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# SIGNIFICANT CHANGES COMING TO WEALTH AND ASSET MANAGERS COURTESY OF THE SEC'S EXTRAORDINARY REGULATORY PUSH

The SEC has launched a flurry of new proposals over the last 12-18 months to address a wide range of regulatory priorities. They have received pushback over the number of briefs, the short comment periods, as well as the scope and content so it remains to be seen exactly which items will be implemented and in what form. However, looking through many of the recent proposals, there are distinct themes emerging that affect the wealth and asset management space. In this series, we look at some of the heightened focus areas of the SEC that deal with conflicts of interest, enhancing consumer protections, increasing disclosure requirements, and alignment on ESG/Climate reporting and investing policies. Part 1 offers an overview of each proposal, or potential proposal, that wealth and asset management professionals should be aware of while future segments will dive into more detail around how they affect both the industry as a whole and its members.

# CORPORATE INSIDER TRADING AND FUND FEE PRACTICES INTENSIFY SCRUTINY OVER CONFLICTS OF INTEREST

Conflicts of interest have been under review by a number of regulatory bodies over the years covering a range of areas where they have a propensity to occur. Many notable regulations came about due to the aftermath of failures to manage these conflicts going back to the 1929 market crash and, more recently, their contributions to the 2008 financial crisis. These examples are at the extreme end of the spectrum but there are innumerable instances where conflicts of interest have meaningful impacts to markets, participants, and investors. Scrutiny has been stepped up not only in the United States, but also in many overseas regulatory frameworks. The SEC has produced several proposals that cover some of the shortcomings they feel exist in the current regulations.

## Rule 10b5-1 and Insider Trading

There is concern the set of rules governing corporate insiders trading securities are designed in a way that allow opportunistic execution on the basis of material non-public information (MNPI). 10b5-1 trading arrangements came about in 2000 and, at a high level, allow corporate insiders to make prearranged buy or sell trades on specified dates. The goal is to prevent insider trading while still allowing these executives and directors to manage their holdings. The current rules allow multiple arrangements which overlap and trading to occur soon after creation or a modification, both of which present real opportunities for abuse. The recent example of two executives from Cheetah Mobile Inc. who mislead investors and then set up 10b5-1 arrangements to sell personal holdings of company stock prior to the release of poor results demonstrates some of the potential shortfalls in the existing model. This proposal looks to close the gaps in 10b5-1 trading arrangements for officers and directors who may exploit the arrangement and undermine the integrity of the securities markets. It includes a raft of measures to limit potential misuse of MNPI, eliminate overlapping arrangements, adjust cooling off periods, and improve transparency by increasing the reporting requirements of issuer organizations.

### Advisers Act Compliance Rule

Private funds hold over $18 trillion in assets and touch almost every corner of the economy from venture capital funding, M & A, to mass retail retirement planning and pensions. Furthermore, direct and indirect exposure to these assets is spread across a wide range of investor types meaning they potentially have an oversized impact on the overall market. The SEC has concern over the continued practices of some funds which cause them to pay more in fees/expenses leading to lower returns and where they provide insufficient disclosure around conflicts of interest. This proposal looks to resolve the lack of transparency for the full costs of investment and their returns as well as address potential conflicts of interest by registered investment advisers of private funds. It casts a wide net, including quarterly investor statements with additional details, annual audit requirements, certain transaction prohibition, and annual compliance policy reviews.

## RISING STANDARDS AND ATYPICAL SECURITY PROLIFERATION SEE HEIGHTENED LENS ON CONSUMER PROTECTION

Consumer protection has been a key pillar of the SEC mission with a particular focus on Main Street investors and the notion of "fairness". There is a wide set of rules to ensure there is sufficient and truthful information available, as well as stipulating how professionals offer advice and provide investment services. The SEC responds to industry and product changes as they evolve to tamp down potentially misleading or unfair practices. A number of proposals have been published looking at some areas with heightened risks for consumers as well as providing public commentary by the SEC chairman on potential upcoming regulation aimed at crypto assets.

### SPACs, Shell Companies, and Projections

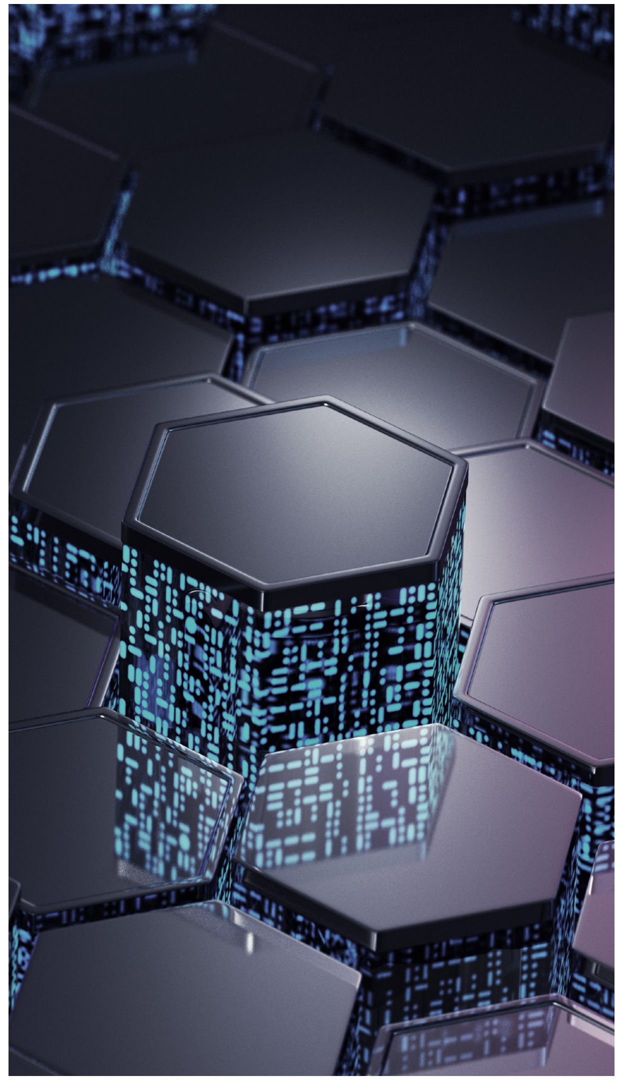
SPACs are not a new concept but rose to prominence with $83B raised in 2020 and further $160B raised in 2021, accounting for more than half of all initial public offerings in both years. Their ability to both raise capital and create liquidity for early stage companies within a relatively short period of time has made it a popular funding route. Additionally, SPACs are not subject to the same rigor of disclosure compared to a traditional IPO. However, this feature can add substantial risks to investors. The SEC laid out a proposal with the intent to improve relevance, completeness, clarity, and comparability of disclosures and provide more investor protections to strengthen confidence in the market.

### Amendments to the Fund "Names Rule"

The name of a fund is often the first thing investors see and can be used to communicate information, including the investments and the associated risks. The SEC believes the name can also play a meaningful role in the decision to invest or not. As a result, the SEC wants to ensure that the name of a fund does not misrepresent these material factors and that the fund's assets are invested on the basis of reasonable expectations indicated by the fund's name. The proposal suggests adopting a policy to invest at least 80% of their assets in accordance with the investment focus the fund's name suggests (including notional value calculations for derivatives) and enhancing recordkeeping and reporting requirements.

## Crypto Regulation

The first cryptocurrency, as we know it today, was Bitcoin which released in 2009. At the time, it was little known, very niche, and didn't carry a high monetary value. This is a far cry from the markets today with about $1T[1] in market value at the time of writing across thousands of coins and other digital assets. For the most part, they have gone widely unregulated by the federal government with debates still swirling around whether they are securities, commodities, or something completely different. Securities and Exchange Commission Chairman Gary Gensler believes most digital tokens fit the definition of a security and should be treated as such from the lens of regulation. This leads to one of the big questions which has been "who should regulate?" and we may be one step closer to that answer with comments from Gensler suggesting the possibility it could sit with the Commodity Futures Trading Commission (CFTC). One of the next big questions is "how will they be regulated?" A lot of that depends on the asset's ultimate classification and the jurisdiction they fall under. While the SEC may defer some or all regulatory oversight, they have suggested the requirement for crypto intermediaries to register with both the CFTC and the SEC which means supervision by both agencies. Gensler has also called for related trading platforms to register as securities exchanges. The indication from his comments is that changes will come with new guardrails to protect investors and stabilize the crypto markets that have been like the proverbial wild west from a regulatory standpoint.



### Money Market Fund Reforms

Money Market Funds (MMF) hold trillions of dollars in the U.S., used by many as a cash proxy with generally higher interest rates compared to traditional savings accounts. The SEC is reviewing some features of these fund around liquidity, pricing, and reporting to “improve the resilience and transparency of money market funds”. Triggering at least a portion of this review can be tied back to investor actions during the 2020 COVID-19 pandemic where a shift to cash and short-term government securities created liquidity challenges with instruments often used for MMFs. Additionally, the risk of redemption gates and liquidity fees incentivized being first out the door at the expense of those remaining or redeeming next. The proposal aims to increase the minimum liquidity requirements to provide an additional buffer during periods with heightened redemption activity, remove the ability to impose liquidity fees or create redemption gates to address incentive for preemptive redemptions, and require swing pricing so remaining investors don’t pay the cost for early redeemers. Additionally, they suggest amending reporting requirements to improve the SEC’s ability to monitor and analyze MMF data.

## ESCALATING CYBER RISKS AND MARKET EVOLUTION LEAD TO INCREASED DISCLOSURE REQUIREMENTS

### Amendments to Form PF

The private equity space has changed in size, scope, and complexity since form PF was first introduced. The number of funds, along with their AUM, have more than doubled since 2013 and the sophistication of products and strategy has also evolved in kind. The SEC has identified gaps and risks in their current data collection which this proposal intends to address. It reduces the AUM threshold for reporting, significantly reduces the amount of time between a reportable event and submission of the form as well as gathers more granular data the SEC can analyze.

### Cybersecurity Risk Management & Disclosure

With heightened cybersecurity risks increasing in both quantity (up 15.1% yoy in 2021[2]) and sophistication, the SEC has two cybersecurity proposals in play. The first requires advisors and funds to implement written policies and procedures to address cybersecurity concerns and materially increases the reporting details around incidents. The second is aimed at similar areas of concern, but for public companies, requiring 8-K incident reporting and more granularity for investors around procedures, risks, management and board cybersecurity expertise.

# ACCELERATION OF ESG STRATEGIES AND CLIMATE-AWARE INVESTORS DRIVE COMPLEX REPORTING OBLIGATIONS

Environmental, Social, and Governance (ESG), as well as specific interests in climate impacts, have been key focus areas to many corporate stakeholders, investors, and regulators alike. The demand for clear and comparable information disclosed to the public addressing both a measurable impact and overall strategy has played out through targeted investment offerings, board rooms, and annual general meeting proxy battles. There has been a surge in ESG specific funds or investment strategies which direct large amounts of capital to firms that embrace compelling ESG and climate ambitions. Impacting billions of dollars in assets under management and over a trillion in Green debt issuance, the SEC has proposed several controversial regulatory changes to bolster both the amount and the standardization of data available to the market.

### Climate Related Disclosures

A key stumbling block for climate-aware investors has been a patchwork of regulations, data reporting inconsistencies, and misrepresentation (green washing) by public companies around their financial risks and metrics. The SEC has submitted a proposal with wide-reaching climate disclosure requirements to provide consistent, comparable, and reliable information to investors. This includes Scope 1, 2, and 3 greenhouse gas carbon intensity, risks & costs, board management & oversight of climate related risks, as well as targets & goals.

### ESG Disclosures for Investment Advisers and Investment Companies

ESG investment strategies have accelerated in the US reaching $357B in AUM during 2021[3] with an additional $1.5T in Green debt issuance.[4] Asset managers are the key conduits for these investments and responded to demand with funds and strategies which consider ESG factors. The SEC has concern that potentially inconsistent and unreliable data may create a risk where actual ESG considerations do not match the expectations of investors. In response, they have proposed defined ESG classifications (Integration Funds, ESG-focused Funds, and Impact Funds), along with significant additional disclosure in their prospectus, annual reports, brochures, and marketing materials which more clearly lay out their ESG considerations.

The SEC's proposal agenda includes significant changes that greatly affect the wealth and asset management space. There is little doubt the final rules that come into effect will create both opportunities and the need to tackle some new and challenging undertakings in the coming months.

# REFERENCES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Capco, a Wipro company, is a global technology and management consultancy specializing in driving digital transformation in the financial services industry. With a growing client portfolio comprising of over 100 global organizations, Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to deliver end-to-end data-driven solutions and fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its Innovation Labs and award-winning Be Yourself At Work culture and diverse talent.

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