

## **Alert** | Investment Management



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### **SEC Risk Alert to Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents**

On Sept. 6, 2023, the Securities and Exchange Commission's Division of Examinations issued a **Risk Alert** detailing the Division's examination selection process for SEC-registered investment advisers (Advisers). The Risk Alert highlights the Division's risk-based approach for both (A) selecting Advisers to examine and (B) determining examination focus areas and documents. The Division heavily uses technology to analyze industry- and firm-level data to identify risks and better understand an Adviser's business, and also reviews disclosure documents (such as the Form ADV) and other regulatory filings. The Risk Alert also attaches a list of typical initial information requested in examinations, identifying 69 specific items organized in four broad areas.

Below is a substantive overview of the Division's examination selection process and risk factors for Advisers to help prepare for examination.

#### **A. Selecting Firms to Examine**

Some of the reasons the Division may select an Adviser for examination include:

- The evaluation of risks present at a particular firm or risks to investors and the markets more broadly.
- The review of how registrants are adapting to new regulatory requirements.

- The Division’s interest in a particular compliance risk area highlighted in the Division’s publication of its **annual priorities**.
- Firm-specific risk factors such as:
  - Prior examination observations and conduct;
  - Supervisory concerns, such as disciplinary history;
  - Tips, complaints, or referrals involving the firm;
  - Business activities that may create conflicts of interest;
  - The length of time since the firm’s registration or last examination;
  - Material changes in a firm’s leadership or personnel;
  - Indications that the firm might be vulnerable to financial or market stresses;
  - News and media reports involving the firm;
  - Data provided to the Division by third-party data services;
  - The firm’s disclosure history; and
  - Whether the firm has access to client and investor assets that present a compliance risk.

## **B. Selecting Examination Focus Areas and Documents**

Once the Division selects a firm for examination, the Division conducts an additional risk assessment of the Adviser’s business to determine the scope of the examination. This involves requesting documents with respect to the firm’s operations, disclosures, conflicts of interest, and compliance practices related to core areas, including custody and safekeeping of client assets, valuation, portfolio management, fees, expenses, brokerage, and best execution.

The Risk Alert contains as an attachment the typical initial information requested of Advisers, organized in four broad areas: (1) general information about the Adviser’s business and investment activities, (2) information about the assessment of risks and the implementation of a written compliance program and internal controls, (3) information with respect to advisory trading activities, and (4) information for compliance testing in particular areas.

### **Conclusion**

Advisers should be aware that the Division’s risk-based approach to the examination selection process is dynamic and adapts to changes in market conditions, industry practices, and investor preferences. The Division expressly noted that the information in the Risk Alert, and particularly the list of topics in the attachment, were provided in part so Advisers may prepare for examinations.

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