

Investment Management Update

December 2024–January 2025

ROPES & GRAY

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SEC Postpones Institutional Investment Managers' Short Sales Reporting Requirements

On February 7, 2025, the SEC issued an [order](#) postponing compliance requirements with Rule 13f-2 under the Securities Exchange Act and reporting requirements on Form SHO. As a result, initial Form SHO reports from institutional investment managers that engage in short sales of "equity securities" exceeding certain thresholds will be due by February 17, 2026 (for the January 2026 reporting period). Prior to the SEC order, the compliance date for Rule 13f-2 and Form SHO was January 2, 2025, with initial Form SHO reports originally due by February 14, 2025.

SEC Updates Fund Names Rule FAQs

In 2023, the SEC amended Rule 35d-1 under the 1940 Act (the "Names Rule") to address certain broad categories of investment company names that are likely to mislead investors. In particular, the amendments expand the rule's 80% investment policy requirement to apply to any fund name containing terms that suggest the fund has a particular investment focus (each, a "Covered Term"). As amended, no later than December 11, 2025, the Names Rule requires each affected fund's prospectus to include each Covered Term in an 80% investment policy.

On January 8, 2025, the staff of the SEC Division of Investment Management [published](#) responses to FAQs related to the implementation of the amended Names Rule (the "2025 FAQs").¹

The 2025 FAQs contain the following new information (i.e., information not contained within the withdrawn 2001 FAQs):

- **Adoption of 80% Investment Policy.** The FAQs confirm that shareholder approval is not required for a fund to add or revise a fundamental 80% investment policy, unless the change would permit a "deviation from the existing policy or some other existing fundamental policy." For example, the 2025 FAQs clarify that a fund that already has a fundamental 80% investment policy that "broadly references equity investments would generally not be deviating from that policy if it were to revise this fundamental policy to reference equity investments with growth characteristics."
- **"Tax-Sensitive" and Similar Terms.** In the 2001 FAQs, the SEC staff noted that a fund that uses the term "tax-sensitive" in its name indicates a fund's strategy instead

of a focus on a particular type of investment. In the 2025 FAQs, the staff stated that this is also true for terms that are “similar” to tax sensitive (e.g., “tax-efficient,” “tax-advantaged,” “tax-managed,” and “tax aware”), and a fund’s use of these similar terms in its name indicates the fund’s objectives rather than the particular characteristics of the fund’s investments. Accordingly, the 2025 FAQs state that use of “tax sensitive (or a similar term)” in a fund’s name does not require the fund to adopt an 80% investment policy.

- **Income.** In the 2001 FAQs, the SEC staff stated that Rule 35d-1 would not apply to the use of the term “income” where that term suggests an investment objective or strategy rather than a type of investment. The 2025 FAQs confirm the staff’s view that, when the term “income” does not refer to “fixed income” securities, the term “income” in a fund’s name “generally suggests that the fund emphasizes the achievement of current income as a portfolio-wide result, and in these circumstances would not, alone, require the fund to adopt an 80% investment policy.”

The 2025 FAQs follow a December 23, 2024 letter from the Investment Company Institute (the “ICI”) to the SEC in which the ICI requested that the SEC extend the Names Rule compliance date (i) by a minimum of 18 months and (ii) base the compliance date on a fund’s fiscal year-end. As of the date of this Update, the SEC has not publicly responded to the request.

SEC Cites Shortcomings in Funds’ Required Website Postings

The Division of Investment Management’s Disclosure Review and Accounting Office (the “DRAO”) is responsible for reviewing fund disclosures. On January 16, 2025, the DRAO [published](#) a bulletin (ADI 2025-15) titled *Website Posting Requirements* in which it described issues recently observed by the SEC staff “relating to the website posting requirements under various Commission rules and certain exemptive orders, including those related to the use of summary prospectuses, exchange-traded funds (ETFs), and money market funds (MMFs).”

Summary Prospectuses. The bulletin describes the following issues observed by the SEC staff:

A summary prospectus cover page is required to include a website address that takes investors directly to the web page where the required online documents can be found. Some summary prospectuses did not include a website address that investors can use to obtain required online documents, while other summary prospectuses included generic website addresses to a registrant’s home page.

A fund’s statutory prospectus and its SAI table of contents are required to be hyperlinked – with a back-and-forth

function – to expedite investor movement through these longer documents. Registrants typically met this linking requirement by including the table of contents for the statutory prospectus and SAI in sidebars to the document page. However, a number of registrants did not include a table of contents in one or both of the required documents or use hyperlinks.

Registrants are required to link a summary prospectus with its corresponding statutory prospectus/SAI by including links that are either available at both the beginning and end of the summary prospectus or with links that remained continuously visible to persons accessing the summary prospectus. Some registrants did not include or only partially satisfied this linking requirement. In addition, some variable product registrants:

- Included a continuously visible sidebar with a link to the statutory prospectus or to the table of contents of the statutory prospectus (rather than links to sections of the statutory prospectus). This approach does not satisfy the linking requirements because it requires a reader to move through two or more hyperlinks to access the referenced section of the statutory prospectus, as opposed to providing a direct link to that section.
- Did not include any of the permitted means of accessing the definitions of special terms used in the online summary prospectus.

ETFs. The bulletin describes the following issues observed by the SEC staff concerning ETFs:

- ETFs that did not include CUSIPs or other identifiers with their daily holdings information, as required.
- ETFs that expressed their market-price-to-NAV premiums and discounts as a dollar figure instead of as a percentage. In addition, some ETFs employed alternative terms when referring to premiums and discounts that have the potential to confuse investors.
- ETFs that either failed to disclose timely historic premium and discount information on their websites (i.e., the disclosure was not updated to reflect information as of the most recent quarter-end or was not disclosed on their website).
- ETFs that employed alternative terms when referring to the 30-day median bid-ask spread (e.g., omitting the term “30-day,” such that the nature of the figure presented may be unclear to investors).

Money Market Funds. The SEC staff observed MMFs that failed to post on their websites the required link to the SEC’s website where a user may obtain the most recent 12 months of publicly available portfolio information filed by the MMF on Form N-MFP.

REGULATORY PRIORITIES CORNER

The following brief updates exemplify trends and areas of current focus of relevant regulatory authorities:

Upcoming Compliance Dates

The following is a reminder of the upcoming compliance dates of significant SEC rulemakings.

- Amended Forms N-PORT and N-CEN and Monthly Form N-PORT Requirements.** In addition to new information required on Forms N-PORT and N-CEN, funds are required to file Form N-PORT reports more frequently and within a shorter period. Fund complexes with aggregate fund net assets of at least \$1 billion will be required to comply with the Form N-PORT amendments for reports filed on or after **November 17, 2025**. For Form N-CEN, all funds will be required to comply with the Form N-CEN amendments for reports filed on or after **November 17, 2025**. The related SEC release is summarized in a Ropes & Gray [Alert](#).
- Amended Regulation S-P.** The amendments to Regulation S-P require broker-dealers, registered investment companies (including business development companies), and registered investment advisers to adopt written policies and procedures creating an incident response program to deal with unauthorized access to customer information, including procedures for notifying persons affected by the incident within 30 days. The compliance date is **December 3, 2025**. The related SEC release is summarized in a Ropes & Gray [Alert](#).
- Names Rule Amendments.** As described above, the compliance date for amended Rule 35d-1 under the 1940 Act is **December 11, 2025**. The related SEC release is summarized in a Ropes & Gray [Alert](#).

SEC Settles Proceeding with Adviser Concerning Target-Date Funds' Disclosure

On January 17, 2025, the SEC issued an [order](#) settling an administrative proceeding against a registered investment adviser (the "Adviser") arising out of alleged misleading statements concerning potential investor tax consequences in the prospectuses of Adviser Investor Target Retirement Funds ("Investor TRFs"). In the order, the SEC alleged the following:

- In 2019, the Adviser's funds included two separate groups of target-date retirement funds ("TRFs") (i) the Investor TRFs for investors with assets of less than \$100 million, including small- and medium-sized retirement plans and individual investors and (ii) the "Institutional TRFs" for institutional investors (primarily larger retirement plans) with assets greater than \$100 million.
- The Investor TRFs had an average expense ratio of 0.14% and the minimum amount to invest in the Investor TRFs

was \$1,000. The Institutional TRFs had an average expense ratio of 0.09% and the minimum amount to invest in the Institutional TRFs was \$100 million.

- By mid-2019, investor demand for TRFs had increased, and the Investor TRFs' assets had grown substantially, mainly due to increased investments by small- and medium-sized retirement plans. The growth in assets resulted in economies of scale that lowered the Adviser's expenses in servicing the Investor TRFs.
- In March 2020, the Adviser considered lowering the minimum investment for the Institutional TRFs to permit small- and medium-sized retirement plans to switch to the Institutional TRFs. The Adviser determined that the movement of investors switching from the Investor TRFs to Institutional TRFs could result in potential capital gains impacts for investors who purchased or continued to purchase Investor TRFs.
- While the Adviser understood that capital gains impacts were likely, these impacts were not a significant factor in the Adviser's analysis due to several errors.
 - The Adviser (i) overestimated the number of Investor TRF investors who held the funds in tax-advantaged accounts, such as employer-sponsored retirement plans or individual retirement accounts and (ii) mistakenly assumed that eligible investor redemptions from the Investor TRFs to purchase the Institutional TRFs would be staggered over time, moderating any potential realization of capital gains.
 - The Adviser did not reevaluate the market conditions and potential impacts on accumulated capital gains after March 2020. In fact, by the third quarter of 2020, the markets had rebounded significantly and, as a result, the accumulated capital gains as a percentage of net asset value in the Investor TRFs had increased from 0.5% to 1.4%.
- In November 2020, the Adviser recommended to the Institutional TRFs' Board of Trustees to change the minimum investment for the Institutional TRFs from \$100 million to \$5 million. The Adviser did not disclose to the Trustees its evaluation of potential capital gains and tax consequences to Investor TRF investors resulting from investor net redemptions of Investor TRFs shares to purchase Institutional TRFs shares.
- The Trustees approved the Adviser's recommendation and, in December 2020, the Adviser announced in a supplement to the Institutional TRFs' prospectuses and a press release that the minimum investment for the Institutional TRFs would be lowered from \$100 million to \$5 million effective immediately. However, the Investor TRFs' prospectuses and the press release did not mention any potential capital gains and tax consequences to Investor TRF investors in taxable accounts that could result from the anticipated movement of a substantial number of Investor TRF investors to the Institutional TRFs.

8. During the first half of 2021, a substantial number of small- and medium-sized retirement plan investors in the Investor TRFs redeemed fund shares to switch to the Institutional TRFs. To meet these redemptions, the Investor TRFs had to sell underlying assets at elevated prices due to the rising financial markets that had rebounded from pandemic lows.
9. From December 2020, when the Adviser and the Institutional TRFs announced the lowering of the minimum investment for these TRFs, to October 2021, redemptions in the Investor TRFs totaled approximately \$130 billion, compared with approximately \$41 billion in redemptions in the prior one-year period from November 2019 to October 2020. Capital gains distributions for the Investor TRFs as a percentage of net asset value from November 2020 to October 2021 averaged 9.69%, nearly seven times the 1.39% average from November 2019 to October 2020.
10. As a result, Investor TRF investors who held the funds in taxable accounts at the Adviser and at other firms realized historically high capital gains distributions and tax consequences for 2021.

Based upon these findings, the SEC concluded that the Investor TRFs' 2020 and 2021 prospectuses were materially misleading and that the Adviser, which was responsible for preparing the prospectuses, caused the Investor TRFs to violate Section 17(a)(2) of the Securities Act. In addition, the SEC concluded that the Adviser (i) violated Section 206(4) of the Advisers Act, and Rule 206(4)-8 promulgated thereunder (prohibiting an investment adviser to a pooled investment vehicle from engaging in a deceptive or manipulative practice with respect to any investor or prospective investor), (ii) violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder (requiring investment advisers to adopt and implement written policies and procedures), and (iii) caused the Investor TRFs to violate Section 34(b) of the 1940 Act (prohibiting untrue statements of a material fact in a fund registration statement).

Without admitting or denying the SEC's findings, the Adviser agreed to be censured and to pay a civil penalty of \$13.5 million to the SEC. This payment is separate from the Adviser's payments of (i) \$92.9 million to settle a related matter instigated by states' attorneys general and (ii) \$40 million to settle a related investor class action.

SEC Claims Adviser Failed to Address Known Vulnerabilities in Its Investment Models

On January 16, 2025, the SEC issued an [order](#) settling an administrative proceeding against affiliated investment advisers Two Sigma Investments, LP and Two Sigma Advisers, LP (collectively, "Two Sigma") arising out of Two Sigma's alleged failures to exercise reasonable care in addressing known material vulnerabilities to a subset of their computer-based algorithmic investment models used to make investment decisions ("Models"). In the order, the SEC alleged the following:

1. Two Sigma is a large, quantitative, analytics-based manager that uses the Models when making investment decisions for its clients, including private funds and separately managed accounts. Two Sigma employees who develop the Models are called "modelers."
2. In March 2019, Two Sigma began to employ machine-learning-based Models, which required a larger database, called "CELL," to store the Model inputs. Two Sigma employees soon identified significant access vulnerabilities to storing Model inputs in CELL. These concerns were shared with senior Two Sigma employees, but Two Sigma made no changes to the controls governing Model inputs stored in CELL in 2019 or 2020.
3. In January 2022, a senior Two Sigma engineer circulated a memorandum to a Two Sigma co-founder and other Two Sigma executives in which he raised concerns about the lack of access controls for Model inputs stored in CELL and the absence of controls to ensure that Two Sigma employees follow an approval process for changes to the Model inputs. Despite these concerns, Two Sigma made no changes to address the vulnerabilities to Model inputs stored in CELL until after a Two Sigma employee accidentally overwrote Model inputs in CELL database in May 2022.
4. Specifically, on May 9, 2022, a Two Sigma employee inadvertently overwrote an entire volume in CELL containing several Models' inputs before certain markets opened for trading. Two Sigma was able to correct for this error before markets opened.
5. In an internal post-mortem document circulated within the Two Sigma engineering group and to Two Sigma senior management on May 10, 2022, Two Sigma employees identified the same access control issues that had been identified in 2019 and noted that these vulnerabilities made possible the prior day's incident.
6. In response to the May incident, in June 2022, Two Sigma implemented a new procedure that limited access to Model inputs stored in the CELL database to a small, dedicated team of engineers and allowed changes to Model inputs only upon receipt of a written request, called a ticket, from a modeler. However, the new procedure merely required modelers to document their changes on a ticket and to submit the ticket to a team of engineers for implementation. The new procedure did not prevent modelers from intentionally changing Model inputs, because modeler tickets were not reviewed, tested, or approved.
7. Between November 2021 and August 2023, Modeler A, a Two Sigma employee, made dozens of unauthorized changes to Model inputs stored in CELL for 14 different Models that Two Sigma used in live trading. These Models included both Models that Modeler A developed himself, as well as Models developed by Modeler A's direct reports and with which Modeler A assisted.

8. Modeler A's unauthorized changes caused the Models to perform differently than expected such that Two Sigma made investment decisions that it otherwise would not have made. In particular, Modeler A's changes resulted in Two Sigma buying or selling more or less of specific securities than it otherwise would have, which caused certain funds and accounts to overperform by more than \$400 million and other funds and SMAs to underperform by approximately \$165 million.
9. Modeler A received millions of dollars of additional compensation from Two Sigma because of the net overperformance attributable to the unauthorized changes. In August 2023, Two Sigma began monitoring CELL to confirm that its modelers had not made, and were not making, unauthorized changes to Model inputs. This led to the discovery of Modeler A's changes.

Based upon these findings, the SEC concluded that Two Sigma (i) violated Section 206(2) of the Advisers Act (prohibiting an investment adviser from engaging in any course of business that operates as a fraud or deceit upon any client), (ii) violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, and (iii) failed to reasonably supervise Modeler A within the meaning of Section 203(e)(6) of the Advisers Act. Without admitting or denying the SEC's findings, Two Sigma agreed to be censured and to pay a civil money penalty of \$90 million to the SEC.

ROPES & GRAY ALERTS AND PODCASTS SINCE OUR OCTOBER–NOVEMBER UPDATE

January 2025 Asset Management ESG Review

January 30, 2025

Ropes & Gray closely monitors the rapidly evolving ESG landscape, helping asset managers and institutional investors navigate the dynamic ESG regulatory environment and keep on top of emerging ESG trends and industry best practices. Our first half-yearly review was published in August 2024. This follow-on edition of the *Asset Management ESG Review* provides a look back at ESG-related developments in the asset management space during the second half of 2024. [Read more.](#)

Updated SEC Staff Accounting Bulletin Rescinds SAB 121 Crypto Accounting Guidance

January 27, 2025

On January 23, 2025, President Trump signed an executive order titled *Strengthening American Leadership in Digital*

Financial Technology, which addressed a variety of crypto-related topics to the great relief of many in the crypto industry. In Staff Accounting Bulletin 122 ("SAB 122"), the SEC rescinded controversial prior administration accounting guidance contained in Staff Accounting Bulletin 121 ("SAB 121") that suggested that financial institutions must reflect client crypto assets they hold as balance sheet liabilities. In its place, SAB 122 reminds entities that have an obligation to safeguard crypto assets for others to determine whether to recognize a liability related to the risk of loss under such an obligation, and if so, the measurement of such a liability, by applying the recognition and measurement requirements for liabilities arising from contingencies set forth in existing Financial Accounting Standards Board and International Accounting Standards (IAS) guidance. [Read more.](#)

SEC Launches Crypto Regulatory Task Force

January 22, 2025

On January 21, 2025, SEC Acting Chairman Mark Uyeda launched a crypto task force to develop a "comprehensive and clear regulatory framework for crypto assets." Commissioner Hester Peirce – dubbed "Crypto Mom" by the industry for her longstanding support and criticism of the SEC's enforcement-focused approach – will lead the task force. As described in this Alert, Commissioner Peirce's prolific dissents and public remarks provide some insight into potential priorities for the new task force and underscore why her appointment is such welcome news to the industry. [Read more.](#)

Ropes & Gray Crypto Quarterly: Digital Assets, Blockchain and Related Technologies Update

January 2025

The landscape of government enforcement, private litigation, and federal and state regulation of digital assets, blockchain and related technologies is constantly evolving. Each quarter, Ropes & Gray attorneys analyze government enforcement and private litigation actions, rulings, settlements, and other key developments in this space. We distill the flood of industry headlines so that you can identify and manage risk more effectively. This newsletter includes takeaways from this quarter's review. [Read more.](#)

Practical Takeaways from *Spence v. American Airlines, Inc.* for ERISA Plan Fiduciaries

January 15, 2025

On January 10, 2025, Judge Reed O'Connor of the Northern District of Texas issued a much-anticipated ruling in *Spence v. American Airlines, Inc.*, which marks the first time that a

federal judge has written an on-the-merits decision on the controversial topic of ESG and the duties of retirement plan fiduciaries under ERISA. In his opinion, Judge O'Connor found that American Airlines and the American Airlines Employee Benefits Committee ("EBC") breached their ERISA duty of loyalty by including funds on the American Airlines 401(k) Plan lineup that were not ESG-focused funds but were managed by a non-party investment manager ("Investment Manager") that the judge determined to have engaged with issuer companies on ESG-related issues and on occasion voted proxies in support of ESG-related proposals. This decision, especially if its reasoning is upheld on appeal and adopted by other courts, could cause ERISA plan fiduciaries to consider changes to their longstanding practice of delegating proxy voting to their investment managers. [Read more.](#)

If you would like to learn more about the issues in this IM Update, please contact your usual Ropes & Gray attorney contacts.

¹ At the same time, the staff [withdrew](#) FAQs that it issued in 2001 in connection with the 2001 adoption of Rule 35d-1 (the "2001 FAQs"), noting that, among reasons, the SEC's 2023 release amending Rule 35d-1 addressed certain topics covered in the 2001 FAQs.