AN AFFILIATE OF DINSMORE & SHOHL LLP

Special Alert

September 17, 2026

SEC Risk Alert Highlights Investment Adviser Annual Compliance Review Expectations

Rule 206(4)-7 under the Investment Advisers Act of 1940 (the "Act") requires SEC registered investment advisers to adopt and implement written compliance policies and procedures. As a component of Rule 206(4)-7, investment advisers are required to conduct a review of their compliance policies and procedures, at least annually, to assess their adequacy and the effectiveness of their implementation. Pursuant to commentary by the SEC in the Adopting Release for Rule 206(4)-7 annual reviews should consider:

- Any compliance matters that arose during the review period;
- Any changes in business activities; and
- Any changes to the Act or Act regulations.

In addition, amendments to the Act recordkeeping rule, Rule 204-2, were adopted requiring investment advisers to maintain books and records documenting the Rule 206(4)-7 review.

Rule 206(4)-7 and the amendments to Rule 204-2 became effective February 5, 2004, with a compliance date of October 5, 2004.

During examinations, the Division of Examinations typically requests information regarding an investment adviser's annual reviews during the examination period in seeking to assess an investment adviser's compliance with Rule 206(4)-7. The SEC's Risk Alert, issued on September 14, 2026, highlights the Division of Examination's observations and certain areas that investment advisers may want to consider when conducting their reviews. Following is a summary of the Division of Examination's observations.

Conducting Timely Annual Reviews

The Division of Examinations observed investment advisers that did not perform reviews at least annually as required by Rule 206(4)-7. The Division noted that some investment advisers performed reviews at least 18 months post-registration with the SEC. The Adopting Release for Rule 206(4)-7 permitted investment advisers to complete the first annual review of their compliance policies and procedures no later than 18 months after the adoption or approval of their compliance policies and procedures. However, this 18-month annual review period was only available to investment advisers after Rule 206(4)-7's compliance date of October 5, 2004. All subsequent reviews are required to be completed no less frequently than annually.

In addition, the Division of Examinations observed investment advisers that instead of performing any annual review, stated that providing personnel with compliance training or obtaining annual attestations of personnel's adherence to the investment advisers' compliance policies and procedures satisfied the requirements of Rule 206(4)-7. Such limited activities do not satisfy the annual review requirements of Rule 206(4)-7.

Adopting Complete Policies and Procedures for Conducting Annual Reviews

The Division of Examinations observed investment advisers that had compliance policies requiring annual reviews, but they did not adopt procedures or had incomplete procedures for their personnel to utilize when assessing whether the investment advisers' compliance policies and procedures were adequate and effectively implemented. The Division of Examinations provide the following examples.

- Investment advisers' maintained policies and procedures requiring the documentation of annual reviews, including testing and validation of the compliance policies as part of the review. However, the investment advisers did not document procedures to be followed for:
    - The tests and validations;
    - The factors personnel should consider when evaluating whether the compliance policies and procedures were adequate and effectively implemented; or
    - The types and level of documentation that should be made and kept in support of such reviews.

- Investment advisers identified required practices, services, and/or operations to be assessed during the annual review in various sections of the investment advisers' compliance policies and procedures but then did not include these topics in the annual review.

Conducting Annual Reviews Consistent with Written Procedures

The Division of Examinations observed investment advisers conducting annual reviews in a manner that was not consistent with their written compliance policies and procedures. As examples, investment advisers did not follow their own policies and procedures to cover a defined review period or scope, utilize specified work papers, and perform specific tasks and test.

Ensuring that Compliance Policies and Procedures Fully Address and Align with Practices

Investment advisers did not recognize during their annual reviews that their compliance policies and procedures did not fully address or were not aligned with actual practices. As examples, the Division of Examinations noted investment advisers that:

- Had not adopted policies and procedures to address risk areas relevant to the investment advisers' businesses; and
- Did not consider changes in their business activities, e.g. failing to inform the Chief Compliance Officer of certain business or operational changes that may impact the scope of the annual reviews.

These inconsistencies were often identified after observing issues in core areas of investment advisers' business, operations, and services, when compared to the investment advisers' annual reviews and applicable compliance policies and procedures. The Division of Examinations highlights annual reviews that did not identify:

- Fee and expense billing practices that deviate from policies and procedures or client disclosures, such as using different fee calculation methodologies, not prorating fees and not applying breakpoints;
- Proxy voting policies referencing the execution of proxy voting responsibility when the investment advisers' disclosed to clients that they did not accept proxy voting responsibility;
- Custody policies and procedures that omitted steps to ensure that accounts over which the investment adviser had custody were identified to the independent public accountants performing the surprise examinations;
- Policies that delegated the execution of services or operations to others, but did not identify how the investment adviser would oversee these delegated responsibilities; and

- Incidents of non-compliance which were identified during the review period but were not addressed or recorded in the annual reviews as instances of non-compliance.

Maintaining Documentation Regarding Annual Reviews

The Division of Examinations noted the following examples of investment advisers failing to maintain required documentation of annual reviews:

Included discussions in their written annual reviews regarding identified compliance violations but failed to maintain the documentation generated during the annual review addressing such compliance issues, such as records regarding the testing performed, issues identified, and/or corrective actions recommended.

Adopted policies and procedures requiring the annual review to be conducted in a specific manner. However, the investment advisers did not satisfy all of their listed requirements or only partially completed them.

Taking Corrective Actions for Issues Identified in Annual Reviews

The Division of The Division of Examinations observed investment advisers that did not take corrective action after their annual reviews recommended changes to the investment advisers' compliance policies or procedures, disclosures and/or business practices.

Following is the link to the SEC's Risk Alert: https://www.sec.gov/files/examinations-observations-regarding-investment-adviser-annual-compliance-review-091426.pdf

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 fim.

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