

PUBLICATION

SEC Issues "Compliance Alert" for Recurring Issues In Audits of RIAs

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On July 22, 2008, the United States Securities and Exchange Commission (SEC) issued a compliance alert to both investment advisers and broker-dealers relating to select areas (or "hot buttons") that have been frequent issues during recent audits and inspections. Senior management personnel of investment advisers are urged to acknowledge the SEC's "hot buttons," carefully review their firm's compliance policies and procedures for potential problems and take corrective action immediately.

The "hot buttons" identified by the SEC are as follows:

- **Personal Trading Policies.** The SEC noted that many firms' Code of Ethics did not address the purchase of investment pools (e.g. hedge funds) by access persons. In addition, the SEC stated that many firms did not have procedures to supervise the trading done by hedge funds and other advisers on behalf of access persons in securities traded by the employer of the access persons. As such, all registered investment advisers (RIAs) should (a) carefully review their personal trading policies to address, limit or prohibit the purchase or sale of outside hedge funds by access persons, (b) institute appropriate "black out periods" or controls on the purchase of hedge funds managed within a firm by its access persons and (c) amend their Form ADV and fund offering documents to adequately disclose the controls on personal trading utilized by the firm.
- **Proxy Voting.** The SEC has noted that many RIAs do not document the review and selection of proxy voting firms, thus raising issues regarding service provider independence and potential conflicts of interest. Firms should institute written procedures for the review of proxy voting firms and identify those criteria which would trigger concerns about conflicts of interest and service provider independence.
- **High Yield Municipal Securities.** The SEC noted that many firms did not provide disclosures stating that an increase in the percentage of holdings in illiquid securities can result in difficulties in the liquidation of positions. Such disclosures should be utilized where appropriate.
- **Soft Dollars.** The SEC noted that many firms have improperly sought to "soft dollar" internet domain fees, wireless services and certain computer equipment. Firms should pay special attention to their hard dollar/soft dollar allocation models, as well disclosures for soft dollars practices under Section 28(e).