

Securities Regulatory and Enforcement: Four Asset Management Trends

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When the United States Investment Company Act and the Investment Advisers Act of 1940 came into force, assets under management were a mere $1 billion. Sixty years later they topped $20 trillion, and by the end of 2020, they skyrocketed to $110 trillion. Along with the considerable increases in the US economy and markets, the industry is experiencing dramatic growth and success. In just the past seven years, from 2013 to 2020, the number of registered investment advisors grew by 50 percent.

So, where is this success originating? During a securities regulatory and enforcement session at Katten's annual Financial Markets Litigation and Enforcement Symposium Series, Katten attorneys and guests discussed the trajectory of this remarkable growth. Key takeaways include the increasing popularity of exchange traded funds, particularly the new Bitcoin futures ETF, the SEC's big wins, and rule changes for asset managers.

Four trends of note:

1. Where Growth Is Trending
2020 performance shows that, while still the largest single asset group, hedge funds were static, and private equity funds, once a growing segment, were flat. However, the asset management sector is showing serious growth, primarily from three distinct areas: robo-advisors, separately managed accounts from individuals, and venture capital funds Overall, private funds comprised approximately $20 trillion of the total $110 trillion in assets under management in 2020.

Globally, registered funds tallied about $60 trillion, with US registered funds accounting for roughly half that number, holding 30 percent of public company equity, 23 percent of public company debt, and almost 30 percent of municipal bonds. Nearly 61 million Americans now have a substantial percentage of their retirement savings invested in registered investment companies.

Of peculiar note, 2020 saw a pandemic-fueled exodus of people from the Northeast, California and Illinois — home to numerous regulated entities — to states such as Texas and Florida. If this trend

continues, we're likely to experience a dramatic sea change in where investment advisors register their principle place of business.

2. Exchange Traded Funds Take Center Stage

After more than eight years of stops and starts, on October 19, 2021, the SEC approved the first-ever Bitcoin-linked ETF, the ProShares Bitcoin Strategy ETF. The launch marked one of the biggest of all time, with the Bitcoin futures ETF accumulating more than $1 billion in assets over the first two days. Notably, the Bitcoin futures ETF gives institutional investors exposure to bitcoin but through the more-regulated futures market — bitcoin futures contracts rather than bitcoin. Proponents of Bitcoin and the cryptocurrency industry, more generally, hope cryptocurrency-linked ETFs will increase the industry's legitimacy through broader exposure and adoption.

While other cryptocurrency-linked ETFs are eager to launch, the SEC indicated it was not ready to approve leveraged Bitcoin ETFs or spot market-based Bitcoin ETFs, largely over concerns that investors may take ill-informed risks and lose significant sums of money. However, because Canada has already approved a spot market-based Bitcoin ETF that has been operating for several months, there is pressure on the SEC to reconsider its approach. Notwithstanding such pressure, the SEC recently rejected yet another application for a spot market-based Bitcoin ETF, this time filed by Cboe BZX Exchange to list and trade the VanEck Bitcoin ETF.

Not to be overshadowed by the Bitcoin futures ETF, both traditional and non-traditional ETFs continue to be attractive for most investors, which are relatively inexpensive and tax efficient. In fact, many analysts believe that the Biden Administration's proposal to increase US capital gains taxes should fuel further interest in ETFs as opposed to mutual funds, with a few caveats. Non-traditional ETF performance over time can be magnified in volatile markets. For firms, regulators continue to pursue disciplinary actions relating to the sale of non-traditional products to retail investors and advise heightened monitoring processes, carefully drafted disclosures, and adequate training for brokers and supervisors regarding risks going forward.

3. The SEC Is Winning

The overall consensus is that the SEC is winning big and advisors can expect more pain next year. Several significant court rulings affirm or increase the SEC's power.

In October, the US Court of Appeals for the Fifth Circuit upheld a disgorgement order issued by the SEC, marking the first appellate ruling on the topic since the Supreme Court's Liu decision (*Liu v. SEC*.) in 2020. The ruling allows the SEC to continue to seek disgorgement as a remedy in federal courts. The impact of *Liu* is not so much an issue of whether the SEC may obtain disgorgement but under what circumstances it may obtain such relief.

In another 2021 win for the SEC, the Supreme Court denied a petition for a writ of certiorari by a broker dealer involved in an SEC suit for violating anti-money laundering rules, leaving in place the Second Circuit's ruling affirming the authority of the SEC to enforce certain Bank Secrecy Act requirements under the Exchange Act.

Also, in the past year, courts have rejected challenges to the SEC's “gag rule.” The SEC's “gag rule” provides that when a party settles an SEC enforcement action, the party cannot deny the allegations after the settlement. The gag order is written into every settlement agreement and the settling party must agree to the gag order. Two recent challenges to the rule failed, all but rendering future challenges to the gag rule dead. In both cases, courts refused to invalidate the gag rule, finding that if the settling party did not like the terms of the settlement, it should not have settled in the first place.

4. Rule Changes Drive Disclosure Activity

New rules, collectively referred to as the “Marketing Rule,” went into effect in May 2021 and dramatically change advertising and solicitation practices for investment advisors. Investment advisers have until November 4, 2022 to comply.

Additionally, the SEC approved a Nasdaq listing requirement where public companies must disclose the diversity of their boards. Public companies without a diverse board must explain why. SEC Chairman Gary Gensler is also considering such disclosure requirements for money managers and brokers.

On the ETF front, Rule 6c-11 provides certain ETFs with exemptions from the 1940 Act and also imposes the following conditions: (1) ETFs must provide a daily portfolio transparency on their website; (2) ETFs are permitted to use baskets that do not reflect a pro-rata representation of portfolio funds if they have certain written policies and procedures in place; and (3) ETFs must disclose certain other information on their website, including historical information regarding premiums and discounts and bid-ask spread information.

Read more coverage from the 2021 Annual Financial Markets Litigation and Enforcement Symposium Series:

The State of Futures: Emerging Trends and Enforcement Priorities

Market Trading Trends: Expect Regulatory Guidance to Accelerate

Global Financial Institutions Legal Departments Share D&I Successes and Lessons Learned

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