December 13, 2022

Ropes & Gray's Investment Management Update October – November 2022

November Alerts on Regulatory Actions

Since our prior Investment Management Update, we have covered two SEC adopting releases and two SEC proposing releases affecting the mutual fund/investment management industry, each of which we discussed in a separate Alert. These four Alerts are summarized below with a hyperlink to the full text of each Alert.

SEC Adopts Streamlined Shareholder Reports for Mutual Funds and ETFs; Fee Information in Fund Advertisements

On October 26, 2022, the SEC unanimously adopted a release (the "Report Release") adopting rule and form amendments that require open-end funds to transmit "concise and visually engaging annual and semi-annual reports to shareholders" that highlight key information deemed "particularly important for retail investors to assess and monitor their fund investments." Other information, including financial statements, will no longer appear in funds' shareholder reports but, instead, must be available online, delivered free of charge upon request and filed on a semi-annual basis on Form N-CSR.

In particular, the Report Release amendments:

- Require that open-end fund shareholders receive new "streamlined" shareholder reports (the existing requirements regarding annual prospectus updates are unaffected);
- Prohibit open-end funds from relying on existing Rule 30e-3 to satisfy shareholder report transmission requirements by making these reports and other materials available online and providing a notice of that availability; and
- Require open-end funds to prepare and transmit shareholder reports that cover only a *single share class* of a *single fund* in which the shareholder is invested, even where the fund offers multiple share classes or where the fund is a series of a multi-series investment company.

Separately, the Report Release amends the advertising rules for all registered investment companies, including closed-end funds and business development companies, to require that a presentation of an investment company's fees and expenses in advertisements and sales literature must be "consistent with the relevant prospectus fee-table presentations and be reasonably current."

Our Alert summarizes the Report Release in detail, including notable departures from the related August 2020 proposing release.

Compliance Date. The compliance date of the changes effected by the Report Release date is July 24, 2024, except for technical amendments to Form N-1A (permitting disclosure (i) for fund officers and directors, of birth year and the year their service began and (ii) for portfolio managers, the year the portfolio manager's service began), for which the compliance date is January 24, 2023. Thus, any open-end fund shareholder report

transmitted to shareholders on or after July 24, 2024 will have to comply with the changes effected by the Report Release.

SEC Expands Proxy Voting Reporting by Registered Funds and Requires Reporting of Executive Compensation Votes by Form 13F Filers

On November 2, 2022, the SEC issued a release (the "Proxy Release") adopting rule and form amendments that:

- 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.

  Note: Like Form 13F, the filing requirement applies to "institutional investment managers," which generally encompasses any manager that exercises investment discretion with respect to accounts holding U.S. equity securities having an aggregate value of at least $100 million (each, a "Manager").

Registered Funds. The Proxy Release expands the proxy voting information that a fund is required to report by requiring each report on Form N-PX:

- For proxy votes where a proxy card is required to be filed with the SEC, to employ the same language employed in an issuer's form of proxy to identify proxy voting matters, presented in the same order employed in an issuer's form of proxy;
- To categorize the subject matter of each of the reported proxy voting matters using a specified list of categories; and
- For securities that have been loaned, to disclose the number of shares that were loaned and not recalled to vote.

Each registered fund must also disclose that its proxy voting record is publicly available on (or through) its website and available upon request, free of charge.

Managers. The Proxy Release requires each Manager to annually report on Form N-PX how it voted proxies concerning certain shareholder advisory votes on executive compensation.

- A Manager's Form N-PX must satisfy all of the requirements of a registered fund's Form N-PX summarized above (even if the shares are not owned by a registered fund), including disclosing the number of shares that were loaned and not recalled to vote, but only with respect to votes on executive compensation; and
- Unlike registered funds, a Manager is not required to disclose on its website that its proxy voting record is publicly available.

Compliance Date. The effective date for the Proxy Release's rule and form amendments is July 1, 2024. Thus, Managers and funds will be required to file their first reports on amended Form N-PX by August 31, 2024, with these reports covering the period July 1, 2023 to June 30, 2024.

SEC Proposes Overhauled Open-End Fund Liquidity Framework Including Mandatory Swing Pricing

On November 2, 2022, the SEC issued a release (the "Release") proposing amendments to its current rules for registered open-end funds regarding liquidity risk management programs, swing pricing, and various reporting forms (the "Proposals"). The Release states that "[t]he proposed amendments are designed to improve liquidity risk management programs and better prepare funds for stressed conditions and improve transparency in liquidity classifications" and also "to mitigate dilution of shareholders' interests in a fund by requiring any open-end fund, other than a money market fund or exchange-traded fund, to use swing pricing" under certain conditions.

The Release explains that, in light of the market stress experienced in March 2020 in connection with the onset of the COVID-19 pandemic, the SEC staff has reviewed the effectiveness of funds' current tools for managing liquidity and limiting dilution and is proposing amendments to funds' liquidity risk management programs "to help better prepare them for stressed market conditions."

If adopted as proposed, the Proposals would amend Rule 22e-4 under the 1940 Act (the "Liquidity Rule"), Rule 22c-1 under the 1940 Act, and certain reporting and disclosure forms under the 1940 Act. Specifically, the Proposals would:

- Change how open-end funds, other than money market funds and in-kind ETFs, classify the liquidity of their investments and require such funds to determine and maintain a highly liquid investment minimum that is equal to or higher than 10% of the fund's net assets;
- Require open-end funds, other than money market funds and ETFs, to use swing pricing and to implement a "hard close" to facilitate swing pricing; and
- Provide for more frequent, timelier, and more detailed public reporting of fund information, including information relating to funds' liquidity and use of swing pricing.

These and other aspects of the Proposals are discussed in our Alert, including some preliminary observations regarding the Proposals.

Transition Periods. The Release states that if the Proposals are adopted as proposed, they would provide for a transition period after the effective date.

- The Release proposes a compliance date of 24 months after the effective date of the Proposals for all open-end funds except money market funds and ETFs with respect to (i) the proposed swing pricing requirement and related reporting requirements on Form N-PORT and (ii) the proposed "hard close" requirement in Proposed Rule 22c-1 and related reporting requirements on Form N-1A.
- The Release proposes a compliance date of 12 months after the effective date of the Proposals for all other aspects of the Proposals, including (i) the proposed amendments to the Liquidity Rule and (ii) the

related reporting requirements on Forms N-PORT and N-CEN, except the swing pricing-related disclosure on Form N-PORT.

Comment Deadline. The Release states that comments on the Proposals should be received by the SEC no later than 60 days after publication of the Release in the *Federal Register*. As of the date of this Investment Management Update, the Release has not been published therein.

SEC Proposes to Regulate Investment Advisers' Outsourcing, Recordkeeping Included

On October 26, 2022, the SEC issued a release (the "Outsourcing Release") proposing new Rule 206(4)-11 under the Advisers Act (the "Proposed Rule") to prohibit registered investment advisers from retaining a service provider to perform certain services or functions unless it meets minimum requirements. If adopted as proposed, the Proposed Rule would require investment advisers to:

- Conduct due diligence prior to engaging a service provider to perform certain services or functions for the purpose of making a reasonable determination that it would be appropriate to outsource those services or functions and to select that service provider; and

- Periodically monitor the performance and reassess the retention of the service provider for the purpose of making a reasonable determination that it is appropriate to continue to outsource to that service provider.

The Outsourcing Release would amend Form ADV to collect census-type information about the service providers within the scope of the Proposed Rule.

The Outsourcing Release also would amend the Advisers Act books and records rule to (i) specify new records evidencing an investment adviser's compliance with the Proposed Rule and (ii) require an investment adviser that relies on a third party to make and/or keep books and records to conduct due diligence and monitor that third-party recordkeeper and to obtain certain reasonable assurances that the third-party recordkeeper will meet required standards.

Our Alert describes the Outsourcing Release in detail.

Transition Period. The Outsourcing Release proposes to require investment advisers to comply with the Proposed Rule starting ten months from the Proposed Rule's effective date (the "compliance date"). The Proposed Rule would apply to any engagement of a new service provider made on or after the compliance date. The Proposed Rule's ongoing monitoring requirements also would apply to existing engagements beginning on the compliance date.

Comment Period. Comments on the Outsourcing Release must be received by the SEC no later than December 27, 2022.

REGULATORY PRIORITIES CORNER

The following brief update exemplifies certain trends and areas of current focus of relevant regulatory authorities.

Closed-End Fund's Shareholder Proposal Regarding Replacing the Fund's Adviser May Not be Excluded from the Fund's Proxy Statement

The SEC staff recently declined to provide no-action reassurance requested by the Japan Smaller Capitalization Fund, Inc., a closed-end fund (the "Fund"), to exclude a shareholder proposal from the Fund's proxy statement. The shareholder requested that the Fund, pursuant to Rule 14a-8 under the Exchange Act, include a proposal in the Fund's proxy statement that the "Board of Directors immediately establish a special committee consisting solely of independent directors to investigate suitable alternatives to replace the Fund's current investment manager" (the "Proposal").

The SEC staff's August 26, 2022 initial no-action refusal letter is available here (the "First Refusal Letter"), and its October 19, 2022 no-action refusal letter, which followed two letters from the Fund requesting reconsideration, is available here (the "Second Refusal Letter)."

Additional Background. On November 3, 2021, the SEC staff 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 outlines the staff's views on Rule 14a-8(i)(7) (the "ordinary business exception"), which may serve as the basis for an issuer to exclude from its proxy statement a shareholder proposal made pursuant to Rule 14a-8.

- 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.[2]

The First Incoming Letter. In the Fund's July 14, 2022 letter ("Incoming Letter 1") the Fund sought no-action assurance that it could exclude the Proposal by relying on the ordinary business exception. The Fund maintained that the Fund's selection of service providers, including its investment adviser, was within the Fund's ordinary business operations. In the First Refusal Letter, the SEC staff declined to concur with the Fund's view that the Fund may exclude the Proposal under Rule 14a-8(a)(i)(7)'s ordinary business exception without providing any additional explanation.

The Two Letters Requesting Reconsideration. Following the First Refusal Letter on August 26, 2022, on September 9, 2022, the Fund submitted another letter ("Incoming Letter 2A") to the SEC staff requesting the

[1] *See* Rel. No. 34-40018 (May 21, 1998).
[2] SLB 14L addresses both premises and is discussed in detail in Ropes & Gray's December 13, 2021 Investment Management Update.

staff to reconsider the matter based on actions by the Fund's board of directors immediately before Incoming Letter 2A was submitted. Specifically, Incoming Letter 2A stated that, on September 7, 2022, a special committee of the Fund's board, comprised of all the independent directors, was established. Incoming Letter 2A also stated that among the specific duties of the special committee were to "[i]dentify and evaluate alternative investment managers" and to "make a recommendation to the Board on whether there is a suitable alternative to potentially replace the Fund's present investment manager as soon as practicable, but not later than March 31, 2023."

Incoming Letter 2A sought the SEC staff's no-action assurance that it could exclude the Proposal pursuant to Rule 14a-8(i)(10), which provides that a shareholder proposal may be excluded from a proxy statement if the issuer "has already substantially implemented the proposal."

On September 19, 2022, the Fund submitted an additional letter to the SEC staff ("Incoming Letter 2B") requesting the staff to reconsider the matter in view of the facts that the Fund intended to file its 2022 proxy materials on or about October 10, 2022 and the Fund's representation that its proxy statement would (i) include a description of the special committee and (ii) disclose the Fund's commitment to disclose the special committee's recommendation.

In the Second Refusal Letter, the SEC staff stated, again without providing its rationale, that it was "unable to concur in [the] view that the Fund may exclude the Proposal from the proxy materials under Rule 14a-8(i)(10) as having been substantially implemented." Therefore, the SEC staff said, it could not assure the Fund that the staff would not recommend enforcement action if the Fund excluded the Proposal from its proxy materials in reliance on Rule 14a-8(i)(10).

ADDITIONAL ROPES & GRAY ALERTS AND PODCASTS SINCE OUR AUGUST – SEPTEMBER UPDATE

These Alerts and podcasts are in addition to the Alerts listed at the beginning of this Update.

SEC Extends Rule 15c2-11 Relief – Delaying the Date by which Rule 144A Issuers may be Required to Publicly Disseminate Financial Statements – until January 2025
December 5, 2022
As discussed in our prior Alert, in September 2020, the SEC amended Rule 15c2-11, which governs when dealers can publish quotations for securities to, among other things, generally prohibit broker-dealers from publishing quotations for an issuer's securities in a quotation medium when current information about the issuer is not publicly available. In 2021, the SEC staff clarified that they interpreted Rule 15c2-11 to apply to fixed-income securities as well as equity securities and granted time-limited relief through January 4, 2023 from the public information requirement for fixed-income securities offered pursuant to Rule 144A.

On November 30, 2022, the SEC staff issued a no-action letter extending that relief until January 4, 2025. This extension is important for both issuers of and investors in Rule 144A fixed-income securities as well as broker-dealers who provide quotes for these securities.

In the no-action letter granting the extension, the SEC staff reiterated its view that Rule 15c2 11 applies to fixed-income securities as well as equity securities. As a result, it remains to be seen how the industry will respond to address the time-limited nature of this relief. We expect that there may continue to be an increased

focus on reporting covenants for Rule 144A fixed-income securities as well as continued advocacy efforts with the SEC regarding the application of Rule 15c2-11 to fixed-income securities.

DOL Final Rule Embraces Principles-Based Approach to ESG Factors in Investments and Proxy Voting – Initial Reactions
November 23, 2022
On November 22, 2022, the U.S. Department of Labor (the "DOL") released its much-anticipated final rule (the "Final Rule") addressing investment selection and environmental, social and governance ("ESG") considerations for ERISA-covered retirement plans (including 401(k) plans) and the exercise of shareholder rights, including voting proxies. The Final Rule is largely consistent with the DOL's 2021 proposal, but the changes it has adopted should make it significantly easier for ERISA plans to include investments that consider or focus on ESG attributes. The revised regulation may also open the door to plan sponsors adding ESG investment options to 401(k) plan menus. This Alert is a high-level overview of the Final Rule, which includes the key changes the DOL has made from the proposal.

PErspectives | In Search of Financing: Sponsors Willing to Seek Debt
November 22, 2022
This is Issue No. 9 of *PErspectives* – Ropes & Gray's periodic publication featuring news, trends and legal developments in the private equity ("PE") industry. In this piece, we examined the impact of inflation and rising interest rates on terms and pricing in the leveraged finance markets. After a 2021 marked by buoyant debt markets and abundant liquidity, we also took a look at how PE sponsors are adapting in this new environment.

Podcast: Digital Assets Discussion: Implications of Ooki DAO CFTC Enforcement Action
November 14, 2022
Following the first action filed by a U.S. federal regulator against a DAO and its members, asset management attorneys Melissa Bender, Jeremy Liabo and Glen Chen discussed the Ooki DAO case and its implications on the potential liability of DAO token holders, DAO legal wrappers and the CFTC's role in regulating digital assets.

Ropes & Gray Crypto Quarterly
November 2, 2022
This is the Ropes & Gray Crypto Quarterly, our publication featuring news, trends, and legal developments in the cryptocurrency industry.

The landscape 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. In this Q3 newsletter, we explore critical questions and issues facing the crypto industry, including takeaways from this quarter's review.

Podcast: Credit Facilities for Registered Investment Funds
October 20, 2022
In this Ropes & Gray podcast, finance partner Alyson Gal and associate Andy Hogan discussed the use of

credit facilities as an important source of liquidity and leverage for registered investment funds. They explored the regulatory landscape applicable to these facilities and reviewed some of their key terms.

State Regulation of ESG Investment Decision-making by Public Retirement Plans: An Updated Survey - October 2022

October 20, 2022

Ropes & Gray is actively tracking the rapidly evolving state approaches to regulating ESG investments by state retirement systems. Since last circulating our multi-state survey in August, we have seen a flurry of activity, including state treasury divestitures from a major asset manager and coalitions forming between pro- and anti-ESG states. In addition to both proposed and enacted legislation, we are also seeing state treasurers updating investment policy statements to expressly exclude consideration of ESG factors when making investment decisions. These actions show that states may act in the ESG space even without actually passing new laws.

SEC Staff Issues FAQ Regarding Investment Adviser Consideration of DEI Factors

October 17, 2022

On October 13, 2022, the SEC staff published a single FAQ and response (the "Staff Guidance") confirming that, consistent with its fiduciary duty and subject to certain conditions, an investment adviser can incorporate diversity, equity and inclusion ("DEI") factors when recommending or selecting an investment adviser for its clients. This Alert discusses the Staff Guidance.

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

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

Sarah Davidoff
New York, NY
+1 212 596 9017
sarah.davidoff@ropesgray.com

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

Isabel K.R. Dische
New York, NY
+1 212 841 0628
isabel.dische@ropesgray.com

Laurel FitzPatrick
New York, NY
+1 212 497 3610
laurel.fitzpatrick@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

Jeremy Liabo
Chicago, IL
+1 312 845 1326
jeremy.liabo@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

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

Chune Loong Lum
Hong Kong
+852 3664 6318
chuneloong.lum@ropesgray.com