

Securities Regulations To Watch In 2024

By **Sarah Jarvis**

Law360 (January 1, 2024, 8:02 AM EST) -- Since the U.S. Securities and Exchange Commission plans to propose and finalize a litany of regulations in 2024, attorneys told Law360 they'll be closely watching measures affecting private funds; equity markets; and environmental, social and governance matters and more.

And while the agency works through its regulatory agenda in the new year, it will also be fighting litigation on various rules it has already enacted, leaving certain regulations up in the air.

Here are some of the top securities regulations to keep an eye on in 2024.

Private Fund Rules

Christine Schleppegrell, an asset management partner at Morgan Lewis & Bockius LLP, pointed to the SEC's rules increasing oversight over private funds — which the agency approved in August — as top-of-mind in the new year. Pro-business groups have challenged the rules in the Fifth Circuit, and Schleppegrell said she is watching the ongoing litigation as her clients discern how many steps they should take in trying to comply with the rules.

She added that her clients are also weighing the agency's amendments to Form PF, the document used for periodic confidential reporting to the SEC and other regulators by certain SEC-registered advisers to private funds. She said the amendments that have been adopted show a focus on current reporting and a requirement that large hedge fund advisers make certain reports within 72 hours of triggering events.

"Managers are thinking about how that's going to inform the SEC examination program and the enforcement program, because now we're looking at a situation where the SEC has new tools and new information to carry out the agency's priorities," Schleppegrell said.

Schleppegrell's colleague Christine Lombardo, a partner who advises investment managers and broker-dealers, added that it's important to follow enforcement actions as well as regulations.

"A lot of the themes in all of these proposals have been very prevalent areas of focus in the exam program over the course of the last year, and I expect that to continue, and we've seen enforcement actions on some of these topics," Lombardo said.

Lombardo noted specifically that the SEC doesn't have a rule covering the areas of environmental, social

and corporate governance matters for investment advisers and private fund managers or registered fund managers. Yet there have still been ESG cases, she said, adding that she balances monitoring guidance through proposals and final rules as well as enforcement actions when advising clients.

Expanded Definitions of Exchange, Dealer

Nick Losurdo, a Goodwin Procter LLP partner who counsels broker-dealers on SEC regulations, said two major regulations on his radar are amendments to Exchange Act Rule 3b-16 to expand the scope of what an exchange is and the definition of a dealer.

He said they're likely to be approved by the commission, and could end up requiring a "staggering" number of companies and software developers in the cryptocurrency and decentralized finance space to register as brokers or dealers with the SEC and the Financial Industry Regulatory Authority.

Losurdo, who previously advised former SEC Commissioner Elad Roisman, a Republican, said the expanded dealer definition "essentially eviscerates the longstanding distinction of what it means to be a trader on the one hand, which is not required to be registered, and a dealer, which is required to be registered."

He also noted that the proposal to broaden what it means to be an exchange saw a reopened comment period, where the commission for the first time discussed how the proposal would mesh with crypto and de-fi.

"I think most have probably taken it as an even greater muddying of the waters," Losurdo said of the reopened comment period. "No one really knows how these things are going to shake out."

He added that the SEC's proposals have lately been vague and unsubstantiated and have elicited a lot of questions from stakeholders.

"It's almost like the commission is holding their finger in the air and saying, 'If wind blows this way, we think this is how this rule should work,'" he said. "And that's just really, really dangerous for the industry."

Equity Market Reforms

Dennis Kelleher, president and CEO of financial industry watchdog group Better Markets, said that among the various pending proposals at the SEC, he anticipates the agency will finalize a suite of equity market structure reforms in 2024, saying the measures are "the most important pro-investor reforms the markets have seen in decades."

The proposals would require brokers to establish written policies for how they intend to get the best trade possible for customers; create an auction system for access to certain individual buy or sell orders; enhance disclosures around the reporting of order execution; and lower acceptable minimum pricing increments for stock trades.

Experts have said the proposals could threaten a key revenue source for popular smartphone trading applications like Robinhood and potentially change the way everyday Americans interact with the stock market. The proposals garnered pushback from industry players and lawmakers, some of whom criticized them as too far-reaching and called for them to be withdrawn.

"The incumbents who are currently making a fortune by, more often than not, engaging in predatory behavior aren't happy about them," Kelleher said of the proposals, adding that everyone "from companies that raise capital in the capital markets to investors to traders" will be better off with the finalized rules.

Kelleher said Better Markets has participated in more than 50 rulemakings at the SEC since Gary Gensler became chair, including all 29 that were pending as of early December. He said that while some proposals have outsize importance in narrow areas, a climate proposal and the market structure proposals stand to have the broadest impact.

Climate Disclosure Rules

David A. Brown, a corporate transactions and securities partner at Alston & Bird LLP, said the SEC's climate disclosure proposal is on the minds of many companies. The proposed rule, issued in March 2022, would require the disclosure of a range of data related to greenhouse gas emissions, the business risks associated with severe weather events, and those tied to the transition to a smaller carbon footprint.

The proposal would also require some larger companies to disclose so-called Scope 3 emissions — which are tied to the emissions of companies' suppliers and customers — if these are deemed "material," or if a company has made a pledge to reduce future emissions. Noting that the SEC could finalize the proposal in the spring, Brown said he is focused on where the agency will land with a rule whose initial iteration was "so transformative and certainly very, very far-reaching."

Brown's colleague Elise N. Paeffgen, a climate change and carbon management partner, added that greenhouse gas disclosure measures signed into law in October by California Gov. Gavin Newsom "are pushing that even further to top of mind, and it'll be interesting to see the impacts that California's laws now have with the SEC's rule."

Paeffgen added that companies should already be calculating their Scope 1 and Scope 2 emissions — which respectively cover a company's direct, operational emissions and its indirect emissions from energy use — and to start thinking about Scope 3, saying it's a matter of time before that information is required from different regimes.

"If it's not the SEC, we already have California, we have Europe, we have much more stakeholder pressure for Scope 3, pressure from industry, from competitors. So really, for companies to get their arms around all three scopes now I think is a prudent step," Paeffgen said.

Still, both Brown and Paeffgen hope the final rule doesn't include Scope 3 requirements because, they said, they are difficult to calculate and the data is often uncertain.

ESG Funds

Lance Dial, a partner with K&L Gates LLP's asset management and investment funds practice, is keeping an eye on the SEC's proposed disclosure rules for ESG funds, for which the SEC is aiming to hold a final vote in 2024. The proposal aims to tackle greenwashing by standardizing disclosures made by investment companies and advisers providing access to ESG funds.

Dial noted the proposal has been delayed, speculating that may be partially due to its close connection with the agency's climate disclosure proposal for public companies. Without the latter rule, the disclosure obligation for mutual funds would be difficult, because public companies wouldn't be required to disclose their carbon emissions, he said.

He anticipates both rules will come out together in the first quarter of 2024, or that a more limited version of the rule for ESG funds would come out if the agency can't finalize the rule for public companies. He noted that route is similar to the agency's approach with its recently finalized rule requiring that funds touting their ESG credentials invest the majority of their assets in their advertised areas of concern.

Separately, Dial said he'll be watching out for the SEC's proposal geared toward protecting the crypto assets of hedge funds, pension funds and other clients of investment advisers, saying it will expand the Advisers Act and pose particularly difficult compliance challenges.

He noted that one reason the proposal garnered a rash of industry pushback is a requirement that investment advisers who oversee money for clients ink separate agreements with those clients' custodians, the terms of which related to the custodians' standard of care. Dial said this means the SEC would indirectly regulate banks, an area over which the agency has no authority.

Predictive Data Analytics

Top of mind for Gary DeWaal, financial markets and funds senior counsel at Katten Muchin Rosenman LLP, is the SEC's proposal targeting brokerage firms' and investment advisers' use of predictive data analytics, which the agency has indicated may go to a final vote by April 2024.

The proposal — which would require brokerage firms and investment advisers to eliminate the use of technology that could put a firm's interests above its investors — is duplicative of existing requirements and includes a definition of covered technology that may be so broad it encompasses spreadsheets, DeWaal said.

DeWaal compared it to the Commodity Futures Trading Commission's 2015 Regulation Automated Trading proposal, which went through two iterations and was ultimately withdrawn by the agency — a fate he hopes for the SEC's proposal.

Kelleher, of Better Markets, pointed to public statements Gensler has made about business owners misleading investors about their artificial intelligence capabilities.

"I think that's the leading edge of a variety of actions you're going to see the agency take in connection with AI," Kelleher said.

Legal Challenges

The fate of some other SEC regulations is uncertain, as the agency faces legal challenges in the Fifth Circuit.

In October, the court found that conservative activists could not sue the SEC for enacting a Nasdaq Stock Market requirement that makes exchange-listed companies publicly disclose board diversity data.

Republican attorneys general from 19 states have backed the activists' bid for a rehearing en banc in that case.

And more recently, a trio of private fund industry groups asked the court to vacate two SEC rules concerning securities loans and short-selling activity, arguing they put forward contradictory disclosure requirements.

The agency is also defending its 2022 rule requiring the disclosure of certain categories of proxy votes, which Republican states have challenged for allegedly promoting "left-wing political goals."

--Additional reporting by Tom Zanki, Madeline Lyskawa, Peter McGuire, Jessica Corso, Hailey Konnath and Al Barbarino. Editing by Emily Kokoll.