DINSMORE COMPLIANCE SERVICES

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DCS INVESTMENT ADVISER ALERT: Division of Examinations Risk Alert: Observations from Examinations of Newly-Registered Advisers

March 27, 2023:

The SEC Division of Examinations (the "Division") issued a Risk Alert on March 27, 2023 detailing observations from examinations of newly-registered investment advisers. The Risk Alert provides information about the typical focus areas reviewed during examinations of newly-registered investment advisers. It also provides observations regarding compliance policies and procedures, disclosures and marketing practices. In the Risk Alert, the Division notes a key observation regarding newly-registered advisers' conflicts of interest and the mitigation and management of such risks by advisers' compliance programs.

Examination Scope

Generally, the examination scope for newly-registered advisers includes the following:

- Business and investment activities;
- Organizational affiliations;
- Compliance policies and procedures; and
- Disclosures to clients.

In reviewing requested documentation and information, the Division works to assess an adviser's compliance with the Advisers Act and to determine whether the adviser's representations and disclosures made to clients and in SEC filings are factually correct. The Risk Alert details the following information and documentation that the Division typically requests as part of an examination:

- General information regarding an adviser's business and operations. This general information includes such things as:
  - o Organizational charts;
  - o Documentation supporting SEC registration;
  - o Information regarding the ownership and control of an adviser and its affiliates;

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    - Information about current and former advisory personnel;
    - Financial information, e.g. balance sheet, income statement, trial balance;
    - Information regarding any threatened, pending or settled litigation or arbitrations involving an adviser or any of its supervised persons.
- Demographic and other data regarding each advisory client account – including:
    - Advisory services provided and/or bundled wrap fee arrangements;
    - Types of client accounts serviced;
    - Levels of advisory authority/whether the adviser has discretionary authority;
    - Personnel with specific account responsibility;
    - Assets under management;
    - Third party service providers; and
    - Investment strategies.
- Information regarding an adviser's compliance program, risk management practices and framework and internal controls – written compliance policies and procedures and code of ethics.
- Information to facilitate the Division testing for regulatory compliance in certain areas, such as portfolio management and trading activities.
- Materials utilized and distributed by an adviser to inform or solicit new and existing clients.

<u>The Division's Observations from Recent Newly-Registered Adviser Examinations</u>
The Risk Alert notes the following identified issues in recent newly-registered adviser examinations:
- Compliance policies and procedures;
- Disclosure documents and filings; and
- Marketing.

<u>Compliance Policies and Procedures</u>
The Division noted the review of compliance policies and procedures that:
- Did not adequately address certain risk areas applicable to the firm;
- Omitted procedures to enforce stated policies; and
- Were not followed by personnel typically because the personnel were not aware of the policies or procedures, or the policies or procedures were not consistent with an adviser's business or operations.

In addition, the Division noted the failure of advisers' annual compliance reviews to address the adequacy of the advisers' policies and procedures and the effectiveness of their implementation. The Risk Alert provides the following examples of advisers that:
- Used off-the-shelf compliance manuals that were not tailored to the firm;
- May not have devoted sufficient resources to comply with regulatory requirements and their own policies and procedures – e.g. advisers assigning additional and unrelated responsibilities to the chief compliance officer, resulting in limited time for the chief compliance officer to dedicate to compliance;
- Had undisclosed conflicts of interest that were not mitigated;
- Outsourced certain business and compliance functions without assessing how these responsibilities were being performed or whether they were consistent with the advisers' compliance policies and procedures; and
- Did not have adequate business continuity plans, including succession plans.

Disclosure Documents and Filings

The Division observed disclosure documents that contained omissions or inaccurate information, as well as advisers failing to make filings or otherwise making untimely filings. Disclosure omissions and inaccuracies were related to advisers':

- Fees and compensation;
- Business or operations, e.g. affiliates, regulatory assets under management, number of clients;
- Services offered to clients, such as disclosures regarding advisers' investment strategies and account reviews;
- Disciplinary information;
- Websites and social medial accounts; and
- Conflicts of interests.

Marketing

The Division observed adviser marketing material that appeared to contain false or misleading information. In addition, the Division notes advisers being unable to substantiate certain factual claims.

Here is the link to the SEC's Alert: https://www.sec.gov/files/risk-alert-newly-registered-ias-032723.pdf

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