Simpson Thacher

Registered Funds Regulatory Update

October 7, 2024

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SEC Rulemaking

SEC Announces Spring 2024 Regulatory Agenda

On July 8, 2024, the SEC's Office of Information and Regulatory Affairs released the SEC's Spring 2024 Regulatory Agenda, which outlines the Division of Investment Management's key regulatory priorities and the anticipated timing. The Agenda features several key investment management-related rule proposals that were previously scheduled to be finalized by April 2024. Those following rule proposals are now scheduled to be finalized by October 2024:

- 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.

Notably, the Agenda also indicates the SEC's intent to repropose the following proposals by October 2024:

- rule amendments and/or proposed new rules under the Advisers Act to improve and modernize the regulations around the custody of assets; and
- 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.

The Agenda also indicates that the SEC now intends to propose the following noteworthy proposals in April 2025:

- 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.

The SEC also intends to repropose the following proposal in April 2025:

- rule amendments for open-end management investment companies regarding liquidity risk management programs and swing pricing.

Finally, the Agenda indicates the following investment management-related rule proposal is scheduled to be finalized by April 2025:

- rule amendments pertaining to shareholder proposals under Rule 14a-8 under the Exchange Act.

Securities and Exchange Commission, *Statement on the Spring 2024 Regulatory Agenda*, (July 8, 2024), available at: https://www.sec.gov/newsroom/speeches-statements/gensler-2024-spring-regulatory-agenda-070824.

SEC Adopts Amendments to Reporting Requirements but Drops Hotly Contested Swing Pricing and Hard Close Proposals

The SEC recently adopted amendments to reporting requirements on Forms N-PORT and N-CEN to provide the SEC and investors with more timely information, and provided guidance on open-end fund liquidity risk management program requirements. Notably, after receiving significant industry opposition to its "swing pricing" and "hard close" proposals, the SEC chose not to adopt them.

SEC Declines to Adopt Swing Pricing and Hard Close Proposals

The SEC declined to adopt proposals relating to mandatory use of swing pricing and a hard close time for transacting in fund shares for all open-end funds other than money market funds and exchange-traded funds, as well as amendments that would have made changes to the so-called "Liquidity Rule's" (Rule 22e-4 under the Investment Company Act) liquidity classification framework. As such, funds will not be required to report swing-pricing related information on Form N-PORT or comply with the proposed changes to liquidity classifications. The SEC also declined to adopt proposed amendments that would have required funds to include their complete portfolio holdings presented in accordance with Regulation S-X with respect to each month's reporting period. Given the SEC's regulatory agenda and the fact that liquidity risk management is a stated priority of the SEC's Division of Enforcement in 2024, it is important to note that certain of the proposed amendments could be reproposed next year.

Forms N-PORT and N-CEN Amendments

The adopted amendments to Form N-PORT increase both the frequency with which portfolio holdings information must be filed with the SEC (from quarterly to monthly within 30 days of the end of each month) and the public availability of such information (to be made publicly available 60 days after the end of the applicable month or, put another way, 30 days after the filing deadline). Where previously the information for the first two months of each quarter remained confidential, under the amendments each monthly report will be made public 60 days after the end of the applicable month. Because these reports will now be publicly available on a monthly instead of quarterly basis, information about fund returns and flows (including net change in unrealized appreciation or depreciation and net realized gain or loss) will only be required for the month to which the report pertains. Items that are non-public under the current regime, including individual portfolio investment liquidity classifications, will remain nonpublic in individual reports under the amendments.

While some commenters pushed back on publicizing Form N-PORT information on a monthly basis, arguing that to do so would overburden funds and service providers and could increase the risk of predatory trading (e.g., front running) by others in the market, harming funds and their shareholders, the SEC pointed to a number of mitigating factors for such concerns, such as the monthly N-PORT disclosure regime aligning with many funds' existing practice of disclosing portfolio holdings on a monthly basis. The SEC also noted that, each month, funds will be allowed to publicly report an aggregate amount of holdings (e.g., securities that are purchased by a fund while building a position that has not previously been publicly disclosed) as "miscellaneous securities" on a non-public basis, with more detailed information about the individual holdings to be provided on a non-public basis to the SEC, provided that such holdings do not exceed five percent of a fund and have not previously been disclosed to the public.

The amendments to Form N-CEN will require open-end funds, closed-end funds, and unit investment trusts that use liquidity service providers to include more information about such service providers to enable the SEC and other industry participants to track certain liquidity risk management programs and requirements.

The amendments to Forms N-PORT and N-CEN will become effective on November 17, 2025. Funds will generally be required to comply with the amendments for reports filed on or after that date, except that fund groups with net assets of less than $1 billion will have until May 18, 2026 to comply with the Form N-PORT amendments.

The SEC Provides Guidance on Mutual Fund Liquidity Risk Management Requirements

While the SEC did not adopt the proposed amendments to the Liquidity Rule, the SEC did provide guidance on liquidity risk management requirements. The SEC's guidance to funds subject to the Liquidity Rule, informed by its outreach in connection with recent market stress events, including the onset of the COVID-19 pandemic, clarifies three key areas of liquidity risk management without introducing new requirements: (i) the frequency of classification; (ii) the meaning of "cash;" and (iii) highly liquid investment minimums.

Under the current Liquidity Rule, funds are required to review liquidity classifications more often than monthly if intramonth changes to relevant market, trading, and investment-specific considerations are reasonably expected to materially affect one or more of its investment classifications. Funds must also adopt and implement policies and procedures reasonably designed to ensure the funds are able to conduct an intramonth review if such changes in conditions have occurred. When considering intramonth changes in investment-specific considerations, the SEC noted that funds generally should consider reviewing liquidity classifications on an intramonth basis if (x) portfolio composition changes, such as a substantial decrease or increase in the size of a position, or (y) the acquisition of a particular investment could reasonably be expected to materially affect one or more investment classifications or the liquidity profile of a fund, respectively.

The Liquidity Rule requires a fund to determine whether an investment can be classified as highly liquid or moderately liquid, which determination requires consideration of the amount of time reasonably expected for such investment to be "convertible to cash" (e.g., sold and settled) without significantly changing the market value of the investment. The SEC clarified in its recent guidance that, for purposes of determining the proper investment classification, "cash" means U.S. dollars only, not foreign currencies or cash equivalents and that non-U.S. currencies should be classified based on conversion time to U.S. dollars. Funds must consider currency conversion time when classifying international investments, and if a fund does not reasonably expect to be able to convert a foreign currency into U.S. dollars within seven calendar days, then the foreign currency should be classified as an illiquid investment.

Finally, the SEC reiterated previous guidance relating to highly liquid investment minimums, particularly for funds with portfolios on the lower end of the liquidity spectrum. The SEC advised that funds with less liquid or illiquid investments or greater volatility of flows should consider higher minimums than their more liquid peers or those whose strategies tend to cause less flow volatility. While credit lines or similar financing arrangements can be considered for purposes of a fund's highly liquid investment minimum, portfolio construction should be the primary method of liquidity risk management. Notably, the highly liquid investment minimum requirement does not impose

a requirement to continuously maintain a specific level of highly liquid assets. If a fund drops below its minimum, the Liquidity Rule requires board notification of the shortfall and, if the shortfall continues for more than seven consecutive calendar days, confidential SEC reporting on Form N-RN within one business day, but does not prevent the fund from using such highly liquid assets for redemptions.

Form N-PORT and Form N-CEN Reporting; Guidance on Open-End Fund Liquidity Risk Management Programs, Release No. IC-35308 (Aug. 28, 2024), available at: https://www.sec.gov/files/rules/final/2024/ic-35308.pdf.

SEC Approves an Amendment to the PCAOB's Contributory Liability Rule

The SEC recently approved an amendment to the PCAOB's ethics rule governing the liability of "associated persons" of a registered public accounting firm who "directly and substantially" contribute to a registered public accounting firm's violations of the laws, rules, and standards that the PCAOB enforces.

The amendments to Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*, lower the bar for the liability of associated persons from recklessness to negligence, while affirming that an associated person must have contributed "directly and substantially" to a registered public accounting firm's violation of the law, rules and standards enforced by the PCAOB. As the SEC noted in its order approving the amendment to Rule 3502, in this context, negligence is "the failure to exercise reasonable care or competence," while "recklessness" is an "extreme departure from the standard of ordinary care" that "presents a danger to investors or to the markets that is either known to the (actor) or is so obvious that the actor must have been aware of it." The amendments are intended to align the PCAOB's liability standard with other negligence-based professional conduct standards (e.g., state licensing requirements and the SEC's standard for sanctions on individuals contributing to firm violations), as well as the standard of reasonable care required for auditors in executing their professional duties.

The amendments to Rule 3502 will become effective in 60 days. Notably, the amendment will only apply to conduct after the effective date.

Public Company Accounting Oversight Board; Order Granting Approval of Amendment to PCAOB Rule 3502 Governing Contributory Liability, Release No. 34-100772 (Aug. 20, 2024), available at: https://www.sec.gov/files/rules/pcaob/2024/34-100772.pdf.

SEC Enforcement

SEC Settles With Nine Advisers for Marketing Rule Violations

On September 9, 2024, the SEC announced that it settled charges against nine RIAs for alleged violations of the so-called "Marketing Rule" under the Advisers Act. These actions, announced approximately one year after the SEC's first round of similar Marketing Rule actions, affirm the SEC's continued focus on and commitment to enforcing compliance with the Marketing Rule following its implementation on November 4, 2022.

The Orders alleged various Marketing Rule violations, including that one or more RIAs violated the Marketing Rule by: (i) publishing advertisements with untrue statements about third-party ratings; (ii) posting an advertisement falsely claiming that the RIA was a member of a "fiduciary firm" that did not exist; (iii) disseminating advertisements that (x) stated the RIAs provided conflict-free advisory services without substantiation and in contradiction to other disclosure, (y) stated a firm principal received an award, which statement and award the RIA could not substantiate, and (z) contained "testimonials" that were not from existing clients; (iv) advertising endorsements without including required disclosures (e.g., that the "endorser" was a paid, non-client); and (v) including third-party ratings, some of which were more than five years old, without including required disclosures (e.g., the dates of the ratings and/or the periods of time upon which the ratings were based). The alleged violations were mostly found on the RIAs' public websites and, to a lesser extent, public websites of third parties, social media sites, online videos, and even a jumbotron and physical objects, such as bags and flags.

Without admitting or denying the findings, each RIA consented to the entry of orders finding that each violated the Advisers Act and ordering each to be censured, cease-and-desist from violating the applicable provisions of the Marketing Rule, comply with certain undertakings, and pay civil monetary penalties ranging from $60,000 to $325,000, for a combined penalty of over $1.2 million.

Litigation Rel. No. 2024-121, *SEC Charges Nine Investment Advisers in Ongoing Sweep into Marketing Rule Violations,* (Sept. 9, 2024), available at: https://www.sec.gov/newsroom/press-releases/2024-121.

SEC Settles With Twenty-Six Firms for Widespread Recordkeeping Violations

The SEC recently settled charges against twenty-six broker-dealers, investment advisers, and dually-registered firms for recordkeeping deficiencies related to the firms' and their employees' failure to maintain and preserve copies of electronic communications, including as a result of the use of personal devices in connection with firm business, in violation of the recordkeeping provisions of the federal securities laws.

According to the Orders, during the relevant period, the firms' employees, including senior employees, routinely

conducted business through various off-channel messaging applications, including personal text messages and other text messaging platforms, such as WhatsApp, without maintaining or preserving the substantial majority of these off-channel written communications in violation of the federal securities laws. The Orders stated that the failures were firm-wide and involved employees at various levels of authority, including supervisors and senior managers. The Orders also stated that during this time, most of the firms received and responded to SEC subpoenas for documents and records requested in several SEC investigations such that these failures likely impacted the SEC's investigations and ability to carry out regulatory functions. While a few of the firms self-reported their violations, the Staff uncovered the majority of the firms' misconduct after commencing a risk-based initiative to investigate the proper retention of business-related communications via personal devices.

Each firm was charged with violating certain recordkeeping provisions of the Advisers Act, the Exchange Act, or both, as applicable, and with failing to reasonably supervise with a view to preventing and detecting those violations. Admitting the SEC's facts and acknowledging that their conduct violated the recordkeeping provisions of the federal securities laws, the firms agreed to, among other things, (i) cease-and-desist from future violations of the relevant recordkeeping provisions, and (ii) retain independent compliance consultants to, among other things, conduct comprehensive reviews of their policies and procedures relating to the retention of electronic communications found on personal devices and their respective frameworks for addressing non-compliance by their employees with those policies and procedures. One firm did not receive the order under (ii) because it had retained an independent compliance consultant prior to the SEC's examination. The firms also consented to censures and civil monetary penalties totaling a combined amount of over $392 million (with individual penalties ranging from $400,000 to $50 million) and have begun implementing improvements to their compliance policies and procedures to address the violations. Notably, the Staff emphasized that self-reporting was a significant factor considered in setting the firms' penalty amounts, with those firms that self-reported their violations ultimately paying "significantly lower" civil penalties.

The SEC continues to focus on off-channel communications and violations of the recordkeeping requirements of the Advisers Act, the Exchange Act, or both, as applicable, most recently settling charges against another eleven firms for their and their personnel's "widespread and longstanding failures…to maintain and preserve electronic communications" in violation of the federal securities laws. The eleven firms agreed to pay combined civil penalties of over $88 million and each of the firms were censured and ordered to cease and desist from future violations of the recordkeeping provisions.

Litigation Rel. No. 2024-98, *Twenty-Six Firms to Pay More Than $390 Million Combined to Settle SEC's Charges for Widespread Recordkeeping Failures,* (Aug. 14 2024), available at: https://www.sec.gov/newsroom/press-releases/2024-98.

Litigation Rel. No. 2024-144, *Eleven Firms to Pay More Than $88 Million Combined to Settle SEC's Charges for Widespread Recordkeeping Failures,* (Sept. 4 2024), available at: https://www.sec.gov/newsroom/press-releases/2024-144.

SEC Settles With Adviser for Hypothetical Performance Ad

The SEC recently settled charges against a RIA for publicly advertising hypothetical performance on its website without adopting and implementing policies and procedures required by the so-called "Marketing Rule" under the Advisers Act.

According to the Order, the RIA advertised quarterly performance reports on its website that included hypothetical performance information derived from its model portfolios that were deemed by the SEC to be "disseminated to the general public rather than to a particular intended audience" in violation of the Marketing Rule. Further, the RIA's policies and procedures failed to specify how it would identify the intended audience of its advertisements or ensure hypothetical performance was relevant to the likely financial situation and investment objectives of the intended audience. The Order therefore found that the RIA willfully violated the Marketing Rule as well as the antifraud provisions of the Advisers Act. Without admitting or denying the findings, the RIA consented to a cease-and-desist order, a censure, and a civil monetary penalty of $430,000.

In the Matter of The Pacific Financial Group, Inc., SEC Admin. File No. 3-21987 (Aug. 9, 2024), available at: https://www.sec.gov/files/litigation/admin/2024/ia-6646.pdf.

Continued Section 13 and 16 SEC Enforcement Sweep Leads to Civil Penalties Against Public Companies, Individuals, and Investment Managers

On September 25, 2024, the SEC announced the settlement of charges against 23 entities and individuals for failing to timely file and/or amend Schedules 13D and 13G and Forms 3, 4 and 5, with penalties amounting to more than $3.8 million in total. These charges represented a continuation of the SEC's September 2023 enforcement sweep with respect to Section 13 and 16 filings.

In this recent round of enforcement actions, the respondents fell into three categories: (i) 13 firms (in their capacity as an investor); (ii) 10 individuals; and (iii) two public companies. The two public companies were charged with contributing to filing failures of certain directors and officers and failing to report delinquencies pursuant to Item 405 of Regulation S-K, which has been a focus of SEC enforcement in recent years. Without admitting or denying the findings, all of the entities and individuals agreed to cease and desist from committing and causing future violations and pay civil monetary penalties ranging from $10,000 to $750,000. The one firm that agreed to pay a penalty of $750,000 was alleged to have failed to timely file 35 Forms 13F in addition to several late Forms 4.

While many of the respondents were charged with numerous late filings, notably some of the respondents in this sweep were charged with having made just a few late filings; for example, one respondent was charged with filing a single Schedule 13D approximately six weeks late. This recent enforcement sweep is another reminder that the SEC is prioritizing the enforcement of beneficial ownership disclosures, particularly with respect to the new filing deadlines for Schedule 13D, which became effective in February 2024, and Schedule 13G, which became effective as of September

30, 2024 (including new quarterly Schedule 13G amendments for material changes since a person's last Schedule 13G filing).

Litigation Rel. No. 2024-148 *SEC Levies More Than $3.8 Million in Penalties in Sweep of Late Beneficial Ownership and Insider Transaction Reports,* (Sept. 25, 2024), available at: https://www.sec.gov/newsroom/press-releases/2024-148.

SEC Charges 11 Institutional Investment Managers for Failing to Report Certain Securities Holdings

On September 17, 2024, the SEC charged 11 institutional investment managers for failing to file Forms 13F, as required for entities that manage over $100 million in certain securities. The SEC also charged two of the 11 RIAs with failing to file Forms 13H, as required for large traders who trade a significant amount of exchange-listed securities.

Form 13F filings, required pursuant to Section 13(f) of the Exchange Act and rules adopted thereunder, are due within 45 days of the end of each calendar quarter and are required to disclose, among other things, the market value and quantity of every "Section 13(f) security" position held by the manager as of the end of the applicable quarter. An initial Form 13H filing must be made promptly after effecting transactions (i) in a single day of 2 million shares or $20 million, or (ii) in a calendar month of 20 million shares or $200 million. Thereafter, the large trader must make annual 13H filings, which are due within 45 days of calendar year-end, and if information in the existing Form 13H filing becomes inaccurate, promptly after each applicable calendar quarter. In contrast to Form 13F filings, Form 13H filings are not publicly available.

The Form 13F violations at issue in the Orders resulted from ongoing failures to make required Form 13F filings over extended periods of time, resulting in nine out of the 11 managers filing en masse the backlog of its applicable late Form 13F filings. Each of these managers agreed to pay civil monetary penalties in an aggregate amount totaling more than $3.4 million, a cease-and-desist order, and a censure. The two remaining managers avoided penalties and censures for their Form 13F filing violations by self-reporting and cooperating with investigators. One of the two managers facing charges for failures to file Forms 13H also avoided penalties by self-reporting.

Litigation Rel. No. 2024-135, *SEC Charges 11 Institutional Investment Managers with Failing to Report Certain Securities Holdings*, (Sept. 17, 2024), available at: https://www.sec.gov/files/litigation/admin/2024/34-101168.pdf.

SEC Charges Business Development Company With Custody Failures

On September 23, 2024, the SEC announced that it settled charges against a publicly-traded business development company, for failing to properly custody uncertificated securities (e.g., privately offered securities, loans, and other securities not represented by a physical certificate) it held in violation of Section 17(f) of the Investment Company Act. The SEC's Order also focused on the BDC's failure to properly custody its uncertificated securities in violation of its written policies and procedures regarding custody of assets.

Section 17(f) of the Investment Company Act requires that registered investment companies and, as Section 59 of the Investment Company Act makes Section 17(f) applicable to BDCs to the same extent as to RICs, companies that have elected to be regulated as BDCs maintain their securities and similar investments with a qualified bank, a member of a national securities exchange, or the RIC itself (i.e., self-custody) subject to any rules prescribed by the SEC. While each option is specifically allowed under Section 17(f), a RIC's policies and procedures must accurately reflect the RIC's actual custodial arrangements. From around July 2019 through June 2022, the BDC failed to ensure that that its uncertificated securities were kept with a qualified custodian bank, even though its policies and procedures stated that these securities would be custodied as such. Moreover, the BDC's board-approved custody agreement contemplated the custody of uncertificated securities with the BDC's custodian. Instead, the BDC variously held these securities with brokers, with transfer agents, and in self-custody.

In accepting the offer and issuing the Order, the SEC recognized the remedial efforts that the BDC had promptly taken, such as updating its own written policies and procedures and custody agreement as to the handling of uncertificated securities. In particular, the SEC noted that the new policies and procedures required that the BDC (i) send all executed documentation regarding an investment to its custodian bank within two business days of investing in a portfolio company; (ii) reconcile on a weekly basis the securities and other assets held in the custody of a board-approved custodian; and (iii) confirm that any transfers or withdrawals of such securities or other assets are only made in accordance with the applicable custody agreement. Further, the custody agreement was updated to explicitly define uncertificated securities to ensure that loans are captured under the term given that the agreement was previously silent with respect to loans.

Without admitting or denying the SEC's findings, the BDC consented to the entry of an order requiring it to cease and desist from further violations of the custody- and compliance-related provisions of the Investment Company Act. Notably, there was no civil monetary penalty.

In the Matter of SuRo Capital Corp., SEC Admin. File No. 3-22158 (Sept. 23, 2024), available at: https://www.sec.gov/files/litigation/admin/2024/ic-35331.pdf.

Litigation

Supreme Court Allows Companies to Challenge More Regulations

In a 6-3 decision on July 1, 2024, the U.S. Supreme Court significantly expanded a plaintiff's ability to contest federal regulations by ruling that the statute of limitations for challenging a federal agency action begins when the plaintiff suffers harm from the action as opposed to when the regulation was initially issued.

The District Court of North Dakota initially dismissed the plaintiff's suit to challenge a federal regulation as time barred given the default six-year statute of limitations applicable to suits against the United States, and the U.S. Court of Appeals for the Eighth Circuit affirmed, ruling that the plaintiff's challenge was untimely given that the case was filed in 2021, past the six-year statute of limitation that started to run when the regulation was published in 2011. The Supreme Court overturned the Eighth Circuit's decision to allow the plaintiff to pursue its case, stating that the claim did not accrue for purposes of the six-year statute of limitations until the plaintiff was injured by the final agency action, which in this case was in 2018.

Writing for the majority, Justice Amy Coney Barrett emphasized that plaintiffs have the right to challenge regulations when they experience harm from the agency action, rather than being constrained by the timing of the regulation's issuance. Barrett argued against the federal agency's claims of "administrative inconvenience," stating that such concerns should not override the clear text of the statute.

In dissent, Justice Ketanji Brown Jackson criticized the ruling, arguing that it effectively eliminates any meaningful limitation periods for challenging agency regulations on their face.

Corner Post, Inc. v. Board of Governors of the Federal Reserve System, No. 22-1008 (U.S. July 1, 2024)

Fifth Circuit Vacates the SEC's Rescission of Its Proxy Advisor Notice-and-Awareness Requirements

The U.S. Court of Appeals for the Fifth Circuit vacated and remanded portions of the proxy voting advice rule that were rescinded by the SEC in 2022 after being adopted by the SEC in 2020. The Fifth Circuit held that the SEC's rulemaking process to rescind these provisions, known as the "notice-and-awareness" conditions, was arbitrary and capricious thereby violating the Administrative Procedure Act.

In 2020, the SEC adopted a new rule requiring proxy advisory firms to (i) share their advice with registrants "at or prior to" sharing it with clients, and (ii) allow clients to review any written responses from registrants before shareholder meetings (the "2020 Rule"). However, following a change in administration, the SEC in 2022 adopted amendments rescinding these notice-and-awareness conditions (the "2022 Amendments"). Notably, the SEC cited

the same "timeliness" and "independence" concerns that it previously concluded the 2020 Rule was designed to remedy—without explaining the reversal in its position.

Plaintiffs challenged the SEC's amendments under the APA, claiming the amendments were arbitrary and capricious because the SEC failed to justify (i) contradicting its previous factual findings supporting the 2020 Rule, and (ii) the 2022 Amendments on their own merits. Initially, the U.S. District Court for the Western District of Texas granted summary judgment in favor of the SEC stating that the SEC "did not contradict prior factual findings and was not required to provide a more detailed justification." It also found that the SEC's justifications were rational and its 30-day comment period was consistent with the comment period standard under the APA.

The Fifth Circuit, however, reversed the decision, finding the SEC's rescission of the notice-and-awareness conditions arbitrary and capricious and vacated the 2022 Amendments. The Fifth Circuit criticized the SEC for not sufficiently explaining why it disregarded previous findings that these provisions posed minimal risk to the timeliness and independence of proxy voting advice. Additionally, it faulted the SEC for failing to provide a reasonable explanation for why the perceived risks under the 2020 Rule justified their removal. The Fifth Circuit noted that the 2020 Rule had followed extensive study and collaboration over nearly a decade, spanning two presidential administrations, with a 60-day comment period. In contrast, the 2022 Amendments were made after just two years, with a 31-day comment period during the holiday season and minimal feedback received.

While acknowledging the SEC's authority to change policies under new administrations, the Fifth Circuit stressed the need for a detailed explanation when reversing prior policies based on conflicting factual findings. The ruling is expected to influence future agency rulemaking processes, underscoring the requirement for thorough justification when departing from established regulatory frameworks.

Nat'l Assoc. of Manufacturers v. SEC, No. 22-51069 (5th Cir. June 26, 2024).

Two Texas Federal Courts Suspend ERISA's New Investment Advice Rule Redefining "Fiduciary"

On July 25, 2024, the U.S. District Court for the Eastern District of Texas issued a stay of the effective date of the DOL's new investment advice fiduciary rule under ERISA, which proposed to redefine when a person would be an "investment advice fiduciary" for purposes of ERISA, as well as associated amendments to prohibited transaction exemption 84-24, which provides exemptive relief to certain transactions relating to the purchase of insurance contracts, annuities, and securities issued by an investment company. The next day the U.S. District Court for the Northern District of Texas issued a separate stay of the 2024 Fiduciary Rule and the remainder of the prohibited transaction exemption amendments proposed as a part of the 2024 Fiduciary Rule. Taken together, these stays put the entire 2024 Fiduciary Rule on hold, pending reversal on appeal or a final decision on the merits by the District Courts, and reinstated the existing definition of investment advice fiduciary and the existing provisions of the

currently effective prohibited transaction exemptions. As a result, the 2024 Fiduciary Rule did not take effect in September as scheduled.

The DOL has made multiple attempts to redefine the term investment advice fiduciary, which has been in place since 1975. A rulemaking in 2010 was withdrawn due to industry opposition and a follow-up rulemaking in 2016 was vacated by the U.S. Court of Appeals for the Fifth Circuit in 2018. Under the historical rule, one is not considered an investment advice fiduciary under ERISA unless the investment advice provided was made, in part, on a "regular basis" and "pursuant to a mutual agreement" that the advice would "serve as a primary basis for investment decisions" and such advice was "individualized based on the particular needs" of the recipient of such advice. In contrast, the 2024 Fiduciary Rule provides that, under certain circumstances, a one-time "recommendation" would be sufficient to impute ERISA fiduciary status on the provider of such advice. Consequently, the 2024 Fiduciary Rule imposes fiduciary status on many financial institutions that were not considered fiduciaries under the historical rule, including, for example, institutions providing "one time" recommendations in connection with retirement plan rollovers such as those made to IRAs.

The plaintiffs in both cases, comprised of various insurance agents licensed in Texas, the Federation of Americans for Consumer Choice, and the American Council of Life Insurers, challenged the 2024 Fiduciary Rule by arguing that the new rule abandons the ERISA statutory standard and historical rule for determining the fiduciary status of investment advice and "completely defies" the 2018 ruling by the Fifth Circuit invalidating the 2016 Fiduciary Rule on similar grounds. In granting the stays, the District Courts concluded that the 2024 Fiduciary Rule "suffers from many of the same problems" as the 2016 Fiduciary Rule, including that it "conflicts with ERISA in several ways" and, therefore, "exceeds the DOL's authority," and that the plaintiffs would likely succeed on the merits of their claims.

Both opinions are clear that the stays are not limited to the parties to the cases and will instead be broadly applied to all service providers to retirement investors. As such, in the interim "consumers will remain protected by existing state and federal regulations," including in particular the historical rule and the pre-amendment versions of the prohibited transaction exemptions in effect.

Fed. of Americans for Consumer Choice, Inc., et al. v. U.S. Dep't of Labor, et al., Case No. 6:24-cv-163-JDK (E.D. Tex. July 25, 2024).

American Council of Life Insurers, et al. v. U.S. Dep't of Labor, et al., Case No. 4:24-cv-00482-O (N.D. Tex. July 26, 2024).

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