



RISK ALERT

DIVISION OF EXAMINATIONS

March 27, 2023

Observations from Examinations of Newly-Registered Advisers*

I. Introduction

The Division of Examinations recognizes that investment advisers that have recently registered with the SEC (“newly-registered advisers”) may face unique compliance risks and issues.¹ As part of its risk-based examination program, the Division has noted its interest in conducting examinations of newly-registered advisers in each of its published examination priorities since 2013.² This Risk Alert 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.

II. Newly-Registered Advisers and Examinations

Examinations of newly-registered advisers provide an opportunity for early engagement between advisers and the staff. Such examinations allow the staff to: provide advisers with information about the Division’s examination program, conduct preliminary risk assessments, facilitate discussions regarding the advisers’ operations and risk characteristics, and promote compliance with applicable statutes and regulations. One of the ways the staff assesses advisers’ risks is by learning about their conflicts of interest and how these risks are mitigated and managed by the advisers through their compliance programs.³ The Division’s examinations of newly-registered advisers often focus on whether these firms have: (1) identified and addressed conflicts of interest;⁴ (2) provided clients with full and fair disclosure such that clients can provide informed

* 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 The number of SEC-registered advisers has increased by more than 20% within the past five years.

² See [Examination Priorities](#) under “Office Resources - Priorities Memos”.

³ An adviser’s fiduciary duty is established by and enforced through Section 206 of the Investment Advisers Act of 1940 (“Advisers Act”). See [Commission Interpretation Regarding Standard of Conduct for Investment Advisers](#), Advisers Act Rel. No. 5248 (Jun. 5, 2019) (“[Fiduciary Interpretation](#)”) (an adviser’s fiduciary duty is broad and applies to the entire adviser-client relationship).

⁴ See [Fiduciary Interpretation](#) *supra* note 3 (an adviser must, at all times, serve the best interest of its client and not subordinate its client’s interest to its own and eliminate, or at least expose through full and fair disclosure, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested). Also, one of the ways the Division assesses an investment adviser’s risk and conflicts of interest is by analyzing its responses to Form ADV.

consent;⁵ and (3) adopted effective compliance programs.⁶

A. Examination Scope

For the past several years, the Division has prioritized examining newly-registered advisers within a reasonable period of time after the adviser's SEC registration has become effective. These examinations typically involve document requests and interviews with advisory personnel addressing the adviser's: (1) business and investment activities; (2) organizational affiliations; (3) compliance policies and procedures; and (4) disclosures to clients. The staff requests information and documents for a defined review period to assess the adviser's compliance with the Advisers Act and to determine whether the adviser's representations and disclosures made to its clients and in SEC filings are consistent with the adviser's actual practices.⁷ For example, among other items, the staff typically requests and reviews the information below.

- *General information to provide the staff with an understanding of the adviser's business and operations*, such as: (1) organizational charts; (2) documentation to support eligibility for SEC registration; (3) information about ownership and control of the adviser and its affiliates; (4) information about current and former advisory personnel, such as the reasons for departure for former personnel (if available), and the roles, responsibilities, physical locations for current personnel; (5) financial information, including the balance sheet, trial balance, and income statement; and (6) information about any threatened, pending, or settled litigation or arbitration involving the adviser or any of its supervised persons.
- *Demographic and other specific data regarding each advisory client account*, including information about: (1) advisory services provided, such as portfolio management, financial planning, and/or bundled wrap fee arrangements; (2) types of client accounts serviced, such as individual, defined benefit retirement plan, registered fund, or private fund; (3) advisory authority to trade in the account, such as whether it has discretionary authority; (4) advisory

⁵ See [Fiduciary Interpretation](#) *supra* note 3 (to meet its duty of loyalty, an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship. Material facts relating to the advisory relationship include the capacity in which the firm is acting with respect to the advice provided). See also: (1) [Form ADV](#) (the uniform form used by advisers to register with both the SEC and state securities authorities, Parts 2 and 3 of which are a series of items that contain disclosure requirements for advisers to provide to certain clients, including any required supplements); (2) SEC, [Form CRS Relationship Summary and Amendments to Form ADV, Advisers Act Rel. No. 5247](#) (Jun. 5, 2019) ("Form CRS") (adopting new rules and forms and amendments to rules and forms, including Form ADV, Part 3, which requires advisers to briefly inform retail investors about: the types of client and customer relationships and services the firm offers; the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; whether the firm and its financial professionals currently have reportable legal or disciplinary history; and how to obtain additional information about the firm); and (3) SEC, [Investment Adviser Marketing](#), Advisers Act Rel. No. 5653 (Dec. 22, 2020) ("[Marketing Rule Adopting Release](#)") (adopting amendments to update rules that govern adviser marketing, and creating a merged rule that replaces both the prior advertising and cash solicitation rules).

⁶ See [Fiduciary Interpretation](#) *supra* note 3 (an adviser's duty of care encompasses the duty to provide advice and monitoring with a frequency that is in the best interest of the client, taking into account the scope of the agreed relationship). See also, SEC, [Final Rule: Compliance Programs and Investment Companies and Investment Advisers](#), Advisers Act Rel. No. 2204 (Dec. 17, 2003) ("[Compliance Rule Adopting Release](#)") (requiring each SEC-registered adviser to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and its rules, review those policies and procedures annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer to be responsible for administering the adviser's policies and procedures).

⁷ See EXAMS, [Examination Information for Entities Subject to Examination or Inspection by the Commission](#) (Feb. 2021) for additional information regarding the Division's examination process.

personnel servicing and overseeing the account; (5) assets under management advised by the firm; (6) third-party service providers, such as custodians, administrators, and auditors; and (7) investment strategies, such as global equity, high-yield, aggressive growth, long-short, or statistical arbitrage. In addition, the staff often requests documents supporting the adviser's representations, such as copies of select contracts, agreements, or third-party account statements.

- *Information regarding the adviser's compliance program, risk management practices and framework, and internal controls*, including written compliance policies and procedures and the adviser's code of ethics.
- *Information to facilitate the staff testing for regulatory compliance in certain areas, including portfolio management and trading activities*, such as a record of specific information for all advisory clients' securities holdings and transactions.
- *Communication used by the adviser to inform or solicit new and existing clients*, including disclosure documents and advertising, such as pamphlets, social media, mass mailings, websites, and blogs.

During the examination, the staff often interviews advisory personnel to understand the adviser's business, operations, investment activities, and compliance program. These interviews, among other examination procedures, assist the staff in assessing the adviser's tone at the top and culture of compliance. These assessments can be important factors in the staff's review of the effectiveness of the adviser's compliance program.

B. Staff Observations From Recent Newly-Registered Adviser Examinations

The staff's review of recent newly-registered adviser examinations identified issues in the following three areas, among others: (1) compliance policies and procedures; (2) disclosure documents and filings; and (3) marketing. Each of these areas is described further below.

- *Compliance Policies and Procedures.*⁸ The staff observed compliance policies and procedures that: (1) did not adequately address certain risk areas applicable to the firm, such as portfolio management and fee billing; (2) omitted procedures to enforce stated policies, such as stating the advisers' policy is to seek best execution, but not having any procedures to evaluate periodically and systematically the execution quality of the broker-dealers executing their clients' transactions;⁹ and/or (3) were not followed by advisory personnel, typically because the personnel were not aware of the policies or procedures or the policies or procedures were not consistent with their businesses or operations. Additionally, the staff observed advisers' annual compliance reviews that did not address the adequacy of the

⁸ See [Advisers Act Rule 206\(4\)-7](#) ("Compliance Rule") and [Compliance Rule Adopting Release](#) *supra* note 6. See also EXAMS, [Observations: Investment Adviser Compliance Programs](#) (Nov. 19, 2020) (noting that Compliance Rule-related deficiencies are among the most common cited by the staff and providing examples of notable deficiencies or weaknesses identified by the staff in connection with this rule).

⁹ See Division, [Compliance Issues Related to Best Execution by Investment Advisers](#) (Jul. 11, 2018) (discussing examination observations when an adviser has the responsibility to select broker-dealers and execute client trades).

advisers' policies and procedures and the effectiveness of their implementation. For example, the staff observed advisers that:

- Used off-the-shelf compliance manuals that were not tailored for consistency with the advisers' operations and business lines.
- May not have devoted sufficient resources to comply with regulatory requirements and their own policies and procedures (*e.g.*, advisers may have assigned additional and unrelated responsibilities to the chief compliance officer ("CCO"), resulting in limited time for the CCO to dedicate to compliance), or to ensure compliance personnel understood actual business practices.
- Had undisclosed conflicts of interest created by the multiple roles and responsibilities of advisory personnel carrying out the assigned duties, and these conflicts were not mitigated.¹⁰
- Outsourced certain business and compliance functions without assessing how these outsourced responsibilities were being performed or whether they were consistent with the advisers' compliance policies and procedures.
- Did not have adequate business continuity plans, including succession plans.¹¹
- *Disclosure Documents and Filings.*¹² The staff observed required disclosure documents that contained omissions or inaccurate information and untimely filings (*i.e.*, material or annual form updates were not made within prescribed timeframes or at all). The disclosure omissions and inaccuracies were related to advisers': (1) fees and compensation; (2) business or operations (including affiliates, other relationships, number of clients, and assets under management); (3) services offered to clients, such as disclosure regarding advisers' investment strategy (including the use of models), aggregate trading, and account reviews;

¹⁰ See [Fiduciary Interpretation](#) *supra* note 3 ("[W]here an investment adviser cannot fully and fairly disclose a conflict of interest to a client such that the client can provide informed consent, the adviser should either eliminate the conflict or adequately mitigate (*i.e.*, modify practices to reduce) the conflict such that full and fair disclosure and informed consent are possible.").

¹¹ See [Compliance Rule Adopting Release](#) *supra* note 6 (stating that an adviser's policies and procedures should address its business continuity plans as part of its "obligation to take steps to protect the clients' interests from being placed at risk as a result of the adviser's inability to provide advisory services after, for example, a natural disaster or, in the case of some smaller firms, the death of the owner or key personnel").

¹² [Advisers Act Rule 204-3](#) requires each SEC-registered adviser to provide its clients and prospective clients with a written disclosure document ("brochure") before or at the time of entering into a contract with the client and annually thereafter. An adviser generally may comply with this brochure requirement by providing its Form ADV, Part 2A. Similarly, [Advisers Act Rule 204-5](#) requires each SEC-registered adviser to deliver Form CRS (a brief "relationship summary") to its retail clients at the beginning of a relationship with the client and when amendments to the relationship summary are required to be made, a different new account is opened, and certain other events occur (*e.g.*, a retirement account is rolled over). Advisers also must make Form CRS available on the advisers' website, if the adviser has one. [Advisers Act Rule 204-2\(a\)\(14\)](#) also requires an adviser to: (1) maintain a copy of each brochure and relationship summary and each amendment or revision to these disclosure documents that was given or sent to clients or prospective clients; and (2) maintain a record of the dates on which such disclosure documents were given or offered to be given to any client or prospective client who subsequently becomes a client. These documents also must be filed electronically with the Investment Adviser Registration Depository and updated when material changes occur.

(4) disciplinary information; (5) websites and social media accounts; and (6) conflicts of interest.

- *Marketing.*¹³ The staff observed adviser marketing materials that appeared to contain false or misleading information, including inaccurate information about advisory personnel professional experience or credentials, third-party rankings, and performance. Advisers were also unable to substantiate certain factual claims.

In addition to the staff observations described above, previously published Division Risk Alerts contain information regarding common examination observations that are broadly applicable to SEC-registered advisers, including newly-registered advisers.¹⁴

III. Conclusion

The Division has focused, and will continue to focus, on examinations of newly-registered advisers to provide an opportunity for early engagement with advisers and to assist firms in their compliance efforts. Advisers are encouraged to review their compliance policies and procedures, marketing, and disclosures for the issues discussed herein. To assist advisers further, the Division has provided some resources with reference links as an attachment to this Risk Alert.

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.

¹³ The examinations described in this Risk Alert predate the Commission's new rule governing advisers' marketing practices. See [Marketing Rule Adopting Release](#) *supra* note 5 (among the significant revisions to Advisers Act Rule 206(4)-1, the new marketing rule addresses the marketing of private funds and provides additional specificity regarding misleading marketing materials). Nevertheless, these observations are relevant to advisers' compliance with this new rule. See also, Division, [Examinations Focused on the New Investment Adviser Marketing Rule](#) (Sept. 19, 2022).

¹⁴ See Division [Risk Alerts](#) (under "Office Resources – Risk Alerts" tab).

Attachment: Resources

The U.S. Securities & Exchange Commission’s (“SEC” or “Commission”) website (www.sec.gov) contains information and links to relevant laws and rules; regulatory actions, such as rulemaking, interpretive, and concept releases; SEC staff-issued guidance, FAQs, speeches, special studies, no-action and interpretive letters (generally from 2001 to present), and other documents; enforcement actions; and educational materials. Advisers may find the following non-exclusive list of informational sources to be helpful.¹

Information Regarding the Division and Examinations	
Examination Priorities (see “Office Resources – Priorities Memo” tab)	The annual publication of the Division’s examination priorities furthers the SEC’s mission and aligns with the Division’s goals to promote and improve compliance, prevent fraud, monitor risk, and inform policy. The examination priorities provide investors and registrants with transparency into those areas the staff believes bring heightened risks to investors, registrants, and the markets.
Risk Alerts (see “Office Resources – Risk Alerts” tab)	Risk Alerts are one way that the Division provides transparency and supports registrants’ compliance efforts. Risk Alerts, which cover a wide array of topics, are designed to raise awareness of compliance and industry risks and are meant to encourage firms to think about their own policies and procedures in particular areas.
Compliance Outreach Program	SEC staff engage with registrants through initiatives such as our Compliance Outreach Program, through which the staff seeks to promote compliance by informing advisers and funds about their obligations under the federal securities laws. The Compliance Outreach Program is designed to provide senior officers, including CCOs, with a forum to discuss compliance issues, share experiences, engage in discussions with Commission staff, and learn about effective compliance practices. The program features both regional meetings at various locations across the country and national seminars in Washington D.C.
Overview of Examinations Conducted by the Division	The Division’s website contains information about the examination program, including its mission, offices and program areas, and leadership. It also provides links to various helpful resources (by registrant type), examination-related forms and announcements, as well as the examination hotline, through which registrants can communicate comments, complaints, or concerns.
Listing of All SEC Regional Offices	Registrants are typically contacted by Division staff located within the SEC’s regional offices. To identify the states overseen by each region, including contact information for senior examination staff, click on the regional office links. The regional offices are assigned to an adviser based on the firm’s Principal Office and Place of Business, as identified on Form ADV.
Examination Brochure	The Examination Brochure is provided to all registrants at the beginning of an examination. It provides information regarding the purpose of examinations, the examination process, the steps taken at the completion of an examination, and the SEC’s Office of the Whistleblower.
Form 1661	Form 1661 is provided to all registrants at the beginning of an examination. It provides information regarding the mandatory production of certain documents to SEC staff, and the effect of not supplying such information or providing the staff with false statements or documents. The form also provides information regarding the principal and routine uses of information requested by the staff and how registrants may submit a request that their information not be disclosed under the Freedom of Information Act.

¹ This list does not provide a complete description of all of the legal obligations of SEC-registered advisers, nor does it provide a comprehensive inventory of resources that may be available.

Information Regarding the Division and Examinations

<p>Division of Investment Management</p>	<p>The Division of Investment Management has primary responsibility for administering the Investment Company Act and Advisers Act, which includes developing regulatory policy for investment companies (<i>e.g.</i>, mutual funds, including money market funds, closed-end funds, business development companies, unit investment trusts, variable insurance products, and exchange-traded funds) and for investment advisers. This site contains information and links to relevant laws and rules, regulatory actions, such as rulemaking, interpretive, and concept releases.</p>
<p>Advisers Act and the rules thereunder</p>	<p>The Advisers Act regulates investment advisers. With certain exceptions, this Act requires that firms or individuals that are in the business of advising others about securities investments and are compensated for that advice must register with the SEC or states and conform to regulations designed to protect investors. Generally only advisers who have at least \$100 million of assets under management or advise a registered investment company must register with the Commission. Other advisers typically register with the states in which they meet the registration requirements of that state.</p>
<p>Investment Company Act and the rules thereunder</p>	<p>The Investment Company Act regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. The Act requires these companies to disclose their financial condition and investment policies to investors when shares are initially sold and, subsequently, on a regular basis. The focus of this Act is on disclosure to the investing public of information about the fund and its investment objectives, as well as on investment company structure and operations.</p>
<p>Form ADV</p> <p>Brochure (Form ADV, Part 2)</p> <p>Form CRS (Form ADV, Part 3)</p>	<p>Advisers use Form ADV to apply for registration as investment advisers with the SEC and the state securities authorities, and registered advisers must amend their Form ADV each year by filing an annual updating amendment within 90 days after the end of their fiscal year. While this form is filed electronically via Investment Adviser Registration Depository (“IARD”), advisers may find it useful to review Form ADV, General Instructions to Form ADV, and Glossary and frequently asked questions about Form ADV and IARD as part of their filing process.</p> <p>Under SEC and similar state rules investment advisers are required to deliver to clients and prospective clients a brochure disclosing information about their business practices, fees, conflicts of interest, and disciplinary information. Advisers also may be required to deliver a brochure supplement disclosing information about one or more of their supervised persons. Part 2 of Form ADV sets out the minimum required disclosure that an adviser’s brochure (Part 2A for a firm brochure, or Appendix 1 for a wrap fee program brochure) and brochure supplements (Part 2B) must contain.</p> <p>SEC rules require advisers and brokers to provide new, prospective, and existing retail customers and clients with a Form CRS “relationship summary,” file their relationship summary with the SEC and post the current relationship summary on the firm’s public website, if the firm has one. While advisers must file their initial relationship summaries (and any amendments) with the SEC using IARD, advisers subject to this filing obligation may find it useful to review Form CRS and frequently asked questions about Form CRS as part of their filing process.</p>
<p>SEC-staff statements and no-action letters</p>	<p>SEC staff-issued statements and no-action letters provided by the Division of Investment Management are informal resource and guidance updates that may be of assistance to practitioners and others; they represent the views of SEC staff and are not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved its content. Examples of such resources include the following Staff Bulletins: (1) Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest; and (2) Standards of conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors.</p>