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SEC Announces 2023 Examination Priorities for Fund Advisers

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On February 7, 2023, the SEC's Division of Examinations (the "Division") issued its report on 2023 Examination Priorities. The following is a summary of key issues highlighted in the Division's report which are of importance to investment advisers registered under the Investment Advisers Act of 1940, as amended.

Private Funds. The Division stated that, during upcoming examinations in 2023, it "will focus on private fund RIAs':

1. conflicts of interest;
2. calculation and allocation of fees and expenses, including the calculation of post-commitment period management fees and the impact of valuation practices at private equity funds;
3. compliance with the new Marketing Rule, including performance advertising and compensated testimonials and endorsements, such as solicitations;
4. policies and practices regarding the use of alternative data and compliance with Advisers Act Section 204A; and
5. compliance with the Advisers Act Rule 206(4)-2 (Custody Rule), where applicable, including timely delivery of audited financials and selection of permissible auditors."

The report also states: "In addition, the Division will focus on RIAs to private funds with specific risk characteristics, such as: (1) highly-leveraged private funds; (2) private funds managed side-by-side with BDCs; (3) private equity funds that use affiliated companies and advisory personnel to provide services to their fund clients and underlying portfolio companies; (4) private funds that hold certain hard-to-value investments, such as crypto assets and real estate-connected investments, with an emphasis on commercial real estate; (5) private funds that invest in or sponsor Special Purpose Acquisition Companies (SPACs); and (6) private funds involved in adviser-led restructurings, including stapled secondary transactions and continuation funds."

Registered Funds. The Division stated that its examinations during 2023 will focus on registered funds' compliance with Investment Company Act Rule 18f-4 (Derivatives Rule) and Investment Company Act Fair Valuation Rule 2a-5. Although these are relatively new rules, the SEC examination staff began to focus on compliance in this area immediately after the compliance dates for those rules.

The Division will "continue to evaluate registered fund boards' processes for assessing and approving advisory and other fund fees, particularly for funds with weaker performance relative to their peers. In addition, the Division will assess the effectiveness of funds' derivatives risk management programs and liquidity risk management programs, as applicable."

"The Division will also focus on [registered] funds with specific characteristics, such as: (1) turnkey funds, to review their operations and assess effectiveness of their compliance programs; (2) mutual funds that converted to ETFs, to assess governance and disclosures associated with the conversion to an ETF; (3) non-transparent ETFs, to assess compliance with the conditions and other material terms of their exemptive relief; (4) loan-focused funds, such as leveraged loan funds and funds focused on collateralized loan obligations, for liquidity concerns and to review whether the funds have been significantly impacted by, and have adapted to, elevated interest rates; and (5) medium and small fund complexes that have experienced excessive staff attrition, to focus on whether such attrition has affected the funds' controls and operations."

Other Areas of Focus. The Division indicated that cybersecurity continues to be an area of focus during exams. It will also focus on whether advisers and broker dealers satisfy applicable AML requirements (which the Division described as particularly important in the current geopolitical environment) and are sufficiently implementing LIBOR transition efforts.

In addition, the Division "will assess whether . . . market participants involved with crypto or crypto-related assets: (1) met and followed their respective standards of care when making recommendations, referrals, or providing investment advice, to the extent required; and (2) routinely reviewed, updated, and enhanced their compliance, disclosure, and risk management practices. In addition, the Division will focus on new or never before examined registrants offering crypto or crypto-related assets."

The Division also indicated it will continue its focus on ESG-related advisory services and fund offerings, including whether the funds are operating in the manner set forth in their disclosures relating to ESG matters.

A copy of the 2023 Examination Priorities can be found at: https://www.sec.gov/files/2023-exam-priorities.pdf.

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