2019 Investment Adviser Coordinated Exams

North American Securities Administrators Association
Exams Overview

• 1078 routine investment adviser examinations
• January – June 2019
• 43 Jurisdictions including Ontario, Canada
• 292 IAs first time examined by the state
• 80% of US Advisers had AUM > 0
  – 67% had AUM > $30MM
  – 33 % had AUM < $30MM
Adviser Stats

• 70.2% of advisers had 1 IAR
• 19% of advisers had 2 IARs
• 63 IAs affiliated with a BD firm
• 30 IAs advised a pooled investment vehicle
• 214 IAs offered financial planning services
• 77 (36 solely) IAs acted as solicitors for other advisers
• 23 IAs payed solicitors for referrals
2019 Top Ten Deficiency Categories
US Advisers with AUM >0

Percent of exams noting at least one deficiency in the category:

- Books & Records: 59.5%
- Registration: 49.5%
- Contracts: 43.9%
- Cybersecurity: 25.8%
- Fees: 20.7%
- Brochure Delivery: 17.3%
- Financials: 17.2%
- Advertising: 17.1%
- Supervision: 16.5%
- Custody: 15.3%
Top 10 Categories – Canada
Canadian Advisers with AUM >0

Percent of exams noting at least one deficiency in the category
Comparison 2019, 2017 and 2015 Deficiencies
US Advisers with AUM >0

Percent of exams noting at least one deficiency in the category

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

*No Cybersecurity Category in 2015

- 2019
- 2017
- 2015
Books and Records

- Written agreements: 11.0%
- Trial balances, financial statements: 10.7%
- Client suitability information: 9.4%
- General and auxiliary ledgers: 8.6%
- Disclosure Brochures: 5.3%
- Bills and statements: 3.1%
- Check books, bank statements: 3.1%
- Advertising file: 3.0%
- No vulnerable persons policies/procedures: 2.4%
- No business continuity plan: 2.4%
Contracts

- The fee formula: 13.8%
- The fee: 13.3%
- In writing: 9.0%
- Other state-specific requirements: 8.9%
- Properly executed (proper signatures and dates): 7.8%
- Discretionary authority: 6.9%
- Not updated: 6.2%
- Services: 5.9%
- Hedge clauses: 5.5%
- 48 hour rescission clause: 5.3%
No or inadequate cybersecurity insurance: 11.6%
No testing of cybersecurity vulnerability: 8.6%
Security Procedures: Securing or limiting access to computers/devices: 6.4%
Security Procedures: Connecting to the internet (e.g., use of public Wi-Fi, VPN, etc.): 5.8%
Weak or infrequently changed passwords: 5.6%
Security Procedures: Maintaining hardware and software (updates, upgrades, etc.): 5.4%
No IT or technology specialist/consultant to advise on cybersecurity: 4.6%
No or inadequate protection (i.e. password or encryption) for sensitive data files: 4.6%
Security Procedures: Continued operation during a cybersecurity event: 4.4%
No contract or written agreement with technology specialist/consultant: 4.4%
Performance fees charged to non-qualified clients

Adviser unable to provide evidence of work product to justify fees

Charging undisclosed fees

Charging on non-managed assets

Unreasonable/Excessive fee (UBP)

Charging miscalculated fees (overcharging)

Fee charged doesn't match contract or ADV

Found with:
- Adviser-calculated fees
- Using 3rd-Part Managers
- Performance-based Fees
- Financial Planning Fees
Advertising

- Untrue or misleading statements or omissions – qualifications, services, or fees (UBP) 21.7%
- Testimonials (UBP) 17.4%
- Insufficient website disclaimer 11.2%
- Misuse of “RIA” or "IAR" 11.2%
- Misleading use of other professional designation 8.7%
- Other untrue or misleading statements or omissions (UBP) (include comment and exhibit) 8.7%
- Other advertising issue/concern (include comment and exhibit) 6.8%
- Untrue or misleading statements or omissions – exaggerated claims (UBP) 6.2%
- Misleading charts, graphs, formulas or other devices (UBP) 3.1%
- Untrue or misleading statements or omissions – performance advertising (UBP) 2.5%

Found in:
- Website 32.9%
- Social Media 18.0%
- Business Card/Stationery 11.2%
- Brochures/Flyers 3.7%
- Seminars 3.1%
Failure to avoid or mitigate conflicts of interest

Failure to have procedures to preventing the misuse of material nonpublic information (UBP)

Failure to follow compliance/supervisory procedures

Other issues

Failure to periodically assess and update compliance/supervisory program

Other Issues
- No business continuity plan
- No cybersecurity policies
- Inadequate procedures in various areas
Custody

- Direct Fee Deduction: Proper client invoice (fee, time period, formula, assets in formula) - 26.5%
- Direct Fee Deduction: Dual invoicing client and custodian - 19.1%
- Other issues - 9.6%
- Direct Fee Deduction: Written client authorization - 6.6%
- Safekeeping: Notice to clients (in writing) - 5.9%
- Other ability to obtain customer funds or securities - 5.1%
- Direct Fee Deduction: Notice to Administrator on ADV - 5.1%
- Safekeeping: Account statements from adviser – Independent CPA annual surprise audit - 3.7%
- Safekeeping: Notice to administrator on ADV - 3.7%

Other Issues:
- Access to client accounts using client credentials
- Standing letters of authorization
Best Practices for Investment Advisers

• Review and revise Form ADV and disclosure brochure annually to reflect current and accurate information.

• Review and update all contracts.

• 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.

• Prepare a written compliance and supervisory procedures manual relevant to the type of business to include business continuity plan and information security policies/procedures.
Best Practices for Investment Advisers  cont.

- Prepare and distribute a privacy policy initially and annually.
- Keep accurate and current financials. File timely with the jurisdiction. Maintain surety bond if required.
- Calculate and document fees correctly in accordance with contracts and ADV.
- Review all advertisements, including website and performance advertising, for accuracy.
- Implement appropriate custody safeguards, especially for direct fee deduction.
- Review solicitor agreements, disclosure, and delivery procedures.