

Regulatory and Enforcement Alert

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

November 26, 2024

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.

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

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](#).

Division may consider the following factors⁵ 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], sales literature.” There is also a general appreciation of “ownership structure, business model, affiliations, and material business operations.”

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.

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.¹ 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 locator (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.
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¹ 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.
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