

SEC Exams of Advisers and Investment Companies

The Division of Examinations has revamped and updated its exam priorities according to its most recent release, [2023 Exam Priorities](#). Consistent with its typical approach the Division plans to focus on a blend of topics and issues in its examinations. Those include points from last year as well as new points and wrinkles. For 2023, the Exams program for investment advisors and companies will center on a range of topics from new rules to RIAs moving to private funds, standards of conduct and ESG.

The New and Notable: Three rules fall into this category: 1) The Marketing Rule for Advisors; 2) The Derivatives Rule for Investment Companies; and 3) The IC Valuation Rule. The focus here will be on compliance. The key question is how the firm and its professionals have implemented the new rule and assessed compliance.

Marketing Rule, Advisors Act Rule 206(4)(1): The provision represents a significant change. The Division of Examinations plans to focus on the way in which the rule has been adopted and implemented. This means, for example, that Exams will assess not just if the advisory has a penned rule update for marketing, but if and how the RIA has complied with the substance of the new marketing directive. Thus, Exams will focus on an assessment of the reasonable basis for underlying performance advertising, testimonials, endorsements and third-party ratings. The compliance date for the rule is November 4, 2022.

Derivatives Rule, Investment Company Act Rule 18f-4: The section applies to investment companies and advisors, closed end funds, and business development companies but not mutual funds. The focus for Exams will center on the manner of adoption. Stated differently, the question will center on how the rule requirements are being implemented -- though the adoption of a derivatives risk management program, board oversight and if disclosures -- or some other method.

Investment Company Act: Fair Valuation, Rule 2a-5: The focus for Exams will be on implementation: How the fund and board are exercising their oversight obligations with

Related Capabilities

- Investment Funds
- Investment Management
- Securities & Financial Services Litigation & Enforcement

the new rule in determining fair value and if the record keeping requirements are being met. Exams will determine if the adjustments made to valuation methodologies, compliance policies, procedures and oversight as well as record keeping and reporting are sufficient.

RIAs to Private Funds: This trend represents a significant change in the business. Presently, about 35% of RIAs manage private funds with gross assets of \$21 trillion. Exams plans to initially focus on five key points: 1) conflicts of interest; 2) the calculation and allocation of fees and expenses; 3) compliance with the marketing rule discussed above; 4) compliance with the provisions for using alternative data and with Advisers Act Section 205(A)(regarding certain compensation); and compliance with Advisers Act Rule 206(4)-2 (custody rule).

A second facet of the exam will evaluate the transition to, and operation of, the new private fund. Specifically, the Division will evaluate risk items such as: 1) the amount of leverage the new private fund has; 2) if the new fund is managed side-by-side with BDCs; 3) the use of affiliated companies and advisory personnel to provide services; 4) the impact on funds with hard-to-value assets such as crypto and real estate; 5) if the fund sponsors a SPAC; and 6) if the fund is involved in an adviser led restructuring or related transaction.

Standards of conduct: Consistent with prior years, Exams plans to evaluate key standards of conduct viewed through the lens of firm operations. Those include Regulation BI, fiduciary duties and Form CRS.

Reg BI and fiduciary duties: This is a traditional area of focus for Exams. Here the Division will consider four points: 1) investment advice and recommendations; 2) disclosure to investors and its completeness; 3) the process used to evaluate best interest recommendations; and 4) factors drawn from the investor's investment profile. The Division will also consider if express or implied conflicts are such that an RIA can obtain informed consent to a conflict.

Overall, the Division plans to consider a variety of factors and conduct to evaluate the operations of the firm. Thus the Division will seek to determine and understand the firm's business model and various economic incentives and operations. The compensation, revenue, and benefits of the business will also be considered as appropriate as well as how the firm deals with conflicts and client relations.

Factors drawn from the overall operation of the business will be used to consider questions regarding complex products, the costs and liquidity of products, the use of proprietary products, unconventional strategies and microcap securities. Overall, these factors can impact compliance with the operative standards.

Form CRS: ESG products and their offering at the advisory will also be evaluated. Exams believes that RIAs are competing for raising investor demand for these products. Accordingly, the Division will evaluate the offerings in this area and if the products are appropriately labeled.

Investment Advisers and Companies

RIA: Exam's approach to RIAs will continue to be its manner of operation as in past years. The Division will analyze current market factors, the firm's operations and its compliance program in the context of its on-going business. Fees and expenses, and the way in which the firm tries to maximize revenue and profit, will also be considered. A key focus will be firm's that have not been previously examined.

ICs, Mutual Funds and ETFs: These are traditional areas of focus for Exams. The Division will thus evaluate compliance programs, governance practices, disclosures and the accuracy of reporting to the Commission. The Division will also evaluate the Board process, the fees charged and the method used to evaluate them as well as the impact of a weaker performance on fees.

Comment: Overall the Division of Examinations, when executing its 2023 Exam Program, will build on its traditional approach in conducting its examinations. The Division will build on that approach by adding current business factors and evaluating the manner in which new rules are adopted and implemented to assess the operations of the business and its delivery of services to investors.