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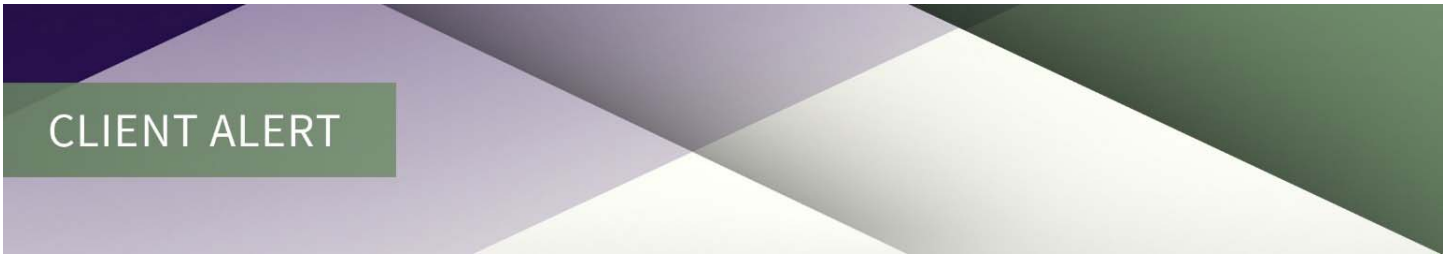

The Impact of the Biden Administration's Regulatory Freeze on Recently Adopted Rules for Registered Investment Companies and Registered Investment Advisers

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On January 20, 2021, President Biden's chief of staff Ron Klain issued a memorandum to the heads of executive departments and agencies ordering an immediate freeze on the proposal or issuance of any new rules, pending review and approval by the Biden administration, subject to certain limited exceptions.[1] The memorandum also directs department heads to take certain actions with respect to rules that were adopted prior to January 20, 2021 but have not yet taken effect, which are discussed below in more detail. In addition, the memorandum also states that further steps may be taken in the future to address any actions that were undertaken before noon on January 20, 2021 to frustrate the purpose underlying the memorandum.

Although the memorandum is technically directed to and binding only on executive departments and agencies, such as the Department of Labor (the "DOL"), and not independent agencies such as the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC"), the SEC and CFTC have sometimes elected to follow similar executive directives as a voluntary matter. Accordingly, we anticipate that the SEC and the CFTC may seek to follow past practice and voluntarily submit to the mandates outlined in the memorandum with respect to certain

[1] *See* Memorandum from Ronald A. Klain, Assistant to the President and Chief of Staff, to the Heads of the Executive Departments and Agencies (Jan. 20, 2021), *available* here.

SEC and CFTC rules that are relevant to registered investment companies ("RICs"), business development companies ("BDCs") and registered investment advisers ("RIAs").

Status of Recently Adopted Rules That Are Not Yet Effective

***Rules Not Yet Published in the* Federal Register**

With respect to rules that have been sent to the Office of the *Federal Register* (the "OFR") but have not been published in the *Federal Register*, the memorandum instructs department and agency heads immediately to withdraw such rules from the OFR to enable review and approval by a department or agency head appointed or designated by President Biden. Below is a significant rule in this category that has been adopted by the SEC:

- *Advisers Act Marketing Rule.* On December 22, 2020, the SEC adopted amendments to Rule 206(4)-1 under the Investment Advisers Act of 1940 to create a single rule governing investment adviser advertisements and compensation to solicitors (the "Marketing Rule").[2] As adopted, the Marketing Rule draws from and replaces the current advertising rule, Rule 206(4)-1, and incorporates aspects of Rule 206(4)-3, known as the "cash solicitation rule," which was rescinded contemporaneously with the adoption of the Marketing Rule.[3] The Marketing Rule is slated to take effect 60 days following its publication in the *Federal Register*, with a compliance date that is 18 months following the effective date. As of noon on January 20, 2021, the Marketing Rule had not yet been published in the *Federal Register*, and, accordingly, it can reasonably be expected that the acting or newly appointed SEC Chair may seek to subject the rule to further review.[4] It should be noted that despite the unanimous vote of approval, Commissioners Allison Herren Lee, who was appointed acting Chair of the SEC on January 21, 2021, and Caroline Crenshaw both criticized the Marketing Rule at the time of its adoption for "eliminat[ing] important safeguards for investors."[5] Remarks by Commissioners Lee and Crenshaw focused in particular on the SEC's failure to adopt a requirement for advisers to review advertisements before they are disseminated, as well as the Marketing Rule's inclusion of "unjustifiable carve-outs" for compliance requirements applicable to certain communications containing hypothetical performance.

***Rules Published in the* Federal Register**

With respect to rules that have been published in the *Federal Register* but have not taken effect, the memorandum directs department and agency heads to *consider* postponing the rules' effective dates for 60 days from January 20, 2021. During

2 *See* Investment Adviser Marketing, Advisers Act Release No. 5653 (Dec. 22, 2020), *available* here.

3 The Marketing Rule does not apply to advertisements, other sales materials or sales literature of RICs or BDCs.

4 It is currently not publicly known whether the Marketing Rule has been sent to the OFR. If the Marketing Rule has not yet been sent to the OFR, then it is possible that the SEC may not send the rule to the OFR in accordance with the memorandum.

5 *See* Investment Adviser Marketing – Past Proposals are Not Necessarily Indicative of Future Adoptions, Statement of Commissioners Allison Herren Lee and Caroline A. Crenshaw (Dec. 22, 2020), *available* here.

the 60-day period and where appropriate and consistent with applicable law, the memorandum instructs department heads to *consider* opening a 30-day comment period to allow interested parties to provide comments about issues of fact, law and policy raised by those rules, and consider pending petitions for reconsideration involving such rules. In addition, as appropriate and consistent with applicable law, and where necessary to continue to review these questions of fact, law and policy, the memorandum instructs department heads to consider further delaying, or publishing for notice and comment proposed rules further delaying, such rules beyond the 60-day period. Following the 60-day delay in the effective date, for those rules that raise no substantial questions of fact, law or policy, the memorandum states that no further action needs to be taken. For those rules that raise substantial questions of fact, law or policy, the memorandum instructs agencies to notify the Director of the Office of Management and Budget (the "OMB Director") and to take further appropriate action in consultation with the OMB Director.

Below are significant SEC and CFTC rules that have been published in the *Federal Register*, but have not taken effect:

- *SEC Derivatives Rule.* On December 21, 2020, new Rule 18f-4 under the Investment Company Act of 1940 (the "Investment Company Act") and amendments to certain existing rules and forms, updating the regulation of the use of derivatives by RICs and BDCs and certain other transactions (the "Derivatives Rule"), were published in the *Federal Register*.[6] The Derivatives Rule permits mutual funds (other than money market funds), exchange-traded funds ("ETFs"), registered closed-end funds and BDCs to enter into derivatives transactions and certain other transactions notwithstanding the restrictions under Section 18 of the Investment Company Act. In connection with these new rules, the SEC also amended Rule 6c-11 under the Investment Company Act to allow leveraged or inverse ETFs to operate without obtaining an exemptive order. The Derivatives Rule is slated to take effect on February 19, 2021, with a compliance date of August 19, 2022. If it were to follow the memorandum, the SEC would need only to *consider* postponing the Derivatives Rule's effective date. It should be noted that SEC Commissioners Lee and Crenshaw dissented when the SEC adopted the Derivatives Rule. Commissioner Lee criticized the Derivatives Rule for "increasing risk, reducing transparency around that risk, and dropping basic sales practice rules for extremely complex products,"[7] while Commissioner Crenshaw stated that the rule "fails to provide a meaningful limit on registered funds' ability to take on leverage," and "the risk management program requirements fail to provide a reliable backstop against [value at risk (VaR)] limitations."[8]

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6 *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 34084 (Nov. 2, 2020), 85 Fed. Reg. 83162 (Dec. 21, 2020), *available* here. For more information on the Derivatives Rule, please see our client alert entitled "The SEC Adopts Derivatives Rule for Registered Investment Companies and BDCs" (Jan. 5, 2021), *available* here.

7 Statement on the Final Rule on Funds' Use of Derivatives, Commissioner Allison Herren Lee (Oct. 28, 2020), *available* here.

8 Statement on the Final Rule on Funds' Use of Derivatives, Commissioner Caroline A. Crenshaw (Oct. 28, 2020), *available* here.

- *Fair Valuation Framework.* On January 6, 2021, Rules 2a-5 and 31a-4 under the Investment Company Act, establishing an updated regulatory framework for fund valuation practices, were published in the *Federal Register*.[9] New Rule 2a-5 under the Investment Company Act establishes requirements for determining fair value in good faith for purposes of the Investment Company Act. The rule will permit boards, subject to board oversight and certain other conditions, to delegate performance of fair value determinations to a "valuation designee." The rule also defines when market quotations are "readily available" for purposes of the Investment Company Act, the threshold for determining whether a fund must fair value a security. New Rule 31a-4 imposes certain recordkeeping requirements associated with Rule 2a-5. The new rules are scheduled to take effect on March 8, 2021, with a compliance date of September 8, 2022. These rules were unanimously approved by the SEC Commissioners.

- *CFTC Speculative Position Limits*. On January 14, 2021, amendments to the CFTC's speculative position limits for derivatives were published in the *Federal Register*.[10] In addition to adopting new and amended position limits for certain types of derivatives contracts, the CFTC amended the definition of "bona fide hedging transaction or position" that includes an expanded list of enumerated bona fide hedges. The rule amendments are scheduled to take effect on March 15, 2021, with compliance dates ranging from January 1, 2022 to January 1, 2023. It should be noted that CFTC Commissioners Dan M. Berkovitz and Rostin Behnam dissented to the adoption of the rule amendments.

The memorandum does not explicitly address the status of rules that have been published in the *Federal Register* and are effective more than 60 days following January 20, 2021. Accordingly, it is unclear what action, if any, the SEC will take with respect to such rules. A notable SEC rule in this category includes the following:

- *Amendments to Procedures for Exemptive Applications.* On September 15, 2020, amendments to Rule 0-5 under the Investment Company Act were published in the *Federal Register*. The amendments to Rule 0-5 provide for an expedited review procedure for exemptive and other applications under the Investment Company Act that are substantially identical to recent precedent and an internal timeframe for review of other applications. The amendments are scheduled to take effect on June 14, 2021.[11] The amendments to Rule 0-5 were unanimously approved by the SEC Commissioners.

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9 *See* Good Faith Determinations of Fair Value, Investment Company Act Release No. 34128 (Dec. 3, 2020), 86 Fed. Reg. 748 (Jan. 6, 2021), *available* here.

10 *See* Position Limits for Derivatives, 86 Fed. Reg. 3236 (Jan. 14, 2021), *available* here.

11 *See* Amendments to Procedures With Respect to Applications under the Investment Company Act of 1940, Investment Company Act Release No. 33921 (July 6, 2020), 85 Fed. Reg. 57089 (Sept. 15, 2020), *available* here. For additional information regarding the expedited application review process, please see our client alert entitled "SEC Adopts Expedited Review Process for Exemptive Applications" (Sept. 11, 2020), *available* here.

Executive Order Regarding DOL ESG Investing Rule

In addition to instituting the regulatory freeze described above, it is anticipated that President Biden will issue an executive order asking the DOL to review a recently adopted rule that updates and clarifies the "investment duties" regulation under the Employee Retirement Income Security Act of 1974 (ERISA).[12] The rule is intended to provide regulatory guideposts for fiduciaries of private-sector retirement and other employee benefit plans subject to ERISA, in light of a renewed focus on environmental, social and governance (ESG) investing. The rule would generally require plan fiduciaries to select investments and investment courses of action based solely on financial or "pecuniary" factors relevant to the particular investments and courses of action. Further, the rule would prohibit plans from selecting as investment options certain investment funds, products, or model portfolios that would serve as a qualified default investment alternative ("QDIA") or as a component of such an investment alternative for the plan if the investment objectives include or consider non-pecuniary factors. The rule became effective on January 12, 2021, but plans will have until April 30, 2022, to make any changes to their QDIAs needed to comply with the rule.

Conclusion

The Biden Administration's regulatory freeze creates uncertainty around the implementation of certain recently adopted rules that are significant to RICs, BDCs and RIAs. It is also possible that the Administration could issue additional orders resulting in regulatory stays.

[12] *See* Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846 (Nov. 13, 2020), *available* here.

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