

## Special Alert

October 24, 2023

### Division of Examinations: 2024 Examination Priorities for Investment Advisers



On October 16, 2023, the Division of Examinations of the United States Securities and Exchange Commission (the “Division”) published the 2024 Examination Priorities. Historically, the Examination Priorities have been published in the 1<sup>st</sup> quarter of the applicable calendar year. For 2024, the Division revised the publication date to align with the start of the SEC’s fiscal year.

#### Focus Areas for 2024

##### Examinations of Investment Advisers

The Division will focus on investment advisers’ satisfaction of their fiduciary obligations to clients, specifically, adherence to their duty of care and duty of loyalty. In reviews, the Division will focus on the following:

- Investment advice provided to clients with regards to products, investment strategies and account types – specifically including the following:
  - Complex products, e.g. derivatives, leveraged ETFs;

- High cost and illiquid products, e.g. variable annuities and REITS; and
  - Unconventional strategies, including those that purport to address rising interest rates.
- Investment advice provided to certain types of clients, such as older investors and those saving for retirement.
- Processes for determining that investment advice is provided in a client's best interest, including the following:
  - Making initial and ongoing suitability determinations;
  - Seeking best execution;
  - Evaluating costs and risks;
  - Identifying and addressing conflicts of interest; and
  - Factors advisers consider in light of the client's investment profiles, including investment goals and account characteristics.
- How advisers address conflicts of interest, including:
  - Mitigating or eliminating conflicts of interest; and
  - Allocating investments to accounts where investors have more than one account, e.g. allocating between accounts that are adviser fee-based, brokerage-commission based and wrap fee, as well as between taxable and non-taxable accounts.
- Economic incentives that an adviser and its financial professionals may have to recommend products, services and account types. The Division will focus on the economic incentives and conflicts of interest applicable to advisers that are dually registered as broker-dealers, use affiliated firms to provide clients services and have financial professionals servicing both brokerage customers and advisory clients to identify:
  - Investment advice to purchase or hold certain types of investments or invest through certain types of accounts when lower cost options are available; and
  - Investment advice regarding proprietary products and affiliated service providers that result in additional or higher fees.
- Disclosures made to investors and whether such disclosures contain all material facts relating to conflicts of interest.
- Investment advisers compliance programs, including whether these reflect the investment adviser's business, compensation structure, services, client base and operations, as well as market risks. The analysis of investment adviser's annual review is described as an important part of assessing whether an adviser's conflicts of interest are addressed in the compliance program. The Division's focus on compliance policies and procedures may include one or more of the following areas:
  - Portfolio management processes;

- Disclosures made to investors and regulators;
  - Proprietary trading by the adviser and personal trading activities of supervised personnel;
  - Safeguarding of client assets from conversion or inappropriate use by advisory personnel;
  - Accurate creation and secure maintenance of required records;
  - Trading practices;
  - Marketing practices;
  - Valuation process, as well as the process to assess fees based on those valuations; and
  - Business continuity plans.
- Marketing practices, including whether investment advisers have:
    - Adopted and implemented policies and procedures to prevent violations of the Advisers Act, inclusive of the Marketing Rule;
    - Correctly disclosed their marketing information on Form ADV Part 1A;
    - Maintained required books and records;
    - Utilized marketing material containing untrue statements, are misleading or otherwise are deceptive; and
    - Comply with specific requirements of the Marketing Rule relating to such things as performance, third-party ratings, testimonials and endorsements.
  - Compensation arrangements, focusing on:
    - Fiduciary obligations to clients;
    - Alternative ways that advisers try to maximize revenue; and
    - Fee breakpoint calculation processes.
  - Valuation assessments relating to illiquid or difficult to value assets, such as commercial real estate or private placements.
  - Advisers' controls to protect client material non-public information, especially in the following instances:
    - When multiple advisers share office locations;
    - When an adviser has a significant turnover of investment adviser representatives; and
    - When advisers use expert networks.
  - The accuracy and completeness of regulatory filings.
  - Policies and procedures for selecting and using third-party and affiliated service providers.
  - The oversight of branch offices when advisers operate from numerous geographically dispersed offices.
  - Obtaining informed consent from clients when advisers implement material changes to their advisory agreements.

### Examination of Advisers to Private Funds

The Division notes that it will continue to focus on advisers to private funds. This focus will include areas such as the following:

- Portfolio management risks present when there is exposure to recent market volatility and higher interest rates, including private funds experiencing poor performance, significant withdrawals and valuation issues, as well as private funds with more leverage and illiquid assets.
- Adherence to contractual requirements regarding advisory boards or similar structures.
- Accurate calculation and allocation of private fund fees and expenses including:
  - Valuation of illiquid assets;
  - Calculation of post-commitment period management fees;
  - Adequacy of disclosures; and
  - Potential offsetting of such fees and expenses.
- Due diligence practices being consistent with policies, procedures and disclosures, especially in regards to assessments of prospective fund investments.
- Conflicts, controls and disclosures regarding private funds managed side-by-side with registered funds.
- The use of affiliated service providers.
- Compliance with the requirements of the Custody Rule.
- Policies and procedures for reporting on Form PF.

<https://www.sec.gov/files/2024-exam-priorities.pdf>

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