ACA

WILLKIE FARR & GALLAGHER LLP

2022 Regulatory Headwinds: Potential Changes to Securities Laws and Regulations and the Impact on Private Fund Managers

February 2022

Introduction

The U.S. Securities and Exchange Commission's (SEC) **updated fall 2021 rulemaking agenda** (Fall 2021 Agenda) reflects a clear shift in focus and prioritization. Recent commentary from SEC Chair Gary Gensler indicated that the agency will push forward with an aggressive rulemaking agenda in 2022. Chair Gensler has also suggested that the SEC will have an active examination and enforcement program. "We will continue to pursue misconduct wherever we find it. That will include the hard cases, the novel cases and, yes, the high-impact cases – whether in special purpose acquisition companies, cyber, crypto or private funds; whether accounting fraud, insider trading, or recordkeeping violations,"[1] Gensler said at the Securities Enforcement Forum in November 2021.

As we move into 2022, several of the proposed rulemakings merit special attention for private fund managers. In this white paper, we discuss:

- Environmental, Social, and Governance (ESG) Rulemaking for Public Companies, Investment Advisers, and Investment Funds
- Expanded Reporting Requirements for Investment Advisers
- Enhanced Regulation of Private Funds
- Implementation of the Investment Adviser Marketing Rule
- Regulation of Digital Assets
- Increased Regulation of Special Purpose Acquisition Companies (SPACs)

1 Chair Gary Gensler, Prepared Remarks at the Securities Enforcement Forum, (Nov. 4, 2021), available at **https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104**.

ESG Rules for Public Companies, Investment Advisers, and Investment Funds

Since the start of the Biden Administration, the SEC has focused on promoting disclosures to provide investors with more information about how companies will both impact and be impacted by climate change. Environmental, social, and governance (ESG) issues are not just a focus for the SEC, they are a priority of the Biden administration as a whole (particularly with respect to climate policy). That emphasis increases the likelihood that the SEC will adopt final rules, the effects of SEC rulemaking will be significant, and rulemaking from other agencies will intersect with SEC rulemaking.[2] In an early step to address ESG issues, the SEC created an ESG task force within the Division of Enforcement in March 2021 to identify and address ESG-related misconduct by investment advisers, investment companies, and public companies.

The SEC has not yet proposed rules relating to ESG disclosure by public companies, however, Chair Gensler has indicated that agency proposed rulemaking on ESG disclosures is likely in early 2022. The SEC rules are expected to mandate some additional level of disclosure by public companies regarding the risks that a company faces from climate change and a company's impact on climate change (e.g., a company's greenhouse gas emissions). The SEC's effort to promote climate-related disclosures will increase corporate transparency into how different companies are contributing to and being affected by climate change, making environmental factors a greater consideration for corporate leadership and investors. The SEC is also considering disclosures related to human capital and board diversity at public companies. While the full scope of the expected new disclosure framework is not certain, the underlying goal is to provide investors (both asset managers and their clients) with more information and more consistent information regarding ESG to inform their investment decisions.[3]

2 Another example of the Biden administration's focus on ESG can be seen in the Department of Labor's proposed rules regarding the extent to which ERISA fiduciaries can consider ESG factors in selecting investments and the obligations of ERISA fiduciaries with respect to voting proxies, including with respect to ESG issues. Private fund managers with ERISA clients or investors will need to consider the potential impact of the Department's rulemaking for asset managers to ERISA plans. Proposed Rule, Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (Oct. 14, 2021), available at **https://www.govinfo.gov/content/pkg/FR-2021-10-14/pdf/2021-22263.pdf**.

3 A recent report by the International Organization of Securities Commissions (IOSCO), of which the SEC is a member, includes five ESG-related recommendations that regulators or policymakers should consider, including: setting expectations for asset managers regarding policies and procedures relating to material sustainability-related risks, product disclosures, supervision and enforcement, encouraging the development of common terminology, and financial and investor education. While the IOSCO recommendations are not binding on the SEC or other national regulators, they may provide some insight into the types of rules the SEC will consider. IOSCO final report "Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management" (Nov. 2, 2021), available at **https://www.iosco.org/library/pubdocs/pdf/IOSCOPD688.pdf**.

In addition to increased public company disclosures, the SEC is scrutinizing how investment advisers and investment companies incorporate and disclose ESG factors that are part of their investment strategies. To date, SEC staff guidance has focused on well-known standards, primarily ensuring that disclosures to investors are consistent with firm practices and that firms are adequately documenting and can support ESG-related practices and claims.[4] While these expectations are well known, between the increasing demands from investors with respect to ESG policies of advisers and funds and the SEC's expected focus on increased transparency related to ESG issues, managers should consider whether their policies and procedures and disclosures to investors should be reviewed or revised. The increased SEC scrutiny also should be considered in the context of Chair Gensler expressing a desire for a more robust enforcement posture to protect investors from misleading information, including with respect to asset management products that are marketed using ESG terminology.

The expected SEC rulemakings for public companies and for the asset management industry are both likely to significantly affect asset managers and investment funds. The public company disclosure regime will determine whether asset managers have access to the type of ESG-related information that the industry has called for to make informed investment decisions. Rules for investment advisers and investment companies will have direct effects on the compliance and investment programs for the industry, as well as affecting marketing materials and other disclosures asset managers make to investors.

4 The Division of Examinations' Review of ESG Investing, SEC Risk Alert (Apr. 9, 2021), available at https://www.sec.gov/files/esg-risk-alert.pdf.

Expanded Reporting Requirements for Investment Advisers

Securities-Based Swaps (SBS) Reporting

On December 15, 2021 the **SEC proposed a set of rules**: (i) intended to prevent fraud, manipulation, and deception in connection with securities-based swaps transactions, (ii) to require large security-based swap positions to be reported publicly, and (iii) intended to prevent undue influence over the Chief Compliance Officer (CCO) in connection with securities-based swaps reporting.[5]

As proposed, Rule 9j-1 prohibits fraudulent, deceptive, or manipulative conduct in connection with all transactions, and attempts to effect a transaction, in security-based swaps, including misconduct in connection with the exercise of any right or performance of any obligation under a security-based swap. The proposal, while similar in a number of respects to the SEC's proposed rules in 2010, expands certain aspects of the scope of the prior proposal, while also proposing two new safe harbors intended to address concerns raised by commenters in response to the 2010 proposal on the breadth of conduct that could be encompassed by the proposal.

Proposed new Rule 10B-1 creates an additional approach to increased reporting of securities-based-swaps. It requires that any security-based swap position, and other specified holdings in the referenced instrument and other related instruments, that exceed the threshold amount set by the rule to promptly file Schedule 10B, no later than the first business day following the day of execution of the security-based swap that results in the person or group exceeding the threshold.[6]

The SEC indicated that the publicly-available filings potentially facilitate risk management and inform pricing of security-based swaps.[7] Private fund managers need to consider the extent to which the scope of and frequency of reporting that would be required under the proposed rules could also provide the market with notice when the firm is in the process of building a position to the detriment of the firm and its clients.

Finally, a security-based swap dealer and major security-based swap participant are required to have a CCO who is charged with ensuring compliance with federal laws applicable to security-based swaps. The SEC has proposed Rule 15Fh-4(c) under the Securities Exchange Act of 1934 (Exchange Act) to protect the independence and objectivity of the CCO by preventing the personnel of the entity from taking actions to coerce, mislead, or otherwise interfere with the CCO in performing his or her duties as described in federal securities laws, rules, and regulations.

The proposed rules are likely to have significant consequences for a wide range of market participants, including investment advisers and private funds that trade security-based swaps. The implementation of these rules, if adopted as proposed, will require advisers to review and/or create policies and procedures to comply with the provisions and advisers will need to consider the effects of the proposed rules, particularly Rule 9j-1 and Rule 10B-1, on their trading strategies. The proposing release is open for comment for 45 days after publication in the Federal Register.

5 A brief summary of the rules is set out in this paper. For a more comprehensive discussion of the proposed rules, see Willkie Farr & Gallagher LLP client alert, SEC Proposes Rules Related to Security-Based Swaps Requiring Public Reporting of Large Positions, Imposing Anti-Fraud and Anti-Manipulation Requirements and Prohibiting Actions to Exert Undue Influence over CCOs (January 12, 2022) (Securities-Based Swaps Alert), available at **https://www.willkie.com/-/media/files/publications/2022/secproposesrulesrelatedtosecuritybasedswaps.pdf**.

6 These new requirements would be in addition to recently adopted SEC rules that will require transaction data to be reported to swap data repositories and, beginning in February 2022, requiring swap data repositories to provide public disclosure regarding those transactions.

7 See Willkie Farr & Gallagher LLP Security-Based Swaps client alert noted in footnote 5 for a discussion of the events related to the collapse of Archegos Capital Management in 2021, which appears to have motivated the proposed rules.

Amendments to Form 13D, Form ADV, Form PF, Form 13F

In addition to increased transparency related to security-based swaps, the SEC has proposed amendments to rules under Sections 13(d) and (g) of the Exchange Act. The proposed rules shorten the initial reporting window for Form 13D from ten days to five days and require material changes to be reported within one business day.[8] The proposed rules shorten the reporting window for Form 13G filers as well. Initial and amending reports currently required to be reported within 45 days of calendar-year end must be reported within five business days of the end of the month. Form 13G filings currently due ten days after month-end must be reported within five days of a threshold being exceeded, and amendments that are currently required to be filed promptly must be filed within one business day. Consistent with Chair Gensler's prior comments with respect to the reporting window in Section 13(d) and Rule 13d-1,[9] a significant basis for the proposed rules is the speed of markets and the technological capability of companies to file Form 13D. The proposed rules appear to reflect the SEC striking a different balance between the need for public reporting with the competing policy objective to permit investors a reasonable period of time to implement their investment decisions before providing notice to the market.[10]

In addition to shortening the reporting windows, the proposed rules address issues related to the formation of a group for purposes of Sections 13(d) and (g). Rule 13d-5 is amended to avoid an interpretation that two or more persons must have an express or implied agreement to be deemed a group. Amended Rule 13d-6 provides, among other things, that two or more persons will not be deemed to be acting as a group for purposes of Section 13(d) or (g) solely because of their concerted actions with respect to an issuer's equity securities, including engagement with one another or the issuer or acquiring, holding, voting or disposing of the issuer's equity securities; provided, that:

1. Communications among or between such persons are not undertaken with the purpose or the effect of changing or influencing control of the issuer, and are not made in connection with or as a participant in any transaction having such purpose or effect, including any transaction subject to rule 13d-3(b); and

2. Such persons, when taking such concerted actions, are not directly or indirectly obligated to take such actions.

On January 26, 2022, the SEC proposed rules to amend Form PF,[11] which would increase significantly the reporting obligations of private fund advisers, including new obligations for:

1. large hedge fund advisers,
2. private equity fund advisers,
3. large private equity advisers, and
4. large liquidity fund advisers.

8 Modernization of Beneficial Ownership proposed rules, available at https://www.sec.gov/rules/proposed/2022/33-11030.pdf.

9 Chair Gary Gensler, Prepared Remarks at London City Week (London City Speech) (June 23, 2021), available at https://www.sec.gov/news/speech/gensler-speech-london-city-week-062321.

10 It also is notable that, unlike Chair Gensler's prior comments, which did not specifically discuss changing the reporting schedule for filing Form 13G, the proposed rules significantly shorten the reporting window for those reports as well.

11 The proposed rules are available at https://www.sec.gov/rules/proposed/2022/ia-5950.pdf. A brief summary of the proposed rules is set out in this paper. For a more comprehensive discussion of the proposed rules, see Willkie Farr & Gallagher LLP Client Alert, SEC Proposes Amendments to Form PF to Enhance Private Fund Reporting (February 1, 2022), available at https://www.willkie.com/-/media/files/publications/2022/secproposesamendmentstoformpftoenhanceprivatefundr.pdf.

The proposed rules create new current reporting requirements for large hedge fund advisers with at least $1.5 billion in regulatory assets under management attributable to hedge funds as of the end of any month in the prior fiscal quarter applicable to hedge funds with a net asset value (NAV) of at least $500 million (Qualifying Fund). The proposal requires large hedge fund advisers to report within one business day information regarding the following:

1. "extraordinary investment losses," meaning 20 percent or more of a Qualifying Fund's most recent NAV (defined to mean the NAV as of the data reporting date at the end of the Qualifying Fund's most recent reporting period) over a rolling 10 business day period;
2. margin increases of more than 20 percent of a Qualifying Fund's most recent NAV over a rolling 10 business day period; a Qualifying Fund's default or inability to meet a margin call; or a counterparty's failure to meet a margin call or make a required payment in an amount greater than 5 percent of a Qualifying Fund's NAV;
3. material changes to a Qualifying Fund's prime brokerage relationships, including material changes to a Qualifying Fund's ability to trade or a termination of the Qualifying Fund's prime brokerage relationship;
4. a decline in the value of more than 20 percent of a Qualifying Fund's unencumbered cash over a rolling 10 business day period;
5. a significant disruption or degradation (defined as a 20 percent disruption or degradation of normal capacity) of a Qualifying Fund's key operations (e.g., investment, trading, valuation, reporting, and risk management); and
6. cumulative requests for net redemptions exceeding 50 percent of a Qualifying Fund's most recent NAV.

The proposal also expands reporting requirements for private equity fund advisers. The proposal requires all private equity fund advisers to report within one business day information regarding:

1. execution of an adviser-led secondary transaction;
2. implementation of a general partner clawback or a limited partner clawback in excess of an aggregate amount equal to 10 percent of a fund's aggregate capital commitments; and
3. investors having voted to remove a fund's general partner, terminate a fund's investment period, or terminate a fund.

The proposal reduces the reporting threshold for large private equity advisers from $2 billion to $1.5 billion in regulatory assets under management attributable to private equity funds as of the last day of the most recent fiscal year. The proposed amendments expand the information that large private equity advisers have to report, to include:

1. investment strategies;
2. restructurings or recapitalizations of portfolio companies following a fund's investment period;
3. investments in different levels of a single portfolio company's capital structure by related funds;
4. fund-level borrowings;
5. whether the adviser or any related persons provide financing or extent credit to a fund's portfolio company;
6. floating rate borrowings of controlled portfolio companies and how many controlled portfolio companies a private equity fund owns; and
7. amended reporting of events of default, bridge financing to controlled portfolio companies, and geographic breakdown of investments.

Finally, the proposed rules require large liquidity fund advisers to report information that is substantially the same as information that money market funds would report on proposed Form N-MFP. Large liquidity fund advisers are defined as those with at least $1 billion in combined regulatory assets under management attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter. The new reporting for these advisers includes:

1. operational information, such as whether the liquidity fund seeks to maintain a stable price per share;
2. assets and portfolio information;
3. financing information;
4. investor information;
5. information about a liquidity fund's disposition of portfolio securities; and
6. the liquidity fund's weighted average maturity and weighted average life.

The frequency and reporting window for Form 13F is also a target for reform. Chairwoman Waters' **bill to amend Section 13(f) of the Exchange Act** would shorten the frequency of Form 13F reporting from quarterly to monthly, with reports due not later than 10 business days after the end of each month.[12] In the absence of legislative action regarding the frequency of reporting, Section 13(f) would seemingly preclude the SEC from requiring reporting under that section for any period that is shorter than one quarter, though the current statute does not prohibit the SEC from shortening the current requirement in Rule 13f-1 to require for institutional investment managers to file Form 13F sooner than 45 days after the end of a calendar quarter.[13]

12 H.R. 4618 also requires the SEC to study the standards and criteria used to determine how confidential treatment requests should be determined by the SEC.

13 In 2020, the SEC proposed amendments to Rule 13f-1, which would have significantly increased the dollar threshold for institutional investment managers required to file Form 13F, which would have significantly reduced the number of managers required to file Form 13F. With the change in administration, those proposed rules would not be part of any proposal from the current Commission to amend Form 13F reporting.

Short Sale Disclosures

Requiring public disclosure of short positions has been a long-standing policy debate. Following the GameStop short squeeze, Congress and regulators are again considering rules that would require public reporting of short sale positions. The SEC has **proposed rules** to require a person lending securities to report information regarding its securities lending transactions to a national securities association and would require the national securities association to make public certain information, including aggregate information regarding securities on loan and available to loan. FINRA has also **proposed changes to Rule 4560** that contemplate FINRA members providing additional data to the SRO regarding short interest and contemplate FINRA consolidating the publication of short interest data.In addition to those existing proposals, Chair Gensler has noted that, under Section 929X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC is required to issue rules regarding aggregate public disclosure of short sales, and he said that he has directed SEC staff to prepare recommendations to implement short sale reporting.[14] Chairwoman Waters has introduced legislation that would require the SEC to adopt rules to implement Section 929X.[15]

Much of the policy debate regarding short sale public disclosures has focused on whether rules should require aggregate reporting of short positions or whether they should require individual firms to report their positions, analogous to reporting requirements for long positions under Section 13(f) of the Exchange Act. Though Section 929X calls for the SEC to issue rules requiring public, aggregate disclosure of short positions, it is expected that the SEC will give strong consideration to requiring public disclosure of short sale positions by individual managers. New rules requiring managers to publicly disclose individual short positions could have significant negative consequences for firms, given the adverse impacts such disclosure requirements can have.

14 *See* Chair Gary Gensler, Testimony Before the House Committee on Financial Services (May 6, 2021) **https://www.sec.gov/news/testimony/gensler-testimony-20210505** (May 6 Testimony).

15 H.R. 4618, *supra* note 12.

Enhanced Regulation of Private Funds

The SEC has proposed a series of rules that would increase regulation of private fund managers.[16] The proposed rules include, among other things:

1. quarterly reporting to investors regarding fees and expenses and performance information,

2. prohibitions on private fund advisers charging certain types of fees and expenses,

3. prohibitions on certain types of preferential terms related to liquidity and portfolio information provided to investors in side letters and through certain other arrangements,

4. disclosure to investors of other types of preferential treatment provided to certain investors, and

5. limitations on indemnification and exculpation provisions in contractual agreements.

Fees

The proposed rules reflect previous comments made by Chair Gensler. For example, citing the growth of the private equity market, Chair Gensler noted the multiple levels of fees that are charged to investors. He further noted that, against the estimated $9 trillion in net assets under management, private equity management and performance fees could be in the range of $250 billion-per year, a figure that is significant to the markets. The Commission and the staff of the Division of Examinations have set the stage for a comprehensive review of private fund advisory fees and of how those fees are disclosed, calculated, and assessed by private fund managers.

Side Letters

Chair Gensler has also expressed concern that certain side letters negotiated with limited partners (e.g., relating to preferred liquidity terms or reduced fees) could "create an uneven playing field."[17] In addition to the proposed rulemaking in this regard, private fund managers should expect this to be an area of interest in SEC examinations.

Performance Metrics

The proposed rules also reflect prior comments by Chair Gensler regarding what he characterized as a lack of transparency regarding private fund performance metrics. The Chair expressed his view that, unlike mutual funds, which provide detailed public information regarding fees and performance, basic facts about private fund performance are less readily available to their investors, much less to the public. He voiced concern that investors might have difficulty analyzing the performance of private funds as compared to public equity markets.

16 The proposed rules are available at https://www.sec.gov/rules/proposed/2022/ia-5955.pdf.

17 Chair Gary Gensler, Prepared Remarks at the Institutional Limited Partners Association Summit (ILPA Summit) (November 10, 2021), available at https://www.sec.gov/news/speech/gensler-ilpa-20211110.

Conflicts of Interest

Chair Gensler has repeatedly reminded private fund advisers that their actions need to be consistent with the adviser's fiduciary duties, and the proposed rules reflect the Chair's prior comments about seeking an opportunity to address conflicts of interest in a way that would "strengthen trust in the private funds market."[18] While the new disclosure rules reflect an approach that is more consistent with the SEC's traditional approach to advisers mitigating conflicts of interest through informed client consent, the proposed prohibitions of particular practices break new ground and could create significant challenges for certain business relationships or business models.

Private Offering Rules

A key SEC policy objective under the prior administration, expanding access for retail investors in private offerings, was heavily criticized by Commissioners Crenshaw and Lee.[19] In addition to criticizing rules adopted in 2020, the Commissioners have expressed their view that the SEC should reconsider its 2013 rule proposals to amend Regulation D under the Securities Act of 1933 (1933 Act), Form D, and Rule 156 under the 1933 Act.[20] The SEC has placed on its Fall 2021 Agenda a review of the rules related to private offerings, including enhancing the information available regarding offerings made pursuant to Regulation D under the 1933 Act.

In addition to potential rulemakings under the Investment Advisers Act of 1940 (Advisers Act), the SEC included in its Fall 2021 Agenda potential amendments to Regulation D and Form D. In 2013, the SEC proposed rules to amend Regulation D offerings,[21] which were proposed (but not finalized) by the SEC while enacting rules to implement the Jumpstart our Business Startups Act. These 2013 proposed rules would have made a number of changes to Regulation D offerings, requiring:

» increased information to be reported on Form D and an advance initial Form D to be filed;

» an additional filing at the close of a Regulation D offering;

» legends on written general solicitation materials;

» written general solicitation materials to be submitted to the SEC; and

» automatic disqualification of issuers for failure to properly file a Form D.

The 2013 proposed rules, if adopted, would affect both private funds conducting offerings under Rule 506(c) under the 1933 Act that include a general solicitation, and funds conducting traditional private offerings pursuant to Rule 506(b) under the 1933 Act. The enhanced disclosure obligations would place additional burdens on funds while an automatic, or other disqualification from relying on Regulation D for late filings of or errors on Form D, would create significant compliance and business risks for private funds who could lose access to private capital markets.

18 *Id*

19 *See Joint Statement on the Failure to Modernize the Accredited Investor Definition (Aug. 26, 2020), available at* **https://www.sec.gov/news/public-statement/lee-crenshaw-accredited-investor-2020-08-26.**

20 *See Commissioner Allison Herren Lee, Leveraging Regulatory Cooperation to Protect America's Investors, (May 21, 2021), available at* **https://www.sec.gov/news/speech/lee-2021-section-19d-conference**. *See also Commissioner Caroline Crenshaw, Mind the (Data) Gaps, (May 14, 2021), available at* **https://www.sec.gov/news/speech/mind-the-data-gaps**.

21 Proposed Rule, Amendments to Regulation D, Form D and Rule 156, Release No. 33-9416; Release No. 34-69960; Release No. IC-30595 (July 10, 2013), available at **https://www.sec.gov/rules/proposed/2013/33-9416.pdf**.

Implementation of Investment Adviser Marketing Rule

New Rule 206(4)-1 (the Marketing Rule) under the Advisers Act, which went into effect in May 2021 (with a November 2022 compliance date), rescinded the old advertising and cash solicitation rules[22] under the Advisers Act as well a number of SEC staff no-action letters and other staff guidance issued under the old rules.[23] The Marketing Rule is described as taking a principles-based approach to compliance, replacing the prior advertising rule's "broadly drawn limitations." However, the Marketing Rule contains a number of specific requirements, in particular with respect to the presentation of performance information. Private fund managers will need to consider use of net-of-fee performance, pre-fund track records, and highlighting certain investment performance. The Marketing Rule also expands the definition of an advertisement in certain regards, resulting in some significant differences from the prior rules that will impact the compliance obligations of private fund managers. For example, the old cash solicitation rule did not apply to soliciting investors in private funds, while the Marketing Rule explicitly covers such activity as paid endorsements or testimonials. The Marketing Rule has also been expanded to cover non-cash payments for endorsements and testimonials.

As with the adoption of any new or significantly modified rule, there will be a number of interpretive issues that arise. While the SEC staff has expressed a willingness to provide guidance, to date it has only provided answers to two **frequently asked questions on its website**. Notably, **one of those FAQs** makes clear the staff's view that investment advisers may not selectively choose to comply with some, but not all provisions of the new rule prior to the compliance date.

Creating further uncertainty about how the SEC is likely to interpret adviser compliance obligations under the new Marketing Rule, Commissioners Lee and Crenshaw have expressed displeasure with what they viewed as changes from the proposed rules that weakened their investor protections, including the change to remove a pre-review requirement and changes to the disclosures required to accompany hypothetical performance information in certain situations.[24] Private fund managers can likely expect the Division of Examinations to focus on areas that the Democratic Commissioners have identified as being of concern once the compliance date has passed.

Managers will need to create or update their policies and procedures to address how they will comply with relevant portions of the Marketing Rule (including the corresponding amendments to Rule 204-2 under the Advisers Act (the books and records rule) and amendments to Form ADV).

22 In addition to rescinding the old rules, the Marketing Rule also combines the scope of activity that was covered by the two old rules into one, modified rule.

23 The staff of the Division of Investment Management has published IM Information Update 2021-10, which contains a list of no-action letters and other staff guidance that will be modified or withdrawn, effective as of November 4, 2022, **https://www.sec.gov/files/2021-10-information-update.pdf**.

24 Commissioners Allison Herren Lee, Caroline A. Crenshaw, Investment Adviser Marketing - Past Proposals are Not Necessarily Indicative of Future Adoptions, SEC (Dec. 22, 2020), available at **https://www.sec.gov/news/public-statement/lee-crenshaw-marketing-2020-12-22**.

Regulation of Digital Assets

Digital assets present a broad set of regulatory issues, including fundamental questions about when digital assets are securities, commodities, or currencies. At the center of these questions are considerations about how digital assets will fit within the many regulatory frameworks governing financial transactions. Bill Hinman, former Director of the Division of Corporation Finance, notably commented that while Bitcoin and Ethereum are not securities in themselves, investment products that include these currencies are most often an investment contracts, making them securities for regulatory purposes.[25] Chair Gensler has discussed in a number of public statements the need for additional investor protections related to digital assets, notably referring to crypto finance as the "Wild West or the old world of 'buyer beware."[26] The Chair also stated that regulatory jurisdiction could include the SEC, the Commodity Futures Trading Commission, or both agencies, as well as the need to coordinate with banking regulators and the Department of the Treasury.[27] Given the breadth of legal issues relevant to digital assets, the SEC has opened a five-year comment period to help clarify industry concerns around custody and storage of digital assets.[28]

Absent a clearly developed set of rules to address cryptocurrency issues, the SEC has relied on its enforcement authority to regulate the space, for example, asserting that digital assets constituted investment contracts. Notably in *SEC v. Telegram, Inc.*,[29] the SEC compelled Telegram to disgorge over a billion dollars in investor funds it had received in an initial coin offering (ICO) of "Grams."[30] Because investment contracts are securities and Telegram had not registered the securities, the SEC alleged the offering of Grams violated the registration requirements of the federal securities laws. The SEC has brought similar enforcement actions in other cases.[31]

While these cases have highlighted the regulatory focus on digital assets potentially being securities, many industry participants have expressed concern that there remains significant uncertainty regarding the analysis of when a digital asset should be considered a security. The SEC also has indicated that its focus on digital assets may include issues involving crypto market intermediaries, crypto lending, and analyzing crypto and other digital assets under all of the federal securities laws. Uncertainty for issuers, digital asset exchanges, and investors may also have broader effects on the asset class and market participants transacting in digital assets, all of which should be considered by managers when deciding if and when it is appropriate to invest client funds in digital assets.

25 William Hinman, Director, Division of Corporate Finance, Digital Asset Transactions: When Howey Met Gary (Plastic), SEC (June 14, 2018), **https://www.sec.gov/news/speech/speech-hinman-061418**.

26 Chair Gary Gensler, Testimony Before the House Committee on Banking, Housing and Urban Affairs (September 14, 2021) **https://www.banking.senate.gov/imo/media/doc/Gensler%20Testimony%209-14-21.pdf**.

27 Gary Gensler, Chair, Testimony Before the United States House of Representatives Committee on Financial Services (Oct. 5, 2021), available at **https://www.sec.gov/news/testimony/gensler-2021-10-05**.

28 SEC Statement and Request for Comment: Custody of Digital Asset Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 90,788 (CCH) (Dec. 23, 2020), available at **https://www.sec.gov/rules/policy/2020/34-90788.pdf**.

29 Telegram to Return $1.2 Billion to Investors and Pay $18.5 Million Penalty to Settle SEC Charges, SEC News Release (June 26, 2020), **https://www.sec.gov/news/press-release/2020-146**.

30 *Id.*

31 SEC Charges New Hampshire Issuer of Digital Asset Securities with Registration Violations, SEC News Release (Mar. 29, 2021), available at. **https://www.sec.gov/litigation/litreleases/2021/lr25060.htm** (LBRY litigation release).

Increased Regulation of SPACs

With special-purpose acquisition (SPAC) offerings increasing to record levels, Chair Gensler has identified SPACs as an area of focus for the SEC.[32] Chair Gensler has identified investor protections in SPAC offerings, in particular raising questions about whether investors receive sufficient information at the initial public offering (IPO) stage and at the merger or "de-SPAC" stage when the SPAC merges with the target operating company.[33] Because the de-SPAC transaction is a merger transaction, rather than an IPO, SPACs are subject to disclosure rules regarding mergers and acquisitions (M&A) in connection with the de-SPAC transaction. Unlike IPO transactions, M&A transactions are not subject to a so-called "quiet period," allowing greater flexibility with respect to the company's public statements compared to IPO transactions. Notably, Chair Gensler has consistently referred to the merger acquisition as a "target IPO," which could suggest a potential shift in the SEC's view as to whether the de-SPAC transaction should be subject to more strict disclosure rules that are applicable to IPOs.[34]

Chair Gensler also has expressed concern about the lack of disclosure to investors in connection with de-SPAC transactions. "Currently, I believe the investing public may not be getting like protections between traditional IPOs and SPACs," the SEC chair said in remarks at the virtual Healthy Markets Association Conference. "Due to the various moving parts and SPACs' two-step structure, I believe these vehicles may have additional conflicts inherent to their structure."[35]

The SEC also has concerns about the dilution that retail investors can face and whether additional rules or guidance are needed to address those concerns.[36] Chair Gensler said that the SEC will conduct an economic analysis of how SPAC transactions affect investors. The SEC's Investor Advisory Committee has also suggested recommendations to the SEC to enhance disclosures and for the SEC to undertake further analysis with respect to SPACs, expressing concerns about conflicts of interest, investor dilution, and what the Committee described as a trend in institutional investors seeking redemptions at the time of the de-SPAC transaction.[37]

SEC rulemaking or guidance regarding SPACs could have significant implications for managers that sponsor SPACs and for private funds that invest in SPACs. While it is not clear what any final rules or guidance from the SEC will look like, new rules could affect sponsor costs, obligations or liabilities, rights of investors in the initial IPO, or rights of investors in connection with the de-SPAC transaction, and have other implications for sponsors and investors. The SEC's Fall 2021 Agenda includes proposed rulemakings related to SPACs.

32 Chair Gary Gensler, Testimony Before the Subcommittee on Financial Services and General Government, U.S. House Appropriations Committee (May 26, 2021), available at https://www.sec.gov/news/testimony/gensler-2021-05-26. Chair Gensler also has noted that the SEC has been looking at other issues in connection with SPAC offerings, including the accounting treatment of warrants.

33 *Id.*

34 *Id.*

35 Chair Gensler remarks at the Healthy Markets Association Conference (December 9, 2021), available at https://www.sec.gov/news/speech/gensler-healthy-markets-association-conference-120921.

36 *Id.*

37 Draft Recommendations of the Investor as Purchaser and Investor as Owner Subcommittees of the SEC Investor Advisory Committee regarding Special Purpose Acquisition Companies (Aug. 26, 2021), presented at Sept. 9, 2021 Meeting of the Investor Advisory Committee, available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/draft-recommendation-of-the-iap-and-iao-subcommittees-on-spacs-082621.pdf.

Conclusion

2022 is set to be a year of active rulemaking at the SEC, with the above issues and other rules that could have significant implications for private fund managers. 2022 is also likely to be a year of increased SEC examinations and enforcement actions that will require private fund preparation. Given the potential impact of the SEC's rulemaking agenda, fund managers should closely monitor the expected regulatory developments.

In addition, in light of Chair Gensler's focus on increased examinations, managers should review their policies and procedures and ensure they are consistent with the practices of the firm, and that appropriate updates have been made as regulations and internal controls have changed. As policies and procedures are updated, advisers should ensure they are consistent with what is being disclosed in fund documents and marketing materials.

About the Authors

Benjamin B. Allensworth

Benjamin Allensworth is counsel in Willkie Farr & Gallagher LLP's Asset Management Group. Ben has more than 19 years of asset management experience that includes private fund and investment adviser formation, formation and regulatory counseling to business development companies, regulatory advice on investment company status and other specialized provisions of the Investment Company Act of 1940, regulatory counseling to investment advisers with respect to securities law matters, and regulatory advice in connection with asset manager M&A transactions.

Prior to rejoining Willkie Farr & Gallagher LLP as counsel, Ben was Managing Director and Counsel at the Managed Funds Association, the global trade association for the alternative investment fund industry. At MFA, he worked with alternative investment managers to provide regulatory advocacy in front of U.S. and EU legislative and regulatory bodies and counseling managers in connection with legislative and regulatory developments. Ben's advocacy work and counseling to managers included issues under the Advisers Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Jumpstart our Business Startups Act, the Tax Cuts and Jobs Act, and the Alternative Investment Fund Managers Directive. He also provided advocacy and counseling to managers in connection with Department of Labor rulemakings under ERISA.

View Benjamin Allenworth's full bio **here**.

Christi James

Christi James is a Principal Consultant with ACA Group. Christi brings more than 15 years of experience as a regulatory compliance officer and corporate leader. As a Principal Consultant with ACA's Investment Adviser Division, Christi works with investment advisers to develop, maintain, and review their compliance policies and procedures. She has extensive knowledge of the Investment Advisers Act of 1940 and FINRA regulations for registered investment companies.

Prior to ACA, Christi served as lead compliance manager in global communications compliance, at T. Rowe Price. There, she acted as a subject matter expert for marketing and regulatory requirements for ETFs, as well as lead compliance manager for new product launches, including separately managed accounts, model portfolios, and collective investment trusts. Previously, Christi has served as a compliance and legal manager with the CR Group, and as a compliance manager with JP Morgan Chase and Invesco.

About ACA Group

ACA Group (ACA) is the leading governance, risk, and compliance (GRC) advisor in financial services. We empower our clients to reimagine GRC and protect and grow their business. Our innovative approach integrates consulting, managed services, and our ComplianceAlpha® technology platform with the specialized expertise of former regulators and practitioners and our deep understanding of the global regulatory landscape.

About Willkie Farr & Gallagher LLP

Willkie Farr & Gallagher LLP is an elite international law firm of approximately 1,000 lawyers located in 13 offices in six countries. For more than 130 years, Willkie Farr & Gallagher LLP has delivered sophisticated legal advice to companies and individuals facing complex issues across a wide spectrum of business areas, industries, countries and cultures. We have a number of highly successful practices whose lawyers are stars in their fields.