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SEC in Focus

Quarterly summary of current SEC activities

In this issue:

SEC adopts rules requiring climate-related disclosures......1

SEC rulemaking and staff guidance updates 2

SEC expands required SPAC disclosures, clarifies requirements for shell companies 2

SEC amends Form PF to expand private fund reporting requirements 2

SEC rules expand definitions of dealers and government securities dealers 3

SEC amends registration requirements for certain internet investment advisers...3

Other SEC matters 4

Greiner named director of SEC's Division of Investment Management..........................4

Enforcement activities...............4

SEC charges electric vehicle manufacturer with misleading investors...............................4

SEC charges footwear and apparel company with failing to disclose related party payments......................4

SEC charges investment advisers with false statements about their use of AI 4

SEC adopts rules requiring climate-related disclosures

The Securities and Exchange Commission (SEC) adopted final rules that will require registrants to disclose climate-related information in registration statements and annual reports, including material climate-related risks, descriptions of board oversight and risk management activities, the material impacts of these risks on a registrant's strategy, business model and outlook, and any material climate-related targets or goals.

The landmark rules also will require accelerated and large accelerated filers to disclose gross direct greenhouse gas (GHG) emissions from operations they own or control (Scope 1 emissions) and/or indirect emissions from purchased electricity and other forms of energy their operations consume (Scope 2 emissions), if material. These disclosures will be subject to independent third-party assurance. Nonaccelerated filers, emerging growth companies and smaller reporting companies will be exempt from the requirements to disclose Scope 1 and Scope 2 emissions.

In a shift from the proposal, the rules will not require registrants to disclose indirect GHG emissions from upstream and downstream activities (Scope 3 emissions). They also further incorporate the US Supreme Court's definition of materiality and give companies more time to comply. Some of the requirements, such as those related to organizational boundaries, are better aligned with those required or allowed by other reporting regulations and standards (e.g., the European Union's Corporate Sustainability Reporting Directive, California's climate disclosure laws, the International Sustainability Standards Board's standards). However, significant differences remain, such as the absence of a requirement to report Scope 3 emissions.

Registrants will also have to disclose, among other things, certain effects of severe weather events and other natural conditions (e.g., hurricanes, tornadoes, flooding) and amounts related to carbon offsets and renewable energy credits or certificates in their audited financial statements.

EY resources

- *Technical Line, A closer look at the SEC's climate-related disclosure requirements*
- *Technical Line, How the climate-related disclosures under the SEC rules, the ESRS and the ISSB standards compare (28 March 2024)*

The rules will require registrants to disclose whether any climate-related risks have had or are reasonably likely to have a material impact on their strategy, results of operations or financial condition. Registrants will have to describe the actual and potential material impacts of each disclosed climate-related risk on their strategy, business model and outlook, and how they are considered as part of their strategy, financial planning and capital allocation.

Registrants will need to provide a quantitative and qualitative description of material expenditures and material impacts on financial estimates and assumptions resulting directly from activities to mitigate climate-related risks, among other activities. Registrants will also be required to disclose any climate-related targets or goals that have materially affected or are reasonably likely to materially affect their business, results of operations or financial condition.

Following the adoption of the rules, several lawsuits were filed challenging them and subsequently consolidated into the Eighth Circuit Court of Appeals. The SEC issued an **order** on 4 April 2024 to stay the rules pending the judicial review by the Eighth Circuit of the consolidated challenges. Absent the stay, the rules would have been effective 28 May 2024 and phased in starting in 2025 depending on the registrant's filer status and the type of disclosure. Because the outcome of such litigation is uncertain, companies should not delay preparing to comply with the rules.

SEC rulemaking and staff guidance updates

EY resources

- *To the Point, SEC rules require new SPAC disclosures and clarify reporting requirements for shell companies*
- *Technical Line, Navigating the requirements for merging with a special purpose acquisition company*

SEC expands required SPAC disclosures, clarifies requirements for shell companies

The SEC adopted rules requiring new disclosures when a special purpose acquisition company (SPAC) conducts an initial public offering (IPO) and when it combines with a private operating company in what is known as a de-SPAC transaction, among other related changes.

The rules require a SPAC to disclose the role of its sponsor, conflicts of interest, dilution and whether its board determined that the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders. The rules also align financial statement requirements in de-SPAC transactions with those of traditional IPOs and require a redetermination of smaller reporting company status after a de-SPAC transaction.

Under the new rules, SPAC targets are deemed co-registrants, subjecting them to liability for untrue material statements or material omissions. The rules also amend the definition of a blank check company to make the safe harbor from liability for forward-looking statements unavailable to SPACs.

In addition, the rules amend Item 10(b) of Regulation S-K, which allows management to present projected financial information that has a reasonable basis in SEC filings, to require registrants to clearly distinguish projected measures that are not based on historical financial results from those that are and to present corresponding historical results with equal or greater prominence.

The rules are effective on 1 July 2024, and the related structured data requirements are effective 30 June 2025.

SEC amends Form PF to expand private fund reporting requirements

The SEC amended Form PF, the confidential reporting form for certain SEC-registered investment advisers to private funds, to expand certain reporting requirements.

Hedge fund advisers and their advised hedge funds now need to report additional information on investment strategies, counterparty exposures, and trading and clearing mechanisms. Large hedge fund advisers now need to report additional information for hedge funds with a net asset value of $500 million or more, including fund exposure reporting, risk metrics and liquidity reporting, among other things.

Private fund advisers and their advised private funds need to report additional basic information, including assets under management, withdrawal and redemption rights, gross asset value and net asset value, inflows and outflows, base currency, borrowings and types of creditors, fair value hierarchy, beneficial ownership, and fund performance.

The amendments also change how private fund advisers report complex structures by generally requiring (1) separate reporting for each component fund of a master-feeder arrangement and parallel fund structure and (2) aggregated reporting for trading vehicles used by reporting funds. In addition, the amendments eliminate the requirement for large hedge fund advisers to report certain aggregated information about the funds they manage that could obscure the data about hedge funds, including by masking the directional exposures of individual funds.

Registered investment advisers must comply with the amendments beginning 12 March 2025.

SEC rules expand definitions of dealers and government securities dealers

The SEC adopted rules under the Securities Exchange Act of 1934 (the Act) that define a dealer or government securities dealer as a person who engages, as part of a regular business, in either of the following activities:

- Regularly expresses trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants
- Earns revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest

The rules clarify that a person who does not engage in these activities may still be a dealer or government securities dealer.

The rules are intended to address SEC concerns that certain market participants, such as proprietary or principal trading firms, act as de facto market makers without registration and with limited regulatory oversight.

Absent an exception or exemption, a dealer or government securities dealer is required to (1) register with the SEC under Section 15(a) or Section 15C of the Act (broker-dealer registration), (2) join a self-regulatory organization (SRO), and (3) comply with federal securities laws and regulatory obligations, as well as SRO and US Treasury rules and requirements. Proprietary trading firms, registered investment advisers, private funds and other entities that previously did not meet the definitions of dealer or government securities dealer may now meet either definition.

The revised definitions exclude any person that has or controls total assets of less than $50 million, investment companies registered under the Investment Company Act of 1940, central banks, sovereign entities and international financial institutions as defined in the rules.

The rules are effective on 29 April 2024, with compliance required one year later.

SEC amends registration requirements for certain internet investment advisers

The SEC adopted amendments to the rule that exempts certain internet investment advisers from the prohibition on SEC registration for smaller investment advisers.

The amendments require an investment adviser relying on the exemption to (1) provide investment advice to its clients solely through an operational interactive website and (2) represent on Schedule D of its Form ADV that, among other things, it has an operational interactive website. The amendments also eliminate the current rule's de minimis exception, which allowed internet advisers to have a limited number of non-internet clients.

An adviser relying on the exemption must comply with the rule by 31 March 2025. An adviser that is no longer eligible to rely on the amended exemption must withdraw its registration with the SEC by filing a Form ADV-W by 29 June 2025.

> "As more and more investors consider using AI tools in making their investment decisions or deciding to invest in companies claiming to harness its transformational power, we are committed to protecting them against those engaged in 'AI washing.'
>
> — Director of the SEC's Division of Enforcement, Gurbir S. Grewal

Other SEC matters

Greiner named director of SEC's Division of Investment Management

The SEC named Natasha Vij Greiner as director of its Division of Investment Management, succeeding William Birdthistle. Ms. Greiner previously served as deputy director of the SEC's Division of Examinations.

Enforcement activities

SEC charges electric vehicle manufacturer with misleading investors

The SEC charged an electric vehicle manufacturer with making materially false and misleading statements about the company's flagship product in SEC filings and other public statements during and subsequent to the company's merger with a SPAC. The SEC's order alleged the company exaggerated demand for its flagship product and misrepresented the timeline for deliveries.

Without admitting or denying the SEC's findings (and subject to bankruptcy court approval), the company agreed to a cease-and-desist order and disgorgement of $25.5 million, which will be deemed satisfied by payments of up to $25.5 million related to pending class action lawsuits.

SEC charges footwear and apparel company with failing to disclose related party payments

The SEC charged a footwear and apparel company with failing to make required disclosures of related party transactions in its annual reports and definitive proxy statements for multiple years.

The SEC's order alleged the company failed to disclose compensation paid to certain immediate family members of its executive officers and that multiple executives owed more than $120,000 to the company for personal expenses paid by the company on behalf of the officers.

Without admitting or denying the SEC's findings, the company agreed to a cease-and-desist order and to pay a $1.25 million civil penalty.

SEC charges investment advisers with false statements about their use of AI

The SEC charged two investment advisers with making false and misleading statements about their purported use of artificial intelligence (AI). The SEC's order against one investment adviser alleged the firm made false and misleading statements in SEC filings and press releases about its use of AI and machine learning that incorporated client data in its investment process. The SEC's order against the other investment adviser alleged the firm made false and misleading claims on its website and social media about its use of AI.

Without admitting or denying the SEC's findings, the investment advisers agreed to settle the SEC's charges and pay $400,000 in total civil penalties.

EY resources

- *Five key SEC Priorities in 2024*

What's next at the SEC?

We expect the SEC's robust rulemaking agenda to continue in 2024, particularly to finalize rules, although it may also consider proposing rules on human capital management and board diversity. Additionally, we expect uncertainty from litigation to continue in 2024 as market participants seek to implement new rules, including climate-related disclosures.

The SEC is also expected to continue focusing on the role of newer technologies in capital markets, including crypto assets and AI. SEC Chair Gary Gensler has signaled that the SEC staff is scrutinizing the accuracy of company disclosures relating to the use of AI and has warned companies not to make false claims about their use of AI. Market participants should monitor developments closely.

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