

SEC Issues Risk Alert on Observations from Examinations of Newly-Registered Advisers

by David Tang and Michael Schmieder

On March 27, 2023, the SEC's Division of Examinations (the "Division") issued a Risk Alert on its observations from examinations of newly-registered advisers.¹ The Division focused on whether newly-registered advisers identified and addressed conflicts of interest, provided clients with full and fair disclosures so that clients can give informed consent, and adopted effective compliance programs. The Risk Alert highlighted three areas where the Division identified issues.

Compliance Policies and Procedures

The Division observed newly-registered advisers with policies and procedures that:

- Failed to adequately address areas of risk applicable to the firm, such as portfolio management and fee billing;
- Lacked procedures to enforce the adviser's policies. For example, advisers adopted policies and procedures stating the firm would seek best execution without any procedures to evaluate the execution quality of broker-dealers on a periodic and systematic basis; and/or
- Were not followed because advisory personnel were not aware of the policies and procedures or the policies and procedures were not consistent with the firm's operations or business.

Additionally, the Division observed newly-registered advisers' annual compliance reviews did not address the adequacy of the advisers' policies and the effectiveness of their implementation. This includes advisers that:

- Used "off the shelf" compliance manuals that were not tailored for their particular businesses;
- May not have allocated the appropriate level of resources to comply with regulatory requirements and their own policies and procedures (such as assigning additional and unrelated responsibilities to the chief compliance officer);
- Had undisclosed and unmitigated conflicts of interest created by the multiple roles and responsibilities of advisory personnel carrying out assigned duties;

Related People

- David Tang
- Michael Schmieder

Related Capabilities

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

- Outsourced certain business and compliance functions without assessing whether the outsourced responsibilities were being performed or whether they were consistent with the advisers' compliance policies and procedures; and
- Failed to have adequate business continuity plans, including succession plans.

Disclosure Documents and Filings

The Division observed disclosure documents and filings that were not made on a timely basis or contained omissions or inaccuracies regarding fees and compensation; business or operations (including affiliates, other relationships, number of clients, and assets under management); services offered to clients, such as disclosure regarding advisers' investment strategy (including the use of models), aggregate trading, and account reviews; disciplinary information; websites and social media accounts; and conflicts of interest.

Marketing

The Division observed deficiencies in advisers' marketing materials, including marketing materials that appeared to have false or misleading information, inaccurate information about advisory personnel experience or credentials, third-party rankings, and performance. Some advisers examined were unable to substantiate certain factual claims.

Dorsey Observations

The topics covered in the SEC's examinations of newly-registered advisers is not surprising. The Division's Risk Alerts have broadly alerted advisers to these focus areas. It is clear that the Division has and will continue to focus on examinations of newly-registered advisers. Newly-registered advisers should take steps to prepare for examinations and regularly review the adequacy and effectiveness of their compliance programs. Dorsey's regulatory compliance services are available to assist firms with exam preparation and mock audits and advise firms through the SEC examination process.

¹SEC Division of Examinations Risk Alert: Observations from Examinations of Newly-Registered Advisers (March 27, 2023) *available at* <https://www.sec.gov/files/risk-alert-newly-registered-ias-032723.pdf>.