Say What? Keeping Current with U.S. Fund Disclosures

Expectations for U.S. based investment companies' narrative disclosures continue to evolve from a regulatory and best practices perspective. As a result, boards of trustees, investment advisers and other service providers must remain informed to enable transparency and compliance.

This article explores recent evolutions in narrative disclosure requirements that apply to funds, highlighting key areas of focus for compliance while providing insights on how company policies can be updated to adapt to the regulatory landscape.

Introduction

Disclosure requirements for registered investment companies (including mutual funds and exchange traded funds (ETFs), or "funds"[1]) have expanded in recent years, driven by regulatory changes and heightened expectations for transparency.

A review of key developments impacting disclosure obligations for funds, including risk alerts and recent enforcement actions focusing on lapses in this area, can be a good start to understanding emerging best practices.

A holistic approach is essential to evaluating the interconnectedness of disclosure throughout offering documents, shareholder communications, marketing materials, policies and procedures, board reports and meeting minutes. Implementing robust disclosure practices is also essential for helping to maintain a strong culture of compliance, mitigating legal and reputational risks, and upholding the core principle that investors should have access to full and fair disclosures.

SEC Exams and Disclosure

The U.S. Securities and Exchange Commission's (SEC) Division of Examinations (Division) conducts the SEC's National Exam Program. The Division's mission is to protect investors, ensure market integrity and support responsible capital formation through risk-focused strategies that: i) improve compliance; ii) prevent fraud; iii) monitor risk; and iv) inform policy.

The results of the Division's examinations are used by the SEC to inform rule-making initiatives, identify and monitor risks, improve industry practices, and pursue misconduct. During exams, SEC staff will seek to determine whether the entity being examined is adhering to the quantitative and narrative disclosures it has made to its clients, customers, the general public, and the SEC.

The Division recently stated that it continues to prioritize the oversight of funds, in part, due to their importance to retail investors, particularly those saving for retirement. Fund examinations typically focus on whether funds: i) have adopted and implemented effective written policies and procedures to prevent any violation of federal securities laws and regulations; ii) provide clear and accurate disclosures that accord with the funds' practices; and iii) promptly address compliance issues as and when identified.

SEC FY 2025 Exam Priorities

On 21 October 2024, the Division released its 2025 examination priorities, informing investors and registrants of the key risks, examination topics and priorities that it

will focus on in the upcoming year. For both funds and their advisers, a continued focus on disclosures to investors and regulators is evident.

Examinations by the SEC of investment companies will continue to review their disclosures in regulatory filings, marketing materials and investor communications, including portfolio management practices and disclosures for consistency with policies and procedures. Emphasis will be placed on assessing whether and how advisers adequately mitigate and fairly disclose conflicts of interest as they may arise in any area of the business.

With respect to artificial intelligence (AI), the Division noted that it will review registrant representations regarding their AI capabilities or AI use for accuracy. If advisers integrate AI into advisory operations, including portfolio management, trading, marketing, and compliance, an examination may look in-depth at compliance policies and procedures as well as disclosures to investors related to these areas.

The Division further stated that it will examine investment advisers that employ certain digital engagement practices, such as digital investment advisory services, recommendations, and related tools and methods. Assessments generally will include whether i) representations are fair and accurate, and ii) operations and controls in place are consistent with disclosures made to investors.

Of note, the priorities were published prior to changes in the U.S. administration and leadership at the SEC. On 9 April 2025 Republican Paul S. Atkins was confirmed as the next Chairman of the SEC, having previously served as a commissioner from August 2002 through August 2008. Priorities are expected to shift with the views of the new administration, including with respect to regulatory enforcement and rulemaking.

2024 Risk Alert Observations and Disclosure

The Division issued a Risk Alert on 4 November 2024 (2024 Risk Alert) that included observations related to, among other things, fund disclosures and governance practices that generally stemmed from exams that its staff had recently conducted.

The oversight of funds was reflected as a priority due to their importance to retail investors, particularly those saving for retirement. Fund exams typically focus on whether funds: i) have adopted and implemented effective written policies and procedures to prevent violation of the federal securities laws and regulations; ii) provide clear and accurate disclosures that accord with the funds' practices; and iii) promptly address compliance issues when identified.

The Division observed some deficiencies or weaknesses related to funds disclosure. These included incomplete or outdated information or potentially misleading statements included in fact sheets, annual reports, and semi-annual reports, as well as untrue statements or omissions of material fact included in sales literature.

For example, funds were found to have omitted information about transactions with affiliates in their prospectus or statement of additional information, disclosed investment processes or analyses that were not consistent with advisers' practices, or repeatedly exceeded disclosed investment thresholds. Funds also described as "no-load" charged such fees, and others mischaracterized the use of environmental, social, and governance (ESG) factors in their investment decision-making processes compared to their actual practices.

A number of the deficiencies or weaknesses related to funds' governance practices were also observed. Notably, board minutes did not fully document board actions (e.g., they did not memorialize the approval of funds' liquidity risk management programs or accurately capture the board's process in approving advisory agreements), resulting in deficiencies under the books and records requirements. A variety of issues associated with the approval of fund advisory agreements were observed, including boards' failure to request, obtain or consider certain information necessary to evaluate advisory agreements before approving them or to effectively oversee fund practices.

Finally, the Division found that fund boards did not make certain required determinations (e.g., annually determine whether certain joint liability insurance policies remained in the funds' best interest) and did not adopt certain written policies and procedures tailored to the funds' operations (such as liquidity risk management programs, anti-money laundering programs and Rule 12b-1 plans).

As Jennifer English, Regulatory Administration, Citi explains,

> "The 2024 Risk Alert highlights the importance of carefully preparing board materials and drafting meeting minutes, ensuring that they accurately reflect the substance of the meeting. They should serve as a source for related public disclosures and tie to comprehensive board materials. Best practices can be adopted around tracking items for board approval, such as annual calendars that are updated on an ongoing basis and processes for drafting and reviewing meeting minutes that adequately capture and reflect board discussions, deliberations, and approvals."

Recent Regulatory Changes Impacting Funds' Disclosure Obligations

Over recent years, narrative disclosure obligations for funds have been revised and expanded several times. Ms. English suggests that

> "A review of the recent SEC rulemaking, proposals and guidance in this area can serve as a prompt for identifying select areas for review."

She further notes that

> It can be helpful to refocus on impacted disclosures shortly after they have been drafted or revised in order to ensure that they reflect operational practices and policies and procedures, which may have been modified or adjusted after implementation.

Tailored Shareholder Reports and Disclosure of Material Fund Changes

On 26 October 2022, the SEC adopted rules and amendments impacting funds' annual and semi-annual shareholder reports, requiring concise and visually engaging summary reports that highlight key information, such as fund expenses, performance, and portfolio holdings to be distributed to shareholders in lieu of full financial statements. The new requirements applied to all fund shareholder reports as of 24 July 2024. Additionally, the amendments required fund advertisements and sales literature to use fee and expense information consistent with relevant prospectus fee table information and be reasonably current, among other things.

While many of the shareholder report revisions focused on the presentation of information related to fund fees and expenses, and performance and portfolio holdings, a requirement was added to include narrative disclosure regarding any new material fund changes in a separate section within reports. Disclosures included in this section of shareholder reports are intended to highlight and consolidate information about changes to a portfolio's name, investment objectives, strategies or risks, or fees, in a way that makes them more noticeable to shareholders. They also serve to create consistency in the way material changes are presented across fund families.

Formerly, shareholders often received information about such changes in annual prospectus updates, restated prospectuses, or one-off supplements to current prospectuses. These changes were often challenging for shareholders to identify, as revisions in offering documents are not highlighted or otherwise identified. A diversity of practices among funds regarding which changes result in a rule 497 sticker filing for the prospectus (prospectus sticker), and whether to transmit the prospectus sticker to shareholders, was recognized. Accordingly, new shareholder report requirements include a list of fund changes that the SEC believes are important to fund shareholders and trigger disclosure obligations.

Specifically, funds are required to briefly describe any material changes since the beginning of the reporting period that relate to a change in the fund's: i) name; ii) investment objectives or goals; iii) annual operating expenses, shareholder fees, or maximum account fee, including the termination or introduction of an expense reimbursement or fee waiver arrangements; iv) principal investment strategies; v) principal risks of investing in the fund; and vi) investment adviser(s), including sub-adviser(s).

Funds are required to provide a concise description of each change with enough detail to allow shareholders to understand the change and how it may affect them, along with a specific legend adjacent to the disclosure and a prominent statement on the report's cover page.

Funds are also permitted to include material changes regarding topics that do not appear on the enumerated list if they may be helpful for investors to understand the fund's operations or performance over the reporting period and may also optionally disclose material changes it plans to make in connection with updating its prospectus for the current fiscal year.

When considering whether a change should be disclosed as material, factors identified when requirements were adopted include: the nature of the change; whether it reflects a material change in the way the fund is currently being managed; whether it reflects a material change in the fund's risk profile; which section(s) of the prospectus the change affects; and how likely the change would be to influence a shareholder's decision to continue to invest in the fund.

On 6 November 2024, the staff of the Disclosure Review and Accounting Office of the SEC's Division of Investment Management issued an Accounting and Disclosure Information publication to identify several recurring issues with funds' shareholder reports. With respect to material fund changes, some funds have omitted the required cover page disclosure alerting shareholders to the description of changes, while others have included the cover page disclosure but do not include any related disclosures about material fund changes.

Shareholder Reporting Amendments

The now-obsolete Form N-Q was adopted on 27 February 2004, requiring funds to increase the frequency of portfolio holdings disclosures from semi-annually to quarterly. At the same time, the SEC adopted rule amendments that required additional disclosures about expenses borne by shareholders, among other things.

Twelve years later, on 13 October 2016, the SEC adopted a new Form N-PORT, rescinding Form N-Q and requiring funds to report monthly portfolio holdings information to the SEC, among other disclosures, and Form N-CEN, which requires funds to report census-type information to the SEC annually.

Notably, only data reported on Form N-PORT for the end of each fund's fiscal quarters is made publicly available and on a 60-day lag, with reporting data for other months remaining confidential. Information included in non-public disclosures has been used by the SEC in its regulatory programs, including

examinations, investigations, and enforcement actions.

On that same day in 2016, the SEC also adopted amendments to Regulation S-X, which requires standardized disclosure about derivatives and amendments to Forms N-1A, N-3 and N-CSR, mandating certain disclosures regarding securities lending activities.

The SEC also adopted Rule 22e-4, requiring funds (excluding money market funds) to adopt and implement written liquidity risk management programs, and appoint a liquidity risk management program administrator that provides an annual report to the fund's board.

These rules introduced reporting and disclosure requirements related to liquidity risk management policies and adopted confidential Form N-LIQUID, which requires notification and disclosures to the SEC by a fund when its level of illiquid investments exceeds 15% of the fund's net assets or when highly liquid investments fall below set minimum thresholds for more than a specified period of time.

Under these rules, funds must provide disclosures surrounding the operation and effectiveness of its liquidity risk management programs, including any significant liquidity challenges faced over the past year and how those challenges were managed. A fund may include information, or a summary of information, that was provided to its board about the operation and effectiveness of the program along with insight into how the program functioned over the past year.

A failure to adopt written liquidity risk management programs, or related policies and procedures, or appropriately document related board approvals, was identified as a deficiency area in the 2024 Risk Alert.

Adoption of amendments to Form N-PORT and Form N-CEN reporting requirements for funds

On 28 August 2024, the SEC adopted amendments to Form N-PORT reporting requirements, increasing the frequency and timing of disclosures, among other things. The changes represent a significant acceleration of disclosure obligations, requiring funds to prepare, file, and publicly disclose portfolio holdings more frequently and on a tighter timeline than ever before. Larger fund complexes will be required to comply with the new reporting requirements as of 17 November 2027, under a recent two-year extension and pending the outcome of an ongoing litigation.[3]

The N-PORT amendments increase the publication frequency of full fund portfolio holdings disclosures and other detailed information (from quarterly to monthly) and reduce the timeframe to prepare and file (from 60 days to 30 days).

The amendments require funds to file each Form N-PORT within 30 days after the end of a month. Currently, each Form N-PORT for a fiscal quarter is filed 60 days after the end of the fiscal quarter. The amendments will make funds' monthly reports on Form N-PORT public 60 days after the end of the month. Currently, only the report for the third month of every fiscal quarter is made public upon filing, due 60 days after the end of that month.

On 26 February 2025, the Investment Company Institute submitted a letter to the Acting SEC Chairman requesting that the SEC eliminate the publication of each monthly Form N-PORT (including a fund's full portfolio holdings) in favor of the current quarterly disclosure framework and provide funds with at least 45 days, rather than 30 days, after month end to file the form.

Additionally, amendments were adopted to Form N-CEN, requiring funds to report certain identifying information about liquidity service providers, their affiliation with the fund or its investment adviser, the asset classes for which that service provider provided liquidity classification's and whether the service provider was hired or terminated during the reporting period.

Proxy Voting and Share Ownership

On 2 November 2022, the SEC adopted amendments to Form N-PX , requiring additional disclosure about funds' proxy votes, as well as the reporting of certain executive compensation votes by institutional investment managers. Funds and managers filed their first reports on amended Form N-PX by 31 August 2024, covering the period of 1 July 2023 to 30 June 2024.

The SEC adopted the amendments to increase transparency of fund and manager voting records in order to effectively enable investors to monitor their funds' and managers' involvement in the governance activities of their investments.

For any proxy matters where a proxy card was filed with the SEC, reporting entities must now i) use the same language as reflected on the proxy card for identifying voting items, and ii) list voting items in the same order as they appeared on the proxy card.

If a proxy card was not required in connection with a voting item, reporting entities may provide a brief description of the voting item, but must limit the use of abbreviations in the description to "commonly understood terms" or use the same abbreviations appearing in the issuer's description of the voting item. Each voting item must also be classified under one of fourteen broad subject matter categories[4] specified in the form.

Additional amendments and new Rule 14Ad-1 require institutional investment managers to disclose their proxy votes relating to executive compensation (say-on-pay) matters (including merger & acquisition golden parachutes) in Form N-PX.

A manager must report when it has, and then exercises, the power to vote, to influence a vote (as part of a larger decision-making group), or to abstain from voting on a security. Voting

decisions entirely determined by a client or another party are not covered by Rule 14Ad-1. Instead, this rule includes a provision for jointly reporting votes when multiple parties exercise voting power over securities.[5]

Schedule 13G Eligibility

On 11 February 2025, the staff of the SEC's Division of Corporation Finance issued an updated guidance with respect to reporting persons' eligibility to disclose beneficial ownership information on Schedule 13G in lieu of the Schedule 13D otherwise required.

The guidance states that eligibility to report on Schedule 13G will depend, among other things, on whether the shareholder acquired or is holding the subject securities with the purpose or effect of changing or influencing control of the issuer.

The guidance determination is based upon all the relevant facts and circumstances, however a shareholder who exerts pressure on an issuer's management to implement specific measures or changes to a policy may be "influencing" control over the issuer.

Examples of such attempts to influence include, among other things: recommendations that the issuer remove its staggered board; switch to a majority voting standard in uncontested director elections; eliminate its poison pill plan; change its executive compensation practices; or undertake specific actions on a social, environmental, or political policy or conditional arrangements with respect to director elections.

Investment advisers should ensure that any disclosures on Form N-PX reconcile with Section 13 filings.

Names Rule

On 20 September 2023, the SEC adopted amendments to Rule 35d-1 (the Names Rule), which requires certain funds to adopt policies to invest at least 80% of the value of their assets in investments that are consistent with their respective names.

The SEC's amendments broaden the scope of funds subject to the Names Rule, introduce enhanced disclosure and reporting requirements and impose additional compliance and recordkeeping obligations to prevent fund names from misrepresenting investments and risks.

The amendments' compliance date was extended by six months to 11 June 2026 for fund groups with net assets of USD1 billion or more, and allows for compliance based on the timing of certain annual disclosure and reporting obligations tied to the fund's fiscal year-end.

The amendments expand the 80% investment policy requirement to apply to fund names suggesting a focus on investments with "particular characteristics" rather than particular investments, industries, or geographical regions.

Fund names containing terms such as 'growth' and 'value' and names indicating a thematic focus or incorporation of one or more ESG factors must now comply with the rule. Any term in a fund's name suggesting an investment focus must align with those terms' "plain English" meaning or "established industry use" and must be defined in the fund's prospectus, including the criteria used to select investments suggested by the fund name.

Anecdotally, to comply, funds have updated offering documents to include definitions of key terms and criteria used in investment selection. The SEC emphasized that there must be a meaningful nexus between an investment and the focus implied by the fund's name. Additionally, funds must make enhanced disclosures on their Form N-PORT filings, including: (i) the value of the fund's 80% basket; (ii) whether an investment is included in the 80% basket; and (iii) the definitions of terms used in a fund's name.

Artificial Intelligence

In April 2023, the SEC's Investor Advisory Committee shared its consensus that observations from the Division's examinations of advisers using AI should be used by the SEC to draft best practices, which could also be informed by existing frameworks developed by other regulatory authorities. Whilst there are not specific AI related SEC disclosure requirements, a number of existing rules or regulations may require disclosure about how a company uses AI and the risks related to its use.

On 4 September 2024, the then chairman of the SEC addressed "AI washing" in an Office Hours video, stressing the value of "full, fair, and truthful disclosure" to investors and that "the basics of the securities laws still apply." He noted that material risk disclosures about AI may be operational, legal and competitive and should be particular to the company, not just boilerplate language.

Additionally, companies may be required to define for investors what they mean when referring to AI, including how and where is it being used at the company and whether technology is being developed by the company or supplied by others.

This followed a 24 June 2024 statement by the then-director of the SEC's Division of Corporation Finance that AI is a disclosure priority. He observed a significant increase in mentions of AI in public company annual reports and noted that incorporating the use of AI into business operations may introduce additional operational and regulatory risks.

Cybersecurity

On 9 February 2022, the SEC proposed rules related to cybersecurity risk management for investment advisers and funds. The proposed rules would require advisers and funds to adopt and implement written cybersecurity policies and procedures designed to address cybersecurity risks that could harm advisory clients and fund investors and require advisers to report significant cybersecurity incidents to the SEC on a new confidential form. Both advisers and funds would be required to disclose cybersecurity risks and significant cybersecurity incidents that occurred in the last two fiscal years.

On 26 July 2023, the SEC adopted rules requiring public companies to disclose material cybersecurity incidents they experience and to disclose on an annual basis material information regarding their cybersecurity risk management, strategy, and governance. Ioannis Tzouganatos, Regulatory Administration, Citi notes that,

> "While these rules are not applicable to investment companies or their advisers that are not public companies, disclosure guidance may be gleaned from their requirements."

The SEC also adopted rules requiring foreign private issuers to make comparable disclosures.

The rules impacting public companies require registrants to disclose any material cybersecurity incident and to describe the material aspects of the incident's nature, scope, and timing, as well as its material impact or reasonably likely material impact on the registrant. This disclosure would be made on a Form 8-K four business days following a determination that a cybersecurity incident was material.

The rules require registrants to describe their processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats, as well as the material effects or reasonably likely material effects of risks from cybersecurity threats and previous cybersecurity incidents.

They also require registrants to describe the board of directors' oversight of risks from cybersecurity threats and management's role and expertise in assessing and managing material risks from cybersecurity threats. These disclosures are required in a registrant's annual report on Form 10-K.

Final Thoughts

Kelli O'Brien points out that

> "Disclosure requirements for funds continue to expand and robust compliance measures can serve as an important support for accelerated reporting deadlines and increasing public transparency obligations."

She further suggests considering the following best practices:

- Establish a disclosure review framework. Implement a structured review process that includes calendaring features to help ensure timely updates to fund disclosures. Knowing when events that may trigger a disclosure update are scheduled or more likely to occur will help keep shareholder disclosures, fund fact sheets, sales materials and websites current.
- Enhance board oversight and reporting. Review routine board materials and reports for consistency with regulatory requirements and internal policies and procedures frequently. Ensure that report templates are updated and maintained as needed to assist board members with their oversight of fund practices and in making required determinations. Conduct education sessions for the board related to disclosure changes where appropriate.
- Ensure accuracy in meeting minutes. Give adequate attention to the drafting of meeting minutes, ensuring that they accurately reflect the substance of the meeting. Capture the board's discussions, deliberations, decisions and rationales which should be clearly supported by the meeting materials. Final approved minutes serve as a source for related public disclosures.
- Strengthen prospectus review processes. Include approvals from those knowledgeable about investment processes and how they are implemented on a day-to-day basis with respect to the fund. Ensure that disclosed investment thresholds align with approved investment guidelines, portfolio management systems and compliance monitoring.
- Monitor and track material changes. Maintain a process for tracking and communicating material changes that must be disclosed in a fund's next shareholder report.
- Refine shareholder communication procedures. Update or establish processes for the dissemination of documents to shareholders that includes a review of cover pages or envelopes for appropriate legends.
- Maintain accurate proxy voting disclosures. Establish clear procedures for accurately recording and categorizing a fund's voting records as detailed in Form N-PX and in the required format. Consider how this disclosure aligns with any Section 13 beneficial ownership filings.
- Adapt narrative disclosures to evolving technology. Continue to review narrative disclosure around operational practices as technology evolves, including support for the provision of data in a timely manner.

A well-structured and proactive approach to disclosure processes can mitigate compliance risks and demonstrate a commitment to transparency, accuracy and sound governance practices.

This article was accurate as at the time of writing: 21 April 2025

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[1] For purposes of this article, the term "fund" includes mutual funds, closed-end funds, and exchange traded funds that are registered as investment companies under the Investment Company Act of 1940 ("Investment Company Act") (but excludes unit investment trusts that are not ETFs and small business investment companies). Funds are regulated primarily under the Investment Company Act and must comply with the Investment Company Act and the rules and registration forms adopted thereunder. Funds are also subject to the Securities Act of 1933 and the Securities Exchange Act of 1934. Their investment advisers are regulated under the Investment Advisers Act of 1940 ("Investment Advisers Act").

[2] See Form N-PORT and Form N-CEN Reporting; Guidance on Open-End Fund Liquidity Risk Management Programs, Inv. Co. Act Rel. No. 35308, 89 Fed. Reg. 73764 (Sept. 11, 2024).

[3] US Court of Appeals for the Fifth Circuit has stayed further proceedings in a challenge to the amendments, pending an SEC review of the rulemaking. See Ct. Ord. Granting Motion to Stay at 1, Registered Funds Ass'n v. SEC, No. 24-60550 (5th Cir. Feb. 11, 2025).

[4] The categories are: 1. Director Elections; 2. Section 14A; 3. Audit-Related; 4. Investment Company Matters; 5. Shareholder Rights and Defenses; 6. Extraordinary Transactions; 7. Capital Structure; 8. Compensation; 9. Corporate Governance; 10. Environment or Climate; 11. Human Rights or Human Capital/Workforce; 12. Diversity, Equity and Inclusion; 13. Other Social Issues; 14. Other. N-PX Adopting Release, supra n.1, at 32-33.

[5] See section 14A(a) and (b) of the Exchange Act; 17 CFR 240.14a-21. Shareholder votes on executive compensation that are not required by sections 14A(a) and (b), such as in the case of foreign private issuers (as defined in 17 CFR 240.3b-4(c) ("rule 3b-4(c) under the Exchange Act")) that are exempt from the proxy solicitation rules, will not be required to be reported on Form N-PX.

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