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SEC Issues FAQ Relating to Investment Adviser Considerations of DEI Factors

by David Tang

The staff ("Staff") of the Securities and Exchange Commission issued a FAQ (the "FAQ") relating to an investment adviser's consideration of factors relating to diversity, equity, and inclusion ("DEI") when recommending or selecting other investment advisers for its clients.[1]

In the FAQ, the Staff clarified that an investment adviser must have a reasonable belief that the advice it provides is in the best interest of the client based on the client's objectives. In forming a reasonable belief, the adviser will typically consider a variety of factors. The Staff stated that those factors may include, without limitation, factors relating to DEI provided that use of such factors is consistent with a client's objectives, the scope of the relationship, and the adviser's disclosures.[2]

Dorsey Observations

The FAQ provides helpful guidance to investment advisers that consider DEI factors in their investment process. Similar to the consideration of environmental, social, and corporate governance ("ESG") factors, investment advisers that consider DEI factors must ensure that its use of DEI factors is consistent with stated client objectives, the scope of the client relationship, and client disclosures regarding the use of DEI (e.g., disclosures in fund offering documents, investment management agreements, Form ADV, and marketing materials). Investment advisers that consider DEI factors would be well advised to maintain documentation that effectively demonstrates their consistent consideration of DEI factors.

[1]Staff FAQ Relating to Investment Adviser Consideration of DEI Factors, *available at* https://www.sec.gov/tm/staff-faq-relating-investment-adviser-consideration-dei-factors.

[2]The SEC further clarified that, in the context of recommending or selecting other investment advisers, an investment adviser's fiduciary duty does not require restricting such a recommendation or selection to investment advisers with certain specified

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characteristics, such as a minimum amount of assets under management or a minimum length of track record.