



Morgan Lewis

REGISTERED FUNDS

TRENDS AND DEVELOPMENTS

Quarter in Review Series: EIGHTH EDITION

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Overview

- SEC Rulemaking Wave Continues With Proposed Amendments to Expand Names Rule
- More Rulemaking: Proposed ESG Rules for Advisers and Funds
- Adviser Status of Information Providers in Question: SEC Requests Comment
- Director Birdthistle Provides Insights on Current Issues and Trends in IM
- SEC Prevails in Share-Class Selection Case

SEC RULEMAKING WAVE CONTINUES WITH PROPOSED AMENDMENTS TO EXPAND NAMES RULE

SEC Rulemaking Wave Continues with Proposed Amendments to Expand Names Rule

- **Background:** Rule 35d-1 under the Investment Company Act of 1940 currently requires a fund with a name suggesting that the fund focuses on the following categories to adopt an “80% policy”: (i) a particular type of investment; (ii) a particular industry; (iii) a particular geographic area; or (iv) tax-exempt funds
- **Proposed Amendments:**
 - **Broader Scope**
 - Included: names that suggest a focus on “investments that have, or whose issuers have, particular characteristics”
 - Not included: “names that reference characteristics of a portfolio as a whole” or “elements of an investment thesis without specificity as to particular characteristics”
 - **Enhanced Prospectus Disclosure**
 - Definitions of “the terms used in its name”
 - Disclosure of “the specific criteria the fund uses to select the investments that the term describes, if any”
 - Plain-English requirement – disclosure can’t modify a name
 - ESG Funds must be ESG-Focused Funds or Impact Funds (not Integration)
 - For a defined term to be reasonable, there must be a “meaningful nexus between the given investment and the focus suggested by the name”

SEC Rulemaking Wave Continues with Proposed Amendments to Expand Names Rule (cont.)

– **Specific Compliance/Correction Obligations**

- Not just a time-of-purchase test; the proposal would eliminate “under normal circumstances” qualifications

– **New Treatment of Derivatives Compliance**

- A fund is permitted to include synthetic instruments in the 80% policy if it has economic characteristics similar to the securities included in the 80% policy
- Notional amount generally serves as a measure of a fund’s investment exposure to an underlying reference security and is therefore more indicative of a fund’s investment focus

– **More Disclosures and SEC Reporting**

- E-delivery of notices re: policy changes (and name changes)
- N-PORT Reporting
- Recordkeeping

Derivatives Examples – Equity Fund

Example 1 (Excluding Cash up to Notional)	Example 2 (Including Hedging Transactions)
<p>Holdings:</p> <ul style="list-style-type: none">• \$80 equity swap;• \$80 UST;• \$20 other (nonqualifying securities)	<p>Holdings:</p> <ul style="list-style-type: none">• \$100 foreign-equity swap• \$100 currency forwards (not “equity” investments)• Nothing else
<p>Rule Math:</p> <ul style="list-style-type: none">• Num: \$80 swap• Den: \$80 swap + \$80 UST + \$20 other – \$80 UST• $\\$80 / (\\$80 + \\$80 + \\$20 - \\$80) = \\$80 / \\$100 = 80\%$	<p>Rule Math:</p> <ul style="list-style-type: none">• Num: \$100 swap + \$100 forwards• Den: \$100 swap + \$100 forwards• $(\\$100 + \\$100) / (\\$100 + \\$100) = \\$200 / \\$200 = 100\%$
<p>Compare:</p> <ul style="list-style-type: none">• Num: \$80 swap• Den: \$80 swap + \$80 UST + \$20 other – \$80 UST• $\\$80 / (\\$80 + \\$80 + \\$20) = \\$80 / \\$180 = 44\%$	<p>Compare:</p> <ul style="list-style-type: none">• Num: \$100 swap + \$100 forwards• Den: \$100 swap + \$100 forwards• $\\$100 / (\\$100 + \\$100) = \\$100 / \\$200 = 50\%$

MORE RULEMAKING: PROPOSED ESG RULES FOR ADVISERS AND FUNDS

More Rulemaking: Proposed ESG Rules for Advisers and Funds

- Scope: Advisers, Open-End Funds, Closed-End Funds, BDCs
- Three types of ESG strategies would be defined:
 - **ESG Integration:** Considers ESG factors alongside other factors in its investment decisions, but ESG factors will generally not be determinative
 - Emerging Markets Fund: “considers sustainability factors when making investments”
 - **ESG-Focused:** Focuses on one or more ESG factors by using them as a significant or main consideration for investments or engagement, OR that is advertised as such
 - Solar Energy Fund: “invests at least 80% of its assets in companies developing or supporting the solar energy industry”
 - Implementation of ESG-related screens could indicate ESG-Focused fund status
 - **ESG Impact:** Seeks to achieve a specific ESG impact or impacts
 - Housing Impact Fund: “invests in companies whose business addresses affordable housing needs”
 - A subset of ESG-Focused funds

More Rulemaking: Proposed ESG Rules for Advisers and Funds (cont.)

- Prospectus Disclosure
 - ESG Integration: *Item 4*: Short narrative summarizing how the fund integrates ESG factors into its investment strategy; *Item 9*: More detailed description of how ESG factors are incorporated into the fund's investment strategy, including GHG emissions disclosure, if applicable
 - ESG-Focused: ESG Strategy Overview Table provides prescriptive information about ESG aspects of a strategy
 - ESG Impact: Enhanced requirements for additional, specific information in the second row of table, including what impact(s) the fund is seeking to achieve and how the fund measures progress toward these impacts
- Annual Report Disclosure
 - Proxy Voting / Engagement / GHG Emissions / Impact KPIs
- Adviser Disclosure Requirements
 - Form ADV Part 2A – Adviser Brochure
- Other Form Amendments and Compliance Guidance
 - N-CEN
 - ADV Part 1A
 - Compliance Guidance

**ADVISER STATUS OF
INFORMATION PROVIDERS IN
QUESTION: SEC REQUESTS
COMMENT**

Adviser Status of Information Providers in Question: SEC Requests Comment

- Potentially Affected Information Providers
 - Index Providers
 - Model Providers
 - Pricing Services
- Implications of Investment Adviser Registration
 - Funds
 - 15(c) Process and Board Oversight
 - Registration-Statement Disclosure
 - Shareholder Approval
 - Information Providers
 - Compliance Programs
 - Registration
 - Insurance
- Industry Response

**DIRECTOR BIRDTHISTLE
PROVIDES INSIGHTS ON
CURRENT ISSUES AND
TRENDS IN IM**

Director Birdthistle Provides Insights on Current Issues and Trends in IM

On July 26, Director Birdthistle discussed current IM issues and trends at a PLI event that centered thematically around the SEC's tripartite mission.

- **Investor Protection**

- Fund Fees: the Division's role in helping investors understand fees and costs

- **Capital Formation**

- Proposed Rules for Private Fund Advisers: such rules would create more transparency around private funds and prohibit private fund advisers from engaging in certain practices adverse to public interest and protection of investors

- **Maintenance of Fair, Orderly, and Efficient Markets**

- Proxy voting: the integration of shareholders into proxy-voting process in effort to democratize the markets to more fairly reflect the views and priorities of investors as opposed to large-asset managers

Director Birdthistle Provides Insights on Current Issues and Trends in IM (cont.)

Other discussion points:

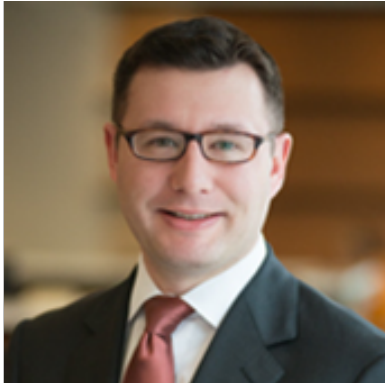
- **LIBOR transition:** Director Birdthistle noted the importance of advisers and funds being prepared for the final transition away from LIBOR on June 30, 2023
 - Recommended that advisers (i) consider how the value and liquidity of LIBOR-linked investments can change, (ii) plan for how and when portfolio positions will convert from LIBOR to an alternative reference rate, and (iii) ensure that all material risks related to the LIBOR transition are disclosed
 - The Division will continue to evaluate preparedness, including through examinations and outreach efforts
- **Expiration of MiFID II, No-Action Letter**
 - SIFMA Letter was intended to be temporary, and the no-action relief will not be extended beyond its July 3, 2023 expiration date
- **Money Market Reform**
 - Prime MMFs were impacted by COVID-19, including with high redemption rates driven by the possibility of MMFs imposing liquidity fees and gates
 - Swing pricing may be a better solution for MMFs during periods of market stress, but may have operational challenges that could require upgrades to our financial infrastructure

SEC PREVAILS IN SHARE- CLASS SELECTION CASE

SEC Prevails in Share-Class Selection Case

- On September 7, the US District Court for the Eastern District of Pennsylvania entered final judgments in a civil enforcement action brought by the SEC against Ambassador Advisors, LLC (Ambassador), a registered investment adviser, and three of its owners and executive officers.
- Allegations: In violation of certain provisions of the Investment Advisers Act of 1940 (Advisers Act), Ambassador and the other defendants breached their fiduciary duties in connection with their mutual fund share-class selection practices and receipt of Rule 12b-1 fees (including duties to act in clients' best interests, seek best execution of clients' transactions, and disclose conflicts of interest).
- At trial, the SEC offered evidence that (i) from August 2014 through December 2018, Ambassador invested its clients' money in mutual fund share classes that charged Rule 12b-1 fees despite the fact that those clients were eligible for share classes of the same funds that did not charge 12b-1 fees, and (ii) an affiliated broker received the 12b-1 fees paid by Ambassador's clients and returned 95% of those fees to the other defendants.
- The court ordered Ambassador and the other defendants to (i) pay more than \$2 million combined in disgorgement, prejudgment interest, and civil penalties; (ii) correct misleading statements about the case on Ambassador's website and in its Form ADV; and (iii) send a notice to clients correcting those misleading statements.
- The judgments follow a jury verdict finding that Ambassador and the other defendants violated Section 206(2) of the Advisers Act by breaching their fiduciary duties with respect to their share-class selection practices and the receipt of revenue derived from 12b-1 fees. They also follow partial summary judgment granted to the SEC on its claim that Ambassador violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder because it failed to adopt and maintain written policies and procedures that were reasonably designed to prevent these violations.
- Several other investment advisers have settled similar claims with the SEC in 2022.

Biography



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The investment management world is complex and highly regulated, and **David** works closely with mutual funds, exchange-traded funds (ETFs), closed-end funds, private funds, and their investment advisers to navigate the shifting terrain. He brings particular experience in launching new fund complexes, from identifying legal issues that arise from proposed fund strategies, through initial US Securities and Exchange Commission (SEC) registration, organizational board of directors meetings, and fund seedings.

View David's extended profile here:

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Abby counsels registered investment companies and investment advisers in connection with their organization, registration, and operation, including advice on regulatory and compliance matters. Abby also advises US and international clients on compliance with the Investment Company Act and the Investment Advisers Act. She regularly works with exchange-traded funds (ETFs), open-end funds, closed-end funds, and investment advisers of varying sizes and assets under management. Abby also counsels clients on the preparation and filing of registration statements, proxy statements, and exemptive applications with the US Securities and Exchange Commission.

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Biography



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Brian represents mutual funds, exchange-traded funds (ETFs), closed-end funds, private funds, and their investment advisers in US and international legal, regulatory, and transactional matters. His experience extends to work in several areas, including the development and launch of new funds, fund reorganizations, corporate governance matters, and ongoing compliance issues. Additionally, Brian counsels investment adviser clients on the applicability and interpretation of securities laws, including with respect to business combinations, registration and disclosure, and pay-to-play issues.

Brian also counsels fund clients with respect to the filing of registration statements, proxy statements, and exemptive applications with the US Securities and Exchange Commission.

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Lauren focuses her practice on counseling investment advisers, registered investment companies and private funds in a wide range of regulatory, corporate and transactional matters. She has experience with the development and launch of new funds, fund reorganizations, ongoing compliance and corporate governance.

Before joining Morgan Lewis, Lauren worked in-house at an investment management firm focusing on co-investment and secondary transactions, and prior to that, as a legal and compliance associate at a hedge fund and an affiliated broker-dealer. Lauren previously held FINRA Series 24, 62 and 63 licenses. She also worked at a professional sports management agency.

THANK YOU

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