Lowenstein Sandler

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SEC Provides Guidance to Newly Registered Investment Advisers

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Introduction

The Securities and Exchange Commission (the SEC) routinely prepares Division Risk Alerts to provide helpful information to federally registered investment advisers (advisers).[1] On March 27, the SEC released a Division Risk Alert that summarized its examination of materials submitted by advisers that have recently registered with the SEC (newly registered advisers) to provide observations that are helpful for such advisers to consider.[2] This client alert provides a brief overview of the SEC's review[3] and provides a summary of the SEC's observations related to compliance policies and procedures, marketing, and disclosure practices.

SEC Review

After an adviser's registration becomes effective, the SEC may conduct a routine examination of the adviser at any time. The SEC typically conducts a routine examination of newly registered advisers within a reasonable time after such registration is effective (often within the first year or two of registration). The SEC utilizes document requests and interviews to examine the full scope of the adviser's business, operations, affiliations, investment activities, adherence to internal policies, and client disclosures. Document requests and interviews help the SEC determine if the adviser is compliant with the Advisers Act. The SEC also evaluates the consistency of the adviser's practices and the representations made to both the adviser's clients (and investors therein, if applicable) and the SEC.[4] The SEC closely analyzes investment adviser information related to, among other things, the following:

- Business and operations of the adviser
- Detailed demographic information for each of the adviser's clients
- Investment adviser compliance programs, risk management practices, and associated policies
- Information to assist with SEC regulatory compliance review
- Materials used to recruit new clients or investors therein

Issues Identified in Newly Registered Adviser Materials

Over the course of the past five years, the number of advisers has increased by more than 20 percent.[5] The SEC identified the following issues when reviewing newly registered adviser materials in the areas of compliance policies and procedures, disclosure documents and filings, and marketing:

- *Compliance Policies and Procedures*
  - Policies that inadequately addressed risk areas
  - Procedures that did not support adherence to stated policies
  - Policies and procedures that were not followed by adviser personnel
  - Compliance reviews that neither determined the viability of compliance policies and procedures nor assessed implementation
- *Disclosure Documents and Filings*
  - Omissions or inaccurate information detailed on disclosure documents (including but not limited to fees and compensation, business or operations, services offered to clients, disciplinary

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[1] *See* SEC.gov | Division of Examinations (under "Officer Resources – Risk Alerts" tab).
[2] *See* Observations from Examinations of Newly-Registered Advisers (sec.gov).
[3] As part of its risk-based examination program, the SEC has noted its interest in conducting examinations of newly registered advisers in each of its published examination priorities since 2013.
[4] *See* exam-brochure.pdf (sec.gov).
[5] *See* Observations from Examinations of Newly-Registered Advisers (sec.gov).

- information, websites and social media accounts, and conflicts of interest)
    - Untimely submission of filings
- *Marketing*
    - Inaccurate or misleading information used in marketing materials (including but not limited to information about staff, third-party rankings, and adviser performance)
    - Marketing materials that contained information that proved hard to substantiate

Takeaways

Every newly registered adviser should tailor their disclosures and compliance policies and procedures to fit the adviser rather than using generally applicable materials or templates prepared by service providers without alteration. Well in advance of an SEC examination, advisers should consider conducting comprehensive conflicts and risk assessments in order to effectively tailor such disclosures and compliance policies and procedures. Conducting a mock examination before an actual SEC examination can also greatly help a newly registered adviser prepare for the SEC's first (and subsequent) visit(s). To ensure that the review process is efficient, advisers should closely review their policies, procedures, disclosure documents, filings, and marketing materials to avoid the issues identified by the SEC that are summarized above.

Next Steps

For further information, guidance, and clarity on how advisers can avoid the pitfalls identified in this client alert, please reach out to the authors–Scott Moss, partner in Lowenstein Sandler's Investment Management Group and Chair of the firm's Fund Regulatory & Compliance Group, and Nathan Ford, associate in the firm's Mergers & Acquisitions and Investment Management practice groups–or reach out directly to your regular Lowenstein Sandler contact.

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