

# POINTS TO NOTE ABOUT US SEC EXAMINATIONS





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# INTRODUCTION

In recent years, an increasing number of corporations registered with both, Hong Kong's Securities and Futures Commission ("SFC") and the U.S.' Securities and Exchange Commission ("SEC"), have been subject to the SEC's National Exam Program ("SEC Examinations"). The objective of such investigations is to determine corporations' adherence to the regulatory environment.

## OVERVIEW OF THE US SEC EXAMINATION REGIME

### 1. WHAT IS A US SEC EXAMINATION?

The Division of Examinations ("the Division") conducts US SEC Examinations, at individual corporations in order to understand the firm's operations, assess the effectiveness of their compliance programs, monitor potential risk and review the procedure and controls in place.

Purposes of US SEC Examinations:

- a. To support responsible capital formation through risk-focused strategies
- b. To improve compliance to current rules and regulations
- c. To prevent fraud and monitor risks to protect investors
- d. To ensure market integrity and investors' confidence in the market



A vertical image on the left side of the page showing an American flag waving in front of a tall skyscraper, likely in New York City.

### 3. TYPES OF US SEC EXAMINATIONS


There are 3 major types of US SEC Examinations conducted by the Division, namely routine examinations, for cause examinations and sweep examinations.

#### a. Routine Examinations

- **Definition:** Conducted periodically to determine whether their compliance procedures are in accordance with regulations. Statistically, corporations should expect to be examined approximately every 5-7 years.
- **Factors Increasing Chances of Assessment:** Corporations are selected for the examinations based on the US SEC's adoption of a risk-based program and data-driven research. In general, firms with higher AUM, history of regulatory issues and any other signs of poor controls are subject to greater scrutiny, putting them higher up on the US SEC's risk-based rankings.
- **Scope of Assessment:** Corporations are normally assessed based on the US SEC Priorities List of that particular year.

#### b. "For Cause" Examinations

- **Definition:** Generally triggered by an investor or employee tip, complaint or referral. It could also be triggered by surveillance-identified issues, media reports, or the US SEC's own risk assessment process for identifying questionable activity. Due to the nature of this type of examination, the US SEC conducts the examinations without prior notice, to prevent the destruction of documents and the disappearance of client assets.



The results of these examinations help the US SEC identify and monitor risks, inform rule-making initiatives, improve and update industry practices as well as pursue misconduct.

## 2. WHO WILL BE SUBJECT TO THE US SEC EXAMINATIONS ?

Corporations that are registered with the HK SFC and the US SEC can be subject to the US SEC examinations. In the event that the HK SFC licensed corporations do not have an operating office in the US but are registered with the US SEC, they can still be subject to the US SEC examinations via a phone call and/or email instead of an on-site review.

Another factor to consider is whether the firm is a Registered Investment Adviser ("RIA") or an Exempt Reporting Adviser ("ERA").

	<u>ERA</u>	<u>RIA</u>
Definition	A Large Investment Adviser (i.e. AUM of over US\$100million) that qualifies as either a Venture Capital Fund Adviser or Private Fund Adviser.	Provides investment advice to and manage portfolios of high net-worth individuals.
Requirements	<b>Not required</b> to be registered with the US SEC.	<b>Required</b> to be registered with the US SEC if regulatory assets under management ("AUM") is equivalent to US\$100 million or more.

It is important to note that although ERAs are not registered with the US SEC, the US SEC has the legal authority to examine an ERA's books and records.

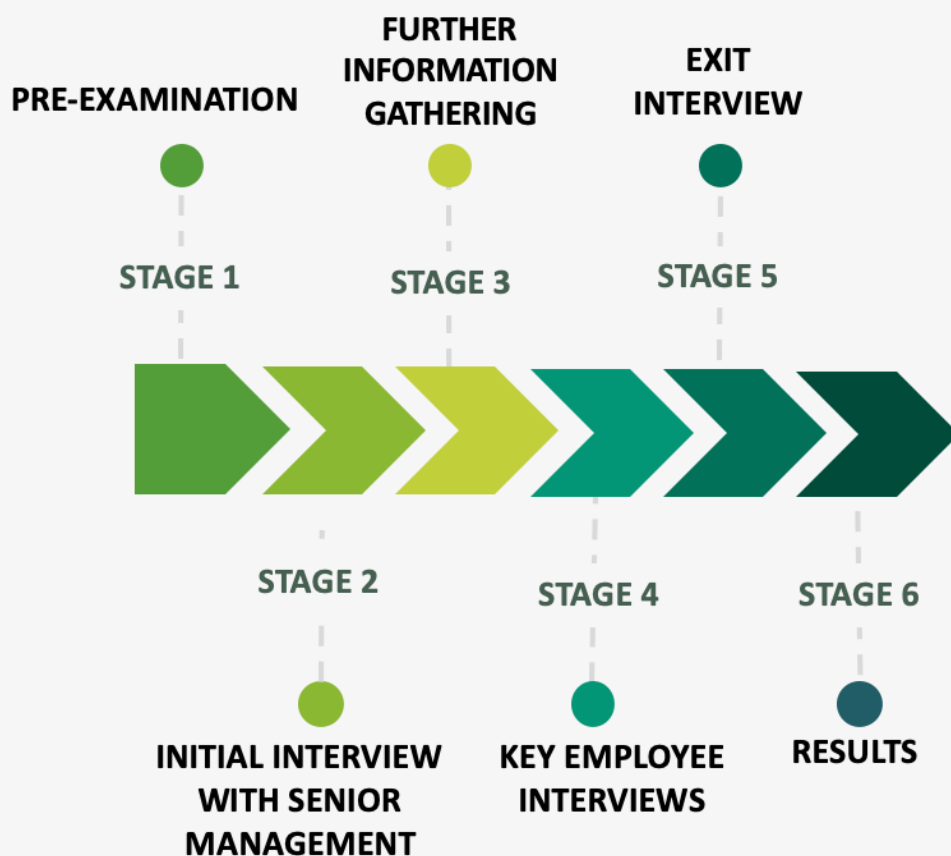


- **Scope of Examination:** Such inspections mainly focus around the area of the tip or complaint, with the intention of getting to the bottom of the alleged impropriety.

c. **Sweep Examinations**

- **Definition:** Such examinations are conducted with a focus on industry-wide compliance risk areas. They are often performed with little to no notice and target a specific area of practice or a compliance risk area.
- **Scope of Examination:** The examinations are generally identified from patterns in routine examinations or the US SEC's internal risk assessment process.

## 4. PROCESS OF A US SEC EXAMINATION





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## 5. HOW TO BE FULLY PREPARED FOR A US SEC EXAMINATION ?

While the US SEC Examination is often perceived to be a daunting and lengthy process, understanding what is expected out of licensed corporations can make it a smooth experience.

The US SEC issues a Priorities List annually, which documents the key focus areas they intend on assessing in that particular year. For 2021, the Division's focus includes the following as their priorities:

- Retail investor protection
- Information security
- Operational resiliency
- Financial technology and innovation, including digital assets
- Anti-money laundering
- LIBOR transition
- Selected areas for registered investment advisers
- Environmental, Social and Governance (“ESG”)-related matters

However, it is important to note that the examination focus may vary for each corporation, depending on the US SEC’s analysis of the firm’s documents or the type of examination.

In addition, the Division also releases Risk Alerts through which the US SEC sheds light on their observations of deficiencies and internal control weaknesses from recent examinations of investment advisers.





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In order to be fully prepared, it is advised to:

- Conduct Mock Examination regularly for both announced and unannounced examinations.
- Invest in proper technology and hire appropriate compliance staff according to the size and complexity of your operations.
- Appoint a dedicated contact in the event of the examination to facilitate the entire examination process
- Be friendly and professional. Treat the regulators well; be respectful and honest throughout the entire examination process.

## 6. HOW CAN COMPLIANCEPLUS HELP ?

Preparation is the key to performing well in the SEC examinations and CompliancePlus is here to help you through! As a leading compliance consultant firm in Hong Kong, CompliancePlus is dedicated to offering its services to assist ongoing clients in being fully equipped for the entire process, from preparing a document checklist to conducting mock examinations.

Our excellent team of compliance officers have experienced years of professional training and projects in areas of supervising and minimizing regulatory operational and reputable risks, providing professional compliance consulting and commendable recommendations to all our clients seeking for guidance and advice.

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By partnering with **CompliancePlus**, our clients gain access to compliance solutions that they can trust and the latest knowledge of regulatory policies and procedures. Through building up strong relationships with our clients and by ensuring our availability to them, we are trusted advisors helping clients to navigate a challenging and changing regulatory environment.

For any queries, please feel free to contact us on the above information, or send an email to your usual contact!

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