2015 Investment Adviser Coordinated Exams

North American Securities Administrators Association
Exams Overview

- 1170 routine investment adviser examinations
- January – June 2015
- 42 Jurisdictions
- 823 Advisers had AUM
- 232 had AUM > $30MM
- 591 had AUM < $30MM
- 324 first time examined by the state
Adviser Stats

- 738 advisers had 1 IAR
- 191 advisers had 2 IARs
- 97 affiliated with a BD firm
- 38 advised a pooled investment vehicle
- 414 offered financial planning services
- 95 acted as solicitors for other advisers
- 21 payed solicitors for referrals
Percent of Exams With Category Deficiencies

All Advisers with AUM >0

Percent of exams noting at least one deficiency in the category
Percent of exams noting at least one deficiency in the category.
2015 Compared to 2013 and 2011

Percent of exams noting at least one deficiency in the category

- Books & Records
- Contracts
- Registration
- Privacy
- Fees
- Custody
- Advertising
- Brochure Delivery
- Supervision
- Financials

Legend:
- Blue: 2015
- Red: 2013
- Green: 2011
AUM Comparison
All Advisers with AUM > $0

Percent of exams noting at least one deficiency in the category

- Books & Records
- Contracts
- Registration
- Privacy
- Fees
- Custody
- Brochure Delivery
- Advertising
- Supervision
- Financials

AUM < $30MM
AUM > $30MM
1 IAR vs. >1 IAR

Percent of exams noting at least one deficiency in the category

- Books & Records
- Contracts
- Registration
- Privacy
- Fees
- Advertising
- Brochure Delivery
- Custody
- Supervision
- Financials

Legend:
- 1 IAR
- >1 IAR
Books and Records

1515 Deficiencies
74.8% of Advisers with AUM

Client suitability information: 9.8%
Order memorandum: 8.3%
Written agreements (Missing one or more): 8.0%
Trial balances, financial statements: 6.6%
Inadequate WSP – Business Continuity/Disaster Recovery plan: 6.1%
Disclosure Brochures: 4.4%
General and auxiliary ledgers: 3.6%
No Supervisory/compliance (WSP) procedures: 3.4%

Other WSPs regarding professional designations, custody, and privacy
Contracts

633 Deficiencies
49.5% of Advisers with AUM

- The fee: 12.3%
- In writing: 9.6%
- The fee formula: 9.5%
- Properly executed (proper signatures and dates): 9.3%
- 48 hour rescission clause: 9.2%
- Not updated: 9.0%
- Capital gains compensation: 7.4%
- Hedge clauses: 7.1%
- Services: 6.0%
- Refund of pre-paid fees: 4.9%
- Discretionary authority: 4.3%
- Non-assignment clause: 3.6%
Registration

517 Deficiencies
41.5% of Advisers with AUM

- Form ADV - Inconsistencies between Part 1 and Part 2: 17.4%
- Timely filing of amendments: 12.8%
- Form ADV - Fee structure: 10.6%
- Form ADV - Services provided: 9.1%
- Form ADV - Business description: 8.1%
- Form ADV - Personnel: 7.5%
- Form ADV - Understated AUM: 6.2%
- Form ADV - Affiliations: 5.6%
- Unregistered adviser representative: 4.4%
- Form ADV - Conflicts of interest: 4.1%
- Form ADV - Overstated AUM: 2.9%
- Other
  - Inaccurate U4
  - Undisclosed bankruptcies and tax liens
166 Deficiencies
20.1 % of Advisers with AUM

Direct Fee Deduction: Proper client invoice (fee, time period, formula, assets in formula) 48.8%

Direct Fee Deduction: Dual invoicing client and custodian 17.5%

Beneficial Trust: Signed acknowledgement of beneficial owner 6.0%

Direct Fee Deduction: Written client authorization 4.2%

Safekeeping: Account statements from adviser – proper statements 3.6%

Other ability to obtain customer funds or securities 2.4%

Other

Invoicing replaced by calculations on customer statement from custodian

Delegation of fee notices – invoices to 3rd-party adviser

NASAA
Fees

166 Deficiencies
21.2% of Advisers with AUM

Fee charged doesn't match contract or ADV 54.8%
Unreasonable/Excessive fee (UBP) 17.5%
Charging miscalculated fees (overcharging) 12.7%
Charging undisclosed fees 5.4%
Preferential fees without reasonable justification or disclosure 4.2%
Performance fees charged to non-qualified clients 3.0%

Other
Retainer fees
Inaccurate refunds
Fees charged on large cash holdings
<table>
<thead>
<tr>
<th>Advertising</th>
<th>164 Deficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Untrue or misleading statements or omissions – qualifications, services,</td>
<td>18.8% of Advisers</td>
</tr>
<tr>
<td>or fees (UBP)</td>
<td>with AUM</td>
</tr>
<tr>
<td>Other untrue or misleading statements or omissions (UBP) (include comment</td>
<td>23.8%</td>
</tr>
<tr>
<td>and exhibit)</td>
<td></td>
</tr>
<tr>
<td>Testimonials (UBP)</td>
<td>16.5%</td>
</tr>
<tr>
<td>Insufficient website disclaimer</td>
<td>13.4%</td>
</tr>
<tr>
<td>Misuse of “RIA” or &quot;IAR&quot;</td>
<td>12.8%</td>
</tr>
<tr>
<td>Untrue or misleading statements or omissions – exaggerated claims (UBP)</td>
<td>Found in</td>
</tr>
<tr>
<td>Misleading charts, graphs, formulas or other devices (UBP)</td>
<td></td>
</tr>
<tr>
<td>Misleading use of other professional designation</td>
<td></td>
</tr>
</tbody>
</table>

- Website: 30%
- Business Cards: 13%
- Stationery: 12%
- Brochures: 10%
- Social Media: 10%
- Newsletters: 1%
Privacy

- Annual delivery of privacy policy: 50.3%
- Initial delivery of privacy policy: 21.7%
- No privacy policy: 14.0%
- Inadequate privacy policy: 11.5%
- Disclosed confidential client information without proper authorization (UBP): 2.5%

157 Deficiencies
21.5% of Advisers with AUM
Brochure Delivery

Annual offering/delivery: 63.3%
Update/Material change delivery: 23.1%
Initial delivery: 13.6%

147 Deficiencies
16.7% of Advisers with AUM
Compliance/Supervision

- Failure to have procedures to preventing the misuse of material nonpublic information (UBP) - 38.9%
- Failure to periodically assess and update compliance/supervisory program - 31.0%
- Failure to follow compliance/supervisory procedures - 27.4%

113 Deficiencies
16.0% of Advisers with AUM
<table>
<thead>
<tr>
<th>Financial Matter</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inadequate net worth (for discretion)</td>
<td>34.9%</td>
</tr>
<tr>
<td>Commingling IA records with outside business or personal accounts</td>
<td>13.2%</td>
</tr>
<tr>
<td>Inadequate net worth (for custody)</td>
<td>12.3%</td>
</tr>
<tr>
<td>Inadequate net worth (no discretion, no custody)</td>
<td>10.4%</td>
</tr>
<tr>
<td>Insufficient bond</td>
<td>9.4%</td>
</tr>
<tr>
<td>Poor financial condition</td>
<td>6.6%</td>
</tr>
<tr>
<td>Evidence of borrowing from customers (UBP)</td>
<td>4.7%</td>
</tr>
<tr>
<td>Evidence of income or expenses for investments or offerings not recorded on regular IA books/records</td>
<td>3.8%</td>
</tr>
</tbody>
</table>
Pooled Investment Deficiencies

14 Deficiencies
23.7% of all PIV Managers

- Suitability questionnaires for each investor: 21%
- Custody created by adviser serving as general partner/managing member of the fund: 21%
- Independent CPA performs annual audit (if required): 14%
- Fund fees not consistent with subscription agreement and offering document: 14%
- Performance fees miscalculated/inaccurate (overcharged): 7%
- Adviser’s brochure not provided to investors (if required): 7%
- Other violation of offering exemption (depending on specific exemption claimed): 7%
- Fund not investing according to subscription agreement and offering document: 7%
PIV Managers vs. Non-PIV Managers

Percent of exams noting at least one deficiency in the category

- **PIV**
- **Non-PIV**

Categories:
- Books & Records
- Registration
- Contracts
- Privacy
- Custody
- Financials
- Brochure Delivery
- Fees
- Advertising
- Supervision
IA Acts As a Solicitor

8 Deficiencies
5.7% of Advisers Acting as Solicitors

- Solicitor not providing its solicitor disclosure document to prospects: 37.5%
- Solicitor not providing the third party adviser’s ADV Part 2/disclosure brochure to prospects: 25.0%
- Solicitor disclosure document: Name of the third party adviser: 25.0%
- Solicitor disclosure document: No written document: 12.5%
Paying Solicitors For Referrals

12 Deficiencies
15.0% of Advisers Paying Solicitors

- Solicitor not providing its solicitor disclosure document to prospects: 16.7%
- Solicitor disclosure document: No written document: 16.7%
- Solicitor agreement: Compensation arrangement: 16.7%
- Solicitor agreement: No written agreement with each solicitor: 16.7%
- Solicitor disclosure document: Clause for any additional advisory fees charged to compensate the solicitor: 8.3%
- Solicitor agreement: Provision requiring solicitor to deliver third party adviser’s disclosure brochure: 8.3%
- Solicitor agreement: Provision requiring solicitor to comply with adviser’s instructions and applicable laws: 8.3%
- Solicitor agreement: Description of solicitors activities: 8.3%
# Financial Planning

34 Deficiencies
9.1% of Financial Planners

- Inadequate planning contract (services, fees, other terms and conditions): 32.4%
- Inadequate disclosure of planning fees: 26.5%
- No written planning contract: 20.6%
- No or inadequate disclosure of conflicts of interest: 11.8%
- Unreasonable or unfair planning fees: 8.8%
Best Practices for Investment Advisers

• Prepare and maintain all required records, including financial records. Back-up electronic data and protect records.

• Prepare and maintain client profiles or other client suitability info.

• Review and update all contracts. Make sure all fees are clearly noted and adequately explained in the contract.

• Review and revise Form ADV and disclosure brochure annually to reflect current and accurate information. File amendments in a timely manner.

• Prepare and distribute a privacy policy initially and annually.

• Calculate and document fees correctly in accordance with contracts and ADV.
Best Practices for Investment Advisers

• Keep accurate financials. File timely with the jurisdiction. Maintain surety bond if required.

• Implement appropriate custody safeguards, paying attention to direct fee deduction if applicable.

• Review all advertisements, including website and performance advertising, for accuracy.

• Provide disclosure brochure to clients initially, then provide updates and offers to deliver afterwards as required.

• Prepare a written compliance and supervisory procedures manual relevant to the type of business to include a business continuity plan.

• Keep accurate financials. File timely with the jurisdiction. Maintain surety bond if required.

• Review solicitor agreements, disclosures, and delivery procedures.