2017 Investment Adviser Coordinated Exams

North American Securities Administrators Association

The information provided herein is for your convenience only, is illustrative, and is not intended as legal advice.
Exams Overview

• 1227 routine investment adviser examinations
• January – June 2017
• 38 Jurisdictions including Ontario, Canada
• 946 Advisers had AUM > 0
• 336 had AUM > $30MM
• 610 had AUM < $30MM
• 331 first time examined by the state
• 535 were examined in last 5 years
Adviser Stats

- 741 advisers had 1 IAR
- 220 advisers had 2 IARs
- 101 affiliated with a BD firm
- 74 advised a pooled investment vehicle
- 572 offered financial planning services
- 78 acted as solicitors for other advisers
- 27 paid solicitors for referrals
**Top Deficiency Categories**

US Advisers with AUM > 0

Percent of exams noting at least one deficiency in the category

- **Books & Records**: 64.6%
- **Registration**: 54.3%
- **Contracts**: 45.4%
- **Fees**: 27.2%
- **Custody**: 27.2%
- **Cybersecurity**: 23.4%
- **Financials**: 20.8%
- **Advertising**: 19.1%
- **Supervision**: 14.4%
- **Brochure Delivery**: 14.1%
- **Privacy**: 13.0%
- **Investment Activities**: 7.4%
- **Unethical Practices**: 5.9%
Comparison to 2015
US Advisers with AUM > 0

Percent of exams noting at least one deficiency in the category

*Cybersecurity is a new category in 2017

2017
2015
Books and Records

2110 Deficiencies
64.6% of US Advisers with AUM

- Client suitability information: 9.00%
- Trial balances, financial statements: 8.53%
- Written agreements (IA-Client contracts): 8.01%
- General and auxiliary ledgers: 5.97%
- Disclosure Brochures: 3.98%
- Order memorandum: 3.70%
- Advertising file: 3.08%
- Check books, bank statements: 3.08%
- Inadequate business continuity/succession planning: 2.80%
- Journals: 2.65%

Other
- Not updating WSPs
- Timely posting to financial records
- WSPs for Cybersecurity
Registration

903 Deficiencies
54.3% of US Advisers with AUM

Form ADV - Inconsistencies between Part 1 and Part 2: 14.8%
Other issues: 12.3%
Form ADV - Fee structure: 8.0%
Timely filing of amendments: 7.6%
Form ADV - Business description: 7.6%
Form ADV - Personnel: 6.5%
Form ADV - Services provided: 6.2%
Form ADV - Conflicts of interest: 4.8%

Other
Outdated Info: Address, Contact, and Personnel Info
Undisclosed Judgements/Liens
Outside Businesses
### Contracts

- **The fee**: 12.03%
- **The fee formula**: 10.41%
- **In writing**: 9.59%
- **Other issues**: 8.92%
- **Capital gains compensation**: 8.78%
- **Not updated**: 8.11%
- **Properly executed**: 6.89%
- **Other state-specific requirements**: 6.76%
- **Hedge clauses**: 6.49%
- **Services**: 4.59%

**740 Deficiencies**

45.4% of Advisers with AUM

Other:
- Outdated accredited investor definition
- Governing law issues
- Referencing 1940 Act
- SEC Registration
3.2% Insufficient net worth to charge > $500 and > 6 months in advance

6.8% Adviser unable to provide evidence of work product to justify asset management fees

8.1% Fee charged doesn't match contract or ADV

19.4% Charging miscalculated fees (overcharging)

26.2% Other Fee issues/concerns (include in comment)

29.4% Charging on non-managed assets

309 Deficiencies
27.2% of Advisers with AUM

Other Required disclosure for 3% fee
Asset mgmt fee mixed with other fees, not itemized
Doesn't match 3rd-party adviser's fee method
Fee Issues Found Where?

- Adviser-calculated fee: 33.3%
- Custodian-calculated fee: 12.5%
- Annuities: 12.5%
- Private offerings: 10.4%
- Fee refunds: 8.3%
- Certain class mutual funds: 6.3%
- Fee based on net worth of client: 6.3%
- "Retainer" fees: 2.1%
- "Concierge" Fees: 2.1%
- "Monitoring" fees: 2.1%
Custody

- Safekeeping: Notice to administrator on ADV
- Safekeeping: Notice to clients (in writing)
- Safekeeping: Account statements from adviser – proper statements
- Pooled Vehicle (Annual Audit): Audit distributed to all investors w/in 120 days of FYE
- Direct Fee Deduction: Proper client invoice (fee, time period, formula, assets in formula)
- Direct Fee Deduction: Dual invoicing client and custodian
- Safekeeping: Qualified custodian (separate client accounts or under adviser as agent)

Other issues

- Other
- Password access to client accounts
- Holding private placements for clients
- Commingling client funds with personal funds

314 Deficiencies
27.2% of Advisers with AUM
Cybersecurity

590 Items Noted
23.4% of Advisers with AUM

- No or inadequate cybersecurity insurance: 15.6%
- No testing of cybersecurity vulnerability: 11.0%
- Procedures: Securing/limiting access to devices: 7.3%
- No IT or technology specialist/consultant: 7.1%
- Procedures: Hardware/software updates, upgrades, etc: 6.3%
- Weak or infrequently changed passwords: 4.6%
- Procedures: Internet use (public Wi-Fi, VPN, etc.): 4.2%
- No contract or written agreement with technology specialist/consultant: 3.9%
- Procedures: Phishing and other unauthorized access attempts: 3.7%
- Procedures: Training (protection against breaches, etc): 3.1%
- No off-site storage of back-up data: 2.9%
- Procedures: Oversight of third-party IT or data service providers (e.g., due diligence, etc): 2.7%
Evidence of income or expenses for undisclosed outside business activities
Evidence of lending to customers (UBP)
Evidence of borrowing from customers (UBP)
Insufficient bond
Poor financial condition
Inadequate net worth (normal)
Inadequate net worth (for custody)
Inadequate net worth (for discretion)
Commingling IA records with outside business or personal accounts
Other issues

Other
Not in accordance to GAAP
Timely posting to fin'l records
Timely filing of financials
Vague expenses and income

Financial Matters
232 Deficiencies
20.8% of Advisers with AUM

Other issues
41.4%
Inadequate net worth (for discretion)
18.5%
Commingling IA records with outside business or personal accounts
9.1%
Inadequate net worth (for custody)
7.8%
Inadequate net worth (normal)
7.8%
Poor financial condition
2.6%
Insufficient bond
2.2%
Evidence of borrowing from customers (UBP)
1.7%
Evidence of income or expenses for undisclosed outside business activities
1.3%
Evidence of lending to customers (UBP)
1.3%
Advertising

230 Deficiencies
19.1% of Advisers with AUM

- Misleading qualifications, services, or fees (UBP): 19.1%
- Other untrue or misleading statements (UBP): 14.8%
- Insufficient website disclaimer: 12.2%
- Testimonials (UBP): 11.7%
- Misuse of “RIA” or "IAR": 9.1%
- Misleading use of professional designation: 8.7%
- Exaggerated claims (UBP): 5.2%
- Misleading performance advertising (UBP): 5.2%
- Misleading charts, graphs, formulas (UBP): 3.0%
- Guarantees of specific results or against loss (UBP): 2.2%

Other
- Untrue affiliations
- Implying endorsement by jurisdiction
- Unfounded "Specialty" areas

Found in:
- Website: 44.5%
- Social Media: 21.9%
- Business Cards: 14.4%
- Brochures/Flyers: 11.0%
- Newsletters: 4.1%
- Seminars: 2.1%
- Newspapers: 2.1%
Failure to avoid or mitigate conflicts of interest 2.5%
Failure to have procedures to preventing the misuse of material nonpublic information (UBP) 15.3%
Failure to periodically assess and update compliance/supervisory program 21.2%
Failure to follow compliance/supervisory procedures 34.7%
Other issues 26.3%

Supervision

118 Deficiencies
14.4% of Advisers with AUM

Other
- Personal trading review
- Identifying client "insiders"
- Remote office reviews
- Outsourced compliance functions
135 Deficiencies
14.1% of Advisers with AUM

Brochure Delivery

- Annual offering/delivery: 42.2%
- Update/Material change delivery: 29.6%
- Initial delivery: 11.9%
Investment Activities Issues Found Where?

- Equities (stocks): 16.7%
- Debt securities (bonds, notes): 10.0%
- Leveraged ETFs: 10.0%
- Mutual funds (well-known fund families): 10.0%
- Margin: 6.7%
- Discretionary trading: 6.7%
- Private placements: 6.7%
- Annuities: 6.7%
- Inverse (short) ETFs: 6.7%
- Passively managed ETFs: 6.7%
- 3rd party advisers/money managers: 3.3%
- Pooled investment vehicle: 3.3%
- Options: 3.3%
- Actively managed ETFs: 3.3%
AUM <30MM vs. AUM >30MM
US Advisers with AUM > 0

Percent of exams noting at least one deficiency in the category

- Books & Records: 63.3%
- Registration: 55.3%
- Contracts: 47.1%
- Fees: 27.9%
- Custody: 28.9%
- Cybersecurity: 22.6%
- Financials: 17.5%
- Advertising: 23.3%
- Supervision: 16.0%
- Brochure Delivery: 11.8%
- Privacy: 11.0%
- Investment Activities: 6.1%
- Unethical Practices: 7.5%
1 IAR vs. >1 IAR
US Advisers with AUM > 0

Percent of exams noting at least one deficiency in the category

- Books & Records
- Registration
- Contracts
- Fees
- Custody
- Cybersecurity
- Financials
- Advertising
- Supervision
- Brochure Delivery
- Privacy
- Investment Activities
- Unethical Practices
Independent IAs vs. BD-affiliated IAs

Percent of exams noting at least one deficiency in the category

<table>
<thead>
<tr>
<th>Category</th>
<th>Ind. IA</th>
<th>IA-BD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Books &amp; Records</td>
<td>66.2%</td>
<td>58.9%</td>
</tr>
<tr>
<td>Registration</td>
<td>58.9%</td>
<td>49.3%</td>
</tr>
<tr>
<td>Contracts</td>
<td>35.3%</td>
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Comparison Non-PIV to PIV Advisers
US Advisers with AUM > 0

Percent of exams noting at least one deficiency in the category

- Books & Records: 70.8%
- Registration: 60.6%
- Contracts: 46.6%
- Fees: 46.5%
- Custody: 27.1%
- Cybersecurity: 27.1%
- Financials: 27.8%
- Advertising: 23.9%
- Supervision: 13.1%
- Brochure Delivery: 15.2%
- Privacy: 10.4%
- Investment Activities: 15.3%
- Unethical Practices: 8.5%
Best Practices for Investment Advisers

• Prepare and maintain all required records, including financial records. Back-up electronic data and protect records. Document checks forwarded.
• Prepare and maintain client profiles or other client suitability info.
• Review and revise Form ADV and disclosure brochure annually to reflect current and accurate information.
• Review and update all client advisory contracts.
• Calculate and document fees correctly in accordance with contracts and ADV.
• Implement appropriate custody safeguards, especially for direct fee deduction.
• Start considering Cybersecurity policies, procedures, and measures.
• Keep accurate and current financials. File timely with the jurisdiction. Maintain surety bond if required.
• Review all advertisements, including website and performance advertising, for accuracy.
• Prepare a written compliance and supervisory procedures manual relevant to the type of business to include business continuity plan.

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