December 13, 2021

Ropes & Gray's Investment Management Update October – November 2021

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

SEC Reports Results of Fund Exams of Practices That May Impact Retail Investors

On October 26, 2021, the SEC's Division of Examinations (the "Division") published a Risk Alert (the "Fund Alert") reporting the results of a series of examinations that focused on mutual funds and exchange-traded funds and assessed industry practices and matters of regulatory compliance that may impact retail investors. The text below summarizes (i) various deficiencies and weaknesses that the Division staff observed most frequently in its examinations and (ii) various noteworthy or commendable practices that the Division staff observed during its examinations.

A. Staff Observations – Deficiencies and Weaknesses

Compliance Program

The staff observed funds and advisers that did not establish and maintain appropriately tailored compliance programs, including inadequate policies and procedures covering the following areas:

Compliance Oversight of Investments and Portfolios

- Monitoring for (i) portfolio management compliance, including monitoring compliance requirements regarding trade allocation and best execution, (ii) adherence to each fund's specific investment restrictions, (iii) risks specifically associated with each fund's asset classes and (iv) compliance with the "Fund Names Rule," when applicable.

- Administration of each fund's liquidity risk management program ("LRMP"), including appropriate oversight of third-party vendors that provide liquidity classifications for purposes of the LRMP.

Compliance Oversight of Valuation

- Maintaining an appropriate compliance program for the valuation of funds' portfolio securities, including oversight of pricing vendors that provide evaluated prices.

- Maintaining policies and procedures for the valuation of portfolio securities, including elements that address potential conflicts (*e.g.*, portfolio managers who are permitted, as voting members of the valuation committee, to provide input on prices of securities in funds they manage).

Compliance Oversight of Trading Practices

- Addressing trade allocation among client accounts so that all clients are treated fairly, and the payment of soft dollar commissions among clients to determine whether any client is disadvantaged.

- Preventing prohibited principal transactions and/or joint transactions with affiliated persons, and identifying cross trades and preventing violations of the legal requirements for cross trades.

Compliance Oversight of Conflicts of Interest

- Addressing advisers' conflicts of interest with funds and their service providers (*e.g.*, where an adviser to an index fund also is the fund's index provider).
- Reviewing index providers for (i) conflicts of interest with advisers, such as when they share personnel, are affiliated, and/or have business arrangements (*e.g.*, marketing support payments by index providers to advisers and/or revenue-sharing payments by advisers to index providers) and (ii) the sharing, or the potential misuse, of material non-public information.

Compliance Oversight of Fees and Expenses

- Monitoring allocations of expenses between funds and their advisers.
- Reviewing fee calculations for any inconsistencies between a fund's contractual expense limitation and its disclosures regarding expenses included in operating expenses.

Oversight of Compliance Program

The Division staff also observed issues with funds' policies and procedures for their boards' oversight of the funds' compliance programs. For example, the staff observed funds that did not:

- Have appropriate policies and procedures for monitoring and reporting to their boards with accurate information, such as information regarding (i) fees paid by the funds to financial intermediaries and other service providers for providing shareholder services, (ii) the type of services provided by service providers, (iii) pricing exceptions under the funds' valuation policies and procedures, (iv) adviser's recommendation whether a fund's liquidation may be in the best interest of the fund and its shareholders, and (v) portfolio compliance with senior securities and asset coverage requirements.
- Include appropriate processes as part of the fund board's annual management agreement review to determine whether the adviser has any financial condition that is reasonably likely to impair its ability to meet its contractual commitments to clients.
- Complete required annual reviews of the funds' compliance programs that address the adequacy of policies and procedures and the effectiveness of their implementation.
- Ensure that the annual report from the fund's CCO addressed the operation of the policies and procedures of the fund's adviser.
- Adopt or maintain policies and procedures for the funds' boards to exercise appropriate oversight where the funds' delegated responsibilities to their advisers were not reflected in the advisers' compliance programs.

Disclosure to Investors

The Fund Alert provided the following examples of deficiencies or weaknesses observed by the Division staff concerning fund disclosures to investors in fund filings, advertisements, sales literature and/or other shareholder communications.

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- Omitted disclosures regarding (i) principal investment strategies and/or risks of investing in the funds, (ii) potential conflicts associated with allocating investment opportunities among overlapping investment strategies and (iii) change in the broad-based indexes used for comparison of funds' performance.

- Inconsistent and/or inaccurate disclosure concerning the funds' net assets and net expense ratios, contractual expense limitations and/or operating expenses subject to the contractual expense limitation.

- Omitted disclosure required in the funds' SAIs concerning standing committees of a fund's board and accurate information regarding the number of accounts and total assets managed by portfolio managers.

B. Staff Observations – Noteworthy Compliance and Disclosure Practices

Compliance Programs

Certain funds and their advisers adopted and implemented compliance programs that provided for the following:

- Review of compliance policies and procedures for consistency with practices.

- Periodic testing and reviews for compliance with disclosures and assessing the effectiveness of compliance policies and procedures in addressing conflicts of interest.

- Ensuring compliance programs adequately address the oversight of key vendors, such as pricing vendors (*e.g.*, written pricing vendor oversight procedures that include reviewing variance reports on stale or outlier prices and price challenges).

- Adopting and implementing policies and procedures to address (i) compliance with applicable regulations (*e.g.*, cross trades), (ii) compliance with the terms and conditions of exemptive orders and (iii) undisclosed conflicts of interest, including potential conflicts between funds and/or advisers and their affiliated service providers.

Oversight of Compliance Program

Some funds' boards provided oversight of funds' compliance programs by assessing whether:

- The information provided to the board was accurate, including whether funds and their advisers were accurately disclosing to the boards (i) funds' fees, expenses and performance and (ii) funds' investment strategies, any changes to the strategies and the risks associated with the respective strategies.

- Funds were adhering to their processes for board reporting, including an annual review of the adequacy of the funds' compliance programs and effectiveness of their implementation.

Disclosure to Investors

Some funds adopted and implemented policies and procedures concerning disclosure, such as those that require:

- Review and amendment of disclosures in funds' prospectuses, SAIs, shareholder reports or other investor communications consistent with the funds' investments and investment policies and restrictions.

- Amendment of disclosures for consistency with actions taken by the funds' boards.

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- Update of funds' website disclosures concurrently with new or amended disclosures in funds' prospectuses, SAIs, shareholder reports or other client communications.

- Review and testing of fees and expenses disclosed in funds' prospectuses, SAIs, shareholder reports or other client communications for accuracy and completeness of presentation.

- Review and testing of funds' performance advertising for accuracy and appropriateness of presentation and inclusion of necessary disclosures.

Plaintiff Asserts Securities Act Claims Against Mutual Fund for Alleged Non-Disclosure of Closet Indexing Strategy

On November 5, 2021, an alleged purchaser (the "plaintiff") of shares of the American Century Value Fund (the "Fund") initiated a securities class action against the Fund and its directors, adviser and distributor in the U.S. District Court for the Northern District of California. The complaint asserted that the Fund's registration statements contained untrue statements of material fact and omitted to state other material facts in violation of the Securities Act.

- In particular, the plaintiff asserted that that the Fund's registration statements disclosed the Fund's adviser would employ an active value investment strategy by looking for stocks of companies that it believed were undervalued at the time of purchase.

- The plaintiff claimed that the registration statements were misleading because the Fund's true, undisclosed strategy was, like an index fund's, to buy and sell stocks so that the Fund's performance merely closely tracked the performance of its benchmark, the Russell 1000 Value Index. According to the plaintiff, the Fund misrepresented that it employed an active value investment strategy that would seek to outperform the Fund's benchmark index because, in fact, the Fund employed an undisclosed "closet indexing" strategy to match that index.

In support of these claims, the plaintiff asserted that the Fund's performance throughout the relevant period "barely strayed from the movement of its benchmark" and that, statistically, the variance of the price of the shares of the Fund was explained by the variance of its benchmark index.

In addition, the plaintiff asserted, during the relevant period (i) the adviser's management fees were excessive because the adviser did not engage in active management and (ii) the Fund's trading activity was significantly greater than the trading activity of passive index funds that tracked the same benchmark as the Fund, resulting in the Fund incurring "excessive" trading costs. Despite its fee-related allegations, however, the complaint did not include any claims under Section 36(b) of the 1940 Act – limiting itself only to Securities Act disclosure-based claims.

SEC Sues Corporate Insider Using Novel Application of Rule 10b-5

On August 17, 2021, in the U.S. District Court for the Northern District of California, the SEC initiated a civil lawsuit against a former executive (the "defendant") of Medivation Inc. ("Medivation"), asserting that the defendant had engaged in insider trading transactions in violation of Exchange Act Section 10(b) and Rule 10b-5 thereunder while employed by Medivation.

Notably, according to the SEC, the securities transactions in question did not involve securities issued by Medivation but, instead, were issued by Incyte Corporation ("Incyte"), a peer company to Medivation in the biopharmaceutical industry. The complaint further alleges:

- Medivation was a mid-cap, oncology-focused biopharmaceutical company until it was acquired by Pfizer Inc. ("Pfizer") on September 28, 2016. At the time of the acquisition, the defendant was an employee of Medivation with the title of Senior Director of Business Development.
- At the outset of his employment with Medivation, the defendant signed Medivation's insider trading policy, which prohibited employees from personally profiting from material nonpublic information concerning Medivation by trading in Medivation securities or in the securities of another publicly traded company, including competitors of Medivation.
- During 2015-2016, in the course of his work with the investment banks advising Medivation about its strategic options, the defendant reviewed presentations authored by investment bankers in which the investment banks identified companies that were comparable to Medivation. In particular, the bankers drew close parallels between Medivation and Incyte, including that both were valuable, mid-cap, oncology-focused publicly traded companies with a profitable FDA-approved (commercial stage) drug on the U.S. market.
- In 2016, just prior to the Pfizer acquisition of Medivation, the defendant knew that (i) large-cap pharmaceutical companies were interested in acquiring oncology-focused mid-cap biopharmaceutical companies with commercial-stage drugs, (ii) there were only a few such companies – including Medivation and Incyte – left to acquire and (iii) each such acquisition was material to the remaining companies because it made them potentially more valuable acquisition targets and could thus positively affect the stock price of those companies.
- In August 2016, the defendant learned confidential information through his employment that Medivation would be imminently acquired by Pfizer at a significant premium to the company's stock price. Within minutes of receiving this highly confidential news from Medivation's CEO, the defendant is alleged to have misappropriated Medivation's confidential information by purchasing, from his work computer, out-of-the-money, short-term stock options in Incyte.
- Over the course of the trading day on which Medivation announced its acquisition by Pfizer, the price of Medivation shares rose by approximately 20%. That same day, the stock price of Incyte rose materially by approximately 8% on the news of Medivation's acquisition, and the value of the defendant's stock options roughly doubled. By trading ahead of the announcement, the defendant obtained profits of $107,066.

The SEC's suit is an attempt to extend the misappropriation theory of insider trading to a set of facts where the material non-public information ("MNPI") did not concern an issuer that was a party to an undisclosed transaction. This type of trading has been termed "shadow trading."

Shadow trading transactions, like those in which the defendant engaged, present incremental difficulty to compliance personnel in detecting misuse of MNPI because of the difficulty of determining whether MNPI that an employee obtains about one issuer results in MNPI about other issuers. Sometimes, the connection may be obvious – *e.g.*, MNPI about a large defense contractor winning a major Department of Defense contract is likely to affect the contractor's major subcontractors. The connections in other fact patterns may be more difficult to detect.

SEC Opens Door for More ESG Proposals by Shareholders

On November 3, 2021, the staff of the SEC Division of Corporate Finance ("CorpFin") published new guidance in Staff Legal Bulletin 14L ("SLB 14L") for companies and shareholders regarding shareholder proxy statement proposals made pursuant to Rule 14a-8 under the Exchange Act. Among other things, SLB 14L rescinds prior Staff Legal Bulletin Nos. 14I, 14J and 14K (the "rescinded SLBs") and outlines CorpFin's views on both Rule 14a-8(i)(7) (the "ordinary business exception") and Rule 14a-8(i)(5) (the "economic relevance exception"). Either exception may serve as the basis for a company to exclude from its proxy statement a shareholder proposal made pursuant to Rule 14a-8.

As described below, SLB 14L is likely to narrow the bases upon which management may exclude a shareholder proposal from proxy statements, and may, in particular, narrow the application of the exceptions with respect to proposals concerning environmental, social, or governance ("ESG") issues.

Ordinary Business Exception – Rule 14a-8(i)(7)

The ordinary business exception permits a company to exclude a shareholder proposal that "deals with a matter relating to the company's ordinary business operations." The purpose of the exception is "to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting."[1] The SEC has stated that the policy underlying the ordinary business exception rests on two premises: the proposal's subject matter and the degree to which a proposal "micromanages" the company. SLB 14L addresses both premises.

Significant Social Policy Exception. SLB 14L states that CorpFin will "realign its approach" for determining whether a proposal relates to ordinary business with the standard the SEC initially articulated in 1976 and reaffirmed in 1998.[2] That standard provided an exception to the ordinary business exception for certain proposals that raise significant social policy issues. SLB 14L states that CorpFin "will no longer focus on determining the nexus between a policy issue and the company." Instead, CorpFin will "focus on the social policy significance of the issue that is the subject of the shareholder proposal." In making this determination, CorpFin will "consider whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company."

As an example, SLB 14L states that shareholder proposals "squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company."

Micromanagement Exception. SLB 14L also states that CorpFin has determined that its recent application of the micromanagement concept, as outlined in rescinded SLB Nos. 14J and 14K, expanded the concept of micromanagement beyond the SEC's policy directives. The SEC has stated that a proposal "micromanages" the company "by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." SLN 14L states that the rescinded SLBs "may have been taken to mean that any limit on company or board discretion constitutes micromanagement" and, therefore, served as a basis for a company to rely on the ordinary business exception.

Prospectively, SLB 14L says, CorpFin will take a measured approach when evaluating companies' micromanagement arguments – "recognizing that proposals seeking detail or seeking to promote timeframes or methods do not per se constitute micromanagement." Instead, CorpFin will focus on the "level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management."

As an example, CorpFin highlighted its recent denial of no-action relief to an energy company[3] that sought to exclude a shareholder proposal regarding greenhouse gas emissions targets. The shareholder proposal requested that the company set emission reduction targets, and it did not impose a specific method for doing so. The CorpFin staff concluded this proposal did not micromanage to such a degree as to justify exclusion under Rule 14a-8(i)(7).

Economic Relevance Exception – Rule 14a-8(i)(5)

Another basis for a company to exclude a shareholder proposal from its proxy statement is the "economic relevance exception," which permits a company to exclude a proposal that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business."

SLB 14L states that CorpFin will return to its long-standing approach, prior to the issuance of SLB 14I, of analyzing the economic relevance exception consistent with a federal district court's 1985 opinion.[4] Accordingly, SLB 14L states that

proposals "that raise issues of broad social or ethical concern related to the company's business may not be excluded, even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5)."

Other Matters

SLB 14L also provides guidance on the use of email for shareholder proposal submissions and responses thereto. Separately, SLB 14L also restates guidance in rescinded SLBs 14I and 14K regarding the use of graphics and images in shareholder proposals and proof of ownership letters with minor technical amendments.

Observations

SLB 14L curtails the latitude given to management to exclude a shareholder proposal under Rule 14a-8 from a company's proxy statement. Consequently, beginning in the 2022 proxy season, we expect that more proxy statements will contain shareholder proposals, especially proposals concerning ESG issues.

SEC Proposes to Reverse its 2020 Amendments to the Proxy Rules Governing Proxy Voting Advice

Background. As described in this Ropes & Gray Alert, on July 22, 2020, the SEC adopted amendments to its rules governing proxy solicitations and the filing exemptions for proxy voting advice (the "2020 Amendments"). With Democratic Commissioner Lee dissenting, then-Chairman Clayton and the two Republican commissioners closed the initial chapter in a more than decade-long attempt to rein in the influence of "proxy voting advice businesses" ("Proxy Advisers"). The 2020 Amendments conditioned the exemptions for reports issued by Proxy Advisers from the filing and information requirements of the federal proxy rules on compliance with disclosure and procedural requirements. In addition, the 2020 Amendments codified in Rule 14a-1(l)'s definition of "solicitation" the SEC's longstanding view that Proxy Advisers' reports are solicitations subject to the anti-fraud provisions of the federal proxy rules.

What Remains and the Proposed Changes. On November 17, 2021, Chair Gensler, joined by the two Democratic SEC commissioners, voted to propose changes to the 2020 Amendments and issued a release (the "Proxy Proposals") containing rule amendments that, if adopted, would eliminate some of the 2020 Amendments' requirements, while leaving others unchanged.

- The Proxy Proposals would leave unaffected the Rule 14a-1(l) codification, within the definition of "solicitation," that Proxy Advisers' reports are solicitations subject to the anti-fraud provisions of the federal proxy rules.

- The Proxy Proposals would not affect the 2020 Amendments' enhanced conflicts of interest disclosure requirements regarding any interest, transaction, or relationship of the Proxy Adviser (or its affiliates) that is material to assessing the objectivity of the proxy voting advice, or the requirements regarding adoption and public disclosure of written policies and procedures used to identify and steps taken to address, any such material conflicts of interest.

- The Proxy Proposals would **eliminate** the 2020 Amendments' requirement that a Proxy Adviser adopt and publicly disclose written policies and procedures reasonably designed to ensure that (i) registrants 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 Proxy Adviser's clients and (ii) the Proxy Adviser provides its clients with a mechanism by which they can be expected to become aware of any written statements regarding its proxy voting advice by registrants that are the subject of such advice, in a timely manner before the security holder meeting.

- The Proxy Proposals would **eliminate** the 2020 Amendments' Note (e) to Rule 14a-9, the general antifraud rule applicable to proxy statements. The Note sets forth examples of what may, depending on the particular facts and circumstances, be misleading within the meaning of Rule 14a-9 with respect to proxy voting advice. According to the Proxy Proposals, the Note was merely intended to clarify the potential implications of Rule 14a-9 for

proxy voting advice and, more generally, proxy solicitations under existing law. However, the Note appears to have unintentionally created a misperception that the addition of Note (e) to Rule 14a-9 "purported to determine or alter the law governing Rule 14a-9's application and scope, including its application to statements of opinion."

Comment Deadline. Comments on the Proxy Proposals must be received by the SEC no later than December 27, 2021.

SEC Adopts Universal Proxy Card; Registered Investment Companies and BDCs Excluded

At the November 17, 2021 meeting described above, the SEC issued a release containing amendments of the federal proxy rules to require the use of a universal proxy card in all non-exempt solicitations involving contested director elections. The amendments will ***not*** affect director/trustee elections involving registered investment companies and business development companies.

The universal proxy card will be required to include the names of both registrant and dissident nominees, and it is intended to enhance the ability of shareholders to elect directors through the proxy process "in a manner consistent with their ability to vote in person at a shareholder meeting." The new rules become effective for any shareholder meeting featuring an election contest held after August 31, 2022.

SEC Proposes Rule to Enhance the Transparency of Securities Lending Market – May Impact Large Non-Agency Lenders

On November 18, 2021, the SEC issued a release (the "Release") containing proposed Rule 10c-1 (the "Rule") under the Exchange Act. If adopted, the Rule would require lenders of securities to report the material terms of their securities lending transactions in detail, as well as information regarding the securities the lender has on loan and available to loan, to a registered national securities association (an "RNSA"). Currently, FINRA is the only RNSA. The Rule is intended to supplement the publicly available information involving securities lending and to minimize information asymmetries between market participants. The SEC believes that the Rule would "increase market efficiency, and lead to increased competition among providers of securities lending analytics services and to reduced administrative costs for broker-dealers and lending programs."

Rule Requirements

- For each securities loan, the Rule would require any "Lender"[5] to provide to an RNSA the detailed, material terms of the transaction (the "10c-1 Information")[6] – in the format and manner required by RNSA – within the fifteen minutes after the securities loan is effected or the terms of the loan are modified. The Rule would require that each RNSA make publicly available certain information about each transaction.

- The Rule also would require each Lender to provide information about its securities available to loan and securities on loan be provided to an RNSA (also, "10c-1 Information"). For each security about which the RNSA receives this information, the Rule would require the RNSA to make publicly available aggregate information for each security not later than the next business day.

Reporting Persons

The Rule would require any bank, clearing agency or broker-dealer that acts as an intermediary in a securities loan transaction (a "lending agent") on behalf of the beneficial owner of the loaned securities to (i) provide the 10c-1 Information to an RNSA on behalf of the beneficial owner in a timely manner or (ii) enter into a written agreement with a broker-dealer (a "reporting agent") to provide the 10c-1 Information to an RNSA on behalf of the beneficial owner in a timely manner. Thus, a beneficial owner itself would ***not*** be required to provide the 10c-1 Information to an RNSA for any loan of securities intermediated by a lending agent.

- However, the Release notes that, if a beneficial owner does not employ a lending agent or enter into a written agreement with a reporting agent, the beneficial owner would be responsible for complying with the Rule's requirements to provide the 10c-1 Information to an RNSA. The Release states that "only large beneficial owners run their own lending programs without the assistance of a lending agent" and if a "beneficial owner is not using a lending agent, the [SEC] believes that it would likely enter into a written agreement with a reporting agent."

- Based on the number of investment companies that do not employ a lending agent, which is based upon an SEC review of Form N-CEN reports filed, the SEC estimates that there would be 278 Lenders that would not employ a lending agent. Of these 278 Lenders, the SEC estimates that one half, or 139 Lenders, will provide information to a reporting agent, and the remaining 139 Lenders would not rely on a reporting agent to provide the 10c-1 Information to an RNSA ("self-providing Lenders"). The SEC's estimates do not indicate the number of investment company complexes in its estimates or whether it anticipates that there are other types of institutional investors that do not employ a lending agent.

- Investment advisers and institutional investors that anticipate being a self-providing Lender under the Rule may want to examine and comment upon the SEC-estimated costs of capturing and providing 10c-1 Information to an RNSA. Similarly, Lenders not using a lending agent that anticipate entering into a written agreement with a reporting agent may wish to examine and comment on the SEC-estimated costs of capturing and providing 10c-1 Information to a reporting agent.

Comment Deadline

The Release states that comments should be submitted to the SEC no later than January 7, 2022.

Electronic Submission of Applications for Orders under the Advisers Act and the 1940 Act, Confidential Treatment Requests for Filings on Form 13F and Form ADV-NR; Amendments to Form 13F

On November 4, 2021, the SEC issued a release containing proposed rule amendments (the "Proposals") that, if adopted, would require the filing of certain applications, confidential treatment requests and forms to be filed electronically through the EDGAR system. The principal changes that would be effected by the Proposals are summarized below.

Advisers Act Applications for Orders. Currently, an applicant seeking 1940 Act relief submits its application electronically to the SEC via EDGAR, while an applicant seeking Advisers Act relief submits its application, as well as a proposed notice of application, in paper form. The Proposals would require filing on EDGAR of applications for an order under any section of the Advisers Act. Thus, the Proposals would harmonize the requirements for submitting applications for orders under the Advisers Act with the requirements applicable to 1940 Act applications. These changes would allow for applications under both the 1940 Act and the Advisers Act to be made in a single filing. The Proposals also would eliminate the requirements applicable to Advisers Act applications (i) to have verifications of applications and statements of facts notarized and (ii) that applicants include proposed notices as exhibits to applications.

Confidential Treatment Requests. The Proposals would require electronic filing of confidential treatment requests for filings made under Section 13(f) of the Exchange Act (each, a "CTR") through the EDGAR system as a separate, non-public filing. This would replace existing practice whereunder CTRs are submitted to the SEC in paper, typically through the mail or by express delivery. The Proposals state that the SEC staff would work to design controls and systems for the handling of CTRs and associated confidential data.

Form 13F Changes. The Proposals re-propose certain amendments to Form 13F that the SEC proposed in July 2020. Specifically, the Proposals would (i) require each Form 13F filer (each, a "Manager") to include its CRD number and SEC file number, if any, (ii) modify an instruction within Form 13F's Confidential Treatment Instructions requiring the Manager to demonstrate that the information is customarily and actually kept private by the Manager, and that failure to

grant the CTR would be likely to harm the Manager[7] and (iii) modify the Form 13F summary page to add a requirement for a Manager seeking confidential treatment to indicate that fact on the summary page. The SEC is not re-proposing the amendments to raise the reporting thresholds for Form 13F that it proposed in July 2020.[8]

Form ADV-NR. The Proposals would require the electronic submission of Form ADV-NR by non-resident general partners and non-resident managing agents of investment advisers (domestic or non-resident). Form ADV-NR is filed with or in connection with an adviser's initial Form ADV submission and requires a non-resident general partner or managing agent of an investment adviser to appoint an agent for service of process in the U.S. Currently, Form ADV-NR must be filed as a paper filing submission. The Proposals would require these Form ADV-NR filings to be made through the IARD system.

Comment Deadline. Comments on the Proposals must be received by the SEC no later than December 20, 2021.

Regulatory Priorities Corner

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

SEC Issues Risk Alert Regarding Advisers that Provide Electronic Investment Advice

On November 9, 2021, the SEC Division of Examinations (the "DE") published a Risk Alert (the "Risk Alert") to raise awareness of compliance issues the DE staff observed while conducting examinations of advisers "providing, or claiming to provide, robo-advisory services, including advisers that operate, recommend, or sponsor discretionary investment advisory programs."

The DE staff examined advisers that provide their investment advisory services online, by mobile applications or both ("robo-advisers") that (i) provided robo-advisory services to employer-sponsored retirement plans ("retirement plans") and/or retail investors, including retirement plan participants; (ii) sold or licensed or otherwise granted interactive, digital platform access to third parties, such as advisers, broker-dealers and banks and/or (iii) provided advisory or sub-advisory services to an interactive, digital investment platform. The DE staff also examined robo-advisers that were relying on Advisers Act Rule 203A-2(e) (the "Internet adviser exemption") and 1940 Act Rule 3a-4 (the safe harbor from the definition of "investment company").

The Risk Alert states that nearly all of the examined advisers received a deficiency letter, with observations most often noted in the areas of (i) compliance programs, including policies, procedures, and testing, (ii) portfolio management, including, but not limited to, an adviser's fiduciary obligation to provide advice that is in each client's best interest and (iii) marketing/performance advertising, including misleading statements and missing or inadequate disclosure. The Risk Alert also details DE staff observations regarding commendable compliance practices by robo-advisers and ways to improve compliance.

- ***Tailored policies and procedures.*** The Risk Alert suggests that advisers can improve compliance by adopting, implementing and following written policies and procedures that are tailored to the adviser's practices. In particular, the Risk Alert stated that advisers with compliance programs that appeared to be adequate and effective were not cited for deficiencies related to (i) portfolio management (*e.g.*, best interest advice, best execution and practices being inconsistent with disclosures), (ii) custody and (iii) required books and records. Moreover, the Risk Alert states that such advisers also "rarely had deficiencies related to marketing, performance advertising, or billing practices."

- ***Testing algorithms periodically to ensure that they are operating as expected.*** The Risk Alert states that, where algorithm-related testing was performed at least quarterly, the DE staff observed the following practices.

  - Testing was performed by the advisers' algorithm developers, but rarely in isolation. Most testing included one or more other groups in their testing process, such as portfolio management, compliance, internal audit and information technology ("IT") staff.
  - Where compliance was included in the testing process, compliance staff performed independent testing and also relied on work performed by others.
  - Use of exception reports or other reporting mechanisms. Reports often were reviewed by algorithm developers and compliance staff, but many robo-adviser firms also had portfolio management staff and/or IT staff review them.

- ***Safeguarding algorithms.*** The Risk Alert states that most advisers employed safeguards to prevent unauthorized algorithm changes. Robo-advisers using white-label platforms generally could not modify the platform's underlying code and instead relied on platform providers to notify the advisers of changes.

According to the Risk Alert, almost one-half of the advisers claiming reliance on the Internet adviser exemption were ineligible to rely on the exemption. With respect to advisers claiming to rely on Rule 3a-4 for programs they sponsored or operated, frequently, the advisers or programs did not comply with all of the provisions of the Rule 3a-4 safe harbor. Therefore, the Risk Alert also recommends that advisers (i) relying on the Internet adviser exemption should review their registration eligibility and (ii) advisers that recommend discretionary investment advisory programs relying on Rule 3a-4 should "assess whether clients are being provided with individualized advice and whether sufficient policies, procedures, and practices are being employed to prevent such programs from being deemed unregistered investment companies and securities."

SEC Issues Follow-Up Risk Alert on Advisers' Fee Calculations

As described in this Ropes & Gray IM Update, in 2018, the DE (then known as the "Office of Compliance Inspections and Examinations") issued a Risk Alert (the "2018 Alert") outlining the most common advisory fee billing violations mentioned in deficiency letters sent to SEC-registered investment advisers over the prior two years.

On November 10, 2021, the DE published a follow up Risk Alert (the "Fee Alert") to supplement the 2018 Alert by providing greater detail regarding compliance issues observed more recently, including additional details regarding the DE staff's observations concerning fee-related deficiencies and fee-related compliance and disclosure issues.

The Fee Alert details the following DE staff observations regarding commendable compliance practices as examples of policies and practices to assist advisers meet their fee-related requirements.

- ***Adopt and implement written policies and procedures addressing advisory fee billing processes and validating fee calculations.*** The Fee Alert reports that, in general, fewer errors were observed when the examined advisers had specific written policies and procedures addressing the supervision, calculation, review and billing of advisory fees.
- ***Centralize the fee billing process and validate that the fees charged to clients are consistent with compliance procedures, advisory contracts, and disclosures.*** The Fee Alert notes that the DE staff observed that advisers with centralized billing had fewer clients being billed incorrectly.
- ***Ensure resources and tools established for reviewing fee calculations are utilized.*** The Fee Alert states that checklists and other resources for reconciling client fee calculations with client advisory agreements can be useful if used in a consistent manner by all of a firm's personnel.

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- ***Proper records.*** The Fee Alert states that advisers should properly record all advisory expenses and fees assessed to and received from clients, including those paid directly to advisory personnel.

DOJ Civil Cyber-Fraud Initiative Could Impact Some Investment Advisers

This November 10, 2021 Ropes & Gray Alert describes the Civil Cyber-Fraud Initiative by the Department of Justice (the "DOJ") that targets companies that fail to meet government cybersecurity standards. Under the initiative, the DOJ's Civil Division's Commercial Litigation branch plans to utilize the False Claims Act to pursue government contractors and grant recipients for misrepresenting their cybersecurity practices or falling short of the government's cybersecurity standards. In particular, the new initiative will focus specifically on at least three areas of accountability: failing to comply with cybersecurity standards, misrepresentation of security controls and practices and failing to timely report suspected breaches.

While the DOJ's initiative is not targeted at any particular industry, investment advisers that contract with the federal government or any federal agency or entity could fall within the scope of the initiative. Therefore, the Alert should be of interest to investment advisers that are within the scope of the DOJ Civil Cyber-Fraud Initiative.

Withdrawal and Modification of Staff Letters Related to Rulemaking on Investment Adviser Marketing

On December 22, 2020, the SEC issued a release adopting amended Rule 206(4)-1 under the Advisers Act (the "Marketing Rule"), which replaced existing Rule 206(4)-1 (the "advertising rule"). At the same time, the SEC rescinded Rule 206(4)-3 (the "solicitation rule").

Consistent with the SEC discussion in the release, on December 29, 2021, the SEC Division of Investment Management published an Information Update announcing that it would be withdrawing certain SEC staff statements relating to (i) the advertising rule and the solicitation rule and (ii) both the advertising rule or the solicitation rule and other topics. Appendix A of the Information Update lists the specific statements, virtually all of which are no-action letters, that will be withdrawn or modified as of the Marketing Rule's November 4, 2022 compliance date.

Ropes & Gray Alerts and Podcasts Since Our August–September Update

Report: Hot Topics for Credit Fund Managers 2021
November 29, 2021
Ropes & Gray's credit funds team offers forward-thinking advice on all aspects of our credit manager clients' businesses, including fund formation, investments and compliance and regulatory issues. In this new report, we address issues relevant to credit managers and their legal and business professionals. The articles outline two capital-raising structures that have become increasingly popular—rated feeder funds for insurance company investors, and BDCs—as well as recent trends we have observed in subscription facilities, European restructuring matters and MNPI issues relating to bank loans.

Podcast: The DOL's About-Face on ESG for ERISA Plan Fiduciary Investment Decision-making
November 22, 2021
In the latest installment of our Ropes & Gray podcast series addressing emerging issues for fiduciaries of 401(k) and 403(b) plans to consider as part of their litigation risk management strategy, ERISA and benefits partner Josh Lichtenstein, benefits consulting group principal David Kirchner, and benefits consultant Aneisha Worrell revisited the Department of Labor's ("DOL") regulation of ERISA investment duties and ESG considerations, and in particular, its recently re-proposed rule. As compared to the prior rule passed by the Trump administration at the end of last year, which Messrs. Lichtenstein and Kirchner and Ms. Worrell discussed in the first episode of this series in February, the latest proposal signifies a major shift in the DOL's attitude towards ESG factors and, if finalized, would significantly alter the investment landscape for ERISA plan sponsors and fiduciaries.

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SEC Proposes Expanded Proxy Voting Reporting by Registered Funds and New Reporting of Executive Compensation Votes by Form 13F Filers

November 9, 2021

On September 29, 2021, the SEC issued a proposing release (the "Release") containing rule and form amendments that, if adopted, would:

- expand the proxy voting information that each registered fund is required to report on Form N-PX and
- require each Form 13F filer, ***for the first time***, to annually report on Form N-PX how it had voted proxies concerning certain shareholder advisory votes on executive compensation.

The Release is discussed in detail in this Alert.

ESG and Proxy Voting: The DOL's About-Face on Trump-Era Regulations

October 18, 2021

On October 13, 2021, the DOL proposed amendments (the "Proposal") to final rules released by the Trump administration on investment selection and ESG considerations for ERISA-covered retirement plans (including 401(k) plans) and the exercise of shareholder rights, including voting proxies. The Proposal should help resolve some of the confusion and chilling effects caused by the Trump administration's rule regarding integration of climate change and other ESG factors in investment decisions and responsible proxy voting by ERISA plan fiduciaries. The Proposal explicitly permits plan fiduciaries to consider climate change and other ESG factors that are material to a risk-return analysis in evaluating and selecting investments, and it addresses misconceptions about fiduciaries' responsibilities when it comes to conscientiously exercising shareholder rights to protect the interests of plan participants. As a result, the Proposal may dramatically increase the number of ERISA plans that invest in ESG-type funds or offer them to participants.

This Alert contains an overview of the changes the Proposal would make to the DOL's existing investment duties regulation. The Proposal provides for a 60-day comment period, which will end on December 13, 2021.

1. *See* Release No. 34-40018 (May 21, 1998).
2. *See* Release Nos. 34-12999 (Nov. 22, 1976), 34-40018 (May 21, 1998).
3. ConocoPhillips Company, SEC No-Action Letter pub. avail. (Mar. 19, 2021).
4. *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554 (D.D.C. 1985).
5. Lender, for purposes of the Rule, is any person that "loans a security on behalf of itself or another person, including persons that own the securities being loaned ('beneficial owners'), as well as third party intermediaries, including banks, clearing agencies, or broker-dealers that intermediate the loan of securities on behalf of beneficial owners."
6. For each securities loan, the 10c-1 Information includes, among other things: the name of the security issuer, the amount of the security loaned, the type of collateral used to secure the loan, the securities lending fee or rate, the percentage of collateral to value of loaned securities required to secure the loan, and the rebate rate or any other fee or charges (for a loan collateralized by cash).
7. The change to the instruction is intended to conform to a June 2019 U.S. Supreme Court decision that overturned the standard for determining whether information is "confidential" under Exemption 4 of the FOIA, 5 U.S.C. §552(b)(4), on which the current instruction is based. *See Food Marketing Institute v. Argus Leader Media*, 139 S.Ct. 2356 (2019).
8. Rule 13f-1 requires investment managers to file quarterly reports on Form 13F if the accounts over which they exercise investment discretion hold an aggregate of more than $100 million in Section 13(f) securities. As described in an earlier Ropes & Gray IM Update, in July 2020, the SEC proposed to amend Exchange Act Rule 13f-1 and Form 13F to increase the reporting threshold from $100 million to $3.5 billion.

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