

Insights

SEC STAFF PROVIDES GUIDANCE ON INVESTMENT ADVISER EXAMINATIONS

Sep 15, 2023

INTRODUCTION

On September 6, 2023, the SEC Division of Examinations (the “Division”) published a [Risk Alert](#) entitled “Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents” (the “Alert”). This Alert offers valuable insight into the Division’s internal processes and guidance on how SEC-registered advisers (“advisers”) can bolster their internal compliance systems and prepare for the inevitable examination.

ADVISER SELECTION

As described in the Alert, despite the growth of the registered adviser population to more than 15,000, up 13% over the last three years, the Division has not slowed its adviser examination rate, which is equal to roughly 15% of all advisers each year. To manage the examination process over such a large and diverse adviser population, the Division employs a risk-based approach, looking not just at firm-specific risk factors but also broader areas of focus that the Division identifies as posing a potential risk to investors and the US market.

For example, an adviser may be examined to evaluate risks present at that particular firm, to respond to events that pose risks to investors and the markets more broadly, and/or to assess how registrants are adapting to new regulatory requirements. The Division also leverages technology to collect and analyze large sets of industry- and firm-level data to help identify risks and better understand an adviser’s business during examinations. The Division also reviews disclosure documents and various filings with regulators (e.g., Form ADV, including the brochure, and Form PF).

The Alert specifies eleven firm-specific risk factors that the Division considers when selecting advisers for examination, such as those related to a particular adviser’s business activities, conflicts of interest, and regulatory history. For example, the Division may consider: (1) prior examination observations and conduct, such as when the Division has observed what it believes to be repetitive deficient practices, significant fee- and expense-related issues, and significant compliance program

concerns; (2) supervisory concerns, such as disciplinary history of associated individuals or affiliates; (3) tips, complaints, or referrals involving the firm; (4) business activities of the firm or its personnel that may create conflicts of interest, such as outside business activities and the conflicts associated with advisers dually registered as, or affiliated with, brokers; (5) the length of time since the firm's registration or last examination, such as advisers newly registered with the SEC; (6) material changes in a firm's leadership or other personnel; (7) indications that the adviser might be vulnerable to financial or market stresses; (8) reporting by news and media that may involve or impact the firm; (9) data provided by certain third-party data services; (10) the disclosure history of the firm; and (11) whether the firm has access to client and investor assets and/or presents certain gatekeeper or service provider compliance risks.

EXAMINATION SCOPE AND DOCUMENT REQUESTS

Once an adviser is selected for examination, the Alert indicates that the Division will conduct an additional risk analysis with respect to that adviser to determine the specific area or areas of focus for its review, which will in turn determine what information and documentation the adviser will ultimately be required to produce (typically in electronic format if available). While this means that no two examinations are identical, the Alert highlights certain areas of focus and initial document requests that are typically included in the Division's review, regardless of the reasons for conducting the examination.

Examinations may be conducted on an announced or unannounced basis. To best prepare for a potential examination, advisers should ensure that their internal policies, procedures and document retention, particularly with respect to those items highlighted below, are in good order.

The areas of focus generally reviewed as part of every examination include, (i) the adviser's operations, (ii) disclosures, (iii) conflicts of interest and (iv) compliance practices with respect to certain areas including, but not limited to, custody and safekeeping of client assets, valuation, portfolio management, fees and expenses and brokerage and best execution. Consistent with the focus areas noted above, the initial document requests typically include requests for the following information, (i) general information about the adviser, including background information (e.g., organizational charts), to provide the SEC staff with an understanding of the adviser's business and investment activities, (ii) information about compliance risks the adviser has identified and the written policies and procedures the firm has adopted and implemented to address each of those risks, (iii) information to facilitate testing with respect to advisory trading activities, and (iv) information for the staff to perform its own testing for compliance in various areas.

To assist advisers in preparing for a potential examination, the Division included its *Typical Initial Information Examiners Request of Investment Advisers* as an attachment to the Alert and that attachment is included below for your reference.

CONCLUSION

Advisers should re-evaluate their internal policies and procedures in light of the Alert to assess what changes, if any, should be made to update or strengthen their policies and procedures and to enable advisers to respond promptly and efficiently to examiners' requests.

Attachment: Typical Initial Information Examiners Request of Investment Advisers

Described below are the types of initial information, including documents, that staff may request and review during a typical examination of an adviser that does not engage in additional activities and/or have additional relationships (e.g., manage private funds). These information requests are generally transmitted through secure email, and responses are also typically provided electronically. If certain records are not maintained electronically or cannot be produced electronically, the staff may request that the adviser make such records available for in-person examination.

General Information	
Organizational Information	<ul style="list-style-type: none"> ▪ Organizational structure, affiliations, and control persons. ▪ Remote offices and branch locations. ▪ Joint ventures or other businesses (including those with respect to the firm or any officer, director, portfolio manager, or trader). ▪ Current and former supervised persons, officers, or directors.
Business and Operations	<ul style="list-style-type: none"> ▪ Committees (e.g., responsibilities, members, meeting frequency, meeting minutes). ▪ Client advisory contracts or agreements. ▪ Agreements and arrangements with third parties associated with the management of client accounts (e.g., sub-advisers, third-party managers, referrals, wrap fee programs, and third-party investment platforms used for clients). ▪ Fees and payments for services rendered. ▪ Power of attorney obtained from clients. ▪ Service providers and the services they perform.
Disclosures and Filings	<ul style="list-style-type: none"> ▪ Disclosure documents and filings with regulators (e.g., Form ADV, including the brochure, and Form CRS).
Legal and Disciplinary	<ul style="list-style-type: none"> ▪ Threatened, pending, and settled litigation, arbitration, or administrative proceedings involving the adviser or any supervised person.

- Remedial actions taken against supervised persons.

Information Regarding the Compliance Program, Risk Management, and Internal Controls

Compliance Program and Oversight Process

- Compliance policies and procedures in effect during the examination period.
- Tests performed (e.g., compliance reviews, quality control analyses, surveillance, or forensic or transactional tests performed by the firm).
- Compliance consultant reports resulting from a review of compliance policies and procedures, operations, or books and records.
- Annual or interim reviews of policies and procedures, including any reports prepared.
- Record of compliance exceptions.
- Remote office or independent advisory contractor oversight process.
- Client complaints and correspondence and the process for monitoring such communications, including electronic communications.
- Inventory of compliance risks and conflicts of interest that form the basis for policies and procedures and notations regarding changes made to the inventory.
- Written guidance and training provided to employees regarding compliance program and documentation of attendance.

Valuation

- Valuation process.
- Pricing services, quotation services, and externally acquired portfolio accounting systems used in the valuation process and payment information.
- Fair-valued and illiquid securities held by clients.
- Advisory fee calculations.
- Pricing overrides.

Information Processing,

- Safeguards for the protection of customer records and information.
- Electronic access controls.

Reporting, and Protection	<ul style="list-style-type: none"> ▪ Business continuity plan. ▪ Cybersecurity incidents or breaches (e.g., incident description, impact, and remediation).
Information to Facilitate Testing With Respect to Advisory Trading Activities	
Information About Advisory Clients and Accounts	<ul style="list-style-type: none"> ▪ Current advisory client account information regarding: account inception, type, balance, and management discretion; client demographic information; client affiliation with the firm; custodial arrangements; firm authority with respect to the account (e.g., trading authority, custody, and trustee); services provided; investment strategy and investment objectives; portfolio manager; fee computation; fee payment arrangements; and consultant related to obtaining the client, if any. ▪ Advisory clients lost during review period.
Portfolio Management	<ul style="list-style-type: none"> ▪ Securities held in all client portfolios, including information identifying each client holding an interest, the amount owned by each client, the aggregate number of shares or principal or notional amount held, and the total market value of the position. ▪ Information about certain types of client investments (e.g., private investments and initial public offerings). ▪ Publicly traded companies for which employees of the adviser or its affiliates serve as officers or directors. ▪ Companies for which employees of the adviser or its affiliates serve on creditors' committees. ▪ Outside compensation to supervised persons, including compensation related to client's transactions or investments. ▪ Client portfolio profile information (e.g., investment objectives, investment strategy, risk tolerance, suitability, and mandates).
Brokerage and Trading	<ul style="list-style-type: none"> ▪ Trade blotter. ▪ Brokerage arrangements and best execution evaluation documentation.

	<ul style="list-style-type: none"> ▪ Soft-dollar budget and products and services obtained using clients' brokerage commissions. ▪ Commission-sharing arrangements. ▪ Affiliated broker-dealers. ▪ Principal trades and cross transactions. ▪ Wrap fee programs. ▪ Trade errors and related information. ▪ Trade allocation information regarding initial public offerings and secondary offerings in which clients, proprietary accounts, or access persons participated.
Conflicts of Interest and Insider Trading	<ul style="list-style-type: none"> ▪ Code of ethics and insider trading policies and procedures for the firm and its affiliates. ▪ Code of ethics attestations. ▪ Exemptions from code of ethics for supervised persons. ▪ Reports of securities transactions reported by access persons. ▪ Fee splitting or revenue sharing arrangements.
Information to Perform Testing for Compliance in Various Areas	
Marketing and Advertising	<ul style="list-style-type: none"> ▪ Advertisements and marketing materials disseminated, including newsletters, public audio and video programs, pitch books, pamphlets, brochures, websites, blogs, social media, and other promotional or marketing materials used. ▪ Client or investor meeting materials and presentations. ▪ Sponsored and attended seminars or events. ▪ Client performance information. ▪ Composite performance information, including current and terminated composites and composite returns.

	<ul style="list-style-type: none"> ▪ Requests for proposal, due diligence questionnaires, and any other questionnaires (e.g., third-party consultant database or other performance database). ▪ Testimonials and endorsements, including payments made and compensation received. ▪ Third-party ratings and rankings.
Financial Records	<ul style="list-style-type: none"> ▪ Balance sheets, trial balances, income statements, and cash flow statements. ▪ Cash receipts and disbursements journal. ▪ General ledger and chart of accounts. ▪ Loans and sales of firm or affiliate's stock.
Custody	<ul style="list-style-type: none"> ▪ Custodian identification and contact information for entities that maintain custody of client assets. ▪ Surprise examination documentation, such as engagement letters, client account lists, and reports, results, and recommendations. ▪ Auditor engagement letters, opinions, and findings. ▪ Custodial confirmation of positions for specific clients.

RELATED CAPABILITIES

- Corporate
- Financial Regulation Compliance & Investigations

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