October 11, 2021

Ropes & Gray's Investment Management Update August – September 2021

The following summarizes a number of recent legal developments of note affecting the mutual fund/investment management industry:

SEC Proposes to Expand Proxy Voting Reporting by Registered Funds and Reporting of Executive Compensation Votes by Institutional Investment Managers

On September 29, 2021, the SEC issued a proposing release (the "Release") containing rule and form amendments that, if adopted, would affect the proxy-voting reporting of registered funds and institutional investment managers that are subject to Section 13(f) of the Exchange Act.[1] Among other things, the amendments would require funds to tie the description of voting matters to the issuer's form of proxy and to categorize voting matters by type, as well as require reporting of information on Form N-PX to be in a structured data language. The Release will be discussed in an upcoming Ropes & Gray Alert.

Plaintiff-Shareholder Seeks to Assert Derivative Claims on Behalf of a SPAC

On August 17, 2021, a derivative complaint was filed in the U.S. District Court for the Southern District of New York, nominally against Pershing Square Tontine Holdings, Ltd. ("PSTH"), a special purpose acquisition company, or SPAC, by one of its purported shareholders. The complaint asserts derivative claims on behalf of PSTH against its sponsor, Pershing Square TH Sponsor, LLC, PSTH's board of directors and various affiliates of the sponsor, and seeks a declaratory judgment, damages and rescission of contracts whose formation and performance are alleged to violate the 1940 Act and the Advisers Act.

The plaintiff's fundamental assertion is that PSTH is an "investment company" as defined in 1940 Act and, as a result, the arrangements for the management of PSTH were required to comply with the 1940 Act and Advisers Act. Specifically, the complaint focuses on (i) the definitional threshold of an investment company, which under the 1940 Act includes any company that "is or holds itself out as being engaged primarily . . . in the business of investing, reinvesting, or trading in securities" and (ii) the fact that, since PSTH's July 2020 initial public offering, it has invested nearly all of its assets in short-term U.S. Treasury securities and securities of money market funds.

If the plaintiff's theories are accepted by the court, and SPACs are required to register as investment companies, the SPAC industry would be adversely affected – and potentially threatened outright, given the onerous requirements of the 1940 Act.

In an interesting development, shortly after the PSTH derivative complaint was filed, more than 60 leading law firms, including Ropes & Gray, published a joint statement refuting that SPACs are "engaged primarily . . . in the business of investing, reinvesting, or trading in securities." The joint statement noted that SPACs:

> are engaged primarily in identifying and consummating a business combination with one or more operating companies within a specified period of time. In connection with an initial business combination, SPAC investors may elect to remain invested in the combined company or get their money back. If a business combination is not completed in a specified period of time, investors also get their money back. Pending the earlier to occur of the

[1] Institutional investment managers that would be required to comply with the Release's requirements are the same entities that are required to report securities holdings on Form 13F under the Exchange Act.

completion of a business combination or the failure to complete a business combination within a specified time frame, almost all of a SPAC's assets are held in a trust account and limited to short-term treasuries and qualifying money market funds.

Consistent with long-standing interpretations of the 1940 Act, and its plain statutory text, any company that temporarily holds short-term treasuries and qualifying money market funds while engaging in its primary business of seeking a business combination with one or more operating companies is not an investment company under the 1940 Act. As a result, more than 1,000 SPAC IPOs have been reviewed by the staff of the SEC over two decades and have not been deemed to be subject to the 1940 Act.

Notably, PSTH sought and later abandoned a minority stock purchase deal that is distinguishable from the ordinary initial business combinations sought by other SPACs. Following the filing of the lawsuit, William Ackman of Pershing Square stated in a letter to PSTH shareholders that he would return SPAC proceeds to investors if his alternative "SPARC" structure receives SEC approval, which may have the effect of mooting the litigation against PSTH. However, the same plaintiff-shareholder has since filed two additional lawsuits against other industry-leading SPACs. We anticipate the SPACs in all three cases to file motions to dismiss.

SEC Approves Exchanges' Rule Amendments to Permit Use of Custom Baskets by Semi-Transparent ETFs

On September 24, 2021, the SEC issued an order (the "NYSE Arca Order") approving a proposed rule amendment by NYSE Arca, Inc. ("NYSE Arca"). Similarly, on September 28 2021, the SEC issued an order (the "Cboe Order" and, together with the NYSE Arca Order, the "Orders") approving a proposed rule amendment by Cboe BZX Exchange, Inc. ("Cboe"). As amended, NYSE Arca Rule 8.601-E and Cboe Rule 14.11(m) (the "Rules") permit semi-transparent ETFs ("ST ETFs") to create or redeem shares in return for custom baskets, consistent with exemptive relief recently issued by the SEC under the 1940 Act to certain ST ETFs.

The prior SEC exemptive orders permit creations and redemptions of shares by an ST ETF using a custom basket that includes instruments that are not included, or included with different weightings, in the ST ETF's proxy portfolio. However, prior to the Orders, NYSE Arca-listed and Cboe BZX-listed ST ETFs were unable to implement these SEC exemptive orders without the rule changes effected by the Orders.

Among the changes effected by the Orders, the Rules include requirements tracking conditions within the related SEC exemptive orders, including requirements to ensure that information relating to custom baskets is kept confidential prior to its public disclosure and is not subject to misuse. Thus, the Rules require application of a "fire wall" and other requirements applicable to persons that have information concerning the composition of custom baskets (in addition to existing rule requirements concerning the actual and proxy portfolios of the ST ETF). Similarly, to ensure that information relating to custom baskets utilized by the ST ETF is publicly available to market participants at the same time, NYSE Arca and Cboe will be required to obtain a representation from each ST ETF that the ST ETF and any person acting on behalf of the ST ETF will comply with Regulation FD, including with respect to any custom basket.

REGULATORY PRIORITIES CORNER

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

Chair Gensler's Senate Committee Testimony on SEC Initiatives

On October 5, 2021, SEC Chair Gary Gensler provided testimony to the U.S. House of Representatives Committee on Financial Services in which he summarized the initiatives in the SEC's current unified agenda.[2] Several of the initiatives are of interest to the mutual fund/investment management industry and are summarized below.

ESG Disclosure. Chair Gensler noted that the SEC has seen "a growing number of funds market themselves as 'green,' 'sustainable,' 'low-carbon,' and so on." He has asked the SEC staff to consider ways to determine what "information stands behind those claims" and how the SEC can ensure that "the public has the information they need to understand their investment choices among these types of funds."

Cybersecurity. The SEC staff is developing a proposal for the SEC's consideration on cybersecurity risk governance, which could include "cyber hygiene" and incident reporting.

Private Fund Disclosure. Chair Gensler observed that private fund managers face conflicts of interest regarding information they are providing investors about the fees they charge. He believes the SEC can enhance disclosures in this area, thereby "enabling pensions and others investing in these private funds to get the information they need to make investment decisions."

Money Market Funds and Bond Mutual Funds. Chair Gensler noted that, following the challenges of the spring of 2020, the SEC "can build greater resiliency in both money market funds and open-end bond funds." Accordingly, he has asked the SEC staff for recommendations to address resiliency during times of stress, based upon "feedback [the SEC] received on the President's Working Group report as well as other information."

Security-Based Swaps Disclosure. Chair Gensler observed that total return swaps were at the heart of the recent failure of Archegos Capital Management, a family office. He noted that (i) under Section 10B of the Exchange Act, Congress had provided the SEC with authority to mandate disclosure for positions in security-based swaps and related securities and (ii) he has asked the SEC staff to consider potential rulemaking under this authority such that the SEC can see positions in security-based swaps and related securities. He stated, "[a]s the collapse of Archegos showed, this may be an important reform to consider."

Crypto Assets Market. Chair Gensler has asked the SEC staff to look at ways to enhance investor protection "in crypto finance, issuance, trading, or lending," which he likened to "the Wild West or the old world of 'buyer beware' that existed before the securities laws were enacted." He has instructed the SEC staff, working with other regulators, to work along two tracks to address (i) how the SEC, with other financial regulators under current authorities, can best bring investor protection to these markets and (ii) how Congress can help fill regulatory gaps.

SEC Publishes Sample Comment Letter Highlighting the Need to Consider Climate Change Disclosures in SEC Filings

On September 22, 2021, the SEC's Division of Corporation Finance published a sample letter (the "Letter") for corporate issuers. While the Letter does not break new ground substantively, it underscores the SEC's increasing focus on climate

[2] Chair Gensler's testimony was virtually identical to his testimony to the Senate Committee on Banking, Housing, and Urban Affairs on September 14, 2021.

disclosures and its views more generally on the relevance to investors of climate-related risks. A separate Ropes & Gray Alert discusses the Letter and takeaways for public companies.

SEC Investor Bulletin on U.S.-Listed Companies Operating Chinese Businesses Through a VIE Structure

On September 20, 2021, the SEC's Office of Investor Education and Advocacy, along with the Office of the Chief Accountant and the Division of Corporation Finance, issued an Investor Bulletin to educate investors about risks associated with investing in certain U.S.-listed shell companies that provide exposure to China-based companies through a structure known as a variable interest entity (a "VIE").

- In many cases, a U.S.-listed issuer does not have operations in China. Instead, the U.S.-listed issuer is a holding company formed outside of both the U.S. and China that may not own stock or other equity in the China-based company. While the U.S.-listed company does not own any equity in the China-based company, the U.S.-listed company purports to exercise power over and obtain economic rights from the China-based company based on contractual arrangements. The China-based company is structured as what is known under U.S. GAAP as a VIE, and the operations and financial position of the China-based VIE are included in consolidated financial statements prepared by the U.S.-listed company.

- The Investor Bulletin reminds potential investors that, if (i) a China-based VIE breaches its contractual arrangements with the U.S.-listed shell company, (ii) Chinese law changes in a way that affects the enforceability of these arrangements or (iii) the contractual arrangements are otherwise not enforceable under Chinese law, investors may suffer significant losses with little or no recourse available.

We are aware of SEC staff giving comments on registration statements asking for risk disclosures arising from a VIE structure. For a U.S.-listed company that seeks to provide exposure to a China-based company employing a VIE structure, the SEC will require disclosures in the U.S.-listed company's registration statement and periodic reports to cover the risks arising from the VIE structure.

ROPES & GRAY ALERTS AND PODCASTS SINCE OUR JUNE–JULY UPDATE

SEC Publishes Sample Comment Letter Highlighting the Need to Consider Climate Change Disclosures in SEC Filings
October 4, 2021
In late September, the staff of the SEC's Division of Corporation Finance published a sample comment letter relating to climate change disclosures. While the sample letter does not break new ground substantively, it underscores the SEC's increasing focus on climate disclosures and its views more generally on the relevance to investors of climate-related risks. This Alert discusses the sample comment letter and take-aways for public companies.

Podcast: Recent ERISA Litigation Trends and Outcomes
September 22, 2021
In this seventh episode in a series of Ropes & Gray podcasts addressing emerging issues for fiduciaries of 401(k) and 403(b) plans to consider as part of their litigation risk management strategy, litigation and enforcement partner Dan Ward, ERISA and benefits partner Josh Lichtenstein, and benefits consultant Jack Eckart discussed some recent updates on the continued ERISA retirement plan litigation landscape, including current trends and important takeaways for plan sponsors.

NFA Amends Branch Office Definition to Accommodate Remote Work by APs
September 17, 2021
The National Futures Association ("NFA") recently amended Interpretive Notice 9002 – Registration Requirements;

Branch Offices (the "Interpretive Notice") to allow certain NFA members, including registered commodity pool operators and commodity trading advisors, to implement remote and hybrid work arrangements for their associated persons ("APs") without listing APs' remote work locations, whether homes or shared co-working spaces, as branch offices. The revised Interpretive Notice went into effect as of September 23, 2021.

Digital Assets, the Regulatory Void and Director Oversight
September 13, 2021
In an article published by *The Review of Securities & Commodities Regulation*, asset management partner and Chicago Office Managing Partner Paulita Pike and Senior Attorney David Geffen provide an overview of fund directors' oversight of investments in cryptocurrencies and other digital assets.

The Cross-Border Marketing Rules and Alternative Investment Funds
August 5, 2021
New rules have come into effect, but lack of certainty continues for non-EU managers.

Directive (EU) 2019/1160 and Regulation (EU) 2019/1156 (the "Cross-Border Marketing Rules") came into force in the European Union on 2 August 2021. These introduce new restrictions on what pre-marketing activities can be undertaken in the EU as well as a new notification obligation. The Cross-Border Marketing Rules were introduced to streamline certain aspects of marketing investment funds under the regime for alternative investment fund managers ("AIFMs"). Divergent approaches and interpretations by Member States to certain aspects of the AIFMs regime have led to uncertainty for managers marketing their funds in the EU. While the Cross-Border Marketing Rules are a step in the right direction to provide some consistency, much uncertainty remains. This is more so for non-EU managers, who are arguably not directly caught by the new requirements except at the discretion of the national regulators.

Podcast: Fundraising Update: Secondaries Funds
August 4, 2021
In this Ropes & Gray podcast, asset management partners Lindsey Goldstein and Isabel Dische provided a snapshot of recent developments in the fundraising market for secondaries funds, and discussed how some trends with deal activity in the secondaries market may influence fundraising in this sector over the months ahead.

If you would like to learn more about the developments discussed in this Update, please contact the Ropes & Gray attorney with whom you regularly work or any member of the Ropes & Gray Asset Management group listed below.

United States

Nathan Briggs
Washington DC
+1 202 626 3909
nathan.briggs@ropesgray.com

Jason E. Brown
Boston, MA
+1 617 951 7942
jebrown@ropesgray.com

Jim Brown
New York, NY
+1 212 596 9696
james.brown@ropesgray.com

Bryan Chegwidden
New York, NY
+1 212 497 3636
bryan.chegwidden@ropesgray.com

Sarah Clinton
Boston, MA
+1 617 951 7375
sarah.clinton@ropesgray.com

Gregory C. Davis
San Francisco, CA
+1 415 315 6327
gregory.davis@ropesgray.com

Timothy W. Diggins
Boston, MA
+1 617 951 7389
timothy.diggins@ropesgray.com

Michael G. Doherty
New York, NY
+1 212 497 3612
michael.doherty@ropesgray.com

Leigh R. Fraser
Boston, MA
+1 617 951 7485
leigh.fraser@ropesgray.com

Pamela Glazier
Boston, MA
+1 617 951 7420
pamela.glazier@ropesgray.com

Thomas R. Hiller
Boston, MA
+1 617 951 7439
thomas.hiller@ropesgray.com

Josh Lichtenstein
New York, NY
+1 212 841 5788
joshua.lichtenstein@ropesgray.com

John M. Loder
Boston, MA
+1 617 951 7405
john.loder@ropesgray.com

Brian D. McCabe
Boston, MA
+1 617 951 7801
brian.mccabe@ropesgray.com

Paulita A. Pike
Chicago, IL
+1 312 845 1212
paulita.pike@ropesgray.com

George B. Raine
Boston, MA
+1 617 951 7556
george.raine@ropesgray.com

Elizabeth J. Reza
Boston, MA
+1 617 951 7919
elizabeth.reza@ropesgray.com

Amy Roy
Boston, MA
+1 617 951 7445
amy.roy@ropesgray.com

Adam Schlichtmann
Boston, MA
+1 617 951 7114
adam.schlichtmann@ropesgray.com

Robert A. Skinner
Boston, MA
+1 617 951 7560
robert.skinner@ropesgray.com

Jeremy C. Smith
New York, NY
+1 212 596 9858
jeremy.smith@ropesgray.com

David C. Sullivan
Boston, MA
+1 617 951 7362
david.sullivan@ropesgray.com

James E. Thomas
Boston, MA
+1 617 951 7367
james.thomas@ropesgray.com

Joel A. Wattenbarger
New York, NY
+1 212 841 0678
joel.wattenbarger@ropesgray.com

London

Thomas Alabaster
London
+44 20 3847 9062
tom.alabaster@ropesgray.com

Emily Brown
London
+44 20 3201 1589
emily.brown@ropesgray.com

Eve Ellis
London
+44 20 3201 1530
eve.ellis@ropesgray.com

Anna Lawry
London
+44 20 3201 1590
anna.lawry@ropesgray.com

Asia

Vince Ip
Hong Kong
+852 3664 6560
vincent.ip@ropesgray.com