U.S. SEC Division of Investment Management Update

September 2024

Proposed Rules

Customer Identification Programs for Registered Investment Advisers and Exempt Reporting Advisers

Summary: On May 13, 2024, the Securities and Exchange Commission (SEC or Commission) and the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a joint notice of proposed rulemaking (NPRM) to apply customer identification program (CIP) obligations to certain investment advisers. The proposed rule would require SEC-registered investment advisers (RIAs) and exempt reporting advisers (ERAs) to, among other things, implement a CIP that includes procedures for:

- Verifying the identity of each customer to the extent reasonable and practicable; and
- Maintaining records of the information used to verify a customer's identity, including name, address, and other identifying information

The proposed rule seeks to prevent illicit finance activity involving the customers of investment advisers by strengthening the anti-money laundering/countering the financing of terrorism (AML/CFT) framework for the investment adviser sector.

Dates: Public comment period is over

https://www.sec.gov/rules-regulations/2024/05/s7-2024-02#BSA-1proposed

Applicable to: RIAs and ERAs

Safeguarding Advisory Client Assets

Summary: The SEC proposed to amend and redesignate rule 206(4)-2 under the Investment Advisers Act of 1940 ("Advisers Act") to enhance investor protections relating to advisory client assets. The proposed amendments would:

- Expand the current custody rule to protect a broader array of client assets and advisory activities to the rule's protections;
- Enhance the custodial protections that client assets receive under the rule; and
- Update related recordkeeping and reporting requirements for advisers.

Dates: Public comment period is over

https://www.sec.gov/rules-regulations/2023/08/safeguarding-advisory-client-assets#IA-6384proposed

Applicable to: RIAs and their investment products

KPMG Observations: The proposed rule is significant in scope and would significantly alter compliance with the custody rule. Coverage of the rule would expand from client securities to client assets such as digital assets. The proposed rule has received many comments. In a speech on May 16, 2024, Chair Gensler said the SEC "have gotten robust feedback" on the proposed rule and he "asked the staff to consider whether it would be appropriate to seek further comment, possibly, on a modified proposal."

Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers

Summary: The SEC proposed new rules and amendments to address certain conflicts of interest associated with the use of predictive data analytics by broker-dealers and investment advisers ("firms") in investor interactions. The proposal would require:

- A firm to eliminate or neutralize the effect of conflicts of interest associated with the firm's use of covered technologies in investor interactions that place the firm's or its associated person's interest ahead of investors' interests;
- A firm that has any investor interaction using covered technology to have written policies and procedures reasonably designed to prevent violations of (in the case of investment advisers) or achieve compliance with (in the case of broker-dealers) the proposed rules; and
- Recordkeeping related to the proposed conflicts rules

Dates: The public comment period is over

https://www.sec.gov/rules-regulations/2023/07/s7-12-23#34-97990proposed

Applicable to: RIAs and their investment products

KPMG Observations: The proposed rule is significant in scope. The proposed rule has received many comments.

Form N-PORT and Form N-CEN Reporting; Guidance on Open-End Fund Liquidity Risk

Summary: On August 28, 2024, the SEC adopted amendments to certain registered investment company (fund) reporting requirements. The amendments are intended to improve the SEC's oversight of the asset management industry and enhance public transparency by:

- Requiring timelier reporting of funds' monthly portfolio holdings and related information to the SEC to promote more effective regulatory monitoring and oversight of the fund industry for the benefit of fund investors;
- Providing for more frequent public disclosure of funds' portfolio holdings to help investors make more informed investment decisions; and
- Requiring information about service providers that open-end funds use to comply with liquidity risk management program requirements to allow tracking of certain liquidity risk management practices.

In connection with the amendments, the SEC also provided guidance related to open-end fund liquidity risk management program requirements.

Dates: The amendments will become effective November 17, 2025. Funds generally will be required to comply with the amendments for reports filed on or after that date, except fund groups with net assets of less than $1 billion will have until May 18, 2026, to comply with the Form N-PORT amendments

https://www.sec.gov/rules-regulations/2024/08/open-end-fund-liquidity-risk-management-programs-swing-pricing-form-n-port-reporting#IC-35308final

Applicable to: Certain Registered Investment Companies that file form N-PORT and N-CEN.

KPMG Observations: The rule will necessitate changes in processes and controls to provide for the more frequent reporting. Funds will want to consider whether any changes are warranted to their liquidity risk management policies and procedures because of the guidance issued by the SEC, including the oversight of their liquidity information service providers.

Qualifying Venture Capital Funds Inflation Adjustment

Summary: The SEC is adopting a rule that adjusts for inflation the dollar threshold used in defining a "qualifying venture capital fund" under the Investment Company Act of 1940 ("Investment Company Act" or "Act"). The final rule also allows the Commission to adjust for inflation this threshold amount by order every five years and specifies how those adjustments will be determined. This rule implements the inflation adjustment requirements of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 ("EGRRCPA") relating to qualifying venture capital funds.

Dates: Effective 9/30/24

https://www.sec.gov/rules-regulations/2024/08/qualifying-venture-capital-funds-inflation-adjustment#IC-35305final

Applicable to: Venture Capital Funds

Registration for Index-Linked Annuities and Registered Market Value Adjustment Annuities and Amendments to Form N-4

Summary: On July 1, 2024, the SEC adopted amendments to provide a tailored form to register the offerings of registered index-linked annuities (RILAs) and registered market value adjustment annuities (registered MVA annuities, and collectively with RILAs, non-variable annuities).

The rule and form amendments are designed to help investors make informed decisions regarding non-variable annuities and will:

- Require offerings of RILAs and registered MVA annuities to be registered on Form N-4;
- Provide investors with tailored disclosures and key information about these complex products;
- Modernize and enhance the registration, filing, and disclosure framework for non-variable annuities;
- Apply a current Commission rule – which provides guidance as to when sales literature is materially misleading – to non-variable annuity advertisements and sales literature; and
- Update the form for all offerings, including those of variable annuities, and make technical amendments to other insurance product registration forms.

Dates: The compliance date for most of the final amendments to Form N-4 and for the related rule and form amendments will be May 1, 2026.

https://www.sec.gov/rules-regulations/2024/07/rila#33-11294final

Applicable to: Variable annuities, RILAs and registered MVA annuities

Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information

Summary: The SEC is adopting rule amendments that will require brokers and dealers (or "broker-dealers"), investment companies, RIA funding portals, and transfer agents registered with the Commission or another appropriate regulatory agency ("ARA") as defined in the Securities Exchange Act of 1934 ("transfer agents") to adopt written policies and procedures for incident response programs to address unauthorized access to or use of customer information, including procedures for providing timely notification to individuals affected by an incident involving sensitive customer information with details about the incident and information designed to help affected individuals respond appropriately. In addition, the amendments extend the application of requirements to safeguard customer records and information to transfer agents; broaden the scope of information covered by the requirements for safeguarding customer records and information and for properly disposing of consumer report information; impose requirements to maintain written records documenting compliance with the amended rules; and conform annual privacy notice delivery provisions to the terms of an exception provided by a statutory amendment to the Gramm-Leach-Bliley Act ("GLBA").

Dates: Larger entities will have until December 3, 2025 to comply with the amendments, and smaller entities will have until June 3, 2026 to comply.

https://www.sec.gov/rules-regulations/2024/06/s7-05-23#34-100155final

Applicable to: Broker-dealers, investment companies, RIAs and transfer agents

Inspections and Examinations

2024 examination priorities applicable to RIAs and investment companies

1. Adherence to the fiduciary standard with a focus on:
   - Investment advice provided to clients regarding products, investment strategies, and account types, particularly those involving:
     (1) Complex products, such as derivatives and leveraged exchange-traded funds (ETFs);
     (2) High cost and illiquid products, such as variable annuities and non-traded real estate investment trusts (REITs); and
     (3) Unconventional strategies, including those that purport to address rising interest rates.
   - Processes for determining that investment advice is provided in clients' best interest, including those processes for
     (1) Making initial and ongoing suitability determinations,
     (2) Seeking best execution,
     (3) Evaluating costs and risks, and
     (4) Identifying and addressing conflicts of interest.
   - Economic incentives that an adviser and its financial professionals may have to recommend products, services, or account types, such as the source and structure of compensation, revenue, or other benefits. Such economic incentives may exist when there is revenue sharing, markups, or other incentivizing revenue arrangements.
   - Completeness, accuracy and representational faithfulness of disclosures to clients related to conflicts of interest.
2. Focus on the efficacy and completeness of the RIAs compliance program with a focus on:
   - Marketing practice assessments for whether advisers, including advisers to private funds, have:
     (1) Adopted and implemented reasonably designed written policies and procedures to prevent violations of the Advisers Act and the rules thereunder including reforms to the Marketing Rule;
     (2) Appropriately disclosed their marketing-related information on Form ADV; and
     (3) Maintained substantiation of their processes and other required books and records
   - Compensation arrangement assessments focusing on:
     (1) Fiduciary obligations of advisers to their clients, including registered investment companies, particularly with respect to the advisers' receipt of compensation for services or other material payments made by clients and others;
     (2) Alternative ways that advisers try to maximize revenue, such as revenue earned on clients' bank deposit sweep programs; and
     (3) Fee breakpoint calculation processes, particularly when fee billing systems are not automated.
   - Valuation of illiquid or difficult to value investments
   - Safeguarding assessments for advisers' controls to protect clients' material non-public information
   - Disclosure assessments to review the accuracy and completeness of regulatory filings

3. Focus on advisers' policies and procedures for:
   (1) Selecting and using third-party and affiliated service providers;
   (2) Overseeing branch offices when advisers operate from numerous or geographically dispersed offices; and
   (3) Obtaining informed consent from clients when advisers implement material changes to their advisory agreements.
4. Focus on RIAs to Private Funds with a focus on:
   - Portfolio risks present when there is exposure to recent market volatility and higher interest rates
   - Adherence to contractual requirements regarding limited partnership advisory committees or similar structures (e.g., advisory boards)
   - Accurate calculation of fees and expenses (both fund-level and investment-level)
   - Due diligence practices
   - Conflicts, controls, and disclosures regarding private funds managed side-by-side with registered investment companies and use of affiliated service providers
   - Compliance with Advisers Act requirements regarding custody including timely completion of audits, distribution of financial statements and reporting on Form ADV
   - Policies and procedures on Form PF reporting
5. Investment company topics including:
   - Fees and expenses with a focus on:
     (1) Charging different advisory fees to different share classes of the same fund;
     (2) Identical strategies offered by the same sponsor through different distribution channels but that charge differing fee structures;
     (3) High advisory fees relative to peers; and
     (4) High registered investment company fees and expenses, particularly those of registered investment companies with weaker performance relative to their peers.
   - Derivatives risk management and valuation programs, policies, procedures and disclosures

Enforcement & Litigation

SEC Charges Independent Director and Ex-CEO with Concealing Close Friendship with Company Executive

9/30/24 – The SEC announced settled charges against a former CEO, Chairman, and board member of a public company, for violating proxy disclosure rules by standing for election as an independent director without informing the board of his close personal friendship with a high-ranking executive thereby causing the company's proxy statements to contain materially misleading statements. Without admitting or denying the SEC's allegations, the board member agreed to resolve the SEC's charges. If the settlement is approved, the individual will be subject to a five-year officer-and-director bar.

The SEC's complaint, filed in U.S. District Court for the Southern District of New York, alleges that, between January 2020 and March 2023, the board member maintained a close personal relationship with a member of the company's executive team. Among other things, the board member frequently vacationed with the executive and the executive's spouse, including six trips that spanned eight countries on five continents. According to the SEC's complaint, the board member never disclosed his relationship with the executive to the company and he allegedly encouraged the executive to conceal the relationship as well. As a result, the company's board was unaware of the board members personal relationship with the executive, and the company's proxy statements subsequently identified the board member as an independent director.

Advisory Firm Charged with Policies Failures Regarding Potential Receipt of Confidential Information from Ad Hoc Creditors' Committees

9/30/24 – The SEC announced settled charges against a registered investment adviser for failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information relating to its participation on ad hoc creditors' committees.

SEC Charges Advisory Firm with Violating Whistleblower Protection Rule

9/26/24 – The SEC announced settled charges against a registered investment adviser for entering into agreements with candidates for employment and a former employee that made it more difficult for them to report potential securities law violations to the SEC.

These included:

- Entering into non-disclosure agreements with 12 candidates for employment that prohibited them from disclosing confidential information about the adviser, including to government agencies. While the agreements permitted the candidates to respond to requests for information from the SEC, it required notification to the adviser of any such request and prohibited responding to requests arising from a candidate's voluntary disclosure.
- Entering into a settlement agreement with a former employee whose counsel had told the adviser that he or she intended to report alleged securities law violations to the SEC. Specifically, the settlement agreement said that it permitted reporting possible securities law violations to government agencies, including the SEC; however, it also required the former employee to affirm that he or she had not done so; was not aware of facts that would support an investigation; and would withdraw any statements already made that might support an investigation. These provisions violated the whistleblower protection rule.

The SEC stated, "Whether through agreements or otherwise, firms cannot impose barriers to persons providing evidence about possible securities law violations to the SEC."

Eleven Firms to Pay More Than $88 Million Combined to Settle SEC's Charges for Widespread Recordkeeping Failures

9/24/24 – The SEC announced charges against 12 firms, comprising broker-dealers, investment advisers, and one dually-registered broker-dealer and investment adviser, for widespread and longstanding failures by the firms and their personnel to maintain and preserve electronic communications in violation of recordkeeping provisions of the federal securities laws.

The firms admitted the facts set forth in their respective SEC orders, acknowledged their conduct violated recordkeeping provisions of the federal securities laws, agreed to pay combined civil penalties of $88,225,000, and have begun implementing improvements to their compliance policies and procedures to address these violations.

This continues the SEC's focus on off-channel communications. A twelfth firm was charged but paid no penalty because it self-reported, self-policed, and demonstrated substantial efforts at compliance.

SEC Charges Advisory Firm with Fraud Related to Valuation of Odd-Lot Fixed Income Securities

9/19/24 – The SEC announced a registered investment adviser will pay a total of $79.8 million to settle charges for overvaluing approximately 4,900 largely illiquid collateralized mortgage obligations (CMOs) held in 20 advisory accounts, including 11 retail mutual funds, and for executing hundreds of cross trades between advisory clients that favored certain clients over others.

According to the SEC's order, from January 2017 through April 2021, the adviser managed a fixed-income investment strategy primarily invested in mortgage-backed securities, CMOs, and treasury futures. Strategy investments included thousands of smaller-sized, "odd lot" CMO positions that traded at a discount to institutional, larger-sized positions. The adviser valued the odd lot CMOs using prices obtained from a third-party pricing service that were intended for institutional lots only. The pricing service did not provide separate valuations for odd lots. The order finds that the adviser had no reasonable basis to believe it could sell the odd lot CMOs at the pricing vendor's valuations, and thousands of odd lot CMO positions were marked at

inflated prices. This resulted in the adviser overstating the performance of client accounts holding the overvalued CMOs.

The order further finds that the adviser attempted to minimize losses to redeeming investors by arranging cross trades with affiliated accounts, rather than selling the overvalued CMOs into the market. In one instance, the adviser executed 465 internal cross trades between a selling account and 11 retail mutual funds above independent current market prices. These trades resulted in the retail mutual funds absorbing losses that otherwise would have been borne by the selling account in a market sale. The adviser also arranged for approximately 175 dealer-interposed cross trades in which the adviser temporarily sold odd lot CMO positions to third-party broker-dealers and then repurchased those same positions for allocation to one or more affiliated client accounts, providing liquidity to redeeming investors in an otherwise illiquid market, often at above-market prices.

SEC Charges Nine Investment Advisers in Ongoing Sweep into Marketing Rule Violations

9/9/24 – The SEC announced settled charges against nine registered investment advisers for violating the Marketing Rule by disseminating advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures. All nine firms have agreed to settle the SEC's charges and to pay $1,240,000 in combined civil penalties.

This continues the SEC's focus on compliance with the Marketing Rule.

SEC Charges Seven Public Companies with Violations of Whistleblower Protection Rule

9/9/24 – The SEC announced settled charges against seven public companies for using employment, separation, and other agreements that violated rules prohibiting actions to impede whistleblowers from reporting potential misconduct to the SEC. To settle the SEC's charges, the companies agreed to pay more than $3 million combined in civil penalties.

SEC Charges Advisory Firm with Custody Rule and Liability Disclaimer Violations

9/3/24 – The SEC announced settled charges against a registered investment adviser for failing to comply with requirements related to the safekeeping of client assets and for its use of impermissible liability disclaimers in its advisory and private fund agreements.

According to the SEC's order, the adviser failed to timely distribute annual audited financial statements to investors in certain private funds that it advised. In addition, in its advisory agreements and certain private fund partnership and operating agreements, the adviser included liability disclaimers, commonly referred to as hedge clauses, that could lead a client to incorrectly believe that the client had waived non-waivable causes of action against the adviser. Certain of the liability disclaimers also contained misleading statements regarding the adviser's otherwise unwaivable fiduciary duty.

Financial Statement Comments

SEC Staff continues to expand the use of data tools to review both structured and unstructured data in filings with a focus on

- Identification of performance or flow outliers
- New products
- Monthly N-PORT submissions – to come
- Certifications

Material Weakness – 17 mutual funds and 6 business development companies

- Majority are around valuation and taxes
- Tax issues mostly around non-qualifying income
- SEC staff typically reaches out within days of reporting a MW

Restatements

- Registrant should be performing a SEC Staff Accounting Bulletin (SAB) 99 analysis if changing PY financial statement information and should expect to have to provide that analysis to the SEC
- Some registrants made changes in PY financial statement amounts without performing a full SAB 99 analysis which the SEC found unsatisfactory
- SEC staff have disagreed with several SAB 99 analysis and subsequent restatements occurred after SEC Staff review
- SEC staff point to a speech made by Paul Munter, the Chief Accountant of the SEC

  https://www.sec.gov/newsroom/speeches-statements/munter-statement-assessing-materiality-030922

Tailored Shareholder Report (TRS)

- SEC is reviewing and noticing several issues in the first month (10% of TRS filings)
- Expenses – Beginning balance vs. Average, annualized expenses vs. period
- Inappropriate tagging of benchmarks
- Websites – Incorrect links, hard to find financial statements and prospectus, etc.
- IM Guidance

  https://www.sec.gov/resources-small-businesses/small-business-compliance-guides/tailored-shareholder-reports-mutual-funds-exchange-traded-funds-fee-information-investment-company

General Financial Statement Comments

- Extraordinary expense should be disclosed in detail. Staff continue to see items that they believe should not be included in extraordinary expenses (e.g., proxy, audit, interest expense).
- Restricted securities – Required to disclose acquisition date and cost. Staff continues to see these registrants missing these disclosures or cost is not provided on a security by security basis.

Future Areas of Focus

- Private credit
- Fixed income instruments with payment-in-kind, defaults, non-accrual and restructurings
- Management's discussion and analysis and management's discussion of fund performance
- Real estate
- Consolidation analysis of underlying joint ventures and operating companies
- Whether real estate investment trust type disclosures are warranted

Other Item

SEC Announces Departure of Enforcement Director Gurbir S. Grewal

Gurbir S. Grewal, Director of the Division of Enforcement, will depart the agency, effective Oct. 11, 2024. Upon Mr. Grewal's departure, Sanjay Wadhwa, the Division's Deputy Director, will serve as Acting Director, and Sam Waldon, the Division's Chief Counsel, will serve as Acting Deputy Director.