

**MEMO# 35929**

November 20, 2024

# **SEC Staff Issues Risk Alert on Registered Investment Company Examinations**

[35929]

November 20, 2024

TO: ICI Members

Chief Compliance Officer Committee

Chief Risk Officer Committee

Internal Audit Committee SUBJECTS: Compliance RE: SEC Staff Issues Risk Alert on Registered Investment Company Examinations

Earlier this month, the Securities and Exchange Commission's Division of Examinations issued a Risk Alert: (i) providing insights into the risk-based selection process it uses to choose which registered investment companies ("funds") to examine; (ii) highlighting key deficiencies and weaknesses it has observed in fund compliance programs, disclosures and filings, and governance practices; and (iii) identifying information it typically requests as part of any fund examination.[\[1\]](#)

The Risk Alert focuses on funds, as they are one of the primary investment vehicles that investors, including retail investors, use to save for retirement, and because of their tremendous growth over the years. It adds that fund examinations primarily focus on whether funds:

- 1) have adopted and implemented effective written policies and procedures to prevent violation of the federal securities laws and regulations;
- 2) provide clear and accurate disclosures that accord with the funds' practices; and
- 3) promptly address compliance issues, when identified.

This memo summarizes each of the Risk Alert's three main sections.

## **Examination Selection and Scoping**

The Division uses a risk-based approach to select funds for examination that often combines real-time and periodic assessments of information from both internal and external sources. For example, staff constantly evaluate tips, complaints, and referrals, data submitted in Commission filings, and a fund's or adviser's specific risk factors (e.g., business activities, conflicts of interest, and/or regulatory history). In addition, the Division

may consider various factors, including:

- 1) Whether a fund's investment strategy and/or portfolio holdings meet criteria relevant to the focus areas described in the Division's priorities;
- 2) Whether new regulatory requirements are applicable to a fund; and
- 3) The fund complex's examination history or when the fund first commenced operations.

Although some exams are limited in scope or are thematic, the majority incorporate core areas that are tailored to address applicable business practices, conflicts, and higher risk areas. In this regard, the Division typically will review three core areas: fund compliance programs (assessing effectiveness and whether they address certain risks, such as allocating expenses between the fund and adviser), fund disclosure and regulatory reports (for their consistency and appropriateness, and for conflicts of interest), and fund governance (evaluating governance processes, the efficacy of board oversight, and the investment advisory agreement approval process).

### **Staff Examination Observations**

The Risk Alert identifies the following common deficiencies and weaknesses in each of the three core areas (i) fund compliance programs; (ii) fund disclosures and filings; and (iii) fund governance practices.[\[2\]](#)

#### **Fund Compliance Programs**

- 1) Funds did not perform the required oversight or reviews under their policies and procedures or perform required assessments of the effectiveness of their compliance programs;
- 2) Funds did not adopt, implement, update, and/or enforce policies and procedures, including those addressing critical areas of fund compliance (e.g., requirements for custody, derivatives and liquidity risk management programs, valuation of portfolio assets, and affiliated transactions);
- 3) Policies and procedures were not tailored to the funds' business model or were incomplete, inaccurate, or inconsistent with actual practices;
- 4) Funds' Codes of Ethics were not adopted, implemented, followed, enforced, or did not otherwise appear adequate; and
- 5) CCOs did not provide requisite written annual compliance reports to fund boards.

#### **Fund Disclosures and Filings**

- 1) Fund registration statements, fact sheets, annual reports, and semi-annual reports contained incomplete or outdated information or contained potentially misleading statements;
- 2) Sales literature, including websites, appeared to contain untrue statements or omissions of material fact; and
- 3) Fund filings were not made or were not made on a timely basis.

## Fund Governance Practices

- 1) Fund board approvals of advisory agreements appeared to be inconsistent with the Investment Company Act of 1940 and/or the funds' written compliance procedures;
- 2) Fund boards did not receive information to effectively oversee fund practices, including for illiquid investments and changes to funds' compliance programs;
- 3) Fund boards did not perform required responsibilities (e.g., annually determining whether certain joint liability insurance policies were in the funds' best interest or adopting certain written policies and procedures tailored to the funds' operations);
- 4) Fund board minutes did not fully document board actions, resulting in deficiencies under the books and records requirements.

## Typical Information Requests

Lastly, the Division outlines what the initial request for information sought from funds typically includes, which are: (i) general information about a fund's business and operations; (ii) 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; (iii) information to assess board governance processes and the efficacy of board oversight of the fund's compliance program; and (iv) information to facilitate the staff's own testing for compliance in various areas.

To aid funds and their advisers, the Division includes an attachment to the Risk Alert describing the types of initial information that it may request and review during a typical fund examination.<sup>[3]</sup> We replicate that attachment and attach it as Appendix A to this memo.

Kenneth Fang  
Associate General Counsel

Robert Hill  
Legal Intern

### Notes

<sup>[1]</sup> SEC Division of Examinations, [Risk Alert: Registered Investment Companies: Review of Certain Core Focus Areas and Associated Documents Requested](#) (Nov. 4, 2024).

<sup>[2]</sup> The staff identified each deficiency or weakness after evaluating deficiency letters sent to funds during the most recent four-year period.

<sup>[3]</sup> The attachment begins on page 8 of the Risk Alert.