Quarterly Perspectives: SEC 4Q 2023

This paper provides an overview of key proposals and final rules issued by the SEC from October to December 31, 2023, along with updates on significant outstanding proposals (excluding technical amendments and EDGAR updates). The developments included in this update are intended to be a reminder of recently issued accounting and other guidance that may affect you in the current reporting period. This quarterly update is intended as general information and should not be relied upon as being definitive or all-inclusive.

A. Highlights

The SEC closed out the year by issuing six final rules in the fourth quarter, bringing the year-to-date total to 23 (including Edgar and technical updates). This compares to 17 final rules issued in 2022 and nine in 2021. Despite this scorching pace of standard setting, many of SEC Chair Gary Gensler's high-priority proposals remain unfinalized. A spate of legal cases on both the SEC's scope of authority and compliance with administrative rulemaking procedures are winding through the court system and could have a significant impact on future rule setting, most notably for the planned climate disclosure rules. The SEC's 2024 exam priorities for investment companies and broker-dealers notably dropped environmental, social, and governance (ESG) as a top concern. Recent comments by SEC commissioners hint at some of the challenges in finalizing these disclosures.

> "We got a lot of comments around what's called Scope 3 disclosures, and that's what we're trying to move forward on,"
>
> Gensler's September 12, 2023 testimony before the Senate Committee on Banking, Housing, and Urban Affairs.

> At a recent speech, Republican SEC Commissioner Mark Uyeda shared his thoughts on finalizing the ESG proposal and provided the basis for a legal challenge:
>
> "Before the Commission adopts any final rule that significantly deviates from the proposal, it should seriously consider re-proposing the rule with revised rule text and an updated economic analysis. The Commission should do everything possible to not promulgate a rule that is costly and ineffective, as doing so might be indicative of a flawed process that raises the question of whether the rule is arbitrary and capricious under the Administrative Procedure Act."
>
> Uyeda also championed scaled disclosure and/or staggered effective dates for smaller entities. Echoing preparer comment letter feedback, he also urged a review of the cumulative cost of the multiple rules issued recently.

As noted below, the most recent regulatory agenda rolled forward the issuance of the climate change rule to April 2024.

Legal Challenges

Legal challenges continue on the SEC's scope of authority and adherence to the administrative process in recent rule setting**.**

Share Repurchase

On May 3, 2023, the SEC issued a final rule updating and modernizing 2003 regulations on share repurchases by issuers, listed closed-end funds, and foreign private issuers (FPIs). The U.S. Chamber of Commerce brought a legal challenge,

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and in October 2023, the U.S. Court of Appeals for the Fifth Circuit required the SEC to provide additional materials by November 30, 2023. On December 1, 2023, the SEC indefinitely postponed the effective date of the rule. This is the first reform under Gensler's term to be struck down in a lawsuit.

Regulatory Agenda

The fall reg flex agenda was published in the **Federal Register** in December. New items from the spring 2023 agenda are marked with an asterisk.

Forthcoming SEC Proposals – Fall Reg Flex[1] Agenda			
Registrants (Division of Corporate Finance)	**Investment Funds & Advisers (Division of Investment Management)**	**Broker-Dealers & Clearing Agencies (Division of Trading & Markets)**	**Capital Formation (Division of Trading & Markets)**
Corporate board diversity	Fund fee disclosure & reform	Single stock exchange-traded funds (ETFs)	Regulation D improvements
Human capital management disclosure	Registration for index-linked annuities		Rule 144A holding period
Resource extraction issuers' payment disclosure			Securities held of record definition
Incentive-based compensation			Regulation ATS modernization*

[1]The SEC is not precluded from considering or acting on any matter not included in the agenda, and an agency is not required to consider or act on any matter that is included in the agenda.

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Forthcoming SEC Final Rules – Fall 2023 Reg Flex Agenda		
Registrants (Division of Corporate Finance)	**Investment Funds & Advisers (Division of Investment Management)**	**Broker-Dealers & Clearing Agencies (Division of Trading & Markets)**
Climate change disclosures	Cybersecurity risk management	Consolidated Audit Trail (CAT) data security
Shareholder proposals (Rule 14a-8)	Investment company names	Clearing agency resilience
Special purpose acquisition companies (SPACs)	ESG investment practices	Exchange definition (Rule 3b-16)
	Outsourcing by investment advisers	Dealer definition
	Form PF: Large private equity (PE) & liquidity fund advisers	Regulation best execution
	Safeguarding advisory client assets	Regulation NMS
	Consumer information privacy (Regulation S-P)	Order competition
	Liquidity & swing pricing open-end funds*	Order execution disclosures
	Predictive data & conflicts of interest*	Daily 15c3-3 lockup*
	Exemption for internet investment advisers*	Cybersecurity broker-dealers*

See the Appendix for additional details on the proposals related to these forthcoming final rules.

On the Horizon

Artificial Intelligence (AI)

Concerns over the use of AI are growing louder. At a recent conference, Lindsay McCord, chief accountant of the SEC's Division of Corporate Finance, signaled that the regulator is "open" to issuing disclosure guidance on AI.[2] Until then, registrants' disclosures should specify the impact to the overall business or any related risks if the company's work with the technology is material.

"Issuers should be thoughtful and careful to make sure they are doing things that are accurate and not misleading the public." Gensler said.[3]

[2] "AI Plans, Risks Should Be Clear to Investors, SEC Official Says," bloombergtax.com, November 13, 2023.
[3] "SEC's Gensler Warns Corporate America: Don't 'AI-Wash,'" politicopro.com, December 5, 2023.

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Statement of Cash Flows

In a speech on December 4, 2023, SEC Chief Accountant Paul Munter highlighted the importance of the statement of cash flows to investors. The statement of cash flows should have the same level of quality, rigor, and effective internal controls as the income statement and balance sheet. Preparers should carefully evaluate if a classification restatement is material. Companies should consider direct controls over the classification of cash flows and disclosure of noncash items.

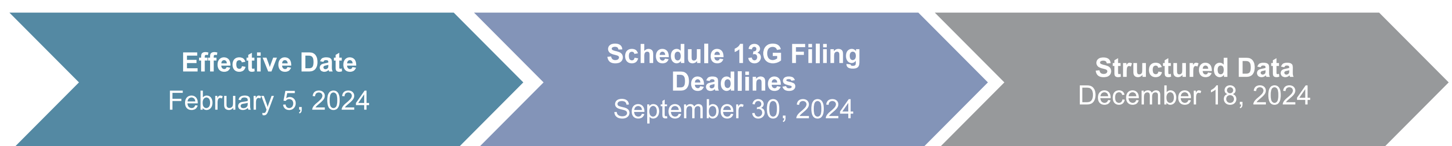
"For example, we believe issuers could further disaggregate amounts currently reported in the statement of cash flows, disclose additional information to better enable investors to understand the relationships between amounts reported in the statement of cash flows and those in the statement of financial position, and consider reporting operating cash flows under the direct method," Munter said.

B. Notable Final Rules Issued 4Q 2023

1. Beneficial Ownership

On October 10, 2023, the SEC issued a final rule modernizing beneficial ownership reporting rules. An investor with control intent files Schedule 13D, while exempt investors and investors without a control intent, such as qualified institutional investors and passive investors, file Schedule 13G. These rules were last updated in 1968 and 1977, respectively. Highlights include:

- Shortened deadlines for initial and amended Schedule 13D and 13G filings as follows:
    - Schedule 13D – Cut the initial filing deadline once a 5% interest is acquired to five business days (from 10 days) and amendment filing deadline within two days.
    - Schedule 13G – For qualified institutional investors, the initial filing deadline is now 45 days after the end of the **calendar quarter** in which the investor beneficially owns more than 5% of the covered class (up from 45 days after the end of a **calendar year**). For other Schedule 13G filers, *i.e.*, passive investors, the rule shortens the initial filing deadline from 10 days to five business days. For all Schedule 13G filers, an amendment must be filed 45 days after the **calendar quarter** in which a material change occurred rather than 45 days after the **calendar year** in which any change occurred. The rule also accelerates the Schedule 13G amendment obligations for qualified institutional investors and passive investors when their beneficial ownership exceeds 10% or increases or decreases by 5%.
- Disclosures on Schedule 13D must include interests in all derivative securities (including cash-settled derivative securities) that use the issuer's equity security as a reference security. (Currently, investors are considered beneficial owners of a security if they have voting and/or investment power and no one is included with a purely economic security interest, *e.g.*, cash-settle equity swaps.)
- Require that Schedule 13D and 13G filings use a structured, machine-readable data language.



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2. Securities Lending

On October 13, 2023, the SEC approved—in a three-to-two vote—new Rule 10c-1a to increase transparency in the securities lending market by mandating disclosures for security lenders. This rule not only covers investment companies but also banks, insurers, and pension plans. Only 12 pieces of data are required, but the implementation effort is substantial.

Resource: SEC New Disclosures on Securities Lending

3. Short Sales

On October 13, 2023, the SEC voted three to two to create new Rule 13f-2 and update the CAT to increase market transparency on short activity on equity securities. Institutional investment managers will be required to report certain short sale-related data to the SEC monthly, 14 days after month-end. At the end of the following month, the SEC would publicly report aggregate data about large short positions, including daily short sale activity for each individual security.

Resource: SEC Finalizes New Short Sale Disclosures

4. Security-Based Swaps Execution

On November 2, 2023, the SEC issued a final rule that:

- Creates a regime for the registration and regulation of security-based swap execution facilities (SBSEFs)
- Addresses various issues relating to the “trade execution requirement” for security-based swaps (SBSs)
- Addresses conflicts of interest at SBSEFs and national securities exchanges that trade SBSs
- Promotes consistency between SBSEFs’ rules and the *Securities Exchange Act of 1934*

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5. Clearing Agency Governance & Conflicts of Interest

On November 16, 2023, the SEC adopted rules to establish new governance requirements for all registered clearing agencies, including requirements:

- For independent directors and for the composition of a registered clearing agency's board of directors, nominating committee, and risk management committee
- To identify, mitigate, or eliminate conflicts of interest involving directors or senior managers and to document such actions
- For policies and procedures that obligate directors to report conflicts of interest
- For policies and procedures for the management of risks from relationships with service providers for core services
- For policies and procedures for the board to solicit, consider, and document the views of participants and other relevant stakeholders

6. Conflicts of Interest – Securitization

On November 27, 2023, the SEC issued a final rule completing a Dodd-Frank Act mandate to prohibit conflicts of interest in securitizations. The rule covers an asset-backed security (ABS) and hybrid cash and synthetic ABS and applies to any underwriter, placement agent, initial purchaser, or ABS sponsor. The rule prohibits a securitization participant from entering a conflicted transaction for a period ending one year after the date of the first closing of the ABS's sale. Conflicted transactions are defined as follows:

- Transaction is:
  - A short sale of the ABS
  - The purchase of a credit default swap or other credit derivative that entitles the securitization participant to receive payments upon the occurrence of specified credit events with respect to the ABS
  - The purchase or sale of any financial instrument (other than the relevant ABS) or entry into a transaction that is substantially the economic equivalent of a transaction described in the first two bullet points above, other than—for the avoidance of doubt—any transaction that only hedges general interest rate or currency exchange risk
- Materiality – Is there a substantial likelihood a reasonable investor would consider the relevant transaction important to the investor's investment decision, including a decision whether to retain the ABS?

There are certain exceptions for hedging and risk management.

7. Treasury Clearing & Broker-Dealer Customer Protection Rule

On December 13, 2023, the SEC issued a final rule expanding the use of central clearing for U.S. Treasury securities for secondary market transactions, including:

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- All repurchase and reverse repurchase agreements collateralized by U.S. Treasury securities to which a direct participant is a counterparty
- All purchase and sale transactions of U.S. Treasury for direct participants who are acting as interdealer brokers
- All purchases and sales of U.S. Treasury securities between a direct participant and a registered broker-dealer, government securities dealer, or government securities broker; a hedge fund; and a levered account

To address a jump in margin requirements resulting from increased central clearing, the proposal also would update the broker-dealer customer protection rules to permit margin required and on deposit at a covered clearing agency to be included as a debit item in the customer reserve formula, subject to certain conditions.

The SEC cited the March 2020 COVID-19 market disruptions and the increased U.S. Treasury trading by principal trading firms and hedge funds that are not centrally cleared as the primary reasons for the changes.

C. Final Rules Effective/Partially Effective 4Q 2023

1. Cybersecurity Disclosures

On July 26, 2023, the SEC voted three to two along party lines to standardize disclosures about cybersecurity risk management, strategy, governance, and material cybersecurity incidents by public companies subject to the reporting requirements of the *Securities Exchange Act of 1934*. Highlights include:

- **New Item 1.05 of Form 8-K:** Registrants will be required to disclose on this item any cybersecurity incident they determine to be material and to describe the material aspects of the incident's nature, scope, and timing, as well as its material impact or reasonably likely material impact on the registrant. This will generally be due four business days after a registrant determines that a cybersecurity incident is material. The disclosure may be delayed if the U.S. attorney general determines that immediate disclosure would pose a substantial risk to national security or public safety with written notification to the SEC.
- **New Regulation S-K Item 106:** Will require registrants to describe—on an annual basis—their processes for assessing, identifying, and managing material risks from cybersecurity threats, as well as the material effects or reasonably likely material effects of risks from cybersecurity threats and previous cybersecurity incidents. Item 106 requires registrants to describe the board of directors' oversight of risks from cybersecurity threats and management's role and expertise in assessing and managing material risks from cybersecurity threats. These disclosures are required in the 10-K.

Resources:
Details on SEC's New Cybersecurity Disclosures
SEC's New Cyber Disclosure Rule: Answering Your Top Questions (Webinar)

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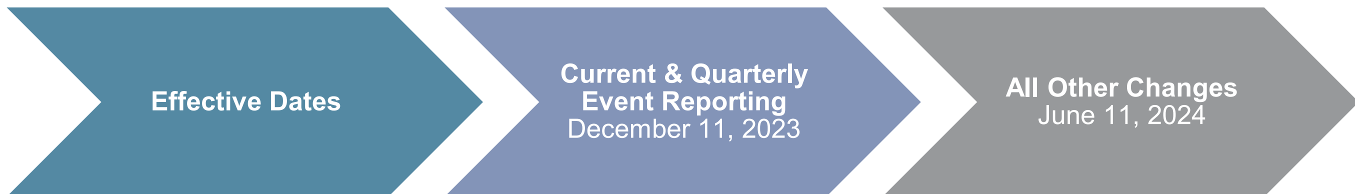
2. Form PF Updates

On May 3, 2023, the SEC voted three to two along party lines to issue a final rule updating Form PF requirements for hedge fund and PE fund advisers as follows:

- Require large hedge fund advisers to report certain key events within 72 hours
- Require all PE fund advisers to report certain key events quarterly
- Require enhanced reporting by large PE fund advisers



Resource: SEC Finalizes First Round of Form PF Updates

3. Executive Pay Clawbacks

This final rule addresses standards for exchange-listed companies for the recovery of erroneously awarded compensation to executive officers, known as a clawback policy. The executives covered are broad and include the issuer's president; principal financial officer; principal accounting officer; any vice president in charge of a principal business unit, division, or function; and any other officer who performs policymaking functions. Highlights include:

- National securities exchanges (NSEs) must establish listing standards that would require listed companies to adopt and comply with a compensation recovery policy. Noncompliance would result in delisting.
- Listed issuers must disclose any recovery of excess incentive-based compensation and file their clawback policy as an annual report exhibit.
- All issuers' annual reports will include a checkbox if the financial statements reflect an error correction to previously filed statements. Disclosure is required if the restatement required a recovery analysis and any actions taken related to its recovery policy.

The rule has raised a number of questions from financial statement preparers. On November 21, 2023, the SEC issued a third set of clarifications on the rule's application. The Compliance & Disclosure Interpretations added eight new questions and answers and updated two previous items. This round of updates focused on peer groups.

Resources:
SEC Finalizes Executive Pay Clawback Rules
Updates to SEC's Executive Pay Clawback Rules

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4. Private Fund Reforms

On August 23, 2023, the SEC approved a final rule that significantly expands oversight, disclosure, and audit requirements for private funds.

SEC-registered private fund advisers must:

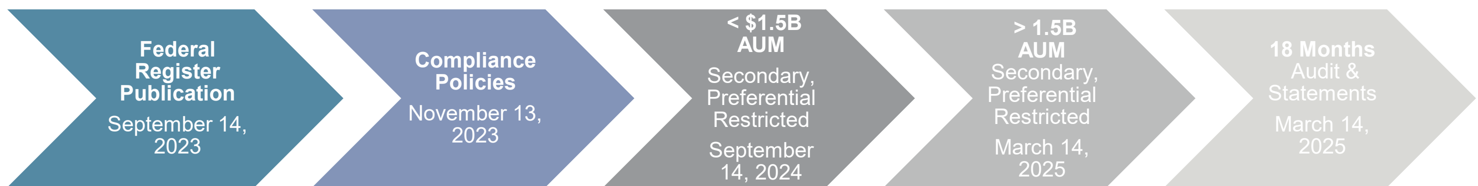
- Provide investors a quarterly statement with details on fund performance, fees, and expenses
- Obtain an annual audit for each private fund under the audit provisions of the custody rule
- Obtain a fairness opinion for adviser-led secondary transactions

All private fund advisers would be required to:

- Restrict certain activities without consent or disclosure
- Prohibit certain preferential treatment unless disclosed to current and prospective investors

All registered advisers, including those that do not advise private funds, must document the annual review of their compliance policies and procedures in writing.

Resource: SEC Finalizes Extensive Private Fund Reforms



D. Final Rules on the Horizon

1. T+1 Settlement

The final rule reduces risks in the clearance and settlement of securities as follows:

- Shorten the standard settlement cycle for securities transactions from two business days after trade date (T+2) to one business day after trade date (T+1) on March 31, 2024
- Eliminate the separate T+4 settlement cycle for firm commitment offerings priced after 4:30 p.m.
- Improve the processing of institutional trades by proposing new requirements for broker-dealers and registered investment advisers (RIAs) intended to improve the rate of same-day affirmations
- Facilitate straight-through processing by proposing new requirements applicable to clearing agencies that are central matching service providers

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Resources:

Ready for T+1 Settlement by May 2024?

Five Steps to Prepare for T+1 – Key Updates to Know

Exploring the Global Impact of T+1

2. Money Market Fund (MMF) Reforms

On July 12, 2023, the SEC voted three to two along party lines to approve a final rule making significant updates to requirements for MMFs and large liquidity advisers. Highlights include:

- Increase minimum daily and weekly liquidity requirements to 25% and 50%
- Remove provisions on redemption gates and decouple the imposition of liquidity fees from a fund's liquidity level
- In the most significant change from the proposal, the SEC backed away from swing pricing and instead will require institutional prime and tax-exempt MMFs to impose redemption fees. Non-government MMFs could impose a discretionary liquidity fee with board approval
- Additional reporting requirements for large liquidity fund advisers
- Specific guidance for a negative interest rate environment

Resource: Sweeping Changes for Money Market Funds

E. Notable Proposals Issued 4Q 2023

1. Index-Linked Annuities Registration

On September 29, 2023, (after our 3Q publication date) the SEC issued a 420-page proposal that would update registration, disclosure, and advertising requirements for registered index-linked annuities (RILAs). The RILA market has more than tripled since 2017, and as of 2022, the market size is estimated at $41 billion. A RILA investor's gains or losses are based on whether a selected benchmark, typically an index, goes up or down over a set period of time. These annuities also have a "bounded return structure," meaning that they will usually limit an investor's losses when the index goes down, but at the cost of limiting that investor's gains when the index goes up. The proposal would require insurance companies to register RILA offerings on Form N-4, the form used for most variable annuities. Details would include the features and risks of RILAs.

Comments were due by November 28, 2023.

Resource: SEC Changes Coming to Registered Annuities?

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2. Volume-Based Exchange Transaction Pricing for NMS Stock

On October 18, 2023, the SEC proposed Rule 6b-1 under the *Securities Exchange Act of 1934* to prohibit national securities exchanges from offering volume-based transaction pricing in connection with the execution of agency-related orders in certain stocks. If exchanges offer such pricing for their members' proprietary orders, the proposal would require the exchanges to adopt rules and written policies and procedures related to compliance with the prohibition, as well as disclose—monthly—certain information, including the total number of members that qualified for each volume tier during the month.

"Currently, the playing field upon which broker-dealers compete is unlevel," said Gensler. "Through volume-based transaction pricing, mid-sized and smaller broker-dealers effectively pay higher fees than larger brokers to trade on most exchanges. We have heard from a number of market participants that volume-based transaction pricing along with related market practices raise concerns about competition in the markets. I am pleased to support this proposal because it will elicit important public feedback on how the SEC can best promote competition amongst equity market participants."

Comments were due by January 5, 2023.

See the Appendix for previously issued outstanding proposals.

Conclusion

The assurance team at **FORVIS** delivers extensive experience and skilled professionals to assist with your objectives. Our proactive approach includes candid and open communication to help address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. FORVIS works with hundreds of publicly traded companies in the delivery of assurance, tax, or advisory services, within the U.S. and globally. For more information, visit **forvis.com**.

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Appendix – Significant Outstanding Proposals

Unless otherwise noted, the comment periods are all closed.

A. Significant 2023 Proposals

1. Safeguarding Advisory Client Assets

On February 15, 2023, the SEC voted four to one to approve a proposal to significantly expand investor protection on advisory client assets. The proposal would:

- Expand the custody rule's scope to cover additional client assets and add discretionary authority as a custody activity
- Enhance the custodial protections for client assets
- Add new custody record-keeping and reporting requirements

If approved, the final rule would have staggered compliance dates depending on an adviser's regulatory assets under management (AUM).

The SEC received almost 300 comment letters from advisers, custodians, industry groups, and individuals. Feedback was mixed; most cited significant costs to both custodians and advisers and especially smaller entities, difficulties and potential reduction in custodying certain assets (such as derivatives, annuities, repo agreements, and loans), and an increase in advisory costs shutting out smaller individual investors.

On August 23, 2023, the SEC reopened the comment period until October 30, 2023.

Several hundred additional comment letters were received with the vast majority criticizing the proposed changes. The Securities Industry and Financial Market Association's feedback was consistent with other industry participants. "Ultimately, if not significantly revised and subjected to additional review and comment, we believe that the Proposal likely would (i) significantly disrupt the operation of financial markets, (ii) restrict the ability of advisers to provide clients with investment advice for certain asset classes, (iii) limit the availability of custodial services, (iv) increase costs borne by investors, (v) result in fewer custodians for clients and advisers from which to choose, and (vi) negate the efforts and considerations taken in previous guidance issued by the SEC."

There also was strong pushback from crypto and decentralized finance (DeFi) market participants.

Resource: Expansion of Adviser's Safeguarding & Custody Rules?

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2. Cybersecurity Risk Management – Broker-Dealers & Other Market Participants

On March 15, 2023, the SEC issued a proposal that addresses cybersecurity risk management policies and procedures for broker-dealers, the Municipal Securities Rulemaking Board, clearing agencies, major SBS participants, national securities associations, national securities exchanges, SBS data repositories, SBS dealers, and transfer agents, collectively, "market entities." Under new Rule 10, all market entities would be required to establish, maintain, and enforce written policies and procedures that are reasonably designed to address their cybersecurity risks. At least annually, market entities also would be required to review and assess the design and effectiveness of their cybersecurity policies and procedures, including whether they reflect changes in cybersecurity risk over the time period covered by the review. Covered entities also would need to give the SEC immediate written electronic notice of a significant cybersecurity incident upon having a reasonable basis to conclude that the significant cybersecurity incident had occurred or is occurring. New Form SCIR would require information about the entity's efforts to respond to—and recover from—the cyber incident. Form SCIR would be filed with the SEC and posted on the entity's website. Covered broker-dealers, subject to additional requirements, would include carrying and introducing broker-dealers, broker-dealers with regulatory capital equal to or exceeding $50 million, broker-dealers with total assets equal to or exceeding $1 billion, broker-dealers that operate as market makers, and broker-dealers that operate an ATS.

> The SEC received 245 letters mostly supporting the proposal. Some respondents felt the scope was too broad and costly while others suggested the scope could be expanded.

3. Regulation S-P, Privacy of Consumer Information

On March 15, 2023, the SEC approved a proposal that would update Regulation S-P (issued in 2000). The rule covers broker-dealers, investment companies, RIAs, and transfer agents. Changes include:

- Covered institutions must adopt written policies and procedures for an incident response program to address unauthorized access to or use of customer information. The incident response program should be reasonably designed to detect, respond to, and recover from unauthorized access to or use of customer information; include procedures to assess the nature and scope of any such incident; and contain and control such incidents
- Covered institutions must have written policies and procedures to provide timely notification (no later than 30 days after an incident) to affected individuals whose sensitive customer information was or is reasonably likely to have been accessed or used without authorization
- Broadening the scope of information covered by Regulation S-P's requirements

> Feedback was mixed. There was some general support, but other respondents felt the proposal was too complex and costly to implement, especially for smaller entities.

4. Covered Clearing Agency (CCA) Resilience & Recovery & Wind-Down Plans

On May 17, 2023, the SEC issued a proposal that would amend the current rules on intraday margin and the use of substantive inputs to a CCA's risk-based margin system and add a new rule with nine specific requirements for a CCA's recovery and wind-down plan.

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Seventeen comment letters were received. There was general support to codify existing guidance to be consistent with international standards, but there was pushback on the proposal's prescriptiveness and potential costs versus benefits on some requirements.

According to the SEC, "certain aspects are overly prescriptive and are unrealistic considering the practical limitations on a CCA's ability to plan for extreme loss scenarios." Several respondents requested additional time to review the SEC's proposal and the Commodity Futures Trading Commission (CFTC) proposal to help ensure consistency.

5. Daily 15c-3-3 Calculations

On July 12, 2023, the SEC approved a proposal that would require daily 15c-3-3 calculations and lockup for carrying broker-dealers with customer credits exceeding $250 million.

Resources:
Daily 15c3-3 Calculations Coming Soon?
Brokering Changes: Why Daily Reporting Should Compute

Seventy comment letters were received. Investors almost universally supported the changes. There were several requests to reconsider the $250 million threshold and tweaks to the on-ramp and off-ramp requirements. There was pushback on cost for smaller firms (most notably from SIFMA) and the impact of several other final rules to be implemented in the same time frame (most notably T+1 implementation).

6. Conflicts of Interest From Predictive Data Analytics Use by Broker-Dealers & Investment Advisers

On July 26, 2023, the SEC issued a proposal that would require:

- A firm to eliminate or neutralize the effect of conflicts of interest related to the firm's use of covered technologies in investor interactions that place the firm's or its associated person's interest ahead of investors' interests
- Investment advisers and broker-dealers using covered technology must have written policies and procedures reasonably designed to comply with the proposal
- Record-keeping related to the proposed conflicts rules

"Covered technology" includes a firm's use of analytical, technological, or computational functions, algorithms, models, correlation matrices, or similar methods or processes that optimize for, predict, guide, forecast, or direct investment-related behaviors of an investor. This would generally apply to use of a covered technology in a firm's engagement or communication with an investor, including by exercising discretion with respect to an investor's account, providing information to an investor, or soliciting an investor.

7. Exemption for Internet Investment Advisers

Currently under Rule 203A-2(e), investment advisers are generally prohibited from registering with the SEC unless they either reach the $100 million in AUM threshold, advise a registered investment company, or qualify for an SEC exemption. State security authorities regulate these firms. The Internet Advisers exemption permits SEC registration if advisory services are primarily through the internet, which is defined as fewer than 15 non-internet clients. This rule was last updated in 2002 and does not reflect evolutions in technology since then. The proposal narrowed the use of this exemption by:

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- Requiring an investment adviser relying on the exemption to at all times have an operational interactive website through which the adviser provides investment advisory services on an ongoing basis to more than one client
- Eliminating the de minimis exception for non-internet clients. An internet investment adviser would be required to provide advice to all its clients exclusively through an operational interactive website

Ten comment letters were received. There was general support to codify existing guidance to be consistent with international standards, but there was pushback on the proposal's prescriptiveness and potential costs versus benefits on some requirements.

B. 2022 Outstanding Proposals

1. Regulation Best Execution

On December 15, 2022, the SEC issued a proposal updating Regulation Best Execution as follows:

- Establish a best execution standard for brokers, dealers, government securities brokers, government securities dealers, and municipal securities dealers, collectively "broker-dealers"
- Require broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to comply with the best execution standard
- Require more robust policies and procedures for broker-dealers that engage in certain conflicted transactions for or with a retail customer
- Require broker-dealers to review the execution quality of their customer transactions at least quarterly
- Exempt broker-dealers that qualify as "introducing brokers" from certain requirements if they establish, maintain, and enforce specified policies and procedures
- Require broker-dealers to review their best execution policies and procedures at least annually and present a report detailing the results of such review to their boards of directors or equivalent governing bodies

More than 2,250 comment letters were received, including four form letters, primarily from individual investors and investor advocacy groups that supported the changes. Asset managers and pension funds with high concentrations of retail activity supported the changes. They cited increased costs due to lack of price discovery from payment-for-order-flow arrangements. Not surprisingly, firms like Citadel that pay for order flow vehemently opposed the proposed changes. Industry participants, trade groups, and NYSE and NASDAQ generally supported the need for improvement to the existing "weak" FINRA rule but pushed back hard on the need for a massive overhaul of the equities market (four proposals) and suggested a sequential approach to market reform with adequate time to study the impacts of each change. Several bond market participants cited potential unintended impacts on their market segment without editing changes to the proposal's scope.

2. Order Competition

The proposed rule, issued on December 15, 2022, would enhance competition for the execution of marketable orders of individual investors. The rule would require certain orders of individual investors to be exposed to competition in fair and open auctions before they could be executed internally by any trading center that restricts order-by-order competition.

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This proposal received more than 3,600 comment letters, including several form letters. Most market participants felt the proposal as written would not achieve the SEC's intended goals and included significant areas for improvement. A slower approach to the overhaul of the equity market was a key theme.

3. Regulation NMS: Tick Size, Access Fees, & Odd-Lots

The proposed rule would:

- Amend the minimum pricing increments (tick size) to establish a variable minimum pricing increment model that would apply to both the quoting and trading of national market system (NMS) stocks, which are stocks listed on an NSE, regardless of trading venue
- Reduce the access fee caps and require NSEs to make the amounts of all fees and rebates determinable at the time of execution
- Accelerate the implementation of the round-lot and odd-lot information definitions adopted in 2020 under the Market Data Infrastructure Rules and amend the odd-lot information definition to require the identification of the best odd-lot order

Almost 3,000 comment letters were received. Most respondents supported modernizing these rules with edits/modifications. Large pension funds supported these changes.

4. Order Execution Disclosures

The proposal would update disclosures required under Rule 605 of Regulation NMS as follows:

- Expand the scope of entities subject to Rule 605 by requiring broker-dealers that introduce or carry 100,000 or more customer accounts, single-dealer platforms, and entities that would operate qualified auctions to make available to the public monthly execution quality reports
- Amend the definition of "covered order" to include certain orders submitted outside of regular trading hours, orders submitted with stop prices, and nonexempt short-sale orders
- Recategorize required information, including changing the order type categories and order size categories to include fractional share orders, odd-lot orders, and larger-sized orders
- Eliminate time-to-execution categories in favor of average time to execution, median time to execution, and 99th percentile time to execution statistics, each as measured in increments of a millisecond or finer
- Amend the information required to be reported under the rule, including changing the realized spread statistics to 15-second and one-minute realized spread and requiring new statistical measures of execution quality that could be used to evaluate price improvement and size improvement for all order types, additional price improvement statistics for market and marketable order types, and certain statistical measures that could be used to measure execution quality of nonmarketable limit orders
- Enhance the accessibility of the required reports by requiring all entities subject to Rule 605 to make a summary report available

Almost 800 letters were received. There was universal support for better disclosure in this area. Many suggested using CAT data to generate the information to improve consistency and reduce implementation and ongoing expenses.

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5. Liquidity & Swing Pricing for Open-End Funds

On November 2, 2022, the SEC issued a 444-page proposal that would significantly change liquidity risk management and pricing practices for open-end management investment companies:

- Update the classification of investment liquidity and require a minimum of 10% of highly liquid assets
- Require the use of swing pricing and implement a hard close
- Monthly, timelier, and more detailed public reporting of fund information

The changes would not apply to MMFs or certain ETFs. If adopted, the final rule would have a two-year compliance date for the swing rule changes and allow one year to implement the liquidity updates.

Resource: Funds Face New Liquidity & Swing-Pricing Requirements

More than 2,500 letters were received. Individual investors supported the amendments. Service providers, advisers, and adviser advocacy groups pushed back on the following points: overlap with existing fiduciary rules and pricing service rules in Rule 2a-5, implementation costs understated and prohibitive to smaller IAs, implementation time too short given scope of change, and other regulatory updates.

6. Outsourcing by Investment Advisers

On October 26, 2022, the SEC issued a proposal seeking feedback on new minimum due diligence and monitoring requirements for investment advisers who outsource certain covered services:

- Advisers must conduct due diligence before outsourcing and periodically monitor service providers' performance and reassess whether to retain them. Oversight must be documented and detailed information on service providers would be required on Form ADV
- Enhanced due diligence and monitoring will be required for third-party record-keepers

If approved, the compliance date would be 10 months from the rule's effective date.

Resource: New Outsourcing Rules for Investment Advisers?

Ninety letters were received. Individual investors supported the amendments. Service providers, advisers, and adviser advocacy groups pushed back on the following points: overlap with existing fiduciary rules and pricing service rules in Rule 2a-5; implementation costs understated and prohibitive to smaller IAs; implementation time too short given scope of change and other regulatory updates; scope clarification/exemptions for regulated banks; bank-affiliated RIAs, qualified custodians, and index providers; potential cyberthreats from required vendor disclosure; and lack of jurisdiction over service providers.

7. Form PF Amendments

On August 10, 2022, the SEC issued a second set of proposed Form PF updates jointly with the CFTC that covers private funds, commodity pool operators, and commodity trading advisors. Significant changes include:

- Section 1 and general instruction changes – Applicable to all Form PF filers
  - New details on advisers and the private funds they advise, including a breakout of digital assets
  - Reporting of complex structures

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- Enhanced reporting on hedge funds

- Section 2 changes – Applicable to large hedge fund advisers who advise qualifying hedge funds
  - Enhanced reporting
  - Removal of aggregate reporting

Resource: SEC Proposes Second Set of Form PF Disclosure Updates

8. Shareholder Proposal Exclusion

On July 13, 2022, the SEC voted three to two to issue a proposal to update three of the substantive bases for excluding a shareholder proposal from a company's proxy statement. The changes would restrict the grounds for excluding shareholder proposals and, if adopted, would most likely increase the number of shareholder proposals that would have otherwise been excluded under prior SEC conclusions.

Resource: Excluding Shareholder Proposals May Get Tougher with SEC Proposal

Sixty-two letters were received. Individual investors and shareholder advocate groups supported the amendments. Trade associations opposed the amendments, citing an increased number of minor or trivial proposals on proxy statements, and arguing not enough time has passed since the 2020 amendments to properly assess additional changes.

Thirty comment letters were received with universal support from individual investors, exchanges, and funds, including Citadel. ICE believes that any final rule should expressly acknowledge the potential for multiple Treasury clearing agencies and prohibit a clearing agency's rules from restricting or impeding a member's ability to clear a Treasury security or repo/reverse repo agreements at another clearing agency. ICE did not support the requirement to return excess margin within one business day. GTS and ICI requested a staggered implementation, perhaps by security type, or to begin with an expansion of central clearing before any mandates. Exemption was requested for 2a-7 funds and interdealer brokers.

9. ESG Disclosures for Investment Advisers & Investment Companies

On May 25, 2022, the SEC issued a 362-page proposal with new rules and disclosures to give investors consistent, comparable, and reliable information on funds' and advisers' use of ESG factors. The changes would apply to registered investment companies and business development companies, collectively "funds," and RIAs and certain unregistered advisers, collectively "advisers." Highlights include:

- New disclosures on ESG strategies in fund prospectuses, annual reports, and adviser brochures
- Implementing a layered, tabular disclosure approach for ESG funds to allow investors to easily compare ESG funds
- Greenhouse gas (GHG) emissions disclosure would be required for certain environmentally focused funds for portfolio investments

Resource: Investment Advisers & Companies Face New ESG Disclosures

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Almost 200 comment letters were received. There was universal support for consistent standards. Investor groups supported the changes while investment funds and industry groups suggested improvements to address the vagueness of the terms, materiality consideration, consistency with global standards, and application to fixed income funds. There was pushback on the three required buckets, primarily on the ESG integration category. There was pushback from the energy and timber sectors that felt these rules could negatively impact fund investments held. Many pushed back on the GHG disclosure as those protocols continue to evolve. NASDAQ noted the rule could disincentivize funds and advisers from considering ESG investment strategies. The Forum for Sustainable and Responsible Investment pushed back: "Some aspects of the Proposal do not align with real-world fund investment approaches or investor informational needs." Several respondents, including SIFMA and the attorneys general from several states, cited *West Virginia v. EPA*. Others urge a final rule on ESG reporting before these changes to investment advisers.

10. SPAC Disclosures

On March 30, 2022, the SEC proposed amendments covering SPACs, shell companies, and projections disclosure. Highlights include:

- New disclosures and additional investor protections in SPAC initial public offerings and in business combination transactions between SPACs and private operating companies (de-SPAC transactions)
- Address the treatment under the *Securities Act of 1933* of business combination transactions involving a reporting shell company and amend the financial statement requirements for transactions with shell companies
- Provide additional guidance on the use of projections in SEC filings
- Assist SPACs in assessing when they may be subject to regulation under the *Investment Company Act of 1940*

Ninety-seven comment letters were received, and feedback was mixed. Most approved of the additional disclosures. Many cautioned that the underwriter liability expansion and fairness opinion went too far, and the 18- and 24-month time frames were too strict.

11. Dealer Definition

On March 28, 2022, the SEC released a proposal that would require market participants, such as proprietary trading firms, that assume certain dealer-like roles and/or engage in certain levels of buying and selling government securities, to register with the SEC, become a member of a self-regulatory organization, and comply with federal securities laws and regulatory obligations. New rules would further define the phrase "as a part of a regular business" in the *Securities Exchange Act of 1934* to identify certain activities that would cause persons engaging in such activities to be "dealers" or "government securities dealers" and subject to the registration requirements.

- Rules 3a5-4 and 3a44-2 would set forth identical qualitative standards designed to identify market participants who assume certain dealer-like roles; in particular, those who function as market liquidity providers
- Rule 3a44-2 establishes a quantitative standard under which a person engaging in certain specified levels of activity would be deemed to be buying and selling government securities "as a part of a regular business," regardless of whether it meets any of the proposal's qualitative standards. No presumption shall arise that a person is not a dealer solely because that person does not engage in the activities identified in the proposed rules. The proposal does not address all circumstances when a person may be acting as a dealer or government securities dealer or replace otherwise applicable interpretations and precedent

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- The proposal excludes any person who has or controls total assets of less than $50 million and an investment company registered under the *Investment Company Act of 1940*

Fifty-seven comment letters were received, and feedback was negative overall. Fund industry groups felt the changes would have a negative effect on Treasury market liquidity, resiliency, and efficiency; the proposal exceeds the SEC statutory authority; and that the costs do not outweigh the benefits. T. Rowe Price and Citadel felt there were other, more efficient ways to address the SEC concerns: "If the proposed rules are adopted in their current form, it would lead to unnecessary and burdensome monitoring obligations for a range of asset management organizations and activities that, in our view, are unlikely to raise the concerns cited by the SEC. And for registered investment advisers (or their funds or their clients' advisory accounts) that would ultimately be classified as dealers, the burdens would be amplified. Regulating these parties as dealers would not serve the public's interest and would cause a host of negative impacts."

12. ESG – Climate Disclosures

On March 21, 2022, the SEC answered investor and company requests for more standardized guidance on ESG issues. The SEC released a 490-page proposal that focuses on prescriptive climate-related disclosures that would be included in registration statements and SEC filings. The proposal would require information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition. The SEC hopes for more consistent and comparable information across companies. The rules would apply to all SEC reporting companies, even those with no publicly listed securities. Required disclosures would include:

- Climate-related metrics and related note disclosure in audited financial statements that would be subject to internal control over financial reporting requirements
- Disclosure of climate-related risks over the short, medium, and long term and their impact on business activities
- Risk management and governance of identified climate-related risks
- GHG emissions. This includes Scope 1 and Scope 2 emissions, *e.g.*, from a registrant's owned or controlled operations and purchased or acquired electricity, steam, heat, or cooling, which would be subject to assurance. Scope 3 emission disclosures would be required if the emissions are material or if a registrant has set a GHG emissions reduction target including its Scope 3 emissions. Scope 3 disclosures would be covered by a safe harbor provision
- Information about climate-related targets and goals, internal carbon price, and transition plan, including progress against the plan, targets, or goals

Resources:

SEC's ESG Climate Proposal – What You Need to Know

Attestation and Internal Control Considerations for ESG Programs

Where to Start? Building Your PMO Within ESG

Behind the Curtain: What You Need to Know About ESG Assurance

13. Cybersecurity – Investment Advisers

On February 9, 2022, the SEC proposed new rules to enhance cybersecurity preparedness and improve the resilience of investment advisers and investment companies against cybersecurity threats and attacks as follows:

- Require advisers and funds to adopt and implement written policies and procedures reasonably designed to address cybersecurity risks

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- Require advisers to report significant cybersecurity incidents to the SEC on proposed Form ADV-C within 48 hours
- Enhance adviser and fund disclosures related to cybersecurity risks and incidents
- Require advisers and funds to maintain, make, and retain certain cybersecurity-related books and records

Seventeen comment letters were received at the end of the first comment period. Feedback mirrored comments on the registrant's cyber proposal above. Several funds requested more flexibility in implementing any new cyber rules, especially smaller funds. Many felt that administratively, cyber rule setting should not be under the anti-fraud provisions, but rather under the general rulemaking authority. After the second reopened comment period, an additional 84 comment letters were received. According to the IAA, "The Commission has severely underestimated the costs of the Adviser Proposals – both in isolation and on a cumulative basis – for all advisers, and especially for smaller advisers. At the same time, it has, in our view, overestimated the potential benefits, and we are concerned that the Adviser Proposals collectively will harm rather than further the Commission's stated goals. … Before taking final action on the Adviser Proposals, seek public feedback on a comprehensive implementation timeline for tiered and staggered compliance requirements and dates for all these proposals." Most industry participants felt 48 hours was too short for reporting and most requested an extended implementation period.

14. ATSs – Exchange Definition (Rule 3b-16)

On January 26, 2022, the SEC reissued a proposal, first issued in September 2020, to expand and modernize Rule 3b-16, which governs alternative trading systems (ATSs). ATSs are trading systems for securities that meet the exchange definition under federal securities laws but are not required to register with the SEC as an NSE if the ATS complies with certain exemption conditions. The proposal would make the following updates:

- Expand Regulation ATS for ATSs that trade government securities, NMS stock, and other securities
- Extend Regulation SCI to ATSs that trade government securities
- Amend the SEC exchange definition to include communication protocol systems

More than 300 comment letters were received. Most agreed with the first bullet point above. There was confusion over the application of Rule 15c2-11 to fixed income securities based on a no-action letter issued on September 24, 2021, and this ATS proposal. Much of the pushback concerned updating the "exchange" definition and a request for a definition of communication protocol system. Blockchain and decentralized finance groups pushed back on SEC overreach in applying existing concepts to new technology innovations.

On April 14, the SEC reopened the comment period until June 13, 2023. The reopening release reiterated the applicability of existing rules to platforms that trade crypto asset securities, including so-called "DeFi" systems, and provides supplemental information and economic analysis for systems that would be included in the new, proposed exchange definition. The reopening release also requested information and public comment on crypto asset securities trading on such systems and certain aspects of the proposed amendments applicable to all securities.

An additional 2,000 comment letters were received. Several comment letters cited the cost for smaller ATSs and a potential reduction in the number of firms.

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