# Investment Services Regulatory Update

## July 2024

Monthly Version

VedderPrice

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# Litigation and Enforcement Matters

## LITIGATION DEVELOPMENTS

### Texas Federal Court Enjoins Federal Trade Commission's Enforcement of Non-Compete Ban

In a highly anticipated July 3, 2024 decision, the U.S. District Court for the Northern District of Texas has preliminarily enjoined enforcement of a controversial Federal Trade Commission (FTC) rule that would have banned most non-compete agreements throughout the United States effective September 4, 2024. But while the court in *Ryan LLC v. Federal Trade Commission* sided with Ryan and its intervenor allies, it declined, at least for now, to enter a nationwide bar on the ban's enforcement as to all non-competes that violate the rule, instead limiting its injunctive relief to Ryan and the four entity intervenors that joined its lawsuit, the Chamber of Commerce of the United States of America, Business Roundtable, Texas Association of Business and Longview Chamber of Commerce. The *Ryan* court stated its intent to issue a merits-based ruling on whether to permanently enjoin the FTC from enforcing its ban rule by August 30, 2024—just five days before the ban's effective date.

Attorneys in Vedder Price's Labor & Employment group recently published a summary of the District Court's decision and its implications, which is available here.

### *Chevron* Deference Overruled by Supreme Court

On June 28, 2024, the Supreme Court ruled in *Loper Bright Enterprises v. Raimondo* to overrule the Court's 1984 opinion in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, in a 6-3 decision.

Where congressional intent to interpret a statute administered by a federal agency is unclear, the Supreme Court's holding in *Chevron* afforded deference to the administering agency's interpretation of the statute so long as the agency interpretation is based on a "permissible construction" of the statute. The Supreme Court's ruling in *Loper* returns the judiciary to the doctrine of "*Skidmore* deference," which requires courts to "respect" the experience and informed judgment of an agency's interpretation, rather than defer to it.

On July 3, 2024, attorneys in Vedder Price's Litigation group published an article discussing the *Loper* decision, available here.

### *SEC v. Jarkesy:* A Divided Supreme Court Holds That the SEC Cannot Seek Civil Penalties through an Administrative Proceeding

On June 27, 2024, the Supreme Court affirmed the ruling of the U.S. Circuit Court for the Fifth Circuit in *SEC v. Jarkesy* and held that a defendant facing civil penalties in a securities fraud claim brought by the SEC has a right to a jury trial in a federal court. Specifically, the Supreme Court held that the SEC's attempt to compel respondents to defend themselves before the agency, namely in an administrative proceeding before an Administrative Law Judge employed by the SEC, violates respondents' Seventh Amendment right to a jury trial in cases where the SEC pursues civil penalties. Accordingly, this decision will likely limit the number of future SEC actions adjudicated by an Administrative Law Judge in an administrative forum due to the restriction on the available remedies.

On June 28, 2024, attorneys in Vedder Price's Government Investigations and White Collar Defense group published an article discussing the decision, available here.

## Fifth Circuit Court of Appeals Vacates SEC's 2022 Rescission of Certain 2020 Amendments to Proxy Rules

On June 26, 2024, the U.S. Court of Appeals for the Fifth Circuit vacated the SEC's 2022 rescission of certain rule amendments regarding proxy advisory firms, holding that the SEC's explanation for rescinding the amendments was "arbitrary and capricious and therefore unlawful."

In July 2020, the SEC under the Trump Administration adopted certain amendments to the proxy rules under the Securities Exchange Act of 1934, which were intended to enhance the accuracy and transparency of information provided by proxy voting advice businesses (PVABs) to investors and investment advisers that vote proxies on behalf of their clients, as previously summarized here. Among other things, the 2020 amendments added conditions in Rule 14a-2(b)(9)(ii) to exemptions from the proxy rules' information and filing requirements upon which PVABs often rely. Specifically, the 2020 amendments required (1) PVABs to make their advice available to the companies that are the subject of their advice at or before the time that they made the advice available to their clients; and (2) clients of PVABs to be provided with a means of becoming aware of any written responses by such companies to proxy voting advice. Two years later, in July 2022, the SEC under the Biden Administration voted to adopt further amendments to the proxy rules, which, among other things, rescinded the aforementioned "notice-and-awareness" conditions in the 2020 amendments and related safe harbors and exclusions, with the SEC noting that "we are no longer persuaded that the potential benefits of those conditions sufficiently justify the risks they pose to the cost, timeliness, and independence of proxy voting advice." The 2022 rescission was previously summarized here.

Shortly after the 2022 rescission, the National Association of Manufacturers and the Natural Gas Services Group, Inc. filed suit against the SEC in federal district court, arguing that under the Administrative Procedures Act (APA) the 2022 rescission was arbitrary and capricious as the SEC failed to provide an adequate explanation for its change in policy. In December 2022, the district court rejected plaintiffs' arguments and granted summary judgment in favor of the SEC. The plaintiffs appealed the decision to the Fifth Circuit.

On June 26, 2024, the Fifth Circuit reversed the district court's grant of summary judgment and vacated the SEC's 2022 rulemaking, solely with respect to the rescission of the 2020 amendments' notice-and-awareness conditions, and remanded it to the SEC. As noted in the Fifth Circuit's opinion, "[t]he APA's arbitrary-and-capricious standard requires that agency action be reasonable and reasonably explained" and that although federal agencies have the authority to alter or rescind their policies, "[a]n agency's "failure to explain its decision to 'disregard facts…that underlay…the prior policy' is arbitrary and capricious." In its decision, the Fifth Circuit held that the SEC acted arbitrarily and capriciously in rescinding the notice-and-awareness conditions of the 2020 amendments in two ways: first by failing "adequately to explain its decision to disregard its prior factual finding that the notice-and-awareness conditions posed little or no risk to the timeliness and independence of proxy voting advice;" and second by failing "to provide a reasonable explanation why these risks were so significant under the 2020 [amendments] as to justify [their] rescission."

The Fifth Circuit's memorandum opinion was issued under the caption *Nat'l Ass'n of Manufacturers v. SEC*, No. 22-51069 (5th Cir. 2024).

# ENFORCEMENT DEVELOPMENTS

## SEC Settles Enforcement Proceedings Against Business for Allegedly Insufficient Internal Controls Relating to Cybersecurity Incident

On June 18, 2024, the SEC announced the settlement of administrative proceedings brought against a marketing and business communications firm for alleged internal accounting control deficiencies that caused the firm's failure to promptly respond to a ransomware attack that occurred between November 29, 2021 and December 23, 2021, and which involved the unauthorized encryption of the firm's computers, exfiltration of firm and client data, and business service disruptions. According to the order, the firm received and reviewed network intrusion alerts escalated to it by its third-party managed security

services provider, but the firm's cybersecurity alert review and incident response policies and procedures failed to adequately establish a prioritization scheme and provide clear guidance to internal and external personnel on procedures for responding to such incidents. As a result, the firm did not take the malware-infected instances off its network, investigate the activity, or take other steps to prevent further network compromise until December 23, 2021.

The SEC alleged that the firm "failed to design effective disclosure-related controls and procedures around cybersecurity incidents to ensure that relevant information was communicated to management to allow timely decisions regarding potentially required disclosure" and also "failed to reasonably design and maintain internal controls that complied with Section 13(b)(2)(B) of the Securities Exchange Act of 1934." The SEC found that the firm also violated Exchange Act Rule 13a-15(a), which requires issuers of securities (such as the firm) to maintain disclosure controls and procedures designed to ensure that information required to be disclosed by an issuer is properly recorded, processed, summarized, and reported.

Without admitting or denying the SEC's findings, the firm consented to cease and desist from future violations and to pay a civil monetary penalty of approximately $2.1 million. In agreeing to the settlement, the SEC considered the remedial acts promptly undertaken by the firm, including voluntarily adopting new cybersecurity technology and controls, and its cooperation with the SEC staff. In response to this action, Commissioners Peirce and Uyeda issued a statement expressing their concerns over, among other things, the SEC's use of Section 13(b)(2)(B) of the Exchange Act as a "Swiss Army Statute to compel issuers to adopt policies and procedures the Commission believes prudent."

The SEC's order is available here, and a related press release is available here.

## SEC Settles Enforcement Proceedings Against Adviser for Allegedly Misleading Performance Advertising

On June 14, 2024, the SEC announced the settlement of administrative proceedings brought against a registered investment adviser for disseminating allegedly misleading performance information of a private fund that it advised.

The SEC alleged that from at least November 2021 through February 2023, the adviser advertised performance returns that were experienced by a single investor in a private fund as the private fund's performance even though the investor's performance was at times significantly higher than the fund's performance. According to the order, the performance disparity was due to certain successful IPO investments the fund had made that were credited to the investor's capital account in greater proportion than other fund investors' capital accounts because the other investors were unable to participate fully in the IPO investments due to investment restrictions under FINRA Rules 5130 and 5131.

The SEC found that the adviser willfully violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder, which make it unlawful for any investment adviser to make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading to any investor or prospective investor, or to otherwise engage in any fraudulent, deceptive, or manipulative act with respect to any investor or prospective investor. The SEC also found that the adviser willfully violated Rule 206(4)-1 under the Advisers Act, known as the Marketing Rule, which, among other things, prohibits advisers from presenting misleading advertising and including or excluding performance results in a manner that is not fair and balanced.

Without admitting or denying the allegations, the adviser agreed to cease and desist from future violations, to be censured, and to pay a civil monetary penalty of $100,000. In agreeing to the settlement, the SEC considered the remedial acts promptly undertaken by the adviser and its cooperation with the SEC staff. This settlement is in line with the SEC's continued focus on Marketing Rule violations. In particular, in September 2023 and April 2024, the SEC settled enforcement actions against additional registered investment advisers involving alleged violations of the Marketing Rule.

The SEC's order is available here, and the related press release is available here.

# New Rules, Proposed Rules, Guidance and Alerts

## GUIDANCE AND OTHER DEVELOPMENTS

### SEC Approves Exchange Listings for Spot Ether ETPs

On May 23, 2024, the SEC approved exchange rule changes that will allow the listing and trading of a number of spot Ether exchange-traded products (ETPs). Ether is the second-largest cryptocurrency by market capitalization after Bitcoin. The decision follows the SEC's recent approval of spot Bitcoin ETPs in January 2024, as previously summarized here.

The SEC separately allowed the first Bitcoin futures ETPs and Ether futures ETPs to begin trading on an exchange in October 2021 and October 2023, respectively.

Consistent with its previous order approving the listing and trading of spot Bitcoin ETPs, the SEC concluded with respect to the approved spot Ether ETP filings that fraud or manipulation that impacts prices in spot Ether markets would likely similarly impact Ether futures prices and that the relevant securities exchanges' comprehensive surveillance-sharing agreement with the Chicago Mercantile Exchange (CME) Ether futures market could therefore be reasonably expected to assist in detecting and deterring fraudulent and manipulative acts and practices in the spot Ether markets. The SEC specifically cited in its approval order the high level of correlation between the Ether futures market and the spot Ether markets in recent years.

The spot Ether ETPs will be able to start trading after their registration statements are declared effective.

The SEC's approval order is available here.

## NEW AND PROPOSED RULES

### NYSE Proposes to Exempt Registered Closed-End Funds from Annual Shareholder Meeting Requirement

On June 6, 2024, the New York Stock Exchange (NYSE) filed an application with the SEC pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder, proposing a rule change that, if approved by the SEC, would exempt closed-end funds (CEFs) registered under the Investment Company Act of 1940 and listed on the NYSE from the requirement to hold annual shareholder meetings.

Section 302.00 of the NYSE Listed Company Manual currently requires companies listing common stock or voting preferred stock and their equivalents, which includes CEFs, to hold an annual shareholders' meeting for the holders of such securities each fiscal year. In its application, the NYSE stated its belief that an exemption from this requirement for CEFs is appropriate in light of the "significant statutory protections under the [Investment Company Act] provided to the shareholders of CEFs," including requirements related to the election of directors by shareholders, the approval of certain significant actions by disinterested directors and the approval of a number of material matters by shareholders, noting that "there are no parallel legal protections for the shareholders of public operating companies." The NYSE also highlighted that all other categories of listed investment companies (e.g., exchange-traded funds) are already explicitly exempted from the annual shareholder meeting requirement.

The proposed rule change is subject to a public comment period through July 30, 2024. The notice of the proposed rule change was published in the Federal Register on July 9, 2024 and the SEC is required to approve or disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved, within 45 days of that publication date, which period may be extended up to 90 days under certain circumstances.

The NYSE's proposed rule change is available here.

# SEC Adopts Significant Form and Rule Amendments for the Registration of RILAs and MVAs

On July 1, 2024, the SEC adopted tailored disclosure requirements and offering processes for non-variable annuity contracts—specifically, for registered index-linked annuities (RILAs) and annuity contracts that offer fixed investment options and apply market value adjustments (MVAs) to amounts withdrawn before the end of the fixed option's term. The final rule will require issuers of RILAs and MVAs to register offerings on an amended Form N-4, the form currently used to register most variable annuities.

Unlike variable annuities, for which the SEC previously adopted specific tailored registration statement forms (i.e., Forms N-3 and N-4), non-variable annuities do not currently have a dedicated form of registration statement, resulting in insurance companies' use of Securities Act registration Form S-1, the "default" form for general registration, or Form S-3, the simplified form available only to issuers subject to Exchange Act reporting requirements, to register offerings of non-variable annuities. Forms S-1 and S-3, however, are designed for a wide range of securities offerings and require extensive information about the registrant that an RILA or MVA investor may view as less important than particularized information about the contract's features. Moreover, as SEC Chair Gary Gensler noted in a statement on the final rule's adoption, the market for RILAs has grown significantly in recent years, as reflected in approximately $47.4 billion of RILA sales in 2023 alone. The growth in these retirement products spurred the industry to advocate for registration and disclosure changes; the *Registration for Index-Linked Annuities Act* (RILA Act), enacted by Congress in 2022, directed the SEC to adopt a registration form specific to RILAs.

In implementing the RILA Act's mandate, the SEC has continued to incorporate the principle of layered disclosure, which generally seeks to provide investors with key information relating to an investment's features, benefits and risks in summary form in the first "layer," and more detailed or technical information in the second "layer" of disclosure.

Highlights of the rule and form amendments are as follows:

- **Use of Amended Form N-4 to Register Non-Variable Annuity Offerings; SAP Financials; More Efficient Registration and Update Process.** The SEC is adopting amendments to Form N-4 to accommodate the registration of RILA and MVA offerings on that form. Notably, by using Form N-4, insurance companies will be permitted to file financial statements prepared in accordance with statutory accounting principles (SAP) rather than pursuant to generally accepted accounting principles (GAAP), in certain circumstances, and will have greater flexibility to update their registration statements during certain times of year without the need to update their financial statements. Other amendments to the registration process will enable issuers to pay registration fees annually based on net sales. With regard to disclosures, the amendments to Form N-4 to accommodate non-variable annuities include disclosure requirements related to: (i) information about non-variable annuities generally and an overview of certain key elements of any index-linked option offered under the contract; (ii) a more in-depth description of any index-linked investment options available under the contract; (iii) the inclusion of an appendix that consolidates certain summary information related to any index-linked options and fixed options available under the contract; and (iv) certain principal risks relating to investing in the non-variable annuity contract that the prospectus describes.

- **Form N-4 Amendments for Variable Annuity Offerings.** In addition to form amendments to accommodate non-variable annuities, the SEC is adopting amendments that are applicable to offerings of variable annuities. For Form N-4 issuers generally, the amendments require registrants to disclose market risk, early withdrawal risk, contract benefits risk, insurance company risk and the risk of contract changes.

- **Summary Prospectus.** The amendments will permit non-variable annuity issuers to make use of the summary prospectus framework available to variable annuity registrants on Form N-4.

- **Communications Rules Applicable to Non-Variable Annuities.** The amendments require non-variable annuity issuers to comply with Rule 156 under the Securities Act of 1933, which provides guidance as to when sales literature is materially misleading under the federal securities laws. The SEC is also making a

technical amendment to Rule 433 under the Securities Act to allow those non-variable annuity issuers that can satisfy the rule's conditions to continue to use a free writing prospectus without it needing to be preceded or accompanied by a prospectus that satisfies the requirements of Section 10 of the Securities Act.

**"Traces of Anti-RILA Bias"**

While the insurance and retirement product industry presumably will welcome the efficiencies offered by using an amended Form N-4 and a registration process that parallels the offering of variable annuities, Commissioner Hester M. Peirce stated that the rule's positive aspects are tempered by "traces of anti-RILA bias," citing, as an example, the requirement that RILA issuers disclose on the front cover page the maximum potential loss that an investor could experience in connection with a negative contract adjustment. "[A]bsent necessary context," Commissioner Peirce suggested, "[such] disclosure seems designed to dissuade investors from purchasing RILAs" and pointed to commenters who asserted that "no other securities offerings are burdened by the same disclosure."

**Compliance and Effective Dates**

The amendments will take effect 60 days after publication in the Federal Register, with compliance required by May 1, 2026 for most of the final amendments to Form N-4 and related rule changes, except with respect to Rule 156. Compliance with amended Rule 156 will be required on the effective date.

A fact sheet regarding the final rule is available here and a related SEC press release is available here.

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