

2023 SEC Regulatory Outlook – Asset Managers & Funds

This paper provides an overview of key SEC final rules and proposals that may impact asset managers and investment funds. The developments included in this update are intended to be a reminder of recently issued accounting and other guidance that may affect you in 2023. This update is intended as general information and should not be relied upon as being definitive or all-inclusive.

Overview

In 2021, the industry set a new record for global assets under management (AUM) globally; however, market disruptions in 2022 have slowed domestic AUM growth as noted in the graphs below. Asset managers and funds have weathered COVID-19, inflation, and a rising interest rate environment fairly well. At the same time, SEC Chair Gary Gensler has set a pace of standard setting that surpasses the regulation issued subsequent to the 2007 mortgage crisis and the Enron and WorldCom bankruptcy that gave rise to the Sarbanes-Oxley Act.

Given the number of proposals and the complexity of the underlying issues, there was substantial pushback on the operational implementation challenges and regulatory overload if multiple proposals are approved with the current effective dates. A Committee on Capital Markets Regulation report indicates that the SEC has failed to evaluate the burden and overlapping requirements of the recent proposals on companies and funds. With the outcome of the November elections, rules are unlikely to be overturned by the Congressional Review Act, but other legal challenges may be considerable:

- The U.S. Supreme Court decision in *West Virginia v. Environmental Protection Agency* found that federal agencies need specific congressional authorizations before issuing regulations that deal with major questions. This could tie up the environmental, social, and governance (ESG) proposals below in court battles for years.
- The National Association of Manufacturers and the Natural Gas Services Group filed a lawsuit alleging the SEC exceeded its authority in rescinding two amendments that increased restrictions on proxy advisory firms.

In a surprising turn of events, the standard-setting calendar for the fourth quarter of 2022 was upended when the comment period for 12 high-profile proposals was reopened until November 1, 2022. The affected rule proposals include those for ESG, cybersecurity, money market reform, and short sales, among others.

ESG

In the absence of final rules on ESG and climate, the SEC's Climate and ESG Task Force continues to leverage 2010 interpretive guidance. The 2010 guidance clarifies what companies should be doing—making disclosure about the effects of climate-related legislation, regulation, and international accords, if material to their business. The task force also analyzes disclosure and compliance issues related to investment advisers' and funds' ESG strategies and recently fined Goldman Sachs Asset Management \$4 million for allegedly failing to have written policies and procedures for ESG research and, once policies and procedures were established, failing to follow them consistently.

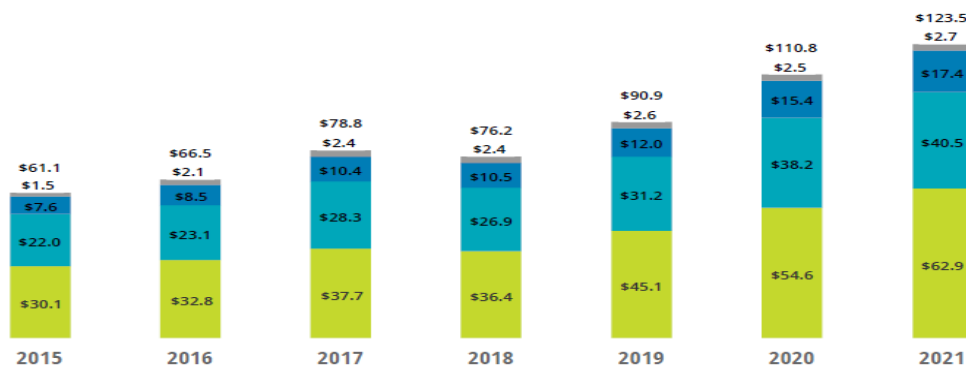
“Today’s action reinforces that investment advisers must develop and adhere to their policies and procedures over their investment processes, including ESG research, to ensure investors receive the advisory services they would expect to receive from an ESG investment,” said Andrew Dean, co-chief of the Enforcement Division’s Asset Management Unit.

Resource: [SEC Lays Out ESG Reporting Expectations](#)

Global AUM has increased year-over-year crossing the US\$120 trillion mark in 2021 with North America attracting the most investments and Asia Pacific recording the fastest growth since 2015

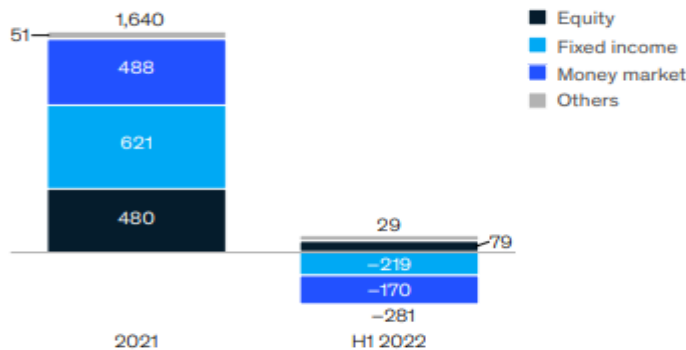
■ North America, CAGR 13.1% ■ Europe, CAGR 10.8% ■ Asia Pacific, CAGR 14.7% ■ RoW, CAGR 10.1%

Global professionally managed AUM (US\$T)



Sources: Investments and Pensions Europe; Investment Company Institute; Deloitte Center for Financial Services analysis.

Annual and first-half totals by asset class, North America, \$ billion



¹Includes open-end mutual funds, exchange-traded funds (ETFs). Excludes funds of funds.
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Final Rules

1. Tailored Shareholder Reports & Advertising Rule Updates

In a rare unanimous vote, the SEC approved on October 20, 2022 a [final rule](#) with comprehensive changes to the mutual fund and exchange-traded fund (ETF) disclosure framework. The rule also updates advertising rules for registered investment companies (RICs) and business development companies (BDCs) to include certain standardized figures and reasonably current information.

Resource: [New Fund Shareholder Report & Advertising Rules](#)



2. Fund Proxy Voting & Say-on-Pay Disclosures

On November 2, 2022, in a partisan three-to-two vote, the SEC approved a [final rule](#) enhancing the information mutual funds, ETFs, and other registered management investment companies (funds) report annually on proxy votes. The rule also completes a Dodd-Frank Act requirement for institutional investment managers to report annually on proxy voting related to executive compensation say-on-pay matters. Other highlights:

- Funds and managers would categorize voting by type using the issuer's proxy language
- Funds and managers must disclose the number of shares that were voted and the number of shares held by the funds that were loaned out on the record date and not recalled for voting

These changes will be effective for votes occurring on or after July 1, 2023. The first filing date for amended Form N-PX will be on August 31, 2024.

Resource: [Funds Get New Proxy Voting & Say-on-Pay Disclosures](#)

Proposals

Unless otherwise noted, the comment periods on the below periods are all closed.

* Comment period reopened to November 1, 2022, due to a technical glitch.

1. 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 money market funds (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. Comments are due by February 14, 2023.

Resource: [Funds Face New Liquidity & Swing-Pricing Requirements](#)

2. 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. Comments were due on December 27, 2022.

Resource: [New Outsourcing Rules for Investment Advisers?](#)

3. Treasury Clearing & Broker-Dealer Customer Protection Rule

In a rare unanimous vote, the SEC issued a proposal on September 14, 2022 expanding the use of central clearing for U.S. Treasury securities for secondary market transactions, including:

- 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 increase in U.S. Treasury trading by principal trading firms and hedge funds that are not centrally cleared as the primary reasons for the changes.

Comments are due 60 days after publication in the **Federal Register**.

Resource: [Changes Coming to Treasury Clearing & the Customer Protection Rule](#)

4. Form PF Amendments (Two Proposals)

On August 10, 2022, the SEC issued a second set of [proposed Form PF](#) updates jointly with the Commodity Futures Trading Commission 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
 - 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](#)

Roughly 30 comment letters were received. Many were frustrated with the short comment period. The Securities Industry and Financial Markets Association (SIFMA) noted the cost, operational challenges, and entry barriers for smaller and emerging funds and advisers. Others suggested that the proposal exceed the SEC's Dodd-Frank mandate to monitor systemic risk.

On January 26, 2022, the SEC approved a [proposal](#) to amend Form PF, the confidential reporting form for SEC-registered investment advisers to private funds as follows:

- Require new current reporting of certain events for large hedge fund advisers and advisers to private equity (PE) funds
- Decrease the reporting threshold for large PE advisers from \$2 billion to \$1.5 billion in AUM
- Revise reporting requirements for large PE advisers and large liquidity fund advisers

Resource: [Investment Advisers & Private Funds Face Expanded Form PF Disclosures](#)

The SEC received 125 comment letters. This comment summarizes the fund and fund association feedback: "We find the SEC's proposal to be overbroad, lacking in specificity, and poorly designed to balance the costs of reporting with the potential benefits to investors, regulators, and the market as a whole." Private retail investors universally supported these changes.

5. 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 RICs and BDCs, collectively "funds," and registered investment advisers 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](#)

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 a 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 vs. EPA. Others urge a final rule on ESG reporting before these changes to investment advisers.

6. Fund-Naming Rules*

On May 25, 2022, the SEC issued a [proposal](#) that would update the 20-year-old "Name Rule" that ensures a fund's name accurately reflects the fund's investments and risks. The proposal would make the following changes:

- Updates to the 80% Investment Policy Requirement. Currently, funds with certain names must invest 80% of their assets in the investments suggested by that name. This would be expanded to apply to any fund name with terms suggesting that the fund focuses on investments that have—or investments whose issuers have—particular characteristics, e.g., "growth" or "value" fund names and those indicating that the fund's investment decisions incorporate one or more ESG factors. A fund also would be required to use a derivatives instrument's notional amount, rather than its market value, to calculate compliance with its 80% investment policy. A registered closed-end fund or BDC with shares not listed on a national securities exchange would not be permitted to change its 80% investment policy without a shareholder vote.
- Misleading use of ESG terminology. A fund that considers ESG factors alongside but not more centrally than other, non-ESG factors in its investment decisions would not be permitted to use ESG or similar terminology in its name.
- Enhanced prospectus disclosure, reporting, and record-keeping

7. Short Sales*

A short sale involves a trader borrowing a company's shares from a broker-dealer and then selling the borrowed securities with the hopes of buying them back at a lower price in the future. On February 25, 2022, the SEC proposed new Rule 13f-2 and amendments to Regulation SHO and CAT to increase market transparency on short selling. Under the proposed changes, market participants would be required to collect and submit certain short sale-related data to the SEC on a monthly basis. The SEC would then publicly report aggregate data about large short positions, including daily short sale activity for each individual security.

Resource: [SEC Cracks Down on Short Sales – New Disclosures for Asset Managers?](#)

More than 250 comment letters were received, and opinions were sharply divided. Fund managers, exchanges, and industry groups felt the SEC could better leverage existing sources (FINRA, exchanges) for this information. These groups highlighted the benefits of short selling (liquidity and price discovery) and felt this proposal could cast a chill on the market. Individual retail investors universally supported the changes, citing the current uneven playing field.

8. Securities Loan Reporting*

Given the interaction between short selling and securities lending, the SEC reopened the comment period for its November 18, 2021 [proposal](#) on securities loan reporting. The proposal would require lenders of securities to provide the material

terms of securities lending transactions to a registered national securities association within 15 minutes after a loan is effected or modified and information on securities available to loan and securities on loan would be required by the end of the business day. Public disclosure would be required as soon as practicable. The proposal is a result of a Dodd-Frank Act mandate to increase transparency regarding the loan or borrowing of securities for brokers, dealers, and investors by ensuring that market participants, the public, and regulators have access to timely and comprehensive information about the securities lending market.

More than 300 comment letters were received. Individual investors supported greater transparency on short selling. Others noted that compliance cost would be a burden to midsize and smaller entities. Some objected to the tight deadlines and suggested the SEC should consider end-of-day reporting versus within 15 minutes of a transaction. Clearing agencies like DTCC asked for clarification on scope or an exemption from disclosure requirements.

9. 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
- 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

Resource: [New Cyber Rules Proposed for Investment Funds & Advisers](#)

Sixty comment letters were received. While there was universal support for consistent, comparable, and decision-useful cybersecurity disclosures and XBRL tagging, most felt this proposal was overkill. Objections included:

- *Poorly defined terms that are too subject to interpretation to promote consistent reporting*
 - *No lookback period is defined for aggregating immaterial incidents or how long previously reported incidents must be continuously disclosed*
 - *Public disclosure of certain facts may expose a registrant to additional risk of cyberattacks*
 - *The four-day reporting timelines could divert time and resources at the same time as a cyberattack; meaningful details at this cutoff may be limited*
- 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 antifraud provisions, but rather under the general rule-making authority*

10. Private Fund Reforms*

On February 9, 2022, the SEC approved a [proposal](#) to update the *Investment Advisers Act of 1940* to expand the regulation of private fund advisers. The new rules would:

- Require **registered private fund advisers** to give investors a quarterly statement with details on fund performance, fees, and expenses
- Require **registered private fund advisers** to get an annual audit for each private fund
- Require **registered private fund advisers** to obtain and distribute to investors a fairness opinion for adviser-led secondary transactions, along with a written summary of certain material business relationships between the adviser and the opinion provider
- Prohibit **all private fund advisers**, including those that are not registered, from certain activities and practices

- Prohibit **all private fund advisers** from providing certain types of preferential treatment that have a material negative effect on other investors, and prohibiting other types of preferential treatment unless disclosed to current and prospective investors
- Require **all registered advisers**, including those that do not advise private funds, to document the annual review of their compliance policies and procedures in writing

Resource: [SEC Proposes Extensive Private Fund Reforms](#)

More than 225 comment letters were received. Pension funds universally supported performance fee disclosures. Not surprisingly, private funds and industry associations cited the lack of SEC statutory authority to enact any of these changes. Fund of fund managers noted the 45-day deadline after quarter-end would be operationally challenging and should be exempted from certain reporting requirements. Smaller funds noted that the cost burden of these changes would be prohibitive and lead to further concentration in the biggest firms and eliminate funding opportunities for small startups. Several respondents asked for clarity on how the proposal would impact collateralized loan obligations that rely on the Section 3(c)(7) exclusion. Several large accounting firms weighed in on the audit, disclosure, and independence aspects of the proposal. They sought clarity on scope and consolidation reporting and highlighted that the presentation of quarterly performance statements might be inconsistent with U.S. GAAP financial statement presentation. Accounting firms also requested that the SEC consider leveraging existing custody rules rather than requiring all funds to distribute separately audited financial statements. They also noted additional transition time would be required to meet independence standards.

11. Money Market Reform*

The December 15, 2021, [proposal](#) is a result of the March 2020 market movements arising from the economic uncertainty about the impact of the COVID-19 pandemic. MMF safeguards put in place after the 2008 mortgage crisis did not work as intended and may have even escalated a downward price spiral for certain financial instruments. The 2020 market movements highlighted MMFs' continued susceptibility to heavy redemptions in times of stress. The proposal would make the following updates to MMF rules:

- Increase minimum liquidity requirements to provide a more substantial buffer for rapid redemptions
- Remove the ability of MMFs to impose liquidity fees and redemption gates when they fall below certain liquidity thresholds to eliminate an incentive for pre-emptive redemptions
- Require institutional prime and institutional tax-exempt MMFs to implement swing pricing so that redeeming investors bear the liquidity costs of their redemptions
- Enhance reporting requirements to improve the SEC's ability to monitor and analyze MMF data
- Specify the calculations of dollar-weighted average portfolio maturity (WAM) and dollar-weighted average life maturity (WAL) must use market value and not amortized cost to reduce diversity in practice

Resource: [Changes Ahead for Money Market Funds?](#)

Sixty-four comment letters were received. There was universal support for the immediate removal of gates and liquidity fees that did not work as intended in March 2022 as well as consistency in the WAM/WAL calculations. Most supported an increase in the daily and weekly minimum liquidity requirements but many suggested levels of 20/40 versus 30/50. Most opposed a move to swing pricing, citing operational challenges and a further reduction in the number of these funds. Most disagreed with the proposal to address a negative interest rate environment; most funds wanted flexibility, including the option for reverse distributions. Funds cited a minimum of 24 months for implementation. Most felt that the new disclosures should be kept confidential.

Conclusion

The asset management team at **FORVIS** has more than 50 years of experience providing accounting, tax, and consulting services to various types of investment holdings, including conventional debt and equity investments, loans, businesses,

alternative investments, and other unique assets. As of August 2022, Convergence Optimal Performance ranked FORVIS as a top 25 accounting and audit firm to registered investment advisors. FORVIS also was ranked in the top 20 by assets under management. We have experience providing services to fund complexes with net assets ranging from a couple million to several billion dollars. Our experience allows us to provide tailored services to help meet your unique needs. For more information, visit forvis.com.

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