



Morgan Lewis

REGISTERED FUNDS TRENDS AND DEVELOPMENTS

Quarter in Review Series: 10th Edition

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Amy McDonald, Ali Rivett, and Christopher Trueax | September 21, 2023

Presenters



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Agenda

- ▶ **ESG updates:** The debate continues at state and federal levels
- ▶ **The latest on SEC enforcement actions**
- ▶ **New money market reform:** What you need to know
- ▶ **Impact of the new executive order on certain US outbound investments**

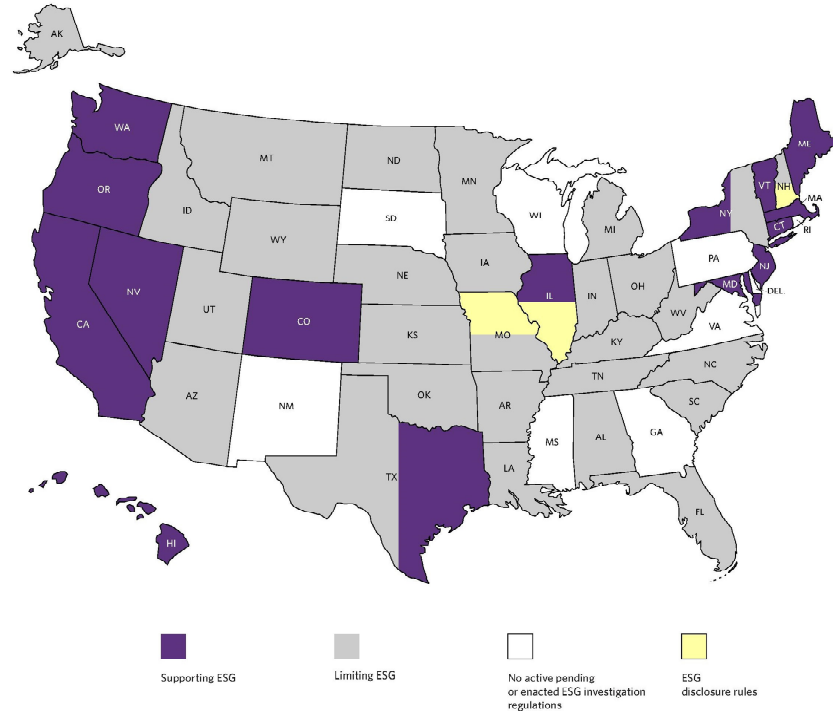
ENVIRONMENTAL, SOCIAL, & GOVERNANCE (ESG) UPDATE

SEC ESG Pulse Check

- **Disclosure Review:** Do what you say and say what you do
 - Greenwashing vs Greenhushing
- **Examinations and Enforcement:** materiality, compliance, third-parties, recordkeeping, marketing
- **Rulemaking Activity:**
 - Issuers Climate-Related Disclosures Rule Proposal (3/21/2022)
 - ESG Disclosure for Advisers and Funds Rule Proposal (5/25/2022)
 - Names Rule Final Amendments 9/20/2023 (Proposal 5/25/2022)
- **What's next?**

ESG and the States

- As of September 4, 2023:
 - **21 states** have enacted anti-ESG regulations
 - **8 states** have enacted pro-ESG regulations
 - **3 states** have enacted disclosure-related ESG regulations
- Dozens of rules, both pro- and anti-ESG, are currently pending across 24 states



Categories of ESG Laws

- **ESG Consideration Promotions/Requirements**
- **ESG-Based Investment Prohibitions**
- **Prohibitions on ESG Considerations**
- **Prohibitions on ESG Discrimination**
 - Prohibition on ESG Discrimination (Vendors)
 - Prohibition on ESG Discrimination (Customers)
 - Prohibition on ESG Discrimination (Generally Applied)
- **No-Boycott Legislation**
- **Required Disclosure of ESG** (*New Category*)

SEC ENFORCEMENT HIGHLIGHTS

SEC Enforcement Highlights

- Sweeps, Sweeps, and More Sweeps?
- Shorter Grace Periods for Compliance with New Rules
- Independent Trustees Recently Caught in the SEC's Crosshairs
 - Investment Adviser and Fund Trustees Charged with Liquidity Rule Violations (May 2023)
 - Investment Adviser Charged with Misleading ETF's Independent Trustees (August 2023)

NEW MONEY MARKET REFORM: WHAT YOU NEED TO KNOW

New Money Market Reform: What You Need to Know

On July 12, the SEC adopted amendments to the rule governing money market funds (Rule 2a-7). Some key takeaways:

- **Mandatory Liquidity Fees**

- Institutional Prime and institutional tax-exempt money market funds must impose mandatory liquidity fees when a fund experiences net redemptions that exceed 5% of net assets, unless liquidity costs are *de minimis* (requirement applies even to nonpublicly offered institutional funds, but not to retail and government money market funds).
- Institutional money market funds must make a good-faith estimate of costs of selling portfolio securities to satisfy redemption requests; or apply a default fee of 1% of the value of shares redeemed.

- **Discretionary Liquidity Fees and Removal of Temporary Redemption Gates**

- Under current rule, a non-government money market fund may impose a liquidity fee of up to 2% if weekly liquid assets fall below 30%, and the fund must impose a 1% liquidity fee on redemptions if weekly liquid assets fall below 10%.
- The amendments remove the regulatory tie between the imposition of liquidity fees and a fund's liquidity level.
- Amendments would allow nongovernment money market funds to impose discretionary liquidity fees (not to exceed 2% of value of shares redeemed) if in the fund's best interest, irrespective of liquidity or redemption levels.
- Following 2014 amendments, nongovernment money market funds were permitted to suspend redemptions for up to 10 business days within a 90-day period if weekly assets fell below 30%. The 2023 amendments do not allow temporary redemption gates.

- **WAM and WAL Calculations**

- Money market funds must use the market value of each portfolio security when calculating dollar-weighted average portfolio maturity (WAM) and dollar-weighted average life maturity (WAL) instead of the amortized cost of each security as currently permitted.

New Money Market Reform: What You Need to Know

- **Increased Minimum Daily and Weekly Liquidity Requirements**

- Money market funds must hold at least 25% of total assets in “daily liquid assets” and 50% in “weekly liquid assets” (up from current requirements of 10% and 30%, respectively). Tax-exempt money market funds are not subject to requirements.

- **Negative Interest Rate Amendments**

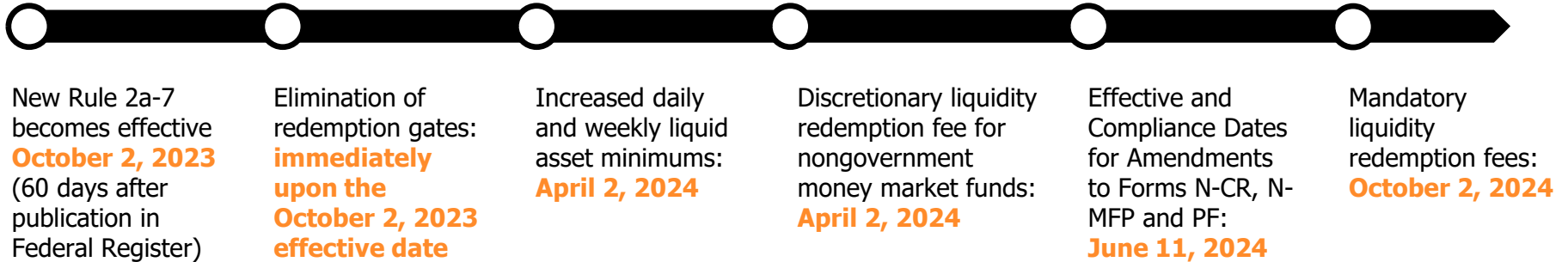
- Government and retail prime and tax-exempt money market funds that maintain a stable NAV may, under the amendments, convert to a floating NAV and engage in share cancellation in potential negative interest rate environments.

- **Amendments to Forms**

- Form N-CR was amended with respect to reporting liquidity events (daily liquid assets or weekly liquid assets falling below 12.5% and 25%, respectively).
- Form N-MFP amended to include additional information about shareholders, portfolio securities sold by institutional prime money market funds, liquidity fees, and use of share cancellation.
- Form PF Amendments—for investment advisers to large liquidity funds—amended to require confidential reporting about large liquidity funds’ shareholders, operations, portfolio holdings, subscriptions/redemptions, and other information.

New Money Market Reform: What You Need to Know

Aggressive and tiered compliance timeframe:



IMPACT OF THE NEW EXECUTIVE ORDER ON CERTAIN US OUTBOUND INVESTMENTS

Executive Order 14105

- Implemented by the Treasury, in consultation with Commerce and other departments.
- Outlines and authorizes new regulatory regime for outbound investment to address national security threat to the US posed by “countries of concern.”
- Focused on sensitive or advanced technologies and products critical for military, intelligence, surveillance, and cyber-enabled capabilities.
- EO is not self-executing and requires implementing regulations with no specific deadline.
- Assessment within one year of adoption of regulations.
- Regulations will not be retroactive, but ANPRM reserves the right to inquire about transactions entered into after August 9, 2023.
- The Treasury did not publish proposed or interim regulations, but rather published an ANPRM, which requests public comments on 83 questions by September 28, 2023.

Executive Order 14105

- In the EO Annex, President identified People's Republic of China (PRC), Special Administrative Region of Hong Kong, and Special Region of Macau as countries of concern.
- The US already prohibits or restricts the export to PRC of many of the technologies and products under consideration for the new program.
 - The new program would prevent certain US investments from helping accelerate the indigenization of these technologies in PRC.
- The EO would add to the existing restrictions on investment by US persons in certain publicly traded PRC companies that are viewed as being part of the PRC military industrial complex.

Executive Order 14105

- The EO would:
 - Require US persons to notify the Treasury of certain transactions; and
 - Prohibit US persons from undertaking certain transactions.
- The EO identified three categories of national security technologies:
 - Semiconductors and microelectronics;
 - Quantum information technologies; and
 - Certain artificial intelligence systems.
- The EO also provides the Treasury with authority to investigate violations of the EO and regulations, and to pursue penalties for violations.

ANPRM

- ANPRM does not itself implement the EO and is not draft regulatory text.
- ANPRM is a means for the Treasury to solicit public comments in order to allow early stakeholder participation in the rulemaking process.
- Draft regulations will be proposed at a later unspecified date.
- ANPRM reflects the framework that the Treasury anticipates proposing and includes some limited proposed regulatory language for comment.

ANPRM

- **US Persons** — Program will apply to US persons using a standard broad definition. May also apply to certain foreign entities where a US person knowingly directs transaction by the non-US person.
- **Covered Transactions** — Program will apply to certain types of transactions that convey tangible benefits: acquisition of equity interests (e.g., via mergers and acquisitions, private equity, venture capital, and other arrangements; greenfield investments, joint ventures, and certain convertible debt financings).
- **Foreign Persons** — Covered transactions will include countries of concern; and entities that are organized in the country of concern, have principal place of business in the country of concern, or are majority-owned by the country of concern's individuals or entities.
- **Exceptions** — The Treasury is considering excepting from the program's coverage certain US investment into publicly traded securities, index funds, mutual funds, exchange-traded funds, certain investments made as a limited partner, committed but uncalled capital investments, and intracompany transfers of funds a US parent company to a subsidiary.

ANPRM

- **Semiconductors and Microelectronics** — May prohibit the development of electronic design automation software or semiconductor manufacturing equipment; the design, fabrication, or packaging of advanced integrated circuits; and the installation or sale of supercomputers. May require notification of design, fabrication, and packaging of less-advanced integrated circuits.
- **Quantum Information Technologies** — May prohibit production of quantum computers and certain components; the development of certain quantum sensors; and the development of quantum networking and quantum communications systems. No notification requirement currently being considered.
- **Certain Artificial Intelligence (AI) Systems** — The Treasury is soliciting guidance on how to narrowly define a prohibition on certain activities related to software that incorporates an AI system and is designed for particular end uses with national security implications (e.g., military surveillance end use). The Treasury is considering a broader notification requirement.

Key Questions

- ▶ What does the ANPRM reveal about the challenges of implementing an outbound investment program, and what questions remain unresolved?
- ▶ How broadly will the three covered technologies likely be scoped? What is the process for adding additional technologies?
- ▶ Are companies and investors outside the three covered technologies safe from the new regulations?
- ▶ What exceptions will there likely be, and how will the exceptions be important to investors?
- ▶ Why has the Treasury said there will be no case-by-case review/advisory opinion process; and how can investors protect themselves against a subsequent challenge by the US government?
- ▶ How do the EO and ANPRM compare with the recent Senate Amendment to the NDAA, and how might the EO and ANPRM affect the pending legislation?
- ▶ What has China's reaction been to the EO and ANPRM?
- ▶ Will US allies adopt a similar outbound investment regime?
- ▶ What should investors be doing now to prepare for new regulations, including by influencing the rulemaking process?

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Mana represents registered investment companies and onshore and offshore private equity funds and hedge funds. She also counsels in reorganizing large mutual fund complexes and numerous mutual fund mergers, and preparing various US Securities and Exchange Commission filings, including registration statements and proxy statements. In addition, Mana counsels domestic and international clients on various issues relating to private equity and hedge fund offerings, including fund formation, organization of domestic and offshore entities, and compliance with US law.

Before joining Morgan Lewis, Mana also represented public and private companies in their execution of transactions to meet strategic and financial goals, including complex corporate combinations, stock and asset acquisitions, and securities and structured finance issuances.

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Giovanna is a member of the Morgan Lewis CFIUS working group.

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Sean advises companies in the securities industry on investment management matters. Investment advisers, mutual funds, closed-end funds, private investment companies, registered funds of hedge funds, and exchange-traded funds seek his advice on organizational issues, registration, and ongoing regulatory compliance matters. He also serves as counsel to the boards of directors of mutual funds, and he advises insurance companies on regulatory matters relating to variable insurance products.

Sean counsels clients on regulatory and transactional investment management matters. These include the development of new products and services, US federal and state registration and compliance issues, and US Securities and Exchange Commission (SEC) enforcement actions. He advises clients on mergers and acquisitions involving investment companies and investment advisers, and addresses interpretive and “no-action” letter requests, SEC exemptive orders, and related matters.

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David, the former acting chief of the US Department of Justice's Foreign Investment Review Section, represents clients such as venture capital, private equity, and infrastructure firms. In particular, he steers clients through government national security review processes for foreign investment, including by the Committee on Foreign Investment in the United States (CFIUS) and Team Telecom. In addition, David focuses on trade, information communications technology and services, and critical and emerging technology. He maintains a security clearance and advises clients on their most sensitive matters.

David has been named to the Foreign Investment Watch Top Advisors 2023 list, which recognizes leading legal, financial, compliance, and communications professionals who provide advice concerning national security review of foreign investments in the United States and overseas.

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Amy advises registered funds, including mutual funds and exchange-traded funds (ETFs), and their investment advisers in a number of areas, such as US Securities and Exchange Commission (SEC) filings, regulatory and compliance issues, corporate matters, and Board governance. Amy also helps clients with advocacy efforts surrounding SEC rulemakings and advising on subsequent implementation and compliance questions. Amy is an active member of the firm's ESG & Sustainability Advisory Working Group, and frequently advises clients on ESG investing, disclosure, and compliance questions.

In addition to supporting clients in drafting fund documents, including registration statements, proxy materials, and exemptive applications, Amy has experience in a broad range of legal, regulatory, and transactional matters. Before joining Morgan Lewis, Amy spent almost 10 years practicing in house, serving most recently as legal counsel to the ETF business of a New York-based asset manager. Prior to this, Amy served in legal, regulatory and compliance roles for a Boston-based investment adviser/fund complex.

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