Private Equity Regulatory Update

November 26, 2019

Rules and Regulations

SEC Proposes Amendments to Modernize the Advertising and Cash Solicitation Rules

On November 4, 2019, the Securities and Exchange Commission (the "**SEC**") proposed amendments to Rule 206(4)-1 (the "**advertising rule**") and Rule 206(4)-3 (the "**solicitation rule**") under the Investment Advisers Act of 1940, as amended (the "**Investment Company Act**") in an effort to modernize two rules that have remained largely unchanged since their respective adoptions decades ago.

The proposed amendments to the advertising rule would replace many of the current rule's limitations with principles-based provisions, and would allow for the use of testimonials, endorsements and third-party ratings under certain conditions.

The proposed amendments to the solicitation rule would expand the rule's scope to cover non-cash solicitation arrangements and solicitors for private funds, among other changes.

Davis Polk has published a **client alert** discussing the proposed amendments and will publish a full client memorandum shortly.

SEC Proposes Rules to Regulate Proxy Advisory Firms and Shareholder Proposals

On November 5, 2019, at an open meeting, the SEC voted (3 to 2) to propose amendments to the proxy rules. The proposed amendments relate to regulating proxy advisory firms. The SEC also voted to propose amendments with regard to shareholder proposals, including eligibility standards for submission and resubmission.

Davis Polk has published a **client alert** and a **client memorandum** discussing the proposed amendments.

SEC Proposes Amendments to Exemptive Application Procedures

On October 18, 2019, the SEC issued a release (the "**Release**") proposing amendments to Rule 0-5 under the Investment Company Act, which sets forth the procedures for applications for exemptive relief. The proposed amendments would, among other changes: (i) establish an expedited review process for routine exemptive relief applications that are substantially identical to recent precedents and (ii) implement a new rule to deem an application withdrawn if the applicant does not respond in writing to comments within 120 days. In addition, the Release announced that the SEC will begin publicly

disseminating comments on exemptive applications through the EDGAR system and on its website. The Release noted that the proposed amendments are intended to improve efficiency and to "provide additional certainty and transparency in the application process." The SEC requested comments on various aspects of the proposed amendments, which will be due 30 days following the Release's publication in the Federal Register.

Background

Certain provisions of the Investment Company Act empower the SEC to issue orders granting exemptive relief from certain requirements of the Investment Company Act. For example, Section 6(c) gives the SEC authority to "conditionally or unconditionally exempt any person, security, or transaction . . . from any provision or provisions of [the Investment Company Act] or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Investment Company Act]." According to the Release, the current review process consists of the following process: if a request "meets the applicable standards," the SEC publishes a notice in the Federal Register and on its website indicating its intent to grant the requested relief; "interested persons" then have an opportunity to request a hearing on the application; if the SEC does not receive such a request and does not otherwise order a hearing during the notice period, the SEC issues an order granting relief. For applications that do not initially satisfy the applicable standards, the SEC may issue comments "asking for clarification of, or modification to, an application to determine whether, or ensure that, the relief meets the [Investment Company] Act's standards." The Release noted that the majority of notices of applications and orders are issued by the SEC through SEC staff under delegated authority; alternatively, for applications for which the staff does not have delegated authority, the staff presents its assessment to the SEC.

According to the Release, the application process "has been a significant and valuable tool in the evolution of the investment management industry, and sometimes is the origin of new rules under the [Investment Company] Act." The Release also noted that applicants have "sought relief to implement innovative features or create new types of funds that do not fit within the regulatory confines" of the Investment Company Act, such as exchange-traded funds. However, according to the Release, applicants have expressed concern regarding the time required to obtain relief for both "routine and novel applications." The SEC has taken various steps over the years "aimed at improving the application process." According to the Release, in 1993, the SEC proposed amendments to Rule 0-5 to establish an expedited review for some routine applications, but the amendments were not adopted. In 2008, SEC staff implemented an internal target of providing comments on at least 80% of applications within 120 days, and in 2010, the SEC staff met this goal on 100% of applications and "has not dropped below 99% each year since." The Release noted that for applications received on or after June 1, 2019, the SEC staff has implemented a new target of providing comments "on both initial applications and amendments within 90 days."

Expedited Review

The proposed amendments to Rule 0-5 "would establish an expedited review procedure for applications that are substantially identical to recent precedent." The Release identified various potential benefits of the proposed amendments, including the SEC's ability to grant relief more quickly and to "devote additional resources to the review of more novel requests," as well as a less expensive application process for applicants.

According to the Release, under proposed Rule 0-5(d), an applicant may request expedited review if the application is "substantially identical" to two other applications for which an order granting relief has been issued within two years of the application's initial filing. Substantially identical applications would be defined as "those requesting relief from the same sections of the [Investment Company] Act and rules thereunder, containing identical terms and conditions, and differing only with respect to factual differences that are not material to the relief requested." The Release noted that the substantially identical

requirement "would help to ensure that applicants use the [expedited] procedure only when they do not need to modify the terms and conditions of the precedent applications and are not raising new issues for the [SEC] to consider." The Release stated that certain types of applications, including those filed under sections 2(a)(9), 3(b)(2), 6(b), 9(c), and 26(c) of the Investment Company Act, are unlikely to qualify for expedited review because they are too fact-specific.

According to the Release, proposed Rule 0-5(e) would require an application submitted for expedited review to include the following additional information: (i) a notation on the cover page of the application prominently stating "EXPEDITED REVIEW REQUESTED UNDER 17 CFR 270.0-5(d)"; (ii) exhibits with marked copies of the application showing changes from the two precedents identified as substantially identical; and (iii) a cover letter identifying the two precedents and certifying that the applicant "believes the application meets the requirements of [the rule] and that the marked copies . . . are complete and accurate."

The Release stated that, under proposed Rule 0-5(f), a notice for an application for expedited review would be issued no later than 45 days from the date of filing, "unless the applicant is notified that (i) the application is not eligible for expedited review because it does not meet the criteria in Rule 0-5(d), or (ii) further consideration of the application is necessary for appropriate consideration of the application." The Release provided examples of when further consideration may be required, including: "cases where the [SEC] is considering a change in policy that would make the requested relief, or its terms and conditions, no longer appropriate" and "cases where [SEC staff] is investigating potential violations of [f]ederal securities laws that may be relevant to the request for relief." According to the Release, proposed Rule 0-5(f) would impose conditions on the operation of the 45-day period. The Release stated that the 45-day period would restart upon the filing of any amendment that the SEC or its staff did not solicit (although SEC staff may act before the end of the additional 45-day period "if the unsolicited amendment relates only to factual differences not material to the relief requested or to some other minor change"). In addition, the 45-day period would stop running upon: (i) any comment on the application by SEC staff, and would resume running on the fourteenth day after the applicant files an amended application responsive to such request; or (ii) any irregular closure of the SEC's Washington, D.C. office to the public for normal business hours, and would resume upon the reopening of the office.

According to the Release, under proposed Rule 0-5(f), if an applicant does not file an amendment responsive to SEC staff's request within 30 days of receiving such request, including the required marked copy and certification discussed above, the application would be deemed withdrawn and such withdrawal would be without prejudice.

Standard Review

The SEC has proposed a new rule to provide a time frame for all other applications filed under Rule 0-5 that do not qualify for the expedited review process, in order to "provide applicants with added transparency regarding the review of applications." According to the Release, under paragraph (a) of the proposed rule, SEC staff "should" take action on applications subject to standard review within 90 days of the initial filing and any amendments thereto. Taking "action" on an application or amendment could consist of: "(i) issuing a notice of application; (ii) providing the applicants with comments; or (iii) informing the applicants that the application will be forwarded to the [SEC], in which case the application is no longer subject to paragraph (a) of the rule." The Release stated that SEC staff may also grant 90-day extensions and applicants "should" be notified of such extensions. In addition, the Release noted that if SEC staff does not support the requested relief, it typically notifies applicants, giving applicants an opportunity to withdraw an application before a recommendation to deny relief is made.

According to the Release, the SEC has also proposed to amend Rule 0-5 to deem an application withdrawn if an applicant does not respond in writing to SEC staff comments within 120 days of the request. The Release stated that this procedure will allow the SEC to maintain "a clear record of pending applications, as well as provide the public, including potential new applicants, with a better sense of the

applications that the [SEC] is actively considering at any given time." In addition, the Release noted that such withdrawals would be without prejudice.

Release of Comments

According to the Release, the SEC plans, through the EDGAR system and on its website at **www.sec.gov**, to "publicly disseminate [SEC staff] comments on applications, and responses to those comments, no later than 120 days after the final disposition of an application." The public distribution of comments is intended to "expand the transparency of the applications process, so that the public can benefit from greater transparency into the applications process without the delay or burden of submitting [Freedom of Information Act] requests." This change would apply to both standard and expedited review of applications. The effective date of this new process will be announced in a subsequent adopting release.

- **See a copy of the Release**

Industry Update

SEC Enforcement Division Issues Report on Priorities and FY 2019 Results

On November 6, 2019, the Division of Enforcement of the SEC (the "**Enforcement Division**") issued a report (the "**Annual Report**") highlighting its priorities for the upcoming year and reviewing the enforcement actions it brought during the 2019 fiscal year.

According to the Annual Report, five core principles guided the Enforcement Division's decision making in 2019: focusing on retail investors' interests, focusing on individual accountability, keeping pace with technological change, imposing remedies that most effectively further enforcement goals and constantly assessing resource allocation within the Enforcement Division.

The Annual Report also summarizes the Enforcement Division's enforcement results for fiscal year 2019. According to the Annual Report, the Enforcement Division brought 862 enforcement actions during 2019, which led to more than $4.3 billion in disgorgement and penalties and about $1.2 billion returned to investors. These enforcement actions also resulted in the suspension of trading in the securities of 271 companies and the barring or suspension of 595 individuals.

According to the Annual Report, 526 of the 862 enforcement actions were standalone actions, of which 36% concerned investment advisory and investment company issues, 21% concerned securities offerings, and 17% concerned issuer reporting/accounting and auditing matters. Other major categories included market manipulation, insider trading, and broker-dealer issues, each of which constituted 6-7% of the total number of standalone actions.

Davis Polk has published a **client memorandum** discussing the Annual Report.

- **See a copy of the Annual Report**

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