ACUITY KNOWLEDGE PARTNERS

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Regulatory Newsletter

Special Edition – SEC 2024 Examination Priorities

Key risk areas likely to impact all market participants:

- Information security and operational resilience
- Crypto assets and emerging financial technology
- Regulation systems compliance and integrity
- Anti-money laundering

Investment advisors

Marketing practice assessments

These include advisors to private funds assessing the following:

1. Reasonably well-designed written policies and procedures have been adopted and implemented to prevent violation of the Advisers Act and the Marketing Rule
2. Marketing-related information has been appropriately disclosed on Form ADV
3. Processes are substantiated and other required books and records are maintained

Marketing practice reviews would also assess whether disseminated advertisements include untrue statements of a material fact, are materially misleading or are otherwise deceptive and do not comply with the requirements for performance (including hypothetical and past performance), third-party ratings, and testimonials and endorsements.

Compensation arrangement assessments

These focus on the following:

1. Fiduciary obligations of advisors to their clients, particularly with respect to the advisors' receipt of compensation for services or other material payments made by clients
2. Alternative ways that advisors try to maximise revenue, such as revenue earned on clients' bank deposit sweep programmes
3. Fee breakpoint calculation processes, particularly when fee billing systems are not automated

Valuation assessments

These will focus on advisors' recommendations to clients to invest in illiquid or difficult-to-value assets, such as commercial real estate or private placements.

Safeguarding assessments

These will focus on advisors' controls to protect clients' material non-public information, particularly when multiple advisors share office locations, have significant turnover of investment advisor representatives or use expert networks.

Disclosure assessments

These will focus on the accuracy and completeness of regulatory filings, including Form CRS, with a particular focus on inadequate or misleading disclosures and registration eligibility.

Policy assessments

These will focus on policies and procedures for the following:

1. Selecting and using third-party and affiliated service providers
2. Overseeing branch offices when advisors operate from numerous or geographically dispersed offices
3. Obtaining informed consent from clients when advisors implement material changes to their advisory agreements

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Investment advisors to private funds

The SEC focuses on the following:

1. Portfolio management risks amid exposure to recent market volatility and higher interest rates
2. Adherence to contractual requirements in terms of limited partnership advisory committees or similar structures, including contractual notification and consent processes
3. Accurate calculation and allocation of private fund fees and expenses, including valuation of illiquid assets, calculation of post-commitment-period management fees, adequacy of disclosures and the potential offsetting of such fees and expenses
4. Due diligence practices to ensure consistency with policies, procedures and disclosures
5. Conflicts, controls and disclosures relating to private funds managed side-by-side with registered investment companies and use of affiliated service providers
6. Compliance with the Advisers Act in terms of custody, including accurate Form ADV reporting, timely completion of private fund audits by a qualified auditor and the distribution of private fund audited financial statements
7. Policies and procedures for reporting on Form PF

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Investment companies

Fee and expense assessments

These will focus on the following:

1. Adoption of effective written compliance policies and procedures
2. Board approval of the advisory contract and registered investment company fees
3. Whether different advisory fees are charged to different share classes of the same fund
4. Whether identical strategies are offered by the same sponsor through different distribution channels but different fee structures are employed
5. Whether advisory fees are higher than peers'

6. Whether registered investment company fees and expenses are high

Derivatives risk management assessments

These will focus on the following:

1. Adoption of effective written compliance policies and procedures to prevent violation of the Commission's fund derivatives rule (Investment Company Act Rule 18f-4)
2. Review of the adoption and implementation of a derivatives risk management programme
3. Board oversight
4. Whether disclosures relating to the registered investment companies' or business development companies' use of derivatives are incomplete, inaccurate or potentially misleading
5. Associated registered investment companies' or business development companies' procedures for, and oversight of, derivative valuations
6. Compliance with the terms of exemptive order conditions and issues associated with recent market dislocations and volatility, such as whether registered investment companies in liquidation are following liquidation procedures

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Broker-dealers

The SEC focuses on the following:

1. Recommendations with regard to products, investment strategies and account types
2. Disclosures made to investors regarding conflicts of interest
3. Conflict-mitigation practices
4. Processes for reviewing reasonably available alternatives
5. Factors considered in light of the investor's investment profile, including investment goals and account characteristics

Examinations will focus on those recommended products that are (1) complex, such as derivatives and leveraged ETFs; (2) costly, such as variable annuities; (3) illiquid, such as non-traded REITs and private placements; (4) proprietary; and (5) microcap securities.

The following will be evaluated:

1. Whether the broker-dealer has established, maintained and enforced written policies and procedures that are reasonably well designed to comply with the SEC's Regulation Best Interest
2. Dual registrants
3. Conflicts of interest, account-allocation practices and account-selection practices
4. Broker-dealers' supervision of branch office locations

Form CRS assessments

These will focus on the following:

1. Relationships and services offered to retail customers
2. Fees and costs
3. Conflicts of interest
4. Whether broker-dealers disclose any disciplinary history

5. Whether broker-dealers have met their obligations to file their relationship summaries with the Commission and delivered their relationship summaries to retail customers

Financial responsibility rule assessments

These will focus on the following:

1. Compliance with the Net Capital Rule, Customer Protection Rule and related internal processes, procedures and controls
2. Fully paid lending programmes and broker-dealer accounting for certain types of liabilities, such as reward programs, point programmes, gift cards and non-brokerage services
3. Broker-dealer credit, interest rate, market and liquidity risk management controls to assess whether broker-dealers have sufficient liquidity to manage stress events

Trading practice assessments

These will focus on the following equity and fixed income trading practices:

1. Regulation SHO, including rules relating to aggregation units and locate requirements
2. Regulation ATS and whether the operations of alternative trading systems are consistent with the disclosures provided in Forms ATS and ATS-N
3. Exchange Act Rule 15c2-11
4. Quote generation, order routing and execution practices, market data ingestion, regulatory controls and risk management

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About Acuity Knowledge Partners

Acuity Knowledge Partners (Acuity) is a leading provider of bespoke research, analytics and technology solutions to the financial services sector, including asset managers, corporate and investment banks, private equity and venture capital firms, hedge funds and consulting firms. Its global network of over 6,000 analysts and industry experts, combined with proprietary technology, supports more than 500 financial institutions and consulting companies to operate more efficiently and unlock their human capital, driving revenue higher and transforming operations. Acuity is headquartered in London and operates from 10 locations worldwide.

Acuity was established as a separate business from Moody's Corporation in 2019, following its acquisition by Equistone Partners Europe (Equistone). In January 2023, funds advised by global private equity firm Permira acquired a majority stake in the business from Equistone, which remains invested as a minority shareholder.

For more information, visit www.acuitykp.com or write to contact@acuitykp.com