



Investment Services Regulatory Update

February 2024
Monthly Version

NEW RULES, PROPOSED RULES, GUIDANCE AND ALERTS.	1
GUIDANCE AND OTHER DEVELOPMENTS	1
SEC Staff Issues Statement Regarding ETFs' Disclosure of Foreign Currency Holdings	1
Regulatory Agenda Highlights Potential and Pending SEC Rulemaking Topics	1
LITIGATION AND ENFORCEMENT MATTERS	2
LITIGATION DEVELOPMENTS.	2
Pennsylvania District Court Allows Claims Regarding Target Date Funds' Unexpected Tax Liabilities to Proceed	2
Second Circuit Affirms Lower Court Decision Regarding Closed-End Fund Control Share Bylaw Provision	3
ENFORCEMENT DEVELOPMENTS	3
SEC Releases Enforcement Highlights for Fiscal Year 2023	3
PRESS RELEASES, SPEECHES AND OTHER PUBLIC STATEMENTS	4
PUBLIC STATEMENTS	4
SEC Approves Exchange Listings for Spot Bitcoin ETPs	4

New Rules, Proposed Rules, Guidance and Alerts

GUIDANCE AND OTHER DEVELOPMENTS

SEC Staff Issues Statement Regarding ETFs' Disclosure of Foreign Currency Holdings

On January 19, 2024, the staff of the SEC's Division of Investment Management issued a statement regarding the disclosure by ETFs of foreign currency holdings pursuant to Rule 6c-11 under the 1940 Act. Rule 6c-11(c)(1) requires an ETF to disclose its portfolio holdings on its website each business day before the opening of regular trading in order to facilitate the arbitrage mechanism that generally keeps the market prices of an ETF's shares at or near the net asset value of those shares. The portfolio holdings information required to be disclosed consists of the ticker symbol, CUSIP or other identifier, description of the holding, quantity held, and percentage weight of the holding in the portfolio.

The staff observed that some ETFs describe their holdings of foreign currency positions simply as "cash" for purposes of their daily portfolio holdings disclosure on their websites. The staff stated its view that describing foreign currency positions as cash does not provide market participants with enough information to distinguish between an ETF's holdings of U.S. dollars and holdings of other currencies for purposes of assessing the values of the ETF's holdings throughout the day for arbitrage purposes. The staff indicated that ETFs should identify the specific non-U.S. currencies it holds in order to comply with the daily portfolio holdings disclosure requirement.

The SEC staff's statement is available [here](#).

Regulatory Agenda Highlights Potential and Pending SEC Rulemaking Topics

On December 6, 2023, the Office of Information and Regulatory Affairs—part of the Office of Management and Budget, within the Executive Office of the President—released the latest Unified Agenda of Regulatory and Deregulatory Actions, reporting on potential rulemaking topics that administrative agencies, including the SEC, will consider in the short and long term. These topics include several areas of interest to funds, advisers and other financial institutions. The topics are categorized in one of three rulemaking stages: proposed rule, final rule and long-term actions.

Proposed Rule Stage. Matters identified in the proposed rule stage include the following:

- Regulation D and Form D amendments, including updates to the accredited investor definition;
- registered investment companies' fees and fee disclosure—a topic that first appeared in the spring 2022 regulatory agenda but has not yet resulted in any SEC release;
- rules to enable issuers of index-linked annuities (RILAs) to register on a form tailored specifically to such insurance products—a topic that the SEC addressed in a proposing release issued on September 29, 2023 (as previously summarized [here](#));
- joint rulemaking with other agencies to establish data standards for the collection of information reported to each agency by financial entities under their jurisdiction—a new development to implement the requirements of recent amendments to the Financial Stability Act of 2010; and
- the listing and trading of exchange-traded products (ETPs) on national securities exchanges relating to a 2015 SEC request for comment.

Final Rule Stage. Matters identified in the final rule stage include the following:

- custody rules for investment advisers;
- enhanced disclosures by investment advisers and funds about environmental, social and governance (ESG) practices;

- open-end fund liquidity risk management programs and swing pricing;
- cybersecurity risk management for investment advisers and funds;
- Form PF and reporting requirements for investment advisers to private funds;
- broker-dealer and investment adviser conflicts of interest in the use of predictive data analytics, artificial intelligence, machine learning and similar technologies in certain investor interactions;
- outsourcing by investment advisers and rules related to advisers' oversight of third-party service providers;
- amendments to the rule governing the registration of "internet advisers" under the Advisers Act;
- amendments to require broker-dealers, investment companies and investment advisers to adopt written incident response procedures, including notification for compromises of sensitive customer information;
- amendments to the definition of "dealer";
- proposed Regulation Best Execution, which would require detailed policies and procedures for all broker-dealers and more robust policies and procedures for broker-dealers engaging in certain conflicted transactions with retail customers, as well as related review and documentation requirements; and
- cybersecurity risk management for broker-dealers, national securities exchanges, transfer agents and other market participants.

Long-Term Actions. Matters identified in the "long-term actions" stage of rulemaking include the following:

- the role of certain third-party service providers, including index providers, model portfolio providers and pricing services, their treatment under the Advisers Act and the implications for the asset management industry; and
- the regulatory regime for transfer agents.

The SEC's rule list for topics identified in the final rule or proposed rule stage is available [here](#); the "long-term actions" list is available [here](#). In addition, SEC Chair Gary Gensler issued a [statement](#) in connection with the release of the regulatory agenda.

Litigation and Enforcement Matters

LITIGATION DEVELOPMENTS

Pennsylvania District Court Allows Claims Regarding Target Date Funds' Unexpected Tax Liabilities to Proceed

On November 20, 2023, the U.S. District Court for the Eastern District of Pennsylvania granted in part and denied in part defendants' motions to dismiss plaintiffs' claims of breach of the fiduciary duty of care, breach of the covenant of good faith and fair dealing, and other claims made by investors in "retail" target date mutual funds against the funds' adviser, certain officers of the adviser and the funds' independent trustees.

The plaintiffs' claims stem from a December 2020 reduction in the investment minimum for "institutional" versions of the target date funds from \$100 million to \$5 million. The plaintiffs, investors in the corresponding "retail" target date funds who held their shares in taxable accounts, claimed that due to the lower expense ratios of the institutional funds there was an "elephant stampede" out of the more costly retail funds and into the more affordable institutional funds. The plaintiffs claimed that the significant amount of redemptions out of the retail funds led to an unprecedented sale of assets by the retail funds in order to fulfill the redemptions, which led to a sharp spike in capital gains distributed to shareholders that did not leave the retail funds. As a result, the plaintiff shareholders faced large unexpected capital gains tax liabilities, and these shareholders sued the funds' adviser, certain officers of the adviser and the funds' independent trustees alleging breach of the fiduciary duty of care and breach of the covenant of good faith and fair dealing, among other claims. The defendants filed motions to dismiss the investors' claims.

To survive a motion to dismiss, a party must simply allege facts that, if true, would “plausibly suggest” an entitlement to relief. In considering the motions to dismiss the plaintiffs’ claims, the court assumed the accuracy of the plaintiffs’ factual allegations and drew “all reasonable inferences” in favor of the plaintiffs. The court held that the plaintiffs plausibly alleged that the funds’ independent trustees and the adviser’s officers knew of the tax consequences and neglected the risks when lowering the institutional target date funds’ minimum investment amount and that the plaintiffs’ unexpected capital gains tax liabilities resulted in a plausible injury in-fact. However, the court found that the plaintiffs failed to allege a plausible fiduciary relationship with the adviser. The court therefore permitted the plaintiffs’ claims against the target date funds’ independent trustees and the adviser’s officers to proceed, but dismissed the claims against the adviser.

The court memorandum was issued under the caption *In Re Vanguard Chester Funds Litigation*, No. 22-955 (E.D.Pa. Nov. 20, 2023).

Second Circuit Affirms Lower Court Decision Regarding Closed-End Fund Control Share Bylaw Provision

On November 30, 2023, the U.S. Court of Appeals for the Second Circuit affirmed a ruling of the U.S. District Court for the Southern District of New York that invalidates control share bylaw provisions adopted by certain closed-end funds organized as Massachusetts business trusts.

On January 16, 2024, attorneys in Vedder Price’s Investment Services group published an article regarding the Second Circuit’s ruling, available [here](#).

ENFORCEMENT DEVELOPMENTS

SEC Releases Enforcement Highlights for Fiscal Year 2023

On November 14, 2023, the SEC announced its enforcement results for fiscal year 2023, which ended on September 30, 2023. The SEC’s fiscal year 2023 results continued to reflect an aggressive approach to enforcement, reaching record highs in multiple enforcement metrics. Specifically, the SEC announced that it brought 784 total enforcement actions, obtained orders totaling nearly \$5 billion in financial remedies and distributed nearly \$1 billion to harmed investors.

On November 29, 2023, attorneys in Vedder Price’s Government Investigations and White Collar Defense group published an article regarding the SEC’s enforcement results, available [here](#).

Press Releases, Speeches and Other Public Statements

PUBLIC STATEMENTS

SEC Approves Exchange Listings for Spot Bitcoin ETPs

On January 10, 2024, SEC Chair Gary Gensler announced that the SEC had approved the listing and trading of a number of spot Bitcoin exchange-traded products (ETPs). The announcement follows an August 29, 2023 decision by the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) in favor of Grayscale Investments in its case challenging the SEC's disapproval of its filing to convert its existing, privately offered Bitcoin investment trust to a spot Bitcoin ETP that would be listed for trading on a national securities exchange. Noting that the approved filings were similar to those the SEC had disapproved in the past, including more than 20 filings for spot Bitcoin ETPs since 2018, Chair Gensler tacitly acknowledged the D.C. Circuit's decision by stating that, as circumstances have changed, the approval of these filings is the "most sustainable path forward."

In general, the SEC's prior disapprovals of spot Bitcoin ETP filings were based on its finding that the relevant securities exchange was unable to establish that it had a comprehensive surveillance-sharing agreement with a regulated market of significant size related to spot Bitcoin that could be reasonably expected to assist in detecting and deterring fraudulent and manipulative acts and practices in the spot Bitcoin markets. Although past filings to list spot Bitcoin ETPs have argued that a comprehensive surveillance-sharing agreement with the Chicago Mercantile Exchange (CME) Bitcoin futures market would satisfy this standard, the SEC had declined to find that the CME Bitcoin futures market is a market of significant size related to spot Bitcoin. The SEC separately allowed the first Bitcoin futures ETPs to list for trading on an exchange in October 2021.

The D.C. Circuit rejected the SEC's attempted distinction between the spot and futures markets for Bitcoin in determining whether market manipulation existed in the underlying spot market. The D.C. Circuit found that the evidence for correlation between the two markets was overwhelming and thus the SEC's attempts to distinguish between the two was arbitrary and capricious. Accordingly, in contrast to its response to previous filings, the SEC ultimately concluded with respect to the approved filings that fraud or manipulation that impacts prices in spot Bitcoin markets would likely similarly impact Bitcoin futures prices and that the relevant securities exchanges' comprehensive surveillance-sharing agreement with the CME Bitcoin futures market could therefore be reasonably expected to assist in detecting and deterring fraudulent and manipulative acts and practices in the spot Bitcoin markets. The SEC specifically cited in its approval order the high level of correlation between the Bitcoin futures market and spot Bitcoin in recent years that the D.C. Circuit relied upon to rule against the SEC.

Chair Gensler emphasized in his statement that the SEC's approval is limited to ETPs holding Bitcoin and does not signal the SEC's willingness to approve listings of crypto asset securities or otherwise indicate the SEC's views with respect to other crypto asset-related matters. Contrasting Bitcoin ETPs to other commodity ETPs, Chair Gensler stated that Bitcoin is primarily a speculative, volatile asset also used for illicit activity and that the SEC does not approve or endorse Bitcoin.

Chair Gensler's statement is available [here](#), and the SEC's approval order is available [here](#).

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