May 15, 2023

Skadden

Investment Management Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Anna Rips
Partner / New York
212.735.3237
anna.rips@skadden.com

Anastasia T. Rockas
Partner / New York
212.735.2987
anastasia.rockas@skadden.com

TJ Wells
Counsel / New York
212.735.2458
terry.wells@skadden.com

Marc Sana
Associate / New York
212.735.3292
marc.sana@skadden.com

One Manhattan West
New York, NY 10001
212.735.3000

SEC Risk Alert Describes Examination Areas for Newly Registered Advisers

On March 27, 2023, the Securities and Exchange Commission's (SEC's) Division of Examinations issued a Risk Alert setting forth typical focus areas reviewed by the staff during its examinations of newly registered advisers. The SEC has prioritized examining newly registered advisers within a reasonable period after their registration with the SEC becomes effective. These examinations often focus on whether newly registered advisers have: (i) identified and addressed conflicts of interest; (ii) provided clients with full and fair disclosure such that clients can provide informed consent; and (iii) adopted effective compliance programs.

Examination Scope

In an examination, the SEC typically requests documents from an adviser and interviews its personnel, addressing the adviser's: (i) business and investment activities; (ii) organizational affiliations; (iii) compliance policies and procedures; and (iv) disclosures to clients.[1] These interviews help the SEC Staff assess an adviser's culture of compliance.

Staff Observations

The staff identified a number of issues in recent examinations of newly registered advisers, including the following:

- **Compliance policies and procedures.** The staff observed compliance policies and procedures that: "(1) did not adequately address certain risk areas applicable to the firm, such as portfolio management and fee billing; (2) omitted procedures to enforce stated policies [for example, stating the advisers' policy is to seek best execution without including any procedures to periodically and systematically evaluate the execution quality of the broker-dealers executing their clients' transactions]; and/or (3) were not followed by advisory personnel, typically because the personnel were not aware of the policies or procedures or [because] the policies or procedures were not consistent with their businesses or operations." The staff also highlighted annual compliance reviews that did not address the adequacy of advisers' existing written policies and procedures and the effectiveness of the implementation of those policies. The staff observed advisers that:
  - Used off-the-shelf compliance manuals that were not specifically tailored for the advisers' actual operations and businesses.

[1] Specific examples of information and documents that the staff typically requests can be found in Section II.A of the Risk Alert.

- May not have devoted sufficient resources to comply with regulatory requirements and their companies' own policies and procedures. (For example, the staff observed chief compliance officers (CCOs) who were assigned additional and/or unrelated tasks and who did not appear to devote sufficient time to fulfilling their compliance oversight responsibilities, including training compliance personnel.)
- Had undisclosed conflicts of interest created by the multiple roles and responsibilities of advisory personnel, which were not mitigated.
- Outsourced certain business and compliance functions without assessing vendor performance or compliance with the companies' policies and procedures.
- Did not have adequate business continuity and succession plans.

- **Disclosure documents and filings.** The staff observed disclosure documents that contained omissions or inaccurate information and untimely filings. For example, material or annual updates to Form ADV were not made on a timely basis or at all. The omissions and inaccuracies observed related to the following:
  - Fees and compensation.
  - Business or operations (*e.g.*, affiliates, other relationships, number of clients and assets under management).
  - Services offered to clients, such as disclosure regarding investment strategy, aggregate trading and account reviews.
  - Disciplinary information.
  - Websites and social media accounts.
  - Conflicts of interest.
- **Marketing.** The staff observed marketing materials that "appeared to contain false or misleading information, including information about advisory personnel[s'] professional experience or credentials, third-party rankings and performance." Also, when the SEC requested additional information to substantiate certain factual claims, newly registered advisers were sometimes unable to substantiate the claims with further information.[2]

Takeaways

This Risk Alert highlights the SEC's long-standing focus on the foundations of investment adviser compliance, the agency's aim to ensure that an adviser's compliance program covers the primary risk areas posed by its advisory business, and the enforcement priority that advisers follow the requirements set forth in their written policies and procedures.

[2] The examinations described in the Risk Alert predate the recently adopted Rule 206(4)-1 (the Marketing Rule). See also Skadden's November 2, 2022, publication on the SEC's Risk Alert regarding the Marketing Rule.