Investment Management Retrospective
2020's Second Half

Skadden

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COVID-19 Update

The U.S. Securities and Exchange Commission (SEC) and market participants continue to deal with the ongoing impact of the COVID-19 pandemic. To help market participants remain in compliance with the SEC's various regulatory requirements during this crisis, the SEC and its staff have issued guidance and several exemptive orders, much of which provide regulatory flexibility to registered open-end funds (OEFs), registered closed-end funds (CEFs) and unit investment trusts (UITs, and collectively with OEFs and CEFs, Registered Funds), as well as business development companies (BDCs, and collectively with Registered Funds, Funds). Much of this guidance and many of the exemptive orders were issued in March and April. Please see our April 9, 2020, client alert, "SEC COVID-19 Relief for Registered Funds and BDCs: A Summary," for a summary of these earlier COVID relief efforts.

For your convenience, we have summarized more recent guidance and orders released through December 16, 2020, that provide regulatory relief specific to Funds or that generally provide relief to market participants and are relevant and applicable to Funds.

President Trump Issues 'Executive Order on Regulatory Relief To Support Economic Recovery'

On May 19, 2020, President Donald Trump issued an executive order (EO) titled "Executive Order on Regulatory Relief to Support Economic Recovery," which sought to "combat the economic consequences of COVID-19" by authorizing executive branch departments, executive agencies and independent agencies (collectively, Federal Agencies) to rescind, modify, waive or provide exemptions from regulations and other requirements that may impede economic recovery, consistent with applicable law, the protection of public health and safety, national and homeland security, and budgetary priorities and operational feasibility. Key provisions of the EO are highlighted below.

- **Rescission and Waiver of Regulatory Standards.** Section 4 of the EO requires the heads of all Federal Agencies to identify regulatory standards that may impede economic recovery and consider taking appropriate action, including by issuing proposed rules as necessary to temporarily or permanently rescind, modify, waive or exempt persons or entities from those requirements, and to consider exercising appropriate temporary enforcement discretion or appropriate temporary extensions of time as provided for in enforceable agreements with respect to those requirements, for the purpose of promoting economic recovery.
- **Compliance Assistance for Regulated Entities.** Section 5 of the EO requires the heads of all Federal Agencies to provide compliance assistance for regulated entities by:
  - accelerating procedures by which a regulated person or entity may receive a pre-enforcement ruling with respect to whether proposed conduct in response to COVID-19 is consistent with the law and the policy considerations set forth in the EO; and
  - considering whether to formulate and make public policies of enforcement discretion that decline enforcement against persons and entities that have attempted to comply with applicable statutory and regulatory standards in good faith.
- **Fairness in Administrative Enforcement and Adjudication.** Section 6 of the EO requires the heads of the federal agencies to consider principles of fairness in administrative enforcement and adjudication and revise their procedures and practices in light of them, consistent with applicable law and the policies set forth in the EO.
- **Review of Regulatory Responses.** Section 7 of the EO requires the heads of the Federal Agencies to review any regulatory standards that have been temporarily rescinded, suspended, modified or waived during the COVID-19 pandemic, any such actions they take

pursuant to Section 4 of the EO and other regulatory flexibilities they have implemented in response to COVID-19, and determine which, if any, would promote economic recovery if made permanent, insofar as doing so would be consistent with the policy considerations set forth in the EO.

Considerations Under the Investment Company Act of 1940 (1940 Act)

In response to the unique circumstances arising from COVID-19, the SEC has provided targeted regulatory relief to public companies, including Registered Funds and BDCs (see SEC orders discussed in this section of the newsletter and in previous client alerts). The SEC's targeted regulatory relief efforts provide an important opportunity for the public, after the COVID-19 public health crisis has subsided, to work with the SEC to permanently suspend, rescind or modify certain existing rules and regulations in order to promote economic growth, including rules relating to money market funds, business continuity rules, rules governing the ability of Registered Funds to borrow from affiliates, existing restrictions on co-investments with BDCs, existing rules regarding the notice and access delivery method for proxy materials, existing rules relating to manual signatures and the in-person meeting requirements for Fund boards.

See the Executive Order.

SEC Extends Relief for Virtual Meetings of Fund Boards

On June 19, 2020, the SEC issued an order extending the conditional relief from certain in-person voting requirements for Fund boards under the 1940 Act and the rules thereunder, which it originally provided on March 25, 2020, at least through December 31, 2020.

Time Period for Exemptive Relief

The SEC noted that the relief is limited to the period beginning on the date of the original order to the date to be specified in a public notice from the SEC staff stating that the relief will terminate, which date shall be at least two weeks from the date of the notice and no earlier than December 31, 2020.

In extending the relief, the SEC noted that it intends to continue to monitor the effects of COVID-19 and may, if necessary or appropriate, extend the time period of the relief and include additional conditions or issue other relief.

In-Person Board Meeting Requirements

The order provides that at least through December 31, 2020, Funds are exempt from the in-person voting requirements to approve investment advisory agreements, principal underwriting agreements, auditors and plans regarding distribution-related payments from Fund assets under Section 15(c) and 32(a) of the 1940 Act and Rules 12b-1(b)(2) and 15a-4(b)(2)(ii) under the 1940 Act, provided that:

- reliance on the order is necessary or appropriate due to circumstances related to current or potential effects of COVID-19;
- votes are cast at a meeting in which all directors may participate and hear each other simultaneously; and
- the board, including a majority of the directors who are not interested persons of the Fund, ratifies the approval at the next in-person meeting.

See the June 19, 2020 order.

No-Action Relief Statement on SEC Filing Signature Requirements

On June 25, 2020, the SEC's Division of Investment Management, Division of Corporate Finance, and Division of Trading and Markets updated their joint statement originally issued in March 2020 regarding compliance with Regulation S-T Rule 302(b). Rule 302(b) requires that each signatory "manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing" no later than the time the filing is made with the SEC. Companies must retain the signed documents for five years and furnish copies to the SEC upon request.

The updated statement from the divisions of Corporation Finance, Investment Management, and Trading and Markets extends the relief provided in the March 2020 statement, in which the divisions noted that they will not recommend enforcement action for noncompliance with Rule 302(b), subject to the following conditions:

- the signatory retains a manually signed signature page (or other document) and provides such document, as promptly as reasonably practicable, to the company for retention in the ordinary course pursuant to Rule 302(b);
- such document indicates the date and time when the signature was executed; and
- the company establishes and maintains policies and procedures governing this process.

The signatory also may provide an electronic record (such as a photograph or PDF) of such document when it is signed.

The statement provides that the relief is temporary and will continue to remain in effect until the SEC staff provides public notice that it no longer will be in effect, which notice will be published at least two weeks before the announced termination date. See the Regulation S-T Rule 302(b) statement.

On November 17, 2020, the SEC subsequently adopted amendments to Rule 302(b) of Reg S-T to permit companies to use electronic signatures in documents authenticating typed signatures used in electronic filings. See "SEC Electronic Signatures in Regulation S-T Rule 302."

Staff Statement Regarding Temporary International Mail Service Suspensions to Certain Jurisdictions Related to the COVID-19 Pandemic

On June 24, 2020, the staff of the Division of Trading and Markets and the Division of Investment Management of the SEC (collectively, Division Staff) issued a statement with respect to the mailing of certain regulatory communications to shareholders, clients and customers (Affected Recipients) who: (i) have mailing addresses located in international jurisdictions (Affected Jurisdictions) where the United States Postal Service, other common carrier, or public or private foreign postal operator (Common Carriers) has temporarily suspended international mail service due to impacts related to COVID-19 and (ii) have not consented to electronic delivery of these regulatory communications (Impacted International Mailings). The Division Staff noted that it received inquiries relating to Impacted International Mailings from persons and entities that include broker-dealers, investment advisers, and other intermediaries with clients or customers in Affected Jurisdictions, as well as registered investment companies that offer shares directly and who have shareholders in Affected Jurisdictions (collectively, Delivering Entities).

In light of COVID-19's impact on the delivery of Impacted International Mailings, the Division Staff stated that it will not recommend that the SEC take enforcement action against a Delivering Entity with respect to the failure to deliver Impacted International Mailings to Affected Recipients in Affected Jurisdictions if Delivering Entities:

- are unable to mail Impacted International Mailings to Affected Recipients in an Affected Jurisdiction due to mail service suspensions;
- send a notification to the Division Staff by email to tradingandmarkets@sec.gov (for the Division of Trading and Markets) or IM-EmergencyRelief@sec.gov (for the Division of Investment Management) identifying the specific type(s) of Impacted International Mailings that the Delivering Entity will be holding temporarily due to mail service suspensions and update that notification, as needed, to reflect any material changes;
- prominently publish the information contained in the notification to Division Staff on the Delivering Entity's public website and update that information, as needed, to reflect any material changes;
- for Impacted International Mailings other than written confirmations and alternative periodic reporting required by the Securities Exchange Act of 1934's (Exchange Act) confirmation rule and written statements with respect to free credit balances required pursuant to Exchange Act Rule 15c3-3(j)(1):
  - use reasonable best efforts to timely deliver such documents electronically using contact information for the Affected Recipient (*e.g.*, an email address) that the Delivering Entity has a reasonable basis to believe is current and, in the transmittal message include an explanation regarding why the Delivering Entity is delivering such documents electronically and state that, unless the Affected Recipient elects electronic delivery of such documents going forward, the Delivering Entity will resume physical mailing once the Common Carrier has resumed service to the jurisdiction; and
  - if the Delivering Entity does not have such contact information for an Affected Recipient or receives information indicating that the contact information is not current (such as an email bounce back), use reasonable best efforts to obtain current contact information for electronic delivery of such documents to the Affected Recipient (*e.g.*, through commercially available resources);
- with respect to written confirmations or alternative periodic reporting required by the Exchange Act's confirmation rule and written statements with respect to free credit balances:
  - use reasonable best efforts to notify the Affected Recipient by telephone, email, text message or other means that: (i) the Delivering Entity will be holding such documents due to mail service suspensions in an Affected Jurisdiction; and (ii) the Affected Recipient may consent to electronic delivery of such documents on a temporary or permanent basis;
  - use reasonable best efforts to obtain the consent of the Affected Recipient to electronic delivery of such documents; provided that the Delivering Entity obtains the customer's consent before attempting electronic delivery of such documents; and
  - if the Delivering Entity does not obtain the Affected Recipient's consent to electronic delivery of such documents, (i) hold such documents temporarily and send a paper copy of such documents upon resumption of service to the Affected Jurisdiction (as outlined in the last bullet point below) and (ii) provide the Affected Recipient with a reasonable period of time in which to respond, as needed, to such documents (*e.g.*, to notify the Delivering Entity of any errors in such documents) after such paper copies have been sent;
- maintain contemporaneous records reflecting the Delivering Entity's satisfaction of the steps described in the statement; and

- monitor the relevant Common Carrier websites regularly for updates regarding the status of mail delivery to Affected Jurisdictions and promptly (but, in any event, not later than seven days following resumption of such service) send the Impacted International Mailing upon resumption of service to the Affected Jurisdiction if (i) the Delivering Entity was unable to deliver the Impacted International Mailing electronically or (ii) the Affected Recipient requests delivery of a paper copy.

The Division Staff noted that the staff statement is temporary and expires on the date, as applicable to each specific Affected Jurisdiction, that Common Carriers resume mail delivery of Impacted International Mailings to such Affected Jurisdiction. The Division Staff emphasized that it will continue to work with market participants to help them respond to operational and other changes raised by COVID-19.

See the Division Staff statement.

SEC Issues Risk Alert: Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers

On August 12, 2020, SEC's Office of Compliance Inspections and Examinations (OCIE) issued a risk alert regarding COVID-19 compliance risks and considerations for broker-dealers and investment advisers.

In the risk alert, OCIE shared observations and recommendations relating to COVID-19 issues, risks and practices that fall into six categories: (i) protection of investors' assets; (ii) supervision of personnel; (ii) practices relating to fees, expenses and financial transactions; (iv) investment fraud; (v) business continuity; and (vi) the protection of investor and other sensitive information.

Protection of Investor Assets

OCIE staff observed that some firms have modified their normal operating practices regarding collecting and processing investor checks and transfer requests, including situations where investors mail checks to firms and firms are not picking up mail on a daily basis.

OCIE recommends that firms (i) update their supervisory and compliance policies and procedures to reflect any adjustments made and to consider disclosing to investors that checks or assets mailed to the firm's office location may experience delays in processing until personnel are able to access the mail or deliveries at that office location; and (ii) review and make any necessary changes to their policies and procedures around disbursements to investors, including where investors are taking unusual or unscheduled withdrawals from their accounts, particularly COVID-19 related distributions from their retirement accounts.

Supervision of Personnel

OCIE recommends that, as firms adapt to remote work and deal with significant market volatility and related issues, firms closely review and, where appropriate, modify their supervisory and compliance policies and procedures to address the following potential issues:

- supervisors not having the same level of oversight and interaction with supervised persons when they are working remotely;
- supervised persons making securities recommendations in market sectors that have experienced greater volatility or may have heightened risks for fraud;
- the impact of limited on-site due diligence reviews and other resource constraints associated with reviewing of third-party managers, investments, and portfolio holding companies;
- communications or transactions occurring outside of the firms' systems due to personnel working from remote locations and using personal devices;
- remote oversight of trading, including reviews of affiliated, cross and aberrational trading, particularly in high volume investments; and
- the inability to perform the same level of diligence during background checks when onboarding personnel or to have personnel take requisite examinations.

Fees, Expenses and Financial Transactions

OCIE expressed concern that the recent market volatility and the resulting impact on investor assets and the related fees collected by firms may have increased financial pressures on firms and their personnel to compensate for lost revenue, which may increase the potential for misconduct regarding financial conflicts of interest and fees and expenses charged to investors.

OCIE recommends that firms review their fees and expenses policies and procedures and consider enhancing their compliance monitoring, particularly by:

- validating the accuracy of their disclosures, fee and expense calculations, and the investment valuations used;
- identifying transactions that resulted in high fees and expenses to investors, monitoring for such trends, and evaluating whether these transactions were in the best interest of investors; and

- evaluating the risks associated with borrowing or taking loans from investors, clients and other parties that create conflicts of interest, as this may impair the impartiality of firms' recommendations. OCIE notes that if advisers seek financial assitance, this may result in an obligation to update disclosures on Form ADV Part 2.

Investment Fraud

OCIE notes that times of crisis or uncertainty can create a heightened risk of investment fraud through fraudulent offerings. OCIE states that firms should be cognizant of such risks when conducting due diligence on investments and in determining whether an investment is in the best interest of an investor.

Business Continuity

OCIE noted that as a result of the COVID-19 pandemic, many firms have transitioned to operating from remote sites, which could raise compliance issues and risks that impact protected remote operations. OCIE encouraged firms to review and update their business continuity plans and compliance policies and procedures, as necessary, to address unique risks, including security risks, and conflicts of interest present in remote operations. Firms also should provide disclosure to investors as appropriate if their operations are materially impacted.

Protection of Sensitive Information

OCIE staff has observed that many firms require their personnel to use videoconferencing and other electronic means to communicate while working remotely, which create vulnerabilities around the potential loss of sensitive information, including personally identifiable information, and more opportunities for fraudsters to use phishing and other means to improperly access systems and accounts by impersonating firms' personnel, websites and/or investors. OCIE recommends that firms pay particular attention to the risks regarding access to systems, investor data protection and cybersecurity.

See the Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers Risk Alert.

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See all of our COVID-19 Publications and Webinars.

Update on Closed-End Fund Activism

Activist Campaign Round-Up

Activist closed-end fund (CEF) investors — such as Bulldog Investors, LLC (Bulldog); Special Opportunities Fund, Inc. (SPE), a CEF advised by Bulldog; Saba Capital Management, L.P. (Saba); and Karpus Management, Inc. (Karpus) — continue to promote their agendas during the 2020 proxy season. The below provides an overview of certain activism activity during the 2020 proxy season and upcoming 2021 proxy season. There are other matters of which we are aware but cannot comment on.

On May 1, 2020, Saba filed a verified complaint and an application for preliminary injunction in Maricopa County Superior Court, in Phoenix, Arizona (the Superior Court), naming as defendants Voya Prime Rate Trust, Voya Investments, LLC and the individuals serving on the fund's board. Saba sought a preliminary injunction and permanent equitable relief from the court, primarily in the form of an order striking certain amendments to the fund's bylaws that related to the voting standard to be employed at board elections, as adopted by the board on April 13, 2020, and various other forms of declaratory and unspecified monetary relief. Defendants filed a motion to dismiss the verified complaint and an opposition to Saba's application on May 20, 2020. On June 26, 2020, after a hearing, the court granted Saba's application for a preliminary injunction, ruling that the named defendants are preliminarily enjoined from applying the voting standard set forth in the April 13, 2020, bylaw amendments, and that the fund shall conduct the board election in accordance with the previous voting standard. On July 1, defendants filed an emergency motion with the Superior Court asking for a stay of the preliminary injunction pending a planned appeal from the court's June 24 order, which the court denied on July 6. On July 2, defendants filed an expedited "special action" appeal to the Arizona Court of Appeals, and sought a stay of the Superior Court's June 24 order in connection with that expedited appeal. On July 7, the Court of Appeals declined jurisdiction over the "special action" and denied the appellate motion to stay the preliminary injunction as moot. On July 7, defendants filed an amended notice of appeal indicating that they would pursue a non-expedited "direct appeal" to the Arizona Court of Appeals, and sought another emergency stay of the June 24 order in connection with that ordinary-course appeal. The Court of Appeals again denied the stay request.

At Voya Prime Rate Trust's 2020 annual meeting of shareholders, shareholders of the fund voted for Saba's slate of eight board nominees, thereby replacing the full fund board, and for Saba's nonbinding proposal to tender 40% of the fund's shares outstanding. Saba's proposal to terminate the fund's investment advisory agreement did not pass.

On May 11, 2020, Saba filed a definitive proxy statement to solicit votes against Royce Global Value Trust, Inc.'s proposal to approve a new investment advisory agreement with Royce Investment Partners at the fund's upcoming special meeting of shareholders, which is currently scheduled to be held on October 7, 2020. On December 6, 2020, Saba entered into a voting agreement with the fund and the fund's investment adviser.

On July 29, 2020, Saba filed a proxy statement to solicit votes for its own slate of trustee nominees and for its proposal to terminate the advisory agreement between Pioneer Floating Rate Trust and its investment adviser in connection with the fund's 2020 annual meeting of shareholders. On August 31, 2020, Saba entered into a standstill agreement with the fund and the fund's investment adviser.

At Vertical Capital Income Fund's 2020 annual meeting of shareholders, held on August 28, 2020, the fund's shareholders voted to elect Jack L. Macdowell, Jr., who was considered for nomination as a trustee by the fund board's nomination committee at the suggestion of

Phillip Goldstein as an individual holder of fund shares and on behalf of fund-shareholding clients of Bulldog. Pursuant to Mr. Macdowell's nomination, the fund and Bulldog entered into a standstill agreement.

On October 23, 2020, Karpus disclosed in an amended Schedule 13D/A filing that it has submitted a Rule 14a-8 proposal to First Trust/Aberdeen Global Opportunity Income Fund, requesting that the fund board promptly consider authorizing a self-tender offer for all the outstanding common shares of the fund at or close to net asset value and, if more than 50% of the fund's outstanding common shares are tendered, the tender offer should be cancelled and the fund should take steps necessary to merge, or convert the fund to an open-end mutual fund or exchange traded fund. On December 2, 2020, the fund entered into a standstill agreement with Karpus.

On November 13, 2020, Saba disclosed in an amended Schedule 13D filing that it has submitted to First Eagle Senior Loan Fund a notice informing the fund of its intention to nominate two individuals for election to the fund's board of trustees at the fund's 2021 annual meeting of shareholders.

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With share prices continuing to be adversely impacted as a result of the ongoing COVID-19 public health crisis, many CEFs have expressed concern that they may become vulnerable to shareholder activists. Funds with existing activists already among their shareholders also continue to remain alert.

Withdrawal of Prior SEC Staff Letter on Control Share Statutes Clears Way for Closed-End Funds

On May 27, 2020, the staff of the Division of Investment Management (Staff) of the SEC issued a statement regarding the intersection between state control share acquisition statutes (Control Share Statutes) and the voting requirements of Section 18(i) of the 1940 Act (the Control Share Statute Relief). As anticipated, the Control Share Statute Relief reverses the Staff's prior position, set forth in a 2010 no-action letter issued to Boulder Total Return Fund (Boulder), in which the Staff concluded that a CEF, by opting into a Control Share Statute, "would be acting in a manner inconsistent with Section 18(i) of the Investment Company Act" (Boulder Letter).

In the Control Share Statute Relief, the Staff replaces the Boulder Letter with a new no-action position, stating that the Staff would not recommend enforcement action against a CEF under Section 18(i) for opting into and triggering a Control Share Statute "if the decision to do so by the board of the fund was taken with reasonable care on a basis consistent with other applicable duties and laws and the duty to the fund and its shareholders generally." The Staff reminds market participants that any action taken by a fund board, including regarding Control Share Statutes, should be examined in light of (i) the board's fiduciary duties, (ii) applicable federal and state law, and (iii) the particular facts and circumstances surrounding the board's action. The Control Share Statute Relief reflects only the enforcement position of the Staff and is not binding on the SEC or any court. Although a court could conclude that a CEF opting into a state control share statute violates the 1940 Act, the limited judicial precedent that exists supports CEFs' ability to use Control Share Statutes.

The withdrawal of the Boulder Letter will likely have a significant impact on the CEF industry. Importantly, it provides CEFs organized in states with applicable Control Share Statutes with an important corporate governance tool that can be helpful to fund boards in warding off proposals meant to result in funds liquidating, converting to open-end funds (OEFs) or shrinking in size through liquidity events that the fund board believes are not in the fund's best interest.

Fund boards should promptly evaluate whether to avail their funds of applicable control share statutes. Where such statutes are not available, boards should consider redomesticating to a jurisdiction that has a control share statute or taking other defensive action in anticipation of funds that cannot avail themselves of the protection of a control share statute becoming more likely targets of activist campaigns.

See our June 9, 2020, client alert, "Withdrawal of Prior SEC Staff Letter on Control Share Statutes Clears Way for Closed-End Funds," for more information.

SEC Staff Grants No Action Relief to Delaware Statutory Trust in Recognition of the Principle That State Law Governs Matters of Shareholder Governance Absent Conflict With Federal Law

On April 10, 2020, the staff of the Division of Investment Management of the Securities and Exchange Commission (SEC) issued no action letters (No Action Letters) to Dividend and Income Fund (Fund), a CEF organized as a Delaware statutory trust, in response to two separate requests for relief by the Fund. The No Action Letters permit the Fund to exclude two precatory Rule 14a-8 proposals submitted by shareholders from its proxy materials for the Fund's 2020 annual meeting in reliance on Rule 14a-8(b)(1) of the Securities Exchange Act of 1934 (Exchange Act).[1] In the requests, the Fund sought to exclude the proposals on several bases, including that each proponent did not own shares entitled to vote on the applicable matter as required by Rule 14a-8(b)(1) and that such matter was not a proper subject for action by shareholders under state law and therefore also excludable under Rule 14a-8(i)(1). While relief based on similar facts has been granted by the staff of the SEC's Division of Corporate Finance, the No Action Letters extend such relief to CEFs, many of which are organized under state law as statutory trusts.

Background

In recent no action letters, the staff of the SEC's Division of Corporate Finance concluded that Rule 14a-8(b)(1) provides substantive grounds for excluding proposals in circumstances in which a company's governing documents do not permit the shareholder proponent to vote on the subject of the proposal. Rule 14a-8(b)(1) provides that "to be eligible to submit a proposal, [a shareholder proponent] must have continuously held [the required amount] of the company's securities **entitled to be voted on the proposal** at the meeting for [the required period of time]." [Emphasis added.] In January 2017, RAIT Financial Trust (RAIT), a Maryland REIT, submitted a request for no action relief to exclude a proposal requesting that the company "take the steps necessary to externalize management by entering into an advisory agreement with an external adviser ... "RAIT presented several grounds for exclusion, including that, pursuant to the company's governing documents, the company's shareholders are entitled to vote on only certain enumerated matters, which did not include the subject matter of the proposal or the proposal itself. The SEC staff, in granting relief, wrote:

> You represent that the proponent holds securities that are entitled to vote only on certain matters, which do not include the subject of this proposal ... . Accordingly, we will not recommend enforcement action to the Commission if RAIT omits the proposal from its proxy materials in reliance on rule 14a-8(b). In reaching this position, we have not found it necessary to address the alternative bases for omission upon which RAIT relies."

The SEC staff issued similar no action letters to two other Maryland REITs in 2018 and 2019.

Requests for Relief

During the Fund's 2020 proxy season, the Fund received a proposal from Matisse Discounted Closed-End Fund Strategy (Matisse) seeking a liquidity event at or close to net asset value. The Fund also received a proposal from a person associated with Bulldog Investors, LLC (Bulldog), requesting that the Fund amend its voting standards for trustee elections. In the Fund's requests for no action relief, the Fund sought to exclude both proposals on several bases, including that each proponent did not own shares entitled to vote on the applicable matter as required by Rule 14a-8(b)(1) and that such matter was not a proper subject for action by shareholders under state law and therefore also excludable under Rule 14a-8(i)(1).

[1] On June 17, 2020, the SEC staff of the Division of Investment Management issued a no-action letter to First Trust Senior Floating Rate Income Fund II, permitting the fund to exclude a precatory Rule 14a-8 proposal in reliance on Rule 14a-8(b)(1). The fund similarly argued that the shareholder proponent did not hold securities that are entitled to vote only on certain matters, which do not include the subject of the Rule 14a-8 proposal to declassify the board.

Among other things, the Fund emphasized in its no action requests the principle of freedom to contract underlying the Delaware Statutory Trust Act (DSTA), specifically that the DSTA provides maximum flexibility to those forming a statutory trust to select and construct their own governance structure and provides broad power and discretion to trustees to manage the business and affairs of the statutory trust. The Fund noted that under Delaware law, beneficial owners of a statutory trust are only entitled to vote on those matters as specified in the statutory trust's governing instruments and that, absent a direct conflict with federal law, state law governs matters of shareholder governance. The Fund explained that its declaration of trust specifically enumerates the matters that shareholders may vote on, and the subject matters of the proposals, and the proposals themselves, are not within those enumerated matters or otherwise the subject of a federal shareholder voting right. In addition, the Fund stated that its Declaration of Trust is clear that the board has the authority to decide whether shareholders should vote on the proposals, and the board had determined after careful consideration that it was not necessary or desirable for shareholders to have the power to vote on the proposals. Accordingly, the Fund requested that the SEC staff concur with its conclusion that the proposals should be excluded from the Fund's proxy materials pursuant to Rule 14a-8(b)(1) and Rule 14a-8(i)(1), among other grounds for exclusion.

Consistent with the RAIT no action letter, the SEC staff, in the No Action Letters, concurred with the Fund that "there appears to be a basis for [the Fund's] view that the [proposals] may be excluded in reliance on Rule 14a-8(b)(1)" and stated that the SEC staff did not find it necessary to address the Fund's other bases for excluding each proposal.

Considerations

In recent years, professional activist investors have sought at or near net asset value "liquidity" events from CEFs through the use of the Rule 14a-8 shareholder proposal process. Many industry participants argue that these events often are detrimental to the funds' long-term shareholders. As discussed by the Investment Company Institute (ICI) in a March 2020 report to the SEC, the vast majority of activist activities in the past five years have been carried out by a small, experienced group of professional activists.[2] The range of shareholder proposals put forth by activists includes proxy contests and shareholder proposals seeking to replace trustees, declassification of a fund board, termination of the fund's investment advisory agreement and approval of a direct liquidity event, such as an open-ending, liquidation, substantial tender offer or a commitment to make fixed distributions irrespective of earned income. These proposals detract from the funds' broader investment mandates, with minimal long-term effect on the funds' discount to net asset value.[3]

We believe that the No Action Letters represent an important development in the CEF industry by recognizing the province of state law in matters of shareholder governance, absent a direct conflict with federal law. For CEFs that have carefully defined shareholder voting rights consistent with the requirements of applicable state law,[4] the No Action Letters acknowledge the right of fund boards, if they determine that the actions proposed by an activist investor are not in the best interests of the fund and the fund's long-term shareholders, to exclude precatory proposals submitted by the activist investors that do not fall within the scope of matters that shareholders have a right to vote on under the funds' governing instrument and state law. We believe this recognition of state law in matters of shareholder governance for Registered Funds is an important consideration in the ongoing evaluation of CEF defensive actions by the SEC and the courts.

[2] *See* ICI, Recommendations Regarding the Availability of Closed-End Fund Takeover Defense (March 2020) (ICI Report), available at https://ici.org/pdf/20_ltr_cef.pdf. The ICI noted in its report that "[a]ccording to a survey distributed to ICI members on closed-end funds ... 85 percent of shareholder proposals or proxy contests in the past five years for survey participants were from just four shareholders. ICI received data on 48 shareholder proposals from 17 respondents representing 69 percent of closed-end fund assets and 62 percent of the total number of closed-end funds."

[3] *See id.* for a discussion of the negative effect of activist campaigns on CEFs and long-term shareholders.

[4] Funds should carefully analyze the applicable governing state law to ensure that the relevant state law contains a clear, express policy to give maximum effect to the principle of freedom to contract.

Impact of Rule 14a-8 Amendments on Closed-End Funds

On September 23, 2020, the SEC adopted amendments to the procedural requirements and resubmission thresholds relating to shareholder proposals submitted for inclusion in fund proxy statements pursuant to Rule 14a-8 of the Exchange Act.

Although the Rule 14a-8 amendments may have some deterrence effect on individual shareholders and nonprofessional dissidents, these amendments are unlikely to have much impact on professional activist investors.

Overview of Rule 14a-8 Amendments. The amendments to Rule 14a-8 will make it more difficult for certain shareholders to submit proposals for inclusion in a fund's proxy materials in connection with the fund's special or annual meeting of shareholders. These amendments (i) replace the current ownership requirements with a tiered approach taking into account both the amount of shares owned and the length of ownership; (ii) require certain documentation when a proposal is submitted by a representative on behalf of a proponent; (iii) require a proponent to provide information regarding the proponent's availability for engagement with the fund; (iv) end the ability of representatives to submit multiple proposals on behalf of other shareholders for the same meeting; and (v) raise the levels of support that a proposal must receive to be resubmitted at future shareholder meetings. For a detailed summary of the Rule 14a-8 amendments, including applicable compliance dates, see our September 25, 2020, client alert, "SEC Adopts Amendments to Shareholder Proposal Rules."

Resubmission Thresholds. Rule 14a-8(i) provides 13 bases upon which a fund can exclude a shareholder proposal. Amendments to Rule 14a-8(i)(12) will increase the level of shareholder support that a proposal must receive to be eligible for resubmission. A proposal dealing with substantially the same subject matter as a previous proposal or proposals included in the fund's proxy materials within the preceding five years may be excluded under the amended rules if the most recent vote was within the preceding three years and was:

- less than 5% of the votes cast if previously voted on once;
- less than 15% of the votes cast if voted on twice; and
- less than 25% of the votes cast if voted on three or more times.

These amendments to the resubmission thresholds will likely decrease the number of resubmissions by activist investors and reduce the associated burdens of addressing such resubmissions on the funds and their shareholders. The SEC, however, did not adopt changes to the vote-counting methodology for resubmissions recommended by certain commenters. These amendments therefore do not fully address the unique concerns of CEFs and their investors, including CEFs' continued struggle with low shareholder turnout. The "votes cast" standard, which discounts shareholders who have chosen not to vote, may not reflect "meaningful support" for a shareholder proposal by the fund's broader shareholder base. It remains to be determined how much of an impact these increases to the resubmission thresholds will have on resubmissions to CEFs by professional activist investors.

Tiered Ownership Requirements. Under the new rules, a proponent will be required to satisfy one of three alternative tests. To be eligible to submit a proposal under Rule 14a-8, a shareholder will need to have continuously held at least:

- $2,000 of the fund's securities entitled to vote on the proposal for at least three years;
- $15,000 of the fund's securities entitled to vote on the proposal for at least two years; or
- $25,000 of the fund's securities entitled to vote on the proposal for at least one year.

The Rule 14a-8 amendments may have the effect of deterring some activist activity by better aligning the interests of the shareholder proponent with those of the fund's long-term shareholders. As the SEC stated in the adopting release, "We believe having a longer holding period is particularly important if the dollar value of the ownership interest is minimal, including in terms of a company's market capitalization, and may help address concerns related to misuse of the shareholder-proposal process, while ensuring that smaller investors have access to the proxy statements of companies in which they have a demonstrated continuing interest." However, as noted above, the vast majority of recent CEF activist campaigns have been carried out by a small handful of managers who often accumulate large positions in excess of the $25,000 ownership threshold. Accordingly, these amendments are unlikely to deter professional activist investors from continuing to submit shareholder proposals using the Rule 14a-8 process.

SEC and SEC Role in the Rule 14a-8 Process. In the proposing release, the SEC solicited comments with respect to possible areas within the Rule 14a-8 process for improvement. The SEC acknowledged commenters' concerns regarding the need for a consistent application of Rule 14a-8 but noted that "although the staff strives to apply the rule in a consistent and transparent manner, participants in the shareholder-proposal process 'should not consider the prior enforcement positions of the staff on proposals submitted to other issuers to be dispositive of identical or similar proposals submitted to them.'"

With respect to shareholder voting rights, a topic of recent interest in connection with no-action letters submitted by Dividend and Income Fund, the SEC reiterated that "while Rule 14a-8 provides a federal process for proxy voting and solicitation with respect to a shareholder proposal, matters of corporate organization such as voting rights and whether a proposal is a proper subject for action remain governed by state law."

The SEC noted that it will consider comments received in connection with any future rulemaking or modifications to the no-action process.

For more information regarding the impact of the amendments to Rule 14a-8 on CEFs, see our October 15, 2020, client alert, "Impact of Rule 14a-8 Amendments on Closed-End Funds."

Securities Offering Amendments Effective for Business Development Companies and Registered Closed-End Investment Companies

On April 8, 2020, the SEC voted to adopt a series of rule and form amendments that are intended to modernize the registration, communication and offering processes for BDCs and CEFs under the Securities Act of 1933 (Securities Act). (CEFs and BDCs are collectively defined in the Adopting Release and referred to herein as the Affected Funds.) The amendments allow Affected Funds to use the securities offering rules that have been available to operating companies since 2005. The amendments were approved substantially in the form in which they were proposed in March 2019. Notably, however, the final amendments differ from the proposed amendments in several ways, including by incorporating changes that eliminate proposed Form 8-K filing requirements and expand the scope of Rule 486 under the Securities Act.

The amendments are intended to, among other things:

- streamline the registration process for eligible Affected Funds, including by allowing eligible Affected Funds to use a short-form shelf registration statement on Form N-2;
- permit eligible Affected Funds to qualify as "well-known seasoned issuers" under Rule 405 of the Securities Act;
- permit Affected Funds to satisfy final prospectus delivery requirements by using the same method as operating companies; and
- harmonize the public communication rules applicable to Affected Funds with those applicable to operating companies, which would provide Affected Funds with greater flexibility to communicate with investors, including through the use of "free writing prospectuses."

The Adopting Release also includes amendments intended to further harmonize the existing disclosure and regulatory framework for Affected Funds with that of operating companies. In particular, the amendments impose on Affected Funds structured data requirements (*i.e.*, a requirement to tag certain information using Inline eXtensible Business Reporting Language (Inline XBRL)) and new annual reporting disclosure requirements. Additionally, CEFs that make periodic repurchase offers pursuant to Rule 23c-3 under the 1940 Act, commonly referred to as interval funds, will be permitted to pay securities registration fees using the same method currently used by mutual funds and exchange-traded funds (ETFs).

These amendments will have broad application in the CEF and BDC industries, impacting funds in varying degrees depending on size and type. The rule and form amendments became effective on August 1, 2020, except for the amendments related to registration fee payments by interval funds and certain exchange-traded products, which will become effective on August 1, 2021. For a summary of these amendments, see our April 21, 2020, client alert, "SEC Adopts Securities Offering Reforms for Business Development Companies and Registered Closed-End Investment Companies."

SEC Modernizes Fund Valuation Framework

On December 3, 2020, the SEC voted to adopt new Rule 2a-5 under the 1940 Act, which establishes an updated regulatory framework for fund valuation practices and clarifies the obligations of fund boards with respect to the fair valuation of the investments of a registered investment company or BDC. In the adopting release, the SEC noted it is adopting Rule 2a-5 in response to market and fund investment practice developments since the SEC last comprehensively addressed valuation under the 1940 Act in a pair of SEC releases issued in 1969 and 1970.

Among other things, Rule 2a-5 provides requirements for good faith determinations of fair value for purposes of Section 2(a)(41) of the 1940 Act and Rule 2a-4 thereunder and permits the fund's board (defined under Rule 2a-5 to mean either the entire fund board or a designated committee of the board composed of a majority of directors who are not interested persons of the fund) to designate a "valuation designee" to perform fair value determinations, subject to board oversight and certain reporting, recordkeeping and other requirements. Rule 2a-5 applies to all registered investment companies and BDCs, regardless of their classification or subclassification or their investment objectives or strategies.

The SEC also adopted new Rule 31a-4, which provides the recordkeeping requirements associated with Rule 2a-5. Specifically, Rule 31a-4 requires funds or their advisers to maintain appropriate documentation to support fair value determinations. In cases where the fund board has designated a valuation designee to perform fair value determinations, Rule 31a-4 will require that the reports and other information provided to the board include a specified list of the investments or investment types for which the valuation designee has been designated. Finally, the SEC is rescinding previously issued guidance on the role of fund boards in determining fair value and the accounting and auditing of fund investments.

See the final rule release.

SEC Proposes Amendments To Modernize Fund Shareholder Reports and Disclosures

On August 5, 2020, the SEC proposed rule and form amendments to modernize the disclosure framework for open-end management companies. In the proposing release, the SEC noted that the new disclosure framework would create a new layered disclosure approach designed to highlight key information for retail investors and help investors better assess and monitor their investments and make informed investment decisions.

The SEC's proposal includes the following principal elements:

- **Streamlined Shareholder Reports.** Under the proposal, fund investors would continue to receive fund prospectuses in connection with their initial investment in a fund, but the fund would not deliver annual prospectus updates to investors thereafter. Instead, the fund would deliver "concise and visually engaging annual and semi-annual reports" that highlight information the SEC deems to be particularly important for retail shareholders, such as fund expenses, fund performance, illustrations of holdings and material fund changes.
- **Availability of Additional Information on Form N-CSR and Online.** Under the proposal, information currently included in annual and semi-annual reports that may be less relevant to retail fund shareholders (*e.g.*, the schedule of investments and other financial statement elements) would be made available online and delivered free of charge in paper or electronically upon request by the fund (or intermediary through which shares of the fund may be purchased or sold). This information also would be filed on a semi-annual basis with the SEC on Form N-CSR.
- **Amendments to Rule 30e-3.** The proposal would amend the scope of Rule 30e-3 of the 1940 Act to exclude OEFs. Accordingly, OEFs would not be able to rely on Rule 30e-3 to satisfy shareholder report transmission requirements.
- **Tailoring Required Disclosures to Needs of New vs. Ongoing Fund Investors.** The proposal would eliminate the requirement that funds deliver annual prospectus updates to shareholders. The SEC proposed new Rule 498B, which would provide an alternative approach that uses layered disclosure to keep investors informed about their investments and any material fund changes. Funds under the new rule would rely on the fund's shareholder reports as well as timely notifications to shareholders regarding material changes to keep investments informed of updates and material changes. The current versions of fund prospectuses would be made available online and delivered free of charge upon request.
- **Fund Fees and Risks Disclosure.** The proposal amends the content of fund prospectuses as they relate to fees and risks. The proposal would use layered disclosure principles to tailor disclosure of fees and risks to different types of investors' information needs. The proposal would, among other things, (i) replace the existing fee table in the summary section of the statutory prospectus with a simplified fee summary, (ii) move the existing fee table to the statutory prospectus and (iii) replace certain terms in the current fee table with terms that may be clearer to investors.

  The amendments also would refine current requirements for funds to disclose the "acquired fund fees and expenses" associated with investments in other funds. Specifically, the proposal would permit OEFs that make limited investments in other funds to disclose the fees and expenses associated with those investments in a footnote to the fee table and fee summary, rather than as a fee table line item.

According to the SEC, the proposal would improve OEF prospectus risk disclosure by making it clearer and more specifically tailored to a fund, including by requiring funds to describe risks in order of importance, with the most significant risks appearing first (the proposed new instruction specifies that a fund may use "any reasonable means of determining the significance of risks").

- **Fee and Expense Information in Fund Advertisements.** The SEC proposed amendments to the SEC's advertising rules that are generally applicable to all investment companies, including mutual funds, exchange-traded funds, registered CEFs and BDCs. The proposed amendments would require that presentations of investment company fees and expenses in advertisements and sales literature be consistent with relevant prospectus fee table presentations and be reasonably current. The proposed amendments also address representations of fund fees and expenses that could be materially misleading.

See the proposing release and the hypothetical streamlined shareholder report.

SEC Adopts Rules for Use of Derivatives by Registered Investment Companies

On October 28, 2020, the SEC voted to adopt new rules and rule and form amendments designed to provide an updated, comprehensive approach to the regulation of registered investment companies' use of derivatives and certain other transactions. Initially proposed in 2015 and reproposed in November 2019, the new exemptive rule, Rule 18f-4 under the 1940 Act, modernizes the regulation of the use of derivatives by registered investment companies, including mutual funds, ETFs, CEFs and BDCs (collectively, funds). Rule 18f-4 will permit funds (other than money market funds) to enter into derivatives transactions and certain other transactions, notwithstanding the prohibitions and restrictions under Sections 18 and 61 of the 1940 Act, provided that the funds comply with the specified conditions of the rule. The rule also will permit money market funds and other funds to invest in securities on a when-issued or forward-settling basis, or with a nonstandard settlement cycle, subject to conditions. The rule was adopted largely as proposed, although the SEC determined not to adopt the proposed sales practice rules.

Under this modernized regulatory framework, funds using derivatives generally will have to adopt a derivatives risk management program, to be administered by a derivatives risk manager overseen by the fund's board of directors, and comply with an outer limit on fund leverage risk based on value at risk (VaR). Funds that make only limited use of derivatives will not be subject to those requirements but will have to adopt and implement policies and procedures reasonably designed to manage derivatives risks. Additionally, funds will be subject to reporting and recordkeeping requirements related to their use of derivatives.

In addition, the SEC adopted amendments to Forms N-PORT, N-LIQUID (retitled as Form N-RN) and N-CEN designed to enhance the SEC's ability to oversee funds' use of and compliance with the new rules and to provide the SEC, investors and other market participants additional information regarding funds' use of derivatives.

The SEC also adopted amendments to Rule 6c-11 to allow leveraged and inverse ETFs to operate without the need for exemptive relief.

The SEC did not adopt the proposed new sales practice rules, including new Rule 15l-2 under the Exchange Act and new Rule 211(h)-1 under the Investment Advisers Act of 1940 (Advisers Act). The sales practice rules would have required a broker, dealer or investment adviser that is registered with (or required to be registered with) the SEC to exercise due diligence in approving a retail customer's or client's account to buy or sell shares of funds or listed commodity pools that seek to provide leveraged or inverse exposure to an underlying index. The SEC believes that the enhanced standard of conduct for broker-dealers under Regulation Best Interest and the fiduciary obligations of registered investment advisers help address some of the concerns the sales practice rules were intended to address in the context of recommended transactions and transactions occurring in an advisory relationship. In the adopting release, the SEC stated that the staff has been directed to begin a review to assess the effectiveness of the existing regulatory requirements in protecting investors who invest in leveraged/inverse products and other complex investment products.

Please see our November 23, 2020, client alert, "SEC Adopts Rules for Use of Derivatives by Registered Investment Companies," for a detailed discussion of the new rules and related amendments.

SEC Adopts New Rule for Fund of Fund Arrangements

On October 7, 2020, the SEC adopted Rule 12d1-4 (Final Rule or Rule 12d1-4) under the 1940 Act in an effort to streamline and enhance the regulatory framework for "fund of funds" arrangements. In connection with the adoption of Rule 12d1-4, the SEC is rescinding Rule 12d1-2 under the 1940 Act and most of the existing exemptive orders granting relief from Sections 12(d)(1)(A), (B), (C) and (G) of the 1940 Act. In addition, the SEC also is adopting related amendments to Rule 12d1-1 under the 1940 Act and Form N-CEN.

In response to numerous comment letters, including a letter from Skadden, the Final Rule includes provisions specifically designed to protect CEFs from undue influence resulting from acquiring funds' use of the Final Rule. The Final Rule provides CEFs with a modicum of protection against opportunistic short-term investors that seek to use other registered funds to acquire shares of CEFs at a discount and pursue disruptive agendas. However, significant unaddressed issues remain relating to private funds' ability to circumvent the protections of Section 12(d)(1)(A) and Section 12(d)(1)(C). Please see our November 5, 2020, client alert, "SEC Adopts New Rule for Fund of Fund Arrangements," for a detailed discussion of these issues that we believe remain unaddressed under the Final Rule.

Increasing Investor Opportunities Act

On November 19, 2020, U.S. Representative Anthony Gonzalez (R-OH) introduced the Increasing Investor Opportunities Act (IIOA). The IIOA, among other things, requires private funds to comply with the 10% limitation on investment in registered CEFs and BDCs contained in Section 12(d)(1)(C) of the 1940 Act. The effect of this requirement would be to require one or more private funds with the same investment adviser to limit their aggregate holdings of a registered CEF or BDC to no more that 10% of that fund's outstanding voting stock. Please see our December 1, 2020, client alert, "Proposed Legislation Would Enhance Closed-End Fund Protections by Closing the Private Funds Loophole Under Section 12(d)(1) of the Investment Company Act," for a detailed discussion of the effect of this requirement.

The IIOA also would prohibit the SEC from limiting a CEF's investment in private funds "solely or primarily because of the private funds' status as private funds" and prohibit a national securities exchange from prohibiting the listing or trading of a CEF's securities "solely or primarily by reason of the amount of the company's investment of assets in private funds." The IIOA, if enacted, is intended to give retail investors greater access to private fund investment opportunities while retaining the protections of the 1940 Act. Please see our December 2, 2020, client alert, "Proposed Legislation Seeks To Prevent Regulatory Limitations on Closed-End Fund Investments in Private Funds," for a detailed discussion of the effect of these proposed changes.

SEC Electronic Signatures in Regulation S-T Rule 302

On November 17, 2020, the SEC adopted amendments to Rule 302(b) of Reg S-T to permit companies to use electronic signatures in documents authenticating typed signatures used in electronic filings. The adopted rules also amend certain rules and forms under the Securities Act, Exchange Act and 1940 Act to allow signatories to use such e-signatures in connection with certain other filings, such as Forms 3, 4 and 5, registration statements and amendments to registration statements. Previously, electronic filers had to retain physical copies of the manually signed documents for five years.

In connection with the rule amendments, the SEC updated its EDGAR Filer Manual, which will set forth the signing process requirements for electronic signatures. The updated EDGAR Filer Manual states that for a signatory to use an electronic signature in a signature authentication document, the signing process for the electronic signature must:

- require the signatory to present a physical, logical or digital credential that authenticates the signatory's individual identity;
- reasonably provide for nonrepudiation of the signature;
- provide that the signature be attached, affixed or otherwise logically associated with the signature page or document being signed; and
- include a timestamp to record the date and time of the signature.

In addition, before a signatory initially uses an electronic signature to sign a signature authentication document, the signatory must manually sign a document attesting that the signatory agrees that the use of an electronic signature in any authentication document constitutes the legal equivalent of the signatory's manual signature for purposes of authenticating the signature to any filing for which it is provided. The filer must retain a hard copy of the signatory's manually signed document for at least seven years after the date of the most recent electronically signed authentication document. As amended, Rule 302(b) also will require electronic filers to retain, for five years, electronic copies of signature authentication documents, and such filers must, upon request, furnish to the SEC documents retained pursuant to Rule 302(b).

Filers that choose to use electronic signatures in signature authentication documents should confirm that the electronic signing process their signatories use conforms to the updated EDGAR Filer Manual, that signatories sign the signature authentication documents before the related forms are filed and that filers retain, for the requisite period, each signatory's initial, manually signed signature authentication document.

Separately, the SEC revised its rules to facilitate electronic service and filing in the SEC's administrative proceedings.

See our November 20, 2020, client alert, "SEC Adopts Rules To Allow Use of Electronic Signatures."

SEC Adopts Amendments To Enhance MD&A Disclosures

On November 19, 2020, the SEC adopted amendments to modernize, simplify and enhance certain financial disclosures called for by Regulation S-K, and related rules and forms. These amendments will impact BDCs, notably with respect to Form N-2 registration statement requirements applicable to BDCs.

The SEC adopted the following amendments to Items 301, 302, and 303 of Regulation S-K:

- Eliminated Item 301 (Selected Financial Data); and
- Modernized, simplified and streamlined Item 302(a) (Supplementary Financial Information) and Item 303 (MD&A) by:
  - Revising Item 302(a) to replace the current requirement for quarterly tabular disclosure with a principles-based requirement for material retrospective changes;
  - Adding a new Item 303(a), Objective, to state the principal objectives of MD&A;
  - Amending current Item 303(a)(1) and (2) (amended Item 303(b)(1)) to modernize, enhance and clarify disclosure requirements for liquidity and capital resources;
  - Amending current Item 303(a)(3) (amended Item 303(b)(2)) to clarify, modernize and streamline disclosure requirements for results of operations;
  - Adding a new Item 303(b)(3), Critical accounting estimates, to clarify and codify Commission guidance on critical accounting estimates;
  - Replacing current Item 303(a)(4), Off-balance sheet arrangements, with an instruction to discuss such obligations in the broader context of MD&A;
  - Eliminating current Item 303(a)(5), Tabular disclosure of contractual obligations, in light of the amended disclosure requirements for liquidity and capital resources and certain overlap with information required in the financial statements; and
  - Amending current Item 303(b), Interim periods (amended Item 303(c)) to modernize, clarify and streamline the item and allow for flexibility in the comparison of interim periods to help registrants provide a more tailored and meaningful analysis relevant to their business cycles.

The amendments will become effective 30 days after they are published in the Federal Register. Registrants are required to comply with the rule beginning with the first fiscal year ending on or after the date that is 210 days after publication in the Federal Register (the "mandatory compliance date").

See the final rule release.

SEC Modernizes Business Description, Legal Proceedings and Risk Factors Disclosure Requirements

On August 26, 2020, the SEC adopted amendments to modernize the description of business, legal proceedings and risk factor disclosures that registrants, including registered investment companies and BDCs, are required to make pursuant to Items 101, 103 and 105 of Regulation S-K. The amendments are intended to update the rules in line with more recent market developments, improve the readability of disclosures for investors and simplify compliance requirements for companies.

The final rules will become effective 30 days after publication in the Federal Register. Below is a summary of the noteworthy changes reflected in the final rules. A copy of a summary chart from the SEC's adopting release comparing the existing item requirements with the amendments is available here.

General Development of Business (Item 101(a))

- **Look-Back Period Eliminated.** Companies will continue to be required to describe the general development of their business. The amendments, however, eliminate the look-back period to focus on material developments of a company's business, regardless of a specific time frame.
- **Hyperlinks to Prior Discussion Permitted.** Companies will be allowed to hyperlink to a prior filing for the most recent discussion of the general development of the company's business, rather than repeating the same discussion in subsequent filings, and provide only an update of material developments since the prior filing to which the company has hyperlinked.
- **Prescribed Topics Replaced With Examples.** The amendments make clear that companies need to disclose only information material to an understanding of the general development of the business. In other words, a company will no longer need to address all topics listed in Item 101(a) if it determines that one or more of those topics are not material to understanding the general development of the company's business. The amendments add business strategy as a new topic and reflect minor updates to many of the existing topics.

Business Description (Item 101(c))

- **New Human Capital Disclosure.** Companies will be required to provide human capital disclosures to the extent material to an understanding of the company's business. Specifically, a company will be required to describe (i) the company's human capital resources, including the number of employees (as currently prescribed), and (ii) any human capital measures or objectives that the company focuses on in managing the business, such as measures or objectives that address the development, attraction and retention of personnel, depending on the nature of the company's business and workforce. The SEC declined to define "human capital" or mandate a specific set of metrics, noting that the meaning of human capital and measures and objectives in this context vary significantly and may evolve over time. In this regard, the SEC emphasized in the adopting release that each company's disclosure "must be tailored to its unique business, workforce, and facts and circumstances."
- **Government Regulations.** The final rules require disclosure of the material impact of compliance with all government regulations, expanding the existing requirement, which applies to only environmental regulations.
- **Other Disclosure Topic Examples.** The existing list of prescriptive disclosure items will be replaced by disclosure topic examples and the flexible requirement that companies need to disclose only information material to an understanding of the business taken as a whole.

For example, a company would need to describe its dependence on key products and services that are material, instead of describing products and services that meet quantitative thresholds as currently prescribed. The amendments also reflect updates for business, market and technology developments and remove quantitative thresholds and certain topics that are typically addressed in the Management's Discussion and Analysis (MD&A).

Legal Proceedings (Item 103)

- **Increased Dollar Threshold for Environmental Sanctions.** Companies will remain obligated to disclose legal proceedings to which a governmental authority is a party and that seek monetary sanctions under certain environmental laws, unless the company reasonably believes those monetary sanctions will not exceed a specified dollar threshold. The amendments increase the specified dollar threshold to $300,000 (from $100,000) to adjust for inflation.
- **Hyperlinks or Cross-References Permitted.** The final rules will explicitly permit hyperlinks or cross-references to legal proceedings disclosure elsewhere in the document (such as in the MD&A, risk factors or notes to the financial statements) to avoid duplication, consistent with common practice today.

Risk Factors (Item 105)

- **Updated Materiality Standard.** Item 105 will be updated to require "material" risk factors (replacing the existing "most significant" standard) to focus on risks that are important to investors in making an investment decision.
- **Summary of Risk Factors May Be Required.** If a company's risk factors exceed 15 pages, those risk factors will be required to be preceded by a new summary of the principal factors that cause an investment in the company or offering to be speculative or risky. The summary must consist of concise, bulleted or numbered statements on no more than two pages.
- **Headings Now Required.** The amendments specifically require risk factors to be organized under relevant headings (along with the currently required subcaptions for each risk factor), codifying the approach that many companies have already adopted. In addition, although the amended rule continues to explicitly discourage disclosing risks that could apply generically to any company or offering, such risks may be presented at the end of the risk factor section under a separate caption, "General Risk Factors."

For more information on these amendments, see our August 31, 2020, client alert, "SEC Modernizes Business Description, Legal Proceedings and Risk Factors Disclosure Requirements" and the adopting release.

Obeslo v. Great-West Capital Mgmt., LLC, No. 16-00230 (D. Colo. Aug. 7, 2020)

In *Obeslo v. Great-West Capital Management, LLC*, filed on January 29, 2016, in the District Court of Colorado, plaintiffs alleged that an investment adviser breached its fiduciary duties under Section 36(b) of the Investment Company Act of 1940 by charging excessive advisory fees to 17 Great-West funds (the Funds). On September, 28, 2019, the court denied defendants' motion for summary judgment. This is one of the few cases where board deference was not granted at summary judgment, and plaintiffs focused almost their entire case on this factor. The bench trial before Judge Christine Arguello began on January 13, 2020, and lasted 11 days.

On August 7, 2020, the court ruled in favor of defendants and dismissed plaintiffs' claims. In a concise opinion, the court held that plaintiffs (i) "failed to meet their burden of proof with respect to **all** of the *Gartenberg* factors" and (ii) failed to "establish that **any** actual damages resulted from Defendants' alleged breach of fiduciary duty." [Emphasis in original.]

The court began its opinion by contrasting the credibility, persuasiveness and expertise of defendants' witnesses and plaintiffs' witnesses. The court noted that (i) "[e]ach Plaintiff's testimony had limited probative value with respect to whether Defendants' fees were excessive"; and (ii) plaintiffs' expert, J. Chris Meyer, had "not worked in the mutual fund industry since 2009." In contrast, the court highlighted (i) the independent directors' "significant leadership and executive experience in the financial industry" and "[decades] of experience in the mutual fund industry"; and (ii) the substantial qualifications and experience of defendants' experts.

After outlining the litigation landscape under Section 36(b), the court summarily rejected plaintiffs' arguments as to every *Gartenberg* factor — "adopt[ing], and incorporate[ing] by reference, Defendants' proposed findings of fact and conclusions of law with regard to the *Gartenberg* factors and surrounding circumstances." (citing ECF No. 378 at 14-46). The court further concluded that "even though they did not have the burden to do so, Defendants presented persuasive and credible evidence that overwhelmingly proved that their fees were reasonable and that they did not breach their fiduciary duties."

The court also rejected plaintiffs' excessive fees claims for the independent reason that plaintiffs "failed to meet their burden with respect to damages." The court noted that plaintiffs' only damages evidence was the testimony of their expert, Mr. Meyer, but "Mr. Meyer was **thoroughly discredited** on cross examination." [Emphasis in original.] The court noted the "abundant examples of ... weaknesses and inconsistencies in Mr. Meyer's testimony" including: (i) his "unfamiliar[ity] with relevant changes in the mutual fund industry that have occurred in the past 11 years since his employment ... concluded," (ii) his failure to take into account "relevant information such as expense limitation agreements that caused [the adviser] to return funds to shareholders from its advisory fees," and (iii) his failure to quantify economies of scale or account for methods of sharing economies of scale.

In addition to finding Mr. Meyer's testimony "non-credible," the court rejected his damages theories as "legally flawed." Mr. Meyer argued that plaintiffs' damages included "(i) the extent to which some Funds had fees that exceeded the average or median of their peers; (ii) disgorgement of certain top-level fees charged to a group of Lifetime Funds; and (iii) the lost investment opportunities that resulted from the excessive fees." The court summarily rejected the first theory because "charging a fee that is above the industry average does not violate Section 36(b)." The court rejected the second theory because "total disgorgement of a fee is inappropriate absent evidence the adviser performed no services" [emphasis in original] and plaintiffs' argument that the adviser "earned sufficient profit on the underlying Funds amounts to rate regulation." The court rejected the third theory because "[t]he legislative history of [Section 36(b)] makes clear that 'lost gains' are not 'actual damages' recoverable under the statute." In light of Mr. Meyer's lack of credibility and flawed damages theories, the court held that his expert opinions were "entitled to **no weight**." [Emphasis in original.]

In addition to dismissing all of plaintiffs' claims, the court sanctioned plaintiffs' attorneys and granted defendants' motion for attorneys' fees under 28 U.S.C. § 1927, which "was designed to compensate victims of abusive litigation practices."

The court held that sanctions under § 1927 were warranted because "Plaintiffs' counsel recklessly pursued their claims through trial despite the fact that they were lacking in merit." In so holding, the court reasoned that:

i. Plaintiffs conceded that "no plaintiff who has pursued a claim under § 36(b) of the Investment Company Act has ever won in the 50 years of that section's existence" and, therefore, "Plaintiffs' counsel knew they were facing an up-hill battle from the outset of this case."

ii. Once plaintiffs "took into account the flaws that Defendants pointed out with respect to Mr. Meyer's opinions, they should have recognized that they had no plausible means of establishing actual damages or 'the outer bounds of arm's length bargaining,' which is the benchmark for a § 36(b) violation."

iii. Defendants "overwhelmingly proved that their fees were reasonable and that they did not breach their fiduciary duties" and "[h]ad Plaintiffs' attorneys objectively reviewed the evidence in this case, that fact would have been as obvious to them as it was to the Court."

iv. Plaintiffs' "decision to continue through trial was inherently lawyer driven. Plaintiffs' counsel manufactured this case by placing an advertisement in the newspaper seeking individuals to join the suit."

The court concluded that, in light of these considerations, "[p]roceeding to trial ... was, therefore, objectively reckless." In awarding sanctions, the court ordered plaintiffs' attorneys to reimburse defendants' "excess costs, expenses, and attorney fees reasonably incurred from the period beginning on the first day of trial and ending on the date Defendants filed the instant motion" up to $1.5 million.

Plaintiffs appealed the court's trial decision on September 1, 2020.

The Ninth Circuit recently affirmed another trial judgement in favor of a mutual fund adviser in *Kennis v. Metropolitan West Asset Management, LLC*, No. 19-55934 (9th Cir. 2020). The only other case pending from the most recent wave of Section 36(b) actions is *Zoidis v. T. Rowe Price Associates, Inc.* No. 16-02786 (D. Md. April 27, 2016), which is still in the fact discovery phase.

House Bill Proposes To Amend Section 36(b) of 1940 Act

On September 8, 2020, Rep. Tom Emmer introduced the Mutual Fund Litigation Reform Act, which would amend Section 36(b) of the 1940 Act by adding a new standard. Investors suing under Section 36(b) would be expected to "state with particularity all facts establishing a breach of fiduciary duty" and "have the burden of proving a breach of fiduciary duty by clear and convincing evidence." For claims brought "based on information and belief" rather than documentary evidence, the complaint must "state with particularity all facts on which that belief is formed." The Mutual Fund Litigation Reform Act was referred to the Committee on Financial Services.

Investment Company Institute president and chief executive officer Paul Stevens issued a statement in support of the bill, noting "[t]he Mutual Fund Litigation Reform Act will help federal courts to terminate before trial abusive lawsuits against mutual fund advisers, while preserving the right of shareholders to bring meritorious actions."

See the bill.

OCIE Observations Regarding Investment Adviser Compliance Programs

On November 19, 2020, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a risk alert titled "OCIE Observations: Investment Adviser Compliance Programs," which provides an overview of notable compliance issues identified by OCIE related to Rule 206(4)-7 (the Compliance Rule) under the Advisers Act.

The OCIE staff identified the notable deficiencies in the following categories:

- **Inadequate Compliance Resources.** The staff observed advisers that did not devote adequate resources (*e.g.*, information technology, staff and training) to their compliance programs.
- **Insufficient Authority of the Adviser's Chief Compliance Officer (CCO).** The staff observed CCOs who lacked sufficient authority to develop and enforce appropriate policies and procedures.
- **Annual Review Deficiencies.** The staff observed advisers that were unable to demonstrate that they performed an annual review or whose annual reviews failed to identify significant existing compliance or regulatory problems.
- **Implementing Actions Required by Written Policies and Procedures.** The staff observed advisers that did not implement or perform actions required by their written policies and procedures.
- **Maintaining Accurate and Complete Information in Policies and Procedures.** The staff observed advisers' policies and procedures that contained outdated or inaccurate information about the adviser, including off-the-shelf policies that contained unrelated or incomplete information.
- **Maintaining or Establishing Reasonably Designed Written Policies and Procedures.** The staff observed advisers that did not maintain written policies and procedures or that failed to establish, implement or appropriately tailor written policies and procedures that were reasonably designed to prevent violations of the Advisers Act. Where firms maintained written policies and procedures, the staff observed deficiencies or weaknesses with establishing, implementing or appropriately tailoring their written policies and procedures in the areas relating to portfolio management, marketing, trading practices, disclosures, advisory fees and valuation, safeguards for client privacy, required books and records, safeguarding of client assets and business continuity plans.

See the risk alert.

OCIE Observations on Supervision and Compliance for Branch Offices

On November 9, 2020, OCIE issued a risk alert titled "Observations from OCIE's Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices," which contains the OCIE staff's observations resulting from a series of examinations that focused on registered investment advisers operating from numerous branch offices.

In the risk alert, the staff stated that it observed that the branch office model may pose certain risk factors that advisers should consider in designing and implementing their compliance programs and in supervising personnel and processes occurring in branch offices, including with respect to the following topics:

- **Compliance Programs.** The staff observed that more than one-half of examined advisers had compliance policies and procedures that were: (i) inaccurate because they included outdated information (*e.g.*, references to entities no longer in existence and personnel that had changed roles and responsibilities); (ii) not applied consistently in all branch offices; (iii) inadequately implemented because, among other things, the compliance department did not receive records called for in the policies and procedures; or (iv) not enforced. The staff noted that these issues often were related to the advisers failing to recognize that they had custody of clients' assets, failing to adequately implement and oversee their fee billing practices, or both.
- **Oversight and Supervision of Supervised Persons.** The staff observed that supervision deficiencies related to: (i) the failure to disclose material information, including disciplinary events of supervised persons; (ii) portfolio management, such as the recommendation of mutual fund share classes that were not in the client's best interest; and (iii) trading and best execution, including enforcing policies and procedures the adviser had in place.
- **Advertising.** The staff observed that advisers often had deficiencies related to advertising, both generally and specifically regarding the materials prepared by supervised persons located in branch offices and/or supervised persons operating under a name different than the primary name of the adviser.
- **Code of Ethics.** The staff noted that several advisers were cited for code of ethics deficiencies because they failed to: (i) comply with reporting requirements, including by submitting transactions and holdings reports less frequently than required by the rule or not submitting such reports at all; (ii) review transactions and holdings reports; (iii) properly identify access persons; or (iv) include all required provisions in their codes of ethics.
- **Investment Advice.** The staff stated that more than one-half of the examined advisers were cited for deficiencies related to portfolio management practices, which often were related to: (i) oversight of investment decisions, including the oversight of investment decisions occurring within branch offices; (ii) disclosure of conflicts of interest; and (ii) trading allocation decisions.

In the risk alert, the OCIE staff also discussed practices that it observed with respect to branch office activities that OCIE believes could assist investment advisers in designing and implementing relevant compliance policies and procedures. For example:

- Adopting and implementing written compliance policies and procedures that (i) were applicable to all office locations and all supervised persons, (ii) included elements that took into account aspects of individual branch offices and (iii) specifically addressed compliance practices necessary for effective branch office oversight.
- Performing compliance testing or periodic reviews of key activities at all branch offices at least annually.
- Establishing policies and procedures to check for prior disciplinary events when hiring personnel and periodically confirming the accuracy of disclosure regarding such information.
- Requiring compliance training for branch office employees.

See the risk alert.

SEC Adopts Amendments to Exemptive Applications Procedures

On July 6, 2020, the SEC adopted amendments to Rule 0-5 under the 1940 Act to establish expedited review procedures for exemptive applications that are substantially identical to recent precedent and to create an internal timeframe for standard review of applications outside of the new expedited review procedure. The SEC also adopted amendments to Rule 0-5 to deem an application outside of expedited review withdrawn when the applicant does not respond in writing to comments within 120 calendar days.

The rule amendments will be effective June 14, 2021.

Eligibility for Expedited Review

Under the rule amendments, an applicant may request expedited review if the application is "substantially identical" to two other applications for which an order granting the requested relief has been issued within three years of the date of the application's initial filing. New Rule 0-5(d)(2) defines "substantially identical" applications as ones requesting relief from the same sections of the 1940 Act and rules thereunder, containing identical terms and conditions, and differing only with respect to factual differences that are not material to the relief requested (*e.g.*, the applicants' identities, the state of legal organization of a fund and the constitution of the fund's board of directors). The SEC notes that applicants that mix and match multiple precedents will not meet the "substantially identical" standard in Rule 0-5. In addition, the three-year lookback period for precedent applications is an increase from the two-year period the SEC initially proposed. In connection with the extension of the lookback period, the rule amendments require an applicant to explain in a cover letter why the applicant chose the particular precedents used and, if more recent precedents were available, why the precedents used, rather than more recent precedents, are appropriate.

In response to comments received in response to the proposing release, the SEC declined to explicitly exclude any particular type of application from expedited review. However, the SEC noted that based on the SEC staff's experience, certain lines of application will generally not meet the standards for expedited review because they are too fact-specific to meet the substantially identical standard (for example, deregistration applications filed under Section 8(f) of the 1940 Act and applications filed under Sections 2(a)(9), 3(b)(2), 6(b), 9(c) and 26(c) of the 1940 Act).

Additional Information Required for Expedited Review

An applicant seeking expedited review must include certain information with the applicant's application, including:

- a notation on the application cover page that prominently states: "EXPEDITED REVIEW REQUESTED UNDER 17 CFR 270.0-5(d)";
- exhibits with marked copies of the application that show changes from the final versions of the two precedent applications; and
- an accompanying cover letter, signed on behalf of the applicant by the person executing the application, that (a) identifies the two substantially identical applications that serve as precedent and explains why the applicant chose those particular applications (and, if more recent applications of the same type have been approved, why the applications chosen, rather than the more recent applications, are appropriate) and (b) certifies that the applicant believes that the application is substantially identical to the two precedent applications and that the marked copies provided are complete and accurate.

Expedited Review Timeframe

Under the expedited review process, the SEC will have 45 days from the date of filing of an application to either (i) notice the application or (ii) notify the applicant that the application is not eligible for expedited review because (a) it does meet the standards for expedited review or (b) additional time is necessary for appropriate consideration by the SEC staff. If the SEC staff notifies the applicant that its application is not eligible for expedited review, the applicant will be asked to either withdraw the application or amend it so that the application can be considered under the standard review process.

For purposes of calculating the 45-day period, the 45-day period will stop running upon:

- any request for modification of an application and will resume running on the 14th day after the applicant has filed an amended application responsive to such request, including a marked copy showing any changes made and a certification signed by the person executing the application that such marked copy is complete and accurate;
- any unsolicited amendment of the application and will resume running on the 30th day after such an amendment, provided that the amendment includes a marked copy showing changes made and a certification signed by the person executing the application that such marked copy is complete and accurate; and
- any irregular closure of the SEC's Washington, D.C. office to the public for normal business, and will resume upon the reopening of the SEC's Washington, D.C. office to the public for normal business.

If an applicant does not file an amendment responsive to the SEC staff's request for modification within 30 days of receiving such request, including a marked copy showing any changes made and a certification signed by the person executing the application that such marked copy is complete and accurate, the application will be deemed withdrawn.

Timeframe for Standard Review

In addition to establishing an expedited review process, the SEC adopted new Rule 13 to provide an informal timeframe for standard review applications that do not qualify for expedited review. Rule 13 encourages the SEC staff to take action on all standard review applications within 90 days of the initial filing and each of the first three amendments thereto, and within 60 days of any subsequent amendment, subject to 60-day extensions that may be granted at the SEC staff's discretion. The SEC explains that for purposes of Rule 13, action on an application or amendment by the SEC staff may consist of (i) noticing the application, (ii) providing the applicant with comments or (iii) informing the applicant that the application will be forwarded to the SEC for consideration. The SEC notes that if the SEC staff does not support the requested relief, the SEC staff will typically notify the applicant that it would recommend that the SEC deny the application and give the applicant the opportunity to withdraw the application before the SEC staff makes such recommendation.

Applications Deemed Withdrawn Under the Standard Review Process

The SEC amended Rule 0-5 to provide that an application for standard review will be deemed to have been withdrawn without prejudice if an applicant does not respond in writing to comments within 120 days of receipt. The SEC notes that the applicant would be free to refile, but the timeline would restart with the new application.

See the adopting release.

SEC Adopts Proxy Rule Amendments Relating to Proxy Voting Advice Businesses

On July 22, 2020, the SEC, by a 3-1 vote, adopted amendments to the federal proxy rules relating to proxy voting advice businesses (Proxy Advisers). The amendments categorize the voting advice issued by these firms generally as a solicitation under the federal proxy rules and place additional conditions on these firms to qualify for exemptions from the information and filing requirements under the proxy rules. These new conditions will require Proxy Advisers to provide disclosure regarding conflicts of interest, to adopt and publicly disclose policies designed to ensure that their voting advice is made available to subject companies on a timely basis, and to report to their clients any company responses regarding the voting advice. Also by a 3-1 vote, the SEC issued supplemental guidance to investment advisers, often clients of Proxy Advisers, regarding those advisers' proxy voting responsibilities in light of these new rules.

Proxy Advisers are not required to comply with the new requirements to qualify for exemptions from the information and filing requirements of the proxy rules until December 1, 2021. Accordingly, these amendments will not impact the 2021 proxy season. Moreover, they may have only a modest impact thereafter.

Proxy Voting Advice Is a Solicitation

The amendments codify the SEC's long-standing view that proxy voting advice provided in the context of a firm that markets its expertise as a provider of such advice and sells that advice for a fee falls within the definition of "solicitation." This establishes the predicate for regulation of the voting advice under the federal proxy rules. Note that Institutional Shareholder Services had initiated a lawsuit against the SEC challenging the position that proxy voting advice is a solicitation under the proxy rules. Whether that litigation, which had been stayed pending the adoption of final rules, will now move forward remains to be seen.

Requirements for Proxy Voting Advice To Be Exempt From the Proxy Information and Filing Requirements

A solicitation under the proxy rules is subject to certain information and filing requirements unless an exemption from those requirements is available. The final rules, which adopt a principles-based approach, condition the exemptions relied on by Proxy Advisers on two new requirements: (i) conflict of interest disclosure and (ii) policies requiring notice of proxy voting advice and of company responses to that advice.

Conflicts of Interest Disclosure. The first new requirement is that the Proxy Adviser must include in the proxy voting advice, or in an electronic medium used to deliver the proxy voting advice, prominent disclosure regarding (i) any interest, transaction or relationship that is material to assessing the objectivity of the proxy voting advice and (ii) any policies and procedures the firm uses to identify material conflicts of interest and steps taken to address any such conflicts. The SEC's adopting release affirms that this materiality standard allows firms to apply their judgment to determine which situations merit disclosure and the level of detail of such disclosure.

Notice of Proxy Voting Advice and Company Responses. The second requirement is that the Proxy Adviser must have adopted and publicly disclosed written policies and procedures reasonably designed to ensure that (i) companies that are the subject of proxy voting advice have such advice made available to them at or prior to the time such advice is disseminated to the firm's clients and (ii) the firm provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding the voting advice by the companies that are the subject of that advice in a timely manner before the shareholder meeting.

Anti-Fraud Provisions

Soliciting material that is exempt from the proxy rule information and filing requirements is still subject to the anti-fraud provisions of the federal proxy rules. The amendments add a new note to the anti-fraud provision to establish that, depending upon the particular facts and circumstances, the failure to disclose material information regarding proxy voting advice, such as the Proxy Adviser's methodology, sources of information or conflicts of interest, could be considered misleading.

Guidance to Investment Advisers

The SEC previously issued guidance to investment advisers regarding their proxy voting responsibilities, including considerations the investment adviser should take into account when utilizing a Proxy Adviser to assist it with voting securities. The new supplemental guidance discusses how an investment adviser can demonstrate that it is making voting decisions in its clients' best interests when it utilizes a Proxy Adviser's pre-populated or automated voting system and becomes aware that a company has filed additional soliciting materials containing the company's statement regarding the voting advice of the Proxy Adviser. One possible consequence of this guidance is that more institutional investors will delay voting until the day or two prior to a shareholder meeting, resulting in less advance visibility for companies into voting outcomes.

See our July 27, 2020, client alert, "SEC Adopts Proxy Rule Amendments Relating to Proxy Voting Advice Businesses."

SEC Proposes To Raise Form 13F Reporting Threshold From $100 Million to $3.5 Billion

On July 10, 2020, the SEC voted 3-1 to approve proposed rules that, among other things, would raise the Form 13F reporting threshold for institutional investment managers (Managers) from $100 million to $3.5 billion. If this change takes effect, it would be the first time the threshold has changed since it was adopted over 40 years ago. The proposal, if adopted, would provide relief for a significant number of smaller Managers but would also remove a key disclosure avenue for closed-end funds (CEFs) and other issuers to monitor the positions of activist investors.

Proposed Increase in Form 13F Reporting Threshold

The proposed rules would increase the Form 13F reporting threshold from $100 million to $3.5 billion, which is proportionally the same market value of U.S. equities that $100 million represented in 1975 when Congress first set the threshold. The proposed threshold, according to the SEC, would retain disclosure of over 90% of the dollar value of the holdings data currently reported while relieving nearly 90% of the current filers that are smaller Managers.

The SEC also proposes to review the Form 13F reporting threshold every five years to assess whether it aligns with the market environment. Any future change to the threshold would be made through notice-and-comment rulemaking.

One anticipated effect of the proposed rules, if adopted, is that positions of smaller Managers will not appear on quarterly reports, making it more difficult to confirm whether such Managers hold such positions or have changed the size of their investment. Because many of the activist investors who typically target CEFs are smaller Managers, we expect this to be of particular concern to the CEF industry.

Other Proposed Amendments

The proposed rules include the following additional proposed amendments to Rule 13f-1 and Form 13F:

- **Remove the Omission Threshold for Individual Securities on Form 13F.** Form 13F currently allows managers to omit holdings of fewer than 10,000 shares or less than $200,000 principal amount of convertible debt securities and less than $200,000 aggregate fair market value. The proposal would remove this exemption and require managers that meet the $3.5 billion threshold to report all of their positions in Section 13(f) securities regardless of the size.
- **Require Filers To Provide Certain Additional Identifying Information.** The proposal would require each Form 13F filer to provide, as applicable, its Central Registration Depository number with the Financial Industry Regulatory Authority or the Investment Adviser Registration Depository and the filer's SEC filing number.
- **Make Certain Technical Amendments to Form 13F.** These amendments, among other things, are intended to conform the ability of managers to obtain confidential treatment for information contained in Form 13F to a recent U.S. Supreme Court determination;[5] they require managers to demonstrate only that the information is both customarily and actually kept private by the Manager and to show how the release of the information could cause harm to the Manager (rather than the "substantial harm" standard found in the current instructions).

The comment period closed on September 29, 2020.

[5] *See Food Mktg. Inst. v. Argus Leader Media*, 139 S. Ct. 2356 (2019).

The SEC received over 2,000 comment letters opposing the proposed amendments. According to Bloomberg, this proposal could be "shelved." The SEC submitted the below quote to Bloomberg: "It remains clear that the current threshold is outdated. The comments received illustrate that the form is being used in ways that were not originally anticipated when the form was adopted. We are focused on examining these important issues before we move forward with determining the appropriate threshold."

See our July 21, 2020, client alert, "SEC Proposes To Raise Form 13F Reporting Threshold From $100 Million to $3.5 Billion."

Statement by the Staff Standards of Conduct Implementation Committee Regarding New Form CRS Disclosures

On July 27, 2020, the staff of the Standards of Conduct Implementation Committee (Committee) issued a public statement regarding the Committee's review of Form CRS. In the public statement, the staff noted that the Committee is reviewing relationship summaries from a cross-section of firms to assess compliance with the content and format requirements of Form CRS. The staff stated that while the relationship summaries reviewed to date generally comply with Form CRS requirements, the Committee has identified examples that may lack certain disclosures or could be clearer or otherwise improved. The staff noted that the Committee will engage with firms to share best practices and provide feedback on the filings. The Committee also plans to host a roundtable this fall where SEC staff will share additional thoughts following the Committee's review of firms' initial relationship summaries.

See the staff statement.

SEC Issues OCIE Risk Alert on LIBOR Transition Preparedness

On June 18, 2020, OCIE issued a risk alert discussing OCIE's examination initiative regarding registrants' London Interbank Offered Rate (LIBOR) transition preparedness. OCIE noted that that it previously identified registrant preparedness for the transition away from LIBOR as an examination program priority for FY 2020. OCIE stated that it was issuing the risk alert to provide registrants with additional information about the scope and content of LIBOR transition-related examinations.

Examination Focus

In the risk alert, OCIE states that it plans to conduct examinations of a variety of registrant types to assess their LIBOR transition preparedness. OCIE will review whether and how the registrant has evaluated the potential impact of the LIBOR transition on its: (i) business activities; (ii) operations; (iii) services; and (iv) customers, clients, and/or investors (collectively, Investors).

For example, OCIE notes that it plans to review:

- the firm's and Investors' exposure to LIBOR-linked contracts that extend past the current expected discontinuation date, including any fallback language incorporated into these contracts;
- the firm's operational readiness, including any enhancements or modifications to systems, controls, processes, and risk or valuation models associated with the transition to a new reference rate or benchmark;
- the firm's disclosures, representations, and/or reporting to Investors regarding its efforts to address LIBOR discontinuation and the adoption of alternative reference rates;
- identifying and addressing any potential conflicts of interest associated with the LIBOR discontinuation and the adoption of alternative reference rates; and
- clients' efforts to replace LIBOR with an appropriate alternative reference rate.

The risk alert includes an appendix that identifies the types of information and documents that OCIE may request as part of the examinations.

Resources for Registrants To Aid With LIBOR Transition

OCIE notes that registrants should visit the "Alternative Reference Rates Committee" webpage to receive updates regarding the latest transition-related developments and best practices. OCIE also continues to encourage the public to share information about the potential impact of the expected discontinuation of LIBOR by emailing the SEC at LIBOR@sec.gov.

See the Examination Initiative: LIBOR Transition Preparedness Risk Alert.

FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings

On July 1, 2020, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 20-21 (Notice) to provide guidance to help FINRA member firms comply with FINRA Rule 2210 (Communications with the Public) when creating, reviewing, approving, distributing or using retail communications in connection with private placement offerings, most of which are sold pursuant to one of three "safe harbors" under Rules 504, 506(b) and 506(c) of Regulation D under the Securities Act.

The Notice provides guidance on the following five topics:

- **Third-Party Prepared Materials.** The Notice reminds member firms that they can be liable for Rule 2210 violations when distributing or using noncompliant retail communications prepared by third parties. FINRA also has observed that some issuer-prepared private placement memoranda (PPMs) are bound or presented as one electronic file with retail communications. FINRA notes that regardless of whether a member firm distributes a retail communication that is attached to a PPM or as a standalone document, it constitutes a communication of the member firm subject to Rule 2210.
- **Balanced Presentation of Risks and Investment Benefits.** The Notice states that retail communications that discuss the potential benefits of investing in a private placement should balance such discussion with disclosure of their risks. According to the Notice, providing risk disclosure in a separate document (such as a PPM) or in a different section of a website does not substitute for disclosure contained in or integrated with retail communications governed by Rule 2210.
- **Reasonable Forecasts of Issuer Operating Metrics.** The Notice notes that private placement retail communications should not project or predict returns to investors such as yields, income, dividends, capital appreciation percentages or any other future investment performance. According to the Notice, FINRA would not consider reasonable forecasts of issuer operating metrics (*e.g.*, forecasted sales, revenues or customer acquisition numbers) that may convey important information regarding the issuer's plans and financial position to be inconsistent with Rule 2210. However, such presentations of reasonable forecasts of issuer operating metrics should provide a sound basis for evaluating the facts, including, for example, clear explanations of the key assumptions underlying the forecasted issuer operating metrics and the key risks that may impede the issuer's achievement of the forecasted metrics.
- **Distribution Rates.** The Notice notes that Rule 2210 prohibits misrepresentations of the amount or composition of distributions that include the return of principal or loan proceeds and does not permit member firms to state or imply that a distribution rate is a "yield" or "current yield" or that investment in the program is comparable to a fixed income investment such as a bond or note. The Notice also states that presentations of distribution rates must include various additional disclosures to be consistent with Rule 2210. In addition, retail communications should not include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive full quarterly periods.
- **Internal Rate of Return (IRR).** The Notice states that FINRA interprets Rule 2210 to permit retail communications to include IRR for completed investment programs (*e.g.*, the holding matured or all holdings in the pool have been sold). In addition, FINRA does not view as inconsistent with Rule 2210 retail communications that provide an IRR for a specific holding in a portfolio if the IRR represents the actual performance of that holding. The Notice

observes that investment programs such as private equity funds and REITs may have a combination of realized investments and unrealized holdings in their portfolios. The Notice notes that for an investment program that has ongoing operations, FINRA interprets Rule 2210 to permit the inclusion of IRR if it is calculated in a manner consistent with the Global Investment Performance Standards (GIPS) adopted by the CFA Institute and includes additional GIPS-required metrics such as paid-in capital, committed capital and distributions paid to investors.

See Regulatory Notice 20-21.

SEC Issues OCIE Risk Alert: Observations From Examinations of Investment Advisers Managing Private Funds

On June 23, 2020, OCIE issued a risk alert regarding certain compliance issues observed in examinations of registered investment advisers that manage private equity funds or hedge funds (collectively, Private Fund Advisers).

The risk alert discusses three general areas of deficiencies that OCIE has identified in examinations of Private Fund Advisers: (i) conflicts of interest, (ii) fees and expenses, and (iii) policies and procedures relating to material nonpublic information (MNPI). OCIE noted that many of the compliance issues identified in the risk alert have caused investors in private funds to pay more in fees and expenses than they should have or resulted in investors not being informed of relevant conflicts of interest concerning the Private Fund Adviser and the fund. In the risk alert, OCIE encourages Private Fund Advisers to review their practices and written policies and procedures, including implementation of those policies and procedures, to address the issues identified therein.

Conflicts of Interest

OCIE staff has observed the following conflicts of interest that appear to be inadequately disclosed and deficiencies under Section 206 of the Advisers Act or Rule 206(4)-8 thereunder:

- **Allocations of Investments.** OCIE staff observed Private Fund Advisers that did not provide adequate disclosure about conflicts relating to allocations of investments among clients, including the adviser's largest private fund clients (flagship funds), private funds that invest alongside flagship funds in the same investments (coinvestment vehicles), sub-advised mutual funds, collateralized loan obligation funds and separately managed accounts (SMAs) (together, Clients).
- **Multiple Clients Investing in Same Portfolio Company.** OCIE staff observed Private Fund Advisers that did not provide adequate disclosure about conflicts created by causing clients to invest at different levels of a capital structure (*e.g.*, one Client owning debt and another Client owning equity in a single portfolio company).
- **Financial Relationships between Investors or Clients and the Adviser.** OCIE staff observed Private Fund Advisers that did not provide adequate disclosure about economic relationships between themselves and select investors or Clients.
- **Preferential Liquidity Rights.** OCIE staff observed Private Fund Advisers that entered into agreements with select investors (side letters) that established special terms, including preferential liquidity terms, but did not provide adequate disclosure about these side letters. The staff noted that failure to disclose these special terms adequately meant that some investors were unaware of the potential harm that could be caused by selected investors redeeming their investments ahead of other investors, particularly in periods of market dislocation where there is a greater likelihood of a financial impact.
- **Private Fund Adviser Interests in Recommended Investments.** OCIE staff observed Private Fund Advisers that had interests in investments recommended to Clients (including, in some instances, adviser principals and employees that had preexisting ownership interests, referral fees or stock options in the investments), but did not provide adequate disclosure of such conflicts.
- **Coinvestments.** OCIE staff observed inadequately disclosed conflicts related to investments made by coinvestment vehicles and other coinvestors, potentially misleading certain investors as to how these coinvestments operate. The staff explained that lack of adequate

disclosure regarding coinvestments may have caused investors to not understand the scale of coinvestments and in what manner coinvestment opportunities would be allocated among investors.

- **Service Providers.** OCIE staff observed inadequately disclosed conflicts related to service providers and Private Fund Advisers.
- **Fund Restructurings.** OCIE staff observed Private Fund Advisers that inadequately disclosed conflicts related to fund restructurings and "stapled secondary transactions" (*i.e.*, a transaction that combines the purchase of a private fund portfolio with an agreement by the purchaser to commit capital to the adviser's future private fund).
- **Cross-Transactions.** OCIE staff observed Private Fund Advisers that inadequately disclosed conflicts related to purchases and sales between clients.

Fees and Expenses

OCIE staff observed the following fee and expense issues that appear to be deficiencies under

Section 206 or Rule 206(4)-8:

- **Allocation of Fees and Expenses.** OCIE staff observed Private Fund Advisers that have inaccurately allocated fees and expenses, causing certain investors to overpay expense. For example, advisers allocated shared expenses in a manner that was inconsistent with disclosures to investors or policies or procedures; advisers charged private fund clients for expenses that were not permitted by the relevant fund operating agreements; advisers failed to comply with contractual limits on certain expenses that could be charged to investors; and advisers failed to follow their own travel and entertainment expense policies.
- **"Operating Partners."** OCIE staff observed Private Fund Advisers that did not provide adequate disclosure regarding the role and compensation of individuals that may provide services to the private fund or portfolio companies, but are not adviser employees (known as "operating partners"), which could potentially mislead investors about who would bear the costs associated with these operating partners' services and potentially cause investors to overpay expenses.
- **Valuation.** OCIE staff observed Private Fund Advisers that did not value client assets in accordance with their valuation processes or in accordance with disclosures to clients.
- **Monitoring/Board/Deal Fees and Fee Offsets.** OCIE staff observed Private Fund Advisers that had issues with respect to the receipt of fees from portfolio companies, such as monitoring fees, board fees or deal fees.

Policies and Procedures Relating to MNPI

OCIE staff observed the following issues that appear to be deficiencies under Section 204A or

Rule 204A-1:

- **Section 204A.** OCIE staff observed Private Fund Advisers that failed to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of MNPI as required by Section 204A.
- **Rule 204A-1.** OCIE staff observed Private Fund Advisers that failed to establish, maintain and enforce provisions in their code of ethics reasonably designed to prevent the misuse of MNPI.

See the Observations From Examinations of Investment Advisers Managing Private Funds Risk Alert.

SEC Expands Accredited Investor Definition To Allow More Participation in Private Offerings

On August 26, 2020, the SEC adopted amendments to expand the definition of "accredited investor" in Rule 215 and Rule 501(a) of Regulation D promulgated under the Securities Act. The amendments will allow more investors to participate in private offerings by adding new categories of individuals who may qualify as accredited investors based on their professional knowledge, experience or certifications. The amendments also expand the list of entities that may qualify as accredited investors by, among other things, allowing any entity that meets an investment test, rather than an asset test, to qualify.

To conform with the updated accredited investor definition, the SEC also expanded the definition of "qualified institutional buyer" (QIB) in Rule 144A under the Securities Act.

Amendments to Accredited Investor Definition

Professional Certifications, Designations or Other Credentials

The amendments add a new category to the definition for individuals to qualify as accredited investors based on possession of certain professional certifications, designations or other credentials that demonstrate a background and understanding in the areas of securities and investing. In particular, holders in good standing of Series 7, 65 or 82 licenses will qualify as accredited investors.

In addition, the amendments provide the SEC with flexibility to evaluate and adjust the professional certifications, designations and credentials that confer accredited investor status on an ongoing basis because specific qualifying credentials are recognized by means of an SEC order. For example, if educational institutions, self-regulatory organizations, industry bodies or members of the public believe a program of study or credential qualifies, they could apply to the SEC for consideration as a qualifying certification or credential.

The SEC also committed to providing public notice and an opportunity for public comment before modifying the list of qualifying criteria. The SEC has clarified that an individual's possession of any qualifying credentials or designation would need to be publicly or otherwise independently verifiable.

Knowledgeable Employees of Private Funds

The amendments also add a new category to the accredited investor definition for individuals that would enable "knowledgeable employees" of a private fund to qualify as accredited investors for investments in the fund.

Under the amendments, a "knowledgeable employee" has the same definition as in Rule 3c-5(a)(4) of the Investment Company Act. This includes, among other persons: (i) executive officers, directors, trustees, general partners, advisory board members or persons serving in a similar capacity of a Section 3(c)(1) or 3(c)(7) fund, or affiliated persons of the fund who oversee the fund's investments; and (ii) employees or affiliated persons of the fund (other than employees performing solely clerical, secretarial or administrative functions) who, in connection with the employees' regular functions or duties, have participated in the investment activities of such private fund for at least 12 months.

Expansion of Certain Entities

The amendments also recognize the following entities as accredited investors:

- Investment advisers registered under Section 203 of the Advisers Act, investment advisers registered under the laws of the various states, and exempt reporting advisers under Section 203(m) or Section 203(l) of the Advisers Act;

- Limited liability companies (LLCs) that satisfy the other requirements of the accredited investor definition. This amendment codifies the long-standing staff position that LLCs, which have become a widely accepted corporate vehicle since the drafting of the 1989 rules, may qualify as accredited investors, provided they meet all other requirements applicable to entities; and
- Rural business investment companies (RBICs).

In addition, the amendments add a catch-all provision to qualify any entity, including Native American tribes, that was not formed for the specific purpose of acquiring the securities being offered but that owns "investments" as defined in Rule 2a51-1(b) under the Investment Company Act in excess of $5 million.

Family Offices and Family Clients

The amendments add a new category to the accredited investor definition for a "family office," as defined by the "family office rule" set forth in Rule 202(a)(11)(G)-1 of the Advisers Act, which meets the following requirements:

- it has at least $5 million in assets under management;
- it is not formed for the specific purpose of acquiring the securities offered; and
- its prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.

"Family clients," whose prospective investment is directed by their family office, will also be accredited investors under the amendments.

Income and Asset-Based Accredited Investors

In its proposing release, the SEC also requested public comment on whether the income and asset-based tests for accredited investors should be adjusted in light of inflation, geography or any other factor. While many comments were received, the SEC declined to adjust the financial thresholds, noting that while more individuals qualified as accredited investors now than when the thresholds were set in 1982, it did not follow that those individuals were less able to protect themselves, including because access to timely information is more readily available to a greater variety of market participants than when thresholds were adopted. It also noted that there were no widely reported cases of fraud or abuse under the current standards.

Nevertheless, some conforming changes were added to the financial threshold tests. In particular, the amendments add the term "spousal equivalent" (*i.e.*, a cohabitant occupying a relationship generally equivalent to that of a spouse) to the accredited investor definition when calculating joint income under Rule 501(a)(6) and include spousal equivalents when determining net worth under Rule 501(a)(5), so that both spouses and spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The SEC also amended its rules to clarify how certain forms of equity ownership are treated for purposes of determining accredited investor status. Codifying a long-standing staff interpretive position, the amendments add a note to Rule 501(a)(8) specifying that in determining accredited investor status under the rule, one may look through various forms of equity ownership to evaluate a natural person's accreditation.

Amendments to QIB Definition

Rule 144A provides a nonexclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain restricted securities to QIBs. In response to investor concerns and to avoid inconsistencies between the entity types that are eligible for accredited investor status and QIB status, the SEC expanded the QIB definition by making conforming changes to Rule 144A, including adding RBICs and LLCs to the list of entities covered by Rule 144A.

Further, to ensure that entities that qualify for accredited investor status also may qualify for QIB status when they meet the Rule 144A(a)(1)(i) threshold requiring $100 million in owned and invested securities, the amendments add a new paragraph (J) to Rule 144A(a)(1)(i), permitting certain institutional accredited investors to automatically qualify as QIBs when they satisfy the dollar-amount threshold. This new QIB category reflects the "catch-all" category in the amended accredited investor definition for entities owning investments in excess of $5 million that are not formed for the specific purpose of acquiring securities, as well as any other entities that may be added to the accredited investor definition in the future, provided that any such entities also would have to meet the $100 million threshold to qualify as QIBs. As a result, Indian tribes, governmental bodies and bank-maintained collective investment trusts may now qualify as QIBs.

For more information, see our August 28, 2020, client alert, "SEC Expands Accredited Investor Definition To Allow More Participation in Private Offerings."

SEC Issues OCIE Risk Alert: Cybersecurity: Ransomware Alert

On July 10, 2020, OCIE issued a risk alert regarding potential measures market participants can adopt to address ransomware attacks. In the risk alert, OCIE noted that it has observed an increase in sophistication of ransomware attacks on SEC registrants, including broker-dealers, investment advisers and investment companies, and has also observed ransomware attacks impacting service providers to registrants. In light of the increased ransomware threats, OCIE encourages registrants, as well as other financial services market participants, to monitor the cybersecurity alerts published by the Department of Homeland Security Cybersecurity and Infrastructure Security Agency (CISA), and to share this information with their third-party service providers, particularly with those that maintain client assets and records for registrants.

OCIE noted that it has observed registrants using the following measures to enhance their cybersecurity preparedness and operational resiliency:

- **Incident Response and Resiliency Policies, Procedures and Plans.** Assessing, testing and periodically updating incident response and resiliency policies and procedures, such as contingency and disaster recovery plans.
- **Operational Resiliency.** Determining which systems and processes are capable of being restored during a disruption so that business services can continue to be delivered.
- **Awareness and Training Programs.** Providing specific cybersecurity and resiliency training, and considering undertaking phishing exercises to help employees identify phishing emails.
- **Vulnerability Scanning and Patch Management.** Implementing proactive vulnerability and patch management programs that take into consideration current risks to the technology environment and that are conducted frequently and consistently across the technology environment.
- **Access Management.** Managing user access through systems and procedures that: (i) limit access as appropriate; (ii) implement separation of duties for user access approvals; (iii) recertify users' access rights on a periodic basis; (iv) require the use of strong, and periodically changed, passwords; (v) utilize multi-factor authentication leveraging an application or key fob to generate an additional verification code; and (vi) revoke system access immediately for individuals no longer employed by the organization, including former contractors.
- **Perimeter Security.** Implementing perimeter security capabilities, including firewalls, intrusion detection systems, email security capabilities and web proxy systems with content filtering, that are able to control, monitor and inspect all incoming and outgoing network traffic to prevent unauthorized or harmful traffic.

In concluding the risk alert, OCIE reminded registrants that cybersecurity has been a key examination priority for OCIE for many years and that information security is a key risk area that registrants should focus on.

See the Cybersecurity: Ransomware Alert.

SEC Decreases Fee Rates for Fiscal Year 2021

On August 26, 2020, the SEC announced that effective October 1, 2020, the fees that public companies and other issuers pay to register their securities with the SEC will be set at $109.10 per million dollars, down from the rate of $129.80 per million dollars for fiscal year 2020.

See the SEC Order.