

Private Equity Regulatory Update

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Industry Update

- OCIE Announces Five Most Frequent Compliance Topics Identified during Examinations of Investment Advisers

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On February 7, 2017, the Office of Compliance Inspections and Examinations (“**OCIE**”) issued a risk alert (the “**Risk Alert**”) announcing the following five compliance topics under the Advisers Act most frequently identified in deficiency letters sent to SEC-registered investment advisers following an OCIE examination:

Compliance Rule

According to the SEC, Rule 206(4)-7 under the Advisers Act makes it unlawful for an adviser to provide investment advice to clients unless the adviser: (i) adopts and implements written policies and procedures reasonably designed to prevent violation, by the adviser and its supervised persons, of the Advisers Act and the rules promulgated thereunder; (ii) reviews, no less frequently than annually, the adequacy of its policies and procedures and the effectiveness of their implementation; and (iii) designates a chief compliance officer responsible for administering the compliance policies and procedures that the adviser adopts. According to the Risk Alert, the most common deficiencies relating to the Rule 206(4)-7 identified by OCIE staff include the following:

- Compliance manuals are “off-the-shelf” and not reasonably tailored to the adviser’s business practices;
- Annual reviews are not performed or do not address the adequacy of the adviser’s policies and procedures;
- The adviser fails to follow its compliance policies and procedures, such as by not performing certain internal reviews or not adhering to certain practices relating to marketing, expenses or employee behavior; and
- Compliance manuals are not current, such as by including strategies no longer offered by the firm or listing personnel no longer working for the firm.

Regulatory Filings

According to the SEC, advisers are obligated to accurately complete and timely file certain regulatory filings with the SEC, including: (i) pursuant to Rule 204-1 under the Advisers Act, amending their Form ADV at least annually, within 90 days of the end of their fiscal year and more frequently if required by the instructions; (ii) pursuant to Rule 204(b)-1 under the Advisers Act, filing a report on Form PF for advisers to one or more private funds with private fund assets of at least \$150 million; and (iii) pursuant to Rule 503 under Regulation D of the Securities Act of 1933, as amended, filing Form Ds on behalf of their private fund clients no later than 15 calendar days after the first sale of securities in the offering of a private fund. According to the Risk Update, typical deficiencies identified by OCIE staff include:

- Advisers making inaccurate disclosures on Form ADVs;
- Advisers not promptly amending their Form ADVs when certain information became inaccurate or timely filing their annual updating amendments;
- Advisers with an obligation to file Form PF not completing the form accurately or completely; and
- Advisers not accurately completing and/or timely filing Form Ds on behalf of their private fund clients.

Custody Rule

According to the SEC, advisers with custody of client cash or securities – that is, advisers or their related persons who hold, directly or indirectly, client funds or securities or have any authority to obtain possession of them – must comply with Rule 206(4)-2 of the Advisers Act. According to the Risk Alert, an adviser also has custody if it has an arrangement under which it is authorized or permitted to withdraw client funds or securities. Typical deficiencies identified by OCIE staff include, according to the Risk Alert:

- Advisers not recognizing that they may have custody via online access to client accounts;
- Advisers with custody obtaining surprise examinations that do not meet the requirements of Rule 206(4)-2 (e.g., independent public accountants were not provided with a complete list of accounts or the “surprise” examinations were conducted at the same time each year); and
- Advisers not recognizing they may have custody as a result of certain authority over client accounts (e.g., powers of attorney, or related persons with powers of attorney, authorizing the adviser to withdraw client cash or securities).

Code of Ethics Rule

According to the SEC, Rule 204A-1 under the Advisers Act requires that each adviser's code of ethics (i) establish a standard of business conduct that the adviser requires of all its supervised persons, (ii) require an adviser's “access persons” to periodically report their personal securities transactions and holdings to the adviser's chief compliance officer or other designated persons and (iii) require that access persons obtain the adviser's pre-approval before investing in an initial public offering or private placement. The SEC also noted that, pursuant to Rule 204A-1, each adviser must (i) provide each supervised person with a copy of the code of ethics and any amendments thereto and require a written acknowledgment of receipt and (ii) describe its code of ethics in its Form ADV Part 2A brochure and indicate that the code of ethics is available to any client or prospective client upon request. According to the Risk Alert, typical deficiencies identified by OCIE staff include:

- Advisers not identifying all of their access persons;
- Adviser's code of ethics missing required information, such as a review of the holdings and transactions reports or specific submission time frames;
- Untimely submission of transactions and holdings; and
- Form ADVs not containing descriptions of code of ethics or not indicating that the code of ethics is available upon request.

Books and Records Rule

According to the SEC, Rule 204-2 under the Advisers Act requires advisers to make and keep certain books and records relating to their investment advisory business, including typical accounting and other business records as required by the SEC. Typical deficiencies identified by OCIE staff include, according to the Risk Alert:

- Advisers not maintaining all required records (e.g., advisory agreements and general ledgers);

- Books and records being inaccurate or not updated (e.g., outdated client lists and inaccurate fee schedules); and
- Advisers maintaining contradictory information in separate sets of records.

According to the Risk Alert, in sharing these compliance topics, OCIE hopes to encourage advisers to reflect upon their own practices, policies and procedures in these areas and to promote improvements in investment adviser compliance programs.

- ▶ [See a copy of the Risk Alert](#)

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