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Preview of SEC Examination Priorities for 2014 for Investment Advisers and Investment Companies

At the recent IAWatch fall conference in Philadelphia, Pa., Mark Dowdell, Assistant Regional Director in the SEC's Philadelphia Office of Compliance Inspections and Examinations ("OCIE"), provided a preview of the SEC's examination priorities for 2014 for investment advisers and investment companies. According to Dowdell, the SEC should finalize and publicly release the list of exam priorities by January 2014. The issues that Dowdell said OCIE staff members will be looking at, as well as questions that compliance professionals should be asking themselves, include:

CUSTODY

The staff will focus on whether advisers are appropriately recognizing that they have custody of client assets and whether such advisers are fully complying with the qualified custodian requirement, and the "surprise exam" requirement or "audit approach," as applicable. Dowdell also explained that the staff views an adviser that has custody of client assets as having a higher risk profile than an adviser that does not, and that the basis for having custody also factors into an adviser's risk profile. For example, an adviser with custody due to the ability to directly debit fees from client accounts is viewed as presenting a low risk, whereas advisers that serve as a GP to a private fund, use an affiliated administrator (or no administrator) for a private fund that

they advise, or have the ability to pay bills from client funds present a greater risk of theft, loss, and misuse of client assets.

CONFLICTS OF INTEREST

Dowdell warned that the staff will be looking at conflicts of interest relating to advisory fees. Additionally, continuing an initiative from the SEC's 2013 exam priorities, the staff will again be looking for undisclosed or hidden payments by advisers and funds to distributors and intermediaries.

MARKETING AND PERFORMANCE ADVERTISING

Examiners are interested in whether firms have effective advertising policies and procedures and will evaluate the accuracy of performance advertising. In particular, the staff will focus on advisers' use of hypothetical and back-tested performance.

Additionally, Dowdell noted that the staff will continue to focus on the following risk areas:

- Quant Firms
- Wrap Fee Program Sponsors
- Securities Lending
- Alternative Products

Please feel free to contact us if you have any questions regarding these compliance issues or any other SEC-related matter.