

Investment Company Issues

Hot Topics

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Overarching Principles

Section 36 of the Investment Company Act of 1940 governs breaches of fiduciary duty.

- Applies to officers, directors, members of any advisory board, among others
- Fiduciary duty obligations relate to the receipt of compensation for services, or payments of a material nature, paid by the registered investment company
- Does not require an allegation of any personal misconduct by the defendant

Overarching Principles

Rule 38a-1 of the Investment Company Act of 1940

- Requirements of the rule relate to:
 - The Adoption of Policies and Procedures
 - Board Approval
 - Annual Review
 - Chief Compliance Officer

Obligations of Directors

- Section 10(a) of the Investment Company Act of 1940 stipulates that the composition of the Board be not more than 60% interested persons.
- Disinterested Directors are seen as the Watchdogs, their role is critically important in policing conflicts of interest between the ICs, their Advisers, & Affiliated broker-dealers

Obligations of Directors

- Directors may be liable for a breach of fiduciary duty, under Section 36 unless protected by the “business judgment rule,” a presumption that when making their decision on matters affecting the ICs, they acted on an informed basis, **in good faith**, and in the honest belief that the action was in the best interests of the IC.

Specific Commission Initiatives

- Fixed Income Initiative
- Alternative Investment Companies
- Never-Before-Examined Investment
Companies (NBE IC)

Fixed Income Initiative

With Interest rates expected to rise in the future, the exam program will focus on whether mutual funds that have significant interest rate risk have implemented liquidity risk management policies and procedures to mitigate liquidity risk and allow funds to meet redemption requests.

- Compliance Policies and Procedures
- Portfolio Management Activities to Manage Liquidity Risk
- Board Oversight of Portfolio Liquidity
- Communication of Risks to Shareholders

Alternative Investment Companies

Alternative mutual funds present a number of additional or heightened risks to funds and shareholders as compared to traditional mutual funds. The goal of this initiative is to understand the steps funds are taking to address these additional or heightened risks. Focusing on:

- Leverage
- Liquidity
- Corporate Governance
- Marketing
- Disclosures

NBE IC

The primary focus for exam candidates are investment companies that launched in the last two years. Exams will be focusing on:

- Compliance Programs
- Annual contract reviews
- Advertising and distribution of fund shares
- Valuation of portfolio assets and NAV Calcs
- Leverage and use of derivatives