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REGISTERED FUNDS TRENDS AND DEVELOPMENTS

Quarter in Review Series

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Overview

- Update on New Derivatives Rule
- New Framework for Fund Valuation
- Changes for Fund of Funds Arrangements
- Revisiting Accredited Investor Definition
- Evolving ESG Regulatory Oversight

Updates on New Derivatives Rule (Rule 18f-4)

On October 28th, the SEC adopted the new derivatives rule. Funds will likely have until fall 2022 to comply with the new rule. Some key takeaways:

- All funds must adopt a Derivatives Risk Management Program
- Funds that use derivatives to a limited extent (i.e., 10% or less of net assets, excluding currency and interest rate hedges) will only have to adopt written risk management programs, but all other funds must designate a derivatives risk manager to administer the Derivatives Risk Management Program and will also have to comply with related requirements
- Permitted levels of investment in derivatives will be subject to either a relative Value-at-Risk test based on a designated reference portfolio, or absolute Value-at-Risk test, with at least daily compliance testing
- Leveraged and inverse funds will be permitted, but effectively will be limited to 200% Value-at-Risk, and an expansion of the ETF Rule (Rule 6c-11) that the SEC simultaneously adopted will permit new leveraged and inverse ETFs to come to market if they comply with the rule
- Funds will be permitted to treat reverse repurchase agreements and similar financing transactions as derivatives for purposes of the rule, or can subject those transactions to the asset coverage requirements of Section 18
- The SEC did not adopt asset segregation requirements proposed in December 2015.

New Framework for Fund Valuation (Rule 2a-5)

On December 3, the SEC adopted a new rule that establishes an updated regulatory framework for fund valuation practices. Funds will likely have until fall 2022 to comply with the new framework. Some key takeaways:

- Determining fair value in good faith will require assessing and managing material risks associated with fair value determinations; selecting, applying, and testing fair-value methodologies; and overseeing and evaluating any pricing services used
- A board may designate the fund's adviser or, if the fund does not have an adviser, an officer or officers of the fund as the "valuation designee" to perform determinations of fair value
    - Assuming a fund board appoints a "valuation designee," the board's role effectively will be limited to one of oversight, and the rule establishes a principles-based framework for such oversight
- Rule 2a-5 was modified from proposal to provide the board or valuation designee with additional flexibility to exercise judgment
- The recordkeeping requirements were moved into a new, separate rule: Rule 31a-4
- The SEC stated that the rule's definition of "readily available market quotations" will apply to all relevant provisions of the 1940 Act and rules thereunder

Changes for Fund of Funds Arrangements

On October 7, the SEC adopted the Fund of Funds Rule (Rule 12d1-4) and related amendments. Funds will likely have until January 2022 to comply with the rule. Some key takeaways:

- The rule is designed to provide a more consistent and efficient regulatory framework for funds that invest in other funds
- The SEC rescinded Rule 12d1-2 under the 1940 Act, rescinded most exemptive orders granting relief from certain provisions of Section 12(d)(1) of the 1940 Act, and withdrew certain no-action letters
- The Fund of Funds Rule is available to registered funds and BDCs seeking to invest in other registered funds and BDCs beyond the limits currently imposed by Section 12(d)(1) of the 1940 Act, assuming certain conditions are satisfied
- An acquiring fund must comply with five general conditions in order to utilize Rule 12d1-4: (1) limits on control and voting; (2) required evaluations, findings, and reports; (3) required fund of funds investment agreements; (4) limits on complex structures; and (5) recordkeeping requirements. Acquired funds must also make certain findings before entering into fund of funds investment agreements.

Revisiting Accredited Investor Definition

- On August 26, the SEC adopted amendments to expand the term "accredited investor" in Rule 215 and Rule 501(a) of Regulation D promulgated under the Securities Act
- The amendments create new categories of accredited investors, including those that qualify irrespective of wealth
- The amendments add SEC- and state-registered investment advisers, as well as certain investment advisers exempt from SEC registration, to the list of entities that qualify as accredited investors based on their status alone
- The amendments clarify that the definition applies to LLCs, and also adds a catch-all for other types of entities
- To conform with the updated accredited investor definition, the SEC also expanded the definition of "qualified institutional buyer" (QIB) in Rule 144A under the Securities Act

* The amendments became effective on December 8, 2020

Evolving ESG Regulatory Oversight

- The SEC has continually engaged with ESG funds by providing feedback and comments through the registration statement disclosure review process
- The SEC staff has expressed concerns over "greenwashing," which occurs when a fund holds itself out as ESG-focused when in reality ESG considerations are only a small part of the fund's strategies
- Additionally, in March 2020 the SEC released a request for comments on fund names and sought input on a number of topics relating to the Names Rule, garnered substantial input from industry participants regarding, among other things, ESG funds
- The ESG space presents numerous challenges to achieving standardized terminology and investment practices
- While the industry awaits further SEC action, it is prudent that fund advisers employ sound fiduciary principles in managing ESG mandates and other mandates that incorporate ESG as part of their investment strategies

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Jack counsels registered and private funds and fund managers in connection with organizational, offering, transactional, and compliance matters. He regularly works with a variety of different fund structures, including open-end and closed-end funds, exchange-traded funds, and hedge funds. He also counsels investment adviser and broker-dealer clients on various matters, particularly with respect to registration and disclosure, marketing regulations, pay-to-play issues, and transactions in exchange-traded funds.

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Barry Hurwitz's practice focuses on the representation of registered investment companies, investment advisers, and fund directors. He counsels clients on a wide variety of regulatory, transactional, fund formation, and compliance matters. His practice also includes advising issuers with respect to exemptions from the Investment Company Act of 1940.

Barry has considerable experience with the onboarding of subadvisers by fund complexes operating under manager of managers orders. In addition, he provides advice on issues relevant to investment advisers under the Securities Act of 1933 and the Securities Exchange Act of 1934. Barry also counsels public and private operating companies on a wide range of corporate and transactional issues.

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Christine M. Nassauer focuses her practice on representing mutual funds, closed-end funds, private funds and their investment advisers in a wide variety of legal, regulatory, transactional, and compliance matters. Her experience extends to work in several areas, including fund formations and reorganizations, corporate governance matters and regulatory issues. She also counsels investment adviser clients on the applicability and interpretation of securities laws, including with respect to registration and disclosure, marketing regulations and pay-to-play issues.

While in law school, Christine was a member of the Temple Law Review. Christine also won the prize for the highest academic average in her LL.M. program, focused on international business and economic law.

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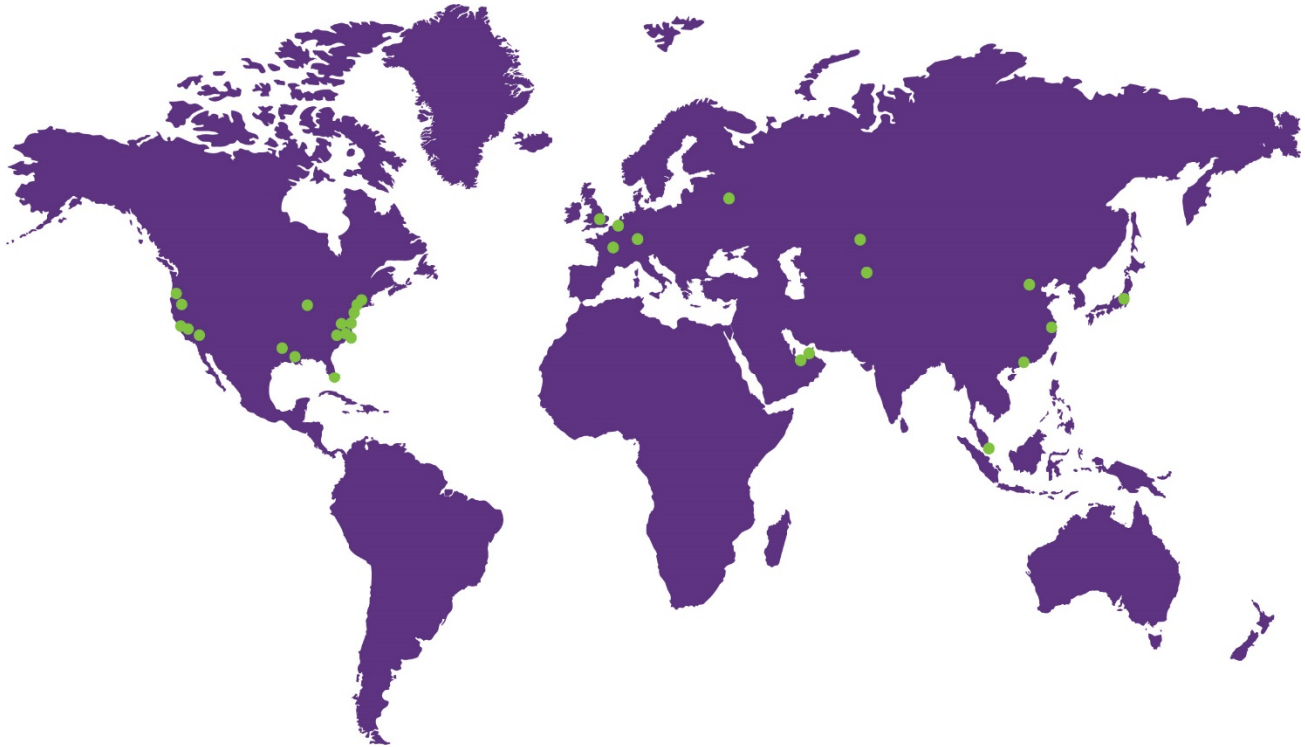

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