SULLIVAN & CROMWELL LLP

S&C Quarterly Investment Management Newsletter

Q3 2024

The S&C Quarterly Investment Management Newsletter highlights key legal and regulatory developments relevant to the investment management industry. For more information on these and other developments, we encourage you to reach out to your regular Sullivan & Cromwell contact.

Highlights

- In this issue, we discuss key developments in Q3 2024, including recent rulemakings, court decisions, enforcement actions and other key updates affecting the investment management industry.
- At the end of the issue we preview the SEC EXAMS's examination priorities for 2025, which will be discussed in more detail in our upcoming Q4 2024 issue.
- Our recent client alerts also provide more detailed discussions of the SEC's liquidity rule guidance and adoption of amendments to Forms N-PORT and N-CEN and the SEC and CFTC's recent focus on recordkeeping violations.

Recent Rulemakings

FDIC adopts Notice of Proposed Rulemaking ("NPR") that would subject investments in bank holding companies, including by mutual funds and other asset managers, to review by the FDIC in addition to the Federal Reserve. On July 30, the board of directors of the FDIC voted 3 to 2 (with Vice Chairman Travis Hill and Director Jonathan McKernan dissenting) to adopt an NPR to amend the FDIC's regulations under the Change in Bank Control Act of 1978 ("CBCA"). The implications of this proposal, if adopted, could be substantial. Such a change has the potential to create uncertainty with respect to investments by mutal fund complexes in banking organizations, which are a critical and stable source of capital for the banking industry. It may also create challenges for certain funds, such as index funds, to implment their investment strategies.

The CBCA generally provides that no person, acting directly or indirectly, may acquire control of an insured depository institution unless the person has given the appropriate federal banking agency prior notice of the proposed transaction and the agency has not disapproved the transaction. The FDIC's CBCA regulations currently specify eight transactions that are exempt from providing prior notice to the FDIC. The FDIC now proposes to remove one of the exemptions, 12 C.F.R. § 303.84(a)(8), relating to "[t]he acquisition of voting securities of a depository institution holding company for which the Board of Governors of the Federal Reserve System reviews a notice pursuant to the [CBCA]."

Although both the current regulation and the proposal refer to an "exemption" for transactions reviewed by the Federal Reserve, the need for that exemption presupposes the FDIC's statutory authority to exercise a second level of approval authority over investments in bank holding companies that have state nonmember bank subsidiaries. With the removal of the exemption, the FDIC would seek to exercise the approval authority implied by the existing regulation.

In issuing the NPR, the FDIC is asserting approval authority over not only investments by mutual fund complexes, at which the proposal is apparently directed, but also by all investors. Moreover, the Office of the Comptroller of the Currency could conceivably depart from its precedent and take a similar position with respect to national bank subsidiaries of bank holding companies, particularly after Acting Comptroller Michael J. Hsu, as a member of the FDIC board, voted in favor of the proposal. If adopted, the proposal could result in higher costs to investors in mutual fund complexes, including the retirement investments of Main Street investors. Such an approach would also put investors in a challenging position in the event that one federal banking agency issues a non-objection following its review of a CBCA notice and the other federal banking agency fails to issue such a non-objection, or fails to respond. Comments on the notice of proposed rulemaking are due on November 18. For more on the implications of the FDIC's NPR, please see our client alert here and our publication on the NPR here.

SEC issues Liquidity Rule guidance and adopts amendments to Forms N-PORT and N-CEN. On August 28, the SEC adopted amendments to the reporting requirements for certain registered investment companies, including registered open-end funds, registered closed-end funds and unit investment funds, on Forms N-PORT and N-CEN and provided guidance related to rule 22e-4 under the Investment Company Act. Rule 22e-4, also known as the Liquidity Rule, governs open-end fund liquidity risk management.

The amendments to Form N-PORT will result in more frequent reporting of Form N-PORT information to the SEC and more frequent public disclosures under the amendments. Funds will be required to file Form N-PORT reports on a monthly basis within 30 days of the end of each month, whereas funds were previously required to file monthly reports within 60 days of the end of the fiscal quarter. Further, certain portions of the funds' monthly reports will now be made public 60 days after the end of the month, whereas reports were previously made public 60 days after the end of each fiscal quarter. The amendments to Form N-CEN will require funds to identify and provide certain information about the service providers used to fulfill the requirements of the Liquidity Rule.

The SEC also provided guidance on three issues in the adopting release relating to the liquidity rule. First, the SEC noted that the Liquidity Rule requires funds to adopt policies that are reasonably designed to enable funds to conduct intra-month reviews of liquidity classifications if there are changes in relevant market and trading conditions. Next, the SEC clarified the meaning of "cash" in the rule, noting that, when classifying investments, funds need to consider the time it takes to convert those investments, including non-U.S. dollar currencies, into U.S. dollars. Finally, the SEC reiterated that a fund having a

substantial amount of less liquid or illiquid investments should establish a highly liquid investment minimum that is higher than that of funds with more liquid assets.

The compliance date for the amendments is November 17, 2025, with the exception of the Form N-PORT amendments for fund groups with net assets of less than $1 billion as of the most recent fiscal year, which have a compliance date of May 18, 2026. For more information on the adopted amendments to Forms N-PORT and N-CEN and the guidance related to the Liquidity Rule, please see our client memo here.

Agencies propose joint financial data standards. On August 22, pursuant to the Financial Data Transparency Act of 2022 (the "FDTA"), the SEC, OCC, Federal Reserve Board (FRB), FDIC, CFTC, CFPB, the Federal Housing Finance Authority, the National Credit Union Association and the Department of the Treasury jointly published proposed data standards to promote interoperability of financial regulatory data across such agencies. The FDTA requires the eight agencies and the Department of the Treasury to jointly adopt data standards for (1) certain collections of information reported to each agency by financial entities under the jurisdiction of the agency and (2) data collected from the Agencies on behalf of the Financial Stability Oversight Council. The Agencies proposed specific identifiers for the following information: legal entity identifiers (LEIs); swaps; financial instruments; data fields; geography (e.g., U.S. state or country); and currency. The FDTA also requires the agencies, except for the Department of Treasury and CFTC, to individually issue agency-specific rules that adopt the joint data standards. The application of the final joint standards to specific collections of information would thus take effect through adoption by agency-specific rulemaking. Comments were due October 21, 2024.

The Financial Conduct Authority (the "FCA") implements new rules to allow FCA-authorized investment managers to make joint payments for investment research. In July, the FCA issued a policy statement setting forth the FCA's final rules that enables FCA-authorized investment managers and advisers to purchase investment research from third-party providers using a new option: joint payments for third-party research and execution services, which mean payments for research can be bundled with other services provided by the third-party service providers. This is in addition to two other payment methods that investment managers and advisers can choose from to pay for research: (1) managers and advisers can make direct payment for research from their own resources, or (2) they can agree to a separate charge with their clients made from a separate research payment account. The rules were proposed in April 2024 to provide United Kingdom ("UK") investment managers and advisers with additional flexibility to pay for investment research through joint payments for third-party research and execution services, as long as certain requirements are met. The changes are part of wider reforms implemented to strengthen the UK's position in the capital markets which the UK is now able to implement following its withdrawal from the European Union ("EU"), as the rules prohibiting joint fees were a requirement of EU law. The EU will continue to enforce MiFID II across EU jurisdictions.

In order to engage in joint payments for third-party research and execution services, firms must meet a number of key requirements, including providing: (1) a written policy

describing the firm's approach to joint payments; (2) an arrangement that stipulates the methodology for calculating and separately identifying the cost of research; (3) a structure for the allocation of payments between research providers; (4) an approach for the allocation across clients of the costs of research purchased through joint payments; (5) a periodic assessment of the value, quality, use and contribution to investment decision-making of the research purchased; (6) disclosure to clients on the firm's approach to joint payments; (7) operational procedures for the administration of accounts used to purchase research; and (8) a budget to establish the amount needed for third-party research. The changes do not apply to FCA-authorized alternative investment fund managers (AIFMs), but the FCA announced plans to ensure consistency between the regimes applicable to authorized investment managers and AIFMs. The final rules went into effect on August 1.

The SEC amends rules to apply Form N-4 disclosure requirements to registered index-linked annuity ("RILA") and registered market value adjustment ("MVA") annuity issuers. On July 1, the SEC adopted rule and form amendments to provide a tailored form to register the offerings of non-variable annuities, based largely on the existing registration and disclosure framework for variable annuities. The changes allow RILAs and MVA annuity issuers to use the same disclosure approach and registration process and pay registration fees on the same basis as variable annuities, subject to certain amendments intended to tailor the required disclosures to RILA and MVA annuity investors. In addition, the rule requires RILA issuers and issuers of registered MVA annuities to comply with rule 156 under the Securities Act of 1933 (the "Securities Act"), which provides guidance as to when sales literature is materially misleading under Federal securities laws and, in a departure from the proposal, makes a technical amendment to rule 433 of the Securities Act to allow non-variable annuity issuers that can meet the rule's conditions to continue to use a free writing prospectus without it needing to be preceded or accompanied by a prospectus satisfying section 10 of the Securities Act. The rule and form amendments became effective on September 23, 2024.

FinCEN finalizes AML Rules for investment advisers. On August 28, FinCEN unveiled finalized anti-money laundering rules that would require certain investment advisers to monitor and report suspicious client activities. The rules amend the definition of "financial institution" under the Bank Secrecy Act to cover investment advisers registered with the SEC and those that report to the SEC as exempt reporting advisers. The final rules are part of the Biden Administration's 2021 U.S. Strategy on Countering Corruption and help to address the illicit finance risks in the investment adviser sector, which were documented in a February 2024 risk assessment by the U.S. Department of the Treasury. Under the final rules, covered advisers will be required to establish and implement a written AML compliance program by January 1, 2026, which program must include suspicious activity reporting and independent testing requirements, two practices that may not be familiar to advisers. The final rules narrow the types of advisers covered by AML requirements to exclude RIAs that register with the SEC solely because they are (i) mid-sized advisers, (ii) multi-state advisers, (iii) pension consultants, or (iv) RIAs that do not report any assets under management (AUM) on Form ADV. In addition, FinCEN clarified that for investment advisers subject to the rule with a principal place of business

outside of the United States the rule applies only to their activities that (i) take place within the United States or (ii) provide services to a U.S. person or a foreign-located private fund with an investor that is a U.S. person. The new rules will take effect in January 2026.

The SEC adopts rule to adjust for inflation the dollar threshold used to define a "qualifying venture capital fund" and sets future adjustments to consumption index. On August 21, the SEC adopted a final rule that adjusts for inflation the dollar threshold in the definition of "qualifying venture capital fund" for the purposes of the Investment Company Act of 1940 (the "Investment Company Act"). In addition, the rule requires the SEC to make future inflation adjustments by order every five years. Prior to the rule, Section 3(c)(1)(C) of the Investment Company Act defined "qualifying venture capital funds" as venture capital funds with no more than $10,000,000 in aggregate capital contributions and uncalled committed capital, and required that this threshold "be indexed for inflation once every five years by the Commission." The adopted rule raises the threshold to $12,000,000 or, following November 1, 2029, the dollar amount specified in the most recent order issued by the SEC. The adjusted threshold takes – and contemplated future adjustments will take – into account historic and current levels of the Personal Consumption Expenditures Chain-Type Price Index published by the Department of Commerce. There are five venture capital funds that cannot currently take advantage of the exclusion from registration as investment companies but would be "qualifying venture capital funds" after the threshold is increased to $12,000,000.

Recent Court Decisions

Sixth Circuit upholds the SEC's proxy adviser rule change. On September 10, in *Chamber of Commerce of the United States v. Securities and Exchange Commission*, the U.S Court of Appeals for the Sixth Circuit held the SEC did not exceed its authority under the Administrative Procedure Act (the "APA") when it partially reversed the previous administration's regulations on proxy advisers, creating a circuit split. The original Proxy Adviser Rule, adopted by the SEC in September 2020, imposed "notice and awareness" conditions on proxy advisory firms, which required them to inform companies of their voting recommendations at or before the time recommendations were sent to clients and notify clients of the companies' written responses to that advice. However, the SEC rescinded the rule in 2022 on the basis that the informational benefits did not justify the potential impact to timely proxy advice. In a 2-1 opinion of a three-judge panel, the Sixth Circuit upheld the SEC's rescission of the rule and found the SEC's action did not violate the APA. The Chamber of Commerce and other litigants challenging the recission of the Proxy Adviser Rule in front of the Sixth Circuit argued the SEC did not provide an adequate notice-and-comment period on the rule change and acted arbitrarily and capriciously because the rescission immediately followed a change in administration. The court rejected both arguments. According to the court, the APA only requires the notice-and-comment period be "meaningful," and the challenged 31-day comment period met that standard. Further, the court held that the SEC did not act arbitrarily, as a federal agency may rescind a rule based solely on the agency's changed policy preferences, so long as the change is reasonably explained. The Sixth Circuit's decision creates an apparent split with the Fifth Circuit on whether the rescission of theProxy Adviser Rule violated the APA. In June, the Fifth Circuit held that the SEC's decision was arbitrary and

capricious due to the SEC's disregard of an earlier finding that the 2020 rule did not pose a risk to the timeliness and independence of proxy advice. For more on the Fifth Circuit's decision, see our June ESG Newsletter here. Given the circuit split, it is not immediately clear whether the SEC will be able to enforce the 2022 rescission of the Proxy Rule and whether parties in the Sixth Circuit case will appeal to the Supreme Court.

Federal Court issues statewide injunction against Missouri Securities Division rules requiring investment advisers that consider ESG objectives to disclose such considerations to investors and obtain investors' written consent. On August 20, the U.S. District Court for the Western District of Missouri Central Division struck down two rules issued by the Missouri Securities Division, which required investment advisers to obtain written consent from Missouri investors before incorporating a "social objective" or other "nonfinancial objective" into their securities recommendations or investment advice. The court granted summary judgment to SIFMA, who filed a legal challenge to Missouri's rules in August 2023, and issued a statewide injunction against the rules. The court held that the rules are (1) preempted by the National Securities Markets Improvement Act (NSMIA) and ERISA, (2) unconstitutional under the First and Fourteenth Amendment's protection against compelled speech and (3) impermissibly vague under the Fourteenth Amendment. The court's legal analysis could impact future challenges to similar laws in other states. The Missouri Attorney General initially indicated that the state would appeal to the Eighth Circuit, but has since agreed with SIFMA to abandon the appeal.

The U.S. District Court for the Eastern District of Texas issues a stay on the Department of Labor's Retirement Security Rule. On July 25, the U.S. District Court for the Eastern District of Texas held the DOL's Retirement Security Rule "conflicts with the Employee Retirement Income Security Act of 1974 ('ERISA') in several ways, including by treating as fiduciaries those who engage in onetime recommendations to roll over assets from an ERISA plan to an IRA." Further, the court declined to defer to the DOL's interpretation of ERISA under the recent *Loper Bright* standard of reviewing agency action. The following day, the U.S. District Court for the Northern District of Texas issued a stay that incorporated the Eastern District's holding but went further and extended the stay to the prohibited transaction exemption changes made under the DOL's rule. The DOL adopted the Retirement Security Rule on April 23. The Retirement Security Rule sought to change the meaning of "investment advice" under ERISA's definition of a "fiduciary," which has been unchanged since 1975, and would have significantly expanded the circumstances in which a person would be treated as a fiduciary under ERISA. Following the DOL's adoption of the Retirment Security Rule, several insurance industry trade groups filed suit in the Fifth Circuit's Eastern and Northern Districts of Texas, claiming the rule was effectively a repackaging of a 2016 rule that had been invalidated by a 2018 Fifth Circuit decision. A joint resolution is now circulating in the House of Representatives to disapprove the rule. For more on the DOL's Retirement Security Rule, see our memo here.

Recent Enforcement Actions

SEC continues to focus on Private Fund Advisers. In August and September, the SEC announced a number of settled enforcement actions involving investment advisers to private funds, covering topics such as custody of client assets, liability disclaimers (also known as hedge clauses) and preferential treatment. A number of these actions focus on topics addressed by the SEC's now-vacated Private Fund Adviser Rules.

- On September 20, the SEC announced it settled charges against ACP Venture Capital Management Fund LLC, an exempt reporting adviser, for failing to register as an investment adviser and to comply with the Advisers Act Custody Rule. The SEC alleged that, during the relevant period, ACP took the position that it qualified for the exemption from registration available to advisers that manage only private funds with an aggregate value of assets under management of less than $150 million, even though it had significant operational and ownership overlap with its registered investment adviser affiliate, including overlapping owners, managers, advisory personnel and operations. In addition, the SEC alleged that during this period ACP did not comply with the Custody Rule by failing to obtain audited financials or surprise examinations to verify its custody of its funds' securities. ACP agreed to a cease-and-desist order and to pay a civil penalty of $45,000 and to obtain a verifying examination of the funds and securities held by the funds for which it serves as adviser by an independent public accountant.

- On September 3, the SEC announced it settled charges with two advisers to Private Funds for violation of the Custody Rule. According to the SEC's order against Galois Capital Management LLC, the adviser failed to ensure that certain crypto assets held by the private fund it advised were maintained by trading platforms that were not qualified custodians. In November 2022, approximately half of the fund's assets were lost in connection with the collapse of FTX Trading Ltd. To settle the SEC's charges, Galois agreed to a cease-and-desist order, a censure and a civil penalty of $225,000, which will be distributed to its fund's harmed investors. Separately, the SEC's order settling charges against ClearPath Capital Partners LLC alleged that the adviser failed to timely distribute annual audited financial statements to investors in certain private funds it advised. In addition, the partnership and operating agreements of certain funds advised by the adviser included (i) liability disclaimers that would have led investors to believe that they had waived certain non-waivable causes of action against the adviser and (ii) misleading language regarding the adviser's unwaivable fiduciary duty to its private funds. ClearPath agreed to a cease-and-desist order, a censure and a $65,000 civil penalty.

- On August 19, the SEC announced charges against Obra Capital Management, LLC for violating the SEC's Pay-to-Play Rule for investment advisers after it continued to provide investment advisory services to a government entity after its associate made a campaign contribution to an elected official with influence over

the selection of investment advisers for the government entity. Obra agreed to a cease-and-desist order, a censure and a $95,000 civil money penalty.

SEC continues streak of enforcement actions related to off-channel communications. In August and September, the SEC announced the latest in a series of SEC recordkeeping resolutions, a key enforcement focus area for the Commission since December 2021. These enforcement actions focus on employee usage of unapproved platforms for business communications, including on personal mobile devices.

- On August 14, the SEC announced it settled charges with 26 firms, including broker-dealers, investment advisers and dual-hatted firms, for allegedly failing to maintain and preserve electronic communications in violation of the recordkeeping provisions of the Exchange Act and Advisers Act. Consistent with many of the prior resolutions in this space, the firms agreed to cease and desist from future violations of the recordkeeping requirements, implement improvements to their compliance procedures and pay a penalty of over $393 million collectively to resolve the matter. Three firms received lower penalties because they self-reported their violations.

- On September 23, the SEC announced charges against Texas-based investment adviser Atom Investors LP for recordkeeping violations. The SEC noted that Atom Investors avoided a penalty because of its substantial cooperation with SEC staff, including self-reporting the conduct and promptly remediating the violation.

- On September 24, the SEC announced charges against 12 firms for widespread and long-standing recordkeeping failures. Eleven firms agreed to cease and desist from future violations of the relevant recordkeeping provisions and pay a penalty of over $88 million collectively to resolve the matter. Similar to the Atom Investors enforcement action announced the previous day, the SEC did not impose a penalty on one firm, Qatalyst Partners LP, because Qatalyst uncovered the recordkeeping violations during an internal investigation, self-reported those violations and cooperated with the SEC staff's investigation. Nevertheless, the SEC brought recordkeeping and supervision charges against Qatalyst, and censured the firm. The action indicates that the risk of SEC enforcement exists even where firms take proactive measures, identify discrete non-compliance and self-report to the SEC.

For a discussion of the implications of these recent SEC actions on self-reporting and violations of firm communications policies, see our client memo here.

SEC charges two investment advisers with failure to maintain policies and procedures related to MNPI. In August and September, the SEC announced it settled charges with two registered investment advisers to private funds for compliance failures in handling material nonpublic information ("MNPI"). On September 30, the SEC settled charges with adviser Marathon Asset Management LP for failing to establish, maintain

and enforce policies and procedures reasonably designed to address the specific risks associated with the adviser's regular participation on ad hoc creditors' committees where it could receive MNPI on debtors. Marathon consented to a $1.5 million penalty, a cease-and-desist order and a censure. The settled Marathon charges follow the SEC's August 26 announcement that it had settled charges against Sound Point Capital Management LP for failing to establish, maintain or enforce any written policies or procedures on the potential impact of MNPI that it came into contact with about loans held by third-party-managed CLOs received as part of the adviser's separate credit business, even though this MNPI was about companies whose loans were held in CLOs that Sound Point traded. The SEC noted that Sound Point began to conduct pre-trade compliance reviews of the potential impact of MNPI in 2019 after a related incident, but did not adopt written policies or procedures until 2024. Sound Point agreed to a cease-and-desist order, a censure and a $1.8 million penalty.

SEC charges 11 institutional investment managers with failing to report certain securities holdings on Form 13F; two of such managers are also charged with failing to report large transactions on Form 13H. On September 17, the SEC announced settled charges against 11 institional investment managers for failing to file Form 13F reports, which are quarterly reports required to be filed by firms that have discretion over more than $100 million in certain securities (generally, U.S. exchange-traded stocks; shares of closed-end investment companies; and shares of ETFs). Two of the firms were also charged with failing to file Forms 13H, which are required to be filed by large traders who trade a significant amount of exchange-listed securities. Nine of the firms agreed to pay over $3.4 million in combined civil penalities. While the two firms that self-reported violations did not have to pay any civil penalities, including one firm that was charged with Form 13H violations.

SEC charges nine investment advisers for Marketing Rule violations. On September 9, the SEC announced charges against nine registered investment advisers for violating Rule 206(4)-1 of the Advisers Act, known as the Marketing Rule. The SEC alleged that the investment advisers disseminated advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements or third-party ratings that lacked required disclosures. According to the SEC, these alleged violations pose a serious risk of misleading investors. The firms agreed to pay $1.24 million in combined civil penalties to resolve the matter. This is the third set of cases that the SEC has brought as part of an ongoing targeted sweep concerning Marketing Rule violations after charging five advisory firms in April 2024 and nine advisory firms in September 2023. For more on these prior sweeps, see our Q2 Newsletter here.

SEC charges Asset Manager for misrepresenting ESG investments. On October 21, the SEC announced charges against WisdomTree Asset Management Inc. for making misstatements and for compliance failures relating to the execution of an investment strategy that was marketed as incorporating ESG factors. The SEC alleged that WisdomTree represented in prospectuses for three ESG-marketed exchange-traded funds that the funds would not invest in companies involved in activities including fossil fuels and tobacco. However, the three ESG-marketed exchange-traded funds invested in

companies that engaged in coal mining and transportation, natural gas extraction and distribution, and retail sales of tobacco products. According to the SEC, WisdomTree used data from third-party vendors that did not screen out all companies involved in fossil fuel and tobacco-related activities and did not have any procedures over the screening process. WisdomTree agreed to cease and desist from further violations and to pay a $4 million civil penalty to resolve the matter.

Other Recent Key Updates

The SEC's examination Division ("SEC EXAMS") releases examination priorities for 2025. On October 21, SEC EXAMS released its 2025 examination priorities, along with the accompanying press release. Among the perennial and emerging risk areas that the SEC plans to prioritize in the coming year are investment advisers' fiduciary duties and compliance programs, cybersecurity, crypto assets and artificial intelligence. Similar to the SEC's recent enforcement activity, the examination priorities continue to emphasize SEC EXAMS' focus on private fund advisers. This year the SEC highlighted as areas of interest private funds' compliance with the new Form PF amendments and the accuracy of calculations and allocations of private fund fees and expenses. Similar to last year, the examination priorities also focus on private fund advisers' disclosures, conflicts and controls, highlighting for the coming year (1) use of debt, fund-level lines of credit, investment allocations, adviser-led secondary transactions, transactions between fund(s) and/or others; (2) investments held by multiple funds; and (3) use of affiliated service providers.

Financial Services Committee chairs demand FRB, FDIC, OCC and SEC provide interagency communications regarding SAB 121. On September 23, the Chairman of the House Financial Services Committee, Patrick McHenry; Chairman of the Oversight and Investigations Subcommittee, Bill Huizenga; Chairman of the Digital Assets, Financial Technology and Inclusion Subcommittee, French Hill; and Chairman of the Financial Institutions and Monetary Policy Subcommittee, Andy Barr, sent letters to several regulatory agency heads demanding that regulators provide interagency communications regarding SEC Staff Accounting Bulletin No. 121 ("SAB 121"). SAB 121, which was released in March 2022, provides accounting and disclosure guidance related to certain Exchange Act registrants' and certain other covered entities' obligations to safeguard crypto-assets held in custody for their customers. Specifically, the bulletin requires these entities to record the fair market value of the crypto-asset on their balance sheet alongside a corresponding liability. According to the Financial Services Committee, SAB 121 imposes burdensome requirements that upend bank custody rules for digital assets, weaken consumer protections and stifle financial innovation. The letters to regulators are part of an ongoing effort by the Committee to understand the SEC's interagency communications leading up to the publication of SAB 121. For more on Congress's response to SAB 121 and President Biden's veto of the joint resolution disapproving of SAB 121, see our Q2 IM Newsletter here.

Elected state and federal officials continue to scrutinize ESG efforts by the SEC and asset managers.

- On September 18 and 19, respectively, the U.S. House of Representatives passed H.R. 5339, the *Roll Back ESG to Increase Retirement Earnings*

(RETIRE) Act, and H.R. 4790, the *Guarding Uniform and Responsible Disclosure Requirements and Information Limits (GUARDRAIL) Act*, which would, if passed by the Senate, (1) require investment advisers for pension plans to make investment decisions based only on pecuniary factors, reverting back to the DOL's 2020 rule; and (2) limit the SEC's rulemaking authority such that the agency could not require issuers to report nonmaterial information, a response to the SEC's climate-related disclosure rules, which were adopted in March and later stayed by the agency pending judicial revenue.

- On August 1, the Republican congressional ESG Working Group published its final staff report on the rise of ESG-related initiatives. The report asserts that the SEC's recent rulemaking exceeds the agency's statutory authority and recommends implementing proxy voting reforms and shielding U.S. companies from EU sustainability-related regulation.

- On August 30, a coalition of 24 state attorneys general, led by Montana Attorney General Austin Knudson, sent a letter to 25 asset managers raising concerns over alleged abdication of their fiduciary duties to shareholders. The letter notes that the asset managers backed environmental shareholder proposals recommended by Institutional Shareholder Services (ISS) at over twice the rate of the overall market. The attorneys general assert that these asset managers have been outsourcing their decision-making to ISS in violation of their fiduciary duties.

SEC is urged by private fund group to withdraw proposed rules following adverse decision from Fifth Circuit. On July 9, following the invalidation of the SEC's Private Fund Adviser Rule by the U.S. Court of Appeals of the Fifth Circuit in its June 5, 2024 decision, several groups of investment managers submitted a letter to the SEC urging that it withdraw three rulemaking proposals that could affect the private funds industry: (1) the Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies and Business Development Companies; (2) Outsourcing by Investment Adviser; and (3) Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers (collectively, the "Proposed Rules"). The letter notes that under the Fifth Circuit's holding that since section 206(4) of the Advisers Act specifically requires the SEC to "define" an act, practice or course of business that is "fraudulent, deceptive, or manipulative" before it can prescribe "means reasonably designed to prevent" "such" act, practice or course of business, the SEC does not have the authority to promulgate the Proposed Rules. The letter alternatively refers to the Fifth Circuit's holding that sections 211(h) of the Advisers Act is applicable only to the relationship between investment advisers and "retail customer" clients and requests that, if the proposals are not withdrawn, the SEC clarify that the Proposed Rules would not apply to any clients that are not retail customers.

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