be provided separately from any other documents; (2) update the legend requirements alerting the investor to a change in investment policy and/or name; (3) specify the content that the notices include, requiring that the notice describes, as applicable, the fund's 80% Investment Policy, the nature of the change to the 80% Investment Policy, the fund's old and new names, and the effective date of any investment policy and/or name changes; and (4) specify notices that may be delivered electronically.[15]

9. N-PORT Reports. The Amended Names Rule amends Form N-PORT to require funds to include (1) definitions of terms used in the fund's name, including any specific criteria used to select investments related to those terms, if applicable; (2) the value of the fund's 80% basket, expressed as a percentage of the fund's total assets; and (3) a declaration regarding whether each investment falls within the fund's 80% Investment Policy.

[15] Notably, the Adopting Release does not address whether notice is required if a fund changes a defined term in its 80% Investment Policy without modifying the 80% test itself.

Changes from the Proposal: The final Form N-PORT amendments modify the proposed reporting approach by requiring reported information for the third month of each quarter, instead of for every month. The Proposed Rule also would have required a fund to indicate the number of days, if any, that it was not in compliance with its 80% Investment Policy during the reporting period.

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Memorandum

SEC Grants Exemptive Relief From Rule 15c2-11 Disclosure Requirements for Rule 144A Fixed-Income Securities

July 24, 2024

In a reversal of its 2021 guidance, on October 30, 2023, the Securities and Exchange Commission (the "SEC") issued an order granting exemptive relief to broker-dealers from the disclosure requirements of Rule 15c2-11 under the Securities Exchange Act of 1934 ("Rule 15c2-11") with respect to fixed-income securities issued pursuant to Rule 144A under the Securities Act of 1933 ("Rule 144A"). The order effectively restores disclosure requirements for Rule 144A fixed-income securities to pre-2021 status, and maintains the current disclosure system for the Rule 144A market.

Background

As amended in 2020, Rule 15c2-11 prohibits broker-dealers from providing price quotations in over-the-counter securities unless certain information about the issuer of the securities is current and publicly available. In 2021, the SEC clarified that amended Rule 15c2-11 would apply to debt securities issued in private offerings pursuant to Rule 144A and Regulation S under the Securities Act of 1933, in addition to equity securities, thus expanding the number of companies that could be compelled to publicly disclose current financial and other information.

The compliance date for the amended rule was initially set for September 28, 2021, but was extended to January 4, 2025 for issuers of fixed-income securities pursuant to a series of no-action letters.

The new exemptive relief for broker-dealers with respect to 144A debt securities comes after the National Association of Manufacturers and the Kentucky Association of Manufacturers brought suit against the SEC in September of this year, arguing that the SEC's interpretation of Rule 15c2-11 to apply to debt securities issued in private offerings without allowing a public comment period was in violation of the Administrative Procedure Act.

Impact of Exemption

The exemption is significant for issuers of fixed-income securities pursuant to 144A that are not otherwise public reporting companies under the Securities Exchange Act of 1934, as these issuers will not be required to comply with the public disclosure requirements of Rule 15c2-11 in order to enable broker-dealers to continue to provide price quotations. The exemption eliminates the anticipated chilling effects that the SEC's earlier interpretation of the rule may have had on 144A issuers, as those issuers would have been compelled to make a decision between providing current public disclosure pursuant to Rule 15c2-11 or risking reduced liquidity and opaque pricing on

their existing or future issuances. The exemptive relief is a welcome development for 144A issuers of fixed-income securities and preserves the existing disclosure framework of the Rule 144A market.

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