June 15, 2023

Ropes & Gray's Investment Management Update April – May 2023

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

Court Affirms that 1940 Act's "Interested Person" Definition Applies Under State Law to Determine Independence of Trustees of Fund Organized as a Massachusetts Business Trust

A recent decision of the U.S. Court of Appeals for the Fifth Circuit held that, in the context of a derivative lawsuit filed by a fund shareholder, the relevant independence standard for trustees of a Massachusetts business trust that is a registered investment company is determined by Massachusetts General Laws, chapter 182, § 2B, which incorporates the definition of "interested person" in Section 2(a)(19) of the 1940 Act. Specifically, § 2B states that "a trustee of a trust who with respect to the trust is not an interested person, as defined in [the 1940 Act], shall be deemed to be independent and disinterested when making any determination or taking any action as a trustee."

Background. A plaintiff-shareholder sent a demand letter to the board of Highland Capital Global Allocation Fund, a registered closed-end fund organized as a series of a Massachusetts business trust (the "Fund") alleging that (i) the Fund's adviser, Highland Capital Management Fund Advisors, L.P. ("Highland") had breached its contractual obligations to the Fund by causing the Fund to invest in shares of another registered fund within the Highland funds complex and (ii) the Fund's trustees had breached their fiduciary duties by allowing those investments. The demand letter requested that the Fund take legal action against Highland and the trustees regarding these alleged breaches.

- In response to the demand letter, the Fund's board formed a committee that hired outside counsel, conducted an investigation and issued a report recommending that the plaintiff's demand should be rejected. The five trustees, with one interested trustee abstaining, voted unanimously to adopt the report's recommendation and to reject the plaintiff's demand.
- The plaintiff then filed suit in a federal district court against Highland and five of the six trustees, asserting a derivative claim for breach of fiduciary duty and breach of contract and a direct class action claim for breach of fiduciary duty (together, Highland and the five trustees, the "Defendants").

The Defendants filed a motion to dismiss, which the district court granted. The plaintiff filed an appeal to the U.S. Court of Appeals for the Fifth Circuit (the "Court"). Following a *de novo* review, the Court rejected the plaintiff's arguments and agreed with the district court's holdings.

The Court's Opinion. The Court agreed with the Defendants' argument that Massachusetts General Laws, chapter 156D, § 7.44 under the Massachusetts Business Corporations Act (the "MBCA") applied. In pertinent part, that section provides that a derivative proceeding "shall be dismissed by the court on motion by the corporation" if "a majority vote of independent directors present at a meeting of the board of directors if the independent directors constitute a quorum" "has determined in good faith after conducting a reasonable inquiry upon which its conclusions are based that the maintenance of the derivative proceeding is not in the best interests of the corporation." The Court noted that, according to the Massachusetts Supreme Judicial Court, § 7.44 "incorporates the business judgment doctrine."

The plaintiff contended on appeal that the district court had (i) utilized the wrong legal standard to evaluate whether trustees were "independent" and (ii) erred by finding that a majority of the trustees were independent. The court rejected both of the plaintiff's arguments.

- The Court noted that the MBCA does not define what makes a director (or in this case, a trustee) "independent." The plaintiff contended that a "totality of the circumstances" test should be applied, which is a test for director independence that had been followed by a Massachusetts trial court outside the context of registered investment companies. The Defendants instead cited § 2B under the Massachusetts Business Trust ("MBT") statute.

- As noted above, § 2B provides that "a trustee of a trust who with respect to the trust is not an interested person, as defined in [the 1940 Act], shall be deemed to be independent and disinterested when making any determination or taking any action as a trustee." In addition, § 2B applies to "a trust that is an investment company, as defined in the [1940 Act]" and is registered with the SEC.
- The Court agreed with the district court's holdings that the Fund met the § 2B requirements and, therefore, § 2B should be applied in determining whether the trustees were "independent."

- The Court additionally held that the district court correctly reasoned that there was not necessarily a conflict between MBCA § 7.44 and § 2B under the MBT statute because "the two statutes can be applied together, but that to the extent there is a conflict, § 2B should govern as the more specific statute applicable to the trustees." Thus, rejecting the plaintiff's second argument, the Court held that the district court was correct in concluding that a majority of the board of trustees was independent pursuant to § 2B because a majority of the board of trustees was not "interested persons" under the1940 Act.

Observations. The Court's decision helpfully provides additional authority applying the MBT statute's clear mandate that trustees of registered investment companies organized as Massachusetts business trusts are independent when making decisions regarding derivative claims and, more generally, in making decisions under the business judgment rule.

Court Affirms Denial of Excess Insurance Coverage Where Adviser Misrepresented Knowledge of Pending SEC Investigation

On May 2, 2023, the Supreme Court of Delaware issued an order[1] affirming an August 15, 2022 decision[2] by the Delaware Superior Court (the "Court") granting summary judgment in favor of three insurers regarding their obligations to advance funds to Infinity Q Capital Management, LLC ("Infinity Q") under D&O/E&O and enterprise policies providing for excess insurance coverage (the "Policies").

Background. Infinity Q was the investment adviser to a registered open-end fund.[3]

In May 2020, the SEC sent a letter with the caption "In the Matter of Infinity Q Capital Management, LLC," addressed to the Infinity Q's Chief Operating Officer (who also served as Infinity Q's CCO), stating that the SEC was "conducting an inquiry [of Infinity Q] to determine if violations of the federal securities laws have occurred." The letter included a request for documents including, among other things, "all valuation policies," documents regarding "concerns about the valuation of assets held by the Infinity Q Funds," and "concerns about models for the valuation of assets." Infinity Q responded to the SEC letter by the end of May.

In June 2020, the SEC sent another letter addressed to Infinity Q's Chief Operating Officer requesting additional documents regarding the fund's valuation committee.

In August 2020, each of the insurers issued the Policies after Infinity Q's Chief Operating Officer executed statements to the insurers warranting that:

> No person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance that may give rise to a claim under the proposed insurance.

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[1] *In re Infinity Q Capital Mgmt*., 2023 Del. LEXIS 143 (Del. S. Ct May 2, 2023).
[2] *Infinity Q Capital Mgmt. v. Travelers Cas. & Sur. Co*., 2022 Del. Super. LEXIS 363; 2022 WL 3902803 (Del. Super. Ct. Aug. 15, 2022).
[3] In February 2021, Infinity Q requested an order from the SEC to suspend redemptions and stop calculating the fund's NAV. Within three days, the SEC issued an order permitting the fund to suspend redemptions and postpone the date of redemption payments beyond seven days.

> It is agreed that any claim for, based upon, arising from, or in any way related to any act, error, omission, fact or circumstance of which any such person or entity has any knowledge or information shall be excluded from coverage under the proposed insurance.

In the fall of 2020, Infinity Q learned that the SEC would be commencing an investigation that generally alleged that Infinity Q may have been employing schemes to defraud clients or prospective clients. In November 2020, the SEC issued a subpoena to Infinity Q as part of its investigation. In May 2021, the insurers denied coverage under the Policies based upon their rights arising under the warranty statements and, in July 2021, the insurers filed a complaint with the Court seeking a declaration that they were not obligated to make payments under the Policies.

The Court's Reasoning. The Court held that the undisputed facts demonstrated that, at the time the warranty statements were made, Infinity Q's founder/Chief Investment Officer and its Chief Operating Officer knew that there was an ongoing inquiry by the SEC's Division of Enforcement regarding the fund's valuation practices. Thus, Infinity Q (and its executives) had knowledge of "any act, fact or circumstance that may give rise to a claim under the policies that would be issued by the Insurers."

Accordingly, the Court granted the insurers motion for summary judgment permitting them to deny advancing funds under the Policies.

Observations. Insureds should seek to avoid warranties whenever possible. When required, if there is any potential claim at any level, an insured should consult with counsel to ensure that the warranty is both accurate and as narrow as possible. It may be possible to add severability language to a warranty such that the warranty excludes coverage only for any insured who knew that the warranty was materially false at the time it was made. In addition, insureds may try to limit the warranty so that the signatory is only making a warranty as to his or her knowledge based upon "a reasonable inquiry."

EXAMS Issues Risk Alert Concerning LIBOR-Transition Preparedness

On May 11, 2023, the SEC Division of Examinations ("EXAMS") published a Risk Alert focused on exams of registered investment advisers and investment companies ("firms") to assess firms' preparedness for the cessation of U.S. Dollar LIBOR. The Risk Alert was intended to remind firms of the June 30, 2023 cessation date and summarize some observations from the EXAMS staff based upon recent firm examinations.

Observations Concerning Firms' Practices

The EXAMS staff observed the following practices that firms have implemented to address the transition away from LIBOR.

Risk Management

- Firms with significant exposures have formed LIBOR transition working groups, often overseen by a risk governance committee, created detailed written transition plans with work streams and timelines and completed comprehensive impact assessments on investment and operational exposures.
- Almost all examined firms are either members of the Alternative Reference Rates Committee ("ARRC") or rely on guidance AARC has provided.
- Firms have made deliberate efforts to ensure that traders, portfolio managers, and client-facing representatives are kept informed concerning both the LIBOR transition generally and any internal policies, procedures or guidance. The nature and extent of training and guidance vary from firm to firm based on the level of transition impact and each firm's business lines and client types.

Operations

- Firms have planned their level of engagement with service providers, sub-advisers and third-party managers according to the importance of each entity to the firm's business or the level of exposure at such entity. Many

firms are working extensively with fund administrators and pricing or data providers to understand their readiness for the transition.

- Firms that require internal system updates have performed end-to-end testing to confirm systems can accommodate alternative reference rates ("ARRs") currently used or to be used post-transition.
- Several firms have incorporated rigorous reconciliation processes, aiming to ensure all the terms and conditions of the ARRs are properly accounted for by counterparties and service providers.

Portfolio Management

- When applicable, firms have taken a global approach to contract identification, looking broadly at LIBOR exposure across subsidiaries and affiliates.
- Many firms have used third-party service providers with specialized skills in document review to identify fallback provisions.
- Firms have proactively assessed risks associated with the various fallback provisions (or lack thereof) and prioritized identifying and assessing contracts considered "tough legacy" contracts that may be more challenging to transition, such as those with fallbacks that give discretion to a third party.
- Firms have considered what, if any, trading restrictions to place on new and legacy LIBOR-linked instruments and communicated their approaches to relevant personnel such as portfolio managers and compliance staff. Some firms have created internal controls, such as pre-trade compliance checks or purchasing guidance.
- While many instruments may not be susceptible to early transition, or firms are not in the position to renegotiate them (*e.g.*, situations in which the firm is not party to an underlying agreement), firms have been converting to ARRs where practicable and urging counterparties to convert ahead of June 30, 2023.

Fiduciary Responsibilities and Investor Communications

- With their fiduciary duties in mind, the EXAMS staff observed advisers with large direct client exposure addressing the remediation of contracts, while advisers with indirect client exposure typically appeared to manage exposure through due diligence of third-party fund managers concerning their transition readiness.
- Similarly, to fulfill their fiduciary duties, firms have considered conflicts of interest related to the transition including, by way of example, cross-trading, principal transactions, allocation of transition costs and clients with conflicting priorities. Risks arising from conflicts of interest identified have been monitored through firms' compliance programs.
- Firms with significant exposures have included comprehensive disclosures for risks associated with the transition, such as legal, operational, credit and regulatory risks.
- Firms have implemented a wide range of client communication and engagement strategies, depending on their businesses and the type of information that would be meaningful to their clients. Some firms have adopted a multifaceted approach, communicating frequently and proactively with clients that have greater exposures, as well as making available more generalized disclosures on their website or in brochures and fund documents.

Keeping Informed About Ongoing and New Challenges

The EXAMS staff observed that firms have stayed informed of ongoing and new challenges to a smooth transition and are working to prepare accordingly, noting the following examples:

- ARRC has encouraged market participants to remediate as many outstanding LIBOR-linked bank loans as practicable before June 30, 2023 to avoid a flood of contracts requiring individually negotiated amendments in mid-2023.

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- A few firms have identified highly complex LIBOR-linked contracts (i) that are issued overseas and not subject to the Adjustable Interest Rate (LIBOR) Act of 2021 (the "LIBOR Act") and (ii) where no fallback language exists and/or transition via an amendment process is impracticable. It is likely that many of these contracts will now transition to a synthetic LIBOR.[4]
- Firms have noted significant operational complexities associated with the conversion of LIBOR-linked contracts that will be transitioning, whether by hardwired fallback provisions, an amendment process, or the LIBOR Act for legacy contracts with no or impracticable fallback provisions. Firms have recommended continued monitoring of ARRC and other industry resources for guidance and tools in addressing these complexities.

EXAMS Issues Risk Alert Concerning Safeguarding Customer Records and Information at Branch Offices

On April 26, 2023, EXAMS published a Risk Alert to highlight the importance of establishing written policies and procedures for safeguarding customer records and information at branch offices of broker-dealers and investment advisers (collectively, "covered firms"). The Risk Alert noted that, while many covered firms have implemented safeguarding policies and procedures at their main office, some covered firms did not adopt or implement written policies and procedures that address safeguards for their branch offices despite the existence of the same or similar risks.

Background

The Safeguards Rule within Regulation S-P (the "Safeguards Rule") requires covered firms to adopt written policies and procedures that are reasonably designed to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of customer records and information, and protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

Staff Observations

In assessing compliance with the Safeguards Rule, the EXAMS staff observed the following:

Vendor Management. In many instances, covered firms did not appear to reasonably ensure that their branch offices perform proper due diligence and oversight of their vendors (*e.g.*, cybersecurity, technology operations and business applications), as required by the covered firms' policies and procedures.

Email Configuration. In many instances, email configuration services are managed from the main office where staff or vendors provide accounts for branches. However, in some instances, covered firms did not manage email accounts for branch offices. Moreover, some covered firms lacked policies and procedures addressing branch office email configurations and allowed branch office staff to obtain their own email services from vendors without specifying the technical requirements adequate to secure the branch offices' email configurations.

Data Classification. Covered firms often maintain data classification written policies and procedures to identify where customer records and information were stored electronically, but covered firms did not always apply these policies and procedures to branch offices.

Access Management. Covered firms often maintain policies and procedures requiring password complexity and multi-factor authentication for remote access to covered firm systems. Although some covered firms required these controls for the main office, they did not require similar controls for branch offices.

Technology Risk. Many covered firms focus on technology risk by implementing written policies and procedures for inventory management, patch management and vulnerability management. However, for some covered firms that

[4] *See* FCA Decision on Synthetic US Dollar LIBOR (March 4, 2022).

maintain reasonable technology policies and procedures for their main office, they did not apply any such policies and procedures in connection with their branch offices. As a result, branch offices were not up to date with system patching.

REGULATORY PRIORITIES CORNER

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

SEC Announces Spring Regulatory Agenda

The Office of Information and Regulatory Affairs semi-annually publishes the "Unified Agenda of Regulatory and Deregulatory Actions" of the various federal agencies. The Unified Agenda includes the SEC's Current Agenda, which reflects only the priorities of SEC Chair Gary Gensler.

On June 13, 2023, the SEC announced its Spring 2023 Current Agenda, containing the following items from the Division of Investment Management (or items otherwise of interest to the mutual fund/investment management industry) for which the Current Agenda indicates completion by October 2023. The number of items suggests that there will be a busy period of SEC rulemaking affecting the mutual fund/investment management industry during the remainder of 2023 (items 1 to 14) and continuing into 2024 (items 15 to 19).

Adoptions by October 2023

1. Open-End Fund Liquidity Risk Management Programs and Swing Pricing;
2. Money Market Fund Reforms;
3. Enhanced ESG Practices Disclosures by RIAs and Investment Companies;
4. Investment Company Names;
5. Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies;
6. Private Fund Advisers; Documentation of RIA Compliance Reviews;
7. Safeguarding Advisory Client Assets;
8. Form PF; Reporting Requirements for All Filers and Large Hedge Fund Advisers (joint Form PF rulemaking with CFTC proposed in addition to recent Form PF amendments);
9. Modernization of Beneficial Ownership Reporting (accelerates the filing deadlines for reports on Schedules 13D and 13G; additionally, holders of certain cash-settled derivative securities would be deemed beneficial owners of the reference equity securities);
10. Climate Change Disclosure (operating companies).

Proposals by October 2023

11. Registration for Index-Linked Annuities (new Current Agenda item);
12. Prohibition of Conflicted Practices for Investment Advisers That Use Certain Covered Technologies (f/k/a the "digital engagement practices" rulemaking);
13. Registration for Internet Advisers (new Current Agenda item); and
14. Regulation D and Form D Improvements.

The remaining items are either new to the Current Agenda or show slightly deferred SEC action, with the SEC indicating that the following actions are not intended to be completed before October but are intended to be completed in Q4 2023 or Q1 2024.

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Adoptions by April 2024

15. Outsourcing by Investment Advisers;
16. Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information; and
17. Major market structure reforms – Order Competition Rule; Disclosure of Order Execution Information; Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders; Regulation Best Execution.

Proposals by April 2024

18. Exchange-Traded Products; and
19. Fund Fee Disclosure and Reform.

Navigating State Regulation of ESG Investments

Ropes & Gray is pleased to share an interactive website offering resources for monitoring the rapidly evolving legal and regulatory landscape concerning what role, if any, ESG factors should play in managing public retirement plan assets, and other related developments. Among the new developments described at the website are the following:

> **State Attorneys General Send Letters to Six Major Banks**. On May 19, 2023, the Attorneys General of 23 states sent a joint letter to the chief executive officers of six of the largest U.S. banks and financial services companies. The letter noted that, in the most recent proxy season, "your shareholders considered one or more resolutions related to climate change" but "[e]ach of your boards unanimously opposed these proposals."
>
> The letter stated that, given the fiduciary duties of the recipient asset managers, "we assume you and your proxies will vote in other companies consistent with the reasoning you articulated when rejecting similar proposals at your own company." However, "[i]f your votes are instead exercised in favor of proscriptive environmental targets that presume the 'energy transition' will happen . . . you implicitly concede to a conflict of interest in your asset management arm that threatens your fiduciary duties."
>
> The letter concluded with the following caution:
>
>> In the event that you vote for other companies to have less of a focus on financial return than your own, whether you act directly or through a proxy advisor, be assured that our respective offices will certainly take notice. Such contradiction will raise serious questions, and we will use the full measure of our investigative authority to seek answers.
>
> **State Treasurers Send Letters to Major Asset Managers**. On May 15, 2023, the state treasurers and financial officers of 18 states (collectively, the "treasurers") sent a letter and questionnaire to the chief executive of the parent companies of 20 of the largest asset management firms. The letter stated that the treasurers were concerned that taxpayers' best long-term economic interests "might have become subordinated to environmental, social, and political interests often divorced from shareholder value – and often pushed through shareholder proposals."
>
> The letter requested each firm to respond to a questionnaire by June 29, 2023 to help the treasurers understand how the firm makes proxy-voting decisions. The nine-page questionnaire consisted of more than 50 questions seeking information about the asset management firm's proxy voting, including:

- How the asset management firm evaluates shareholder proposals generally and uses or relies on proxy advisory firms;
- Whether the firm is a signatory to the U.N.'s Principles for Responsible Investment or a member of any other ESG-related organizations;

- How the firm evaluates shareholder proposals relating to climate reporting (including, "Do you have empirical evidence that any climate report or audit that your firm voted in favor of in fact benefited shareholders' economic interests?");
- How the firm evaluates shareholder proposals relating to actions to reduce greenhouse-gas emissions (including, "Do you have empirical evidence that any GHG emissions-reduction requirement that your firm voted in favor of in fact benefited shareholders' economic interests?"); and
- How the firm evaluates shareholder proposals relating to diversity or racial equity (including, "Do you have empirical evidence that any diversity requirement that your firm voted in favor of in fact benefitted shareholders' economic interests?").

Division's Experience with Expedited Review and Automatic Withdrawal of Exemptive Applications

On July 6, 2020, the SEC approved rule amendments to establish an expedited review procedure for exemptive and other applications under the 1940 Act, as well as automatic withdrawal of these applications in certain circumstances (described in this Ropes & Gray IM Update). The amendments became effective on June 14, 2021.

On May 18, 2023, the SEC's Division of Investment Management (the "Division") published an Information Update to share its experience with these procedures and to provide applicants with assistance in filing applications.

Rule 0-5 under the 1940 Act provides expedited review procedures for obtaining exemptive relief where an application for relief is "substantially identical" to exemptive relief that the SEC has recently provided. The Information Update reported that, in the nearly two years that the new procedures have been effective, a number of applications requested but failed to qualify for expedited review. In particular, the Division received eight co-investment applications seeking expedited review, none of which met the expedited review rule's "substantially identical" standard because the applications typically included different terms and conditions than those contained within precedent applications.

Application Tips. The Information Update offered the following tips for filing applications for expedited review under Rule 0-5:

- When preparing an expedited application, applicants should note the SEC's statement that "[t]he reference to 'identical' terms and conditions requires that not only the substance of the terms and conditions be the same, but also that their wording be the same." Thus, the wording of applications requesting expedited review should track the chosen precedents (except for factual differences that are not material to the requested relief).
- Applicants must file the marked copies of the expedited application required by rule 0-5(e)(2) in a manner so that they are visible to the public on EDGAR.
- Rule 0-5(e)(1) requires an applicant to include a notation on the cover page of the application that states prominently, "EXPEDITED REVIEW REQUESTED UNDER 17 CFR 270.0-5(d)." This notation must be on the application itself rather than the attached cover letter that is not visible to the public.
- Rule 0-5(e)(3) requires that the cover letter be signed, on behalf of the applicants, by the person executing the application. When two or more people sign the application, each must sign the cover letter.
- Rule 0-5(e)(3)(i) requires that the cover letter include an explanation as to why the applicants chose their particular precedents.
    - If more recent applications of the same type have been approved, applicants should explain why their precedents, rather than the more recent applications, were chosen. This explanation should include enough specificity to enable the Division to understand what unique terms or conditions the chosen precedents have.
    - If the precedent applications are the most recent applications of the same type having received an order at the time the application was filed, applicants may provide that as the explanation.

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- Consistent with Rule 0-5(e)(3)(ii), applicants must certify in the cover letter that the applicants believe the application meets the requirements of paragraph (d) of Rule 0-5 and that the marked copies required by Rule 0-5(e)(2) are complete and accurate.
- If applicants prefer to receive communications regarding the application via e-mail, they should include an e-mail address in the contact information listed in the application or the cover letter.
- An applicant should list the precedents relied on to qualify for expedited review in the precedent section of the application.

Automatic Withdrawal. The Information Update notes that, under Rule 0-5(g), applications (excluding expedited applications) will be deemed withdrawn if the applicant does not respond in writing to the Division staff's comments within 120 days. Under rule 0-5(f)(ii), expedited applications will be deemed withdrawn if an applicant does not file an amendment responsive to the staff's comments within 30 days. The Information Update reminds applicants that such withdrawals are made by operation of law and do not require any action by the Division staff.

Staff Statement on the Holding Foreign Companies Accountable Act and the Consolidated Appropriations Act, 2023

Background. As described in a prior Ropes & Gray IM Update, in December 2021, the SEC published final rules and form amendments (collectively, the "Rules") to implement the disclosure and submission requirements of the Holding Foreign Companies Accountable Act (the "HFCAA"), which became law on December 18, 2020. The Rules became effective on January 10, 2022 and, among other things:

- Created a process by which the SEC identifies "Commission-Identified Issuers," most of which are issuers based in China, and potentially prohibits the trading of these issuers' securities on a national securities exchange or in the over-the-counter market; and
- Specified that Commission-Identified Issuers are issuers that have filed an annual report containing an audit report issued by a foreign public accounting firm that the Public Company Accounting Oversight Board (the "PCAOB") cannot inspect or investigate completely because of a position taken by an authority in the foreign jurisdiction.

Staff Statement. On April 6, 2023, the staff of the SEC Division of Corporation Finance and the SEC Division of Trading and Markets issued a joint statement regarding the Rules (the "Statement"). The Statement noted that, as initially enacted, the HFCAA required the SEC to prohibit trading in the securities of an issuer if it is a Commission-Identified Issuer for three consecutive years. In December 2022, Congress amended the HFCAA to shorten the time frame for the SEC to impose an initial trading prohibition on a Commission-Identified Issuer's securities to two consecutive years. Therefore, once an issuer is identified as a Commission-Identified Issuer for two consecutive years, the SEC will prohibit the trading of the issuer's securities on a national securities exchange and in the over-the-counter market.

MiFID II No-Action Letter Expiring July 3, 2023

In Ropes & Gray's August 2022 IM Update, we described a July 2022 speech by William Birdthistle, Director of the SEC Division of Investment Management, in which Director Birdthistle noted that, with MiFID II's advent in January 2018, the Division staff provided three no-action letters, including a temporary no-action letter stating that the SEC staff would not recommend enforcement action if a broker-dealer provides research services that constitute investment advice under Section 202(a)(11) of the Advisers Act to an investment adviser subject to EU MiFID II regulation (directly or by contract) (each, a "MiFID II Adviser"). This no-action letter (the "SIFMA Letter") permits a broker-dealer to be compensated for providing research to a MiFID II Adviser without the payments being deemed to be "special compensation" under Section 202(a)(11) merely because the payments are made in a manner required by MiFID II.

In late 2022, SIFMA submitted a memorandum to the Division staff explaining the need for continued MiFID II relief. Among other things, the memorandum requested a further extension of the SIFMA Letter. However, as of this date, the

Division staff has not provided an extension. Thus, the SIFMA Letter is scheduled to expire on July 3, 2023 and, after this date, broker-dealers will no longer be able to rely on the SIFMA Letter.

ADDITIONAL ROPES & GRAY ALERTS AND PODCASTS SINCE OUR FEBRUARY – MARCH 2023 UPDATE

House Oversight Committee Holds Its First ESG Hearing – An Overview for Asset Managers
May 26, 2023
The House Committee on Oversight and Accountability recently held a hearing titled "ESG Part I: an Examination of Environmental, Social, and Governance Practices with Attorneys General." The hearing covered a range of topics, including fiduciary duties, antitrust and consumer protection, proxy voting, ERISA, and the banking, insurance and utilities industries. This Alert unpacks the nearly four-hour hearing and where it fits into the broader debate over ESG integration by asset managers.

PErspectives | Calm in the Storm: Investing in Infrastructure
May 24, 2023
This is Issue No. 10 of Perspectives, Ropes & Gray's periodic publication featuring news, trends and legal developments in the private equity industry. In this piece, we examined the drivers of growth in the PE infrastructure space and why the asset class appeals to investors in this uncertain macroeconomic environment. We also looked at the broadening remit of PE infrastructure investing and the objectives behind the different investment strategies.

Why Conduct a GP-Led Secondary?
May 23, 2023
In this Ropes & Gray podcast, asset management attorneys Amanda Persaud and Kevin White discussed reasons why a sponsor would consider conducting a GP-led secondary transaction. Ropes & Gray has recently been ranked as the #1 firm in the 2023 Secondaries Investor Annual Survey, and the market for these transactions has grown significantly over the last several years. Many sponsors who have not previously been involved in this market have entered this market and found the transactions to be highly appealing. Amanda and Kevin explored several of the rationales for why sponsors have found these transactions so appealing.

The Applicability of the SEC's Proposed Custody Rule to Real Estate
May 22, 2023
The SEC has proposed sweeping changes to its custody rule that would impose new obligations on registered investment advisers with respect to physical assets such as real estate. In this Ropes & Gray podcast, regulatory partner Nicole Krea and real estate funds partner Matt Posthuma, both in the firm's asset management practice, discussed how these requirements would affect investment advisers in their management of real estate assets.

Analysis of Amendments to Form PF
May 11, 2023
The SEC adopted amendments to Form PF (the "Amendments") on May 3, 2023. The Amendments include (i) new current reporting requirements for large hedge fund advisers, (ii) new quarterly and annual event reporting for advisers to private equity funds and (iii) amendments to certain annual reporting requirements for large private equity fund advisers.

SEC Brings Suit against Independent Trustees, Adviser and Registered Fund Officers
May 11, 2023
On May 5, 2023, the SEC filed a civil complaint in the U.S. District Court for the Northern District of New York against a mutual fund's adviser for aiding and abetting violations of Rule 22e-4 (the "Liquidity Rule") by the mutual fund it advised (the "Fund") and whose Liquidity Risk Management Program ("LRMP") it administered. The complaint also claims that the Fund's two independent trustees, the Fund's portfolio manager and the Fund's CCO, aided and abetted the Fund's Liquidity Rule violations.

The action is the first-ever case concerning enforcement of the Liquidity Rule, which prohibits a mutual fund or ETF from investing more than 15% of its net assets in illiquid investments and requires funds to adopt an LRMP to assess and

govern their liquidity risks. If a mutual fund or ETF's illiquid investments exceed the 15% limit, the Liquidity Rule requires the fund to promptly take remedial action.

Financial Stability Oversight Council Proposes a New Process for Determining Nonbank Supervision by the Fed
May 4, 2023
Section 113 of the Dodd-Frank Act authorizes the Financial Stability Oversight Council (the "Council") to subject a "nonbank financial company" to supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), including the Federal Reserve's prudential standards. The definition of a nonbank financial company in Section 102(a)(4) of the Dodd-Frank Act includes all registered investment companies, business development companies and registered investment advisers.

On April 21, 2023, the Council published a release (the "Release") containing proposed interpretive guidance (the "Proposed Guidance") regarding the process the Council would employ to determine whether a nonbank financial company should be designated as subject to the Federal Reserve's supervision.

Current Topics for Corporates Trading Derivatives
May 2, 2023
In this Ropes & Gray podcast, asset management attorneys Egan Cammack and Lindsey Jones highlighted a few key topics for buy-side corporate derivatives users to consider in the coming year as they monitor existing, and assess new, derivatives transactions. Egan and Lindsey discussed counterparty credit evaluation, representations and corporate actions related to derivatives regulatory requirements (including under the Dodd-Frank Act) and planning for the U.S. Dollar LIBOR transition.

"Where Woke Goes to Die"? – New Florida Restrictions on ESG to Create Challenges and Additional Requirements for Asset Managers and Other Financial Institutions
April 27, 2023
After many months of publicly teasing further anti-ESG action, Florida is poised to become the latest state to enact legislation limiting the consideration of ESG factors in the investment decisions of state retirement systems. House Bill 3, "An Act Relating to Government and Corporate Activism," ("HB 3") passed in the Florida State Senate on April 19. The legislation, which is expected to be signed by Governor Ron DeSantis in the coming days, formalizes and expands the directive he announced last August for the State Board of Administration to invest funds of the Florida Retirement System Defined Benefit Plan (and to exercise shareholder proxy voting rights) solely based on pecuniary factors, without sacrificing investment returns to promote non-pecuniary factors such as ESG goals. HB 3 will extend this policy to cover all funds invested by state and local governments, including general revenue, trusts dedicated to specific purposes, money held by retirement plans, and surplus funds. These restrictions will apply to all contracts executed, amended or renewed beginning July 1. The legislation also will put in place new requirements and restrictions applicable to state and municipal bond issuances, government contracting and banks and other financial institutions. This Alert discusses HB 3 in more detail, with a focus on asset managers.

Retailisation of Private Funds – Is the Revised ELTIF Regulation the Solution?
April 21, 2023
The European Parliament and Council approved a new regulation revising the existing regulation on European long-term investment funds (the "ELTIF Regulation") on 15 February 2023. The previous iteration of the ELTIF Regulation, initially adopted on 29 April 2015, was widely viewed as an unsuccessful attempt to attract investment in infrastructure projects and other long-term assets in the European Union.
The new regime is expected to apply starting in Q1 2024. This Alert sets out some of the key changes that may drive a greater demand for ELTIFs in the European Union, bringing benefits to managers, investors and the wider economy, with a focus on the potential to increase retail appetite.

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