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Quarterly Survey of SEC Rulemaking and Major Court Decisions (October 1, 2024 – December 31, 2024)

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This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from October 1, 2024 through December 31, 2024.

This quarter, the SEC proposed no new rules and approved seven final rules. The final rules released this quarter endeavor to insulate market participants from the risks of the U.S securities market and protect the assets of investors who use broker-dealers.

Final Rules

Rules Related to Improving Risk Management and Resilience of Covered Clearing Agencies

On October 25, 2024, the SEC adopted amendments to 1934 Act Rule 17Ad-22(e)(6)(ii) and Rule 17Ad-22(e)(6)(iv) and adopted new 1934 Act Rule 17Ad-26 in an effort to (1) strengthen existing rules related to a covered clearing agency's ("CCA") (a) collection of intraday margin, and (b) use of substantive inputs in its risk-based margin system; and (2) establish requirements for CCAs' recovery and orderly wind-down plan ("RWP"). Individually and collectively, these updates to the regulatory framework of CCAs aim to help ensure the stability of the U.S. securities market by emphasizing effective risk management, maintaining the financial stability of CCAs and ensuring the continuity of critical central counterparty ("CCP") and central securities depository functions ("CSD") for their market and market participants.

CCAs are clearing agencies registered with the SEC. These clearing agencies function as either (1) CCPs, meaning they help facilitate securities transactions between two counterparties by

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acting as the buyer for the seller and the seller to the buyer, or (2) CSDs, meaning they operate a centralized system for the handling and exchange of securities certificates. These functions enable CCAs to serve an important role in the securities market as they enable securities to trade efficiently and help ensure that trades occur in an organized and secure manner.

CCAs "collect intraday margin" when they demand additional collateral from counterparties during the trading day to offset heightened credit risks. Collecting intraday margin helps make sure that counterparties continuously meet the financial obligations of their trades as market conditions change. By collecting intraday margin, CCAs protect against the possibility of a participant defaulting due to unforeseen market movements. This practice also allows CCAs to be reliable central counterparties, maintain trust in the financial system and facilitate the seamless settlement of trades even when one party fails to fulfill its obligations.

Due to the critical role of CCAs, it is vital that they receive effective regulation and management to withstand the impact of stressed market conditions.

Collection of Intraday Margin

The SEC amended Rule 17Ad-22(e)(6)(ii) of the 1934 Act to require that CCAs establish comprehensive systems and policies for ongoing intraday monitoring. Intraday monitoring refers to the real-time assessment of credit risks and exposures that develop throughout the trading day. Ongoing monitoring can help CCAs detect potential increases in credit exposure and respond promptly to mitigate risks. In essence, this approach protects market participants by requiring CCAs to monitor that counterparties maintain adequate collateral to secure their obligations and aims to prevent systemic disruptions caused by unforeseen financial shortfalls.

Additionally, the systems required under this amendment must enable CCAs to make intraday margin calls whenever necessary - for example, when pre-specified risk thresholds are breached or when the markets they serve exhibit significant volatility. Previously, Rule 17Ad-22(e)(ii) required a CCA to have the ability to monitor for intraday exposure and make intraday margin calls, but did not require CCAs to monitor for intraday exposure, nor did it specify the frequency at which CCAs should monitor intraday margin exposure. The SEC anticipates this requirement will curtail gaps in risk coverage that may develop during the trading day, and as a result, promote financial stability.

To keep CCAs accountable, the SEC has also mandated that CCAs document instances where they decide against issuing an

intraday margin call despite indicators suggesting they should. The purpose of this requirement is to promote transparency around the decision-making process of the CCAs and to confirm that they follow the established risk-management frameworks.

When the SEC issued the proposed rule related to this amendment it drew many public comments, many of which emphasized the importance of aligning this requirement with existing state-level regulations to avoid redundancy. While some industry commenters expressed concerns about the operational burden of real-time monitoring of intraday margin, the SEC emphasized that the long-term benefits of the amendment outweigh any challenges. Furthermore, this amendment complements broader regulatory goals by ensuring that CCAs can sustain their obligations under volatile market conditions.

Use of Substantive Inputs in Risk-Based Margin System

The amendments to Rule 17Ad-22(e)(6)(iv) of the 1934 Act focus on ensuring the reliability of risk-based margin systems. Risk-based margin systems calculate the collateral required from participants based on the level of risk their transactions pose to the CCA. Accurate and timely data inputs are essential for CCAs to calculate margins effectively. This amendment requires that risk-based margin systems use price data or substantive inputs from an alternate source when such information is not readily available. In the absence of an alternate source, the amendment requires CCAs to use an alternate risk-based margin system that does not similarly rely on the unavailable or unreliable substantive input.

The SEC crafted this amendment to address vulnerabilities in risk-based margin systems as overreliance on a single data source can disrupt margin calculations during technological outages or other unforeseen inconveniences. Mandating contingency plans or alternate inputs mitigates these risks while ensuring market stability. By addressing these issues, the rule aligns with broader regulatory efforts to strengthen the resilience of financial institutions.

This amendment builds on the SEC's prior proposals, which include those aimed at ensuring that CCAs maintain robust operational controls in high-stakes environments. By requiring that CCAs prepare for data disruptions, the SEC aims to strengthen market resiliency.

Content Requirements for RWPs

To complement the foregoing amendments, the SEC introduced new 1934 Act Rule 17Ad-26, which outlines content requirements for RWPs. RWPs are critical tools for ensuring that CCAs can ei-

ther recover from severe financial stress or wind down their operations in an orderly manner without destabilizing the broader financial system.

Under the this final rule, a CCA's RWP must:

- Identify and describe (1) the CCA's core payment, clearing, and settlement services, (2) address how the CCA would continue to provide those services during a recovery or orderly wind-down, including identifying the staffing necessary to support those services and (3) analyze how the staffing roles would continue during a recovery or orderly wind-down;
- Identify and describe (1) service providers for core services, (2) specify which core services each service provider supports and (3) address how the CCA would ensure those service providers would continue during a recovery or orderly wind-down;
- Identify and describe scenarios that may potentially prevent the CCA from being able to provide its core services as a going concern, including uncovered credit losses, uncovered liquidity shortfalls, and general business losses;
- Identify and describe (1) criteria that could trigger the CCA's implementation of the RWP and (2) the process that the CCA uses to monitor and determine whether the criteria have been met, including the applicable governance arrangements;
- Identify and describe (1) the rules, policies, procedures, and any other tools or resources on which the CCA would rely in a recovery or orderly wind-down and (2) address how the identified rules, policies, procedures, and any other tools or resources would ensure timely implementation of the RWP;
- Require the CCA to inform the SEC as soon as practicable when the CCA is considering implementing a recovery or orderly wind-down;
- Include procedures that (1) test the CCA's ability to implement its RWPs at least once a year, (2) require the participation of the CCA's participants and, if possible, other stakeholders in testing, (3) require that testing to be separate from testing required under 1934 Act Rule 17Ad-22(e)(13) and reported to the CCA's board of directors and senior management, and (4) explain how the RWPs will be updated to address the findings from the tests;
- Include procedures requiring the CCA's board of directors to review and approve the RWPs (a) at least once a year or (b) following material changes to the CCA's operations that would significantly affect the RWP's viability or execution, with such review informed, as appropriate by the RWP testing.

This new rule aligns with the SEC's broader strategy to enhance financial stability by preparing CCAs for extreme stress scenarios and aims to reduce the likelihood of cascading failures within the financial system.

Effectiveness and Compliance Dates

Under the 1934 Act, a registered CCA is a self-regulatory organization ("SRO"). As an SRO, a CCA is subject to Section 19(b) of the 1934 Act, which requires SROs to provide the public with notice and an opportunity to comment on the SRO's proposed rule changes. Compliance with the new rules adopted by the SEC this quarter may require a CCA to propose rule changes to how they operate. These proposed rule changes must be filed with the SEC. Additionally, a CCA may be considered a systemically important financial market utility ("SIMFU") subject to Section 806(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires an SIFMU to provide advanced notice of material changes to its rules, procedures, or operations that could materially affect the nature or level of risks. Each CCA must file any required proposed rule changes or advanced notices by April 17, 2025. The proposed rule changes and advanced notices must become effective no later than December 13, 2025.

Enhancements to the Broker-Dealer Customer Protection Rule

On December 20, 2024, the SEC adopted amendments to 1934 Act Rule 15c3-3 (the "Customer Protection Rule") in an effort to further protect the investing public. The Customer Protection Rule requires broker-dealers that maintain custody of customer securities and cash ("Carrying Broker-Dealers") to have a special reserve account at a bank that must hold cash and/or qualified securities in an amount determined by a computation of the net cash owed to Carrying Broker-Dealers' customers.

Customer Reserve Computation

Under the Customer Protection Rule, Carrying Broker-Dealers are required to compute the net amount of cash owed to customers under a formula set forth under the rule ("Customer Reserve Computation"). Prior to adoption of this final rule, Carrying Broker-Dealers were required to perform the Customer Reserve Computation and make any required deposits in a special reserve account at a bank on a weekly basis. Similar requirements apply to how a Carrying Broker-Dealer must treat proprietary securities and cash it holds for other broker-dealers, known as proprietary accounts of broker-dealers ("PAB Accounts").

Under this final rule, Carrying Broker-Dealers that have aver-

age total credits that are equal to or greater than $500 million must conduct the Customer Reserve Computation on a daily basis rather than a weekly basis. The final rule defines average total credits as the arithmetic mean of the sum of total credits reported in a Carrying Broker-Dealer's customer and PAB Accounts reserve computations reported in the Carrying Broker-Dealer's 12 most recently filed month-end financial and operational reports ("FOCUS Reports"). Thus, the average total credits are a 12-month rolling average, as the Carrying Broker Dealer must add up the sum of the total credits reported in the customer and PAB Accounts reserve computations in each of the 12 most recently filed month-end FOCUS Reports and divide that amount by 12 to calculate the arithmetic mean of the total credits.

Under this final rule, a Carrying Broker-Dealer will be required to comply with the daily Customer Reserve Computation no later than six months after its average total credits equal or exceed $500 million. In the event that a Carrying Broker-Dealer's 12-month rolling average of total credits falls below $500 million, such Carrying Broker-Dealer must continue to perform the Customer Reserve Computation on a daily basis until it provides written notification to its designated examining authority ("DEA") of its election to perform weekly computations. A Carrying Broker-Dealer must provide this written notification 60 days prior to reverting to weekly computations.

Reducing the Aggregate Debit Reduction

Prior to adoption of this final rule, Carrying Broker-Dealers, as part of the customer reserve protections described above, were required to reduce the value of debits items (i.e., customer-related receivables) in the Customer Reserve Computation by either 1% (for debit balances in customers' cash and margin accounts) or 3% (for aggregate debit items which includes all debit items). Whether a Carrying Broker-Dealer must apply the 1% or 3% debit reduction is dependent on how such Carrying Broker-Dealer calculates its minimum net capital requirement under Rule 15c3-1 of the 1934 Act. Rule 15c3-1 of the 1934 Act requires that broker-dealers maintain a minimum level of net capital at all times. The minimum net capital requirement for broker-dealers is calculated by either using the basic method which requires no greater than a 15-to-1 ratio of the broker-dealer's aggregate indebtedness to the broker-dealer's net capital or by using the alternative method which requires that the broker-dealer's net capital is at least 2% of the broker-dealer's aggregate debit items.

Prior to adoption of this final rule, under 1934 Act Rule 15c3-1, a Carrying Broker-Dealer using the alternative method must reduce aggregate debit items (i.e., the total of all debit items in

the Customer Reserve Computation) by 3% when performing its Customer Reserve Computation under Rule 15c3-3 of the 1934 Act. Pursuant to this final rule, a Carrying Broker-Dealer that performs daily Customer Reserve Computations now must only reduce its aggregate debit items by 2% rather than 3%, which will likely lead to a decrease in the amount that must be on deposit in customer reserve accounts. Carrying Broker-Dealers with less than $500 million in average total credits that use the alternative method to calculate its net capital may voluntarily perform a daily Customer Reserve Computation and, in so doing, apply the 2% debit reduction rather than the 3% debit reduction if they notify its DEA at least 30 days prior to beginning the daily computation. If a Carrying Broker-Dealer that voluntarily performs a daily Customer Reserve Computation determines to revert to a weekly computation, it must receive prior approval from its DEA. If such Carrying Broker-Dealer reverts to performing a weekly Customer Reserve Computation, it must also revert to applying a 3% debit reduction.

Effectiveness and Compliance Dates

The final rules will become effective 60 days following publication of the adopting release in the Federal Register. Carrying Broker-Dealers that exceed the $500 million threshold using each of the 12 filed month-end FOCUS Reports from July 31, 2024 through June 30, 2025 must perform customer and PAB Account reserve computations daily beginning no later than December 31, 2025. On or after the effective date, a Carrying Broker-Dealer may voluntarily perform a daily Customer Reserve Computation and apply the 2% debit reduction, provided that it provides at least 30 days' prior written notice to its DEA.

Major Court Decisions

Fifth Circuit Court of Appeals Vacates Nasdaq Diversity Rules

On December 11, 2024, the United States Court of Appeals for the Fifth Circuit, in a 9-8 *en banc* decision, held that Nasdaq's diversity rules were inconsistent with the Securities Exchange Act of 1934. Those diversity rules would require Nasdaq-listed companies to: (i) provide statistical information on its board of directors' gender, race, and self-identification as LGBTQ+; (Rule 5606); and (ii) have at least one director that self-identifies as female, and at least one director that self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islands, two or more races or ethnicities, or LGBTQ+, or explain why the company

does not have at least two directors on its board who meet those categories (Rule 5605(f) (together, the "Nasdaq Diversity Rules")). Nasdaq also submitted proposed Rule IM-5900-9 (together with Rules 5606 and 5605(f), the "Recruiting Rule"), which would provide complimentary access to recruiting resources for diverse board candidates for companies that failed to meet diversity objectives contained in Rule 5605(f).

The U.S. Securities and Exchange Commission ("SEC" or "the Commission") approved each of the Nasdaq Diversity Rules and Recruiting Rule in separate orders. The Alliance for Fair Board Representation ("AFBR") and the National Center for Public Policy Research ("NCPPR"), sought review of the Commission's decision in the Fifth and Third Circuits, respectively. The cases were subsequently consolidated before the Fifth Circuit. On October 18, 2023, the Fifth Circuit denied the petitions for review, and held that the SEC's approval of the Nasdaq Diversity Rules complied with the Securities Exchange Act of 1934 and Administrative Procedure Act. The Fifth Circuit then granted a petition for rehearing *en banc*.

The *en banc* majority held that the Nasdaq Diversity Rules "cannot be squared" with the Securities Exchange Act of 1934. The majority rejected the Nasdaq Diversity Rules as bearing "no relationship" to the purposes of the Securities Exchange Act of 1934, and held that the major questions doctrine applies and confirms the majority's interpretation of the statute. The majority thus granted the consolidated petitions for review and vacated the SEC's order approving Nasdaq's Diversity Rules, but denied as moot the petition for review of the Recruiting Rule.

Eight judges dissented, arguing that the SEC properly approved the Nasdaq Diversity Rules, because "the reviewing scheme that Congress created doesn't permit the SEC to displace Nasdaq's private business judgment - informed by investor behavior - with agency policy priorities."

All. for Fair Bd. Recruitment, et al. v. SEC., case no. 21-60626, in the United States Court of Appeals for the Fifth Circuit.

Fifth Circuit Holds that SEC No-Action Letter Does Not Constitute Final Agency Order and Is Outside the Scope of Judicial Review

On November 14, 2024, the United States Court of Appeals for the Fifth Circuit dismissed an appeal on two jurisdictional grounds: (1) mootness; and (2) lack of subject matter jurisdiction, holding that a no-action letter was informal and nonbinding staff advice, and thus not a reviewable order by the U.S. Securities and Exchange Commission (the "SEC" or "Commission").

The National Center for Public Policy Research (the "Center"),

a shareholder of the Kroger Company, appealed to the United States Court of Appeals for the Fifth Circuit after the Kroger Company refused to include the Center's proposal in the company's 2023 proxy materials. The Kroger Company initially refused to include the Center's proxy statement and notified Commission staff of its intent to exclude it. After the Commission responded with a "no-action" letter agreeing that Kroger had "some basis" to exclude the proposa, the Center asked the Commission to reconsider, but was unsuccessful. The Center appealed directly to the Fifth Circuit Court of Appeals. While the appeal was pending, the Kroger Company ultimately included the Center's proposal in its 2023 proxy materials.

The Commission moved to dismiss the Center's appeal on two grounds: mootness and lack of subject matter jurisdiction over the challenged no-action letter. First, the Commission argued that the Kroger Company's inclusion of the Center's proposal in its 2023 proxy materials caused the case to become moot. The Fifth Circuit Court of Appeals agreed. Second, the Fifth Circuit held that it lacked subject matter jurisdiction to review the case because the disputed no-action letter was not final or binding, and did not represent an official expression of the Commission's views. The Fifth Circuit reasoned that, unlike an official final Commission order that would be reviewable, the no-action letter was issued by Commission staff and served merely as informal guidance that was not subject to judicial review.

Ntl Ctr for Pub Plcy Rsrch v. SEC., case no. 23-60230 in the United States Court of Appeals for the Fifth Circuit.

Corporate Transparency Act Enjoined as Potentially Unconstitutional

On December 26, 2024, in another blow to the Corporate Transparency Act ("CTA"), a panel from the United States Court of Appeals for the Fifth Circuit vacated a decision of another panel of that same court —issued just three days earlier—staying enforcement of a preliminary injunction enjoining enforcement of the CTA.

The CTA was passed in 2021, and obligated certain companies to report the identities of their beneficial owners by January 1, 2025. On May 28, 2024, a group of Plaintiffs commenced an action in the United States District Court for the Eastern District of Texas seeking a declaratory judgment that the CTA is unconstitutional. On June 3, 2024, Plaintiffs moved for a preliminary injunction against enforcement of the CTA and related reporting rule. The District Court granted that injunction on December 3, 2024, enjoining the CTA and corresponding reporting rule, and holding that both are likely unconstitutional. The government moved for a stay of the District Court's injunction.

On December 23, 2024, a motions panel of the United States Court of Appeals for the Fifth Circuit granted the government a temporary stay of a District Court's injunction pending appeal, and expedited the appeal. The motions panel held that the government was likely to succeed on the merits in defending the CTA's constitutionality, the injunction inflicts irreparable harm, and equities and public interest weigh in favor of a stay. Just three days later, another panel of the Fifth Circuit reversed and vacated the December 23, 2024 stay of the District Court's injunction in a two-page Order in order to "preserve the constitutional status quo" while the merits panel considers the appeal. As a result, the CTA remains in limbo and for now, at least temporarily, unenforceable.

Texas Top Cop Shop v. Garland, case no. 24-40792, in the United States Court of Appeals for the Fifth Circuit.[1]

NOTES:

[1]Earlier this year, the Supreme Court stayed the injunction blocking enforcement of the CTA, and the matter returned to the Fifth Circuit, with oral argument scheduled for March 25, 2025. Meanwhile, on January 7, 2025, the United States District Court for the Eastern District of Texas issued an injunction staying reporting requirement under the CTA in Smith v. United States Department of Treasury. Then, on March 2, 2025, the Treasury Department issued a press release stating that it will not enforce penalties or fines in connection with the CTA and will "be issuing a proposed rulemaking that will narrow the scope of the rule to foreign reporting companies only."

