SEC & OTHER DEVELOPMENTS FOR PUBLIC COMPANIES & INVESTMENT ADVISERS

January 8, 2025

GIBSON DUNN

Presenters

Kevin Bettsteller

Partner

Century City

Michael A. Titera

Partner

Orange County

Lauren Assaf-Holmes

Of Counsel

Orange County

Agenda

01 SEC Regulatory Developments

02 Form 10-K Disclosure Trends

03 SEC Enforcement Trends

04 SEC Comment Letter Trends

05 ESG Developments

06 Investment Advisor Regulatory Update

SEC REGULATORY DEVELOPMENTS

01

The Road Ahead for the SEC

From Election Day to Inauguration Day

- On December 4, 2024, President-elect Trump announced that he selected former SEC Commissioner Paul Atkins to lead the SEC
- In December, Senate blocked confirmation for SEC Commissioner Crenshaw
- SEC Commissioner Lizárraga will resign on January 17, 2025
- SEC Chair Gensler will resign at noon on January 20, 2025

After the Inauguration

- On January 20 or 21, 2025, we expect the new Chief of Staff to formally instruct the executive agencies to refrain from proposing or issuing new rules, consistent with prior action taken by the Biden Administration and first Trump Administration
- Acting Chair. The Trump Administration will name an Acting Chair (likely Commissioner Uyeda). Commissioners Uyeda and Pierce are former Counsels to Atkins when he was a Commissioner
- An Immediate 2-1 Majority. The Acting Chair will have a 2-1 majority. In the near-term, we would expect the Acting Chair to:
  - make personnel decisions, including removing Directors of Divisions and appointing Acting Directors; and
  - make decisions about how the Staff administers the laws

New Disclosure Requirements

Annual Disclosure of Insider Trading Policies and Procedures

Companies will be required to disclose in Forms 10-K and proxy statements whether they have adopted insider trading policies and procedures. If a company has not, the company must explain why it has not done so. The company's insider trading policies and procedures must be filed as an exhibit to the Form 10-K

Annual Compensation Disclosure

In their proxy statements and 10-Ks, companies will be required to discuss their policies and practices on the timing of awards of stock options and option-like instruments in relation to the disclosure of MNPI. If during the fiscal year, stock options or option-like instruments were awarded to an NEO within four business days before, or one business day after, the filing of a Form 10-K, 10-Q, or Form 8-K, the company must provide tabular disclosure regarding the award

SEC Adopts EDGAR Next

- On September 27, 2024, the SEC adopted amendments to Rules 10 and 11 of Reg. S-T and Form ID, making technical changes to EDGAR filer access and account management
- EDGAR Next will:
  - require filers to authorize designated account administrators to manage the filers' accounts and make filings on the filers' behalf,
  - add multifactor authentication, and
  - require such account administrators and any other authorized users to have their own individual account credentials to access EDGAR Next
- Form ID application process and ongoing filings will contain new requirements, annual confirmations, and other security measures
- The beta environment for filer testing and feedback closed December 19, 2025
- Amended Form ID requirements apply beginning March 24, 2025, the date of effectiveness for the amendments/updates
- Filers required to comply with other rule and form amendments by September 15, 2025
- *SEC EDGAR Business Office hosting EDGAR Next Section 16 Webinar on January 23, 2025*

SEC Regulatory & ESG Agenda

Back to the future with a Jay Clayton-style SEC?

- Greater focus on efficient capital formation?
- Greater focus on reducing regulatory burdens?
- Shift away from ESG rulemaking priorities? E.g., climate change, human capital management, board diversity
- Shift away from cryptocurrency and cybersecurity enforcement priorities?

- In October 2024, SEC approved publication of its Fall 2024 regulatory agenda
- The latest agenda reflects numerous items pushed to October 2025:
  - proposed rules on human capital management
  - proposed rules on corporate board diversity
  - timing for adoption of disclosure requirements for investment companies and advisers on ESG factors and amendments to Rule 14a-8
- These timeframes are not hard deadlines for future rulemaking and may change in future agendas

***

- In September 2024, the SEC disclosed that it had disbanded its ESG enforcement taskforce
  - The taskforce had been established in March 2021 to focus on misstatements or gaps in company reporting on climate risks, as well as issues in investment advisers' and funds' disclosure and compliance on ESG strategy
  - A spokesperson indicated that the taskforce's expertise would now reside in the Division of Enforcement more broadly

FORM 10-K DISCLOSURE TRENDS

02

The SEC's New Insider Trading Policy Requirements: Disclosure and Exhibit

Background: For fiscal years beginning on or after April 1, 2023, domestic public companies are required to: (i) disclose whether they have adopted insider trading policies and procedures and (ii) if so, file those policies and procedures as an exhibit to their annual reports on Form 10-K.

Two Aspects of Requirement

Disclose whether company has adopted policies and procedures:

- Must be included in:
  - **Form 10-K** (Part III, Item 10 of the Form 10-K every year (either directly or through forward incorporation by reference to the Proxy Statement); and
  - **Proxy Statement** for any meeting involving the election of directors
- Applies to "policies and procedures governing … **the registrant itself**"

File any policies and procedures as an **exhibit**:

- Must be filed with **Form 10-K**
  - **Exhibit 19**
- Applies to "**policies and procedures**"
  - Ancillary materials (e.g., appendices, FAQs, training materials?)
  - Unwritten procedures?

Insights From Filed Insider Trading Policies

Select Preliminary Findings*

Transactions in Other Company Securities:

- 96% of policies specifically include restrictions on trading in securities of another company while aware of MNPI about that company or its securities
  - 82% prohibit trading in the securities of another company when the person is aware of MNPI about such company that was learned in the course of or as a result of the covered person's employment or relationship with the company
  - the remainder apply the prohibition more broadly, without regard to how the information was obtained

*Based on a survey of 49 S&P 500 Company filings addressing these requirements as of June 30, 2024.

Cybersecurity Guidance

- In July 2023, the SEC adopted a final rule requiring the disclosure of material cybersecurity incidents on Form 8-K (applicable beginning December 2023) and annual cybersecurity risk management, strategy, and governance by public companies, including foreign private issuers (applicable in Form 10-K or 20-F for fiscal year ending on or after December 15, 2023)
- In May 2024, Division of Corporation Finance Director Erik Gerding released a statement setting forth certain of his views with respect to when it is appropriate to use Item 1.05 of Form 8-K, as opposed to Item 7.01 or Item 8.01, to report a cybersecurity incident.
- In June 2024, Director Gerding clarified in an announcement that "[n]othing in Item 1.05 prohibits a company from privately discussing a material cybersecurity incident with other parties or from providing information about the incident to such parties beyond what was included in an Item 1.05 Form 8-K." Gerding noted that sharing information with commercial counterparties, such as vendors and customers, as well as other companies that may be impacted by, or at risk from, the same incident or threat actor may assist with remediation, mitigation, or risk avoidance efforts and may facilitate those parties' compliance with their own incident disclosure and reporting obligations.
- In June 2024, the Staff also issued five new C&DIs related to Item 1.05, all of which address ransomware. A C&DI previously released in December 2023 addressed consultation with the DOJ and its relevance to the materiality assessment.

Cybersecurity Disclosure

Background: In July 2023, the SEC adopted a final rule requiring public companies to provide current disclosure of material cybersecurity incidents and annual disclosure regarding cybersecurity risk management, strategy, and governance.

Disclosure Trends*

- While certain disclosure trends have emerged under new Item 1.C of Form 10-K, there is **significant variation** among companies' cybersecurity disclosures.
- We expect company disclosures to **continue to evolve** as their practices change in response to an ever-evolving cybersecurity threat landscape, and as registrants observe and learn from what their peers are doing.

We surveyed 97 S&P 100 companies that had filed cybersecurity disclosures as of November 30, 2024.

Materiality: In response to the requirement in S-K Item 106(b)(2) to describe whether any risks from cybersecurity threats have materially affected or are reasonably likely to materially affect the registrant, most companies either (i) disclose that such risks have not and are not reasonably likely to have a material effect, or (ii) do not include disclosure specifically responsive to this requirement in this section of the Form 10-K and instead provide a cross-ref to Risk Factors.

Cybersecurity Risk Management and Strategy: Companies' programs often reference alignment with external frameworks or standards, with the National Institute of Technology (NIST) Cybersecurity Framework being cited most often.

Board Oversight: Most companies delegate specific responsibility for cybersecurity risk oversight to a board committee and describe the process by which such committee is informed about such risks. Ultimately, however, the substantial majority of surveyed companies report that the full board is responsible for enterprise-wide risk oversight, which includes cybersecurity.

*Based on a survey of 97 S&P 100 companies that had filed cybersecurity disclosures as of November 30, 2024.

Cybersecurity Disclosure (cont'd)

Background: In July 2023, the SEC adopted a final rule requiring public companies to provide current disclosure of material cybersecurity incidents and annual disclosure regarding cybersecurity risk management, strategy, and governance.

Disclosure Trends (cont'd)

Risks Associated with Third Party Service Providers and Vendors: Almost all companies outline processes for overseeing risks associated with third party service providers and vendors.

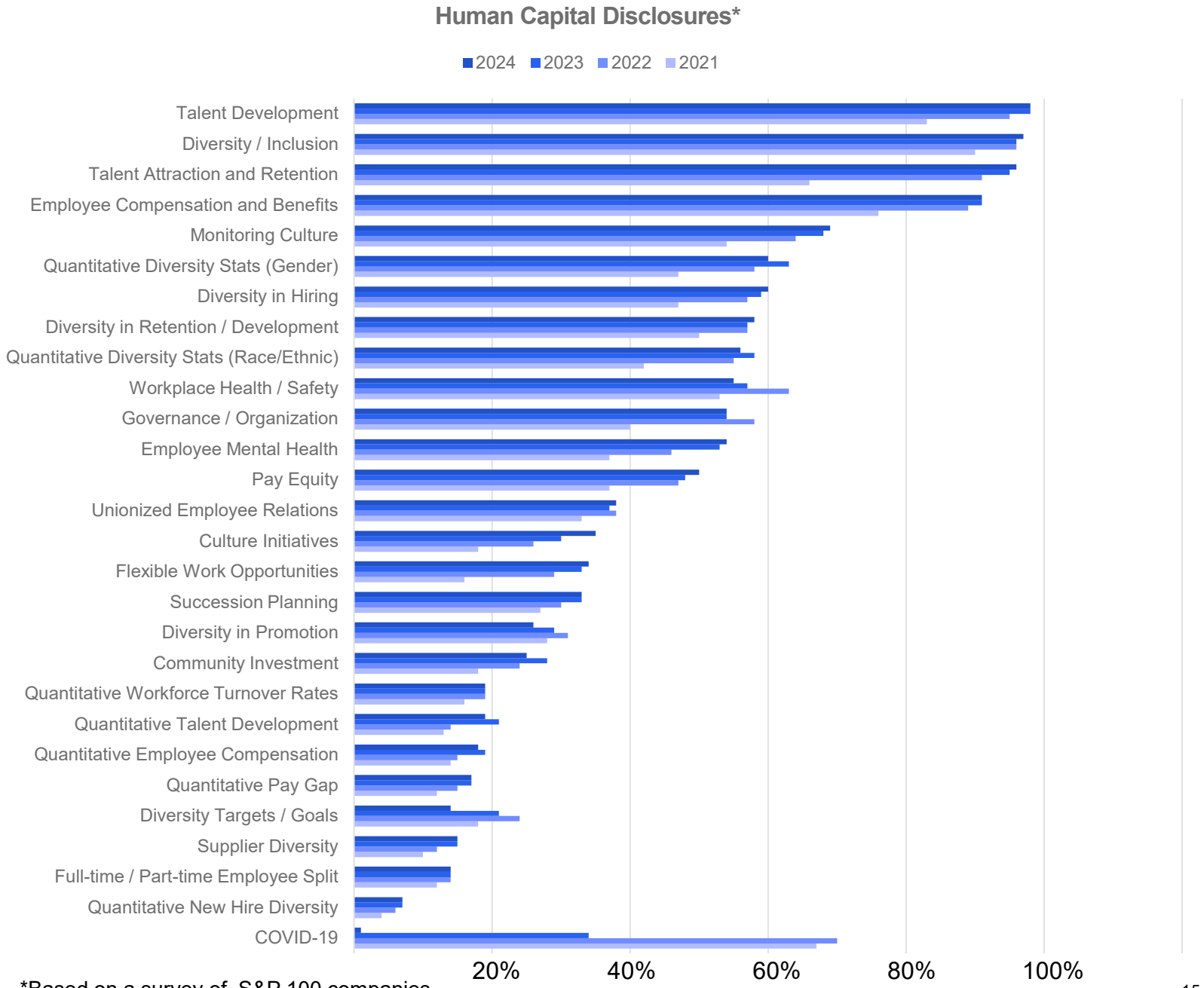
External Auditors, Assessors and Consultants: Almost all companies discuss retention of external parties including auditors, assessors and consultants, as part of their processes for oversight, identification and management of material risks from cybersecurity threats.

Drafting Considerations: Most companies organize their disclosure into two sections, generally tracking the organization of Item 106, with one section dedicated to cybersecurity risk management and strategy and another section focused on cybersecurity governance.

Risk Factors: Almost all companies include a cross-reference to their cybersecurity-related risk factor(s) included in Item 1A "Risk Factors" or to risk factors included in Item 1A more generally.

Human Capital Management Disclosure

Background: Human capital resource disclosures have continued to be a focus since the SEC adopted principles-based rules in August 2020. One major criticism of the rules has been that the resulting disclosures lack comparability.



*Based on a survey of S&P 100 companies.

Director and Officer 10b5-1 Trading Plans: Quarterly Disclosure

Background: In 2022, the SEC adopted rules requiring companies to disclose in Forms 10-Q and 10-K whether, during the company's last fiscal quarter, any director or officer adopted, terminated or modified a Rule 10b5-1 plan or a "non-Rule 10b5-1 trading arrangement."

- A "non-Rule 10b5-1 trading arrangement" is a written trading arrangement that complies with the old Rule 10b5-1 affirmative defense but does not comply with the new affirmative defense conditions.

Surveying Rule 10b5-1 Plans: A S&P 50* survey shows that:

- **62%** reported that at least one director or officer adopted, modified, or terminated a Rule 10b5-1 plan within the last year.
- **Almost 200** directors and officers adopted, modified, or terminated a Rule 10b5-1 plan within the last year.

*As of December 1, 2024; based on the largest 50 companies in the S&P 500 Index by market capitalization.

SEC ENFORCEMENT TRENDS

03

Recent Enforcement Actions: Director Independence and Related Party Transactions

SEC Charges Director with Proxy Violation for Failing to Disclose Friendship with Company Executive

- **Background.** The director was alleged to have a close personal friendship with a high-ranking company executive, including paying more than $100,000 for the executive and his spouse to join the director on numerous vacations.
- **Violations.** The SEC alleged that because the director never disclosed the relationship to the board and encouraged the executive to do the same, the board was not aware of the relationship and the company's proxy statements incorrectly characterized the director as independent.
- **Settlement.** The director agreed to a five-year officer-and-director bar and to pay a civil penalty of $175,000.

SEC Charges Company with Failure to Disclose Related Person Transactions

- **Violations.** The SEC alleged the company failed to disclose: (i) payments to executives' immediate family members that served as a non-executive employees and as independent contractors; and (ii) loans to executives and directors.
- **Settlement.** The company agreed to pay a $1.25 million civil penalty.

Recent Enforcement Actions: Section 16, Schedule 13D/G & Form 13F/H

- For the last year, the SEC has conducted enforcement sweeps targeting delinquent, late, and/or missing filings on Schedule 13D/G and Forms 13F and 13H.
  - In October 2023, the SEC announced civil charges against several officers, directors, and major shareholders of public companies for failing to satisfy their timeline reporting obligations, as well as affiliated public companies for contributing to insiders' reporting failures.
  - In March 2024, the SEC announced an enforcement action against an investment advisory firm regarding its failure to promptly convert from a Schedule 13G to 13D after forming a "control" purpose under Rule 13d-1 and Section 13(d) of the Exchange Act.
  - In September 2024, the SEC announced charges against 34 reporting persons for late and missing filings on Form 13F and Form 13H, and against 23 entities and individuals for failing to file beneficial ownership reports on Schedules 13D and 13G and Section 16 reports on Forms 3, 4, and 5.
- And as a reminder, Schedule 13D and 13G filing requirements have changed:
  - All 13G reporting persons, including exempt investors, must file an amendment within 45 days after the calendar quarter end in which a material change occurred.
  - Qualified institutional investors are subject to an accelerated amendment deadline of five business days after month-end in which beneficial ownership exceeds 10 percent of the covered class or such ownership increases or decreases by 5 percent.
  - Passive investors with less than 20% beneficial ownership must promptly amend within two business days after their beneficial ownership exceeds 10 percent of the covered class or such ownership increases or decreases by 5 percent.

Recent Enforcement Action: Reg. FD

In July 2023, the DraftKings' public relations firm posted on the DraftKings CEO's personal X account regarding "really strong growth" in its states of operation. A similar post was made to the CEO's LinkedIn.

- DraftKings had not disclosed its second quarter 2023 financial results at the time nor the information contained in the posts
- Both posts were subsequently removed at DraftKings' request
- DraftKings did not promptly disclose the information, as required by Reg. FD, but did seven days later when it announced financial earnings for second quarter 2023
- Order charged DraftKings with violating Section 13(a) of the Exchange Act and Reg. FD
- DraftKings agreed to a $200,000 civic penalty and agreed to required Regulation FD training for employees with corporate communications responsibilities, among other matters
- The SEC release reminded companies that use of social media outlets is permitted for key information, but that "investors must first have been alerted about which social media will be used to disseminate such information"

Disclosure Controls and Procedures

SolarWinds (Cybersecurity)

Complaint alleges that SolarWinds made a number of false statements relating to:

1. compliance with the National Institute of Standards and Technology (NIST) Cybersecurity Framework;
2. using a secure development lifecycle when creating software for customers;
3. having strong password protection; and
4. maintaining good access controls.

CIRCOR International (Internal Accounting Controls)

SEC alleged the company "failed to devise and maintain sufficient internal accounting controls concerning financial statement preparation, reconciliation processes, and access to bank accounts" and was therefore unable to prevent fraud by a former finance director that resulted in millions of overstated performance between 2019 and 2021.

Portland General Electric (Internal Accounting Controls and Books and Records)

SEC alleged that the company had deficient internal accounting controls that failed to document and give management and accounting team information regarding its derivatives trading, that it failed to maintain accurate books and records regarding its regulatory assets, and had deficient disclosure controls supporting its market risk disclosure under Reg. S-K Item 305.

R.R. Donnelley (Cybersecurity Internal Controls)

SEC alleged failure to establish sufficient internal controls to elevate cybersecurity incidents to management and protect company assets from cyberattacks, including to assess and respond in a timely manner to unusual activity. The SEC noted that data integrity and confidentiality were critically important to the company's business.

SEC COMMENT LETTER TRENDS

04

Comment Letter Trends

MD&A

- focused on disclosures relating to results of operations, including quantification of material factors, offsets, infrequent or unusual events, and economic developments
- requested that registrants make disclosures about known trends and uncertainties expected to impact near and long term results
- metrics management uses to assess performance
- focused on critical accounting estimates and liquidity and capital resources

Non-GAAP Financial Measures

- aligned with the Compliance and Disclosure Interpretations released last December
  - focus on whether operating expenses are “normal” or “recurring” (and therefore, whether exclusion from non-GAAP financial measures might be misleading)
  - whether certain non-GAAP adjustments to revenue or expenses have made the adjustments “individually tailored”
- compliance with Item 10(e) of Regulation S-K
  - prominence of non-GAAP measures, reconciliations, usefulness and purpose of particular measures
  - exclusion of normal, recurring cash operating expenses
  - use of individually tailored accounting principles

Segment Reporting

- whether a registrant’s operating segments are properly categorized, and impacts from transactions and personnel or organizational structure changes
- absence of entity-wide information under ASC 280

Note: the SEC has taken issue with registrations disclosing multiple measures of segment profit or loss in the notes to the financial statements and has indicated that registrants should not attempt to circumvent non-GAAP requirements when taking this approach.

Other Trends

Other disclosure trends to consider include:

- Generative artificial intelligence
  - E.g., effects on strategy, productivity, market competition and demand for products, investments, reputation, legal and regulatory risks
- Geopolitical conflict
  - E.g., Middle East, Russia/Ukraine, China/Taiwan, China/U.S.
- Potential government shutdown
  - E.g., Risk Factors, MD&A discussion of material losses
- Supply chain concerns
  - E.g., strike disruptions, impacts from geopolitical conflict
- Inflation concerns
  - SEC comment letters have focused on how current inflationary pressures have materially impacted a company's operations, mitigation efforts, and quantification of principal factors contributing to inflationary pressures
- Interest rate concerns
  - SEC comment letters have focused discussion of rising interest rates in Risk Factors and MD&A to identify actual impacts on the business

ESG Developments

05

Regulatory Requirements

SEC Climate Rules

- Background: SEC adopted rules in March 2024, in a 3-2 vote along party lines
- Overview of new required climate-related disclosures in Form S-1 registration statement and annual report on Form 10-K:
  - Governance: board and management governance and practices for climate-related risk identification, assessment, management, and oversight, and related risk processes
  - Risk: climate risks with actual or potentially material impacts on financials, strategy, outlook and business model (but no need to disclose climate expertise on board)
  - GHG emissions: for larger companies, Scope 1 & 2 emissions, if material (but not Scope 3), with independent third-party assurance required on a phased-in basis
  - Targets/goals: climate-related targets or goals established by the company if materially or reasonably likely to materially affect financials, with annual progress updates
  - Transition plans: company-adopted transition plans, scenario analyses, and internal carbon pricing if used to assess material climate risks, plus related material expenditures
  - Financial statement footnote: reporting expenditures and costs of >1% due to "severe weather events," "other natural conditions," and certain carbon offsets and RECs
- Legal challenge: rules were challenged and stayed while subject to ongoing multi-district litigation in 8th Circuit

Stay tuned for further developments given change in administration

Regulatory Requirements

California Climate Laws

California Climate Laws

- Background: in October 2023, California adopted three wide-reaching bills that impose climate reporting requirements for public & private companies doing business or engaging in certain activities in CA
  - GHG emissions reporting: annual disclosure of Scope 1, 2 & 3 emissions + 3rd party assurance (SB 253)
  - Climate risk reporting: biennial disclosure of climate risks and risk management (SB 261)
  - Anti-greenwashing: new disclosures for companies making certain sustainability claims (e.g., net zero, carbon neutral, significant emissions reductions) or deal in voluntary carbon offsets (AB 1305)
- Who's in scope for SB 253/SB 261: among others, companies organized under CA law or meeting sales, property or payroll thresholds in CA, with global annual revenues >$1B (SB 253) or >$500M (SB 261)
- Legal Challenge: rules were challenged in the CA Central District, but have not been stayed
- Amendments: SB 219, adopted in October 2024, delays CARB rulemaking deadline, among other changes
- Enforcement Update: CARB announced in December 2024 that there will be limited enforcement relief for the first year of GHG emissions reporting in 2026 for certain filers
- Request for Comment: CARB released a request for public feedback regarding future rulemaking to implement SB 253 and SB 261

Regulatory Requirements

Other Laws & Developments

EU Laws

- Corporate Sustainability Reporting Directive (CSRD): requires EU & non-EU enterprises with significant EU operations to report material environmental, social and governance matters (using a double materiality framework) in their annual report, including forward-looking, retrospective, qualitative and quantitative information
- Corporate Sustainability Due Diligence Directive (CSDDD): requires EU & non-EU enterprises with significant EU operations to identify and assess adverse human rights and environmental impacts, take steps to prevent/mitigate these impacts, and adopt a Paris Agreement-aligned climate change mitigation transition plan

Other Developments

- International Sustainability Standards Board (ISSB): establishes new global baseline for voluntary sustainability reporting; builds on the framework of the Task-Force for Climate-Related Financial Disclosures (TCFD) and incorporates industry-specific standards from the Sustainability Accounting Standards Board (SASB); voluntary reporting to begin with reports for the fiscal year beginning Jan. 1, 2024
- Global Jurisdictions: incorporating (or planning to incorporate) ISSB into local law, with some variation, including Australia, Canada, the UK, and other countries, among other laws
- COSO Guidance for Sustainability Reporting: provides a comprehensive framework designed to help organizations establish robust internal control mechanisms specifically for sustainability-related disclosures

Investment Adviser Regulatory Update

06

Private Funds Rule Vacated

Private Funds Rule

On August 23, 2023, the SEC by a 3-2 vote adopted a sweeping rule that would have fundamentally changed the way private funds and their advisers are regulated. The rule would have restricted, or even prohibited, the longstanding, widely used business arrangements of private funds—pooled investment vehicles that are generally not accessible to retail customers.

The final rule would have imposed several requirements and restrictions on private-fund advisers. Among other things, the rule ***would have***:

- Prohibited advisers from granting certain investors ***preferential treatment*** in the form of favorable redemption and information rights, unless those rights were offered to all investors.
- Required advisers to prepare and distribute ***quarterly reporting statements*** containing detailed information regarding fees, expenses, and fund performance.
- Banned advisers from charging funds for regulatory, compliance, and investigation ***fees and expenses***, unless the adviser provided notice to—and in some cases, obtained consent from—investors.

The SEC invoked two statutory provisions as purported authority for these regulations:

- Section 913(g) of the Dodd-Frank Act, which is a clean-up provision tacked on to the end of a section about the provision of investment advice to ***retail*** customers.
- Section 206(4) of the Advisers Act, which grants the SEC authority to "define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." 15 U.S.C. § 80b–6(4).

A Complete Victory

Unanimous decision vacated the entire rule

On June 5, 2024, the Fifth Circuit panel issued a unanimous decision that vacated the Private Funds Rule ***in full***.

- The Court held that the SEC had exceeded its statutory authority because neither of the two provisions it relied on empowered it to adopt the rule.
  - The Court decisively rejected the SEC's argument that section 913(g) of the Dodd-Frank Act authorized it to issue rules for the protection of private-fund investors. It agreed with the coalition's argument that this provision applies only to retail customers, noting that private-fund investors "have a significant hand in determining the terms on which they invest."
  - The Court also rejected as "pretextual" the SEC's argument that it could adopt the rule under section 206(4) of the Advisers Act, concluding that the SEC failed to articulate any rational connection between fraud and the rule.

Impact on Pending SEC Proposed Rules

Other pending SEC proposals are vulnerable

The SEC has several pending proposed rules that would impose restrictions on private funds based on the same statutory authorities that the Fifth Circuit found insufficient to justify the Private Funds Rule.

- ***Proposed predictive data analytics rule***, 88 Fed. Reg. 53,960 (Aug. 9, 2023): The SEC has invoked section 913(g) of the Dodd-Frank Act in proposing to limit the extent to which advisers can use technologies to predict investment-related behaviors.
- ***Proposed adviser custody rule***, 88 Fed. Reg. 14,672 (Mar. 9, 2023): The SEC is relying in part on section 206(4) of the Advisers Act in proposing to reshape existing regulations governing the safeguarding of client assets.
- ***Proposed outsourcing rule***, 87 Fed. Reg. 68,816 (Nov. 16, 2022): The SEC has cited both section 913(g) and section 206(4) in proposing to restrict the extent to which advisers can outsource certain services or functions.
- The SEC could in theory rely on section 206(4) if it did a better job of creating a record tying any new rule to actual instances of sufficiently pervasive fraud, but that would be a tall hill to climb. And the Fifth Circuit's decision used language indicating that the agency cannot adopt any rules under this provision that interfere with the internal governance structure of private funds.

.

SEC Exam and Enforcement Focus

Private fund sponsors remain a priority for the SEC

In its 2025 Examination Priorities, the SEC Division of Examinations stated that it "will continue to focus on advisers to private funds and prioritize specific topics," including:

- Consistency of disclosures with actual practices, accuracy of calculations and allocations of private fund fees and expenses, disclosure of conflicts of interests and risks, and adequacy of policies and procedures, and compliance with recently adopted SEC rules, including Form PF amendments and the new marketing rule.

Advisers should continue to be mindful of practices targeted by the Private Funds Rule, such as:

- Charging or allocating fees or expenses related to a portfolio investment on a non-*pro rata* basis when multiple funds and other clients are invested (e.g., broken deal expenses or expenses related to AIVs or blockers).
  - Such allocations should be made in accordance with the relevant governing documents and the adviser's allocation policy.
- Charging or allocating to the fund any regulatory or compliance fees or expenses, or fees or expenses associated with an examination, of the adviser.
  - Advisers engaging in this practice should ensure that it is clearly permitted under the fund governing documents.
- Timely delivery of audited financial statements.

SEC Exam and Enforcement Focus

Other potential areas of focus related to the vacated Private Funds Rule

Advertising:

- The Private Funds Rule quarterly statement requirement would have required illiquid funds to show performance metrics both with and without the impact of fund-level subscription facilities.
- The SEC recently released an FAQ emphasizing its focus on the impact of subscription lines on performance calculations and its view that the same time periods should be used for both gross and net returns.

Indemnification and exculpation provisions:

- The SEC may hold to the position it took in the Private Funds Rule adopting release: that seeking indemnification or exculpation for a breach of fiduciary duty would operate as an effective waiver of this duty that would be invalid under the Advisers Act.
- Advisers should carefully review these provisions with counsel.

Adviser-led secondaries transactions without a third-party fairness opinion or valuation report to address potential conflicts of interest.

Fees for unperformed services (e.g., accelerated monitoring fees).

Reducing the GP clawback amount by actual or hypothetical taxes without explicit authorizing language in the governing documents.

Recent SEC Enforcement Activity

Recent SEC Enforcement Activity Involving Investment Advisers

Text Messaging:

- Enforcement actions against financial firms for record-keeping violations in connection with their employee's use of texting and other forms of instant messaging have continued.

- In 2024 alone, the SEC has settled enforcement actions against 27 broker-dealers and investment advisers for failing to adequately enforce their policy prohibiting the use of "off channel" communications for business purposes.

- Not clear whether new Commission will modify its policy on the use of "off-channel" communications.

Use of AI:

- Two investment advisory firms settled enforcement actions for making misleading claims about their use of AI in the investment decision-making process.

Marketing Rule:

- 9 investment advisers settled claims finding various failures to comply with the requirements of the Marketing Rule with respect to:
  - use of third-party ratings
  - claims to provide "conflict-free" investment advice
  - use of testimonials and endorsements

- 5 investment advisers settled claims for providing hypothetical performance to retail investors.

New FinCEN AML Rule

- On August 28, 2024, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a final rule imposing anti-money laundering and countering the financing of terrorism (AML/CFT) requirements on certain investment advisers, including private fund managers.
- Rule applies to:
  - SEC-registered investment advisers (RIAs), including those managing private funds, excluding:
    - Mid-sized advisers, multi-state advisers, or pension consultants registered solely for state requirements.
    - Advisers reporting zero assets under management (AUM) on Form ADV.
  - Exempt Reporting Advisers (ERAs) managing:
    - Private funds with less than $150 million AUM managed in the U.S.
    - Solely venture capital funds.
  - Foreign-Located Advisers:
    - Applies to advisory activities within the U.S. or involving:
      - U.S. persons.
      - Foreign private funds with U.S.-based investors.

GIBSON DUNN