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Investment Management Update

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In this Update

Covering legal developments and regulatory news for funds, their advisers, and industry participants for the period July 2021 through December 2021.

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Rulemaking and Guidance

National Society of Compliance Professionals (NSCP) Issues NSCP Firm and CCO Liability Framework

12.21.21

Over the past year, the NSCP created a Firm and CCO Liability Framework (NSCP Framework), following an invitation from SEC Commissioner Peirce and the compliance community to provide input on a framework she would like to develop, "detailing which circumstances will cause the SEC to seek personal liability and what circumstances will mitigate against seeking personal liability." *See* https://www.sec.gov/news/speech/peirce-nscp-2020-10-19. Concerns over CCO liability are not new. Indeed, Rule 206(4)-7 of the Investment Advisers Act of 1940 (Investment Advisers Act) supports negligence-based charges against CCOs, whom the rule makes responsible for administering written policies and procedures that must be reasonably designed to prevent violations by the registered investment adviser and its supervised persons of the Investment Advisers Act and SEC rules thereunder.

To provide an industry perspective, NSCP, through its Regulatory Advisory Committee, conducted multiple industrywide surveys with its 2,000+ membership of CCOs and other compliance professionals. The survey assessed members' views on CCO liability and obtain relevant data on CCO empowerment and resources, resulting in the NSCP's Regulatory Advisory Committee developing the NSCP Framework.

Under the NSCP Framework, to evaluate the issue of CCO liability, regulators should consider the following questions where a compliance failure may have occurred. A "yes" answer to any of the questions below mitigates against CCO liability:

- Did the CCO have nominal rather than actual responsibility, ability, or authority to affect the violative conduct?
- Was there insufficient support from firm leadership to compliance, including, for example, insufficient resources, for the CCO to affect the violative conduct?
- Did the CCO escalate the issue or violative conduct to firm management through a risk assessment, annual review, CEO certification meeting/report, or otherwise?
- Did firm management fail to respond appropriately after becoming aware of the issue (through the CCO or otherwise)?
- If the firm made misstatements or omitted material information, did the CCO have nominal rather than actual responsibility, ability, or authority for reviewing or verifying that information?
- Was firm leadership provided the opportunity to review and accept the policies and procedures?
- Did the CCO consult with legal counsel (in-house or external) and/or securities compliance consultants and adhere to the advice provided?
- Did the CCO otherwise act to prevent, mitigate, and/or address the issue?
- Did the CCO reasonably rely on information from others in the firm or firm systems?

The NSCP believes the responses to these questions will help provide examination and enforcement teams with a framework through which to properly evaluate CCO liability. Additionally, the NSCP hopes its NSCP Framework will not only provide guidance to regulatory examiners, but also to CCOs and their firms regarding CCO empowerment and compliance resources.

The NSCP Framework provides a practical approach to CCO liability that complements the “New York City Bar Association White Paper on CCO Liability” published in 2021.

A copy of the NSCP Framework can be found at https://static1.squarespace.com/static/61a9074028e505179c284c97/t/61e19a0f1d3d656f1cfbbf3c/1642174991168/NSCP+Firm+and+CCO+Liability+Framework+Jan+2022.pdf

SEC Proposes Money Market Fund Reforms

12.15.21

On December 15, 2021, the SEC issued proposed amendments to certain rules governing money market funds under the Investment Company Act of 1940 (Investment Company Act). These proposed amendments arise out of the aftermath of the COVID-19 pandemic and attempt to address shortcomings that the current rules exhibited during the market instability.

The SEC proposed a number of amendments to Rule 2a-7 of the Investment Company Act, which regulates money market funds. Many of these proposals seek to weaken investors' incentives to redeem from certain funds during times of market illiquidity, providing funds with a "cooling off" period to temper short-term investor panic. Additionally, the proposals attempt to better equip a fund's ability to manage significant and rapid investor redemption.

One such proposal was to remove the ability of a money market fund to impose redemption gates. The SEC is concerned that redemption gates are not an effective tool for money market funds to stem heavy redemptions in times of stress due to money market investors' general sensitivities to being unable to access their investments for a period of time and tendency to redeem from such funds preemptively if they fear a gate may be imposed. Under the proposal, a money market fund could continue to be able to suspend redemptions if, among other conditions, (1) the fund, at the end of a business day, has invested less than 10% of its total assets in weekly liquid assets, or in the case of a government or retail money market fund, the fund's board determines that such a deviation is likely to occur, and (2) the fund's board has approved the fund's liquidation. The SEC believes that preserving the ability to suspend redemptions will protect potential harm to shareholders without signaling to investors when a gate may be imposed.

Another proposal would remove from Rule 2a-7 the provisions allowing/requiring money market funds to impose liquidity fees once the fund crosses certain liquidity thresholds. While the SEC believes it is important for institutional prime and institution tax-exempt money market funds to have a tool to cause redeeming investors to bear the cost of liquidity if they redeem, it does not believe the current liquidity fee provisions achieve this goal. Therefore, the SEC is proposing to require institutional prime and tax-exempt money market funds to implement swing pricing.

The current liquidity thresholds allow a money market fund to impose a liquidity fee of up to 2%, or temporarily suspend redemption for up to 10 business days in a 90-day period, if the fund's weekly liquid assets fall below 30% of its total assets and the fund's board determines imposing the gate or fee is in the fund's best interest. A nongovernmental money market fund is required to impose a liquidity fee of 1% on all redemptions if its weekly liquid assets fall below 10% of its total assets, unless its board determines this would not be in the best interest of the fund.

While the proposal would remove the liquidity fee provision in Rule 2a-7, a money market fund's board of directors may nonetheless approve the fund's use of redemption fees (up to but not exceeding 2% of the value of shares redeemed) to eliminate or reduce, as practicable, dilution of the value of the fund's outstanding securities under Rule 22c-2 of the Investment Company Act. Therefore, to the extent a fund's board determines that the ability to impose fees may be necessary to protect investors, the board could establish a redemption fee approach to meet the needs of the fund, provided the fund complies with Rule 22c-2 and discloses information about the redemption fee in its prospectus.

These rule amendments also would include removal of the related disclosure and reporting provisions that require funds to disclose certain information about the possibility of fees and gates in their prospectuses and to report any imposition of fees or gates on Form N-CR, on the funds website, and in its statement of additional information. Based on studies, these liquid asset thresholds and potential imposition of fees and gates contributed to investors' incentive to redeem at the outset of the COVID-19 pandemic.

To replace the removal of the fees and gate provisions, the SEC is proposing swing pricing requirements, specifically for institutional prime and institutional tax-exempt money market funds, that would apply when the fund experiences net redemptions. This proposed rule would specify how an institutional fund would determine its swing factor, which would differ based on the amount of net redemptions. Swing pricing policies and procedures must be implemented by a board-designated administrator, segregated from portfolio management, and may not include portfolio managers.

The swing pricing proposal attaches board oversight of swing pricing, requiring board approval of (1) policies and procedures, (2) approving the swing pricing administrator, and (3) annual reviews of reports produced by the swing pricing administrator (which report the fund must maintain for six years).

The swing pricing proposal seeks to ensure the costs from net redemptions are fairly allocated and do not give rise to a first-mover advantage or dilution under either normal or stressed market conditions. Under the proposal, an institutional fund would be required to adjust its current net asset value (NAV) per share by a swing factor reflecting spread and transaction costs, as applicable, if the fund has net redemptions for the pricing period. If an institutional fund has net redemptions for a pricing period that exceed the "market impact threshold," which would be defined as 4% of the fund's NAV divided by the number of pricing periods the fund has in a business day, or such smaller amount of net redemptions as the swing pricing administrator determines, the swing factor also would include market impact.

An institutional fund with multiple classes must determine whether it experienced net redemption activity across all classes in the aggregate, rather than determining net redemption activity on a class-by-class basis.

This is intended to address a fund's reluctance to impose liquidity fees on redeeming investors as no fund wants to be the first fund to impose such a fee. No fund did so in March 2020.

Furthermore, the SEC proposes to increase the minimum liquidity requirements to 25% daily liquid assets and 50% weekly liquid assets. The SEC believes this will provide a substantial buffer that would better equip money market funds to manage significant and rapid investor redemptions, while maintaining funds' flexibility to invest in diverse assets during normal market conditions.

With the increased liquidity levels, the SEC proposes to maintain the current consequence for falling below minimum daily and weekly liquidity requirements. A money market fund's portfolio that does not meet the minimum liquidity standards simply may not acquire any assets other than daily liquid assets or weekly liquid assets until it meets the minimum thresholds. The proposed rule would require the fund to notify its board of directors in the event it falls below a liquidity threshold, outlining the facts and circumstances that led to falling below the threshold(s).

Additionally, the SEC proposes to allow each money market fund to determine the level of liquidity it considers sufficient in connection with the required tests as to whether a fund is able to maintain sufficient minimum liquidity under specified hypothetical events. This departs from requiring funds to test if they can maintain 10% weekly liquid assets under such tests. Each fund would be required to determine the minimum level of liquidity it seeks to maintain during such tests, identify the level in its written testing procedures, periodically test maintaining such liquidity, and provide the fund's board with a report of the results.

The SEC also proposes to require government or retail money market funds (or the fund's principal underwriter or transfer agent on its behalf) to determine that financial intermediaries that submit orders — including through an agent — to purchase or redeem the fund's shares have the capacity to redeem and sell the fund's shares at prices that do not correspond to a stable price per share, or if this determination cannot be made, to prohibit the relevant financial intermediaries from purchasing the fund's shares in nominee name. This comes in response to the concern that interest rates may become negative.

A further proposed amendment to Rule 2a-7 would specify the calculations of "dollar-weighted average portfolio maturity" (WAM) and "dollar-weighted average life maturity" (WAL). WAM and WAL are calculations of the average maturities of all securities in a portfolio, weighted by each security's percentage of net assets. The SEC proposes to require that money market funds calculate WAM and WAL based on the percentage of each security's market value in the portfolio. This increases consistency among the market, decreasing confusion among investors.

The SEC also proposes certain changes to reporting requirements. One such proposal would add a new requirement for a money market fund to file a report on Form N-CR when the fund falls below a specified liquidity threshold, while requiring the filing be filed in a structured data language (*i.e.,* custom eXtensible Markup Language). Under this proposal, a liquidity threshold event, triggering reporting, occurs when the fund has invested less than 25% of its total assets in weekly liquid assets or less than 12.5% of its total assets in daily liquidation assets.

Upon falling below either liquidity threshold, the fund would be required to report the initial date it fell below the threshold, the percentage of the fund's total assets invested in both weekly liquid assets and daily liquid assets on the date of the liquidity threshold event, and a description of the facts and circumstances leading to the event. The proposal also requires funds to provide the registrant's name, series name, and legal entity identifiers for the registrant and series on Form N-CR.

Additional reporting proposals include requiring additional information about the composition and concentration of money market fund shareholders. The proposed rule would require disclosure of the name and percentage of ownership of each person who owns of record or is known by the fund to own beneficially 5% or more of the shares outstanding in the relevant class. For money market funds that are not government money market funds or retail money market funds, they would be required to provide composition of shareholder type and identify the percentage of investors within the following categories: nonfinancial corporation; pension plan; nonprofit; state or municipality government entity; registered investment company; private fund; depository institution or other banking institution; sovereign wealth fund; broker-dealer; insurance company; and other.

The SEC also proposes the addition of a new Part D to Form N-MFP, requiring information about the amount of portfolio securities a prime money market fund sold or disposed of during the reporting period. For purpose of reporting the fund's schedule of portfolio securities in Part C of Form N-MFP, the proposal would require filers to provide required information separately for the initial acquisition of a security and any subsequent acquisition of the security, requiring the trade date on which the security was acquired, and the yield of the security as of the trade date.

Further reporting proposals include requiring daily liquidity, net asset value, and flow data in monthly reports. Also, requiring funds to report gross yields (at the series level) and net yields (at the share class level) each business day.

In addition, the SEC proposes that each fund must identify the name and legal entity identifiers for both the fund registrant and the series.

The SEC further proposes that there be a transition period for compliance with the amendments if adopted:

- A 12-month compliance date for:
    - Any money market fund to comply with the proposed swing pricing requirement and the applicable swing pricing disclosures; and
    - Government and retail funds to determine if financial intermediaries have the capacity to redeem and sell at a price based on the current net asset value per share pursuant to Rule 22c-1 or prohibit the financial intermediary from purchasing in nominee name on behalf of other persons, securities issued by the fund.

- A six-month compliance date for:
  - The proposed increased daily minimum asset and weekly minimum asset requirements; and
  - The amendments to Form N-CR and N-MFP, except the swing pricing-related disclosures on Form N-MFP.

The removal of the liquidity fee and redemption gate provisions in Rule 2a-7, and the removal of associated disclosure requirements in Form N-1A and N-CR, would become effective, if adopted, when the final rule becomes effective.

A copy of the SEC's proposed rule amendments can be found at https://www.sec.gov/rules/proposed/2021/ic-34441.pdf.

SEC Adopts New Rules for Universal Proxy Cards in Contested Director Elections

11.17.21

On November 17, 2021, the SEC announced the adoption of final rules requiring parties in a contested election to use universal proxy cards that include all director nominees presented for election at a shareholder meeting. Registered investment companies and business development companies are not subject to any of the amendments in the final rules at this time. The SEC states, however, that it believes "further consideration of the application of a universal proxy mandate to some or all funds" is appropriate.

The SEC amended the federal proxy rules to require the use of universal proxy cards by management and shareholders soliciting proxy votes for their own candidates in contested director elections. The new rules establish new notice and filing requirements for all soliciting parties, as well as formatting and presentation requirements for universal proxy cards. A universal proxy card lists the names of all duly nominated director candidates for election at an upcoming shareholder meeting, regardless of whether the candidates were nominated by management or shareholders. According to the SEC, the rule changes will give shareholders the ability to vote by proxy for their preferred combination of board candidates, similar to voting in person.

The rule amendments also require enhanced disclosure and voting options in all director elections, including uncontested elections. They mandate that "against" and "abstain" voting options be provided on a proxy card where such options have legal effect under state law. The rule amendments also require disclosure in the proxy statement about the effects of all voting options provided.

The rule amendments will be applicable to shareholder meetings involving director elections held after August 31, 2022.

The SEC's final rule is available at https://www.sec.gov/rules/final/2021/34-93596.pdf.

Risk Alert: Division of Examinations Observations: Investment Advisers' Fee Calculations

11.10.21

On November 10, 2021, the staff of the SEC's Division of Examinations (formerly known as the Office of Compliance Inspections and Examinations or OCIE) released a Risk Alert highlighting compliance issues the staff observed during an initiative that focused on advisory fees, predominantly those charged to retail clients (Advisory Fees Initiative). In the Risk Alert, the staff assessed various ways in which SEC-registered investment advisers charge fees for their services, while also evaluating the adequacy of fee disclosures and the accuracy of fee calculations.

The Risk Alert notes that the staff often reviews whether advisers have: (1) adopted and are following policies and procedures that are reasonably designed to result in the fair and accurate charging of fees; and (2) disclosed their fees with sufficient clarity for their clients to understand the costs associated with their services.

This Risk Alert supplements the Advisory Fees Initiative comments previously published by the staff in April 2018 by providing greater detail on certain compliance issues observed.

The Risk Alert noted that the advisory fee-related deficiencies observed often resulted in financial harm to clients, including: (1) advisory fee calculation errors, such as over-billing of advisory fees, inaccurate calculations of tiered or breakpoint fees, and inaccurate calculations due to incorrect householding of accounts; and (2) not crediting certain fees due to clients, such as prepaid fees for terminated accounts or pro-rated fees for onboarding clients. In addition, the staff observed fee-related compliance and disclosure issues. The Investment Advisers Act establishes a fiduciary duty for investment advisers. The Risk Alert includes the warning that advisers who fail to adhere to the terms of their agreement and disclosures, or otherwise engage in inappropriate fee billing and expense practices, may violate their fiduciary duties and the Investment Advisers Act, including its antifraud provisions.

The Risk Alert devotes several pages to describing examples of notable deficient practices it noticed in its review of approximately 130 advisers.

The Risk Alert is available at https://www.sec.gov/files/exams-risk-alert-fee-calculations.pdf.

Risk Alert: Observations From Examinations of Advisers That Provide Electronic Advice

11.09.21

On November 9, 2021, the staff of the SEC's Division of Examinations issued a Risk Alert outlining certain deficiencies it observed in its examinations of advisers providing automated electronic advisory services, often referred to as "robo-advisers." Providing observations related to the provision of electronic investment advice, the Risk Alert noted deficiencies with respect to a few specific areas, including: (1) robo-advisers' compliance programs (including policies, procedures, and testing), (2) portfolio management practices (including advisers' fiduciary obligations to provide advice that is in each client's best interest), and (3) marketing and performance (including misleading statements and missing or inadequate disclosure). Observations relating to the use of discretionary investment advisory programs identified issues related to robo-advisers' that were relying on, but not acting in accordance with, the internet adviser exemption in the Investment Advisers Act and Rule 3a-4 of the Investment Company Act (Rule 3a-4), which provides a nonexclusive safe harbor from the definition of investment company for certain programs under which investment advisory services are provided on a discretionary basis to a large number of advisory clients with relatively small amounts invested.

With respect to robo-advisers' compliance programs, the Risk Alert noted that most advisers had inadequate compliance programs, most often as a result of either a lack of written policies and procedures, or existing programs that were insufficient for their operations, unimplemented, or untested. Of particular note were observed failings relating to digital advice, including assessing whether the advisers' algorithms were performing as intended and asset allocation and/or rebalancing services were occurring as disclosed. Portfolio management shortcomings noted in the Risk Alert included instances of advisers not satisfying their duty of care, not testing the investment advice generated by their platforms to clients' specific investment objectives, and inaccurate or incomplete disclosures in robo-advisers Forms ADV. Regarding performance advertising and marketing observations, the Risk Alert noted that more than one-half of the advisers had advertisement-related deficiencies, including misleading or prohibited statements on their websites. Cybersecurity and registration deficiencies were noted as well.

Risk Alert observations on robo-advisers' use of discretionary investment advisory programs assessed whether the programs provided retail clients with the sort of unique treatment required for reliance on Rule 3a-4. The staff found that robo-advisers often provided the same or similar investment advice on a discretionary basis to large numbers of advisory clients, frequently using similar asset allocation portfolios and either unaware that the investment programs may be unregistered investment companies, or claimed that programs were relying on Rule 3a-4 when, in fact, the programs didn't comply with the relevant provisions of the rule. Staff observations with respect to Rule 3a-4 also noted shortcomings in obtaining individualized information in establishing client accounts and ongoing communications, among other items.

After completing the examination, the Risk Alert also provided observations on the implementation of practices for robo-advisers to improve their compliance obligations. In response to the staff's observations, some advisers elected to amend disclosures and marketing materials, modify or eliminate performance advertisements, revise compliance policies and procedures, improve data protection practices, and/or change other practices.

The Risk Alert is available at https://www.sec.gov/files/exams-eia-risk-alert.pdf.

Electronic Submission of Applications for Orders Under the Investment Advisers Act and the Investment Company Act, Confidential Treatment Requests for Filings on Form 13F, and Form ADV-NR; Amendments to Form 13F

11.04.21

On November 4, 2021, the SEC proposed amendments to rules to convert the filing of certain applications, confidential treatment requests, and forms from paper to electronic submission. The SEC currently permits and sometimes requires certain forms to be filed or submitted in paper format.

Applications Under the Investment Advisers Act and the Investment Company Act

Section 206A of the Investment Advisers Act gives the SEC the authority to provide exemptions from any provision of the Investment Advisers Act or any rule or regulation thereunder, provided the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Investment Advisers Act. An applicant seeking Investment Advisers Act relief submits its application, as well as a proposed notice of application, in paper and in quintuplicate.

Since 2008, applications for orders under any section of the Investment Company Act, were filed in paper, using a similar process as those seeking orders under the Investment Advisers Act. Based on the staff's experience with electronic filing under the Investment Company Act, the SEC seeks to harmonize the process by which exemptive applications are filed under the Investment Advisers Act. Accordingly, the proposed rules would amend certain rules of Regulation S-T and Investment Advisers Act Rule 0-4 to require electronic filing on EDGAR of applications for an order under any section of the Investment Advisers Act. This is a welcomed reform, which we believe will increase the efficiency in reviewing applications for relief under the Investment Advisers Act.

Also under the Investment Advisers Act, the proposed amendments would require investment advisers' nonresident general partners and nonresident managing agents to file Form ADV-NR electronically through IARD, which is the same system advisers use to file Form ADV.

Rule 13f-1 and Form 13F

Section 13(f) of the Exchange Act, in pertinent part, requires a manager to file a report on Form 13F with the SEC if the manager exercises investment discretion with respect to accounts holding certain equity securities (13(f) Securities), having an aggregate fair market value on the last trading day of any month of any calendar year of at least $100 million.

Under the proposed amendments, the 13(f) Confidential Treatment Requests that filers currently submit to the SEC in paper, typically through the mail or by express delivery, would be required to be submitted electronically via EDGAR.

In addition, the SEC is proposing amendments to Form 13F to require managers to provide additional identifying information. Finally, the SEC is re-proposing certain technical amendments to Form 13F, including modernizing the structure of data reporting and amending the instructions on Form 13F for confidential treatment requests in light of a recent decision of the U.S. Supreme Court.

A copy of the SEC's proposed rule amendments can be found at https://www.sec.gov/rules/proposed/2021/34-93518.pdf.

Division of Investment Management Staff Statement Regarding Withdrawal and Modification of Staff Letters Related to Rulemaking on Investment Adviser Marketing

10.29.21

On October 29, 2021, the SEC's Division of Investment Management announced it was withdrawing and modifying certain staff statements (*e.g.,* no action letters and other staff guidance) relating to the Advertising and Cash Solicitation Rules under the Investment Advisers Act. The withdrawals and modifications are listed in Appendix A to the October 2021 *Investment Management Information Update* issued by the staff.

On December 22, 2020, the SEC adopted amended Rule 206(4)-1 under the Investment Advisers Act, a single rule that will replace each of the current, separate Advertising and Cash Solicitation Rules and will govern investment adviser marketing (Marketing Rule) going forward. The compliance date for the Marketing Rule is November 4, 2022. The adopting release for the Marketing Rule had noted that these staff statements would be withdrawn.

The staff noted that it did not identify any withdrawn no-action letters regarding solicitor disqualification under the Cash Solicitation Rule that would trigger disqualification under the Marketing Rule. The staff encourages persons with a disqualifying event within the Marketing Rule's 10-year lookback period to review their compliance policies and procedures in light of that rule's requirements.

A copy of the staff's statement is available at https://www.sec.gov/files/2021-10-information-update.pdf.

Risk Alert: Observations from Examinations in the Registered Investment Company Initiatives

10.26.21

On October 26, 2021, the staff of the SEC's Division of Examinations (Division) issued a Risk Alert regarding *Observations from Examinations in the Registered Investment Company Initiatives* after a series of examinations that focused on mutual funds and exchange-traded funds (collectively, "funds") to assess industry practices and regulatory compliance in certain areas that may have an impact on retail investors.

The examinations focused on the following categories of funds and their advisers:

- Index funds that track custom-built indexes;
- Smaller ETFs and/or ETFs with little secondary market trading volume;
- Mutual funds with higher allocations to certain securitized investments;
- Mutual funds with aberrational underperformance relative to their peer groups;
- Mutual funds managed by advisers that are relatively new to managing such funds; and
- Advisers that provide advice to both mutual funds and private funds, both of which have similar strategies and/or are managed by the same portfolio managers.

Regarding compliance programs, the staff observed:

- Funds and their advisers that did not establish, maintain, update, follow, and/or appropriately tailor their compliance programs to address various business practices, including portfolio management, valuation, trading, conflicts of interest, fees and expenses, and advertising.
- Issues with funds' policies and procedures for their boards' oversight of the funds' compliance programs.

Regarding disclosure to investors, the staff observed:

- Funds that had inaccurate, incomplete, and/or omitted disclosures in their filings.
- Funds that had inaccurate, incomplete, and/or omitted disclosures on a variety of advertising and sales literature-related topics, such as:
    - Investment strategies and portfolio holdings;
    - The differences in investment objective between predecessor and successor funds;
    - Inception dates;
    - Funds' expenses, contractual expense limitations, and/or expense ratios;
    - Average total returns and/or gross expenses and net expenses;
    - Performance information not disclosed with the required legends;
    - Awards received for fund performance;
    - Weighting of index constituents in the benchmark index;
    - Methodologies for calculating the performance of the benchmark index;
    - Differences in holdings, risk, and volatility between the broad-based and bespoke indexes used for performance comparisons; and/or

- Composition of index used for performance comparisons.

Regarding compliance and disclosure best practices, the staff observed:

- Certain funds and their advisers adopted and implemented compliance programs that provided for the following:
  - Review of compliance policies and procedures for consistency with practices (*e.g.,* funds reviewed their advisers' compliance manuals for specific policies and procedures, addressing various risk areas for which the funds had delegated responsibility to their advisers).
  - Conducting periodic testing and reviews for compliance with disclosures (*e.g.,* review whether funds are complying with their stated investment objectives, investment strategies, restrictions, and other disclosures) and assessing the effectiveness of compliance policies and procedures in addressing conflicts of interests (*e.g.,* review trade and expense allocation policies and procedures in light of potential conflicts that may exist among the various types of accounts managed by the adviser).
  - Ensuring compliance programs adequately address the oversight of key vendors, such as pricing vendors (*e.g.,* written pricing vendor oversight processes include reviewing variance reports on stale or outlier prices and price challenges).
  - Adopting and implementing policies and procedures to address: (1) compliance with applicable regulations (*e.g.,* to identify cross trades, where applicable, and prevent related violations); (2) compliance with the terms and conditions of applicable exemptive orders and any disclosures required to be made under the order; and (3) undisclosed conflicts of interest, including potential conflicts between funds and/or advisers and their affiliated service providers.
- Certain funds' boards provided oversight of funds' compliance programs by assessing whether:
  - The information provided to the board was accurate, including whether funds' and their advisers were accurately disclosing to the boards: (1) funds' fees, expenses, and performance, and (2) funds' investment strategies, any changes to the strategies, and the risks associated with the respective strategies.
  - The funds were adhering to their processes for board reporting, including an annual review of the adequacy of the funds' compliance program and effectiveness of their implementation.
- Certain funds adopted and implemented policies and procedures concerning disclosure, such as those that required:
  - Review and amendment of disclosures in funds' prospectuses, SAIs, shareholder reports, or other investor communications consistent with the funds' investments and investment policies and restrictions.
  - Amendment of disclosures for consistency with actions taken by the funds' boards, as applicable.
  - Update of funds' website disclosures concurrently with new or amended disclosures in funds' prospectuses, SAIs, shareholder reports, or other client communications.
  - Review and testing of fees and expenses disclosed in funds' prospectuses, SAIs, shareholder reports, or other client communications for accuracy and completeness of presentation.
  - Review and testing of funds' performance advertising for accuracy and appropriateness of presentation and applicable disclosures.

In sharing the information in this Risk Alert, the Division encouraged funds and their advisers to review their practices, policies, and procedures in these areas and to consider improvements in their compliance programs and disclosure practices, as appropriate.

The Risk Alert is available at https://www.sec.gov/files/exams-registered-investment-company-risk-alert.pdf.

SEC Proposes to Amend Form N-PX

09.29.21

On September 29, 2021, the SEC proposed to amend Form N-PX under the Investment Company Act to enhance the information mutual funds, exchange-traded funds (ETFs), and certain other funds are required to report annually about their proxy votes, as well as make that information easier to analyze.

The SEC also proposed a new rule (Rule 14Ad-1) and form amendments under the Securities Exchange Act of 1934 (Exchange Act) that would require an institutional investment manager subject to Section 13(f) of the Exchange Act to report annually on Form N-PX how it voted proxies relating to executive compensation matters (*i.e.,* "say-on-pay"), as required by Section 14A of the Exchange Act. The proposed reporting requirements for institutional investment managers, if adopted, would complete implementation of Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Enhancement of Funds' and ETFs' Proxy Voting Disclosures

In 2003, the SEC adopted a final rule on proxy voting disclosures that requires mutual funds, ETFs, and other registered management investment companies to report on the proxy voting records of their portfolio companies no later than August 31 of each year using Form N-PX. The annual filing covers the period from July 1 to June 30.
Form N-PX was originally adopted under the Investment Company Act only. Thus, if adopted, the proposed amendments to Form N-PX will apply under both the Exchange Act and the Investment Company Act.

The SEC's stated goals in proposing the amendments are to enhance proxy voting disclosures, while providing greater protection and transparency for investors. According to SEC Chair Gary Gensler, investors would be able to better understand, analyze, and track the information provided in the annual Form N-PX. Updated Form N-PX would impose the following:

- A requirement that funds and managers tie the description of each voting matter to the issuer's form of proxy and categorize each matter by type to help investors identify votes of interest and compare voting records;
- Prescribe how funds and managers organize their reports and require them to use a structured data language to make the filings easier to analyze; and
- Require funds and managers to disclose how their securities lending activity impacted their voting.

Managers Reporting Obligation on "Say-On-Pay" Voting Matters

The proposal also would implement a statutorily mandated requirement under Section 14A of the Exchange Act by requiring managers subject to Section 13(f) of the Exchange Act to report annually how they voted their proxies on executive compensation matters.

Section 13(f) of the Exchange Act requires a manager to file a report with the SEC if it exercises investment discretion for accounts holding certain equity securities with an aggregate fair market value on the last trading day of any month of any calendar year of at least $100 million. Under the proposal, such managers would provide information on executive compensation voting matters by filing Form N-PX with the SEC no later than each August 31. Similar to funds' and ETFs' current proxy voting disclosures under Form N-PX, the managers' "say-on-pay" disclosures would cover a 12-month period from July 1 to June 30.

The public comment period of 60 days ended on December 14, 2021.

A copy of the SEC's proposed rule and form amendments can be found at https://www.sec.gov/rules/proposed/2021/34-93169.pdf.

Risk Alert: Observations Regarding Fixed Income Principal and Cross Trades By Investment Advisers From an Examination Initiative

07.21.21

On July 21, 2021, the Division of Examinations published a Risk Alert on principal and cross-trading practices by investment advisers. This Risk Alert is a follow-up to a prior Risk Alert published by the staff on September 4, 2019, which highlighted the most common compliance issues observed by SEC staff.

A cross trade occurs when an adviser causes one client to sell a security to another client. A principal trade occurs when an adviser causes a security to be sold to or purchased from a client from or to the adviser's own account (or an account of a related person). A cross trade involving a fund advised by the adviser and another client can be a principal trade if the adviser and its control persons have a significant ownership interest in the fund.

The staff emphasized that, with respect to principal trades, Section 206(3) of the Investment Advisers Act requires advisers to make written disclosures and obtain the consent of the affected client before the transaction is completed. However, the staff also warned that "[c]ompliance with the disclosure and consent provisions of Section 206(3) alone may not satisfy an adviser's fiduciary obligations with respect to a principal or cross trade." According to the staff, there could be circumstances where more particularized conflicts disclosures may be required under the more general anti-fraud provisions of the Investment Advisers Act (*i.e.,* Sections 206(1) and (2)). During the exam initiative, staff focused its review on three general areas: (1) compliance programs, (2) conflicts of interest, and (3) disclosure.

With respect to compliance programs, the staff observed:

1. Failures to comply with the advisers own compliance policies, where:
    a. Advisers engaged in principal trades, which were prohibited by their compliance policies.
    b. Personnel failed to obtain required compliance approvals prior to engaging in trades.
    c. Clients failed to receive clear written disclosure before participating in principal trades.
    d. Cross trades were not executed at an independent market price for securities, as disclosed to clients.
2. Failure to adopt adequate policies, where:
    a. Policies did not include factors for personnel to consider when determining that a trade was in the client's best interest.
    b. Policies did not include provisions designed to meet specific clients' compliance obligations to which the adviser had agreed, for example ERISA restrictions on principal and cross trades.
    c. Policies did not include procedures to "validate" that principal trades and cross trades were affected in a manner that conformed to client disclosures and the Investment Advisers Act.
3. Failure to disclose, where:
    a. Failure to adequately disclose principal and cross-trading activities.

With respect to best practices regarding compliance with Investment Advisers Act Rule 206(3), the staff suggested:

1. ***Define Terms.*** The staff suggested that compliance policies should: (1) incorporate all applicable legal and regulatory requirements; (2) clearly articulate the activities covered by the advisers' written compliance policies and procedures; (3) set standards that address the firms' expectations for each of these activities; (4) include supervisory policies and procedures; and (5) establish controls to determine whether policies and procedures are being properly followed and documented in the required manner.

2. ***Set Standards*.** The staff identified seven standards that they commonly observed in advisers' compliance policies, which reflect an adviser's obligations under the Investment Advisers Act:

    - Transactions are fair and equitable to all participating clients.
    - Pricing methodologies to be followed.
    - Periodic evaluation of execution.
    - Periodic reporting to compliance department.
    - Deliver written information to clients regarding capacity in which the adviser acted.
    - Require written approval from senior management or compliance personnel for certain trades.
    - In the case of principal trades, require prior written consent before the completion of each trade.

3. ***Conduct Testing*.** The staff noted that advisers with written policies and procedures were more likely, as compared to advisers with no or informal practices, to analyze their books and records to identify undisclosed principal and cross trades, and any associated undisclosed conflicts of interest or other issues. Further, some of the examined advisers, when conducting their own internal compliance reviews, identified issues or risks associated with their practices with respect to principal trades, cross trades, or both.

4. ***Written Disclosure.*** The staff described disclosures advisers may consider providing clients:

    - A description of the nature and significance of the conflicts for participating clients.
    - The circumstances under which the adviser will engage in these transactions.
    - Pricing methodologies used to determine at what price the trade will occur.
    - Costs (*e.g.,* brokerage commissions) associated with the transactions.
    - The total amount of commissions or other remuneration associated with these transactions.

The Risk Alert is available at https://www.sec.gov/files/fixed-income-principal-and-cross-trades-risk-alert.pdf.

Risk Alert: Observations From Examinations of Investment Advisers Managing Client Accounts That Participate in Wrap Fee Programs

07.21.21

On July 21, 2021, the staff of the SEC's Division of Examinations released a Risk Alert highlighting compliance issues associated with wrap fee programs from two perspectives, including advisers that: (1) serve as portfolio managers in, or sponsors of, wrap fee programs; and (2) advised their clients' accounts through one or more unaffiliated third-party wrap fee programs (Wrap Fee Initiative).

The Risk Alert discusses that as part of the staff's assessment of marketwide risks and matters of importance to retail investors saving for retirement, the Division of Examinations has prioritized examinations of advisers associated with wrap fee programs, because while wrap fee programs may offer clients certainty concerning advisory and execution costs for implementing, maintaining, and changing their investment strategies, these programs also may create conflicts of interest for advisers and risks to investors.

The staff reportedly observed from the Wrap Fee Initiative that many examined advisers' compliance programs could be improved. The most frequently cited deficiencies were related to: (1) compliance and oversight, including policies and procedures regarding the tracking and monitoring of the wrap fee programs; and (2) disclosures, including disclosures regarding conflicts, fees, and expenses. In some instances, the staff noted it had questioned the appropriateness of recommendations of wrap fee programs for clients, particularly when the clients had no or low trading volume in their accounts.

The Risk Alert discusses these deficiencies and other staff observations, and it concludes by noting that in response to the staff's observations, advisers elected to amend disclosures, revise compliance policies and procedures, conduct suitability reviews of wrap fee clients, or change other practices.

The Risk Alert is available at https://www.sec.gov/files/wrap-fee-programs-risk-alert_0.pdf.

LITIGATION AND ENFORCEMENT

SEC Charges 27 Financial Firms for Form CRS Filing and Delivery Failures

07.26.21

On July 26, 2021, the SEC announced the settlement of regulatory enforcement actions against 21 investment advisers and six broker-dealers relating to failures to timely file and deliver their customer or client relationship summaries (Form CRS) to retail investors (collectively, the "Orders").

Form CRS, created as part of the rulemaking adopted by the SEC in July 2019 that produced Regulation Best Interest among other items, was intended to serve several purposes, according to the SEC, including to enhance and clarify the standards of conduct applicable to broker-dealers and investment advisers and to help retail investors better understand and compare the services offered to make informed choices.

As part of the rulemaking, SEC-registered investment advisers and SEC-registered broker-dealers were required to file their respective Forms CRS with the SEC; begin delivering them to prospective and new retail investors by June 30, 2020; and deliver them to existing retail investor clients or customers by July 30, 2020, in addition to prominently posting respective current Forms CRS on the firm website, if they had one. According to the Orders, each of the firms against whom enforcement actions were taken missed such regulatory deadlines. The Orders indicated that none of the firms filed or delivered the Form CRS, or posted it to its website, until being twice reminded of the missed deadlines by the applicable regulator (the SEC or FINRA). The actions set out in the Orders involved civil penalties, ranging from $10,000 to $97,523, for a total of $910,000, with the most common penalty being $25,000.

Links to the Orders can be found at https://www.sec.gov/news/press-release/2021-139.

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