

## Special Alert

October 29, 2024

# Division of Examinations: SEC Fiscal Year 2025 Examination Priorities for Investment Advisers



On October 21, 2024, the Division of Examinations of the United States Securities and Exchange Commission (the "Division") published the Fiscal Year 2025 Examination Priorities. In addition to investment advisers, the Division has examination responsibility for broker-dealers, investment companies, self-regulatory organizations, clearing agencies and other market participants such as municipal advisers. This alert only addresses the examination priorities applicable to investment advisers.

As with previous years, the 2025 Examination Priorities provides a high level summary of the activities of the Division, as well as general priorities. The following are highlights from the Examination Priorities:

- The Division was created in 1995, and since that time, the Division has grown to a staff of more than 1,100 across five programs with specialized functions and capabilities;
- In the past two years, the Division has added specialized capabilities in the cybersecurity, crypto asset and intelligence space, as well as dedicating additional resources to other areas, including private funds;

- The Division has changed its approach to onsite examinations based on lessons the Division learned operating in a remote and hybrid environment; and
- In fiscal year 2025, the Division anticipates conducting targeted outreach to the securities industry, focusing on the implementation of the requirements contained in the SEC's updates to Regulation S-P.

## Focus Areas For 2025

### Adherence to Fiduciary Standards of Conduct

As a fiduciary, an investment adviser owes a duty of care and a duty of loyalty to clients. In fulfilling this fiduciary obligation an investment adviser must:

- Serve the best interest of clients;
- Not place its own interests ahead of its clients; and
- Eliminate or make full and fair disclosure of all conflicts of interest.

In examining advisers' compliance with fiduciary standards, the Division will focus on recommendations regarding products, investment strategies and account types. In addition, the Division will focus on recommendations related to:

- High-cost products;
- Unconventional instruments;
- Illiquid and difficult-to-value assets; and
- Assets sensitive to higher interest rates or changing market conditions, such as commercial real estate.

The Division will also focus on dual registrants and advisers with affiliated broker-dealers. Areas of focus will include:

- Whether investment advice and recommendations regarding certain products are suitable;
- Disclosures to clients regarding the capacity in which recommendations are made;
- Reviewing the appropriateness of the account selection practices (e.g. brokerage versus advisory), including rollovers from an existing brokerage account to an advisory account; and
- Assessing whether, and how, advisers adequately mitigate and fairly disclose conflicts of interest.

Furthermore, the Division will review the impact of advisers' financial conflicts of interest on providing impartial advice and for best execution, with an additional focus on non-standard fee arrangements.

## Effectiveness of Advisers' Compliance Programs

The Division will assess advisers' compliance programs pursuant to Advisers Act Rule 206(4)-7, the "Compliance Rule." In evaluating advisers' compliance programs, the Division will review such areas as:

- Marketing;
- Valuation;
- Trading;
- Portfolio management;
- Disclosure and filings;
- Custody;
- Annual reviews, inclusive of addressing and monitoring conflicts of interest;
- Fiduciary obligations of advisers that outsource investment selection and management;
- Alternative sources of revenue or benefits advisers receive, such as selling non-securities based products to clients; and
- Appropriateness and accuracy of fee calculations and the disclosure of fee-related conflicts, such as those associated with select clients negotiating lower fees when similar services are provided to other clients at a higher fee rate.

The Division's review of a compliance program will be driven by an adviser's practices and products. As examples, the Division notes the following practices and products:

- Investments in illiquid or difficult-to-value assets, such as commercial real estate, will entail a heightened focus on valuation;
- Utilization of artificial intelligence ("AI") for advisory operations, including portfolio management, trading, marketing and compliance, will entail an in-depth review of compliance policies as well as disclosures;
- Advisers utilizing a large number of independent contractors, working from geographically dispersed locations, may necessitate a focus on supervision and oversight practices; and
- Compliance practices when advisers change their business models or are new to advising particular types of assets, clients or services.

## Examinations of Advisers to Private Funds

Advisers to private funds remain a focus of the Division, with priority given to the following areas.

- Consistency between disclosures and actual practices, including advisers' fulfillment of fiduciary duty during market volatility and interest rate fluctuations. The Division will focus examinations on advisers to private funds that are experiencing poor performance and significant withdrawals and/or hold more leverage or difficult-to-value assets.
- The accuracy of calculations and allocations of fees and expenses – both fund and investment level. Areas that may impact fee calculations include:
  - Valuation of illiquid assets;
  - Calculation of post commitment period management fees;
  - Offsetting of such fees and expenses; and
  - Adequacy of disclosures.
- Disclosures of conflicts of interests and risks, and adequacy of policies and procedures. The Division provides the following examples of products or practices that may warrant enhanced reviews:
  - Use of debt, fund-level lines of credit, investment allocations, adviser-led secondary transactions, transactions between fund(s) and/or others;
  - Investments held by multiple funds; and
  - Use of affiliated service providers.
- Compliance with recently adopted SEC rules, including amendments to Form PF and the Marketing Rule.

## Never Examined Advisers, Recently Registered Advisers and Advisers Not Recently Examined

The Division will continue to prioritize examinations of advisers that have never been examined, not recently examined and newly registered advisers.

## Cybersecurity

The Division will continue to review procedures and practices to assess whether advisers are reasonably managing information security and operational risks, as well working to prevent client service interruptions. In addition, the Division continues to assess adviser practices to protect client information, records and assets. The Division notes that particular attention will be paid to advisers':

- Policies and procedures;
- Governance practices;

- Data loss prevention;
- Access controls;
- Account management; and
- Response to cyber-related incidents, including those related to ransom-ware attacks.

With respect to third-party products and services, the Division will continue to assess cybersecurity risks and resiliency goals associated with:

- Third-party contractors;
- Sub-contractors;
- Information technology resources used without IT department approval, knowledge or oversight; and
- Non-supported infrastructure.

The Division will focus on how advisers identify and address these risks.

### **Regulation S-ID and Regulation S-P**

Regulation S-ID addresses client identity theft detection and prevention. Regulation S-P is the privacy regulation applicable to investment advisers. The Division will focus on advisers' policies and procedures regarding safeguarding customer records and information, including:

- Identity theft detection and prevention protecting against fraudulent transfers;
- Practices to safeguard customer records and client personally identifiable information, especially for advisers with multiple branch offices;
- Identity theft prevention program training; and
- Advisers' efforts to address operational risk, including technology risks.

In addition, the Division provides that in preparation for the compliance date of the amendments to Regulation S-P, the Division will inquire with firms during examinations about their progress in establishing incident response programs. The amended Regulation S-P compliance date is December 3, 2025 for investment advisers with \$1.5 billion or more in assets under management, and June 3, 2026 for investment advisers with less than \$1.5 billion in assets under management.

### **Shortening of the Settlement Cycle**

The Division will evaluate investment advisers' compliance with the amended books and records requirements associated with T+1.

## Emerging Financial Technologies

The Division remains focused on advisers' use of automated investment tools such as AI, and trading algorithms and platforms, as well as risk related to the use of emerging technologies and alternative sources of data. In reviewing the use of such tools, assessments by the Division will include whether:

- Representations are fair and accurate;
- Operations and controls in place are consistent with disclosures;
- Algorithms provide advice or recommendations consistent with investors' suitability profile or stated strategies; and
- Controls to confirm that advice or recommendations from such practices are consistent with regulatory obligations to investors, including older investors.

With respect to AI, the Division will review adviser representations regarding their AI capabilities or AI use for accuracy. In addition, the Division will review how advisers protect against loss or misuse of client records and information that may occur from the use of third-party AI models and tools.

## Crypto Assets

In light of the volatility and activity in the crypto asset markets, the Division will monitor and examine registrants offering crypto asset-related services. These examinations will review whether advisers:

- Meet and follow their respective standards of conduct when recommending or advising clients regarding crypto assets, with a focus on customers who are retail-based, older investors and involve retirement assets; and
- Review, update and enhance their compliance practices relating to such things as:
  - Custody practices;
  - Compliance reviews;
  - Valuation procedures;
  - Risk disclosures;
  - Data integrity; and
  - Business continuity plans.

[Here](#) is the link to the Fiscal Year 2025 Examination Priorities.



## Questions? Contact the DCS Team

Dinsmore Compliance Services (DCS), an affiliate of Dinsmore & Shohl LLP, offers compliance solutions for investment managers and municipal advisers. DCS will help you develop and maintain high-quality compliance programs customized to your particular business demands and operational realities. We offer these services, all as an affiliate of a coast-to-coast, full-service law firm.

### Kevin Woodard

President

(513) 977-8646

[Kevin.woodard@dinsmorecomplianceservices.com](mailto:Kevin.woodard@dinsmorecomplianceservices.com)

### Jeff Chapman

Director of Client Relations

(513) 977-8647

[Jeff.chapman@dinsmorecomplianceservices.com](mailto:Jeff.chapman@dinsmorecomplianceservices.com)

[dinsmorecomplianceservices.com](https://dinsmorecomplianceservices.com)

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