Simpson Thacher

Registered Funds Regulatory Update

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SEC Rulemaking

SEC Proposes Changes to its 2020 Proxy Advice Amendments

The SEC voted to propose amendments to its rules governing proxy voting advice provided by proxy advisory firms by a 3-2 vote. In July 2020, the SEC adopted amendments to the proxy voting rules that were designed to allow investors who utilize proxy advisory firms for proxy voting advice to receive more transparent, accurate and complete information on which to make their voting decisions, without imposing undue costs or delay ("2020 Amendments"). However, the 2020 Amendments were criticized in that they might impede or impair the timeliness and independence of proxy advisers and subject them to undue litigation risk and compliance costs. While keeping the bulk of the 2020 Amendments intact, the most notable proposed changes to the 2020 Amendments would rescind conditions to the availability of two exemptions frequently relied on by proxy advisers to avoid information and filing requirements. Those conditions require proxy advisers to adopt policies and procedures reasonably designed to ensure that they: (i) make their advice available to the public companies that are the subject of the advice at or before the time that they make the advice available to their clients (*e.g.*, funds and investment advisers); and (ii) provide their clients with a mechanism by which they can reasonably be expected to become aware of any written responses by public companies regarding their proxy advice in a timely manner before the relevant shareholder meeting. Certain related safe harbors and exclusions have also been proposed to be rescinded.

Additionally, the proposed amendments would amend Exchange Act Rule 14a-9, the general anti-fraud rule pertaining to proxy rules, which prohibits proxy solicitations from including false or misleading statements. Following the 2020 Amendments, the SEC claims that investors and others expressed concerns regarding an added note setting forth non-exclusive examples of potential false or misleading proxy advice. The proposed amendments would rescind the note in its entirety to seek to avoid exposing a proxy advisory firm to risks of litigation.

Finally, in connection with the proposed amendments, the SEC sought comment as to whether the Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers that was issued in conjunction with the 2020 Amendments should also be reconsidered.

The proposed amendments were subject to comment until December 27, 2021.

Proxy Voting Advice, SEC Release No. 34-93595 (Nov. 17, 2021), available at https://www.sec.gov/rules/proposed/2021/34-93595.pdf.

SEC Proposes New Disclosure Requirements for Stock Buyback Transactions

The SEC proposed amendments to the rules governing issuers' equity share repurchases, often called "stock buybacks," that would require more frequent and detailed disclosure regarding such repurchases. In addition to operating companies, the proposed disclosures would apply to listed closed-end funds and both listed and unlisted BDCs.

Specifically, proposed Exchange Act Rule 13a-21 would introduce new Form SR on which issuers must disclose details regarding an equity share repurchase made by the issuer or any of its "affiliated purchasers" (as defined in Exchange Act Rule 10b-18) within one business day of the repurchase. The SEC's rationale for the proposed amendments is to both improve the "quality, relevance, and timeliness of information related to issuer share repurchases" and address information asymmetries between issuers and shareholders due to the time gap between the repurchase date and the time at which investors are supplied with relevant information about the issuer's repurchase. Currently, an issuer must disclose repurchases of its equity securities registered under Section 12 of the Exchange Act, by either the issuer or affiliated purchasers, in its quarterly reports on Form 10-Q and annual reports on Form 10-K or, if the issuer is a registered closed-end fund, on a semi-annual basis on Form N-CSR.

The proposed amendments require an issuer repurchasing securities registered under Section 12 of the Exchange Act to furnish Form SR to the SEC by the end of the next business day after the share repurchase date. Form SR would require the following disclosures:

- the class of securities purchased;
- the total number of shares (or units) purchased, including all issuer repurchases whether or not made pursuant to publicly announced plans or programs;
- the average price paid per share (or unit);
- the total number of shares (or units) purchased on the open market;
- the total number of shares (or units) purchased in reliance on the safe harbor in Exchange Act Rule 10b-18; and
- the total number of shares (or units) purchased under an Exchange Act Rule 10b5-1 plan.

In addition to Form SR, the proposed amendments would enhance the existing quarterly reporting regarding share repurchases by requiring the issuer to disclose:

- the objective or rationale for the repurchase;
- the process or criteria used to determine the repurchase amount;

- any restrictions relating to the issuer's Section 16 officers and directors trading its securities during a repurchase program, including any restrictions on such transactions;
- any policies and procedures relating to an insider participating in the repurchase;
- whether the issuer is making the repurchases pursuant to a plan that intends to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1 or the conditions of the Exchange Act Rule 10b-18 non-exclusive safe harbor; and
- whether any of the issuer's officers and directors bought or sold the issuer's shares (or units) within 10 business days before or after the announcement of the issuer's repurchase plan.

The proposed amendments are subject to comment for 45 days after publication in the Federal Register.

Share Repurchase Disclosure Modernization, SEC Release Nos. 34-93783 and IC-34440 (Dec. 15, 2021), available at https://www.sec.gov/rules/proposed/2021/34-93783.pdf.

SEC Proposes Amendments to Rule 10b5-1 Insider Trading Plans

The SEC voted to propose amendments to Exchange Act Rule 10b5-1. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit purchasing or selling securities on the basis of material non-public information (MNPI). Rule 10b5-1 states that a purchase or sale constitutes trading "on the basis of" MNPI where the person purchasing or selling the security was aware of the MNPI at the time the purchase or sale was made. Rule 10b5-1(c) also added an affirmative defense against allegations of insider trading for corporate insiders and companies themselves to purchase and sell securities provided they adopted trading plans in good faith before becoming aware of the MNPI. Since its adoption in 2000, many have expressed concern that these trading plans could allow traders to wrongfully take advantage of the liability protections set forth in Rule 10b5-1(c), including SEC Chair Gary Gensler who, in a speech in June 2021, stated that these trading plans have led to "real cracks in our insider trading regime."

The proposed amendments would apply to any person relying on the Rule 10b5-1(c), including registered funds and BDCs. Among other things, the proposed amendments:

- require a 120-day cooling-off period in which officers and directors must wait between entering into or modifying a Rule 10b5-1 trading plan and executing trades under the adopted arrangement. With regards to company trading plans, the SEC proposed a 30-day cooling-off period;
- require officers and directors to certify that they are not aware of any MNPI about the issuer or the security when adopting a new or modified Rule 10b5-1 trading arrangement and that the trading plan is being entered into in good faith;

- further require that officers and directors asserting the affirmative defense under Rule 10b5-1(c)(1) enter the trading arrangement in good faith and not as a plan to evade insider trading prohibitions;
- provide that the Rule 10b5-1(c)(1) affirmative defense does not apply to multiple overlapping Rule 10b5-1 trading plans for open market trades in the same class of securities; and
- limit the availability of the affirmative defense for single trade plans (*i.e.*, permitting only one trading event) to one single trade plan per 12-month period.

Additionally, the proposed amendments would require more comprehensive disclosures from operating companies and BDCs, including quarterly disclosure of trading arrangements, annual disclosure of insider trading policies and procedures and disclosure of changes in beneficial ownership pursuant to a trading plan, detailed below:

- On a quarterly basis, disclose whether, in the last fiscal quarter, the issuer and/or its officers or directors have adopted or terminated any trading plans to trade the issuer's securities, and if so, disclose the material terms of such.
- Annually disclose whether the issuer has adopted insider trading policies and procedures designed to promote compliance with the insider trading regulatory regime. If it has not, the issuer must explain why it has not; if it has, it must disclose such policies and procedures with sufficient detail so investors can assess the sufficiency of such policies and procedures.
- Disclose when changes in beneficial ownership of the issuer's securities (as required to be disclosed on a Form 4 or 5 filing) are the result of a Rule 10b5-1(c) trading plan.

The proposed disclosures would not apply to registered investment companies.

The proposed amendments are subject to comment for 45 days after publication in the Federal Register.

Rule 10b5-1 and Insider Trading, SEC Release Nos. 33-110133 and 34-93782 (Dec. 15, 2021), available at https://www.sec.gov/rules/proposed/2021/33-11013.pdf.

Gary Gensler, SEC Chair, Speech, *Prepared Remarks CFO Network Summit* (June 7, 2021), available at https://www.sec.gov/news/speech/gensler-cfo-network-2021-06-07.

Proposed Updates to Securities Lending

The SEC proposed Exchange Act Rule 10c-1, which will require lenders of securities to report the material terms of securities lending transactions to a national securities association (*e.g.*, the Financial Industry Regulatory Authority). The national securities association would then be required to make certain information reported to it public. In accordance with Congress' mandate in the Dodd-Frank Act, proposed Rule 10c-1 is intended to

strengthen the transparency and efficiency of the securities lending market by providing market participants, the public and regulators access to timely and comprehensive information.

Calling the securities lending market "opaque," SEC Chair Gary Gensler explained that although private data vendors collect and sell some securities lending data, the information is incomplete, as not all market participants choose to participate. Market participants must pay to subscribe to multiple feeds to access even the limited data available. In Gensler's view, this has resulted in information asymmetries between borrowers and lenders, creating inefficiencies in this market.

Under proposed Rule 10c-1, data regarding securities lending transactions would be reported to a national securities association within 15 minutes. Further, at the end of each business day, lenders would be required to report the number of shares of each security they have lent out, as well as the number of shares available to borrow.

"In today's fast-moving financial markets, it's important that market participants have access to fair, accurate, and timely information. I believe this proposal would bring securities lending out of the dark," Gensler said.

Comments to the proposed amendments were due on January 7, 2022. In comments received by the SEC, market participants expressed concerns regarding the proposed 15-minute reporting requirement, noting that the proposed time frame could undermine the intent of the proposed amendments by resulting in incomplete and erroneous market data being published and impose significant costs on securities lenders. Commenters also cautioned the SEC on the timing for implementing the proposed mandates. Comments included recommendations for a minimum two-year implementation period as well as a phase-in approach by asset type.

Reporting of Securities Loans, SEC Release No. 34-93613 (Nov. 18, 2021), available at https://www.sec.gov/rules/proposed/2021/34-93613.pdf.

Gary Gensler, SEC Chair, Statement, *Proposed Updates to Securities Lending Market* (Nov. 18, 2021), available at https://www.sec.gov/news/statement/gensler-securities-lending-market-20211118.

SEC Proposes Amendments to Money Market Fund Rules

The SEC voted to propose amendments to certain rules governing money market funds. The proposed amendments are partly designed to address concerns about prime and tax-exempt money market funds that were brought to light in March 2020 when large outflows from money market funds contributed to the stress on the short-term funding markets. Specifically, the proposed amendments would:

- increase minimum liquidity requirements to provide a more substantial buffer in the event of rapid redemptions;

- remove provisions permitting or requiring money market funds to impose liquidity fees and redemption gates when a money market fund falls below certain liquidity thresholds, which would eliminate any incentives for preemptive redemptions;
- require institutional prime and institutional tax-exempt money market funds to implement swing pricing under certain circumstances, so that redeeming shareholders bear the liquidity costs of their redemptions; and
- enhance certain reporting requirements to improve the availability of money market fund information and the SEC's ability to monitor and analyze money market fund data.

SEC Chair Gary Gensler noted that the proposed amendments "are designed to reduce the likelihood of runs on money market funds during periods of stress" and reduce incentives to redeem as liquidity levels decline.

The comment period will remain open for 60 days following publication in the Federal Register.

Money Market Fund Reforms, SEC Release No. IC-34441 (Dec. 15, 2021), available at https://www.sec.gov/rules/proposed/2021/ic-34441.pdf.

SEC Staff Guidance

SEC Staff Release a Statement on Impending LIBOR Transition

The Staff of the SEC released a statement reminding investment advisers and mutual funds of their obligations, including their fiduciary duties, when recommending securities linked to LIBOR or investment strategy recommendations involving other LIBOR-linked securities, including interest rate swaps, municipal securities or securitizations. In light of these obligations and the impending LIBOR transition, the Statement highlights the following issues for advisers and funds to consider.

- Client Recommendations: Advisers should consider whether any investment advice and risks related to LIBOR-linked securities are consistent with a client's goals. Moreover, an adviser should consider whether any recommendation for any LIBOR-linked securities or any such securities being held by a client remains in the client's best interests.
- Fallback Language: Advisers should consider whether LIBOR-linked investments or related contracts have "robust fallback language" providing for an alternative rate for when LIBOR ceases to be published. Furthermore, if such fallback language is referenced, the adviser should consider that the economic consequences that the alternative rate could cause the investment to depart from a client's strategy or risk tolerance.
- Disclosure Obligations: Funds and business development companies should be mindful of their disclosure obligations with respect to LIBOR. Importantly, this disclosure should include the principal risks associated with such securities and the anticipated impact, as well as the anticipated timing of such impact, of the LIBOR transition, including with respect to volatility, valuation and liquidity.
- Valuation: Given that many funds use valuation measurements that use LIBOR inputs, advisers, funds and fund boards should be aware of any valuation risk and impacts to valuation inputs related to the LIBOR transition.
- Conflicts of Interest: Conflicts of interest associated with the LIBOR transition should be managed and monitored by the adviser. For example, the adviser should carefully consider its disclosure and other legal obligations relating to any performance fees that use a hurdle rate tied to LIBOR. In such circumstances, advisers should clearly disclose the impact of the transition and the fact that the transition to a new benchmark rate may make it easier for the adviser to earn a performance fee.
- Operational Challenges: The transition away from LIBOR could introduce operational complexities that may require significant changes to processes and systems. Advisers, funds and their services providers should prepare for the transition accordingly.

SEC Staff Statement on LIBOR Transition, *Key Considerations for Market Participants* (Dec. 7, 2021), available at https://www.sec.gov/news/statement/staff-statement-libor-transition-20211207.

SEC Division of Examinations Issues Risk Alert on Fee Calculations Under the Advisers Act

The Staff of the Division of Examinations released a Risk Alert identifying notable fee calculation deficiencies as well as related industry best practices in connection with a national initiative conducted by the Staff. The initiative focused on the numerous ways in which advisers charge advisory fees as well as the accuracy and adequacy of fee disclosures and the accuracy of the fees charged. The Staff conducted approximately 130 examinations of SEC-registered investment advisers under the initiative and observed deficiencies with a majority of the examinations.

The Staff observed a variety of fee calculation errors, including advisers using inaccurate percentages to calculate fees, incorrect breakpoint or tiered billing rates and incorrect client account valuations and double-billing. Several examined advisers either did not refund prepaid fees on terminated accounts or did not assess fees for new accounts on a pro-rata basis. The Staff also identified instances of false, misleading or omitted disclosures, missing or inadequate policies and procedures and inaccurate financial statements.

In light of the Staff's findings, it recommends that advisers:

- adopt and implement written policies and procedures addressing the supervision, calculation, review and billing of advisory fees and validating fee calculations;
- centralize fee billing processes and validate that any client fees align with compliance procedures, advisory contracts and disclosures;
- utilize resources and tools established for reviewing fee calculations (*e.g.*, checklists to reconcile client fee calculations with client advisory agreements); and
- properly record all client expenses and fees, including any fees paid directly to advisory personnel.

SEC Division of Examinations, *Observations: Investment Advisers' Fee Calculations* (Nov. 10, 2021), available at https://www.sec.gov/files/exams-risk-alert-fee-calculations.pdf.

SEC Remarks

Commissioner Peirce Releases Statement Critical of New Disclosure Requirements Related to Fixed-Income Transactions; Staff Issues Second No-Action Letter Extending New Disclosure Requirements' Compliance Date

SEC Commissioner Peirce released a statement critical of fixed-income disclosure requirements recently adopted by the SEC that significantly impact the fixed-income market place. Exchange Act Rule 15c2-11 was adopted to address fraudulent behavior generally associated with stock trading in the over-the-counter (OTC) market. Under the amendments, broker-dealers may not publish a quotation for an issuer's security when key information is not current and publicly available. Since the adoption of the amendments to Rule 15c2-11, concerns have been raised regarding the negative impact the amendments have on trading in the fixed-income markets and the inability of market participants to complete the operational and system changes required to comply with the amendments. In response, the Staff issued a No-Action Letter in which it extended the compliance date with the amendments to Rule 15c2-11 from September 28, 2021 to January 3, 2022.

In her statement, Commissioner Peirce argued that the time-limited relief (three months) granted by the Staff to comply with the amendments is "wholly inadequate" to address the need to forestall the effects of the amendments on the fixed-income markets. Instead, she stated that the Staff should issue longer no-action relief and reopen the rulemaking entirely, as little attention was paid to the possible broad application of the amendments on the fixed-income markets. She acknowledged that in her review she only considered the application of amended Rule 15c2-11 in the OTC equity context, not its broader implications. Moreover, she noted that a failure by herself, the SEC and market participants to highlight the issue does mean that Rule 15c2-11 should be applied without "proper deliberation." As such, Commissioner Peirce stated that the implications of amended Rule 15c2-11 on fixed-income markets "deserves careful consideration and engagement with investors, issuers, broker-dealers, and trading platforms, and the general public, through notice-and-comment rulemaking."

Following the release of Commissioner Peirce's statement, the Staff issued a second No-Action Letter extending relief from compliance with the amendments to Rule 15c2-11 from January 3, 2022 to a phase-in schedule depending on the relevant security and information available. Compliance for the first phase will begin on January 3, 2023. Among other things, the No-Action Letter confirms that Rule 15c2-11 encompasses fixed-income securities.

Hester Peirce, SEC Commissioner, *Statement on Staff No-Action Letter Regarding Amended Rule 15c2-11 in Relation to Fixed Income Securities* (Sept. 24, 2021), available at https://www.sec.gov/news/public-statement/peirce-nal-rule-15c2-11-2021-09-24.

SEC Division of Trading and Markets, No-Action Letter, *Amended Rule 15c2-11 in Relation to Fixed Income Securities* (Dec. 16, 2021), available at https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-121621.pdf.

William Birdthistle Named Director of SEC's Division of Investment Management

The SEC announced the appointment of William Birdthistle as the new Director of the Division of Investment Management. Director Birdthistle, a professor at Chicago-Kent College of Law, replaces Acting Director Sarah ten Siethoff. "Professor Birdthistle will bring remarkable expertise in investment funds to the SEC," said SEC Chair Gary Gensler. "The Division of Investment Management develops regulatory policies to oversee investment companies and investment advisers so that American investors can confidently save to buy homes, pay for college, or plan for retirement. I look forward to working closely with William to execute our mission." Birdthistle's appointment follows a pattern of Gensler tapping academics and other industry outsiders to head divisions and fill other positions at the SEC.

Press Release, *William Birdthistle Named Director of Division of Investment Management* (Dec. 21, 2021), available at https://www.sec.gov/news/press-release/2021-268.

Industry Developments

Report Highlights Trends in Governance Practices and Fund Board Demographics

The IDC and Investment Company Institute jointly released a report highlighting trends in fund governance practices and board demographics. The report finds that fund boards generally have set high standards and adopted strong governance practices above regulatory mandates. Additionally, fund boards have made progress in recruiting women and minorities. Some notable data points set forth in the report are as follows:

Fund Governance Practices

- From 1996 to 2020, the number of funds reporting that independent directors held 75% or more of board seats rose from 46% to 84% (though this figure is down from its 2010 peak of 91%).
- Independent directors represented by either dedicated counsel or by counsel separate from the adviser's counsel increased from 64% in 1998 to 95% in 2020.
- Boards with an independent chair increased from 43% in 2004 to 68% in 2020 whereas boards with a lead independent director increased from 18% in 2004 to 27% in 2020.
- Boards with an audit committee financial expert increased from 89% in 2004 to 96% in 2020.
- Boards requiring fund share ownership by independent directors increased steadily from 6% in 1996 to 36% in 2020.
- Boards requiring formal orientation programs for new independent directors increased from 21% in 2010 to 59% in 2020.
- Boards requiring director participation in continuing education programs increased from 9% in 2010 to 15% in 2020.
- The average age of an independent director increased from 62 in 1996 to 67 in 2020.
- The average length of service by an independent director increased from 9 years in 1996 to 12 years in 2020.

Director Diversity

- Female independent directors increased from 20% in 2012 to 32% in 2020 whereas female independent directors among new directors increased from 32% in 2012 to 41% in 2020.
- Minority independent directors increased from 8% in 2015 to 12% in 2020 whereas minority independent directors among new directors increased from 8% in 2015 to 24% in 2020.

Press Release, *New Report Highlights Trends in Governance Practices and Fund Board Demographics* (Oct. 20, 2021), available at https://www.ici.org/news-release/21-news-idcofgp.

Investment Company Institute and Independent Directors Council, *Overview of Fund Governance Practices*, 1994-2020 (Oct. 2021), available at https://www.ici.org/news-release/21-news-idcofgp.

IOSCO Issues Final Report on Sustainability Practices

The Board of the International Organization of Securities Commissions (IOSCO), which the SEC is a member of, published a final report detailing recommendations for asset managers on sustainability and ESG-related policies and procedures, practices and disclosure. The report addresses the difficulties in implementing sustainability and ESG-related initiatives, including the need for consistent, comparable and decision-useful information and the risk of greenwashing (*i.e.*, the practice by asset managers of misrepresenting their own sustainability-related practices or features of their investment products). The report makes the following recommendations to securities regulators and policymakers:

- Practices, policies, procedures and disclosure: set regulatory and supervisory expectations for asset managers regarding the development and implementation of practices, policies and procedures relating to material sustainability-related risks and opportunities and related disclosure. The regulatory and supervisory expectations should address governance around material sustainability-related risks and opportunities, how material sustainability-related risks and opportunities are factored into the asset manager's investment strategies and process, how the asset manager identifies, assesses and manages material sustainability-related risks, the metrics and targets used to assess and manage relevant material sustainability-related risks and opportunities where such information is material.
- Product-level disclosure: create, clarify or expand regulatory requirements or guidance to improve product-level disclosure to help investors better understand sustainability-related products and material sustainability-related risks for all products. The requirements or guidance should include a product authorization system that sets disclosure expectations for sustainability-related products, parameters around naming and labels, disclosure in product offering documents, disclosure of material risks, content requirements for marketing materials and communications and periodic reporting.
- Supervisory and enforcement tools: have supervisory tools to monitor and assess whether asset managers and sustainability-related products are in compliance with regulatory requirements and enforcement tools to address any breaches of such requirements. Supervisory and enforcement tools should be designed to prevent greenwashing at both the asset manager and product levels and promote investor confidence in asset managers that take sustainability-related risks and opportunities into consideration.
- Standard terminology and definitions: encourage industry participants to develop common sustainable finance-related terms and definitions, including related to ESG approaches, to ensure consistency throughout the global asset management industry.

- Education initiatives: promote or enhance existing financial and investor education initiatives relating to sustainability to protect investors from greenwashing, promote awareness of sustainability-related risks and encourage the growth of sustainability-related asset management products.

Final Report, The Board of the International Organization of Securities Commissions, *Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management* (Nov. 2021), available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD688.pdf.

Senate Finance Committee Chair Proposes Legislation to Close Certain Pass-Through Loopholes That Impacts Mutual Funds and ETFs

Senate Finance Committee Chair Ron Wyden (D-Oregon) proposed legislation to close current tax loopholes that permit wealthy investors and large corporations to use pass-through entities, such as partnerships, to avoid paying taxes. The Senator's proposal specifically limits how gains and losses can be allocated, which has significant unintended consequences for mutual funds and ETFs. Under the current federal income tax rules, when a mutual fund or ETF sells an appreciated portfolio security, including to meet redemption requests, the mutual fund or ETF recognizes capital gain that is distributed before year-end to shareholders, who then pay income tax on the gain distributed at year-end. However, in accordance with Section 852(b)(6) of the Internal Revenue Code, mutual funds and ETFs may instead distribute appreciated portfolio securities in-kind to redeeming shareholders without having to recognize a gain on the securities.

This alternative option is routinely used by ETFs. Authorized participants (brokers and dealers) create and redeem ETF shares for shareholders in-kind by providing "baskets" of securities of the ETF in exchange for "creation units" of the ETF, which when redeemed are exchanged for an in-kind distribution of securities equaling the net asset value of the securities redeemed. The proposed legislation would repeal Section 852(b)(6) and require ETFs to recognize gains on appreciated securities distributed to authorized participants in-kind thereby increasing the taxable gain amounts ETFs will distribute to non-redeeming shareholders.

Repealing Section 852(b)(6) may also result in the following additional unintended consequences:

- The vast majority of households that own ETFs have an annual income under $400,000. The proposed legislation could impact more investors than just the "wealthiest households" as originally intended.
- Tax costs associated with short-term trading of ETF shares could be borne by long-term ETF shareholders.
- The ETF industry's large growth is due in part to the favorable tax treatment provided by Section 852(b)(6). Removing that favorable tax treatment may adversely impact the ETF industry.

Senator Wyden's stated goal of making wealthy investors and mega-corporations "pay their fair share" may not in reality be achieved by repealing Section 852(b)(6) as it could lead to retail investors paying the ultimate price for

such changes. Senator Wyden's proposed legislation as drafted would be effective for tax years beginning after December 31, 2022.

Press Release, *Wyden Unveils Proposal To Close Loopholes Allowing Wealthy Investors, Mega Corporations To Use Partnerships to Avoid Paying Tax* (Sept. 10, 2021), available at https://www.finance.senate.gov/chairmans-news/wyden-unveils-proposal-to-close-loopholes-allowing-wealthy-investors-mega-corporations-to-use-partnerships-to-avoid-paying-tax.

IDC Recommends Flexibility on In-Person Voting Requirements

In a letter to the Acting Director of the SEC's Division of Investment Management, the Independent Directors Council ("IDC") recommended that the SEC provide at least six months' notice before withdrawing the temporary relief implemented due to the COVID-19 pandemic that suspended in-person voting requirements for directors of registered investment companies and BDCs under Sections 15(c) and 32(a) of the Investment Company Act and Rules 12b-1(b)(2) and 15a-4(b)(2)(ii) thereunder. The IDC also recommended that the SEC modernize the in-person voting requirements by providing flexibility on a permanent basis.

Currently, the temporary relief may be suspended by the SEC with only two weeks' notice. The IDC asserted that it is vital that the SEC not withdraw the current temporary relief prior to the conclusion of the pandemic, particularly with an "insufficient" notice period. Instead, an extended notice period would provide fund boards with the appropriate time to orderly shift to an in-person meeting format.

The IDC also urged the SEC to provide permanent flexibility to the in-person voting requirements, as appropriate, noting the significant advancements in video conferencing technology that now make it possible for directors to hear and see each other simultaneously. Given the experience and effectiveness of virtual meetings during the pandemic, the IDC believes that permanent relief providing flexibility to the in-person voting requirements would provide directors with additional tools to conduct board business while still allowing them to fulfill their oversight responsibilities. The IDC recommended that any such relief be subject to core conditions, including the following:

- A board must develop written policies and procedures governing board meetings with virtual participation that are subject to review and approval by a majority of the board's independent directors.
- The policies and procedures for board meetings where directors participate virtually must establish appropriate technology and security protocols subject to periodic review.
- The directors who participate virtually in board meetings must be able to communicate with one another simultaneously.
- The identity of each director casting a vote virtually during a board meeting must be known simultaneously to the other directors participating in the meeting.

Letter from Thomas T. Kim, Managing Director, Independent Directors Council, to Sarah ten Siethoff, Acting Director, Division of Investment Management, SEC (Sept. 2, 2021), available at https://www.idc.org/system/files/2021-09/21-ltr-voting.pdf.

Litigation

Mutual Fund Accused of Charging Excessive Fees for "Closet Indexing"

American Century Investments has been accused of charging excessive fees for purported active management on its $2.4 billion American Century Value Fund (the "Fund") when instead the Fund's investment strategy closely tracks its benchmark index (*i.e.*, practicing "closet indexing"). The class-action lawsuit against the Fund and its directors, as well as the Fund's investment adviser and distributor, is the first of its kind in the United States.

The Complaint alleges that the Fund has consistently failed to meet or outperform its index, while continuing to charge fees that are higher than passive index funds that are designed to generate benchmark returns. Moreover, since the Fund is charging higher fees for purportedly active management, the Complaint alleges that the Fund has no real prospect of ever outperforming its benchmark since these additional fees virtually ensure that the Fund cannot match its benchmark over time, let alone beat it. Since the Fund explicitly represents that it is actively managed, the Complaint further alleges that the Fund's offering documents are untrue and misleading.

The complaint claims violations under Sections 11, 12 and 15 of the Securities Act. American Century has denied all claims in the lawsuit.

Complaint, *Hays v. Am. Century Cap. Portfolios, Inc.*, Case 3:21-cv-08625
(N.D. Cal. Nov. 5, 2021).

Jury Finds NY Adviser Violated Anti-Fraud Provisions of Advisers Act

A jury in the U.S. District Court for the Western District of New York found that Gregory Grenda and his firm, the Grenda Group LLC (collectively, the "Defendants"), violated the anti-fraud provisions of the Advisers Act for failing to disclose that Grenda's father, Walter Grenda, was participating in the firm's investment advisory process in violation of the terms of a 2015 settlement agreement with the SEC.

Pursuant to the terms of settlement agreement, Walter Grenda was prohibited from providing any investment advice for a three-year period. To comply with the settlement agreement, the elder Grenda sold the predecessor firm's assets, office space and client list to the Grenda Group. However, Walter Grenda continued to meet with clients and provide investment advice, and even impersonated his son on phone calls with the firm's broker-dealer. In 2018, the SEC settled with Walter Grenda and filed a civil complaint against Defendants for violations of the Advisers Act.

The SEC argued that Defendants facilitated the violations of the settlement agreement and failed to inform clients of Walter Grenda's ban. Earlier this year, the Judge granted the SEC partial summary judgment for claims that the

Defendants violated the Advisers Act by permitting Walter Grenda to work with clients after the settlement. The remaining claims proceeded to trial where a jury found that the Defendants violated the anti-fraud provisions of the Advisers Act set forth in Sections 206(1) and 206(2).

Jury Verdict, *SEC v. Grenda Group, LLC*, No. 1:18-cv-00954-CCR (W.D.N.Y Dec. 10, 2021).

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