



January 31, 2025

Art & Science: Strategies & Practices for Managing SEC Exams

EXECUTIVE SUMMARY

- Regardless of administration and their agendas, SEC exams will always be something investment managers need to prepare for and navigate. While the scope, frequency, topic, and manner of such exams may vary, there are certain strategies and practices investment managers can employ that can increase the chances of more favorable outcomes across all exam varieties.
- In thinking about how to best prepare for and navigate an SEC exam, investment managers should be cognizant of three basic goals when exam time arrives: avoiding deficiencies & enforcement, garnering credibility & trust, and acquiring insights.
- Achieving the aforementioned outcomes first lies in pre-exam preparation. Such preparation can include simple yet effective methods such as undertaking mock exams, conducting information source mapping exercises, creating regulatory exam playbooks, and monitoring SEC risk alerts and enforcement actions.
- During an exam itself, other strategies and practices investment managers can employ include equally simple yet effective approaches such as managing responses in a timely and agreeable fashion, conducting intensive document and information reviews prior to producing requested materials, and being thoughtful about selecting firm personnel to serve as interviewees for SEC discussions, among others.
- Although no strategies or practices can ever guarantee achieving the above-mentioned desired outcomes, they are nevertheless worth considering given their simplicity and demonstrable efficacy.

INTRODUCTION

For many, I'm certain this past month has been filled with initializing or finalizing plans for the year ahead. At the same time, it also seems we are largely still waiting for the agenda and focus of the Atkins SEC and Trump administration to take more shape. Given this apparent lull (at least comparatively), it seemed like it could be valuable to spend some time discussing a perhaps less technical but nevertheless important topic investment managers of all kinds should always be prepared for – regulatory exams.

I recognize this topic may be of varying levels of interest and value to the *Headspace* readership. Readers range from senior partners at some of our industry's leading law firms, all the way to individuals working toward launching their own SEC-registered investment adviser(s) and/or fund(s). Nevertheless, given the perennial possibility of and stakes associated with SEC exams, the topic of exam administration

seemed worth some attention. While SEC exams can become incredibly technical depending on the type of exam being conducted, there are many elements to exam preparedness and administration that can be useful across the spectrum, some of which resemble science, some more art. To that end, I thought this month’s essay could focus on the following:

- ❖ What an investment manager’s desired outcomes should be during an SEC exam (*p. 2*);
- ❖ Pre-exam strategies and practices an investment manager can consider to achieve the aforesaid goals (*p. 3*); and
- ❖ Live-exam strategies and practices an investment manager can consider to achieve the aforesaid goals (*p. 4*).

When investment managers are deliberate and thoughtful about each of the above categories, it can greatly reduce the amount of stress associated with an exam, and also has the potential to lead to result in more favorable outcomes.

DESIRED OUTCOMES

As with the employment of any strategy or practice, the precursor to deciding which strategies and practices to employ take their cue from the outcomes being sought. Therefore, before understanding the types of things an investment manager can do to better prepare for and manage an SEC exam, an investment manager should first think of what are the outcomes desired when the SEC comes knocking. In this respect, there are three key, overarching goals that should impact an investment manager’s exam preparation and management practices: avoiding deficiencies & enforcement; garnering credibility & trust; and acquiring insights.

Avoiding Deficiencies & Enforcement. This one is of course the most obvious. And yet, it should be kept in mind at all times, meaning even through an investment manager’s day-in, day-out activities. When designing and implementing policies & procedures, deciding whether and how to institute certain new or amended business practices, or managing a live regulatory exam itself, investment managers should in part be guided by the goal avoiding deficiency findings, or worse, enforcement actions with corresponding formal remediation plans, fines, and/or industry bars or other discipline.

Garnering Credibility & Trust. Avoiding enforcement actions and less formal findings of deficiency can have the knock-on effect of garnering credibility and trust not just with the SEC, but also clients and owners of the investment manager. While “clean” exams or exams with minimal or non-material deficiency findings should never be taken as the SEC’s approval of or total review and assessment of an investment manager’s business and Compliance practices, they can still provide some degree of comfort to the aforementioned constituencies. Additionally, irrespective of whether there are any substantive findings, how an investment manager handles a regulatory exam) in terms of timeliness and completeness of responses, for example) presents an opportunity to garner credibility with and trust from the SEC itself, both in the immediate and longer-term.

Acquiring Insights. Even in the instance where the avoidance outcomes are not achieved, such results can nevertheless provide an investment manager with insights on how to improve or change their business and/or Compliance practices. Additionally, regulators can often share insights that aren’t necessarily delivered in writing, but that provide a window into how they think through certain issues and topics, allowing investment managers to level-up their Compliance programs short of any written findings or actions. The learning opportunity SEC exams present for investment managers should not be overlooked or undervalued.

PRE-EXAM STRATEGIES & PRACTICES

The desired outcomes discussed above can be and often are accomplished by employing certain strategies and practices well before the SEC makes contact. While independently conducted mock exams can of course foster preparedness, other practices such as periodic information source mapping exercises, SEC risk alert and enforcement action monitoring, and the creation of regulatory exam “playbooks” can also ready investment managers for when the SEC comes knocking.

Mock Exams. A mock exam conducted by an independent party can certainly foster exam readiness and lay a foundation for a successful live exam. Mock exams provide an assessment of a Compliance program with a more detached, arm’s length view of an investment manager’s Compliance program than a manager’s in-house Compliance or legal personnel may be able to offer, potentially identifying gaps or issues that might otherwise be overlooked by more familiar eyes. Mock exams also afford the possibility of providing investment managers with insights about best practices the conducting party may be observing with other managers. They can also be designed in a way that is tailored to a particular manager’s needs and desires, ranging from simple document and data reviews with verbal recommendations being delivered, to also conducting mock SEC interviews with key personnel of the manager and delivering formal written observations and recommendations. The simulative experience of a mock exam can prove valuable so that when a live exam arrives, personnel have experienced producing documents and information under time constraints. They also may feel more comfortable answering challenging questions on-the-spot and may develop a better sense of where certain aspects of their business and Compliance program practices may warrant more nuanced explanations given that a more in-depth review of such matters has preceded the live environment.

Of course, mock exams cost money, along with time and resource dedication, and investment managers should be thoughtful about whether such exercises will yield the right value. Additionally, investment managers should consider having such exams conducted or performed at the direction or request of legal counsel to afford the investment manager the ability to claim that the mock exam results are attorney-client privileged and/or attorney work product not subject to production to the SEC should the SEC request the results. The counter-consideration is that the SEC’s knowing an investment manager had an independent assessment of its Compliance program conducted can also garner trust and credibility with the SEC as it can demonstrate the investment manager attempts to assess its Compliance program with open, unbiased, unfettered eyes. These types of considerations and others should factor into an investment manager’s decision on whether to undertake a mock exam and the nature and scope of such an exercise itself.

Source Mapping. As a scaled back approach to a mock exam, an investment manager on its own can conduct periodic information source exercises. These exercises allow an investment manager to map out not only the types of information and documentation the SEC is likely to or may request, but also identify the internal parties and areas that would be responsible for gathering such items (along with where such information is stored). They also allow an investment manager to acquire a sense for how long certain types of information and documentation may take to produce, along with any risks or issues personnel may foresee with certain items. The framework and results of these exercises can be documented so that when the SEC initiates an exam, the investment manager’s point person does not need to start from scratch when determining where the individual exam requests should be routed internally before being aggregated into a single response back to the SEC. The framework and results also can then be refreshed each year once the initial framework is created.

In terms of the types of documents and information to form the basis of a source map, investment managers can shape such content based on information gleaned from industry associations, as well as exam priorities and other exam information shared publicly by the SEC. Although even the most diligently

maintained source maps will not be able to anticipate every SEC information or documentation request, such maps can at least position an investment manager to more quickly and accurately respond to exam requests. Timeliness and accuracy of response can pay enormous dividends with a regulator (as discussed more fully below).

Exam Playbooks. A close relative of content maps, regulatory exam playbooks also can be useful, depending on the size and nature of an investment manager's organization and business. For investment managers with more manageable employee headcount and governance and reporting structures, having an exam playbook may well not be necessary. For larger, more complex or matrixed organizations, however, playbooks can provide several benefits, including establishing norms and protocols for communicating with SEC exam staff, as well as managing the exam for internal parties. Such norms and protocols can include identifying who is authorized to interface with SEC exam staff and when, review and quality control processes that need to be adhered to prior to furnishing information to the SEC, an inventory of departments and personnel who should be notified and organized once an exam is commenced, and/or housing response or other templates the investment manager may use when furnishing information (among other items). Such playbooks can position investment managers to work with a unified and efficient approach when handling exam requests, minimizing confusion, delays, and errors. The reduction of these risks also can increase the chances an investment manager will be viewed credibly by the SEC.

SEC Risk Alert & Enforcement Monitoring. And of course, investment managers should have a system and/or regular practice of conducting assessments of their own Compliance programs and business practices based on risk alerts and enforcement matters issued and brought, respectively, by the SEC. The form of these practices does not have to be over-engineered. Rather, steps as simple as evaluating enumerated policy & procedure deficiencies noted in an enforcement matter, for example, and comparing those to the investment manager's own policies & procedures, can be highly effective in mitigating the risk of regulatory findings in the future. These types of steps also can garner confidence from the SEC as they create a narrative that the investment manager actively assesses the adequacy of its Compliance program and business practices, rather than simply waiting for scheduled testing or the preparation of its annual Compliance report.

LIVE EXAM STRATEGIES & PRACTICES

During an exam itself – from the time the SEC calls and previews it will be sending a request letter, to the throes of producing documents and being interviewed, to the close-out letter and concluding any required remediation – there are several key thematic and tactical approaches investment managers can employ to achieve the desired outcomes discussed earlier in this essay. Although the following strategies and practices are by no means novel or earth-shattering, they should not be taken for granted, particularly given their efficacy.

Timeliness. Responding to SEC exam requests by the requested deadline can go a long way toward instilling confidence in the SEC. Timely responses demonstrate that an investment manager's recordkeeping practices are sufficiently in order so that retrieval and compilation of certain information requires no extensions. They also give the impression to the SEC that not only may your overall control environment be well-organized and operating just as tightly, but that you are working in good faith with the SEC to allow them to do their job and discharge their responsibilities. While there is no issue per se with requesting an extension, the reason should be one that has a low risk of creating the wrong impression with the SEC (e.g. a request that comes in at a certain time of year when many people are not normally available, or an unanticipated issue arises when extracting certain data from systems for transmission into a different file type). Requests for extension should simply be treated as the exception, not the rule.

Agreeableness. In general, it is best to approach SEC exams in the spirit of cooperation, and unless there is an extraordinary reason not to do so (such as when responding to a request may remove attorney-client privilege for certain documents or information), SEC requests should be accommodated as much as possible. While an investment manager is under no obligation to create a new record or document for the SEC (that it otherwise isn't obligated to maintain pursuant to regulatory books & records requirements), an investment manager can benefit from still being as accommodating as possible. For instance, the SEC may ask to be given an introductory presentation of the investment manager, inclusive of a slide deck of sorts. While the creation of a slide deck isn't necessarily an obligation of an investment manager during the exam process, it nevertheless can foster a positive working rapport with the SEC given it exhibits a level of cooperation and transparency. It also is an opportunity for the investment manager to tell the most compelling story about its business and Compliance program. Indeed, certain requests in particular may equally be viewed not just as good relationship management, but also as opportunities.

Counsel. I've often heard investment managers debate whether having legal counsel serve as liaison to the SEC during the exam process and attend every interview session creates the wrong impression. Detractors of this approach to exam management tend to think that by allowing their attorney to interface with the SEC on topics such as document productions, time extensions, and being present for each interview session may inadvertently signal the investment manager may have something to hide or at least be defensive about (or is simply taking an adversarial posture). Though these are very valid and fair points, I am of the other mind. Although it certainly is not necessary to have counsel liaise with the SEC or be in every interview session, it also is not problematic, perception or otherwise. Indeed, having counsel liaise with the SEC can allow an investment manager to have someone more dedicated to administering, gauging, and strategizing about the exam management process. It also is not uncommon for an SEC exam team to have an attorney from the SEC Division of Enforcement "tag along" as part of the interview sessions; nor is it uncommon for exam staff to be somewhat indeterminate about who may be attending an onsite. Turnabout is fair play, and at worst, an investment manager having counsel liaise with the SEC and be present for all interviews is of neutral consequence in my view. So long as the investment manager's counsel also approaches the exam in the spirit of cooperation (albeit with a more protective mindset), I'm not sure his or her presence or involvement is detrimental.

Pre-Production Reviews. At a more tactical level, prior to handing over documents and information the SEC has requested, everything that is produced should be reviewed thoroughly by more than one person. Yes, a part of this is to ensure good quality control and that documents and information are professionalized. But, the other part concerns preparation. For example, when the SEC requests a log of Compliance violations, rather than blindly copying and pasting the Compliance violations log into a shared electronic folder that will be bundled up and furnished, an investment manager's personnel should review the log to refresh themselves on past violations. Doing so not only allows the investment manager to be better prepared for possible points of inquiry on what has been produced, but it also allows the investment manager to proactively contextualize certain things to the extent such contextualization could not be garnered from the four corners of a document itself. The benefit of proactive contextualization can be helpful in avoiding rabbit holes that may be wasteful to both the investment manager and SEC alike. All documents that are prepared in response to exam requests should also be catalogued and if needed, commented upon, in a document/file similar to the source mapping framework discussed earlier in this essay (note: it is important, when possible, for this file to be maintained by investment manager legal counsel to afford it the protections of attorney-client privilege and/or attorney work product).

Interviewee Selection. While the SEC may ask to speak with specifically named or titled individuals of an investment manager, often, they may simply ask the investment manager to make available an individual or individuals who can provide the SEC with an overview of a certain business practice, product, system, or the like. An investment manager should make available the best suited member of its management or staff. However, what constitutes being the "best suited" is neither solely technical acumen

nor solely presentational polish. The SEC generally understands that more than one person in an investment manager's organization can speak to certain topics. The SEC is looking to understand, and understanding requires an interviewee to be both technically proficient in the discussion topic, while also possessing strong enough communication skills to be both clear and understandable to the SEC, as well as focused on what the SEC is ultimately interested in. When selecting individuals to speak with the SEC on given topics, investment managers should be thoughtful about who they put forth for the sake of the SEC and the investment manager alike.

PARTING THOUGHTS

“Regulators are not your friend,” a former colleague of mine once said. But, they also can't be given the role they need to play. Also, some say that when the SEC comes in, “They're going to find *something*.” On this, while I understand the reason for the sentiment, I also simply have a different view; there are certainly instances where the SEC issues “clean” exam letters, and also many instances where findings are minor. My point is that, notwithstanding the appearance of a strained relationship between the SEC and our industry over the past several years, like investment managers themselves, SEC exam staff are managing their own pressures, goals, and responsibilities. While those can of course be at odds with those of an investment manager, the strategies and practices discussed above are intended to provide means to smooth the edges, so to speak, with a blend of art and science. My own view is that, just like how most investment managers are trying to do the right thing and want what's best for their clients, SEC exam staff do as well. As with any generalization, there are exceptions to both, yes. But as those more exceptional instances arise, an investment manager must simply adapt – something our industry has always been so very good at doing.

Thanks for reading . . .