Key Takeaways

Skadden

Recent Investment Management Litigation and Regulatory Developments

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On February 28, 2017, Skadden hosted a webinar titled "Recent Investment Management Litigation and Regulatory Developments." The Skadden panelists were litigation partners Eben Colby and Seth Schwartz, securities enforcement and compliance partner Colleen Mahoney and investment management counsel Kenneth Burdon.

Mr. Burdon provided an update in the area of investment management regulation. He began by discussing the Trump administration's February 3, 2017, executive order setting out its "core principles" for regulating the financial system. Mr. Burdon explained that the core principles are quite broad, and that federal agencies likely will play a significant role in determining how they are applied. Mr. Burdon discussed the potential application of the administration's core principles to several currently pending rules. As one example, he suggested that the derivatives rule proposed by the Securities and Exchange Commission (SEC) in December 2015 may gain little traction in its proposed form under incoming SEC leadership because of its potential to be at odds with the regulatory priorities suggested by the core principles. Mr. Burdon also discussed the role of the SEC in implementing the core principles, explaining that the SEC will not be strictly bound by the core principles, but is likely to follow their thematic elements, since the incoming SEC chairman will be a Trump appointee who would presumably share the new administration's regulatory philosophy and priorities. Mr. Burdon then noted the tension between the SEC's enforcement-minded approach over recent years and the new administration's focus on promoting economic growth. He explained that viewing enforcement as a tool to be appropriately tailored to achieve effective and efficient regulation — in other words, one of various means to an end — could be a welcome pivot from viewing enforcement as an end in and of itself. Mr. Burdon noted that the SEC remains bound by laws currently in place, such as Dodd-Frank, and that real fundamental change would require an act of Congress. He also noted that the administration's "2-for-1" rule with respect to new regulations does not apply to the SEC because it is an independent agency, but also explained that the Administrative Procedure Act would require the SEC to go through a public notice and comment process to modify or repeal any existing rules. In closing, Mr. Burdon emphasized that the core principles were broad policy objectives and could come to be useful lines of policy-based argument when approaching regulators or commenting on regulatory proposals.

SEC Developments

Ms. Mahoney discussed recent developments in SEC examination and enforcement efforts. She explained that the SEC recently released its 2017 examination priorities, and she addressed the commission's priorities, including with respect to robo-advisers,

senior investors and retirement investments. Ms. Mahoney next discussed the new administration's nominee for SEC chair, Jay Clayton. She explained that Mr. Clayton does not have a white-collar defense background, like most recent Chair Mary Jo White, and offered predictions on how the SEC would operate under Mr. Clayton, including a potentially reduced focus on technical violations and more on big-picture enforcement issues. Ms. Mahoney also noted that both the administration and Mr. Clayton have expressed concern that FCPA enforcement may in some cases harm domestic businesses and economic growth, and she said this may impact the scope of the SEC's FCPA enforcement agenda over the coming years. Ms. Mahoney next discussed the SEC's continued focus on accounting and disclosure cases and outlined recent asset management enforcement cases regarding inadequate disclosures and conflicts of interest. Ms. Mahoney noted that some of the enforcement actions have included proceedings against individuals, but the new administration may have a different perspective on the merits of such actions. She also discussed the acting chairman's decision to centralize the determination whether to open investigations, a change in practice from recent years where SEC staff had that delegated authority. This decision may be driven by a focus on ensuring that any new enforcement actions are consistent with the administration's core principles and focus on economic growth.

Developments in Section 36(b) Litigation

Mr. Colby discussed developments in the current wave of Section 36(b) cases against advisers. He noted that there are primarily two themes within the current wave, both centering around subadvisor fees. He explained that although plaintiffs have filed a number of these cases — and have previously had success surviving motions to dismiss — the recent trend has been favorable to advisers. Notably, since January 2016, two cases were dismissed at the pleading stage, one case resolved in favor of the adviser at summary judgment and one case resulting in a trial victory for the adviser. In addition, Mr. Colby also noted that five cases have been resolved by settlement, as well as two favorable partial summary judgment rulings for advisers. (Additional cases have been resolved since the webinar.) Mr. Colby explained that the takeaway of recent developments is that the board's process remains the most critical factor in litigation. He suggested that advisers and directors remain focused on improving and documenting their robust board processes. Mr. Colby also discussed a recent ruling ordering independent directors to disclose certain emails to counsel under the fiduciary exception to attorney-client privilege, as well as a different ruling requiring the disclosure of documents discussing certain of the adviser's litigation and regulatory matters. Mr. Colby noted that plaintiffs may attempt to use those rulings in other pending cases, having tried to do so in at least one case so far, in an effort to turn the momentum away from advisers.

Developments in ERISA Litigation

Mr. Colby next discussed developments in ERISA litigation, and talked about a number of cases that recently have been filed against advisers. The cases allege that adviser's selection of affiliated funds for a plan's investment lineup breach the fiduciary duties owed to the plan. Mr. Colby explained that some common theories are that the adviser either did not perform an adequate investigation of alternative investments, failed to adequately monitor costs and performance, included duplicative investment options in the plan or failed to offer lower-cost alternatives or the least expensive share class within a fund. Mr. Colby noted that motions to dismiss generally have been denied, and no cases have been litigated to the merits. Mr. Colby also discussed significant settlements of cases in this area. He also discussed steps that an adviser may take to prepare for such cases, including fully documenting the fiduciaries' process for monitoring costs and performance, considering objective performance metrics and considering adding unaffiliated funds.

Developments in Section 11 Litigation

Mr. Schwartz discussed a recent trend in litigation under Section 11 of the Securities Act, which he said may be the next frontier for fund litigation if plaintiffs generally are unsuccessful in the current wave of cases under Section 36(b). Mr. Schwartz noted a recent uptick of Section 11 cases filed in state court and discussed a currently pending petition for *certiorari* before the U.S. Supreme Court regarding the removability of such cases to federal court. As of now, Mr. Schwartz said it appears that the trend of suing in state court will continue. Mr. Schwartz also discussed the challenges faced by plaintiffs in previous Section 11 actions, but noted that as in Section 36(b) litigation, he expects that plaintiffs will continue to refine their theories in an effort to improve their chances of success. Mr. Schwartz discussed the focus of recent cases on challenging the adequacy of risk disclosures in fund prospectuses. He explained that plaintiffs in these cases frequently rely on hindsight as a basis for their claims, and recommended that advisers, as a general practice, review and update their disclosures annually as appropriate.