

Five Things to Think About Before a Surprise SEC Exam

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If a team from the SEC arrives at your office and says, “We are conducting an on-site examination and would like to talk to the CCO right now,” are you prepared? A handful of registered investment advisers have faced surprise SEC exams in recent months. These exams come in two flavors: either a “for cause” exam arising from SEC staff concerns relating to a specific ongoing issue, or a standard exam that for some reason has a surprise component.

There are several logistical items that a fund manager might consider before the SEC shows up unannounced in the lobby, regardless of the substance of the SEC’s inquiry. Thinking and planning ahead can minimize unnecessary stress and confusion in the moment. Fund managers should consider the following questions:

1. You are notified they are here: What will you do first?

- Ask who the SEC staff wishes to speak to and determine if those people are present in the office.
- Show them to a location that will not cause disruption. (Perhaps not the fishbowl conference room in the middle of the office.)
- Is it a “for cause” exam (*i.e.*, are they investigating urgent or time-pressing issues of concern)? If you are able to determine that it is a for cause examination, call counsel before having a substantive conversation with the exam staff.

2. What if the CCO is not available?

- It may be appropriate to reschedule. Ask the staff if they would like to return when the CCO will be back in the office.
- Designate someone to handle regulatory inquiries if the CCO is out.
- Ensure the person is comfortable with both substantive knowledge and the procedural actions to be taken if the SEC were to arrive.

3. How do you determine the purpose of the exam, the SEC’s priorities, and schedule?

- It is normal to ask questions, especially in the context of a surprise visit. Ask whether the exam relates to any specific issues.
- Be prepared to ask them about their expectation for timing and next steps.

4. How should the CCO answer questions and approach requests for interviews during the conversation?

- The CCO may not be fully prepared to provide specific answers to the SEC's questions. It is wiser to stick to general facts and offer to get back to them with specifics.
- If the SEC requests interviews with executives who are unavailable, consider expressing a willingness to schedule meetings when they are, rather than taking senior management out of preexisting obligations and meetings.

5. If they ask for documents, are you ready to turn them over?

- The SEC will likely provide a list of requested documents. Evaluate which documents can be retrieved and turned over quickly (which should include your compliance policies and procedures) and those that will take some additional time, such as those the SEC may request you create. (e.g., lists of certain transactions.)
- If necessary, explain that to the examiners that you will continue to provide documents throughout the day.
- Assign a person to keep the collection of documents up to date or who will be responsible for assisting in a collection the day of a surprise visit.
- Be sure you have first thought about whether certain documents would require consideration of privilege: for example, emails involving attorneys, memos relating to litigation, or communications with consultants working under the direction of counsel.

What is the SEC staff trying to achieve with a surprise exam? If it is a cause examination, they may be trying to determine whether client assets are at risk. Otherwise, the SEC's main justification is that the element of surprise gives the staff a better view of the inner workings of a registered entity. They say it eliminates an opportunity for an advisor to destroy or manipulate records. However, such concern may be overblown, as cover-ups can be detected through electronic storage and metadata, forensic review, and inconsistencies between document drafts. Additionally, a surprise visit can be counterproductive, as key persons may be out of the office or not be immediately available to speak with the staff.

Nevertheless, fund advisers that consider the questions above and have a plan of action ahead of time should have a smoother time in a surprise exam. It may also be helpful for the CCO to make sure management knows what is expected of them, with the goal of imposing some level of organization on a potentially disruptive event.

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