

**MEMO# 31941**

September 5, 2019

## **OCIE Publishes a Risk Alert Reminding Advisers of Obligations When Engaging in Principal and Agency Cross Trades**

[31941]

September 5, 2019 TO: ICI Members  
Investment Company Directors  
Chief Compliance Officer Committee  
Investment Advisers Committee  
SEC Rules Committee SUBJECTS: Compliance  
Investment Advisers RE: OCIE Publishes a Risk Alert Reminding Advisers of Obligations  
When Engaging in Principal and Agency Cross Trades

The SEC's Office of Compliance Inspections and Examinations has published its latest Risk Alert, which is on the topic of principal and agency cross trades.<sup>[1]</sup> After discussing advisers' regulatory obligations under Section 206(3) of the Investment Advisers Act of 1940 and Rule 206(3)-2 thereunder, when engaging in principal trades and agency cross trades when the adviser is acting as a broker,<sup>[2]</sup> this four-page Risk Alert identifies "common" investment adviser compliance issues relating to these trades. The Alert reminds advisers that "compliance with the disclosure and consent provisions of Section 206(3) alone may not satisfy an adviser's fiduciary obligations with respect to a principal or agency cross trade."<sup>[3]</sup> Instead, advisers should read Section 206(3) in conjunction with Sections 206(1) and (2) of the Advisers Act, which require advisers "to disclose facts necessary to alert the client to the adviser's potential conflicts of interest in a principal trade or agency cross trade."<sup>[4]</sup>

Aside from failing to comply with the rule at all, the common deficiencies the Risk Alert mentions include advisers:

- Failing to obtain appropriate prior client consent for each principal trade;
- Failing to provide sufficient written disclosure regarding the potential conflicts of interest and terms of the transaction;
- Obtaining the client's consent to a principal trade *after* completion of the transaction and not before as required;
- When effecting a trade between an advisory client and an affiliated pooled investment vehicle in which the adviser has "significant ownership interests," failing to recognize that the adviser's interests would cause the transaction to be treated as a principal

trade;

- Disclosing to clients that the adviser does not engage in agency cross transactions when, in fact, it does; and
- Failing to maintain documentation evidencing compliance with the regulatory requirements.

The Risk Alert also notes that, in some instances, OCIE staff observed advisers not having policies and procedures relating to Section 206(3) even though such advisers engaged in principal trades and agency cross transactions. In other instances, advisers had such policies and procedures but failed to follow them.

Through the Risk Alert OCIE hopes to encourage advisers to review their written policies and procedures governing these transactions and their implementation to ensure compliance with the Advisers Act.

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#### **endnotes**

[1] See *Investment Adviser Principal and Agency Cross Trading Compliance Issues*, OCIE Risk Alert (September 4, 2019), which is available at: <https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Principal%20and%20Agency%20Cross%20Trading.pdf>.

[2] Generally speaking, these provisions require advisers to make certain written disclosures to clients involved in each of these transactions and obtain the client's written consent.

[3] Risk Alert at p. 2.

[4] *Id.*