Investment Services Regulatory Update

September 2025

Monthly Version

VedderPrice

LITIGATION DEVELOPMENTS

Class Action Lawsuits Claim That Funds' Undistributed Income and Gains Are Effectively Liabilities

In recent months, shareholders of several equity mutual funds have filed class action lawsuits in New York and Delaware state courts alleging false and misleading statements and material omissions in the funds' registration statements related to the funds' accounting practices that treat the funds' dividend income and capital gains as assets until the funds distribute (i.e., pay out) their net investment income and net capital gains to their shareholders. The plaintiffs suggest that these undistributed amounts are "effectively" fund liabilities and should be accounted for as liabilities. They allege that the funds' treatment of undistributed income as an asset, even though done in accordance with U.S. generally accepted accounting principles, artificially inflates a fund's net asset value (NAV) per share and results in investors overpaying for fund shares, paying management fees on what are effectively liabilities, and paying taxes on a portion of the distribution that is effectively a return of the investor's principal. The plaintiffs argue that the defendant equity mutual funds should instead remove realized income from their NAVs on a daily basis, as money market funds do.

The plaintiffs allege that the funds falsely disclosed, or failed to disclose, to shareholders in the funds' registration statements the risk and resulting impact of the funds' accounting practices with respect to these undistributed amounts. The plaintiffs allege that the funds' disclosures—stating that a fund's NAV will be reduced by the amount of the distribution on the ex-dividend date and that buying fund shares "shortly before" or "just before" a distribution can cost the investor money in taxes—wrongly suggest that the impact of distributions is limited to a narrow window of time and fail to disclose the "real economic impact" of their accounting for accrued income and capital gains. Furthermore, they allege that the funds misleadingly defined their NAV as assets minus liabilities because they failed to disclose that the NAV included accrued income and capital gains as assets without any offsetting liability for eventual distributions to shareholders.

The plaintiffs name various equity mutual funds and the funds' trustees, officers, investment adviser, and distributor as defendants in the lawsuits, alleging the defendants are liable for false and misleading statements and material omissions in the funds' registration statements under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933.

We will continue to monitor this litigation and will report significant developments in future editions of the Regulatory Update.

ENFORCEMENT DEVELOPMENTS

Broker-Dealer Settles FINRA Enforcement Proceeding Regarding Mutual Fund Rights of Reinstatement

In August 2025, a broker-dealer settled an enforcement proceeding brought by FINRA regarding the broker-dealer firm's alleged failure to apply mutual fund sales charge waivers and fee rebates. According to the letter of acceptance, waiver, and consent, from August 2019 to July 2024 the firm failed to establish and maintain a system reasonably designed to supervise the application of sales charge waivers and fee rebates to which its customers were entitled through rights of reinstatement offered by mutual fund companies.

Mutual funds that impose sales charges often provide shareholders "rights of reinstatement," which are disclosed in the registration statement and generally allow investors to purchase fund shares without incurring a sales charge, or to recoup a previously paid contingent deferred sales

charge, if the investor previously sold shares of the same fund or another fund in the same fund family during a specified look-back period. According to the letter, the broker-dealer's failure to apply sales charge waivers and fee rebates caused its customers to pay $710,739 in excess sales charges and fees.

FINRA found that the firm violated FINRA Rule 3110(a), which requires each FINRA member to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws, regulations and FINRA rules, and FINRA Rule 2010, which requires each FINRA member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade. Without admitting or denying the allegations, the firm was censured and agreed to pay $710,739 in restitution. This settlement is notable because no fine was imposed "in light of the firm's extraordinary cooperation," which included the firm's extensive review of its systems, practices and procedures, engagement of an outside consultant to identify disadvantaged customers and calculate remediation due, establishment of a plan to efficiently identify, notify and repay customers eligible for restitution, establishment of a process to ensure that customers receive rights of reinstatement benefits, prior payment of restitution to some impacted customers in the amount of $90,563, and substantial assistance to FINRA in the investigation.

The FINRA letter is available here.

GUIDANCE AND OTHER DEVELOPMENTS

New SEC Regulatory Agenda Highlights Potential and Pending Rulemaking Topics

On September 4, 2025, the Office of Information and Regulatory Affairs, part of the Office of Management and Budget, within the Executive Office of the President, released the Spring 2025 Unified Agenda of Regulatory and Deregulatory Actions, reporting on potential rulemaking topics that administrative agencies, including the SEC, will consider. With respect to the SEC, the Spring 2025 agenda is the first agenda issued under SEC Chair Paul Atkins and presents a very different list of potential rulemaking topics compared to the Fall 2024 agenda issued under the prior SEC Chair.

The Spring 2025 agenda reflects the SEC's regulatory focus on crypto assets as well as a number of deregulatory initiatives broadly seeking to alleviate compliance burdens and facilitate capital formation, including potential rule proposals to rationalize disclosure practices, to simplify pathways for raising capital and for investor access to private businesses, and to expand the availability of certain exemptive rules. The Spring 2025 agenda also reflects the SEC's recent withdrawal of 14 prior rule proposals issued during the prior administration, including proposals related to cybersecurity requirements for funds and investment advisers, ESG disclosures by funds and advisers, outsourcing by advisers, safeguarding advisory client assets, and conflicts of interest in the use of artificial intelligence and similar technologies by advisers and broker-dealers, among others.

The topics in the Spring 2025 agenda are categorized into three rulemaking stages: prerule stage, proposed rule stage and final rule stage. Certain notable potential rulemaking topics are highlighted below.

Prerule Stage. Matters identified in the prerule stage include seeking public comment with respect to

eligibility for foreign private issuer status and potential comprehensive reform to the Consolidated Audit Trail (CAT) regulatory reporting and oversight regime.

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

- Several crypto asset-related topics, including proposed rules and/or rule amendments related to: (1) the offer and sale of crypto assets; (2) the trading of crypto assets on alternative trading systems and national securities exchanges; (3) the custody of advisory client and fund assets, including crypto assets; (4) the regulation of transfer agents, including rules related to crypto assets and the use of distributed ledger technology by transfer agents; and (5) the broker-dealer financial responsibility, recordkeeping and reporting rules to address the application of these rules to crypto assets;
- Rationalizing disclosure practices to facilitate material disclosure by companies and shareholders' access to that information;
- Additional initiatives to update disclosure and reporting requirements to reduce compliance burdens, including rule proposals to modernize the shelf registration process, to amend the Form N-PORT portfolio-holding reporting requirements applicable to registered funds, and to modernize the shareholder proposal requirements under Rule 14a-8 under the Securities Exchange Act of 1934;
- Reducing the compliance burden of smaller regulated entities, including rule proposals addressing issuers categorized as "Emerging Growth Companies" and potential amendments to the definition of "small entities" under the Investment Company Act of 1940 and Investment Advisers Act of 1940;
- Expanding the availability of certain exemptive rules, including Rule 144 under the Securities Act of 1933 regarding restricted securities and Rule 17a-7 under the Investment Company Act regarding cross trading; and
- Simplifying pathways for raising capital and for investor access to private businesses.

Final Rule Stage. Matters identified in the final rule stage include a rule proposal under the Bank Secrecy Act (BSA) that would impose new customer identification program (CIP) requirements on registered investment advisers and exempt reporting advisers, as previously summarized here.

The full list of potential rulemaking topics is available here. Chair Atkins' statement on the Spring 2025 agenda is available here.

SEC Names New Director of the Division of Enforcement

On August 21, 2025, the SEC announced that Judge Margaret "Meg" Ryan will become the new Director of the SEC's Division of Enforcement, effective September 2, 2025. The SEC highlighted Judge Ryan's "decades of experience as a respected judge and practitioner of the law," noting her long tenure as a judge of the United States Court of Appeals for the Armed Forces and her current teaching positions at several law schools. With Judge Ryan's appointment, Acting Director of the Division of Enforcement Sam Waldon, who has served in that position since January 2025, will return to his previous role as Chief Counsel for the Division of Enforcement.

The SEC press release announcing Judge Ryan's appointment is available here.

President Trump Signs Executive Order Seeking to Facilitate 401(k) Access to Private Funds and Digital Assets

On August 7, 2025, President Trump signed an executive order aimed at facilitating and expanding access to alternative investments — such as private equity, private credit, real estate and digital assets like cryptocurrency — by retirement plans regulated by ERISA, including 401(k) plans. The executive order directs the Department of Labor to reexamine and clarify its stance on fiduciary obligations when offering alternative assets to ERISA plans within 180 days, and to propose new rules or guidance, including potential safe harbors for plan fiduciaries. To that end, on August 12, 2025, the DOL rescinded guidance from 2021 that discouraged fiduciaries from considering alternative assets in 401(k) plan investment menus (available here). The executive order also directs the SEC to consider revising applicable regulations to faciliate ERISA plan access to alternative investments.

From the perspective of private fund sponsors, the executive order opens the door to access an enormous capital pool estimated at more than $12 trillion, depending on the guidance and/or rulemaking that results from the various regulatory agencies. In addition, the inclusion of digital assets further broadens the scope of potential investors who may benefit from certain platformed tokenized products.

Private fund sponsors should consider the following actions to prepare for the potential regulatory changes that will arise from the order:

- **Forming Strategic Partnerships** – with (i) retirement plan service providers (e.g., recordkeepers, plan fiduciaries and their asset managers) and (ii) asset managers to allocation vehicles currently structured to offer alternative assets to retirement plans (e.g., collective investment trusts (CITs), target date funds, etc.), to discuss product design and suitability for investment menus.
- **Ensuring ERISA Compliance** – including whether the fund sponsor can operate an ERISA-compliant fund and/or avail itself of the Qualified Professional Asset Manager (QPAM) exemption when managing a fund that becomes a "plan asset" look-though entity.
- **Updating Marketing Materials** – to allow retirement plan service providers and asset managers to evaluate a fund sponsor's existing product menu.
- **Monitoring Guidance Closely** – especially as it relates to fiduciary safe harbors provided by regulatory guidance and allowing access to alternative assets through direct investment options (as opposed to access solely through allocation vehicles structured to offer alternative assets to retirement plans).

The executive order is available here.

Significant Developments for Registered Closed End Funds of Private Funds

In a development consistent with the recent executive order allowing 401(k)s to invest in alternatives and crypto, the Securities and Exchange Commission ("SEC") has dropped the requirement that a registered closed-end fund that invests more than 15% of its assets in private funds must (a) limit offers to accredited investors under Regulation D of the Securities Act and (b) require a minimum initial investment of $25,000.

This new guidance appears in an Accounting and Disclosure Information (ADI) 2025-16 which was recently published by the SEC's Division of Investment Management. The SEC's guidance under ADI 2025-16 – Registered Closed-End Funds of Private Funds can be found here. The guidance marks a significant shift from the SEC's position over the last two decades.

Clients with existing registered closed-end fund of fund products should revisit their disclosures to address the SEC's new guidance. Clients evaluating new products should view this as a very welcome development. The SEC's attitude toward private funds continues to change and this guidance, which opens the door to retail investment in private fund of funds, continues that trend.

SEC Staff No-Action Letter Relieves Constraint on Authorized Participants for ETFs with Foreign Holdings

On July 22, 2025, the staff of the SEC issued no-action relief providing that broker-dealers acting as authorized participants for ETFs holding foreign securities do not have to take a net capital charge under Rule 15c3-1 under the Securities Exchange Act of 1934 (which establishes net capital requirements for broker-dealers) to account for unsecured receivables that arise from creation and redemption transactions when the ETF holds foreign securities that are not cleared through an SEC-registered clearing agency. These unsecured receivables for the broker-dealer arise due to a timing mismatch between the settlement of the creation or redemption transaction and the settlement of the underlying foreign securities, such that (1) the broker-dealer cannot deliver the ETF portfolio securities for a creation transaction prior to the settlement of the creation transaction, or (2) a broker-dealer cannot deliver the ETF shares for a redemption transaction before the ETF must instruct the relevant foreign clearing system to transfer the portfolio securities. This guidance would allow broker-dealers in these circumstances to avoid deducting these receivables from their net capital, thereby removing an impediment to broker-dealers participating as authorized participants in this segment of the ETF market.

As set forth in the SEC staff's no-action letter, the staff's position would apply only under the following circumstances:

- For an ETF creation transaction, the broker-dealer must receive the return of its collateral by the fourth business day after the day on which the broker-dealer initially delivered the collateral in respect of the ETF portfolio securities;
- For an ETF redemption transaction, the broker-dealer must receive both the ETF portfolio securities and the return of its collateral by the fourth business day after the day on which the broker-dealer initially delivered the collateral in respect of the ETF shares;
- During any ETF creation or redemption transaction and until completion of the transaction, the ETF's U.S. bank custodian must continue to hold any collateral of the broker-dealer; and
- The amount of the unsecured receivable may not exceed (1) 10% of the broker-dealer's tentative net capital with respect to any single ETF creation or redemption transaction, and (2) 25% of the broker-dealer's tentative net capital in the aggregate across all ETF creation and redemption transactions.

The SEC staff's no-action letter, along with the incoming letter, is available here.

SEC Approves In-Kind Transactions for Crypto Asset ETPs

On July 29, 2025, the SEC approved the use of in-kind creations and redemptions by authorized participants for crypto asset exchange-traded product (ETP) shares. The SEC's approval order applies only to ETPs that are not registered investment companies. Prior to this order, the SEC had approved the listing and trading of a number of spot Bitcoin ETPs and spot Ether ETPs in January 2024 and May 2024, respectively, however those orders only contemplated cash creations and redemptions by authorized participants. As stated by SEC Commissioner Mark Uyeda in conjunction with the SEC's July 29 order, limiting crypto ETP authorized participants to a cash-only creation and redemption structure "forc[es] the ETP issuer to buy or sell the crypto asset on the open market. This introduces significant transaction costs, exposes the product and its investors to price slippage in the underlying asset class, and makes the ETP more expensive."

By permitting crypto ETPs to create and redeem shares on an in-kind basis, the SEC has leveled the playing field with other commodity-based ETPs which are already permitted to create and redeem shares in-kind. In the SEC's press release, Jamie Selway, Director of the SEC's Division of Trading and Markets, stated that the SEC's approval "is an important development for the growing marketplace for crypto-based ETPs. In-kind creation and redemption provide flexibility and cost savings to ETP issuers, authorized participants, and investors, resulting in a more efficient market."

The SEC's approval order is available here, the SEC's press release is available here, and Commissioner Uyeda's statement is available here.

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Investment Services Group

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