Simpson Thacher

Regulatory and Enforcement Alert

SEC Drops First Ever Liquidity Rule Suit Against Mutual Fund Adviser and Officers and Trustees

July 15, 2025

On July 11, 2025, the SEC announced that it had filed a joint stipulation with Defendants Pinnacle Advisors, LLC ("Pinnacle"), two of Pinnacle's officers, and two mutual fund independent trustees to dismiss with prejudice the SEC's first-ever case seeking to enforce the Liquidity Rule. The SEC's case against Pinnacle was filed by a Chair Gensler-led SEC in 2023. The Liquidity Rule requires each 1940 Act-registered open-end fund to manage liquidity risk by adopting and implementing a written program called a Liquidity Risk Management Program ("LRMP") [1] and limits, among other things, a 1940 Act-registered open-end fund from acquiring any illiquid investment [2] if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in illiquid investments.[3]

In the litigation, the SEC had alleged that Pinnacle and two of its officers aided and abetted Liquidity Rule violations by a mutual fund they advised and whose LRMP they administered and aided and abetted the fund's violations of Rule 30b1-10 under the 1940 Act (relating to the filing of current reports). The SEC also charged both of the Pinnacle fund's independent trustees with aiding and abetting violations of the Liquidity Rule. The SEC's complaint alleged that for a 12-month period from 2019 to 2020, the Pinnacle fund held approximately 21% to 26% of its net assets in illiquid investments. The SEC also alleged that Pinnacle classified the fund's largest illiquid investment as a "less liquid investment,"[4] did not present a plan to reduce the fund's illiquid investments to 15% or lower to the fund's board, and did not make required filings with the SEC, all in violation of the Liquidity Rule. The SEC's complaint also alleged that Pinnacle misled the SEC's Division of Investment Management Staff when it described the basis for classifying a fund asset as "less liquid." The SEC alleged that the Pinnacle fund's board, including the independent trustees, aided and abetted the fund's violations by "knowingly or recklessly

[1] 17 CFR § 270.22e-4(b).

[2] An "illiquid investment" is defined as "any investment that the fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment . . . ." 17 CFR § 270.22e-4(a)(8).

[3] In addition, in the event that a fund's illiquid investments exceed 15% of its net assets, the LRMP administrator must report to the fund's board the reason why the fund's illiquid investments exceeded 15% of net assets and present a plan for bringing its illiquid investments to or below 15% within a reasonable period of time. 17 CFR § 270.22e-4(b)(iv)(A). If after 30 days the fund's illiquid investments still exceed 15% of net assets, the fund's board, including a majority of the directors who are not interested persons of the fund, must assess whether the plan to reduce illiquid investments presented to it continues to be in the best interest of the fund. 17 CFR § 270.22e(4)(b)(iv)(B).

[4] A "less liquid investment" is defined as "any investment that the fund reasonably expects to be able to sell or dispose of in current market conditions in seven calendar days or less without the sale or disposition changing the market value of the investment. . .but where the sale or disposition is reasonably expected to settle in more than seven calendar days." 17 CFR § 270.22e(4)(a)(10).

provid[ing] substantial assistance" to the fund with respect to its violations of the Liquidity Rule. The SEC's complaint asked the court to enjoin Pinnacle and related individuals from aiding and abetting further violations and to assess civil monetary penalties.

Pinnacle and its two defendant officers moved to dismiss the complaint in 2023 for failure to state a claim, challenging the validity of the Liquidity Rule itself by arguing that Congress had not given the SEC authority to promulgate liquidity rules for investment companies.[5] After the Supreme Court's 2024 landmark decision in *Loper Bright* that overruled the *Chevron* doctrine and generally eliminated judicial deference to federal agencies' interpretations of their rule-making powers[6], the court in *Pinnacle* asked defendants to resubmit their motions to dismiss to address the *Loper Bright* decision. The defendants' renewed motions to dismiss filed in April 2025 included strengthened arguments that the SEC lacked authority to promulgate the Liquidity Rule pointing to *Loper Bright* as the basis upon which the court should find the rule invalid. Shortly thereafter, in May 2025, the parties informed the court that they had agreed to a resolution in principle. In finalizing the dismissal last Friday, the SEC noted in the joint stipulation that the "Commission's decision to seek dismissal of this Litigation with prejudice does not necessarily reflect the Commission's position on any other case." The accompanying Litigation Release indicated that the SEC's dismissal resulted from "the exercise of its discretion and as a policy matter."[7] To date, the SEC has not made any other public remarks about the dismissal.

It remains to be seen if the SEC will choose to seek enforcement of other potential alleged violations of the Liquidity Rule or if it will avoid doing so, potentially to avoid the risk that a court could vacate the Liquidity Rule on the grounds that the SEC lacked statutory authority to adopt the Liquidity Rule.

As a broader observation, this dismissal continues the expected deregulatory trend in the current administration, including other instances of the SEC walking away from litigation authorized by the Gensler SEC,[8] as well as the SEC recently withdrawing 14 previously proposed rulemakings that had been issued between 2020 and 2023.[9]

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[5] The two mutual fund independent trustee defendants filed a separate motion to dismiss asserting additional arguments as to why the SEC failed to state a claim for aiding and abetting.

[6] *Loper Bright Enters. v. Raimondo*, 603 U.S. 369 (2024).

[7] *See* July 11, 2025 Litigation Release.

[8] *See, e.g.*, *SEC v. Balina*, 22-cv-950 (W.D. Tex. May 1, 2025) (crypto); *SEC v. Dragonchain*, 22-cv-1145-JNW (W.D. Wash. April 24, 2025) (crypto); *SEC v. Cumberland DRW*, 24-cv-9842 (N.D. Ill. Mar. 27, 2025) (crypto); *SEC v. Payward (d/b/a Kraken)*, 23-cv-6003-WHO (N.D. Cal. Mar. 27, 2025) (crypto); *SEC v. Consensys Software*, 24-cv-4578-MKB-TAM (E.D.N.Y. Mar. 27, 2025) (crypto); *SEC v. Coinbase*, 23-cv-4738-KPH (S.D.N.Y. Feb. 27, 2025) (crypto); *SEC v. Long*, No. 23-cv-14260 (N.D. Ill. May 22, 2025) (failure to register as dealer); *SEC v. Tri-Bridge Ventures*, No. 24-cv-5711-ZNQ-RLS (D.N.J. May 22, 2025) (failure to register as dealer); *SEC v. LG Capital Funding*, No. 22-cv-3353 (E.D.N.Y. May 22, 2025) (failure to register as dealer); *SEC v. River North*, No. 19-cv-1711 (N.D. Ill. May 22, 2025) (failure to register as dealer); *SEC v. Silver Point Capital*, 24-cv-2018 (D. Mass. April 4, 2025) (MNPI policies).

[9] Among other withdrawn proposed rules, the SEC withdrew the Safeguarding Rule (the proposed replacement for the Custody Rule), rules requiring disclosure of ESG practices, rules on outsourcing to service providers, cybersecurity risk and breach rules, and rules concerning predictive analytics that covered AI-related conflicts. *See* Rulemaking Activity.

To date, the SEC's focus under the current administration has generally been on these deregulatory items, as certain leadership positions remain to be filled and while Chair Atkins seeks to crystallize his regulatory agenda. However, it bears noting that exam and enforcement programs remain operational, and enforcement has filed a few recent settlements with investment advisers.[10]

In conclusion, investment advisers and boards should continue to monitor for developments in the SEC space — and dismissals can be just as instructive in signaling changes in the current SEC's priorities as are new enforcement actions.

For further information regarding this Alert, please contact one of the following authors:

WASHINGTON, D.C.

Adam S. Aderton
+1-202-636-5549
adam.aderton@stblaw.com

Anne C. Choe
+1-202-636-5997
anne.choe@stblaw.com

Meaghan A. Kelly
+1-202-636-5542
mkelly@stblaw.com

BOSTON

David W. Blass
+1-617-778-9031
david.blass@stblaw.com

Andrew M. Ward
+1-617-778-9037
andrew.ward@stblaw.com

NEW YORK CITY

Michael J. Osnato, Jr.
+1-212-455-3252
michael.osnato@stblaw.com

[10] For example, on February 14, 2025, the SEC announced a settlement with a registered investment adviser and an associated individual for breach of fiduciary duties to clients by failing to disclose that their recommendations to clients would result in significantly higher fees and increased compensation for the associated individual and failure to disclose the resulting conflict of interest. On June 3, 2025, the SEC announced a settlement with a state-registered investment adviser and its principal for a cherry-picking scheme whereby the adviser allocated profitable trades to the accounts of the principal, his family, and the adviser's account, while allocating unprofitable trades to 78 advisory client accounts, resulting in $112,667 in losses.