Published on *The National Law Review* https://natlawreview.com

OCIE Releases Risk Alert Relating to Principal Transaction and Agency Cross Trade Compliance Issues

Article By:

Jacob C. Tiedt

John S. Marten

Nathaniel Segal

Adam S. Goldman

On September 4, 2019, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a risk alert identifying common principal trading and agency cross trading compliance issues observed by OCIE staff in adviser examinations during the past three years. Principal trades and agency cross trades when acting as a broker are governed by Section 206(3) of the Investment Advisers Act of 1940.

The risk alert categorized the compliance deficiencies as follows:

- **Failure to meet specific requirements of Section 206(3)**. Advisers, acting as principal for their own accounts, purchased or sold securities in transactions with individual clients without recognizing that such principal trades were subject to Section 206(3) of the Advisers Act and therefore did not make the required written disclosures to clients or obtain the required client consents. Other advisers recognized that they had engaged in principal trades but failed to meet all of the requirements of Section 206(3) by: (1) failing to obtain appropriate prior client consent for each principal trade; or (2) failing to provide sufficient disclosure regarding the potential conflict of interests and transaction terms. OCIE also observed advisers that obtained client consent to a principal trade *after* completion of the transaction.

- **Failure to identify principal transactions relating to pooled investment vehicles.** Advisers effected trades between advisory clients and an affiliated pooled investment vehicle, but failed to recognize that the advisers' significant ownership interests in the pooled investment vehicle (typically greater than 25%) would cause the transaction to be subject to Section 206(3). Advisers also effected principal trades between themselves and pooled investment vehicles, but did not obtain effective consent from the pooled investment vehicle prior to completing the transactions.

- **Agency cross trade activity despite contrary disclosures to clients**. Advisers engaged in agency cross trades in reliance on Rule 206(3)-2 despite having disclosed to clients that they would not engage in such transactions.
- **Agency cross trade activity without documentation**. Advisers effected agency cross trades purportedly in reliance on Rule 206(3)-2 but could not produce any documentation substantiating their compliance with the written consent, confirmation or disclosure requirements of the rule.
- **Failure to institute policies and procedures.** OCIE observed advisers that either did not have policies and procedures relating to Section 206(3) or failed to follow them.

The risk alert encourages advisers to review their written policies and procedures and the implementation of those policies and procedures to ensure that they are compliant with the principal trading and agency cross transaction provisions of the Advisers Act and the rules thereunder.

OCIE's announcement and a link to the risk alert is available here.

National Law Review, Volume IX, Number 275