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OCIE Announces Risk-Based Exam Initiatives for Mutual Funds—Part 2

My [first post](#) discussed the SEC's Office of Compliance Inspections and Examination's ("OCIE's") recent [Risk Alert](#) (the "Alert") and specific fund categories in its crosshairs. This post will cover the three remaining fund categories and general examination issues identified by OCIE in the Alert.

Concentrations in Securitized Assets

The Alert identifies, *without limitation*, securitized auto loans, student loans, credit card receivables and mortgage backed securities as securitized assets that may expose retail investors to inadequately disclosed risks or unanticipated risks, such as accelerating delinquency rates. Examinations will include assessments of funds' and advisers':

- Oversight policies, procedures and practices;
- Management of portfolio holdings and liquidity based on activities such as risk identification and mitigation practices;
- Valuation policies and procedures, including the funds' pricing practices and use of vendors, especially for illiquid and other difficult-to-value securities;
- Board oversight practices, particularly those regarding valuation; and
- Investor disclosure, especially involving the risks of securitized assets.

Side-By-Side Management

OCIE has previously identified conflicts of interest associated with advisers using similar strategies for both mutual funds and private funds, especially where implemented by the same portfolio manager. Accordingly, examinations will look to an adviser's:

- Policies and procedures for addressing conflicts of interest and other risks inherent in side-by-side management, especially in portfolio management and construction;
- Controls regarding brokerage, best execution and trade allocation, including trade aggregation and allocation of investment opportunities consistent with fiduciary duties;
- Allocation of fees and expenses among the mutual funds and private funds; and
- Disclosures to investors and fund boards.

New Entrants to Mutual Fund Management

Citing the concern that advisers that may not be new to the industry but are new to managing mutual funds could lack the experience with or sufficient knowledge of the Investment Company Act of 1940, increasing risks of prohibited transactions, meeting fund-specific regulatory requirements or other disclosure failures, the Alert says examinations of these advisers will focus on:

- Fund governance and ensuring boards are provided sufficient information to perform their duties;
- The effectiveness of advisers' and funds' compliance programs; and
- Fund marketing and distribution efforts by the adviser.

General Areas of Focus

Noting that examinations will be tailored to funds' and advisers' business practices, risks, and potential areas of conflicts of interest, the Alert indicates that the targeted examinations will generally assess:

- Fund and advisor policies and procedures relative to applicable risks and conflicts, including the board's oversight of the compliance program;
- Disclosures regarding risks and conflicts by funds to their investors and advisers to the funds' boards; and
- Deliberative processes used by funds, their advisers and their boards when assessing practices and controls relating to risks and conflicts, including disclosures, compliance and fund governance.

Additional Considerations

While OCIE may describe examinations or initiatives in an alert as targeted, diligence always favors the fully-prepared, because once an examination is underway, examiners may review anything within the SEC's authority. When preparing for these examinations, compliance officers should anticipate that examiners will:

- Adopt the perspective of a retail investor;
- Look for apparently uncontrolled risks and conflicts; and
- Delve into the board's oversight of the fund's adviser.

Explore more in

[Investment Management](#)