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Audit Committee Quarterly Update

THIRD QUARTER 2023

This newsletter highlights some important 2023 third quarter issues facing audit committees. The content is not all-inclusive. You may also be interested in our quarterly publication, which summarizes accounting, financial reporting, and regulatory matters that may impact both public and private companies.

SEC adopts rules on cybersecurity risk management, strategy, governance, and incident disclosures by public companies

In July 2023, the SEC adopted **rules** requiring registrants to disclose material cybersecurity incidents they experience and to disclose on an annual basis material information regarding their cybersecurity risk management, strategy, and governance. The Commission also adopted rules requiring foreign private issuers to make comparable disclosures.

According to SEC Chair Gary Gensler, "currently, many public companies provide cybersecurity disclosure to investors. I think companies and investors alike, however, would benefit if this disclosure were made in a more consistent, comparable, and decision-useful way. Through helping to ensure that companies disclose material cybersecurity information, today's rules will benefit investors, companies, and the markets connecting them."

The new rules will require registrants to disclose on the new Item 1.05 of Form 8-K any cybersecurity incident they determine to be material and to describe the material aspects of the incident's nature, scope, and timing, as well as its material impact or reasonably likely material impact on the registrant. An Item 1.05 Form 8-K will generally be due four business days after a registrant determines that a cybersecurity incident is material; however, delay may be permitted in circumstances where immediate disclosure would pose a substantial risk to national security or public safety and notifies the Commission of such determination in writing.

The new rules also add Regulation S-K Item 106, which will require registrants to describe their processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats, as well as the material effects or reasonably likely material effects of risks from cybersecurity threats and previous cybersecurity incidents. Item 106 will also require registrants to describe the board of directors' oversight of risks from cybersecurity threats and management's role and expertise in assessing and managing material risks from cybersecurity threats. These disclosures will be required in a registrant's annual report on Form 10-K.

The final rules became effective 30 days following publication of the adopting release in the Federal Register. The Form 10-K disclosures will be due beginning with annual reports for fiscal years ending on or after Dec. 15, 2023. The Form 8-K and Form 6-K disclosures will be due beginning the later of 90 days after the date of publication in the Federal Register or Dec. 18, 2023. Smaller reporting companies will have an additional 180 days before they must begin providing the Form 8-K disclosure. With respect to compliance with the structured data requirements, all registrants must tag disclosures required under the final rules in Inline XBRL beginning one year after initial compliance with the related disclosure requirement.

SEC enhances the regulation of private fund advisers

In August 2023, the SEC adopted new **rules and rule amendments** to enhance the regulation of private fund advisers and update the existing compliance rule that applies to all investment advisers. The new rules and amendments are designed to protect private fund investors by increasing transparency, competition, and efficiency in the private funds market.

"Private funds and their advisers play an important role in nearly every sector of the capital markets," said SEC Chair Gary Gensler. "By enhancing advisers' transparency and integrity, we will help promote greater competition and thereby efficiency."

To enhance transparency, the final rules will require private fund advisers registered with the Commission to provide investors with quarterly statements detailing certain information regarding fund fees, expenses, and performance. In addition, the final rules will require a private fund adviser registered with the Commission to obtain and distribute to investors an annual financial statement audit of each private fund it advises and, in connection with an adviser-led secondary transaction, a fairness opinion or valuation opinion.

To better protect investors, the final rules will prohibit all private fund advisers from providing investors with preferential treatment regarding redemptions and information if such treatment would have a material, negative effect on other investors. In all other cases of preferential treatment, the Commission adopted a disclosure-based exception to the proposed prohibition, including a requirement to provide certain specified disclosure regarding preferential terms to all current and prospective investors.

In addition, the final rules will restrict certain other private fund adviser activity that's contrary to the public interest and the protection of investors. Advisers generally won't be prohibited from engaging in certain restricted activities, so long as they provide appropriate specified disclosure and, in some cases, obtain investor consent. The final rules, however, won't permit an adviser to charge or allocate to the private fund certain investigation costs where there is a sanction for a violation of the Investment Advisers Act of 1940 or its rules.

To avoid requiring advisers and investors to renegotiate governing agreements for existing funds, the Commission adopted legacy status provisions applicable to certain of the restricted activities and preferential treatment provisions. Such legacy status will apply to those governing agreements entered into in writing prior to the compliance date and with respect to funds that have commenced operations as of the compliance date.

SEC adopts rule enhancements to prevent misleading or deceptive investment fund names

In September 2023, the SEC adopted **amendments** to the Investment Company Act "Names Rule," which addresses fund names that are likely to mislead investors about a fund's investments and risks. The amendments modernize and enhance the Names Rule and other names-related regulatory requirements to further the Commission's investor protection goals and to address developments in the fund industry in the approximately 20 years since the rule was adopted.

"As the fund industry has developed over the last two decades, gaps in the current Names Rule may undermine investor protection," said SEC Chair Gary Gensler. "Today's final rules will help ensure that a fund's portfolio aligns with a fund's name. Such truth in advertising promotes fund integrity on behalf of fund investors."

Typically, a fund's name is the first piece of information that investors receive about a fund, and fund names offer important signaling for investors in assessing their investment options. The Names Rule currently requires registered investment companies whose names suggest a focus in a particular type of investment to adopt a policy to invest at least 80% of the value of their assets in those investments. The amendments to the Names Rule will enhance the rule's protections by requiring more funds to adopt an 80% investment policy, including funds with names suggesting a focus in investments with particular characteristics, for example, terms such as "growth" or "value," or certain terms that reference a thematic investment focus, such as the incorporation of one or more environmental, social, or governance (ESG) factors. The amendments will also include a new requirement that a fund review its portfolio assets' treatment under its 80% investment policy at least quarterly and will include specific time frames — generally 90 days — for getting back into compliance if a fund departs from its 80% investment policy.

The amendments will include enhanced prospectus disclosure requirements for terminology used in fund names, including a requirement that any terms used in the fund's name that suggest an investment focus must be consistent with those terms' plain English meaning or established industry use. The amendments will also include additional reporting and recordkeeping requirements for funds regarding compliance with the names-related regulatory requirements.

The amendments will become effective 60 days after publication in the Federal Register. Fund groups with net assets of $1 billion or more will have 24 months to comply with the amendments, and fund groups with net assets of less than $1 billion will have 30 months to comply.