

Practice Update

SEC Division of Examinations Calls Out Compliance Weaknesses and Spells Out Expectations Moving into 2021

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By Paul J. Foley

The SEC's Division of Examinations recently issued a Risk Alert with observations on investment adviser compliance programs, noting numerous deficiencies and weaknesses it has encountered. The same day the Risk Alert was released, Peter Driscoll, Director of the Office of Compliance Inspections and Examinations, now the Division of Examinations, delivered remarks at the 10th National Compliance Outreach Program Seminar on (1) how, despite the Covid-19 pandemic, the Division of Examinations was able to continue its efforts in examinations, and (2) the Division of Examinations' relentless pursuit to ensure that Chief Compliance Officers (CCOs) are effective by focusing on the CCO's empowerment, seniority, and authority. Taken together, the timing and unequivocal public statements are a strong warning to investment advisers to strengthen compliance programs and empower personnel heading into 2021.

1. The Pandemic's Impact on the Division of Examinations

The pandemic placed limitations the Division of Examinations' ability to examine advisers, or otherwise interact with them, in person. The Division of Examinations managed, however, to

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conduct over 2,950 examinations in fiscal year 2020, including 15 percent of all SEC-registered investment advisers and increased its capacity for remote examinations.

After reaching out to investment advisers and investment companies to assess the impacts of COVID-19, the Division of Examinations found that the majority of firms had business continuity plans (BCPs). Many of the BCPs included critical areas for operations, such as providing for remote work, succession plans for the death and incapacity of key personnel, and contingency plans for when other essential personnel are unable to work for extended periods. A small percentage of firms even had pandemic-specific plans in place before the COVID-19 pandemic.

The Director discussed how firms continue to develop new ways to cope with COVID-19, but that new challenges may arise from the solutions. Notably, the Director noted that (1) “the burden on firms to adapt to processes such as remote due diligence on service providers and sub-advisers will require considerable attention by advisory firms and [(2)] new technology adopted to address business or compliance needs during the pandemic may bring with it risks that will need to be evaluated by skilled and knowledgeable compliance departments.”

2. CCO Empowerment, Seniority, and Authority

In his statement, the Director emphasized the theme of “empowerment, seniority, and authority” to ensure that CCOs are effective in their firms. He also noted that “the effectiveness of the CCO and that of a firm’s compliance program is critical to the protection of investors.” He also cautioned firms against taking a “check-the-box” approach to the CCO requirement in which they merely look at it as a way to satisfy the rule. Instead, Driscoll noted, firms should think of the role as an essential component of running an advisory or fund business. The SEC has often spoken of a compliance culture. This approach

to the thinking of the CCO's role follows that same idea.

The Division of Examinations expects to see that firms have adequate resources to support compliance personnel, including adequate training and sufficient staff to support firm growth. Empowerment, however, is at least equal to the training and resources, according to Driscoll. Put differently, the Division of Examinations believes that a firm's compliance department should be fully integrated into the business of the adviser for it to be effective and to have the support of management.

Additionally, on the same day as Driscoll's speech, the Division of Examinations issued a risk alert noting deficiencies that it noted were common in recent examinations. The topics discussed include: (A) inadequate compliance resources, (B) insufficient authority of CCOs, (C) annual review deficiencies, (D) implementing actions required by written policies and procedures, (E) maintaining accurate and complete information in policies and procedures and (F) maintaining or establishing reasonably designed written policies and procedures.

Takeaways

- Firms should consider whether their BCPs adequately and specifically address pandemic preparedness and extended work-from-home policies.
- CCO empowerment, seniority, and authority is likely to be a focus point during SEC examinations and, therefore, investment advisers should consider changes that they may need to make in order to adequately respond to these inquiries.
- Advisers should also review and amend their policies and procedures as necessary to ensure that they are tailored to the adviser's business and enforced.

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