

SEC Issues Risk Alert on Investment Adviser MNPI Compliance Issues

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On April 26, 2022, the Division of Examinations (“EXAMS”) of the Securities and Exchange Commission (“SEC”) issued a Risk Alert highlighting notable deficiencies identified by EXAMS staff in its review of SEC-registered investment advisers relating to Section 204A (“Section 204A”) of the Investment Advisers Act of 1940 (the “Advisers Act”) and Rule 204A-1 (the “Code of Ethics Rule”) thereunder.

Under Section 204A, investment advisers must establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the misuse of material nonpublic information (“MNPI”). Under the Code of Ethics Rule, investment advisers must adopt a code of ethics that sets forth, among other things, the standard(s) of business conduct expected from the adviser’s supervised persons, including requiring access persons to report their personal securities transactions and holdings to the adviser’s chief compliance officer or other designated persons.

EXAMS staff highlighted several notable deficiencies related to MNPI under Section 204A and the Code of Ethics Rule of which investment advisers should take note. With respect to MNPI, EXAMS staff observed advisers that did not have or implement adequate policies and procedures regarding identifying and supervising “value-add investors” who are more likely to possess MNPI. In addition, EXAMS staff observed advisers that used nontraditional data sources, including alternative data, metadata and expert networks, but did not appear to adopt or implement written policies and procedures to address the potential risk of receipt and use of MNPI through these sources. For advisers that use expert networks, EXAMS staff observed advisers that did not appear to have or did not appear to implement adequate policies and procedures regarding discussions with expert network consultants who may have access to MNPI.

With respect to the Code of Ethics Rule, EXAMS staff highlighted inadequate identification and supervision of access persons and the lack of preapproval before such persons directly or indirectly acquired any interests in an initial public offering or limited offering. EXAMS staff also observed instances where advisers could not produce evidence of supervisory review of personal securities holdings and transaction reports, or the information in such reports was incorrect as required by the rule. EXAMS staff also found such reports were not submitted timely or the adviser’s code of ethics did not include provisions requiring access persons to submit such reports. Finally, EXAMS staff found instances where supervised persons were not provided with a copy of the code or did not provide written acknowledgement of their receipt of the code or any amendments thereto.

EXAMS staff directed advisers to consult the Code of Ethics Adopting Release for certain best practices, including incorporating “restricted lists” of issuers about which the advisory firm has inside information, and prohibit any trading in securities of those issuers while they remain on the restricted list. In addition, advisers should incorporate procedures to ensure that investment opportunities must first be offered to clients before the adviser or its employees may act on them.

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The Risk Alert is available [here](#).