



Mutual Fund Directors Forum
Observations from SEC Examinations of Registered Investment Companies
March 1, 2022 2:00-3:00 pm ET

Moderator:

Joanne Skerrett

Panelists:

Allison K. Fraser

Karen Jacoppo-Wood

Elizabeth J. Reza

Kevin M. Gleason

Observations from SEC Examinations of Registered Investment Companies



Agenda

- Background on the SEC's Interest in Registered Funds and its Registered Funds Initiative
- Overview of SEC Risk Alert Issued October 26, 2021: Observations from Examinations in the Registered Investment Company Initiatives
- Topics of Interest and Concern for Board Members, Outside Counsel, Internal Legal Staff, and Compliance Officers:
 - Board Oversight Practices
 - Policies and Procedures
 - Disclosures To Investors
 - Annual Reviews and Reports
- Enforcement Statistics and Rhetoric regarding Registered Investment Companies and Investment Advisers
- Conclusion: Lessons Learned and Takeaways

Background on Registered Funds Initiative

- Through its broad examination function, the SEC staff has a unique ability to observe industry trends with respect to what firms are doing well, and perhaps most importantly, what firms are doing poorly with respect to compliance.
- Periodically, after completing a series of examinations, the staff of the Division of Examinations publishes what it has learned in the form of an industry-wide risk alert.
- These risk alerts can be useful to industry participants, particularly where they highlight areas of deficient compliance programs.
- They also function as somewhat of a roadmap for upcoming areas of examination inquiry, as the staff expects industry participants to make appropriate adjustments to their compliance policies and procedures in response to risk alerts and will often cite to risk alerts in deficiency letters.

Background on Registered Funds Initiative

- On October 26, 2021, the U.S. Securities and Exchange Commission's (SEC) Division of Examinations (the Division) issued a [Risk Alert](#) that provides observations from examinations conducted as part of the Division's registered investment company initiatives (RIC Initiatives). Announced in a [November 2018 Risk Alert](#) and included in the Division's fiscal year 2019 priorities, the RIC Initiatives involved a series of examination initiatives focused on mutual funds and exchange-traded funds to assess industry practices and regulatory compliance in certain areas that may have an impact on retail investors.
- The SEC examined more than 50 fund complexes, more than 200 funds and/or series of funds, and nearly 100 advisers with a focus on practices and compliance in areas that may have an impact on retail investors.
- The SEC and its current leadership have made strong statements and taken more aggressive stances with regard to examination and enforcement of registered investment companies and their investment advisers.

Overview of Risk Alert

- The RIC Initiatives focused on funds and/or their investment advisers that fell into one or more of the following six categories:
 1. Index funds that track custom-built indexes;
 2. Smaller ETFs and/or ETFs with little secondary market trading volume;
 3. Mutual funds with higher allocations to certain securitized investments;
 4. Mutual funds with aberrational underperformance relative to their peer groups;
 5. Mutual funds managed by advisers that are relatively new to managing such funds; and
 6. 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.
- In conducting its examinations, the SEC assessed the effectiveness of policies and procedures in addressing risks, disclosures made to investors and fund boards, and fund governance practices.
- The October 26 risk alert notably highlighted deficiencies and weaknesses in almost every area of fund and adviser compliance and regulatory obligations.

Board Oversight Practices

- The Division observed that some examined funds did not have appropriate policies, procedures, and processes for monitoring and reporting to their boards on certain information.
- Failure to ensure appropriate policies and procedures for funds and advisers to report accurate information to their boards.
- Failure to ensure appropriate processes for the fund's board to conduct an annual review and approval of the fund's investment advisory agreement.
- Failure to conduct annual reviews of the fund's compliance programs to ensure adequacy and effectiveness.
- Failure to ensure the annual report prepared by the fund's chief compliance officer addresses whether the adviser has adequate policies and procedures to address specific risk areas.
- Failure to design and implement policies and procedures for the fund's board to exercise appropriate oversight of responsibilities delegated to the adviser.

Policies and Procedures

- The first set of findings in the risk alert focused on the effectiveness of the compliance policies and procedures of the funds and their advisers to address certain risks – particularly in the areas of disclosures, portfolio management compliance, and conflicts of interest.
- Specifically, the SEC noted that it had observed deficiencies with respect to firms’ compliance programs and practices relating to the following non-exhaustive list of activities:
 - Investment guideline monitoring (including compliance with investment restrictions, limitations on investments in derivatives, and Rule 35d-1, the “Names Rule”).
 - The operation of a fund’s liquidity risk management program.
 - Trading practices, including trade allocation and aggregation, principal transactions, cross trading, and use of soft dollars.
 - Fund valuation processes, including the oversight of pricing vendors and the involvement of investment personnel in the valuation process.
 - Engagement of third-party service providers, including index providers, financial intermediaries, and providers of shareholder services.
 - Annual fund contract renewal processes.
 - Annual fund compliance review processes.

Policies and Procedures

- The breadth of these observations shows that the SEC examinations can be very wide-ranging and suggests that funds and their advisers should review their policies, practices, and procedures over perhaps the entire range of mutual fund operations and compliance functions. While many of these observations were unsurprising (e.g., marketing material reviews), there were a few observations that may deserve additional focus:
 - The staff noted deficiencies in the “oversight of the viability of smaller and/or thinly traded ETFs ... and their liquidation,” as well as funds’ failure to have board reporting processes regarding “whether a fund’s liquidation may be in the best interests of the fund and its shareholders.” These findings suggest advisers and fund boards should be periodically discussing the viability of their smaller funds and developing contingency plans where funds fail to gain sufficient traction in the market.
 - Another deficiency noted by the staff related to “sharing of soft-dollar commissions among clients to assess whether any client is disadvantaged.” While the soft-dollars safe harbor allows advisers to assess whether the amount of commissions paid in the aggregate is reasonable in relation to the value of research provided for the benefit of the adviser's overall clients, this observation is a reminder that a board may want to monitor whether it is comfortable that the funds it oversees are receiving appropriate value if they are paying soft dollars.
 - The staff also noted that advisers were deficient where they did not review index provider relationships for: (1) conflicts of interest with advisers (e.g., shared personnel or other business relationships, such as revenue sharing); and (2) the sharing, or the potential misuse, of material non-public information. Furthermore, the staff noted deficiencies in the case of affiliated index providers’ websites – accessible through hyperlinks in the statements of additional information (SAIs) of self-indexing funds – to access whether the websites may be deemed fund sales literature that should be filed with the Commission or FINRA.

Disclosures to Investors

- The disclosure focus identified several inaccurate, incomplete, or omitted disclosures in both fund filings and sales and advertising literature.
- Fund Filings: These issues included omissions in investment strategies and risks; potential conflicts with allocating investment opportunities among overlapping strategies; and changes in the indexes used for comparison.
- They also included inconsistent and inaccurate information regarding the funds' net assets and expense information, contractual expense limitations, and operating expense calculations.
- Additionally, the Division noted that there were often omissions in disclosure in fund statements of additional information (SAIs) regarding required information about board committees and information about number of accounts and total assets managed by portfolio managers.

Disclosures to Investors

- Sales and Advertising Literature: The Division observed inaccurate, incomplete, and/or omitted disclosure regarding a number of topics including: inception dates of funds, investment strategies and portfolio holdings, weighting of index constituents in the benchmark index, and investment objective differences between predecessor and successor funds.
- The Division also observed inaccurate, incomplete, and/or omitted disclosure regarding such issues as: fund expenses - including gross and net expenses, average total returns, performance information, awards received, differences in the broad based and bespoke indexes used for performance comparison, and composition of indexes used for performance comparison.
- Fees, Expenses, and Performance: Material omissions or misstatements with regard to these matters often result in enforcement actions.

Annual Reviews and Reports

- As noted, the Division observed deficiencies pertaining to fund governance practices for having deliberative processes utilized by funds and funds' boards in connection with exercising oversight of funds' compliance programs.
- A key element of such oversight is the annual compliance review. Rule 38a-1 of the '40 Act requires each registered fund to review adequacy of the policies and procedures and effectiveness of implementation of:
 - The fund
 - Each investment adviser
 - Principal underwriter
 - Administrator
 - Transfer agent
- The Risk Alert identified that certain funds had not completed the annual review
 - Notably, the report by the CCO did not address the operation of the policies and procedures of the fund's adviser

Annual Reviews and Reports

- Annual reviews should assess compliance policies of service providers for consistency with fund practices
 - Example: Adviser's compliance policies for allocation of investments, investment guideline monitoring, affiliated transactions and cross trades
- Conducting periodic testing and reviews of service providers
 - Identify conflicts of interest and managing/mitigating controls
- Conduct initial and ongoing due diligence of key vendors, such as pricing vendors
- Fund Boards need to be apprised of:
 - Material Compliance Matters
 - Conflicts of Interest
- Boards should meet in executive session with CCO to discuss compliance program reviews
- In situations where the fund uses affiliated service providers, consider having periodic compliance reviews by independent third-parties

Enforcement Statistics and Rhetoric

Enforcement Categories						
	2021	2020	2019	2018	2017	2016
Broker Dealer	110	142	38	63	53	61
Delinquent Filings	120	130	-	-	-	-
FCPA	5	10	18	13	13	21
Insider Trading	28	33	30	51	41	45
Investment Advisor/Companies	159	137	92	108	82	98
Issuer Reporting/Audit & Accounting	70	74	191	79	95	93
Market Manipulation	31	28	30	32	41	30
Miscellaneous	7	6	1	3	7	9
NRSRO	2	4	0	2	0	2
Public Finance Abuse	12	12	14	15	17	97
Securities Offering	150	138	108	121	94	90
SRO/Exchange	1	-	3	1	-	-
Transfer Agent	2	1	1	2	3	2
Total	697	715	526	490	446	548

- **SEC Chair Gary Gensler:**

- So, if you're asking a lawyer, accountant, or adviser if something is over the line, maybe it is time to step back from the line. Remember that going right up to the edge of a rule or searching for some ambiguity in the text or a footnote may not be consistent with the law and its purpose.
- As we think about enforcement, to me, the idea is pretty simple: We need rules of the road and a cop on the beat to protect everyday investors and achieve our three-part mission. Enforcement is about following the facts and the law, wherever they may lead, on behalf of investors and working families.
- At the SEC, we are focused on going after misconduct wherever we find it in the financial system. That means holding individuals and companies accountable, without fear or favor, across the approximately \$100 trillion capital markets which we oversee. Individual accountability is an important part of any enforcement agenda. I believe we should continue to pursue bars and similar relief, where appropriate, to protect the public.
- That also means bringing cases that matter to all parts of our mission — whether deceptive conduct by private funds, offering or accounting frauds, insider trading, market manipulation, failures to act in retail customers' best interests, reporting violations, best execution and fiduciary violations, or any other form of misconduct.

- **Director Division of Enforcement Gurbir Grewal:**

- When gatekeepers are living up to their obligations, they serve as the first lines of defense against misconduct. But when they don't, investors, market integrity, and public trust all suffer. Encouraging your clients to play in the grey areas or walk right up to the line creates significant risk. It's when companies start testing those lines that problems emerge and rules are broken. And even if that's not the case, the public loses faith in institutions that appear to be trying to get away with as much as they can. That's why gatekeepers will remain a significant focus for the Enforcement Division, as evidenced by some of our recent actions.
- [I]n addition to punishing misconduct, our remedies must deter it from happening in the first place. . . . When it comes to accountability, few things rival the magnitude of wrongdoers admitting that they broke the law . . . Admissions, given their attention-getting nature, also serve as a clarion call to other market participants to stamp out and self-report the misconduct to the extent it is occurring in their firm. Officer and director bars, likewise, are a critical tool in our efforts. Another related tool we have to help prevent future misconduct is the conduct-based injunction, which enjoins a defendant from engaging in specific conduct in the future. In certain cases, our settlements include undertakings that are tailored to address the underlying violations and affect future compliance, which can include limiting the activities, functions, or operations of a company. In addition, the Commission can require the settling party to hire an independent compliance consultant to review policies and procedures and to determine improvements that can prevent future misconduct.
- You should expect to see us recommend aggressive use of these prophylactic tools to protect investors and the marketplace, and relatedly the public's trust that all institutions and individuals are playing by the same rule set. And we'll take a particularly hard look at whether we need to deploy these tools if the specific offender is a recidivist. When a firm repeatedly violates our laws or rules, they should expect that the remedial relief we seek will take that repeated misconduct into account.

Conclusion

Lessons Learned – Takeaways

1. If you have not heard from your fund and adviser CCOs about the October risk alert, consider asking whether the compliance teams are going through all the items in the risk alert and considering whether there are any gaps.
2. If any comments/deficiencies were noted by the SEC staff at the time of the SEC's last exam of the funds or adviser, consider asking about the status of the responsive actions taken. Are there policies or practices that address the issues identified?
3. Boards should consider asking how CCOs and compliance teams prepare themselves for SEC exams (e.g., mock exams, review of recent SEC exam questions, or engaging an independent third-party to review and test a fund's compliance program or aspects of the program).
4. All of the actions taken by the board and by the adviser regarding any such reviews undertaken on these topics should be documented and retained as books and records of the funds and/or adviser.

Appendix

- “Observations from Examinations in the Registered Investment Company Initiatives,” SEC Division of Examinations Risk Alert (Oct. 26, 2021) (<https://www.sec.gov/files/exams-registered-investment-company-risk-alert.pdf>).
- “Risk Alert: Risk-Based Examination Initiatives Focused on Registered Investment Companies,” SEC Division of Examinations (Nov. 8, 2018).
- SEC Division of Examinations, 2019 Examination Priorities (December 18, 2018).
- Ropes & Gray’s Investment Management Update October – November 2021 (December 13, 2021).
- State Street Regulatory Legal fundRegulatoryBriefs October 2021 – December 2021.
- Compliance Solutions Strategy Roadmap for Registered Investment Companies and Their Advisers (November 2021).

Biography for Allison K. Fraser

- **DIRECTOR OF RIC SERVICES**

- **Compliance Solutions Strategies**

- Allison provides compliance consulting services to investment advisers, registered investment companies and private investment funds, including conducting annual compliance program reviews and testing, developing risk assessments and preparing for SEC examinations.

- She also assists clients with drafting policies and procedures and preparing regulatory filings. On behalf of, the Compliance Services division of CSS, Allison served as the Chief Compliance Officer for a family of alternative funds registered under the Investment Company Act of 1940.

- Prior to joining CSS, Allison served as a Senior Vice President of Compliance at Northern Trust Investments, Inc. (“NTI”), the asset management subsidiary of The Northern Trust Company. In this capacity, she managed and administered the compliance due diligence program for NTI’s Multi-Manager Solutions and Outsourced Chief Investment Officer businesses. Allison also was the Chief Compliance Officer of two registered funds of hedge funds advised by NTI as well as a member of the funds’ Pricing and Disclosure Committees. Before joining NTI, Allison served as the Compliance Director for General Motors Asset Management, where she assisted with the administration of the compliance program for this registered investment adviser.

- Allison earned a B.S. from the University of Vermont and a Legal Assistant Certificate from The George Washington University. Allison has also obtained the designation as a Certified Fraud Examiner (CFE). The CFE credential denotes proven expertise in fraud prevention, detection and deterrence.



Biography for Karen Jacoppo-Wood

- **MANAGING DIRECTOR AND MANAGING COUNSEL**

- **State Street**

- Ms. Jacoppo-Wood has over 25 years of experience in the financial services industry at third-party service administrators and premier global investment advisers. Ms. Jacoppo-Wood leads State Street's Fund Administration Legal Department, a global group of approximately 40 attorneys and paralegals who provide 1940 Act regulatory and corporate governance services to various types of investment companies, including alternative funds, interval funds, BDCs and ETFs, sponsored by asset managers. She has also served on industry panels for the Independent Directors Council and State Street.

- Prior to joining State Street, Ms. Jacoppo-Wood served as Associate General Counsel at Reit Management & Research LLC and Vice President of RMR Advisors, Inc. and RMR Funds, where she was responsible for overseeing a broad variety of legal matters in connection with a large portfolio of office, industrial, hospitality and senior living assets and for managing all regulatory and corporate governance obligations of a proprietary fund family. Ms. Jacoppo-Wood also served as Counsel at Pioneer Investment Management, Inc. and BISYS Fund Services, Inc., providing legal administration services to open-end and closed-end funds, variable annuity funds and multi-class funds.

- Ms. Jacoppo-Wood began her legal career as a paralegal with The Boston Company, Inc. and Scudder, Stevens & Clark, Inc., where she managed other paralegals and coordinated and oversaw the regulatory and corporate governance obligations of a broad group of clients and funds.

- Ms. Jacoppo-Wood holds a law degree from Suffolk University Law School. She also holds a Bachelor of Arts degree from Stonehill College. She is a member of the Massachusetts Bar.



Biography for Elizabeth J. Reza

- **Partner**
- **Ropes & Gray**
- Elizabeth Reza brings a deep understanding of the registered funds regulatory and business landscape to her work with asset managers. A partner in Ropes & Gray's asset management group and former co-head of the firm's registered funds practice, Elizabeth works with clients on everything from launching and operating innovative new fund products to carrying out fund mergers and other transactions and advising on compliance and governance matters.
- In recent years, Elizabeth has devoted significant time to guiding clients that are looking to bring non-traditional asset classes to retail investors, and is familiar with a wide range of alternative investment strategies. In addition to her work with asset managers, Elizabeth counsels independent directors and trustees who oversee fund complexes.



Biography for Kevin M. Gleason

- **Senior Vice President -- Voya Investment Management LLC**
- **Chief Compliance Officer – Voya Funds**
- Mr. Gleason has nearly twenty years of legal and compliance experience at four different global Fortune 500 diversified financial services organizations holding senior level leadership positions. Currently, he manages the compliance function and has oversight responsibility for Voya's funds business with nearly a \$100 billion in assets. Over the course of his career, he has advised institutional asset managers, retail investment advisers, insurance companies, banks and trust companies, broker-dealers, futures commission merchants, commodity trading advisors, commodity pool operators, and hedge funds. He is skilled at developing and implementing compliance and risk management policies and procedures; educating senior management on effective controls and processes; structuring corporate committees, establishing reporting and certification procedures and conducting due diligence on sub-advisers and third-party service providers. He has transacted business on five (5) continents interacting with many of the local regulators and traveled throughout Asia, Europe, and to the Middle East. Mr. Gleason is a dual citizen of the United States and Ireland. He is a board member at National Society of Compliance Professionals (past Chair of the Governance Committee), the Arizona Science Center (past Chair of the Risk Committee), and the Journal of Financial Compliance. Mr. Gleason is a life-long learner. He is a graduate of the University of Notre Dame. He holds a JD/LLM in Financial Services Law and has completed an MBA at the University of Chicago. He recently earned a Certificate in Data Analytics through Cornell University.



Questions

