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OCIE's 2020 Exam Priorities — Key Takeaways for Private Fund Managers

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Last week, the SEC's Office of Compliance Inspections and Examinations released its 2020 Exam Priorities with a number of areas of interest to private fund managers. OCIE reported that it examined 15% of registered investment advisers (RIAs) during fiscal year 2019, down from approximately 17% of RIAs during FY 2018 but consistent with FY 2017's 15% coverage rate. The four-week government shutdown in January 2019 reduced exam activity last year, but we expect the numbers to trend upward in 2020.

The 2020 priorities include a number of new areas of note, although some areas (*e.g.,* conflicts, fees and expenses) appear year after year. Unlike last year's version, OCIE's 2020 priorities contain a section specifically addressing private fund managers, noting the following focus areas:

- Private fund managers advising different types of clients, including those that also manage a registered investment company with a similar investment strategy, or those that advise separately managed accounts side-by-side with private funds. These managers can expect a focus on potential conflicts of interest, allocation issues and fiduciary obligations involving different types of clients.
- Controls to prevent the misuse of material, non-public information (MNPI).
- Compliance risks involving conflicts of interest, such as "undisclosed or inadequately disclosed fees and expenses, and the use of RIA affiliates to provide services to clients."

Alternative Data

For the first time, OCIE has publicly identified alternative data as an exam priority, stating that "examinations will focus on firms' use of these data sets and technologies to interact with and provide services to investors, firms, and other service providers and assess the effectiveness of related compliance and control functions." Fund managers using alternative data should be prepared for questions regarding their diligence process for alternative data vendors, protections against receipt of personally identifiable information (PII), and potential MNPI considerations involving alternative data, among other issues.

Fiduciary Obligations

Following the SEC's recent Interpretation Regarding Standard of Conduct for Investment Advisers, OCIE has reiterated that it will continue to focus on whether advisers are complying with their fiduciary obligations to clients. Specifically, "whether RIAs provide advice in the best interests of their clients and eliminate, or at least expose through full and fair disclosure, all conflicts of interest which might incline an RIA, consciously or unconsciously, to render advice which is not disinterested." Key examples are fee and expense allocations and inadequately disclosed compensation arrangements. These areas and related potential conflicts of interest are typically on OCIE's list of priorities, and we expect them to be a continued focus in light of the SEC's recent interpretive guidance on fiduciary obligations.

New or Emerging Investment Strategies (e.g., ESG)

The 2020 priorities state that OCIE will have a particular interest in the accuracy and adequacy of disclosures provided by RIAs offering clients new types or emerging investment strategies, such as strategies focused on sustainable and responsible investing, or which incorporate environmental, social, and governance (ESG) criteria. We expect exams to focus on disclosures to potential investors, how ESG investments are defined internally and externally, and the internal process for monitoring those strategies.

Information Security

OCIE will continue to prioritize cyber and other information security risks across the entire examination program.

AML Programs

OCIE will continue to review managers' compliance with applicable anti-money laundering (AML) requirements, including whether entities are appropriately adapting their AML programs to address their particular situations and regulatory obligations.

Who's Up Next

Which advisers are most likely to be examined? As stated in the priorities, OCIE remains focused on examining firms that have never been examined or have not recently been examined, especially if the firm has substantially grown or expanded into new products. Because OCIE is focusing on conducting more (and more targeted) exams, the chances of undergoing an exam have remained high, but the scope of the exams may be narrower. The selection is data-driven, so if OCIE's data-crunchers believe that a manager exhibits characteristics falling within its priorities or other risk areas, then the chances of an exam will increase.

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