FUND BOARD VIEWS

Viewpoints

What will second Trump Administration mean for fund directors?

November 13, 2024

By Jay Baris and Nathan Greene, Sidley Austin LLP


Jay Baris


Nathan Greene

The bottom line: In the near term, it's not likely that the roles and activities of mutual fund directors will change much. There will be no pulling back from directors' fiduciary duties and core oversight responsibilities.

But we can expect to see a number of incremental changes that, when taken together over time, could significantly affect the regulatory landscape for funds and investment advisers, and thus fund directors indirectly. These changes likely will relate to the substance, scope, and pace of new regulations, how the Securities and Exchange Commission approaches enforcement actions, and how the SEC addresses new and innovative products and asset classes (e.g., crypto or retail access to private assets).

Of course, no one knows for sure how the incoming administration will change regulation of funds and independent directors (except, perhaps, President-elect Trump and a close advisor or two). And let's be real, it is unlikely that fund regulation—aside from promised support for digital assets—is a "day one" priority. By reading the tea leaves, however, we can make some educated guesses as to how the SEC is likely to approach challenges facing the advisers and independent directors they oversee. Speeches and statements of the Republican commissioners over the past couple of years provide at least the beginning of a roadmap.

Let's start with the composition of the SEC and then look at how the SEC may change its approach to rulemaking, enforcement, and other issues.

The SEC Commissioners. What will the Commission look like under the Trump Administration? The SEC currently consists of five commissioners. By law, no more than three commissioners can be affiliated with the same political party. The three Democratic commissioners are Chair Gary Gensler, Caroline Crenshaw, and Jaime Lizárraga. The two Republican commissioners are Hester Peirce and Mark Uyeda. Commissioners are appointed, with the advice and consent of the Senate, for five-year terms, with the ability to hold over for up to 18 months following the end of term. Commissioners Crenshaw and Peirce were both appointed in the first Trump Administration (and therefore have the shortest remaining tenures); the other three commissioners were appointed either at the outset of the Biden Administration (Chair Gensler) or more recently.

It is well known that there is no love lost between President-elect Trump and Chair Gensler. In July 2024, at the Bitcoin Conference 2024 in Nashville, the president-elect said: "On day one, I will fire Gary Gensler and appoint a new SEC chairman."

Whether a president can unilaterally remove an SEC chair (or other commissioner) at will is unclear and untested, but President Trump may attempt to do so anyway. Or Chair Gensler may act first. He may resign as chair and stay on as a commissioner and serve to the end of his term in 2026, or he may resign from the Commission altogether, as former SEC Chair Mary Jo White did in January 2017 at the end of the Obama Administration.

Either way, it is a safe bet that following the inauguration in January, Gensler will no longer be chair of the SEC. The financial press has mentioned a number of familiar names to succeed Gensler, including Commissioner Peirce, Commissioner Uyeda, and former Commissioners Dan Gallagher and Paul Atkins. Former SEC Chair Jay Clayton, who led the SEC during the first Trump Administration, is said to be under consideration for important roles away from the SEC.

As an aside, you might remember former Commissioner Atkins was then-President-elect Trump's point person for financial regulatory appointments on the transition team. Who will fill that role now is not yet clear.

Whoever the new chair will be, given the significant institutional authority and control of the agenda that comes with the role, he or she will have broad authority to direct the SEC staff to shape a wide range of policy initiatives.

Rulemaking. The SEC under Chair Gensler aggressively proposed a flurry of new rules affecting funds and investment advisers. The SEC adopted some initiatives (names rule, money market fund reform, tailored shareholder reports, to name a few), while others have been stalled (safekeeping of client assets, predictive data analytics), withdrawn due to intense opposition (swing pricing and hard close), or thrown out by the courts (depending on how the SEC's losses are tallied, at least eight rules from this period were stalled or tossed, including the private funds rule). Throughout, the SEC faced criticism that it proposed too many rules too quickly, without allowing for adequate opportunity for public comment.

We are likely to see the pace of new rules slow and engagement with industry stakeholders increase under a new chair for two primary reasons. First, the SEC's court losses have created a judicial speed bump, which effectively forces the next chair to proceed with greater caution. Second, the Republican commissioners have outlined a rulemaking philosophy that leans toward more public engagement and outreach by the commissioners and the staff. In April 2024, for example, Commissioner Peirce laid out a framework based on these principles: pare back the rulemaking agenda; engage with the public through concept releases, public roundtables and consensus workshops; propose realistic rules without "clickbait provisions" that generate many comments but won't be adopted; and encourage the SEC staff to clearly articulate the reasons for hold-ups of new registration statements and exemptive applications.

But, let's remember that the SEC under Chair Clayton adopted multiple consequential rules, including the ETF rule, the valuation rule, the derivatives rule, the fund-of-funds rule, and closed-end fund offering reform. Clayton's biography on the SEC's website describes him as having presided over "one of the busiest rulemaking calendars in Commission history."

A take-away, then: While the context suggests more care, caution, and engagement by the Commission and its staff, the SEC nonetheless may pursue an ambitious rulemaking agenda—regardless of president or party.

Enforcement. We can expect the new SEC chair to appoint a new director of the Division of Enforcement. While we can expect the Enforcement Division to continue to aggressively pursue actions against fraudsters when the evidence of wrongdoing is clear and investors have been harmed, we also predict that the Division will shift its priorities away from some areas that do not involve outright fraud. Some of the Republican commissioners have criticized the SEC for going after industry stakeholders in high-profile actions resulting in multimillion-dollar penalties when investors have not been hurt, or to send a strong message. Think recent cases against financial institutions for off-channel communications violations. The SEC, the critics said, could best achieve its objective of compliance with SEC rules through dialog and guidance, rather than high-profile enforcement.

Digital assets. Republican commissioners have consistently criticized the SEC for slow-walking new investment products, especially those involving crypto assets. Based on recent statements from the president-elect, recent statements and speeches by SEC commissioners, and pending legislative initiatives, it would be reasonable to see the SEC more amenable to fintech innovations coupled with investment education and other guardrails they would apply to crypto products. This is not to say that the SEC will take a hands-off approach to crypto. The SEC will (as it should) continue to go after bad actors and fraudsters in the crypto space.

ESG. The SEC has already disbanded its ESG task force. A further shift away from ESG investing and disclosures as a priority in rulemaking and enforcement will be sharp and definitive under a new administration. Think of this as a hard stop.

Fund boards and the section 15(c) process. The SEC only recently stepped up its focus on the contract renewal process, by focusing on information that boards request and review, and how funds disclose trustees' considerations in approving advisory contracts to shareholders. The SEC staff, in a sense, inserted itself into the contract renewal process by peeking into the boardroom via review of minutes and board materials. Some advisers and fund directors perceived this intrusion as aggressive, even hostile. We expect that the SEC will continue to evaluate how fund directors carry out their oversight responsibilities, but we hope that, going forward, the agency can achieve its goal of protecting investors by improving fund board governance in a way that is perceived as less intrusive and confrontational.

Retail access to private assets. There was a push under the prior (Clayton-led) Commission to further retail access to private assets. The SEC may kick-start this agenda, with rule proposals designed to accelerate a push for innovative new products and strategies for fund boards to evaluate and oversee. This push may especially affect directors of business development companies and so-called "alternative" strategy funds and ETFs.

Congress as a wildcard. The 118th Congress has enacted just over 80 laws, versus a historical norm of 200 to 600 over each bi-annual session. This statistic suggests that the current Congress is in bystander mode when it comes to financial regulation. If the Republicans obtain and hold together governing majorities in the House and Senate, we can expect to see broad legislative initiatives in fintech, regulation of digital assets, and other technical changes designed to encourage innovation in the financial markets. Similarly, the industry will have its own legislative priorities and might, for example, seek legislation to address the legal loopholes currently favored by closed-end fund activists to assemble large stakes in closed-end funds. As sure as night follows day, the SEC's agenda would shift to complying with congressional mandates to implement new laws—a rulemaking priority not seen since the post Dodd-Frank period.

Looking ahead. Listen to the tenor and tone of speeches and statements by the new SEC chair for signals that the SEC will engage more with funds, advisers, and their boards. Whether or not the SEC's regulatory and enforcement tone softens, do not expect the roles and activities of fund directors to change. Fund directors should, and will, continue to diligently carry out their fiduciary duties and advocate for the funds and shareholders they represent.

Jay Baris is a partner in the Investment Funds group at Sidley Austin and has practiced in the asset management area for more than 35 years. He has a breadth of experience representing registered funds, investment advisers, financial institutions, broker-dealers, and independent directors. His experience includes advising on the regulatory aspects of fund and investment advisory operations and representing numerous clients on mergers and acquisitions, reorganizations, exemptive applications, and compliance issues. Baris also advises operating companies on "status" issues that arise under the Investment Company Act of 1940, and more recently, he has been advising FinTech clients on how the federal securities laws apply to digital assets and cryptocurrencies. Baris hosts Sidley's Mutual Fund Minute podcast, is an adjunct professor of law at Brooklyn Law School, and chairs the Task Force on Blockchains, Cryptocurrencies and Investment Management of the Federal Securities Regulation Committee of the American Bar Association's Business Law Section.

Nathan Greene, also a partner in Sidley's Investment Funds group, advises on all aspects of fund and investment advisory operations. His practice includes representation of U.S. and foreign investment companies, advisers, and trustees; SEC registration, exemptions, inspections, and investigations for funds and advisers; board and governance matters; and high-profile corporate transactions involving asset management businesses. He also counsels funds and financial institutions on regulatory considerations around emerging technologies like blockchain, big data, and artificial intelligence.