Simpson Thacher

Registered Funds Regulatory Update

January 6, 2025

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SEC Staff Guidance

SEC Division of Examinations Announces 2025 Examination Priorities

On October 21, 2024, the SEC's Division of Examinations released its 2025 Examination Priorities, aligning the release of the priorities with the start of the SEC's fiscal year for the second straight year in a row. As was the case last year, the goal with releasing the priorities alongside the start of the fiscal year is to provide earlier insight to its focus areas for the upcoming year. The following sets forth an overview of the Division's 2025 examination priorities.

Investment Companies. The Division will continue to prioritize examining registered investment companies given their importance to retail investors, particularly those saving for retirement. Examination focus areas may include:

- review of fees and expenses, and any associated waivers and reimbursements, and whether funds have adopted effective written compliance policies and procedures regarding oversight of advisory fees;
- oversight of service providers (both affiliated and third-party);
- review of portfolio management practices and disclosures for consistency with claims about investment strategies or approaches and with fund filings and marketing materials; and
- issues associated with market volatility.

The Division will also continue to monitor certain developing areas of interest, such as registered investment companies with exposure to commercial real estate and compliance with new and amended rules. Further, consistent with the Division's approach for investment advisers, the Division will continue to have a particular focus on newly registered funds that have never been examined before and those that have not been recently examined.

Investment Advisers. The Division will continue to review a registered investment adviser's adherence to its duty of care and duty of loyalty to its clients by focusing on:

- investment advice provided to clients regarding products, investment strategies, and account types and whether such advice satisfies the fiduciary obligations owed by the registered investment adviser to their clients. In particular, the Division will focus on recommendations related to: (i) high-cost products; (ii) unconventional instruments; (iii) illiquid and difficult-to-value assets; and (iv) assets sensitive to higher interest rates or changing market conditions, including commercial real estate;

- dual registrants and advisers with affiliated broker-dealers, including in particular the following common areas of focus: (i) assessing investment recommendations regarding certain products to determine whether they are suitable for client advisory accounts; (ii) reviewing disclosures to clients regarding the capacity in which recommendations are made; (iii) reviewing the appropriateness of account selection practices (e.g., brokerage versus advisory), including rollovers from an existing brokerage account to an advisory account; and (iv) assessing whether and how advisers adequately mitigate and fairly disclose conflicts of interest; and
- the impact of advisers' financial conflicts of interest on providing impartial advice and best execution, with consideration given for non-standard fee arrangements.

The Division also remains focused on adviser compliance programs and compliance program reviews and will assess whether the policies and procedures are sufficient to support compliance with the adviser's fiduciary obligations. Examinations in relation to an assessment of the effectiveness of advisers' compliance programs typically include an evaluation of the core areas of such compliance programs, including, as applicable, marketing, valuation, trading, portfolio management, disclosure and filings, and custody, as well as an analysis of advisers' annual reviews of the effectiveness of their compliance programs. In particular, the Division called out the following as areas in which the Division's examinations may focus:

- fiduciary obligations of advisers that outsource investment selection and management;
- alternative sources of revenue or benefits advisers receive, such as selling non-securities based products to clients; and
- the appropriateness and accuracy of fee calculations and the disclosure of fee-related conflicts, such as those associated with select clients negotiating lower fees when similar services are provided to other clients at a higher fee rate.

The Division's review of an adviser's compliance program may focus on or go into greater depth depending on its specific practices or products. For instance, examinations of advisers in the commercial real estate space may have a heightened focus on valuation given the highly illiquid nature of real estate assets.

Information Security and Operational Resiliency. The Division will continue to review registrant practices to prevent interruptions to mission critical services and to protect investor information, records, and assets. The Division's exams will focus on firms' policies and procedures, governance practices, data loss prevention, access controls, account management, and responses to cyber-related incidents, including those related to ransomware attacks. Further, the Division will assess registrant compliance with Regulations S-ID and S-P, which pertain to identity theft protection and safeguarding customer records, respectively. In particular, the Division will review compliance with Regulation S-ID and S-P by focusing on:

- identification and detection to prevent and protect against identity theft during customer account takeovers and fraudulent transfers;

- firm practices to prevent account intrusions and safeguard customer records and information, including personally identifiable information, especially as it pertains to firms with multiple branch offices; and
- firm training relating to its identity theft prevention program and whether its policies and procedures are reasonably designed to protect customer records and information.

In addition, the Division will assess registrant compliance with adopted rule changes that reduced the standard settlement cycle for most broker-dealer transactions from T+2 to T+1 and requires broker-dealers engaging in the allocation, confirmation, or affirmation process to have written agreements or written procedures reasonably designed to ensure completion of the process as soon as practicable and no later than end of day on the trade date (T+0).

Crypto-Assets and Emerging Financial Technology. Given the continued volatility of, and activity around, the crypto asset markets, the Division will continue to monitor and, when appropriate, conduct examinations of registrants focusing on the offer, sale, recommendation of, or advice regarding trading and other activities in crypto assets or related products and include whether the firm (i) met and followed its respective standards of conduct when making recommendations or providing advice to customers or clients regarding crypto assets, and (ii) routinely reviewed, updated, and enhanced its compliance practices, risk disclosures, and operational resiliency practices. The Division will also assess whether any technological risks associated with the use of blockchain and distributed ledger technology have been addressed. Additionally, the Division remains focused on registrants' use of automated investment tools, AI, and trading algorithms or platforms. With respect to AI, the Division will review registrant representations regarding their AI capabilities or AI use for accuracy. Further, the Division will assess whether firms have implemented adequate policies and procedures to supervise their use of AI, including for tasks related to fraud prevention, back-office operations, anti-money laundering, and trading functions.

Investment Advisers to Private Funds. The Division will continue to focus on advisers to private funds and prioritize specific topics, such as reviewing:

- whether disclosures are consistent with actual practices and if an adviser met its fiduciary obligations in times of market volatility and whether a private fund is exposed to interest rate fluctuations. The Division noted that investment strategies, such as commercial real estate, illiquid assets, and private credit, may be particularly sensitive to market volatility and/or interest rate changes and highlighted that examinations in particular may focus on private funds experiencing poor performance and significant withdrawals and/or holding more leverage or difficult-to-value assets;
- the accuracy of calculations and allocations of private fund fees and expenses (both fund-level and investment-level) through the review of certain areas impacting the accuracy of such fee calculations, including the valuation of illiquid assets, calculation of post-commitment period management fees, offsetting of such fees and expenses, and adequacy of disclosures related thereto;

- disclosure of conflicts of interest and risks and adequacy of policies and procedures. Examples of products or practices for the focus of such reviews include: (i) use of debt, fund-level lines of credit, investment allocations, adviser-led secondary transactions, transactions between funds, and/or others; (ii) investments held by multiple funds; and (iii) use of affiliated service providers; and
- compliance with recently adopted SEC rules, including amendments to Form PF and amended rules governing investment adviser marketing, to assess whether advisers have established adequate policies and procedures related thereto and whether actual practices conform to such policies and procedures.

The Division noted in particular that, as with previous years, it will continue to prioritize examinations of advisers that have never been examined before and those that have not been recently examined, with continued focus on newly registered advisers.

Broker Dealers. The Division will continue to focus on standards of conduct for broker-dealers, specifically related to compliance with Regulation Best Interest. The Division's examinations will assess practices regarding review of investment alternatives, management of conflicts of interest, and consideration of investment goals and account characteristics. The Division notes the following areas of assessment for its examinations:

- recommendations with regard to products, investment strategies, and account types and whether the broker has a reasonable basis to believe the recommendation is in the best interest of the customer and does not place the broker's interests ahead of the customer's interests;
- disclosures made to investors regarding conflicts of interest;
- conflict identification and mitigation and elimination practices;
- processes for reviewing reasonably available alternatives; and
- factors considered in light of the investor's investment profile, such as investment goals and account characteristics.

Additionally, the Division's examinations will review the content of a broker-dealer's relationship summary, such as how the broker-dealer describes (i) the relationships and services that it offers to retail customers; (ii) its fees and costs; and (iii) its conflicts of interests, and whether the broker-dealer discloses any disciplinary history. The examinations will also evaluate whether broker-dealers met their obligations to file their relationship summary with the SEC and deliver it to retail customers.

2025 Examination Priorities (Oct. 21, 2024),
available at: https://www.sec.gov/files/2025-exam-priorities.pdf.

Staff Provides Guidance on Common Issues Related to New Tailored Shareholder Report Requirements

The SEC's Division of Investment Management recently published guidance, in the form of an Accounting and Disclosure Information, highlighting common issues and suggesting certain practices to ensure a smooth transition with respect to various annual and semi-annual shareholder report requirements, which became effective as of July 24, 2024. As a general note, the Staff reiterated the importance of reviewing shareholder reports and associated disclosures on an ongoing basis to ensure compliance. More broadly, the below reflects a summary of particular staff reminders and suggestions.

1. **Fund Expense Information (Item 27A(c) of Form N-1A)**: A fund must include a simplified expense presentation in annual and semi-annual shareholder reports, which must track a specified format. The Staff highlighted the following points:
    a. *Expense Information Generally*. (i) Semi-Annual reports should reflect the dollar cost related to a $10,000 investment during the period that the semi-annual report covers. The cost should not be annualized. (ii) In contrast, when expressing expenses as a percent of an investor's investment in the fund, such costs must be on an annualized basis.
    b. *Computation and Rounding*. (i) For purposes of calculating expenses in dollars paid on a $10,000 investment, funds must multiply the figure disclosed in the "Cost paid as a percentage of your investment" column by the average account value over the period reflected, based on an investment of $10,000 at the beginning of the period in question. The Staff clarified in particular that multiplying "costs paid as a percentage of your investment" by $10,000, "is not correct." (ii) Expenses in dollars paid on a $10,000 investment during the applicable period must be rounded to the nearest dollar, not to the nearest cent.
2. **Management's Discussion of Fund Performance (Item 27A(d) of Form N-1A)**: A fund (other than a money market fund) must include MDFP in its annual shareholder reports and may include MDFP in its semi-annual shareholder reports. The Staff highlighted the below points:
    a. The required performance table presenting average annual total returns for the past 1-, 5-, and 10-year periods must be based on the fund's net asset value. Do not also include performance based on market value in shareholder reports.
    b. A fund (other than MMFs) must compare its performance to an appropriate "broad-based" securities market index, defined as an index representing the overall applicable domestic or international equity or debt markets, as appropriate, in its shareholder reports and prospectus. The Staff clarified that "broad-based" indexes do not include industry-focused indexes, indexes with characteristics such as "growth," "value," or "small- or mid-camp," indexes that comprise only a subset of the overall applicable market, or commodity indexes. However, while a fund must compare its performance to at least one qualifying "broad-based" index, the Staff also noted that

a narrower index (or indexes) that reflect(s) the market segment(s) in which the fund invests may be included in addition to the "broad-based" index comparison.

c. Funds should include noticeable and prominent disclosure (i.e., by use of text features) that past performance is not a good predictor of the fund's future performance.

3. **Fund Statistics (Item 27A(e) of Form N-1A)**: Funds are permitted to include additional disclosure, such as portfolio-level statistics, in addition to fund-level statistics if the fund believes such additional disclosure would help shareholders better understand its activities and operations during the applicable reporting period. The Staff clarified that portfolio-level statistics, such as average maturity or average credit rating, should be disclosed under the heading "Fund Statistics," not under the heading "Graphical Representation of Holdings."

4. **Graphical Representation of Holdings (Item 27A(f) of Form N-1A)**: Funds must include in annual and semi-annual shareholder reports one or more tables, charts, or graphs reflecting its portfolio holdings by category as of the end of the applicable reporting period and are permitted to show its holdings based on percentage of (i) NAV; (ii) total investments; (iii) total exposure, or (iv) net exposure attributable to each category. The Staff highlighted the below points:

    a. When disclosing holdings as a percentage, disclose the basis for the percentage (net asset value, total investments, or total or net exposures). If disclosing holdings based on credit quality, be mindful that there are special disclosures required for this type or presentation, including (i) a brief description of how the credit quality of the holdings were determined, and (ii) if credit ratings assigned by a credit rating agency are used, a concise explanation of how they were identified and selected.

    b. In particular, the Staff noted that when selecting how to categorize holdings, funds should select categories most helpful for investors to assess and monitor their fund investments.

5. **Material Fund Changes (Item 27A(g) of Form N-1A)**: If certain material changes have occurred since the beginning of the applicable reporting period, annual shareholder reports must include a brief description of such material changes. The Staff clarified that:

    a. If there have been material fund changes since the beginning of the reporting period, the annual report should (i) include a prominent statement on the cover page (or beginning) of the report that the report describes material fund changes, and (ii) disclose in the body of the report the material fund changes.

    b. If there have been no material fund changes since the beginning of the reporting period, the annual report does not need to include (i) or (ii) above.

6. **Availability of Additional Information Online (Item 27A(i) of Form N-1A)**: Annual and semi-annual shareholder reports must include a statement that informs investors about additional information that is available on the fund's website and, pursuant to Rule 30e-1 under the 1940 Act, a fund is required to

make disclosures required by Items 7-11 of Form N-CSR and its complete portfolio holdings as of the end of the fund's most recent first and third fiscal quarters publicly accessible, free of charge, at the website address included at the beginning of the shareholder report. The Staff highlighted the below points:

a. Double check links to ensure that there are no broken links in the report.

b. Any links to additional information on the fund's website must be specific enough to lead investors directly to the particular information; however, a link to a central site including prominent links to the particular information can satisfy this requirement. In contrast, a link to a home page or a section of the fund's website other than on which the particular information is posted does not comply with the requirement.

c. When making disclosures required by Items 7-11 of Form N-CSR available online pursuant to Rule 30e-1, funds should consider labelling the information with a term that is "more descriptive of the collective information" required by Items 7-11. In particular, the Staff noted that some funds refer to these disclosures as "Annual Financial Statements and Additional Information," which the staff implies is more descriptive as compared to more abridged references used, such as "[semi-]annual reports," "N-CSR," or "Financial Statements."

7. **Inline XBRL Data Tagging**: Information in annual and semi-annual shareholder reports must be tagged using Inline XBRL structured data language in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual and this requirement extends to performance information used to satisfy a fund's (other than a MMFs) performance comparison requirements, discussed briefly above. The Staff clarified that to comply with XBRL data tagging requirements, funds should tag broad-based indexes as broad-based indexes, and any additional indexes used should be tagged as an additional index (and should not be tagged as a broad-based index).

8. **Additional Issues**. Finally, the Staff provided the following additional information and guidance.

a. The contents of shareholder reports are restricted to information that is required or permitted under Item 27A of Form N-1A. Any additional disclosure included should be necessary to make required disclosure items (pursuant to Item 27A of Form N-1A) not misleading and should generally be brief. Generally avoid extraneous, lengthy disclosures (such as disclaimers or risk disclosures).

b. Funds must present information in shareholder reports in the same order as is required under Item 27A of Form N-1A.

c. Funds may omit disclosures that are inapplicable, such as, for example, material fund changes and changes in and disagreements with accountants.

ADI 2024-14: Tailored Shareholder Report Common Issues (Nov. 8, 2024), available at: https://www.sec.gov/about/divisions-offices/division-investment-management/accounting-disclosure-information/adi-2024-14-tailored-shareholder-report-common-issues.

Industry Developments

Former SEC Commissioner Paul Atkins Nominated as New Chair SEC

On December 4, 2024, President-elect Donald Trump announced that he intends to nominate Paul Atkins as the new SEC Chair to succeed Gary Gensler, who announced on November 21, 2024 his intention to step down effective January 20, 2025. Atkins, who served as an SEC Commissioner from 2002 to 2008 under President George W. Bush, is well known in the securities regulatory community. In a shift away from Gensler's approach, Atkins is expected to take a lighter regulatory approach to regulation, consistent with his prior tenure at the SEC. During his time as a Commissioner, Atkins emphasized the importance of capital market innovation and reducing regulatory burdens and advanced various reform efforts, such as modifying compliance requirements for smaller companies under the Sarbanes-Oxley Act. Following the end of his term, Atkins founded Patomak Global Partners, a financial services consulting firm that provides advisory services for banks and investment firms on regulatory and compliance matters, including more recently on issues related to crypto and digital assets. He also Co-Chairs the Digital Chamber of Commerce's Token Alliance and serves on the Advisory Board of Securitize, a digital asset firm that promotes the use of digital tokens. Atkins is known to be pro-business, conservative, and a strong advocate of crypto and digital assets. In a statement released in support of Atkins, the Investment Company Institute stated that "[h]is distinguished record, years of experience in the industry, and history of service at the SEC make him a supremely well qualified nominee…".

In addition to Gensler's departure, SEC Commissioner Jaime Lizárraga announced he will be stepping down effective January 17, 2025, which will leave one Democrat, Caroline Crenshaw, on the Commission when President-elect Trump takes office. Crenshaw's future though is uncertain as her term ended in June of 2024, but she is permitted to serve up to 18 months beyond the expiration of her term or she could be nominated for a second term. Depending on the timing of her departure, it is possible that President-elect Trump could be in a position to appoint up to three Commissioners during the first year of his term, subject to Senate confirmation, setting the stage for a Republican-led Commission under Atkins.

Trump Picks Paul Atkins to Run the S.E.C. (Dec. 4, 2024), available at:
https://www.nytimes.com/2024/12/04/business/trump-sec-paul-atkins.html.

SEC Enforcement

SEC Announces Enforcement Results for Fiscal Year 2024

On November 22, 2024, the SEC announced its enforcement results for fiscal year 2024. Over the year, the SEC filed 583 total enforcement actions, down from the 784 actions filed in the 2023 fiscal year, and obtained orders for $8.2 billion in financial remedies, the highest amount in SEC history. The $8.2 billion in aggregate financial remedies consisted of $6.1 billion in disgorgement and prejudgment interest, the highest amount on record, and $2.1 billion in civil penalties, the second-highest amount on record. The SEC also obtained orders barring 124 individuals from serving as officers and directors of public companies, the second-highest number of officer and director bars obtained in a decade.

The SEC distributed $345 million to harmed investors, marking a benchmark of more than $2.7 billion returned to investors since the beginning of fiscal year 2021, and issued whistleblower awards totaling $255 million, down from nearly $600 million in the previous year, the most ever awarded in a single year. The SEC reported that it received more than 45,130 tips, complaints, and referrals in total in fiscal year 2024, the most ever received in one year, including over 24,000 whistleblower tips (more than 14,000 of which were submitted by two individuals), up from the over 18,000 tips received in the prior year.

The SEC issued enforcement actions against a wide variety of market participants, including broker-dealers, credit rating agencies, investment advisers, gatekeepers, and individuals. Notably, the SEC focused on compliance with the recordkeeping requirements of the federal securities laws, the marketing rule, the disclosure requirements for holdings and transactions of certain insiders and market participants under the federal securities laws, whistleblower rights and protections, and in the evolving crypto, cybersecurity, and AI spaces. The enforcement actions brought or settled by the SEC in fiscal year 2024 included, for example:

- Recordkeeping cases resulting in more than $600 million in civil penalties against more than 70 firms, including the SEC's first cases charging recordkeeping violations against municipal advisors. This initiative has resulted in charges against more than 100 firms resulting in more than $2 billion in aggregate penalties since December 2021.
- Enforcement actions to address Dodd-Frank whistleblower protection rule violations, including actions in which firms purported to limit the ability of customers to voluntarily contact the SEC or required employees to waive their rights to a possible whistleblower monetary award. These actions included, for example, an $18 million civil monetary penalty against J.P. Morgan, which marks the largest penalty on record for a standalone violation of the whistleblower protection rule.
- Charges against more than 24 entities and individuals for failures to timely report their holdings and transactions in public company stock or for contributing to filing failures by their officers and directors.

- Charges against 11 institutional investment managers for failures to disclose certain securities holdings in reports that they were required to file as a result of having discretion over more than $100 million in certain securities.
- Cybersecurity related charges against: (i) The Intercontinental Exchange, Inc. and nine wholly-owned subsidiaries, including the NYSE, for failure to timely report a cyber intrusion; (ii) Equiniti Trust Company LLC (f/k/a American Stock Transfer & Trust Company LLC) for failures to ensure client securities and funds were protected against theft or misuse, which led to losses of millions of dollars in client funds; and (iii) R.R. Donnelly & Sons for disclosure and internal control failures relating to cybersecurity incidents.

The year's largest financial remedy ordered is attributable to a more than $4.5 billion monetary judgement obtained after the SEC's jury trial win against Terraform Labs and Do Kwon, who were charged with one of the largest securities frauds in U.S. history. Some of the year's other largest penalties were issued as a result of the SEC's actions against Morgan Stanley for a multi-year fraud involving disclosure of confidential information about certain large "block trades," whereby the firm agreed to pay approximately $166 million in disgorgement and prejudgment interest and an $83 million civil monetary penalty to resolve the charges. In addition, the SEC charged investment advisory firm Macquarie for overvaluing approximately 4,900 largely illiquid CMOs held in certain advisory accounts and for executing certain cross-trades between advisory clients that impermissibly favored certain clients over others. Macquarie agreed to pay disgorgement and prejudgment interest of $9.8 million as well as a $70 million civil monetary penalty to resolve the SEC's charges.

Notably, the SEC consistently recognized meaningful cooperation with the agency to promote compliance across the securities industry, which it emphasized encourages firms to, among other things, proactively self-police, self-report, and remediate violations. The SEC noted increased participant efforts in relation to self-reporting, remediation, and cooperation with the SEC in fiscal year 2024, and rewarded public issuers, private companies, and advisers in connection with a range of violations, including material misstatement, recordkeeping, and whistleblowing violations. The SEC noted in particular that the enforcement numbers for this year do not reflect countless enforcement actions that did not occur due to such market participant cooperation.

SEC Announces Enforcement Results for Fiscal Year 2024, SEC Press Release (Dec. 17, 2024), available at: https://www.sec.gov/newsroom/press-releases/2024-186.

Adviser Settles ESG Greenwashing Violations

The SEC recently charged Invesco Advisers, Inc., a registered investment adviser, for misleading statements about company-wide assets under management made by it and its affiliates that incorporated ESG-related factors into their investment processes. The Order found that these misleading statements were included in presentations provided to the boards of directors of the funds it advised, prospective client proposals, and marketing materials. Specifically, between 2020 to 2022, Invesco cited "ESG integration" estimates ranging from 75% to 94%. However,

those estimates were overstated because Invesco included "a substantial amount of assets" of passive ETFs that did not follow an ESG index and, therefore, "did not consider ESG factors in making investment decisions." In fact, passive ETFs represented approximately one-third of the assets under management reported.

In 2019, ESG team members at Invesco conducted an internal analysis indicating that clients representing "at least $370 billion" in assets under management were "at risk" of leaving. Thus, Invesco believed that integrating ESG considerations globally into its investment processes "was of commercial importance," causing it to expedite its ESG-integration efforts. Despite this, Invesco failed to define "ESG integration," a term it coined, in its policies and procedures even though that term was used in public facing documents, or otherwise ensure that firm-wide assets under management were appropriately classified as ESG integrated assets. As a result, Invesco's method of categorizing assets under management did not evaluate assets under management at the strategy level at all, despite statements that its investment strategies were ESG integrated. Furthermore, certain senior members of the ETFs and Index Strategies group pointed out that the classification of passive ETFs as ESG integrated was problematic, yet no changes were made.

Accordingly, the SEC charged Invesco with, among other things, willfully violating the anti-fraud provisions of the Advisers Act and for distributing misleading advertisements in violation of the Advisers Act. Without admitting or denying the findings set forth in the Order, Invesco consented to a cease-and-desist order, censure, and $17.5 million civil monetary penalty.

In the Matter of Invesco Advisers Inc., SEC Admin. File No. 6770 (Nov. 8, 2024), available at https://www.sec.gov/files/litigation/admin/2024/ia-6770.pdf.

SEC Charges Adviser for Failing to Adhere to Its Own Investment Criteria for ESG Funds

On October 21, 2024, the SEC announced that it had settled charges with WisdomTree Asset Management, Inc., a registered investment adviser, to three ETFs for making misleading statements and for compliance failures relating to the execution of the ETFs' investment strategies, which were marketed as incorporating ESG factors.

According to the Order, from March 2020 until November 2022, WisdomTree represented to each ETF board that the ETFs would not invest in issuers that were "involved in certain controversial products or activities," including fossil fuels and tobacco. Additionally, WisdomTree represented to the boards, and the prospectuses of each ETF disclosed to investors, that its model portfolio upon which the ETFs investments would be based would exclude the securities of fossil fuel and tobacco companies "regardless of revenue measures." Despite these representations, the ETFs invested in issuers that were involved in fossil fuels and tobacco, including coal mining and transportation, natural gas extraction and distribution, and retail sales of tobacco products, in reliance on data purchased from third-party vendors that only identified a subset of issuers involved in fossil fuels or tobacco. However, WisdomTree was aware that there were limitations in the data provided by the vendors but failed to purchase

supplemental data or otherwise conduct further diligence that would have excluded such issuers. The Order found that WisdomTree did not have policies and procedures overseeing the screening process to appropriately select issuers that complied with the ETFs' ESG-investment mandates and, more broadly, its ESG investment process.

By November 2022, WisdomTree updated the ETFs' prospectus disclosure to address the data its model used to exclude the securities of issuers involved in fossil fuels and tobacco, among others. On February 5, 2024, after obtaining Board approval, the ETFs were liquidated.

Accordingly, WisdomTree was charged with violating, among other things, the anti-fraud provisions of the Advisers Act and Section 34(b) of the 1940 Act, which make it unlawful for any person to make any untrue statement of material fact in any registration statement or other document filed with the SEC. Without admitting or denying the findings set forth in the Order, WisdomTree consented to a cease-and-desist order, censure, and $4 million civil monetary penalty.

In the Matter of WisdomTree Asset Management, Inc., SEC Admin. File No. 3-22268 (Oct. 21, 2024), available at https://www.sec.gov/files/litigation/admin/2024/ia-6753.pdf.

Adviser Settles MNPI Violations

The SEC recently settled charges with Marathon Asset Management, L.P., a registered investment adviser to private funds, for willfully violating the anti-fraud provisions of the Advisers Act and failing to adopt and implement written policies and procedures designed to prevent the misuse of material, non-public information relating to its participation on ad hoc creditor committees.

According to the Order, Marathon invested in distressed corporate bonds and other similar debt in the United States, Europe and Asia as a core business strategy. As part of this strategy, Marathon frequently participated in ad hoc creditor committees during which participants often received MNPI and/or worked with financial advisers or consultants that were tasked with analyzing MNPI through which it inadvertently received MNPI.

In August 2020, Marathon participated in an ad hoc committee composed of unsecured creditors of a distressed foreign issuer in which Marathon owned bonds, to explore a potential restructuring. The committee retained a financial adviser to act partly as a liaison between the committee and issuer. The financial adviser signed an NDA with the issuer in October 2020 and thereafter began to receive MNPI from the issuer regarding the restructuring to which Marathon was not privy. Although Marathon did not sign an NDA with respect to the issuer or the committee until November 5, 2020, the financial adviser provided guidance and information to Marathon throughout the duration of the committee, including the period in which Marathon had not executed an NDA. Nonetheless, Marathon continued to build its position in the issuer throughout the time it participated on the committee, only restricting its trading in the issuer in tandem with its entry into the NDA. Furthermore, neither the committee nor Marathon received any written representation regarding the financial adviser's handling of

issuer-related MNPI, nor is there evidence that Marathon conducted any due diligence related to the financial adviser's handling of MNPI.

As such, the Order found that while Marathon had general policies and procedures related to the treatment of MNPI, they were not sufficiently tailored to address the specific risks from its participation on ad hoc creditor committees.

Accordingly, the SEC charged Marathon with, among other things, willfully violating the anti-fraud provisions of the Advisers Act and for failing to adopt policies and procedures to prevent the misuse of MNPI as required by the Advisers Act. Without admitting or denying the findings set forth in the Order, Marathon agreed to a cease-and-desist order, censure, and $1.5 million civil monetary penalty.

In the Matter of Marathon Asset Management, L.P., SEC Admin. File No. 3-22219 (Sept. 30, 2024), available at https://www.sec.gov/files/litigation/admin/2024/ia-6737.pdf.

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Regulatory and Enforcement Alert

SEC Division of Examinations Releases Risk Alert Addressing Examinations of Registered Investment Companies

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Earlier this month, the SEC's Division of Examinations (the "Division") released a Risk Alert pertaining to registered investment companies ("RICs") and their advisers that (i) provides a high-level overview of its risk-based approach to selecting RICs for examination, (ii) covers common examination deficiencies, and (iii) outlines the typical types of initial documents requested in an examination (the "November 2024 Risk Alert" or the "Risk Alert").[1] The November 2024 Risk Alert, summarized below, highlights the Division's ongoing overall focus for RICs on the three "core review areas" of compliance programs, disclosures and regulatory reports, and fund governance practices. RICs are a key focus area for the Division; as noted in the November 2024 Risk Alert, RICs are important investment vehicles for many investors, including those saving for retirement.[2] The Division released a similar Risk Alert in September 2023 for all registered investment advisers ("RIAs") (*i.e.*, not just RIC advisers) that covered registrant selection for examinations, examination scoping, and the typical types of documents initially requested (the "September 2023 Risk Alert").[3]

The November 2024 Risk Alert can serve as a useful resource to RICs and their advisers—both for new registrants building out their compliance programs as well as established registrants looking to update aspects of their compliance programs—with respect to compliance program updates that might be beneficial, in addition to helping RICs and their advisers prepare for their next examination through mock examinations or targeted privileged reviews. The November 2024 Risk Alert should be read in conjunction with other guidance from the SEC, such as other periodic Risk Alerts, the annual Examination Priorities,[4] SEC Staff speeches, and Enforcement activity.

[1] SEC Division of Examinations November 2024 Risk Alert (Registered Investment Companies: Review of Certain Core Focus Areas and Associated Documents Requested).

[2] The November 2024 Risk Alert also highlighted the growing size of the industry—approximately 800 investment company complexes managing nearly 15,000 investment company portfolios.

[3] SEC Division of Examinations September 2023 Risk Alert (Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents) (the September 2023 Risk Alert did not contain common examination deficiencies); *see also* Simpson Thacher Alert here.

[4] *See, e.g.*, SEC Division of Examinations 2025 Examination Priorities.

I. Examination Selection and Scoping

The November 2024 Risk Alert provides that, given the size and variety of the RIC population, the Division takes a risk-based approach for examination selection and scoping. As detailed in the November 2024 Risk Alert, the Division may consider the following factors[5] when selecting candidates for examination:

- Whether a RIC's investment strategy and/or portfolio holdings meet criteria relevant to the focus areas described in the Division's Examination Priorities
- Whether new regulatory requirements are applicable to the RICs
- A fund complex's examination history
- When a fund complex first commenced operations
- The RIC's or its adviser's business activities, conflicts of interest, and/or regulatory history
- Consideration of portfolio composition
- Investment strategies
- Fee structures
- Fund performance as compared to similar funds
- Distribution activities
- Disclosures
- Service providers
- Governance practices
- Media coverage
- Other financial intelligence

In its examination selection process, the Division Staff considers various internal and external information, noting that it is "constantly evaluating tips, complaints and referrals made by the public" and by others in the SEC, as well as data submitted in SEC filings.

With respect to examination scoping, the three "core review areas" noted above (compliance programs, disclosures and regulatory reports, and fund governance practices) incorporate more defined topics such as "portfolio management, brokerage and trading, fees and expenses, valuation, service provider oversight [footnote omitted],

[5] The November 2024 Risk Alert also noted that the factors in the selection process for advisers generally as described in the September 2023 Risk Alert may also be relevant to RICs and their advisers.

sales literature." There is also a general appreciation of "ownership structure, business model, affiliations, and material business operations."

The November 2024 Risk Alert specified certain examples of areas that may be reviewed during examinations, as follows:

- Compliance policies and procedures for RICs and their service providers in addressing risks, including risks associated with allocation of expenses.
- Board governance processes and the efficacy of board oversight of RICs' compliance programs.
    - In this regard, the Risk Alert highlighted that the Staff is focused on the type and quality of information presented to boards: "whether boards are getting information necessary to exercise their oversight responsibilities, boards are requesting and reviewing information necessary to understand the issues and make associated approvals, and funds and their advisers are accurately disclosing information to boards related to the funds' fees, expenses, performance, conflicts of interest, or relevant risks."
    - The Risk Alert noted that "[a] fund board's primary responsibility is to protect the interest of the fund and its shareholders, which may be adversely affected by any substantial ongoing conflicts of interest of the fund's investment adviser."
- RICs' investment advisory agreement approval process and the thoroughness of the board's review of fees for consistency with disclosures.
    - The Risk Alert included example lines of inquiry such as whether the fund's board compared the services to be rendered and amounts to be paid under the contract to those under other advisory contracts with the adviser or other advisers to RICs, such as peer groups, or other types of clients.
- Disclosure in regulatory filings and investor communications for their consistency with operations, conflicts of interest, and actual portfolio management activities.

II. Division Staff Observations from RIC Examinations

The November 2024 Risk Alert detailed common deficiencies for RICs related to the three core review areas based on deficiency letters sent to funds during the most recent four-year period. There was a similar Risk Alert regarding common deficiencies for RICs previously, in October 2021.[6]

[6] SEC Division of Examinations 2021 Risk Alert (Observations from Examinations in the Registered Investment Company Initiatives).

A. CORE REVIEW AREA: FUND COMPLIANCE PROGRAMS

- RICs failed to perform required oversight or reviews as stated in their policies and procedures or failed to perform required assessments of the effectiveness of their compliance programs.
    - Funds did not test for compliance with exemptive orders and derivative segregation requirements
    - Funds omitted material information from their annual compliance reports, or did not conduct or document their annual compliance reviews
    - Funds did not review the policies and procedures of third-party service providers for consistency with contractual requirements and representations, including advisers and sub-advisers to the funds
- RICs did not adopt, implement, update, and/or enforce policies and procedures.
    - The Division Staff observed deficient practices with respect to compliance with custody requirements, fee billing, derivatives and liquidity risk management programs, valuation of portfolio assets, portfolio management, shareholder complaints, distribution of fund shares, trade allocations and errors, affiliated transactions, and execution capabilities of certain broker-dealers
- Policies and procedures were not tailored to the RICs' business model or were incomplete, inaccurate, or inconsistent with actual practices.
    - Examples include deficient policies and procedures applicable to derivatives risk management programs, redemption requests, and compliance risks associated with certain investment strategies or approaches
- RICs' Code of Ethics were not adopted, implemented, followed, enforced, or did not otherwise appear adequate.
- CCOs did not provide requisite written annual compliance reports to RICs' boards.

B. CORE REVIEW AREA: DISCLOSURES AND FILINGS

- Fund registration statements, fact sheets, annual reports, and semi-annual reports contained incomplete or outdated information or contained potentially misleading statements.
    - Funds omitted information regarding in-kind transactions and payments to affiliates in their prospectus and/or statements of additional information
    - Funds disclosed investment processes or analyses that were inconsistent with advisers' practices
    - Funds repeatedly exceeded stated asset investment thresholds
- Sales literature, including websites, appeared to contain untrue statements or omissions of material fact.
    - Funds described as "no-load" actually charged such fees

- Funds mischaracterized the use of environmental, social, and governance factors in their investment decision-making processes compared to their actual practices

- Fund filings were not made on a timely basis.

C. CORE REVIEW AREA: FUND GOVERNANCE PRACTICES

- Fund board approvals of advisory agreements appeared to be inconsistent with the Investment Company Act of 1940, as amended, and/or the funds' written compliance procedures.
  - Fund boards did not timely review advisory and sub-advisory agreements
  - Fund boards did not request, obtain, and/or consider certain information to evaluate advisory agreements before approving them, such as information regarding advisory fees and soft dollar arrangements7
  - Fund boards did not consider material changes to the advisory agreement such as changes of control at the adviser or a change in advisory fees
- Fund boards did not receive certain information to effectively oversee fund practices.
  - Funds did not timely notify their boards that illiquid investments exceeded 15% of net assets and provide a plan to reduce holdings of illiquid investments
  - Funds did not inform their boards of changes to funds' compliance programs
- Fund boards did not perform required responsibilities.
  - Fund boards did not make certain required determinations, such as annually determining whether certain joint liability insurance policies remained in the funds' best interest
  - Fund boards did not adopt policies and procedures tailored to funds' operations, including regarding liquidity risk management programs, anti-money laundering programs, and Rule 12b-1 plans
- Fund board minutes did not fully document board actions.
  - Fund boards did not memorialize the approval of funds' liquidity risk management programs
  - Fund boards did not accurately capture the board's process in approving the advisory agreement

[7] In the Enforcement context, in February 2024, the SEC announced settled charges against Van Eck Associates Corporation due to its failure to disclose to the board of the VanEck ETF Trust (the "Board") accurate information in connection with the Board's approval of an ETF fund launch and management fee in connection with the details of the involvement of an influencer and the influencer's sliding scale fee structure. Van Eck Associates Corporation agreed to pay a $1.75 million civil penalty.

III. Document Requests—Typical Information Initially Requested

The November 2024 Risk Alert also included a chart summarizing the typical types of documents *initially* requested from RICs and their advisers in an examination. The chart is attached here (Attachment A), and covers four general areas: (1) general information to provide the Division Staff with an understanding of the fund's business and operations; (2) information about the compliance risks that the fund and/or its adviser have identified and the written policies and procedures that have been adopted and implemented to address each of those risks; (3) information to assess board governance processes and the efficacy of board oversight of funds' compliance programs; and (4) information to facilitate the Division Staff's testing for compliance in various areas. As shown in the chart, the information is generally organized in the following categories:

- Organizational and operational information
- Compliance program
- Portfolio management and trading
- Valuation
- Conflicts of interest
- Fees and expenses
- Fund advertisements and sales literature
- Fund board governance
- Disclosures
- Financial records and financial analysis

While the chart is helpful with examination preparation and related organization, it should be noted both that the information in the Risk Alert contains *types* of documents typically requested, not actual sample request language or requests letters, and that these types of documents relate to only the scoping initial set of questions, which are typically followed by a series of more bespoke requests for documents and information.

Conclusion

The focus areas highlighted in the November 2024 Risk Alert for RICs and their advisers can inform registrants' examination preparation, as well as assist the smooth functioning of the day to day compliance operation. One point to stress from the Risk Alert is that examinations will include focus on "whether funds . . . promptly address compliance issues, when identified"—RICs and their advisers should ensure their compliance programs have systems in place to identify issues and that necessary remediation is timely completed (and documented as needed).

With the impending change in administration, the Division's focus on RICs, already a priority, is likely to increase given the nexus to retail investors. RICs and their advisers would be well-served to consider how this Risk Alert—and other SEC guidance—might inform enhancements to their compliance programs and operations.

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Attachment A (Excerpt from SEC Risk Alert)

Typical Initial Information Examiners Request of Certain RICs and Their Advisers

Described below are the types of initial information, including documents, that the staff may request and review during a typical fund examination.[8] The staff may request additional information to further tailor the information request depending upon the scope of the examination (*e.g.*, include specific information applicable to money market funds, unit investment trusts, and closed-end funds). Information requests are generally transmitted through secure email, and responses are typically provided electronically in a secure manner as instructed by the staff. If certain records are not maintained electronically or cannot be produced electronically, the staff may request that the fund make such records available for in-person examination.

Organizational and Operational Information	• General information for the fund, including information regarding: adviser(s) and affiliated entities; offices and operational locations; officers, employees, and supervised persons; committees; service providers, including securities lending agents; other business arrangements; fund agreements, whether written or informal; and the uniform resource locater (URL) for the fund's and its associated adviser's websites. • Organizational structure and information regarding each RIC and each portfolio thereunder that is being examined (*e.g.*, fund name, Edgar series identification, SEC registration number, ticker symbol, sub-advisers, current and former portfolio managers, total net assets and net asset value ("NAV") per share, portfolio turnover rate, commencement date of operations, portfolio classification, number of shareholders, and shares outstanding). • Information regarding fund shareholder complaints, threatened, pending or settled litigation, arbitration, or administrative proceedings involving the funds, their adviser(s), and affiliates. • Filings and regulatory correspondence, including prospectus and SAI, shareholder reports, no-action letters and exemptive relief relied upon by the fund and/or its adviser(s). • ETF-specific information, such as index licensing agreements, Exchange notices, and related disclosures.

[8] The staff defines the examination review period in the document request list. As an examination progresses, the staff often makes additional requests for information from the RIC and/or its adviser, as needed. Some of the items discussed below may be included in supplemental requests, rather than the initial request.

Compliance Program	• Fund compliance policies and procedures and inventories of compliance risks, testing, and compliance exception reports. • Reviews conducted regarding fund compliance, including internal audit reports, third-party compliance reviews, and the annual reviews and reports by the fund's CCO under Investment Company Act Rule 38a-1 and annual reviews and reports by the CCO of the funds' investment adviser under Adviser Act Rule 206(4)-7. • Information regarding tools or systems used to carry out compliance-related oversight functions and reporting, and compliance training or guidance provided to personnel. • Information regarding due diligence on, and oversight of, service providers. • Fund trade blotter (*i.e.*, purchases and sales journal) and initial and month-end positions for a specified period. • Executing broker-dealers and commission/fees applicable to fund trades. • Information regarding trade allocation practices, best execution, and trade errors. • Soft dollar arrangements. • Performance information, including comparable returns of funds' prospectus benchmarks.
Valuation	• Valuation policies and procedures of any third-party providers (*e.g.*, third-party administrators) that are directly or indirectly involved in re-viewing of valuations of the funds' portfolio holdings. • Information detailed by asset class regarding reports and/or recommendations from pricing services, quotation services, third-party valuation firms, and externally acquired portfolio accounting systems used in the valuation process. • Information regarding valuation processes (*e.g.*, use of indicative bids for fair valuation, practices for comparing securities' prices against prior day's prices, review of securities' prices against relevant market indices, use of data or models, changes in valuation methodologies). • Valuation reports and recommendations provided by third-party valuation firms. • Communications with auditors, third-party valuation firms, or other third-parties regarding valuations of the funds' portfolio holdings. • Prices provided by a pricing service or third-party valuation firm that were overridden or stale (*e.g.*, prices for a given security have not changed over time).
Conflicts of Interest	• Code of Ethics policies and procedures for the fund and its adviser(s), employee trading restricted lists, and corresponding attestations. • Reports of securities transactions reported by access persons. • Information related to revenue sharing arrangements, cross trading activities, and soft dollar commissions. • Information regarding trade aggregation and allocation of trades among the fund and the adviser's other client accounts.
Fees and Expenses	• Information regarding any expense caps and fee waivers, including management fee waivers in whole or in part. • Information regarding expenses of the adviser, sub-adviser, or any of their affiliates that were reimbursed by a fund and/or a portfolio company held by the fund. • Information regarding any direct or indirect compensation received by the fund, its adviser(s), any sub-adviser(s), or any of their affiliates from any of the fund's service providers.

Fund Advertisements and Sales Literature	• Information regarding advertising materials and sales literature for the fund, including newspapers, periodicals, television and radio ads, websites, fund fact sheets, form letters, and portfolio manager commentaries.
Fund Board Governance	• General information regarding board members and board committees (*e.g.*, election, composition, independence, and compliance with fund governance requirements under the Investment Company Act). • Calendar and agendas of the board and board committee meetings. • Minutes and materials from meetings of the board, the independent directors/trustees of the board, and board committees. • Information about any claim(s) made by the fund or an affiliate under the fund's Directors and Officers/Errors and Omissions insurance policies. • Approval of the investment advisory contract under Investment Company • Act Section 15(c), including information regarding any expense caps and/or fee waivers. • Selection of the fund's auditors and matters related to an audit of the fund's financial statements. • Board's oversight of the fund's compliance program, including review of annual report(s) provided the fund's CCO and its adviser's CCO. • Information regarding service provider relationships and related information provided to the board, including direct or indirect compensation received from service providers. • Information provided to the board for evaluation of brokerage arrangements and best execution, 12b-1 plans, and multi-class plans.
Disclosures	• Prospectus, SAI, annual shareholder report and semi-annual report for the fund (in PDF format). This includes tailored shareholder reports that are now required for mutual funds and ETFs that are registered on Form N-1A (compliance date – July 24, 2024).
Financial Records and Financial Analysis	• The fund adviser's balance sheet, income statement, general ledger, and cash receipts and disbursements journal. • Information about any fund NAV errors.