Davis Polk

Investment Management & Funds Regulatory Update - December 2025

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In this issue we discuss, among other things, an SEC exemptive order permitting a registered fund to offer exchange-traded and non-exchange-traded share classes, and recent enforcement actions involving compliance failures by registered investment advisers.

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Industry update

SEC issues exemptive order permitting registered fund to offer exchange-traded and non-exchange-traded share classes

On November 17, 2025, the SEC granted an exemptive order permitting a registered open-end management investment company advised by Dimensional Fund Advisors (DFA) to offer one class of exchange-traded shares that operates as an ETF and one or more classes of mutual fund shares (the Multi-Class Fund).

The Multi-Class Fund structure would comply with Rule 18f-3 under the Investment Company Act, except for certain ways in which an ETF class and mutual fund class(es) would have different rights and obligations. The Multi-Class Fund

may also offer an “exchange privilege” that would permit shareholders in a mutual fund class to exchange their mutual fund shares for ETF shares.

Such multi-class structure may raise potential issues under the Investment Company Act because, for example, an ETF class that transacts with authorized participants on an in-kind basis and a mutual fund class that transacts with shareholders on a cash basis may give rise to differing costs to the portfolio. As a result, certain costs may result from transactions through one class, but all fund shareholders generally would bear the costs.

DFA, however, states in the application its belief that the multi-class structure will allow investors to choose the manner in which they wish to hold interests in a Multi-Class Fund based on the share class characteristics that are most important to them, and that the multi-class structure could be beneficial to shareholders of each type of class. First, DFA believes that the multi-class structure benefits shareholders of mutual fund class(es) in multiple ways, including, but not limited to, lower transactions and portfolio management costs and greater tax efficiency resulting from in-kind transactions, additional distribution channels and the ability for shareholders to engage in more frequent trading. Additionally, DFA believes that the multi-class structure not only benefits shareholders of the ETF class in the same way as it does with regard to shareholders of mutual fund class(es), but the investor cash flow through a mutual fund class can also allow for more efficient portfolio rebalancing and greater basket flexibility.

The order imposes certain conditions upon DFA in connection with the multi-class structure:

- before the first issuance of ETF shares, and before any material amendment of a written plan under Rule 18f-3 to include an ETF class, a majority of the directors of a Multi-Class Fund, and a majority of the independent directors, shall find that the plan is in the best interests of each mutual fund class and the ETF class individually and of the Multi-Class Fund as a whole;
- to assist the board in its finding pursuant to the condition in the preceding bullet, the advisor of the Multi-Class Fund shall prepare and deliver to the board an initial report that, among other things, discusses the expected benefits and costs to each class individually and the fund as a whole and evaluates the potential for any conflicts between the mutual fund class(es) and the ETF class;
- the Multi-Class Fund will be subject to an ongoing monitoring process of certain numerical thresholds approved by the board, and the board will evaluate the multiple class plan of the Multi-Class Fund at least annually; a majority of the directors of a Multi-Class Fund, and a majority of the independent directors, shall find that the multiple class plan continues to be in the best interests of each mutual fund class and the ETF class individually and of the Multi-Class Fund as a whole; and
- to assist the board in its finding pursuant to the condition in the preceding bullet, the advisor of the Multi-Class Fund shall prepare and deliver to the board an ongoing report that, among other things, discusses any observed benefits or cost savings resulting from the multi-class structure and any observed conflicts of interest between the mutual fund class(es) and the ETF class.

Litigation

Emergency challenge to continuation fund deal lands in Delaware court

On December 3, 2025, the Abu Dhabi Investment Council (ADIC), part of the approximately $300 billion Mubadala investment group, initiated litigation in the Delaware Court of Chancery against affiliates of the Energy & Minerals Group (EMG) arising from EMG’s proposed sale of a 30% stake in Ascent Resources to a continuation fund.[1] The complaint, filed under C.A. No. 2025-1389-NAC, sought injunctive relief in aid of arbitration and alleges that EMG engineered a conflicted, below-market sale that would disadvantage existing investors at the current time. For further information, please see our recent client update on this topic.

SEC charges adviser of registered fund for causing the fund’s violation of auditor independence requirement

On November 21, 2025, the SEC issued an order (the Order) instituting and settling cease-and-desist proceedings against a registered investment adviser (RIA) for causing the registered fund that it advised (the Fund) to violate Section 30(g) of the Investment Company Act. According to the Order, the RIA caused the Fund to hire a solo practitioner accountant to audit the Fund’s financial statements while the RIA was aware that the accountant’s wife had

approximately $290,000 invested in the Fund. The Order stated that the accountant was not independent under Rule 2-01(c)(1) of Regulation S-X because the accountant's wife's investment in the Fund during his audit engagement created a "direct financial interest … in the accountant's audit client" and that the accountant therefore was not in compliance with the auditor independence requirements established by the SEC and the Public Company Accounting Oversight Board (PCAOB).

According to the Order, the RIA "negligently and erroneously" determined that the amount of the accountant's wife's investment was immaterial to the Fund's approximately $52 million in total assets under management, and did not inform the Fund's Board of Trustees of such investment before the Board voted to approve the accountant's engagement with the Fund. The Order stated that as a result of this conduct, the RIA caused the Fund to violate Section 30(g) of the Investment Company Act, which requires that the financial statements included in a registered fund's annual reports be "accompanied by a certificate of independent public accountants." According to the Order, the RIA knew or should have known that its acts would contribute to the Fund's violation of Section 30(g) of the Investment Company Act.

The RIA was ordered to cease and desist from committing or causing any violations and any future violations of Section 30(g) of the Investment Company Act, and agreed to pay a civil money penalty of $10,000.

SEC charges adviser with compliance violations, including failing to provide accurate fee disclosures and failing to obtain written investment advisory agreements with clients

On November 24, 2025, the SEC issued an order (the Order) instituting and settling administrative and cease-and-desist proceedings against a registered investment adviser (the Adviser) that advised mainly retail clients including retirees, and against the Adviser's principal, for violation of compliance rules under the Advisers Act. According to the Order, the Adviser failed to conduct annual reviews of the adequacy of its compliance policies and procedures as is required under Advisers Act Rule 206(4)-7(b). The Order stated that the Adviser also failed to follow its policies and procedures requiring it to periodically review and maintain its Form ADV Part 2A brochure (the brochure) on a current and accurate basis. According to the Order, from at least 2013 through February 2025, the Adviser included in its brochure a fee table that was not actually used to determine fees charged to clients since 2013. The Order also stated that the Adviser failed to follow its policies and procedures requiring it to obtain written investment advisory agreements with all of its clients, even though similar failures were identified in a prior enforcement action against the Adviser and its principal in 2004, and in staff deficiency letters issued in connection with SEC examinations of the Adviser in 2005 and 2020-2021.

The SEC also found that the Adviser violated Section 204 of the Advisers Act and Rule 204-2(a)(14) thereunder by failing to keep, from at least 2011 through at least October 2024, a record of the dates on which the Adviser delivered its brochure and brochure amendments to clients and prospective clients who became clients.

As a result of this conduct, the Order stated that the Adviser violated, and its principal caused the Adviser to violate, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and that the Adviser violated Section 204 of the Advisers Act and Rule 204-2(a)(14) thereunder. The Adviser and its principal were ordered to cease and desist from committing or causing any violations and any future violations of such requirements under the Advisers Act. The Adviser also agreed to pay a civil money penalty of $150,000 and to comply with certain undertakings designed to correct the compliance failures identified.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] Abu Dhabi Inv. Council Co. et al. v. Energy & Minerals Grp. LP et al., No. 2025-1389-NAC (Del. Ch. Dec. 3, 2025) (verified complaint for preliminary injunction in aid of arbitration), https://www.documentcloud.org/documents/26341087-adic-vs-emg/