

Investment Management Update

October–November 2024

ROPES & GRAY

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SEC Publishes 2025 Examination Priorities

On October 21, 2024, the SEC Division of Examinations (“EXAMS”) published its annual [Examination Priorities](#) applicable to SEC-regulated entities.

EXAMS identified the following examination focus areas relevant to registered funds and their advisers:

- Fund fees and expenses, and any associated waivers and reimbursements;
- The oversight of service providers, both affiliated and unaffiliated;
- Portfolio management practices and disclosures, for consistency with claims about investment strategies or approaches and with fund filings and marketing materials; and
- “[I]ssues associated with market volatility.”

EXAMS also will continue to monitor certain developing areas of interest, such as registered funds “with exposure to commercial real estate and compliance with new and amended rules.” As is typical, EXAMS stated that they will prioritize examinations of funds that have never been examined (including recently registered funds) and funds that have “not been recently examined.”

For private fund advisers, EXAMS stated it will continue to prioritize specific topics, including:

- Whether (i) disclosures are consistent with actual practices, (ii) advisers are meeting their fiduciary obligations in times of market volatility, and (iii) private funds are exposed to interest rate fluctuations;
- The accuracy of calculations and allocations of private fund fees and expenses (both fund-level and investment-level);
- The disclosure of conflicts of interests and risks, and the adequacy of policies and procedures; and
- Compliance with recently adopted SEC rules, including amendments to Form PF and the updated rules that govern investment adviser marketing.

EXAMS additionally highlighted “risk areas impacting various market participants,” noting that:

- Cybersecurity remains a perennial examination priority and, accordingly, EXAMS will focus on cybersecurity practices by registrants to ensure the safeguarding of customer records, information, and assets;

- EXAMS will review registrant representations regarding their AI capabilities and use and assess whether firms have implemented adequate policies and procedures to monitor and/or supervise their use of AI in various contexts, including the use of AI for tasks related to fraud prevention and detection, back-office operations, anti-money laundering, and trading functions; and
- EXAMS will continue to monitor the crypto asset markets and, when appropriate, conduct examinations of registrants offering crypto asset-related services.

EXAMS Risk Alert Concerning Registered Funds

On November 4, 2024, EXAMS published a [Risk Alert](#) to provide “insight regarding the examination process for [registered] funds,” and an “attachment that outlines the types of documents and information typically requested” by its staff. Consistent with EXAMS’ practice, the Risk Alert also included a summary of the most common deficiencies and weaknesses observed by EXAMS staff based upon a review of deficiency letters sent to funds during the most recent four-year period.¹

I. Examination Selection and Scoping

The Risk Alert describes EXAMS’ process for selecting examination candidates. EXAMS considers a variety of factors, including whether a fund’s investment strategy and/or portfolio holdings meet criteria relevant to that year’s Examinations Priorities, as well as new regulatory requirements that are applicable to funds, and a fund complex’s examination and regulatory history. In addition, the process includes assessments based on both internal and external information that will include data submitted in SEC filings, which is then combined with a qualitative assessment of potential risk factors.

The Risk Alert’s Attachment reflects the types of initial information, including documents, that the EXAMS staff may request and review during an ordinary-course fund examination. The Risk Alert categorizes the requests into three “core areas,” consisting of (i) compliance programs, (ii) disclosure and regulatory reports, and (iii) fund governance.

II. Staff Observations from Examinations

The remainder of the Risk Alert summarizes the most common deficiencies and weaknesses observed by EXAMS staff based upon a review of deficiency letters that fell within the three core areas, as described above.

Fund Compliance Programs. The following examples of deficiencies or weaknesses observed by the EXAMS staff that relate to funds and their advisers’ compliance programs:

- Funds that did not perform required oversight or reviews as stated in their policies and procedures or perform required assessments of the effectiveness of their compliance programs;
 - Funds that failed to adopt, implement, update, and/or enforce policies and procedures, including those addressing critical fund areas of compliance with the federal securities laws by funds and their service providers;
 - Funds whose policies and procedures were not tailored to the funds’ business model or were incomplete, inaccurate, or inconsistent with actual practices;
 - Funds with codes of ethics that were not adopted, implemented, followed, enforced, or did not otherwise appear adequate, including instances where the funds did not appear to have effective policies and procedures to address compliance with their codes of ethics; and
 - Fund CCOs who failed to provide required written annual compliance reports to fund boards (including instances where the funds did not have an appointed CCO or had an interim CCO who did not prepare the requisite report).
- Fund Disclosures and Filings.** The following are the most common deficiencies or weaknesses observed by the EXAMS staff concerning disclosure issues:
- Fund registration statements, fact sheets, annual reports, and semi-annual reports that contained incomplete or outdated information or contained potentially misleading statements;
 - Fund sales literature, including websites, that appear to contain untrue statements or omissions of material fact; and
 - Funds failing to file required materials with the SEC on a timely basis.
- Fund Governance Practices.** The following are the most common deficiencies or weaknesses observed by the EXAMS staff related to funds’ governance practices:
- Fund boards approving advisory agreements that were inconsistent with the requirements of the 1940 Act and/or the funds’ written compliance procedures. More specifically, the staff observed the following issues in connection with the approval of fund advisory agreements, including (i) boards not reviewing advisory and sub-advisory agreements in a timely manner, (ii) boards that did not request, obtain, and/or consider certain information to evaluate advisory agreements before approving them (e.g., information regarding advisory fees and soft dollar arrangements), and/or (iii) boards not considering material changes to the advisory agreement (e.g., changes of control at the adviser or a change in advisory fees);
 - Fund boards that did not receive certain information to effectively oversee fund practices, including concerning illiquid investments (e.g., funds that did not timely notify their boards that illiquid investments exceeded 15% of net assets and provide a plan to reduce holdings of illiquid investments) and changes to funds’ compliance programs;
 - Fund boards that did not perform required responsibilities, including making required determinations (e.g., annual determination that joint liability insurance policies remained in

the funds’ best interest), and did not adopt written policies and procedures tailored to the funds’ operations; and

- Fund board minutes that failed to fully document board actions.

REGULATORY PRIORITIES CORNER

Upcoming Compliance Dates

The following is a reminder of the upcoming compliance dates of significant SEC rulemakings.

1. **Beneficial Ownership Reporting.** Beneficial owners are required to comply with the revised Schedule 13G filing deadlines on **September 30, 2024**. The compliance date for the structured data (XML-based language) requirements for Schedules 13D and 13G filers is **December 18, 2024**. The related SEC release is summarized in a Ropes & Gray [Alert](#).
2. **Short Position and Short Activity Reporting by Institutional Investment Managers.** Beginning **January 2, 2025**, institutional investment managers that engage in short sales of “equity securities” exceeding certain thresholds are required to file new Form SHO with the SEC within 14 calendar days after the end of each calendar month. The related SEC release is summarized in a Ropes & Gray [Alert](#).

Adviser Settles SEC Enforcement Actions Concerning Transactions with Fund Affiliates

On October 31, 2024, in separate settlement orders (available [here](#) and [here](#)), the SEC announced that it settled two administrative proceedings involving the same registered investment adviser (the “Adviser”). In the first proceeding, among other things, the SEC alleged that the Adviser caused an affiliate to violate Section 17(a)(1) of the 1940 Act with respect to an affiliated person’s transactions with the Adviser’s registered funds. In the second proceeding, the SEC alleged that the Adviser caused registered funds to engage in joint transactions with an affiliated non-US money market fund in violation of Section 17(d) of the 1940 Act and Rule 17d-1 thereunder.

SEC Charges Adviser with Misleading Investors Regarding Funds’ Investment Strategies

In an October 21, 2024 [settlement order](#), the SEC announced that it had settled an administrative proceeding with WisdomTree Asset Management, Inc. (“WisdomTree”), a registered investment adviser to three ETFs (the “ESG Funds”), regarding WisdomTree’s marketing of the ESG Funds and misstatements to the ESG Funds’ board of trustees (“Board”) and investors that the ESG Funds would not invest in companies that were “involved in certain controversial products or activities,” including “fossil fuels” and “tobacco.”

In the October 21 order, the SEC alleged the following:

Board Representations

1. In September 2019, prior to the ESG Funds’ inception date, WisdomTree representatives met on several occasions with the full Board or the Board’s investment committee to seek approval to change the strategy for three ETFs and adopt the ESG Funds’ investment objectives and principal investment strategies.
- In connection with the September 2019 meetings, WisdomTree prepared and distributed to the Board and its investment committee written materials that contained representations about the proposed investment process for the ESG Funds, including the exclusionary screening portion of that process.
- WisdomTree represented to the Board that the model it was developing would have the capability to screen out the securities of issuers that had “any involvement” in fossil fuels and tobacco.
2. In March 2020, WisdomTree provided to the Board an “educational presentation” concerning ESG investment products that was discussed in a Board meeting on September 29, 2020. In three places in that presentation, WisdomTree stated that it was excluding companies involved in, among other activities, “Fossil fuels” and “Tobacco,” including, in one of those instances, specifying that it was excluding companies “with exposure to” any such activities. WisdomTree made similar representations in subsequent presentations.
3. WisdomTree did not describe to the Board any limitations on its ability to conduct exclusionary screening or otherwise describe its interpretation of terms such as “fossil fuels” or “tobacco” in any of its presentations.

Prospectus Disclosures – Fossil Fuel Issuers and Tobacco Issuers

4. From March 2020 until November 2022, the ESG Funds’ prospectuses stated, as it relates to ESG, that WisdomTree “seeks to identify equity securities with positive ESG characteristics as determined by a company’s Sustainability score, which is a composite score based on independent third party ESG research and data and measures a company’s ESG impact along with its exposure to potential controversies.” The prospectuses additionally stated that “[s]ecurities of companies involved in certain controversial products or activities,” including “fossil fuels” and “tobacco,” “are excluded regardless of revenue measures.”
5. From March 2020 until November 2022, the limitations regarding the data sets WisdomTree used in its screening process led to the ESG Funds regularly holding the securities of certain companies involved in fossil fuel-related activities, including companies involved in the transport of coal or the extraction, distribution, or sale of natural gas. In addition, WisdomTree’s model failed to exclude all securities of companies involved in tobacco-related activity. Thus, during this period, WisdomTree continued to invest in companies identified as being involved in retail tobacco sales.

Based upon its findings above, the SEC concluded that WisdomTree violated (i) various antifraud provisions under the Advisers Act, (ii) additional Advisers Act provisions that together require a registered investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, and (iii) Section 34(b) of the 1940 Act, which makes it unlawful for any person to file with the SEC a materially misleading fund registration statement, application, report, or other document pursuant to the 1940 Act. Without admitting or denying the SEC's findings, WisdomTree consented to being censured and agreed to pay a civil penalty of \$4 million to the SEC.

SEC Issues Additional Guidance on Tailored Shareholder Reports

The SEC Division of Investment Management's Disclosure Review and Accounting Office (the "DRAO") is responsible for reviewing fund disclosures, including shareholder report disclosures. On November 8, 2024, the DRAO published [ADI 2024-14](#) titled *Tailored Shareholder Report Common Issues* (the "Report") to highlight recurring issues that it has observed as registered funds implement the new shareholder report requirements and to suggest certain practices. The Report covers eight categories of issues observed by the SEC staff and provides multiple examples in each category, some of which are highlighted below. The Report supplements the staff's existing responses to various frequently asked questions on shareholder reports (the "FAQs," available [here](#)).

- 1. Expense Information.** A fund must include a simplified expense presentation in its annual and semi-annual shareholder report in a specified format. The Report details several recurring issues that the SEC staff has observed. For example, the Report notes, several funds have annualized the expenses in dollars paid on a \$10,000 investment in their semi-annual shareholder report. However, the semi-annual report should reflect the dollar cost over the period and, therefore, should not be annualized. The expenses as a percent of an investor's investment in the fund, on the other hand, must be on an annualized basis.
- 2. Management's Discussion of Fund Performance ("MDFP").** A fund (other than a money market fund) is required to include MDPF in its annual shareholder reports and is permitted, but not required, to include it in its semi-annual shareholder reports. Among the recurring issues observed by the SEC staff in its review of MDPF disclosures, the Report provides the following example. A fund must include a performance table presenting average annual total returns for the past 1-, 5-, and 10-year periods based on the fund's net asset value. However, the SEC staff has observed that many ETFs also disclose their performance based on market value. This additional presentation is not permitted to be included in the shareholder reports.
- 3. Fund Statistics.** Certain fund statistics must be included in a fund's annual and semi-annual shareholder report, including the fund's (i) net assets, (ii) total number of portfolio

holdings, (iii) portfolio turnover rate (other than for money market funds), and (iv) the total advisory fees paid by the fund during the reporting period. A fund may also disclose any additional statistic(s) that the fund believes would help shareholders better understand the fund's activities and operations during the reporting period. The Report states that some funds include portfolio-level statistics, such as average maturity or average credit rating, under the heading "Graphical Representation of Holdings," but these holdings-based statistics should instead be disclosed under the heading "Fund Statistics."

- 4. Graphical Representation of Holdings.** A fund must include in its annual and semi-annual shareholder reports one or more tables, charts, or graphs depicting the fund's portfolio holdings by category, as of the end of the reporting period. A fund is permitted to show its holdings based on the percentage of (i) net asset value, (ii) total investments, (iii) total exposure, or (iv) net exposure attributable to each category. The Report states that some funds have disclosed holdings as a percentage but did not specify whether the percentage is based on net asset value, total investments, or total or net exposure. Form N-1A provides that funds should disclose the basis for their presentation.

In addition, the Report notes that some funds have categorized their holdings based on credit quality but did not provide the special disclosures required for this type of presentation. Form N-1A provides that, if a fund depicts portfolio holdings according to the credit quality, the fund should include a brief description of how the credit quality of the holdings is determined. Moreover, if credit ratings assigned by a credit rating agency are used, the fund should concisely explain how they were identified and selected.

- 5. Material Changes.** A fund's annual shareholder report must include a brief description of certain material changes that have occurred since the beginning of the reporting period. The Report underscores that, if there have been such changes, the cover page (or beginning) of the shareholder report must prominently state that the report describes material fund changes. The SEC staff has observed that some funds have disclosed material fund changes while omitting the required cover page disclosure, while other funds have included the cover page disclosure but did not include any disclosures about material fund changes.
- 6. Availability of Additional Information Online.** A fund's annual and semi-annual shareholder reports must include a statement that informs investors about certain additional information that is available on the fund's website. In addition, Rule 30e-1 under the 1940 Act requires a fund to make the disclosures required by Items 7-11 of Form N-CSR and its complete portfolio holdings as of the close of the fund's most recent first and third fiscal quarters publicly accessible, free of charge, at the website address specified at the beginning of the fund's shareholder report. Despite these requirements, the SEC staff has observed funds that have included broken links in their shareholder reports.

The Report also notes that a link must be specific enough to lead investors directly to the information, rather than to the home page or a section of the fund's website other than on which the information is posted. The link may be to a central site with prominent links to the referenced information.

The Report notes that, while the relevant rules and forms do not prescribe what information must be called when it is referenced on a fund website, the SEC staff has noticed that funds refer to this information as “[semi-] annual reports,” “N-CSR,” or “Financial Statements.” The Report suggests that funds consider referring to this information by a term that is more descriptive of the collective information required by Items 7-11 of Form N-CSR (e.g., “Annual Financial Statements and Additional Information”).

7. Inline XBRL Data Tagging. The Report highlights that funds are required to tag the information in their shareholder reports using Inline XBRL structured data language in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual. The Report also notes that, while a fund may compare its performance to additional indexes (in addition to one or more appropriate broad-based securities market indexes), the SEC staff has observed some funds have tagged all their indexes as broad-based indexes instead of tagging their additional indexes with the separate tag intended for additional indexes.

8. Additional Issues. The Report notes that some funds have included extraneous and sometimes lengthy disclosures such as disclaimers or risk disclosures that are not required or permitted by Item 27A of Form N-1A. The Report reminds registrants that the contents of shareholder reports are restricted to information that is required or permitted under Item 27A of Form N-1A and that funds are required to present the information in shareholder reports in the same order as required under Item 27A of Form N-1A.

IM Staff Statement on FICC Registered Fund Margin Framework under Section 17(f)

On December 13, 2023, the SEC adopted rules (the “Final Rules,” described in a Ropes & Gray [Alert](#)) amending the standards applicable to covered clearing agencies for U.S. Treasury securities. The Final Rules require, among other things, that such covered clearing agencies calculate, collect, and hold margin amounts from a direct participant for its proprietary positions in U.S. Treasury securities separately and independently from margin calculated and collected on behalf of indirect participants. In the Final Rule's adopting release, the SEC took a position that, if, during the five-year period after the effective date of the Final Rules, registered funds use a framework described in the adopting release to post margin at FICC, it would not provide a basis for an enforcement action under Section 17(f) of the 1940 Act.

■ Specifically, the SEC took the position that, for a period of five years beginning on the effective date of the Final Rules,

if a registered fund's cash and/or securities are placed and maintained in the custody of FICC for purposes of meeting FICC's margin deposit requirements that may be imposed for eligible secondary market transactions in connection with the fund's participation in FICC's “Sponsored Program,” it would not provide a basis for enforcement action under Section 17(f) of the 1940 Act if the provision of margin is consistent with certain conditions (the “FICC registered fund margin framework”).

■ On November 21, 2024, the SEC approved FICC's proposed amendments to its rules, including changes related to the separate calculation, collection, and holding of margin for proprietary transactions of direct participants and indirect participant transactions.

Accordingly, on November 22, 2024, the SEC Division of Investment Management issued a [statement](#) confirming that, in the SEC staff's view, the FICC's rules, as amended, would allow a registered fund's margin to be posted at FICC consistent with the FICC registered fund margin framework. In addition, the statement noted, the staff's “view applies equally to tri-party and bilateral repurchase agreement transactions.”

ADDITIONAL ROPES & GRAY ALERTS AND PODCASTS SINCE OUR AUGUST – SEPTEMBER 2024 UPDATE

EDGAR Next: SEC Adopts Improvements to EDGAR Filer Access and Account Management

December 4, 2024

On September 27, 2024, the SEC adopted rule and form amendments to enhance the security and account management of its EDGAR electronic filing system. The amendments, collectively referred to as “EDGAR Next,” aim to address current security flaws in EDGAR access, especially the inability to trace filings by electronic filers (“filers”) to specific individuals and the lack of multifactor authentication. Under current rules, any individual in possession of a filer's EDGAR access codes could file on behalf of the filer, even if unauthorized to do so. EDGAR Next will also facilitate machine-to-machine communication with EDGAR that would provide filers with more efficient and automated filing options through application programming interfaces (“APIs”).

The amendments require filers to authorize EDGAR access to their accounts for only individuals with individual account credentials, authorize administrators for their accounts, and confirm their account information annually, all through a new EDGAR dashboard function (the “dashboard”). Filers who choose to use the optional APIs for machine-to-machine communication with EDGAR will also need to authorize technical administrators, subject to certain exceptions, and use security tokens to communicate with EDGAR. The amendments also amend Form ID, the application form for EDGAR access, to require additional information, including about initial account administrators.

State ESG Update and Analysis for Asset Managers and Financial Institutions

November 20, 2024

Compared to last year, 2024 has seen a significant drop-off in state ESG-related legislation, with half the number of bills proposed and a quarter of the number of bills enacted. This decline might come as a surprise, given that the initiatives motivating last year's wave of activity have not abated – but a closer look reveals that the battleground has arguably shifted from the statehouse to the courtroom as more of these laws have been challenged for their enforceability.

This white paper includes selected commentary on some of the state developments we have tracked this year and addresses what has happened in each of the states in 2024. The first part of this paper includes a roundup of thought leadership covering a variety of state ESG-related topics published in 2024. The second part examines in more granular detail recaps of what has transpired in each state, along with an assessment of the state's policymaking regarding ESG and public pension investments.

A Second Trump Administration: Implications for Asset Managers

November 6, 2024

On Wednesday, November 6, 2024, major media outlets announced Donald J. Trump as the winner of the 2024 U.S. presidential election. This Alert discusses the potential impact of Mr. Trump's election on the SEC and the regulation of asset managers more generally.

Podcast: California Law for Asset Managers: Navigating Noncompete Statutes & Workplace Violence Prevention Plans

October 31, 2024

On this episode of Ropes & Gray's California Law for Asset Managers podcast series, asset management partner Catherine Skulan and employment partners Greg Demers,

Richard Kidd and associate Patrick Maher, discussed recent developments in California employment law that may impact asset managers and their portfolio companies. The group addressed a new California noncompete statute, including a recent case that gives some insight into the contours of the law, and new California requirements to implement comprehensive workplace violence prevention plans.

Court Rejects Activist Hedge Fund's Challenge to Closed-End Fund Majority Voting Standard

October 25, 2024

On October 21, 2024, the Massachusetts Superior Court issued a final ruling in favor of four Eaton Vance closed-end funds and their trustees, rejecting "activist" investor Saba Capital's challenge to the funds' voting standard requiring the support of a majority of outstanding shares to win a contested board election. The ruling followed a seven-day bench trial in which Saba asserted that the majority standard was so difficult to achieve in practice that it denied shareholders a "meaningful opportunity" to elect trustees, relying in large part on evidence of past contested election results. Saba pressed two legal theories as to why the by-law amendment adopting the majority standard should be rescinded, including that it: (i) breached the funds' declarations of trust which grant shareholders the power to vote for the election of trustees and require an annual election of trustees; and (ii) violated Section 18(i) of the 1940 Act, which requires all shares to have equal voting rights. Saba has elected not to appeal the Court's decision.

Ropes & Gray litigators served as trial counsel for the Eaton Vance funds in this matter.

If you would like to learn more about the issues in this IM Update, please contact your usual Ropes & Gray attorney contacts.

1. EXAMS last published Risk Alerts focused on registered funds generally in October 2021 and November 2018. These earlier Risk Alerts were described in Ropes & Gray IM Updates (available [here](#)) (2021) and (available [here](#)) (2018).