Davis Polk

Private Equity Regulatory Update - July 2022

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In this issue, we discuss, among other things, rule amendments that require electronic submission of Advisers Act exemptive order applications and Form 13F confidential treatment requests, and expiration of a temporary no-action letter relevant for broker-dealers receiving compensation for research services after MiFID II.

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Rules and regulations

SEC adopts rule amendments to require electronic submission of certain filings by investment advisers and institutional investment managers

Rule amendments

On June 23 2022, the Securities and Exchange Commission (SEC) adopted rule amendments that require certain forms that are currently submitted in paper format to be filed electronically, and that also modify certain other reporting requirements. Specifically, the rule amendments will give effect to the following primary changes:

- Applications for orders under any section of the Investment Advisers Act of 1940 (Advisers Act) must be submitted electronically via the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. Temporary hardship exemptions from electronic filing will not be available, but continuing hardship exemptions may be available.
  - In addition, applicants seeking orders under the Advisers Act no longer need to notarize verifications and statements of fact in applications, and no longer need to attach proposed notices as exhibits to applications.
- Requests for confidential treatment (Confidential Treatment Requests) of information in Form 13F filings under section 13(f) of the Securities Exchange Act of 1934 (Exchange Act) must be submitted electronically through EDGAR in a nonpublic filing separate from a manager's public Form 13F submission. Other amendments to Form 13F include:
  - A Form 13F filer must provide its Central Registration Depository (CRD) number and SEC file number and those

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of other reporting managers, if any.

  - A Form 13F filer may choose to report a share class level Financial Instrument Global Identifier (FIGI) for any security reported on the Form 13F.
  - A Form 13F filer submitting a Confidential Treatment Request must demonstrate that the information in question is customarily and actually kept private by the manager, and that failure to grant the Confidential Treatment Request would be likely to cause harm to the manager.
  - Form 13F will no longer have character limits for the cover page, summary page or information table, and filers will no longer need to round dollar values to the nearest thousand dollars, as the technical basis of Form 13F will be changed to an XML-based structured data language format that does not have space limitations.

- Filing of a Form ADV-NR to appoint an agent for service of process in the United States must be submitted electronically through the Investment Adviser Registration Depository (IARD) system, unless filers are granted a hardship exemption.

According to the adopting release, the rule amendments become effective on August 29, 2022, except for the Form 13F amendments which become effective on January 3, 2023, with a compliance date that is six months after the effective date of the amendments.

Policy background to rule amendments

The adopting release noted that the adoption of the rule amendments would promote efficiency for both investors and the SEC. In a statement delivered on June 23, 2022, SEC Chair Gary Gensler remarked that "[i]n a digital age, it is important for filers to have easy, online methods to submit information to the Commission, and where appropriate for investors to have easy, online access as well." The SEC received comments agreeing that electronic submissions would reduce burdens on filers as it likely better reflects the current business practices and operations of filers. The SEC also noted that electronic filing minimizes the risks of delay in reviewers receiving information via paper submissions, and increases efficiency in the review process by reducing SEC staff processing time, increasing quality assurance, and improving the ability to review and analyze information contained in electronic submissions.

The SEC also noted that electronic filing would promote transparency, as publicly filed electronic submissions are more readily available on the EDGAR website in easily searchable formats, which benefits investors, the asset management industry, and other market participants. According to the adopting release, the collection and display of information on the EDGAR system makes it easier for the public to view information and understand the interrelationships between managers and related entities by searching for information on a single platform.

Finally, the SEC noted that the modernization of the filing process would increase operational resiliency of submissions and disclosures. They remarked that electronic filing capabilities have proved to be an effective measure in addressing certain of the logistical and operational issues raised by the spread of COVID-19, and that the conversion to electronic filing would allow the SEC staff, and those persons filing the submissions, to more effectively and efficiently navigate any future disruptive events that make the paper submission process unnecessarily burdensome, impractical, or unavailable.

Industry update

SEC Commissioner Crenshaw issues statement on single-stock ETFs

On July 11, 2022, Commissioner Caroline A. Crenshaw released a statement on single-stock exchange-traded funds (ETFs) which provide "leveraged, inverse or other complex exposure to one single security rather than the typical

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portfolio of multiple, more diversified securities." The Commissioner expressed concerns with these products and the risks they pose to the markets and to retail investors in particular.

Commissioner Crenshaw noted that Rule 6c-11 under the Investment Company Act of 1940 (Investment Company Act) provides a framework whereby ETFs meeting certain criteria can come directly to market without first obtaining an exemptive order from the SEC. She noted that single-stock ETFs are coming to market under Rule 6c-11, even though "there is no indication that the rule contemplated such products." Commissioner Crenshaw emphasized the problems posed by this trend of single-stock ETFs coming to market under Rule 6c-11, as single-stock ETFs potentially pose greater risks to investors and the markets than do diversified ETFs. Such products, like most leveraged and inverse ETFs, rebalance daily and when coupled with the effects of compounding, returns on these products may diverge substantially from performance of the underlying single stock. As such, "investors' returns over a longer period of time might be significantly lower than they would expect based on the performance of the underlying stock." Commissioner Crenshaw also noted that in times of market stress and volatility, such products may have unexpected results and "potentially contribute to broader systemic risks."

Because of these risks, Commissioner Crenshaw suggested that it would be challenging for investment professionals to be able to recommend such products to retail investors under their fiduciary and other obligations under Regulation Best Interest. She also noted that self-directed retail investors can access single-stock ETFs without the guidance of investment professionals. She expressed her concern that while single-stock ETFs "may be useful to certain investors who understand their unique features," they remain "risky products" for many investors and the markets as a whole.

Commissioner Crenshaw concluded by re-emphasizing her calls for "a comprehensive and consistent approach to the review of complex exchange-traded products" that "is long overdue." She encouraged the SEC to consider additional rulemaking in order to address the issue of whether such products are in the public interest and consistent with the protection of investors.

Director of SEC's Investment Management Division announces intention not to renew temporary no-action relief for broker-dealers receiving compensation for research services after MiFID II

In his remarks at the Practicing Law Institute on July 26, 2022, William Birdthistle, Director of the SEC's Division of Investment Management, highlighted certain changes on the horizon for investment management, including the impact of MiFID II on the market for investment research. The European Union's Markets in Financial Instruments Directive II, or MiFID II, came into effect in January 2018 and effectively prevents European investment managers from purchasing broker-dealer research with soft dollars. To address certain issues raised by the cross-border implementation of MiFID II provisions, the SEC staff granted temporary relief in a no-action letter to the Securities Industry and Financial Markets Association, under which a broker-dealer may, without becoming subject to the Advisers Act, provide research services to an investment manager that is required, either directly or by contractual obligation, to pay for such research services with MiFID II-compliant research payments. See Securities Industry and Financial Markets Association, SEC No–Action Letter (Oct. 26, 2017). The temporary no-action relief was set to expire on July 3, 2020, and in a subsequent no-action letter, the SEC staff extended the temporary relief until July 3, 2023. See Securities Industry and Financial Markets Association, SEC No–Action Letter (Nov. 4, 2019). In his recent remarks, Director Birdthistle announced that the SEC staff does not intend to renew the temporary relief period beyond the July 3, 2023 expiration date because broker-dealers have developed "a variety of solutions to address the impact of MiFID II" such as dual registration as investment advisers, and use of a registered investment adviser affiliate to provide research services.

Director Birdthistle's remarks went on to highlight the upcoming transition away from LIBOR and encouraged investment advisers to focus on operational readiness and disclosure obligations regarding risks related to such transition. He also highlighted three areas where he envisions "room to improve the oversight of funds and advisers":

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(a) investor protection, including a focus on reviewing fee arrangements, (b) facilitating capital formation, such as the recently proposed rules for private fund advisers and (c) maintaining orderly and efficient markets, including investor participation in the proxy voting process as a means to "promote markets that more fairly reflect the views and priorities of American investors, not just large asset managers." At the end of his remarks, Director Birdthistle discussed the money market fund industry and potential solutions for dealing with large-scale redemptions during times of market stress, such as swing pricing.

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