StradleyRonon

Talking Investment Management: The SEC Under New Management

March 14, 2025 | Podcast Transcript

Listen to this podcast recording

Jan M. Folena (00:03):

Welcome to the latest episode of Stradley's Talking Investment Management podcast. I'm Jan Folena, and I'm joined here with my colleagues, partners, and friends, Dave Grim and Brian Murphy. Together, we went through a number of transitions at the SEC before coming to Stradley. And in light of that experience, we are going to spend the next 30 minutes or so highlighting the incoming new management at the SEC and what that means for investment companies, boards, and investment advisors. Brian has been leading the charge here at Stradley on the regulatory update for our clients, and there have been lots of updates to provide. We hope to get you caught up on some of the key developments today about what has happened, what will happen, and what won't happen with respect to SEC policy, rulemaking, and enforcement in the asset management space. So let's start with the big question, Brian, with you. Who is the new management at the SEC?

Brian P. Murphy (01:01):

Thanks, Jen. This is definitely an exciting time to be in our industry. President Trump has nominated Paul Atkins to chair the SEC as of the time we're recording this podcast. There's no date set for the Senate's consideration of his nomination. Mr. Atkins' nomination should be well received by the fund industry as he's well known and respected within the securities industry. And he has a track record of engaging with the fund clients to ensure that the SEC policy positions are practical and workable. Mr. Atkins served six years as an SEC commissioner, and during that time, he frequently advocated for a free market approach to regulation and a thoughtful consideration of the costs associated with new rules. And I note that Mr. Atkins currently serves as an independent trustee for a closed-end fund, which means he has a unique understanding of the fund industry and the role trustees play in the fund industry. When we wait for Mr. Atkins' confirmation, President Trump has designated Commissioner UDA as acting chair of the SEC. UDA and Commissioner Purse both served as counsel to Commissioner Atkins 10, 15 years ago. So we expect that these three commissioners will be closely aligned and work well together.

And in the backdrop of all of this, there's over 70 executive orders signed by President Trump, which is a topic for another day. So, Dave, you served as director of I am. What could we expect in terms of new leadership within the SEC's divisions?

David W. Grim (02:30):

Thanks, Brian. Thanks, Jan. Great to be here with you today. It's a little hard to predict exactly what's gonna happen yet, but I think there's a couple of themes that I would highlight today based on some of the things that Mr. Atkins has said over the years. For example, in recent years in response to many of the SEC Rulemakings, there's been all kinds of public comments that have requested that the SEC, please consider the cumulative impact of all of the rules that are rolling out. Those requests have generally fallen on deaf ears. But for an SEC under Chairman Atkins, that's gonna be a different story. He's gonna be sympathetic to this kind of rigorous cost-benefit analysis that the industry has been encouraging. And then another theme I would just point out, Brian, and this links back to your point about Mr. Atkins being on a closed-end fund board.

David W. Grim (03:23):

He's had a long history of support for directors. You might remember years and years ago, he dissented from the fund governance rules that were adopted. Those required, among other things, an independent chair and 75% of the directors to be independent. Those rules looking to the objections of Mr. Atkins were overturned by the courts. So the way he describes his philosophy towards directors is as follows: the SEC should eliminate unnecessary obligations of mutual fund independent directors. They should think carefully before imposing new ones and assist independent directors in complying with the remaining obligations. So I think that's a good way to sum up both his approach to directors and rulemaking and policy work more generally. With that, Jan, let's turn to you. You were trial counsel in the division of enforcement when Mr. Atkins was on the commission. Can you talk to us about what type of leadership we can expect with him there?

Jan M. Folena (04:26):

Sure. Thanks Dave. Yes, there was trial counsel when incoming Chair Atkins was on the commission. And while, like you, Dave, I can't predict who will be the new director of enforcement, who may be the new deputy Director of enforcement, but I can talk a little bit about what we're seeing. That is leadership and decision-making in the division of enforcement, and in the SEC, it is generally becoming more centralized at the home office or in DC. Some examples of that are the formal order of investigations and that process; formal orders of investigation must now be approved by the commission and have been taken out of the hands of individual divisions of enforcement management. Also, the removal of the regional directors that centralizes decision making in DC and not in each individual regional office. And then third, what can't be overlooked is the President's executive order requiring independent agencies like the SEC to submit all rulemaking to the executive office of the president, to seek review of budget appropriations within the agency from the Office of Management and Budget, and to follow the Department of

Justice's interpretation of the law with respect to rulemaking, any guidance the agency may issue and all positions advanced in litigation.

Jan M. Folena (05:52):

This will allow in the division of enforcement for a more centralized approach to these decisions and a more consistent application of the law. And you may see that in upcoming enforcement actions. So this transition seems a little different, and I'll tell you why. One is the wholesale dismissal of the crypto registration cases. We have not quite seen a dismissal of cases of this magnitude in it with a change of administration. Second is the abandonment of some of the appeals that the SEC had taken of rule dismissals under Chair Gensler. Having said that, there will be enforcement, and reinforcement will still remain robust around issues of disclosure. Disclosure still needs to be accurate, and that's where you're going to see enforcement. Also, I think you're gonna see a more balanced approach to the, to the role of the SEC, which is investor protection, capital formation and market efficiency, which is likely to result in a return to evaluation of the economic basis for and the impact of certain enforcement actions, discouragement, awards and penalties. Dave, from a policy perspective, it's clear the agency is in transition, and we're still awaiting an identification of an asset management priority list. But what can the industry do to prepare now?

David W. Grim (07:14):

Well, one thing they can do is if they have ideas on what should be on the policy list going forward, they should tell the agency right now because the agency is in the process of developing its list, right? What are the most important things that they can do in the next four years? So as I think about it, and again, this hasn't been decided yet, so it's a little hard to predict as we're talking today. But as I think about some of the issues that an agency like this could take up, here's the kind that I think of. So, electronic delivery of disclosure documents is correct, right? This is one that's been around for a long time. It's time for the default option to be via electronic delivery. Hopefully, the agency will pick that up and make it happen in the next four years.

David W. Grim (07:59):

Another topic that's been around for a while, and again, it's time to make it happen. The fund shareholder approval process is very expensive and very clunky. It's not good for either funds or their shareholders. There are enhancements that can be made by the SEC, and I hope that in the next four years, they'll make that happen. Something that happened during COVID that would be great to see become permanent in terms of flexibility is flexibility around the use of virtual board meetings. The statute from 1940 says it's gotta be in person. You know, in today's day and age, sometimes it's gotta be virtual board should, should have the flexibility to make that call. And then the last one I would highlight today would be the compliance rule. In many ways, the compliance rule has been a big success for the industry. But one way that it has not been used is when it's used by an enforcement tool by the SEC's Division of Enforcement. Commissioner Purse, over the years, has given some remarks about how they might recalibrate that. And I think she's onto something there. And I'm hoping that the new SEC might take that up and make that happen.

Brian P. Murphy (09:14):

Dave, you've served as the division director. How are these priorities created inside the SEC?

David W. Grim (09:21):

Good question. And what I would say is that there's a lot of people coming up with their list, right? All the commissioners have their lists. All kinds of people in the division have their lists. All kinds of people around the building, outside of investment management, have their lists. And then you have the public coming in with their list. And so it's a collection of ideas and ultimately it's up to the chairman to decide, you know, these are the ones that we go on, but he's taking, or he will, he's not there yet, but when he comes, he will take all that input and come up with the list that he thinks makes the most sense. 'cause The chairman of the SEC sets the direction of the agency, and that's why the decision ultimately rests with him.

Brian P. Murphy (10:05):

Yeah. Your statements remind me of a time when I think we have made, we may have been working together at the SEC when we came up with policy priorities, but I certainly remember working with the other divisions and internal staff to ask, What are the biggest pain points? What are the friction points? Where are the risks? And, try to get all of that information on one page and then start to organize it into a priority list that comes within the building, and then obviously compare it with the lists coming from the outside. So, certainly a great time to lean in and make your views now because you have the ability to impact the policy agenda over the next four years.

David W. Grim (10:47):

Exactly. Brian, if you could tell us how the transition might impact the day-to-day work at the SEC, including in IM, I think that'd be great for our listeners.

Brian P. Murphy (10:56):

Yeah, thanks, Dave. The transition shouldn't impact most of the day-to-day operations. I will continue to review disclosure filings, process routine applications, and review tips and complaints. These types of day-to-day functions can consume a large part of the staff's time, and it's usually not the topic that most people talk about. However, the flow of novel issues and new products, through these day-to-day operations, such as the application process or disclosure review process, typically slows as the SEC staff waits for direction from a new chair or a new IM director, for example. The fund industry has filed over 50 applications to offer multiple share class funds over the last couple of years, and progress has been a little slow. I'm hopeful that the SEC, under new leadership, will embrace the structure and its ability to facilitate capital formation. I'll also be talking about this topic at the upcoming ICI investment management conference, so please feel free to swing by and listen in.

Brian P. Murphy (12:01):

I also think we'll see more openness to offering investors access to crypto assets and private credit. The, in fact, the SEC recently stated that meme coins do not need to register under the Securities Act. So I think we'll see more, more of this as momentum builds and the new chair and new division directors get in their seats and start to really think about what does this new administration wanna accomplish? And I'd be interested. We've all, you know, Jan and Dave, and we've all been at the SEC during times of transition. It can be a little stressful as people change roles. This time seems a little different with an intense focus on reduction in force. Do you have any thoughts of how could this impact the day-to-day work of staff? What are they feeling? What are they thinking? What are the impacts to those of us representing clients in front of the SEC?

Jan M. Folena (13:01):

I think transitions like this generally cause a fair amount of anxiety amongst the SEC staff, and that in turn affects morale. And I think when Morale's affected, the division of enforcement in particular is affected the most because they are the outward facing part of the commission, the part of the commission that's in the courts, that is in the press, and that is, you know, that's enforcing the securities laws. And if their morale is down, it's difficult to do your job.

David W. Grim (13:33):

Yeah. And just to add on to that, Jan, from the investment management perspective, I agree with you all that this chatter about reduction in force undoubtedly has an impact on morale in the investment management division. But one thing I would say is that the investment management division is about 200 people out of the almost 5,000 in the agency. And so when, to me, when I think about the ultimate impact of, you know, any sort of reduction in force at the agency, I, I just don't expect it to shrink the division that much further. 'cause It's already a pretty small piece of of, of a bigger agency, right? You know, we're talking a hundred and how many assets are under management of advisors a hundred and something trillion dollars, right? So I don't expect the reductions in force to, to target. I am nonetheless, when you're talking with staff right now, recognize that it's a, you know, it's, it's going on in Washington, it's affecting their morale, and you just have to know that that's part of what's their life right now as, as you're engaging with them.

Jan M. Folena (14:41):

Sure. And in terms of numbers, I'll say this. One of the things we know to be true is that there was a hiring freeze at the SEC during Chair Clayton's term there. So, enforcement numbers did fall during his time at the commission, but enforcement action numbers did not. And the number of enforcement actions under Chair Gensler were largely equal to the enforcement actions under Chair Clayton, at least in the asset management space.

Brian P. Murphy (15:08):

Some recent presidential executive orders require agencies to review agency rules for consistency with President Trump's agenda. Jen, can you remind us what chair Genslerera rules have been struck down in the past few years, and what, if any, remain in the courts?

Jan M. Folena (15:23):

Sure. Thanks Brian. There have been quite a few during my time at the commission. I cannot recall a time when this many rules have been struck down in the courts. Let's start with the first one, which was the private funds rule. This was a rule that would've imposed certain restrictions and requirements on advisors to private funds that had not existed previously in a unanimous decision of the Fifth Circuit. The rule was vacated, and the court found that the rule itself exceeded the statutory authority under the Investment Advisors Act. The court ruled that the SEC could not rely on the retail investor protection provisions of Dodd-Frank to justify the role when such rulemaking authority was conspicuously absent from the provisions of Dodd-Frank that addressed private funds. Secondly, the court found that the SEC could not rely on the general anti-fraud provisions of the Advisers Act to promulgate substantive requirements on private fund advisors.

Jan M. Folena (16:25):

Because Congress did not intend for the internal governance of private funds to be subject to federal regulation, such provisions could not be used, therefore, as a catchall. So, in other words, the anti-fraud provisions could not be used to justify any rule to impose substantive obligations on private funds. The next rule is the proxy rule. The DC circuit vacated an amendment to the public company proxy rule that would have included proxy advisory service providers within the definition of the term proxy solicitors. The DC circuit held that such an amendment was contrary to the plain language of the Securities Exchange Act of 1934, as the term solicit does not encompass providing advice on proxy voting for a fee when the provider has no interest in the outcome of the vote. Similar to the Fifth Circuit, the DC circuit also ruled that the SEC could not rely on broad general rulemaking authority to justify such an amendment when the amendment itself did not conform to the plain language definition of the term solicit.

Jan M. Folena (17:40):

And then finally in November of 2024, the Northern District of Texas ruled that the SEC's newly adopted dealer rule exceeded the statutory authority under the Securities Exchange Act of 1934, because that act already included a definition of dealer, and that definition was written by Congress and the SEC could not promulgate a rule changing Congress's definition. Interestingly, the SEC had appealed that decision, but on February 20, the acting commission abandoned that appeal, and that leaves us, last but not least, the climate rule applicable to public companies. That rule was challenged in so many circuits that the appeal and the challenge of that rule were consolidated in the Eighth Circuit while the appeal was pending. The SEC petitioned the court to halt the argument on the rule so that the new SEC can evaluate the appropriateness of that rule and whether or not they will still maintain the appeal. So that's a lot that happened during this time. I'll send it back to Dave and Brian to talk about what rules might be impacted by the executive order that was issued by President Trump at the beginning of the administration.

David W. Grim (18:58):

When I think about the impact of the regulatory freeze, I think it comes in a number of flavors. The first one is the rules that were proposed but not adopted under the prior administration. Those will not happen. So this includes ESG for funds and advisors, a predictive data AI rule, outsourcing and cybersecurity, not going to happen. Then you have another bucket, which is rules that have been recently adopted, and maybe get some more time to comply with them. So in that category is the short sale reporting form of Treasury Clearing, which has all gotten extensions under the new administration. Then you have the con: the bucket of whether there will be any rules that have been adopted that the SEC will sort of reverse course on. That's still to be sorted out, but one possibility on that front is Form M import. You might have seen recently that the ICI submitted a request to change course on the N port rules that were adopted in a number of ways. I think there's a good chance that it could be picked up by the new SEC. So Brian, what are you thinking in terms of the impact of this executive order?

Brian P. Murphy (20:14):

I see these executive orders in the broader picture of transitioning from a Democratic regime to a Republican regime. We were all at the agency when this happened in the past. And what we typically see is a whole host of new rules during democratic administrations. Then, when Republican administrations take charge, they typically look at what's been done since they last held office, cut the problematic rules, and start to enhance the rules to use some clarity. So I think looking at applying that ideology, I think, you know, the custody rule under the Advisors Act and the company act, particularly with respect to crypto assets, is always on the list. I think the advisors act as marketing rules, another one that has caused challenges and could be ripe for some revisions. And of course, there's always room for clarity regarding the fund names rule. So, I think these are three rules that the industry is going to call on the chair, and I am going to take a fresh look at them and see if there are ways to make them easier for the industry to comply with.

David W. Grim (21:29):

Jan, let's kick it back to you. In addition to the rules that might not be in line with an Atkins LED SEC, are there any rules in particular that the commission could view as beyond the SEC's statutory authority?

Jan M. Folena (21:41):

Yeah, thanks, Dave. There are two rules that come to mind. One is the name's rule, and the second is the liquidity rule. Starting with the name's rule, not in its entirety, but perhaps with respect to the 80% investment limitation for funds based on their name, section 35 D of the Investment Company Act, under which the rule was promulgated permits the SEC to implement rules that define a name or title that might be misleading or deceptive. The 80% provision or requirement arguably does not define a name or title that is mis, that is, misleading. Rather, it really substitutes an advisor's judgment on investment decisions for that of the FEC in a commission that is aiming to be less prescriptive, especially in the asset management area. This is a role that could be challenged, and it's one that I agree with you that they could review. The second, of course, is the liquidity role. And we are currently challenging that rule in the Northern District of New York on the grounds that it is beyond the plain language of the statute that permits rulemaking in a limited area, but really does not include the breadth of the requirements under the liquidity rule with regard to classifying assets.

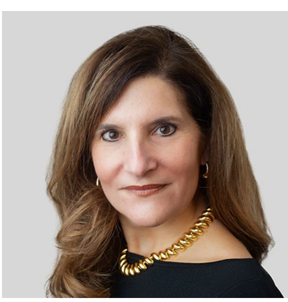
Brian P. Murphy (22:57):

We hope this has provided our listeners with a helpful summary of some of the key issues to know early in the year. Please feel free to reach out to any of us for further information, and keep an eye out for additional updates for Stradley down the road.

(23:11):

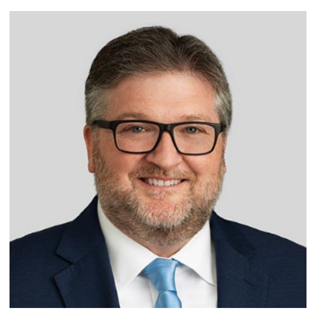
For more than 95 years, Stradley Ronon's investment management practice has helped shape the investment management industry by assisting with the creation of innovative investment products and services. From obtaining industry first exemptive and no action relief to assisting in the development of novel products, we have helped our clients become or remain industry leaders. As the investment management industry and our clients have evolved, so have we. Meet our team at Stradley.com.

For more information, contact:



Jan M. Folena
Partner and Co-Chair,
Securities Enforcement
215.564.8092
jfolena@stradley.com

David W. Grim
Partner and Co-Chair,
Investment Management
202.507.5164
dgrim@stradley.com



Brian P. Murphy
Partner
215.564.8036
bmurphy@stradley.com