
SEC Risk Alert Investment Adviser Compliance Programs

On November 19, 2020, the SEC's Office of Compliance Inspections and Examination's ("OCIE") issued a Risk Alert outlining compliance issues noted by OCIE staff related to Rule 206(4)-7 ("the Compliance Rule") of the Investment Advisers Act of 1940 ("Advisers Act").

Under the Compliance Rule, advisers are required to:

- Adopt and implement written policies and procedures that are customized to the adviser's business and operations and reasonably designed to:
 - Address their fiduciary and regulatory obligations under the Advisers Act;
 - Prevent violation of the Advisers Act from occurring;
 - Detect violations that have occurred; and
 - Promptly correct any violations.
- Conduct an annual compliance review to:
 - Determine adequacy and effectiveness of compliance policies & procedures and their implementation;
 - Consider changes in the adviser's business; and
 - Address regulatory developments.
- Designate a chief compliance officer ("CCO") to administer the policies and procedures.
 - CCO should be competent and knowledgeable regarding the Advisers Act;
 - CCO should be empowered with full responsibility and authority to develop and enforce policies and procedures; and
 - CCO should have sufficient seniority and authority with the organization.

OCIE specifically identified several Compliance Rule deficiencies and weaknesses in adviser compliance programs; below is a summary and examples provided.

Inadequate Compliance Resources – Lack of adequate resources dedicated to information technology, staffing and training

- Insufficient Time – CCOs with multiple professional responsibilities appear unable to devote sufficient time to fulfilling CCO responsibilities or time to develop their knowledge of the Advisers Act.
- Insufficient Resources – Insufficient compliance staff, training or resources to implement an effective program, affecting the completion of annual review, accuracy of Form ADVs and timely responses to OCIE books and records requests.
- Inadequate Updates – Firms that experienced growth in size or complexity did not add staff or adequate information technology.

Insufficient Authority of CCOs – Lack of sufficient authority to develop and enforce policies and procedures

- Inadequate Access – CCOs restricted from accessing critical compliance information and key documents.

- Inadequate Information – CCOs not having critical information of the firm’s strategy, business operations and transactions due to limited interaction with senior management.
- Inadequate Consultation – CCOs were not consulted by senior management and employees regarding matters that had potential compliance implications.

Annual Compliance Review Deficiencies – Failure to document/demonstrate annual review or identify significant existing compliance or regulatory problems

- Evidence of Annual Review – No evidence of annual review having been conducted despite claims that such reviews were conducted.
- Identification of Risks – Failure to identify or review key risk areas applicable to the adviser, such as conflicts and protection of client assets.
- Review of Business – Failure to review key business areas, such as cybersecurity, oversight of third-party managers, calculation of fees and allocation of expenses.

Implementing Actions Required by Written Policies and Procedures – Advisers did not implement or perform required actions. For example, advisers did not:

- Train employees;
- Review advertising materials;
- Implement compliance procedures regarding trade errors, advertising, best execution, conflicts, disclosure and other requirements;
- Follow compliance checklists and other processes, including back testing fee calculations and testing business continuity plans; and
- Review client accounts to assess consistency of portfolios with clients’ investment objectives, on a periodic or scheduled basis.

Maintaining Accurate and Complete Information in Policies and Procedures – Advisers’ policies and procedures were not customized to the adviser’s specific business and practices and/or the policies and procedures were outdated or inaccurate.

Maintaining or Establishing Reasonably Designed Written Policies and Procedures – Advisers relied on informal processes or did not establish, implement or sufficiently tailor policies and procedures to their business, particularly in the following areas:

- **Portfolio Management**
 - Due diligence and oversight of outside managers
 - Monitoring compliance with client investment and tax planning strategies
 - Oversight of third-party service providers
 - Due diligence and oversight of investments, including alternative assets
 - Oversight of branch offices and investment advisory representatives
 - Adherence with investment advisory agreement
- **Marketing**
 - Oversight of solicitation arrangements
 - Prevention of misleading marketing presentations, including websites
 - Oversight of the use and accuracy of performance advertising

- **Trading Practices**
 - Allocation of soft dollars
 - Best execution
 - Trade errors
 - Restricted securities
- **Disclosures**
 - Accuracy of Form ADV
 - Accuracy of client communications
- **Advisory Fees and Valuations**
 - Fee billing calculations, testing and monitoring
 - Expense reimbursement policies and procedures
 - Valuation of advisory client assets
- **Safeguards for Client Privacy**
 - Regulation S-P
 - Regulation S-ID
 - Physical security of client information
 - Electronic security and encryption policies
 - General cybersecurity, including access rights and controls, data loss prevention, penetration testing/vulnerability scans, vendor management, employee training and incident response plans
- **Required Books and Records** – Written policies and procedures to make and keep accurate books and records as required by Rule 204-2 under Advisers Act.
- **Safeguarding of Client Assets** – Written policies and procedures regarding custody and safety of client assets.
- **Business Continuity Plans** – Maintenance of adequate disaster recovery plans – Observed business continuity plans that were not tested or did not contain contact information or designate responsibility for business continuity plan actions.

Many advisers did modify their written policies and procedures to address the issues identified by OCIE staff. OCIE continues to encourage advisers to review their written policies and procedures to ensure they are tailored to the advisers' business and are adequately reviewed and implemented.