



RISK ALERT

DIVISION OF EXAMINATIONS

September 6, 2023

Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents*

I. Introduction

The SEC-registered investment adviser (“adviser”) population is large and diverse, ranging from global asset managers to small firms, engaging in a variety of business activities (*e.g.*, advisory, brokerage, and insurance), servicing a diverse client base (*e.g.*, individuals, trusts, investment companies, private funds, and pension plans), and managing a wide spectrum of assets under management (“AUM”).¹ Given the size and variety of the adviser population, the Division utilizes a risk-based approach for both selecting advisers to examine and in determining the scope of risk areas to examine.

The Division’s risk-based approach is dynamic; it adapts to changes in market conditions, industry practices, and investor preferences. For example, an adviser may be selected for an examination in order for the staff to evaluate risks present at that particular firm, to respond to events that pose risks to investors and the markets more broadly, and/or to assess how registrants are adapting to new regulatory requirements. The Division leverages technology to collect and analyze large sets of industry- and firm-level data to help identify risks and better understand the firm’s business during examinations. The Division also reviews disclosure documents and various filings with regulators (*e.g.*, Form ADV, including the brochure, and Form PF²).

This Risk Alert provides additional information regarding the Division’s examination selection process and includes an attachment with the staff’s typical initial request for documents and information.³ As an examination progresses, the staff often makes additional requests for

* This Risk Alert represents the views of the staff of the Division of Examinations (the “Division” or “EXAMS”). This Risk Alert is not a rule, regulation, or statement of the Securities and Exchange Commission (the “SEC” or the “Commission”). The Commission has neither approved nor disapproved the content of this Risk Alert. This Risk Alert, like all staff statements, has no legal force or effect; it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

¹ There are currently more than 15,000 advisers managing in excess of \$115 trillion in aggregate AUM registered with the SEC. Advisers that manage at least \$100 million in assets are required to register with the SEC, unless they can rely on an exemption. Many advisers managing fewer assets are also registered with the SEC, such as advisers that manage SEC-registered investment companies and certain advisers that exclusively provide investment advice through an interactive website.

Although the registered adviser population has increased by 13% within the past three years, the staff has continued to examine approximately 15% of all (domestic and international) advisers each of these years.

² See [Form ADV](#) and [Form PF](#).

³ See also Division, [Information for Entities Subject to Examination or Inspection by the Securities & Exchange Commission \(Examination Brochure\)](#) (last updated March 2023) for additional information regarding the examination process. The Division conducts examinations to, among other things: (1) promote compliance; (2) prevent fraud; (3) monitor risk; and (4) inform policy. The attachment replaces a similar document that was published in 2008, which has been removed from the SEC’s website ([sec.gov](#)).

information and documents from the adviser, as needed. Some of the items discussed below may be included in supplemental requests, rather than the initial request.

II. Assessing Risks and Scoping Examinations

A. Selecting Firms to Examine

Some of the reasons the Division may select an adviser to examine include, but are not limited to, one or more of the following: the firm's risk characteristics (as discussed above); a tip, complaint, or referral; or the staff's interest in a particular compliance risk area. Each year, the Division's publication of its annual priorities provides advisers with insight regarding those areas that the Division believes present potential risks to investors and the integrity of the U.S. capital markets, including certain products, services, business operations, or practices.⁴ When selecting advisers to examine, the Division considers factors such as which advisers provide services, recommend products, or otherwise meet criteria relevant to the focus areas described in the Division's priorities.

There are also firm-specific risk factors that the staff considers when selecting advisers for examination, such as those related to a particular adviser's business activities, conflicts of interest, and regulatory history. For example, the staff may consider: (1) prior examination observations and conduct, such as when the staff has observed what it believes to be repetitive deficient practices during more than one review of a firm, significant fee- and expense-related issues, and significant compliance program concerns; (2) supervisory concerns, such as disciplinary history of associated individuals or affiliates; (3) tips, complaints, or referrals involving the firm; (4) business activities of the firm or its personnel that may create conflicts of interest, such as outside business activities and the conflicts associated with advisers dually registered as, or affiliated with, brokers; (5) the length of time since the firm's registration or last examination, such as advisers newly registered with the SEC;⁵ (6) material changes in a firm's leadership or other personnel; (7) indications that the adviser might be vulnerable to financial or market stresses; (8) reporting by news and media that may involve or impact the firm; (9) data provided by certain third-party data services; (10) the disclosure history of the firm; and (11) whether the firm has access to client and investor assets and/or presents certain gatekeeper or service provider compliance risks.

B. Selecting Examination Focus Areas

Once an adviser is selected for examination, additional risk assessment occurs to determine the scope of the examination, such as selecting particular areas of the business that examiners will review. Therefore, the scope of an examination, and consequently the documents requested,⁶ will vary from examination to examination depending on the firm's business model, associated risks, and the reason for conducting the examination. However, examinations typically include

⁴ See, e.g., Division, [FY 2023 Examinations Priorities](#) (Feb. 7, 2023).

⁵ See Division, [Risk Alert: Observations from Examinations of Newly-Registered Advisers](#) (Mar. 27, 2023) (discusses the typical focus areas reviewed during examinations of newly-registered advisers and shares staff observations regarding compliance policies and procedures, disclosures, and marketing practices. Although the March 2023 Risk Alert is addressed to newly-registered advisers, all advisers may find its resources attachment helpful.).

⁶ Requests for documents relating to background information (e.g., organizational charts) will be made in most examinations.

reviewing advisers' operations, disclosures, conflicts of interest, and compliance practices with respect to certain core areas, including but not limited to, custody and safekeeping of client assets, valuation, portfolio management, fees and expenses, and brokerage and best execution.

During an examination, the staff requests documents and information applicable to these core areas to gain an understanding of the adviser's conflicts of interest and its risks and corresponding controls, as well as to test the effectiveness of the adviser's compliance policies and procedures for monitoring, mitigating, and managing such risks and conflicts of interest.

III. Selecting Documents to Request – Typical Information Requested

As part of the examination process, the staff usually sends an adviser a letter notifying the firm of the upcoming examination, which contains an initial request list identifying certain information, including documents that the staff will review as part of the examination.⁷ The initial request for information typically includes: (1) general information, which provides the staff with an understanding of the adviser's business and investment activities; (2) information about the compliance risks that the adviser has identified and the written policies and procedures the firm has adopted and implemented to address each of those risks; (3) information to facilitate testing with respect to advisory trading activities; and (4) information for the staff to perform its own testing for compliance in various areas.

To assist advisers further, the Division is providing the *Typical Initial Information Examiners Request of Investment Advisers* as a resource attachment to this Risk Alert.

IV. Conclusion

The Division is providing this information so that advisers may prepare themselves for an examination. Although the Division continuously refines and enhances its risk assessment process, the information shared herein also may assist firms in their compliance efforts.

This Risk Alert is intended to highlight for firms risks and issues that Division staff has identified. In addition, this Risk Alert describes risks that firms may consider to (1) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (2) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some issues discussed in this Risk Alert may not be relevant to a particular firm's business. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

⁷ Examinations may be conducted on an announced or unannounced basis. When the examination is unannounced, the staff may provide the entity with a request for information, including documents, upon arrival.

Attachment: Typical Initial Information Examiners Request of Investment Advisers

Described below are the types of initial information, including documents, that staff may request and review during a typical examination of an adviser that does not engage in additional activities and/or have additional relationships (e.g., manage private funds). These information requests are generally transmitted through secure email, and responses are also typically provided electronically. If certain records are not maintained electronically or cannot be produced electronically, the staff may request that the adviser make such records available for in-person examination.

General Information	
Organizational Information	<ul style="list-style-type: none"> • Organizational structure, affiliations, and control persons. • Remote offices and branch locations. • Joint ventures or other businesses (including those with respect to the firm or any officer, director, portfolio manager, or trader). • Current and former supervised persons, officers, and/or directors.
Business and Operations	<ul style="list-style-type: none"> • Committees (e.g., responsibilities, members, meeting frequency, meeting minutes). • Client advisory contracts or agreements. • Agreements and arrangements with third parties associated with the management of client accounts (e.g., sub-advisers, third-party managers, referrals, wrap fee programs, and third-party investment platforms used for clients). • Fees and payments for services rendered. • Power of attorney obtained from clients. • Service providers and the services they perform.
Disclosures and Filings	<ul style="list-style-type: none"> • Disclosure documents and filings with regulators (e.g., Form ADV, including the brochure, and Form CRS).
Legal and Disciplinary	<ul style="list-style-type: none"> • Threatened, pending and settled litigation, arbitration, or Administrative Proceeding involving the adviser or any supervised person. • Remedial actions taken against supervised persons.
Information Regarding the Compliance Program, Risk Management, and Internal Controls	
Compliance Program and Oversight Process	<ul style="list-style-type: none"> • Compliance policies and procedures in effect during the examination period. • Tests performed (i.e., compliance reviews, quality control analyses, surveillance, and/or forensic or transactional tests performed by the firm). • Compliance consultant reports resulting from a review of compliance policies and procedures, operations, or books and records. • Annual and/or interim reviews of policies and procedures, including any reports prepared. • Record of compliance exceptions. • Remote office and/or independent advisory contractor oversight process. • Client complaints and correspondence and the process for monitoring such communications, including electronic communication.

Compliance Program and Oversight Process (cont.)	<ul style="list-style-type: none"> • Inventory of compliance risks and conflicts of interest that forms the basis for policies and procedures and notations regarding changes made to the inventory. • Written guidance and training provided to employees regarding compliance program and documentation of attendance.
Valuation	<ul style="list-style-type: none"> • Valuation process. • Pricing services, quotation services, and externally acquired portfolio accounting systems used in the valuation process and payment information. • Fair-valued and illiquid securities held by clients. • Advisory fee calculations. • Pricing overrides.
Information Processing, Reporting, and Protection	<ul style="list-style-type: none"> • Safeguards for the protection of customer records and information. • Electronic access controls. • Business continuity plan. • Cybersecurity incidents or breaches (<i>e.g.</i>, incident description, impact, and remediation).
Information to Facilitate Testing with Respect to Advisory Trading Activities	
Information About Advisory Clients and Accounts	<ul style="list-style-type: none"> • Current advisory client account information regarding: account inception, type, balance, and management discretion; client demographic information; client affiliation with the firm; custodial arrangements; firm authority with respect to the account (<i>e.g.</i>, trading authority, custody, and trustee); services provided; investment strategy and investment objectives; portfolio manager; fee computation; fee payment arrangements; and consultant related to obtaining the client, if any. • Advisory clients lost during review period.
Portfolio Management	<ul style="list-style-type: none"> • Securities held in all client portfolios, including information identifying each client holding an interest, the amount owned by each client, the aggregate number of shares or principal and/or notional amount held and total market value of the position. • Information about certain types of client investments (<i>e.g.</i>, private investments and initial public offerings). • Publicly traded companies for which employees of the adviser or its affiliates serve as officers and/or directors. • Companies for which employees of the adviser or its affiliates serve on creditors' committees. • Outside compensation to supervised persons including compensation related to client's transactions or investments. • Client portfolio profile information (<i>e.g.</i>, investment objectives, investment strategy, risk tolerance, suitability, and mandates).

<p>Brokerage and Trading</p>	<ul style="list-style-type: none"> • Trade blotter. • Brokerage arrangements and best execution evaluation documentation. • Soft dollar budget and products and services obtained using clients' brokerage commissions. • Commission-sharing arrangements. • Affiliated broker-dealers. • Principal trades and cross transactions. • Wrap fee programs. • Trade errors and related information. • Trade allocation information regarding initial public offerings and secondary offerings in which clients, proprietary accounts or access persons participated.
<p>Conflicts of Interest and Insider Trading</p>	<ul style="list-style-type: none"> • Code of Ethics and insider trading policies and procedures for the firm and its affiliates. • Code of Ethics attestations. • Exemptions from Code of Ethics for supervised persons. • Reports of securities transactions reported by access persons. • Fee splitting or revenue sharing arrangements.
<p>Information to Perform Testing for Compliance in Various Areas</p>	
<p>Marketing and Advertising</p>	<ul style="list-style-type: none"> • Advertisements and marketing materials disseminated, including newsletters, public audio and video programs, pitch books, pamphlets, brochures, websites, blogs, social media, and other promotional and/or marketing materials used. • Client or investor meeting materials and presentations. • Sponsored and attended seminars or events. • Client performance information. • Composite performance information, including current and terminated composites and composite returns. • Requests for proposal, due diligence questionnaires, and any other questionnaire (e.g., third party consultant database or other performance database). • Testimonials and endorsements, including payments made and compensation received. • Third-party ratings and rankings.
<p>Financial Records</p>	<ul style="list-style-type: none"> • Balance sheet, trial balance, income statement, and cash flow statements. • Cash receipts and disbursements journal. • General ledger and chart of accounts. • Loans and sales of firm or affiliate's stock.

Custody	<ul style="list-style-type: none">• Custodian identification and contact information for entities that maintain custody of client assets.• Surprise examination documentation, such as engagement letters, client account lists, and reports, results, and recommendations.• Auditor engagement letters, opinions, and findings.• Custodial confirmation of positions for specific clients.
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