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Sept. 16, 2019 | Philadelphia, PA

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## Conquering Current Compliance Challenges

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## Conquering Current Compliance Challenges

Recorded: August 14, 2019

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## Private Equity Enforcement Lessons Learned: Compliance Guidance for the PE Business Model

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## The SEC Examinations Priorities Handbook (2019 Edition)

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## What OCIE's asking about – plus tips to help you ace your next exam

Published on: 8/1/2019 Content area: Investment Adviser

Comments?

Sometimes predictions come true. Several CCOs report to **RCW** that their OCIE exams have stretched out due to the government's record long shutdown earlier this year. There were indications this could be the case (**IA Watch**, March 14, 2019).

An exam elongated by the shutdown harmed one private fund adviser's ability to fundraise. "It stalled our efforts," says the adviser's new CCO. Investors typically ask if an adviser is under an **SEC** exam before getting out the checkbook, so the firm waited to raise funds until the exam finally wrapped up.

The new CCO assesses two reasons for the exam's major finding around custody: "We did what most firms do and relied on our compliance consultant," says the CCO. The CCO claims the consultant did a poor job and failed to instruct the firm that two legacy funds needed to be audited after a third fund pushed the adviser above the SEC registration threshold.

### Divided attention

Another contributing factor was the dual-hatted former CCO who "was too busy doing other things running the company" to focus on compliance duties, says the new CCO.

"It's all about custody," says another CCO who went through a recent OCIE exam. "The minutiae about custody is getting more and more annoying," she adds.

OCIE's interest in custody can be seen in a new [document request letter](#) obtained by **RCW** that focused on the topic (see the box on page XXX).

It's well known that if an adviser witnesses a steep decline or surge in its AUM that the change could trigger an OCIE exam. Such was the case with an adviser in the Midwest, which enjoyed a big boost in its managed assets. The exam concentrated on fees and breakpoints and compliance P&Ps for senior clients. Examiners also visited some of the firm's branch offices.

"They coordinated that through me, and I went with them to the branch offices," says the CCO. Examiners wanted to see how the branches serviced existing clients and found new ones. Examiners encouraged the CCO to make more visits on his own.

### Centralizing advertising reviews

Another perennial OCIE target is performance advertising. The value of a centralized approach to approving marketing flashed anew when examiners stumbled upon an ad created by a portfolio manager at a firm in the West who had gone rogue. "You want to have one group tasked" with setting performance advertising policies and ensuring they are being followed, says the CCO.

Another advisory firm in the West went through a never-been-examined inquiry that turned out to go long, again because of the shutdown. Advisers with an affiliated insurance company can benefit from an issue in this exam. OCIE insisted that the adviser's Form ADV needed to disclose the risks of annuities sold to clients by its affiliated insurance company.

"They felt we should be listing the risks of indexed annuities," says the CCO.

The RIA countered that the insurer was an entirely different company and that the insurer disclosed the risks. The adviser's attorney urged his client to add the language to its brochure rather than to go to the mat over the dispute.

Two months after OCIE released a [risk alert](#) urging firms to oversee their cloud storage providers (**IA Watch**, May 23, 2019), the topic's hot on exams, says **Marc Elovitz**, a partner with **Schultze Roth & Zabel** in New York. "In-depth and ongoing vendor due diligence is the expectation" from OCIE examiners, he finds.

### Private fund expenses - again

## What OCIE's asking about – plus tips to help you ace your next exam

More disagreement with examiners can be seen in another exam involving a private fund adviser. The firm holds a minority stake in a portfolio company. An adviser employee did work for the portfolio company at a cost of tens of thousands of dollars. Examiners argued the adviser and not the portfolio company must foot that bill – and not its fund investors – because of the way the adviser's offering documents covered expenses.

The adviser felt the portfolio company should have paid the expense, or at least the adviser's piece should have been limited to its ownership percentage. The lesson for other private fund advisers is to be clear in how your documents disclose the handling of expenses and to abide by those dictates, says a source close to the matter.

The first-ever exam for an adviser in the South centered on how the firm calculates client fees. The CCO says examiners wanted to see evidence that fees matched what's in advisory agreements. The CCO plans to institute new processes for double-checking fee calculations to avoid mistakes.

Be careful if your firm takes any form of loans from clients or a company. **Michelle Jacko**, managing partner of **Jacko Law Group** and CEO of **Core Compliance & Legal Services** in San Diego, says examiners want to see "transparent disclosure in the ADV" about loans as well as documentation supporting any "form of a debt instrument," such as a promissory note or a convertible note.

Besides the disclosure, ensure that you have compliance P&Ps around accepting loans, she recommends.

**Best practice tips**

A CCO in the East came up with a winning solution when examiners recently analyzed a unique product the adviser sells. They were "getting hung up" on valuation and other aspects of the product without fully understanding it, the CCO says.

The CCO invited examiners to speak directly with the portfolio managers and CIOs most knowledgeable of the product. It worked. The CCO didn't have to coach the staffers. They were experienced answering questions about the product posed by institutional investors in their due diligence inquiries. Examiners moved on after the discussion with staff.

You can help yourself by tracking recent SEC enforcement actions and agency releases, continues the CCO. "They come in and they follow that playbook," the CCO says, meaning expect examiners to bring up topics seen in those actions and releases.

Another CCO recommends you create a PowerPoint slide deck that highlights your compliance program for examiners. It should mention your P&Ps, your code of ethics, give examples of what you do on a daily basis, show how you retain records, collect annual attestations and monitor staff e-mails, as well as display the firm's restricted trading list and describe how frequently it gets updated, says the CCO. "Have everything laid out" in the presentation, he adds.

**Books and records**

Another OCIE document request letter sent to an adviser requested the names of "advisory clients lost ... in the **last 7 years.**" The examiners bolded those last three words. Yet the Advisers Act's [books and records rule](#) calls upon firms to maintain records only "for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record."

However, if you keep records longer than five years and the SEC asks for them, you must share them, points out Elovitz.

**Editor's Note:** A full one-hour session devoted to SEC exams will be featured at **RCW's** Sept. 16 Fall compliance conference in Philadelphia. To see the agenda and to register, click [here](#).

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

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Yes  No