GODFREY & KAHN S.C.

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Investment Management Legal and Regulatory Update

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LATEST DEVELOPMENTS

SEC Issues 2022 Examination Priorities

The SEC's Division of Examinations (Division) recently released its 2022 examination priorities. The Division's Acting Director, Richard R. Best, stated, "[i]n this time of heightened market volatility, our priorities are tailored to focus on emerging issues, such as crypto-assets and expanding information security threats, as well as core issues that have been part of the SEC's mission for decades – such as protecting retail investors" and urged firms to consider updating their compliance programs to address the broad landscape of potential risks identified by the 2022 priorities.

The report begins with metrics about the Division's examination program. It notes that the Division completed over 3,040 examinations in 2021 (a 3% increase from 2020) and issued more than 2,100 deficiency letters (an increase of 100 letters from 2020). More than 2,200 registered investment advisers (RIAs) and more than 125 investment company complexes were examined during 2021. The Division examined approximately 16% of RIAs, compared to 15% in the prior two years, although the report indicates that the Division will likely have to lower the annual coverage target "as the growth in the number of RIAs continues to grow at a rate that far outpaces staffing increases." The Division notes that the number of RIAs has increased 20% over the last five years to over 14,800 and the asset management industry continues to grow in complexity.

The Division also reaffirmed its long-standing commitment to, and focus on, promoting compliance despite last year's name change from the Office of Compliance Inspections and Examinations to the Division of Examinations. The Division emphasized that compliance is at the forefront of its work, noting that it engages with compliance officers routinely on each examination and looks for outreach and engagement opportunities with compliance professionals. The Division observed that a key characteristic of an effective compliance program is resiliency, meaning programs should be developed and designed to be effective and withstand changes due to changes in market conditions, key personnel and investor demand.

The 2022 priorities are grouped into the following categories:

- Private Funds
- ESG Investing
- Standards of Conduct for Retail Investors
- Information Security and Operational Resiliency
- Emerging Technology and Crypto-Assets

Private Funds

The SEC continues to focus on private fund advisers and private funds, as evidenced by the 2022 priority list, as well as recent rule proposals and a 2021 risk alert regarding private fund advisers. The Division's report notes that there has been a 70% increase in the assets managed by private fund advisers in the last five years, and more than 5,000 advisers (representing over 35% of all RIAs) manage approximately $18 trillion in private fund assets.

The Division stated that it will review fiduciary duty issues, such as the potential preferential treatment of certain investors by RIAs, and will assess risks by focusing on compliance programs, the calculation and allocation of fees and expenses, compliance with the custody rule, fund audits, valuation, conflicts of interest, disclosures of investment risks, and controls around material non-public information. The Division will also focus on portfolio strategies, risk management and investment recommendations and allocations, concentrating on conflicts and related disclosures. The Division will also review private fund advisers' practices, controls and investor reporting concerning risk management and trading for private funds that show indicia of systemic importance, such as large counterparty or gross notional exposure.

ESG Investing

The Division will continue its focus on RIAs and investment products (such as registered funds and private funds) that employ ESG strategies or incorporate ESG criteria as part of their overall investment strategy. In particular, the Division will review whether advisers and funds are:

- Accurately disclosing their ESG investment strategies (and have adopted corresponding compliance procedures, including review of their portfolio management processes and practices);
- Voting client securities in accordance with proxy voting policies, including in alignment with ESG-related disclosures and investment mandates; and
- Misrepresenting or embellishing the ESG factors considered or incorporated into investment decision making (e.g., "greenwashing"), such as in performance advertising and other marketing materials.

Standards of Conduct: Regulation Best Interest, Fiduciary Duty and Form CRS

The Division will continue to focus on standards of conduct for broker-dealers and RIAs with retail clients. This review will include assessing how advisers are satisfying their obligations under the Advisers Act fiduciary standard, which requires advisers to act in the best interests of retail clients without placing their own interests ahead of retail clients' interests. Examinations will include evaluating advisers' practices regarding the consideration of investment alternatives, how advisers manage conflict of interest, and practices relating to trading, disclosures (such as those in Form ADV and Form CRS), rollover recommendations and account conversions. Focus areas for examinations of advisers to retail clients include:

- Revenue sharing arrangements;
- Recommending or holding more expensive share classes when lower cost share classes are available to the client;
- Recommending wrap fee accounts without analyzing whether the accounts are in the best interests of clients; and
- Recommending proprietary products with higher fees or additional fees.

Information Security and Operational Resiliency

The Division will assess advisers' practices that are intended to prevent interruptions to mission-critical services and to protect client information, records and assets. The Division will continue to focus on whether advisers have taken sufficient measures to:

- Prevent intrusions and safeguard client accounts;
- Oversee service providers' cybersecurity efforts;
- Address phishing or account intrusions or other malicious email activities;
- Respond to incidents, such as ransomware attacks;
- Identify and detect red flags relating to identity theft; and
- Manage operational risk (such as those relating to hybrid working environments).

The Division will also review advisers' business continuity and disaster recovery plans and will focus on whether such plans address climate risk and substantial disruption to normal business operations. Cybersecurity continues to be a perennial focus area in the Division's exam priorities, but this year's report demonstrates the Division's focus on new cyber topics, such as the use of emerging technologies across registrant types.

Emerging Technologies and Crypto-Assets

The Division will also review advisers that are using emerging financial technologies to assess whether the unique risks of such activities are incorporated into the firms' compliance programs. Emerging financial technologies include digital investment advice (i.e., "robo-advising") and the proliferation of trading in crypto-assets. Examinations of advisers will focus on firms employing or claiming to employ these technologies or investing in such assets and assess whether (1) operations and controls in place are consistent with disclosures made, the standard of conduct owed to investors and other regulatory obligations; (2) advice and recommendations are consistent with investors' investment strategies and the standard of conduct owed to them; and (3) controls contemplate the unique risks associated with these practices.

Additional Comments Regarding Examinations of Advisers and Investment Companies

The report also included comments regarding the Division's review of compliance programs and other focus areas during a typical examination.

Advisers. The Division will review an adviser's compliance program in one or more of the following focus areas: marketing practices; custody and safety of client assets; valuation; portfolio management; brokerage and execution; conflicts of interest; and related disclosures. The Division will also focus on whether investment advice is in each client's best interest, whether there are sufficient resources for an adviser to perform its compliance duties and whether oversight of service providers is sufficient. The Division will also focus on disclosures by advisers and issues relating to fees and expenses, including advisory fee calculation errors (and whether they were properly adjusted), inaccurate calculation of tiered fees (such as failing to provide breakpoints or aggregating household accounts), and failures to refund prepaid fees for terminated accounts or to pro-rate fees for new clients.

Investment Companies. The Division will continue to focus on registered funds' compliance programs and governance practices. Focus areas will include disclosures, accuracy of SEC reporting, and compliance with new rules and exemptive orders (including ETF rules and non-transparent ETFs). The Division will also focus on registered funds' liquidity risk management programs to determine whether the programs are reasonably designed to assess and manage the funds' liquidity risk and review the implementation of liquidity classifications and oversight of third party service providers. The Division will also review certain fund practices, such as advisory fee waivers and trading activities of portfolio managers.

Sources: SEC Division of Examinations Announces 2022 Examination Priorities, SEC Press Release 2022-57 (Mar. 30, 2022), available here; 2022 Examination Priorities, SEC Division of Examinations (Mar. 30, 2022), available here.

SEC Issues Rule Proposals on Cybersecurity Risk Management

On February 9, 2022, the SEC proposed new rules and rule amendments relating to cybersecurity risk management and disclosures for registered advisers and registered funds. The rules would require advisers and funds to adopt and implement written policies and procedures that are designed to address cybersecurity risks that could harm their clients or shareholders. In addition, advisers would be required to confidentially report significant cybersecurity incidents to the SEC within 48 hours. The proposed rule and related amendments are intended to address concerns about cybersecurity preparedness of advisers and funds, reduce cybersecurity-related risks, improve investor disclosures about cybersecurity incidents and risks, and improve the SEC's ability to oversee advisers and funds and evaluate systemic risks. The rule's most significant changes are the requirements for advisers to promptly report cybersecurity incidents to the SEC and for both advisers and funds to publicly disclose any significant cyber events in the past two fiscal years.

The public comment period was open for a period of 60 days following the publication of the proposing release (and 30 days after publication in the Federal Register) and closed on April 11, 2022.

Written Policies and Procedures

Proposed Rule 206(4)-9 under the Advisers Act and proposed Rule 38a-2 under the Investment Company Act would require advisers and funds to adopt and implement written cybersecurity policies and procedures that are reasonably designed to address cybersecurity risks. The policies and procedures are intended to assist in addressing operational and other risks that could hurt advisory clients or fund shareholders or result in unauthorized access to or use of adviser or fund information, including personal information of clients or fund shareholders.

Required Elements. The proposed rules would require advisers and funds to:

- Periodically assess, categorize, prioritize and draft written documentation of the cybersecurity risks associated with an adviser's or fund's information systems and information;
- Adopt and implement policies and procedures that are reasonably designed to minimize user-related risks and prevent unauthorized access to information and systems, such as adopting user security and access provisions;
- Monitor information systems and protect information from unauthorized use or access based on a periodic assessment of information systems and the information that resides in such systems;
- Detect, mitigate and remediate cybersecurity threats and vulnerabilities with respect to information and information systems; and
- Have measures in place to detect, respond to and recover from a cybersecurity incident.

Annual Review. The proposed rules would also require that advisers and funds conduct an annual review of cybersecurity policies and procedures to assess their effectiveness, including risk assessments of the advisers, funds and their service providers. Advisers and funds must also prepare a written report that describes the annual review and its results, document any cyber incidents that occurred since the last annual report and summarize any material changes to the policies and procedures since the last annual report. The annual written report should be overseen or prepared by individuals who administer the adviser's or fund's cybersecurity policies and procedures. The SEC staff noted that a cybersecurity expert may provide necessary expertise and perspective in formulating the annual report; however, additional review by adviser or fund personnel is necessary to provide organizational perspective and ensure accountability and sufficient resources.

Fund Board Oversight. Rule 38a-2 would require fund boards of directors, including a majority of the independent directors, to initially approve the cybersecurity risk management program and review the written report on cybersecurity incidents and material changes to such program, at least annually.

Recordkeeping. The rule would also impose new recordkeeping requirements for advisers and funds.

Reporting Significant Cybersecurity Incidents

Proposed Rule 204-6 under the Advisers Act would require advisers to report significant cybersecurity incidents to the SEC, including on behalf of a registered fund or a private fund, by filing new confidential Form ADV-C within 48 hours after having a reasonable basis to conclude that a significant cybersecurity incident had occurred or is occurring. Form ADV-C would include general and specific questions relating to the incident, such as the nature and scope of the incident, as well as whether the firm has made any disclosures about the incident to clients or investors. Rule 204-6 defines "significant adviser cybersecurity incident" as an incident, or a series of related incidents, that significantly disrupts or degrades the adviser's ability, or the ability of a private fund client, to maintain critical operations or leads to unauthorized access or use of information, where such access or use results in (1) substantial harm to the adviser or (2) substantial harm to a client or investor in a private fund whose information was accessed.

Adviser and Fund Disclosure Enhancements

The SEC also proposed amendments to certain forms used by advisers and funds, which would require cybersecurity risks and incidents to be disclosed to investors and other market participants. Specifically, Form ADV Part 2A for advisers and Forms N-1A and N-2, among other fund forms, would be amended. The proposed amendments to Form ADV Part 2A would require the disclosure of cybersecurity risks and how such risks are prioritized, as well as a description of cybersecurity incidents that occurred within the last two fiscal years that significantly disrupted or degraded an adviser's ability to maintain critical operations or that led to unauthorized access or use of adviser information, resulting in substantial harm to the adviser or its clients. The proposed Form ADV Part 2A amendments would also require the prompt delivery of the brochure to clients when an adviser adds disclosure of a cybersecurity incident or materially revises information about a previously disclosed cybersecurity incident. Similarly, fund prospectuses would be required to include cybersecurity-related disclosures, including a description of any significant fund cybersecurity incident that is currently affecting the fund or its service providers or has occurred in the last two fiscal years.

Sources: Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, Release Nos. IA-5956, IC-34497 (Feb. 9, 2022), available here; SEC Proposes Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisors and Funds, SEC Press Release 2022-20 (Feb. 9, 2022), available here; SEC Fact Sheet, Cybersecurity Risk Management (Feb. 9, 2022), available here.

LATEST DEVELOPMENTS: FUNDS

Derivatives Rule – Update on Reporting Forms for Early Adopters

In November 2020, the SEC adopted new Rule 18f-4 of the Investment Company Act that governs funds' use of derivatives, which included adopting new reporting requirements and amendments to Forms N-PORT, N-CEN and N-RN (f/k/a Form N-LIQUID). Rule 18f-4's compliance date is August 19, 2022, and funds may elect to comply with the rule, including the reporting requirements (once the SEC announced such forms were available to registrants), in advance of such date. On February 16, 2022, the SEC announced that amended Forms N-PORT, N-CEN and N-RN were available for filing on the EDGAR system. As such, early adopters of Rule 18f-4 are required to comply with all elements of Rule 18f-4, including Rule 18f-4's new reporting requirements. For more information regarding Rule 18f-4, please see our January 2021 Legal and Regulatory Update.

Source: Accounting and Disclosure Information – Derivatives Rule: Updated Reporting Forms Available for Fund Filers (Feb. 16, 2022), available here.

LATEST DEVELOPMENTS: ADVISERS

SEC Proposes Rule Changes for Private Fund Advisers and Documentation of Compliance Reviews for All Advisers

On February 9, 2022, the SEC voted 3-1 to propose new rules governing private fund advisers. If adopted, the proposed new rules would require SEC-registered private fund advisers to:

- Provide investors with standardized quarterly statements detailing information about private fund fees, compensation, expenses and performance;
- Obtain and distribute annual audits for the private fund and cause the private fund's auditor to notify the SEC upon certain events (e.g., termination of the auditor's engagement or issuance of a modified opinion); and
- Distribute a fairness opinion and a summary of material business relationships between the adviser and the fairness opinion provider to investors, in connection with an adviser-led secondary transaction.

Prohibited Activities Rule. The proposal would prohibit all private fund advisers, including those that are not registered with the SEC (e.g., exempt reporting advisers), from engaging in the following activities and practices:

- Charging certain fees and expenses to a private fund or its portfolio investments, such as fees for unperformed services (e.g., accelerated monitoring fees) and fees or expenses associated with an examination or investigation of the adviser by the SEC or other governmental or regulatory authorities;
- Seeking reimbursement, indemnification, exculpation, or limitation of its liability for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to a private fund;
- Reducing the amount of any adviser clawback (i.e., any obligation of the adviser, its related persons or owners to restore or otherwise return performance-based compensation to the private fund under its governing documents) by actual, potential or hypothetical taxes applicable to the adviser, its related persons or their respective owners or interest holders;
- Charging or allocating fees and expenses related to a portfolio investment on a non-pro rata basis when multiple private funds and other clients of the adviser have invested in the same portfolio investment; and
- Borrowing or receiving an extension of credit from a private fund client.

Preferential Treatment Rule. The proposal would also prohibit all private fund advisers, including those that are not registered with the SEC, from providing:

- Preferential terms to certain investors regarding redemptions from the fund or information about portfolio holdings or exposures; and
- Any other types of preferential treatment to any investor in the private fund, including fee discounts, the right to increase an investment in a private fund (even though the fund is closed to new investors or to additional investments by other existing investors), and "excuse rights" (i.e., the right to refrain from participating in a specific investment the private fund plans to make), unless disclosed to current and prospective investors.

Commissioner Hester M. Peirce characterized the proposal as a "sea change" for private fund advisers in her statement in opposition because "the proposal would impose a host of new mandates on private fund advisers." In addition, she stated that "these changes represent a meaningful recasting of the SEC's mission" and a departure from the SEC's "historical view that [private fund] investors can fend for themselves."

Compliance Rule Amendment. In addition, the SEC proposed to amend the Advisers Act compliance rule to require all registered advisers, including those that do not advise private funds, to document the annual review of their compliance policies and procedures in writing. Although many advisers already prepare written annual reviews as a best practice, the current text of the compliance rule does not expressly require written documentation.

Comments are due April 25, 2022.

Sources: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Release No. IA-5995 (Feb. 9, 2022), available here; SEC Proposes to Enhance Private Fund Investor Protection, SEC Press Release 2022-19 (Feb. 9, 2022), available here; SEC Fact Sheet Private Fund Proposed Reforms, available here; Statement of Commissioner Hester M. Peirce, Statement on Proposed Private Fund Advisers; Documentation of Investment Adviser Compliance Reviews Rulemaking (Feb. 9, 2022), available here.

SEC's Division of Examinations Issues Second Risk Alert on Observations from Examinations of Private Fund Advisers

Shortly before proposing the new rules and rule amendments for private fund advisers discussed in this update, the Division published a risk alert detailing observations from examinations of private fund advisers. This risk alert follows a 2020 risk alert, which noted three general areas of deficiencies identified in examinations of private fund advisers: conflicts of interest, fees and expenses, and policies and procedures relating to material non-public information. The June 2020 risk alert is summarized in more detail in our July 2020 Legal and Regulatory Update.

This new risk alert focuses on the following four concerns:

- Private fund advisers that act inconsistently with material disclosures to clients or investors;
- Private fund advisers that use misleading track records or other marketing statements;
- Private fund advisers that fail to adequately conduct due diligence on investments and service providers; and
- Private fund advisers that use "hedge clauses" (limits on liability) that are potentially misleading.

Actions Inconsistent with Disclosures

The Division staff observed conduct that was inconsistent with private fund advisers' disclosures to clients or investors, including private fund advisers that:

- Failed to follow practices described in limited partnership agreements, operating agreements, private placement memoranda, due diligence questionnaires, side letters or other disclosures, such as failing to obtain informed consent from the appropriate parties regarding conflicts of interest under such arrangements.
- Failed to follow practices described in private fund disclosures regarding the calculation of post-capital commitment managements fees.
- Failed to obtain required approvals to extend the terms of private equity funds and failing to comply with liquidation provisions, as set forth in private fund governing documents, resulting in potentially inappropriate management fees being charged to investors.
- Failed to invest in accordance with private fund disclosures regarding investment strategies.
- Failed to accurately describe "recycling" practices (i.e., contractual provisions that allow a fund to add realized investment proceeds back to the capital commitments of investors) or omitting material information from such disclosures.
- Failed to follow fund disclosures regarding private fund adviser personnel, such as not disclosing whether a "key" person has left the firm in accordance with the private fund's governing documents or not providing accurate information regarding the status of key portfolio managers.

Misleading Performance and Marketing Disclosures

The Division staff observed that some private fund advisers provided misleading track records or other marketing statements to investors or prospects in violation of the Advisers Act. The Division staff also observed violations relating to recordkeeping requirements under the Advisers Act regarding maintaining documentation that is necessary to support performance calculations or security recommendations. The Division staff also observed that certain fund advisers:

- Provided inaccurate or misleading disclosures regarding performance track records, including how the portfolio for the track record was constructed or how benchmarks were used.
- Presented inaccurate performance calculations to investors, such as using inaccurate underlying data from incorrect time periods, mischaracterizing return on capital distributions as dividends from holdings or using projected (rather than actual) performance in such calculations when creating track records.
- Failed to maintain books and records supporting predecessor performance at other advisers and potentially omitting material facts about predecessor performance.
- Made misleading statements regarding industry awards, such as failing to disclose criteria for winning the award or whether the adviser paid to obtain an award.

Due Diligence Failures

As a fiduciary, a private fund adviser must have reasonable belief that investment advice is in the best interests of the firm's clients based on a client's objectives. To form a reasonable belief, the adviser is required to conduct reasonable investigation that is sufficient to ensure that the adviser is not basing its investment advice on materially inaccurate or incomplete information. The Division staff made various observations with respect to due diligence failures, citing some private fund advisers that:

- Failed to sufficiently conduct a reasonable investigation into underlying investments in accordance with policies and procedures, including compliance and internal controls of the underlying investments or funds.
- Failed to perform adequate due diligence on service providers, such as placement agents and alternative data providers.
- Failed to maintain adequate policies and procedures regarding due diligence of investments, such as not tailoring due diligence policies and procedures to an adviser's actual practices.

Misleading Hedge Clauses

The Division staff observed that some private fund advisers included potentially misleading "hedge clauses" in documents that purported to waive or limit their fiduciary duty under the Advisers Act. The Division's staff believes such clauses are only enforceable when there has been a non-appealable judicial findings of the absence of gross negligence, willful misconduct or fraud.

The Division encourages private fund advisers to review their practices and policies and procedures to address the issues summarized in its risk alert.

Source: Division of Examinations Risk Alert: Observations from Examinations of Private Fund Advisers (Jan. 27, 2022), available here.

SEC Proposes Amendments to Form PF

On January 26, 2022, the SEC voted 3-1 to propose amendments to Form PF, the confidential reporting form required to be filed by registered advisers and exempt reporting advisers that manage at least $150 million in private fund assets. If adopted, the proposed amendments would:

- Require current reporting by large hedge fund advisers and private equity advisers within one business day of the occurrence of certain key events:
  - Large hedge fund advisers would be required to file current reports of extraordinary investment losses, significant margin and counterparty default events, material changes in prime broker relationships, changes in unencumbered cash, operations events, and events associated with withdrawals and redemptions; and
  - Private equity advisers would be required to file current reports upon the completion of adviser-led secondary transactions, implementation of general partner or limited partner clawbacks, removal of a fund's general partner, termination of a fund's investment period, or termination of a fund;
- Lower the reporting threshold for large private equity advisers from $2 billion to $1.5 billion in private equity fund assets under management and gather more information regarding fund strategies, use of leverage and portfolio company financings, controlled portfolio companies (CPCs) and CPC borrowings, fund investments in different levels of a single portfolio company's capital structure, and portfolio company restructurings or recapitalizations; and
- Require large liquidity fund advisers to report substantially the same information that money market funds report on Form N-MFP, including operational information, assets and portfolio information, financing information, investor information, disposition of portfolio securities, weighted average maturity and weighted average life.

Commissioner Hester M. Peirce opposed the proposal and commented that "the enhanced reporting seems intended primarily to provide the Commission with additional information to support its regulatory and enforcement programs."

The comment period was only 30 days following publication in the Federal Register and has closed. Despite the short timeline, the SEC received more than 100 comment letters, including letters from the Investment Adviser Association (IAA) and Managed Funds Association (MFA). The IAA commented that the proposal "imposes requirements that would be highly burdensome and costly for those advisers to which it would apply" and urges the SEC "to strike a better balance between its goals and the negative impact on advisers." In its letter, MFA underscores that, "while supporting the broad goal of obtaining timely and relevant information from market participants in a crisis, the breadth and scope of the proposed rule risks inadvertently capturing routine activity and creating an unnecessary and unintended burden on certain asset managers. MFA also stresses that the one-business-day filing requirement is challenging and imposes unnecessary burdens to fund advisers."

Sources: Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, Release No. IA-5950 (Jan. 26, 2022), available here; SEC Proposes Amendments to Enhance Private Fund Reporting, SEC Press Release 2022-9 (Jan. 26, 2022), available here (Jan. 26, 2022); SEC Fact Sheet, Proposed Amendments to Form PF (Jan. 26, 2022), available here; Statement of Commissioner Hester M. Peirce, Statement on Proposed Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers (Jan. 26, 2022), available here; IAA Comment Letter on Proposed Amendments to Form PF (Mar. 21, 2022), available here; MFA Highlights Significant Concerns with SEC Proposed Rules for Security-Based Swaps and Form PF (Mar. 21, 2022), available here.

SEC Issues Rule Proposal Intended to Modernize Beneficial Ownership Reporting

On February 10, 2022, the SEC proposed amendments to modernize beneficial ownership reporting requirements under Sections 13(d) and 13(g) of the Exchange Act, which generally require shareholders holding over 5% of a public company's voting securities to report their beneficial ownership by filing a Schedule 13D or Schedule 13G. The proposed amendments would:

- Accelerate the filing deadlines for Schedules 13D and 13G;
- Extend the reporting requirements of Regulation 13D-G to include certain derivative securities;
- Clarify "group" formation and related exemptions; and
- Require a new format, structured data, for these filings.

SEC Chair Gary Gensler stated that "[t]hese amendments would update our reporting requirements for modern markets, reduce information asymmetries, and address the timeliness of Schedule 13D and 13G filings."

The public comment period was open for a period of 60 days following the publication of the proposing release (and 30 days after publication in the Federal Register) and closed on April 9, 2022.

Proposed Changes to Schedules 13D and 13G Filings

The proposed amendments would shorten the initial and amended filing deadlines as follows:

Type of Filing	Current Deadlines (5:30 p.m. Eastern time)	Proposed Deadlines (10:00 p.m. Eastern time)
Schedule 13D:		
Initial Filing	10 days after acquiring beneficial ownership in excess of 5%	5 days after acquiring beneficial ownership in excess of 5%
Amended Filing	Promptly	1 business day
Schedule 13 G:		
Initial Filing for Qualified Institutional Investors *(e.g., registered-broker dealers, banks, RIAs, etc.)*	45 days after 12/31 in the year that beneficial ownership exceeds 5%	5 business days after month-end of the month that beneficial ownership exceeds 5%
Amended Filing for Qualified Institutional Investors	10 days after month-end of the month that beneficial ownership exceeds 10% or there was an increase or decrease of 5% as of month-end	5 days after beneficial ownership exceeds 10% or there was an increase or decrease of 5%
Initial Filing for Passive Investors *(i.e., beneficial owners of over 5% but less than 20% of securities that were not acquired or held for the purpose or effect of changing or influencing the control of the issuer's securities and were not acquired in connection with a transaction having such purpose or effect)*	10 days after beneficial ownership exceeds 5%	5 days after beneficial ownership exceeds 5%
Amended Filing for Passive Investors	Promptly after beneficial ownership exceeds 10% or there was an increase or decrease of 5% as of month-end	1 business day after beneficial ownership exceeds 10% or there was an increase or decrease of 5% as of month-end
All 13G Filers	45 days after 12/31 in the year any change occurred (excluding any changes in the issuer's outstanding shares)	5 business days after month-end of the month in which a material change occurred

Certain Derivative Securities

The proposed amendments would extend the definition of "beneficial owner" to holders of cash-settled derivative securities (excluding security-based swaps) with respect to reference equity securities. Holders of cash-settled derivative securities would be required to report such holdings in Schedule 13D (provided that beneficial ownership of the subject securities exceeds 5%) if such securities are held for the purpose or effect of influencing control of the issuer of the reference equity securities, or if such holder participated in any transaction having such purpose or effect on the issuer.

Treatment of Groups and Related Exemptions

The proposed amendments are also intended to clarify the situations under which two or more persons have formed a Section 13(d) "group." Such situations would include "tipper-tippee" relationships where the tipper shares non-public information in advance of a Schedule 13D filing and the tippee subsequently purchases the same securities to be reported based on the non-public information received. The amendments would also remove the reference to "agreement" between two or more persons to clarify that an express agreement is not necessary to determine that two or more persons are acting in concert and would thus be considered a "group."

The proposed amendments would also provide new exemptions that would apply to situations where:

- Two or more persons communicate with one another or the company without the purpose or effect of changing or influencing control of the company without being considered a group.
  - This exemption would only be available to persons not directly or indirectly obligated to take the above actions (i.e., they are not required to take such actions by the terms of a cooperation agreement or joint voting agreement). The exemption will also depend on the level of coordination and degree to which persons advocate in furtherance of a common goal or purpose.
- Investors and financial institutions engage in certain derivative securities transactions.
  - This exemption would only be available if the agreement governing the derivatives transaction is a bona fide purchase and sale agreement entered into the ordinary course of business. This exemption would also only be available if the parties do not enter such agreement with the purpose or effect of changing or influencing control of the issuer, or in connection with any transaction having such purpose or effect.

Structured Data Requirements

The amendments would also require that Schedule 13D and 13G filings use a structured, machine-readable data language, which would allow investors and markets to access, compile and examine information disclosed in such filings.

Sources: Modernization of Beneficial Ownership Reporting, Release Nos. 33-11030 and 34-94211 (Feb. 10, 2022), available here; SEC Proposes Rule Amendments to Modernize Beneficial Ownership Reporting, SEC Press Release 2022-22 (Feb. 10, 2022), available here; SEC Fact Sheet, Modernization of Beneficial Reporting (Feb. 10, 2022), available here.

COMPLIANCE DATES FOR FINAL RULES

Final Rule	Compliance Dates
Derivatives Risk Management Rule (Rule 18f-4) and Related Amendments; Rescission of Prior SEC Guidance (Release 10666)	**August 19, 2022** Rule 18f-4 and related amendments to Forms N-CEN, N-PORT and N-LIQUID (to be renamed Form N-RN) became effective on February 19, 2021. The SEC will rescind Release 10666 and related staff no-action letters and guidance effective August 19, 2022.
Fair Valuation Rules (Rules 2a-5 and 31a-4)	**September 8, 2022** Rules 2a-5 and 31a-4 became effective on March 8, 2021.
Advertising and Cash Solicitation Rule Amendments (Rules 206(4)-1 and 204-2)	**November 4, 2022** The rule became effective on May 4, 2021. The current cash solicitation rule (Rule 206(4)-3) will be rescinded. However, until an adviser transitions to the amended marketing rule, the adviser should continue to comply with the previous advertising and cash solicitation rules.