VedderPrice

June 2019

Investment Services Regulatory Update

New Rules, Proposed Rules, Guidance and Alerts

NEW RULES

SEC Adopts Rules and Interpretations Concerning the Standard of Conduct for Broker-Dealers and Investment Advisers

On June 5, 2019, the SEC adopted a package of rules and interpretations addressing standards of conduct for broker-dealers and investment advisers:

Regulation Best Interest. Regulation BI establishes a standard of conduct for broker-dealers when making an investment recommendation to a "retail customer" involving securities. Regulation BI includes specific obligations concerning disclosure, standard of care, conflicts of interest and compliance, requiring a broker-dealer to:

(1) act in the best interest of its retail customer at the time a recommendation is made, without placing the broker-dealer's own interests ahead of its client's interests; and

(2) address conflicts of interest by establishing policies and procedures to identify and disclose, and in certain circumstances mitigate or eliminate, conflicts of interest.

Form CRS Relationship Summary. Investment advisers and broker-dealers will be required to deliver a "relationship summary" to retail investors at the beginning of a client relationship. The form would describe the services offered to retail investors, the standard of conduct applicable to those services, fees and costs, conflicts of interest, the firm's disciplinary history and how to obtain additional information.

SEC Interpretation Regarding Standard of Conduct for Investment Advisers. The SEC issued an interpretive release regarding an investment adviser's fiduciary duty under the Investment Advisers Act of 1940. Among other things, the interpretation discusses an adviser's obligation to act in the best interest of its client at all times and how an adviser fulfills this duty. The interpretive release was not intended to create any new legal obligations for advisers.

"Solely Incidental" Interpretation. Finally, the SEC issued an interpretation of the "solely incidental" prong of the broker-dealer exclusion from the definition of "investment adviser" under the Advisers Act.

Regulation BI and Form CRS will become effective 60 days after publication in the Federal Register and will include a transition period until June 30, 2020, when firms must come into compliance. The SEC's interpretive positions are effective upon publication in the Federal Register.

Vedder Price is preparing a detailed summary of these new rules and interpretations that will be published under separate cover.

The SEC's adopting and interpretive releases are available as follows:

- Regulation Best Interest: https://www.sec.gov/rules/final/2019/34-86031.pdf
- Form CRS: https://www.sec.gov/rules/final/2019/34-86032.pdf
- Commission Interpretation Regarding Standard of Conduct for Investment Advisers: https://www.sec.gov/rules/interp/2019/ia-5248.pdf
- Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser: https://www.sec.gov/rules/interp/2019/ia-5249.pdf

PROPOSED RULES

SEC Proposes Amendments to Financial Reporting Rules for Business Combination Transactions Involving Investment Companies

On May 3, 2019, the SEC issued a proposal to amend certain rules and forms relating to required financial disclosures in business combination transactions involving investment companies.

First, the proposal would streamline applicable significance tests under Regulation S-X to more closely align with significance tests under the Investment Company Act. Proposed Rule 1-02(w)(2) of Regulation S-X would create a separate definition of "significant subsidiary" for investment companies using a modified version of the investment test and income test set forth in Rule 8b-2 under the Investment Company Act, as follows:

Investment Test. An acquisition would be significant if the value of a fund's investment in and advances to the tested subsidiary (i.e., the acquired fund) exceed 10% of the value of the fund's total investments as of the end of the most recently completed fiscal year.

Income Test. An acquisition would be significant if the total investment income of the tested subsidiary as of the most recently completed pre-acquisition fiscal year exceeds 10% of the total investment income of the acquiring fund. The income test includes (1) investment income, such as dividends; (2) net realized gains and losses; and (3) net change in unrealized gains and losses.

In addition, a tested subsidiary would be deemed significant if the income test yields a condition of greater than either (1) 80% by itself, or (2) 10% and the investment test yields a result of greater than 5%.

The proposal also would address required financial statements of acquiring and acquired investment funds, including registered investment companies and private funds relying on Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Proposed Rule 6-11 of Regulation S-X would apply a facts and circumstances evaluation to determine whether a fund acquisition has occurred and, if so, would require only one year of audited financial statements. Financial statements of an acquired fund would need to be provided only if the investment and income significance tests above exceed 20%. For acquisitions of private funds, the financial statements may be prepared in accordance with U.S. GAAP.

Additionally, the proposal would eliminate the requirement for investment companies to provide pro forma financial statements in connection with business combination transactions, and instead require investment companies to provide certain supplemental information about the combined fund post-acquisition, including, among other things, (1) a pro forma fee table; (2) a schedule of the acquired fund's investments and a related narrative discussion if there will be material changes to the acquired fund's investment portfolio resulting from applicable investment restrictions; and (3) narrative disclosure about material differences between the accounting policies of the combined fund and those of the acquired fund.

Finally, the proposal would make certain conforming changes to Form N-14 to align the form with the new rules and amendments discussed above.

The SEC is seeking comments on the proposal on or before July 29, 2019.

The full text of the proposal can be found at:
https://www.sec.gov/rules/proposed/2019/33-10635.pdf

GUIDANCE AND ALERTS

SEC, NASAA and FINRA Issue Senior Safe Act Fact Sheet

On May 23, 2019, in recognition of the one-year anniversary of the passage of the Senior Safe Act, the SEC, the North American Securities Administrators Association and FINRA issued a fact sheet to raise awareness of the Act and its immunity provisions for covered financial institutions in an effort to encourage firms to train their employees on how to detect and report suspected senior financial exploitation. The Act provides immunity to certain financial institutions, including broker-dealers, investment advisers and transfer agents, and their eligible employees from liability in any civil or administrative proceeding for reporting potential exploitation of a senior citizen. The fact sheet provides general information about the Act, including information about the employee training required for immunity and related recordkeeping requirements, among other things.

The fact sheet is available at: https://www.investor.gov/senior-safe-act-fact-sheet

Public Statements, Press Releases and Testimony

Remarks of SEC Commissioner Hester M. Peirce at the ETFs Global Markets Roundtable

In her remarks at the ETFs Global Markets Roundtable on May 21, 2019, SEC Commissioner Hester Peirce commented on the role ETFs play in financial experimentation and innovation, and the SEC's role in protecting investors while not unnecessarily slowing ETF innovation. She discussed the SEC's proposed ETF rule, which would standardize the conditions for ETF exemptive relief, thereby providing a level playing field for ETF sponsors and making it easier for new ETF sponsors to come to market.

Ms. Peirce also discussed the SEC's cautious approach in issuing exemptive orders for actively managed ETFs and approving new types of ETFs. She noted the growth of actively managed ETFs and the SEC's recently issued exemptive order for a non-fully transparent actively managed ETF, and expressed a desire that the SEC would act expeditiously on other outstanding requests for similar exemptive relief. She stated her views that the SEC's concerns about investor comprehension of leveraged and inverse ETFs could be addressed by disclosure and that the SEC's refusal to permit additional ETF sponsors to offer such products creates an oligopoly for the two ETF sponsors that previously received exemptive relief to the detriment of investors.

Ms. Peirce further discussed the continued interest in an exchange-traded cryptocurrency product. She noted that the SEC had disapproved certain product proposals in light of several stated concerns, but stated that approving such a product could lead to increased participation by institutional investors in cryptocurrency markets that could lead to better defenses against theft, improved custody solutions and lower risk of market manipulation.

The transcript of Ms. Peirce's remarks is available at: https://www.sec.gov/news/speech/speech-peirce-052119

Investment Services Group Members

Chicago

Cathy G. O'Kelly, *Co-Chair*..... +1 (312) 609 7657
Juan M. Arciniegas..... +1 (312) 609 7655
James A. Arpaia..... +1 (312) 609 7618
Deborah B. Eades..... +1 (312) 609 7661
Renee M. Hardt..... +1 (312) 609 7616
Joseph M. Mannon..... +1 (312) 609 7883
John S. Marten, *Editor*..... +1 (312) 609 7753
Maureen A. Miller..... +1 (312) 609 7699
S. Jay Novatney..... +1 (312) 609 7609
Jacob C. Tiedt, *Editor*..... +1 (312) 609 7697
Junaid A. Zubairi..... +1 (312) 609 7720
Heidemarie Gregoriev..... +1 (312) 609 7817
Nathaniel Segal, *Editor*..... +1 (312) 609 7747
Adam S. Goldman..... +1 (312) 609 7731
Cody L. Lipke..... +1 (312) 609 7669
Kelly Pendergast..... +1 (312) 609 7719
Mark Quade..... +1 (312) 609 7515
David W. Soden..... +1 (312) 609 7793
Cody J. Vitello..... +1 (312) 609 7816
Jeff VonDruska..... +1 (312) 609 7563
Jake W. Wiesen..... +1 (312) 609 7838

New York

Joel S. Forman..... +1 (212) 407 7775
Luisa M. Lewis..... +1 (212) 407 7795

Washington, DC

Bruce A. Rosenblum, *Co-Chair*..... +1 (202) 312 3379
W. Thomas Conner..... +1 (202) 312 3331
Amy Ward Pershkow..... +1 (202) 312 3360
John M. Sanders..... +1 (202) 312 3332

London

Sam Tyfield..... +44 (0)20 3667 2940

Investment Services Group

With significant experience in all matters related to design, organization and distribution of investment products, Vedder Price can assist with all aspects of investment company and investment adviser securities regulations, compliance issues, derivatives and financial product transactions, and ERISA and tax inquiries. Our highly experienced team has extensive knowledge in structural, operational and regulatory areas, coupled with a dedication to quality, responsive and efficient service.

VedderPrice

Chicago New York Washington, DC London San Francisco Los Angeles Singapore

vedderprice.com