

## CLIENT ALERT

### Investment Advisers Should Pay Attention to the SEC's Examination Priorities for 2014

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On January 9, 2014, the SEC staff issued its annual topic list of examination priorities for investment advisers/mutual funds, for broker-dealers, for exchanges and self-regulatory organizations, and for clearing/transfer agents. For a copy of the SEC's press release, please see [here](#). As in past years, we focus both on general market issues covered by the SEC and those specific to investment advisers/mutual funds. The Staff noted there presently are 11,000 registered investment advisers and 800 registered investment company complexes, collectively managing nearly \$55 trillion for investors. All investment advisers should pay close attention to the SEC's stated priorities, and therefore, prepare for inspection, review and update documentation as appropriate, and apply the important teachings in the release to their businesses.

There are six identified priorities across the entire SEC national examination program: (1) fraud detection and prevention; (2) conflicts of interest and legal / compliance / financial / operational risks (including an evaluation of the "tone at the top"); (3) governance and supervision of IT systems, operational capability, market access, information security, and business continuity/disaster recovery programs; (4) risks presented by businesses that are dually registered, including conflicts of interest (broker-dealers and investment advisers, a combination that the Staff has generally disliked for decades); (5) Staff review of materials triggered by new laws and regulations (principally crowd-funding diligence and supporting paperwork); and (6) issues arising from retirement vehicles and rollover accounts.

The SEC listed twelve priorities for investment managers, some of which are narrow and relevant only to a subset of managers and some of which are broad and likely to apply to almost all firms that are inspected:

1. compliance with the Custody Rule (particularly given enforcement actions and risk alerts concerning custody);
2. conflicts of interest (compensation arrangements, allocation of investment opportunities, risk controls, etc.);
3. performance data and its presentation and marketing;
4. risk-based examinations for firms that have been registered with the SEC for more than three years but not yet inspected;
5. a cluster of issues associated with wrap fee programs;
6. tests specific to quant managers;
7. continuation of the SEC's "presence exams," pursuant to which funds are examined for the first time in five key focus areas set forth in the release;
8. payments made by managers to distributors and intermediaries;
9. disclosures by bond funds especially with respect to changes in interest rates and associated investor risks;
10. management by money market funds of stress events;
11. a broad inquiry concerning mutual funds following "alternative" strategies; and
12. securities lending arrangements to assure legal compliance.

The release makes clear that this list is not exhaustive, and that each inspection will be customized depending on the particular business activity of an advisor or fund. As always, advance preparation is key.

For those managers who have not done so recently, the release is a good reminder to review critical disclosure and documentation issues. Private placement memoranda and power point presentations used in marketing should contain full and appropriate disclosure of conflicts of interest and risk factors, and should be specific to a particular offering. For more than 25 years, the SEC has focused on proper disclosure of performance. Be aware, as well, of the SEC's emerging views on transaction-based compensation for employees of investment advisers who are not registered as broker-dealers and who assist in the capital markets process. All of these issues are and remain central to the operation of private investment partnerships and mutual funds.

In addition, we encourage our clients and other friends of the firm to devote proper resources to be ready for examination. "Tone at the top" matters. Consider these issues and relevant policies, document where applicable, communicate broadly and consistently, periodically review and document those reviews. Empower your chief compliance officers and other compliance and legal personnel so that your inspection goes smoothly. Firms that grow rapidly, particularly through superb investment performance and consequent inflow of capital, need to focus seriously on non-investment functions.

We strongly encourage clients and other friends of the firm to conduct their own internal "mini-examinations" before the SEC calls. Firms should make sure their documents are organized and prepared for immediate production upon demand by the Staff, should fix any matters identified during the internal review stage, and should ensure that any prior deficiencies are corrected (among other reasons, to avoid recidivism and potential enforcement charges), among other things. There are compliance firms, law firms, consulting businesses and others who specialize and can assist you. Consider whether it makes sense to have your law firm retain any third party conducting the review.

We are happy to help you consider how these examination initiatives may affect your firm and how to ensure your house is in order.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.