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OCIE Director makes case for devoting adequate resources to compliance

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If you're having difficulty making the case for sufficient resources for your firm's compliance program, you may want to consider laying the [latest speech](#) from OCIE Director **Peter Driscoll** on the desks of the powers to be. At an industry conference April 29, Driscoll underscored that firms need to continually assess whether their compliance program has adequate resources to support its compliance function.

Driscoll acknowledged being "concerned" when he hears reports of compliance resources and budgets being slashed or not keeping up with firms' risk profiles. As have other OCIE directors in the past, Driscoll called out the need for a sincere "tone at the top" from senior management when it comes to supporting a solid compliance culture. Without that tone, a firm stands to lose "the hard earned trust of its clients, investors, customers and other key stakeholders," he cautioned.

Much like firms, Driscoll stated that it is also imperative for OCIE itself to continually ask how best it can deploy its resources to protect retail investors—a top priority of SEC Chairman **Jay Clayton**. Those resources are primarily dedicated to conducting firm exams.

Examination priorities

Driscoll highlighted exam priorities and risk areas. Not surprisingly, chief among these were disclosures and specifically those tied to conflicts of interest that Driscoll said "abound." OCIE sees conflicts surrounding business structure, compensation structure, personnel or relationships, or relationships with affiliates and service providers.

Driscoll noted that almost all of his office's exams review adviser disclosures in connection with a firm's operations, with the end goal of evaluating whether the adviser has appropriately identified and disclosed conflicts.

Disclosure failure trends

Some disclosure failure trends have emerged. Examples include recommending certain investments to clients without the firm disclosing its own interest in the investment, he said. Not providing adequate disclosure about how the firm allocates investment opportunities among multiple clients with the same or similar investment strategies, or how investment opportunities are allocated between the firm and their clients is another theme.

Affiliates and service providers also are a focus. Driscoll cautioned that examiners have seen firms recommending that their clients use affiliated broker-dealers or other service providers without adequately disclosing the affiliation or the receipt of compensation for making the recommendation.

Another conflict that has gotten attention lately is when an adviser has an incentive to recommend certain share classes over others ([IA Watch](#), March 11, 2019). Driscoll noted that OCIE has focused on mutual fund share class selection since 2016 with more than 250 exams conducted in this area. He professed that OCIE won't rest and will continue to examine for this issue where it still sees deficiencies.

Additional hot button exam priorities highlighted by Driscoll included:

- ✓ **Fees, expenses and related disclosures.** Examiners are seeing instances where firms are not adhering to the terms of their advisory agreements or disclosures contained in their Form ADV, fee schedules, and other materials provided to clients. Such practices expose firms to an increased risk of overbilling clients and potentially violating the federal securities laws, Driscoll cautioned.

To evaluate whether investors are receiving accurate fees and expenses information, Driscoll signaled that examiners will closely review a firm's disclosures with the goal of identifying whether applicable fees and charges were disclosed. Those disclosures will be compared with how the firm in practice is assessing and collecting fees.

Discrepancies have been detected, including where advisers were valuing client assets using a process that differed from that described in the client's advisory agreement. Examples included advisers using the market value of the assets at the end of the billing cycle versus using the average daily balance of the account over the entire billing cycle. Another example is advisers including assets in the fee calculation that the advisory agreement stated would be excluded.

- ✓ **Safeguarding of client assets.** Driscoll considers this an “evergreen” focus for OCIE. His agency continues to examine for compliance with the custody rule where deficiencies have frequently been observed. Driscoll stated that OCIE considers compliance with the custody rule “one of the primary safeguards against misappropriation or misuse of client assets” so it will continue to focus its attention on custody.

Misappropriation is yet another concern. Driscoll stated that it is imperative that firms have a “robust” system of internal controls surrounding their reps’ handling of investor funds and assets. Exams in this area may include a review of firms’ P&Ps and internal controls surrounding its handling or processing of investor funds and assets, he added.

When it comes to asset verification, Driscoll cautioned that OCIE doesn’t take what registrants provide at “face value.” He noted that even well-intentioned firms with competent and ethical personnel can make errors that may not surface until a thorough analysis is performed against a corroborating data set from the custodian(s).

- ✓ **Firms borrowing from clients.** This practice is “fraught with risk to clients,” said Driscoll. He added that when examiners see these arrangements, they will look at whether all material risks, expenses and compensation were adequately disclosed to clients and customers.
- ✓ **Senior investors.** OCIE recently concluded a review of more than 200 investment advisers with a significant senior client base ([IA Watch](#), March 21, 2019). Driscoll pledged that OCIE will remain focused on protecting senior investors through its exams and investor outreach efforts.

The information contained herein was current as of the publication date.

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