2021 Investment Adviser Coordinated Exams

North American Securities Administrators Association
Exams Overview

- 1206 routine investment adviser examinations
- January 1 – July 7, 2021
- 289 IAs first time examined by the state
- 73% of examined US Advisers had AUM > 0
  - 62.8% had AUM > $30MM
  - 37.2% had AUM < $30MM
  - Others were solicitors or financial planners with 0 AUM
- Most exams were conducted remotely
Adviser Stats

- 68.4% of advisers had 1 IAR
- 30% of advisers had > 1 IARs
- 60 IAs affiliated with a BD firm
- 23 IAs advised a pooled investment vehicle
- 177 IAs offered financial planning services
- 62 IAs solely acted as solicitors for other advisers
- 24 IAs payed solicitors for referrals
Top 10 Categories

US Advisers with AUM >0

Percent of exams noting at least one deficiency in the category
Form ADV - Inconsistencies between ADV Part 1 and Part 2 20.50%
Form U4 – Other inaccuracies 8.52%
Form U4 – Undisclosed businesses 7.89%
Form ADV - Inaccurate Fee structure 5.87%
Non-Timely filing of amendments 5.55%
Form ADV – Inaccurate Custody 5.30%
Other registration issue 4.61%
Form ADV – Inaccurate Other businesses 4.54%
Form ADV - Inaccurate Business description 3.91%
Deficient annual offering/delivery 3.79%
Form ADV - Inaccurate Services provided 3.66%
Unregistered adviser representative 2.40%
Non-Timely filing of financials 2.40%

Other U4
Residential Hx
Prof. Designations
Employment Hx

Other Registration
Business Filing with SOS
Firm not registered in all required states
## Books and Records

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client suitability information</td>
<td>20.53%</td>
</tr>
<tr>
<td>All written agreements (client contracts plus all business agreements)</td>
<td>8.82%</td>
</tr>
<tr>
<td>Form ADV Revisions</td>
<td>7.94%</td>
</tr>
<tr>
<td>Trial balances, financial statements</td>
<td>7.38%</td>
</tr>
<tr>
<td>Order memorandum</td>
<td>6.42%</td>
</tr>
<tr>
<td>Inadequate business continuity/succession planning</td>
<td>4.65%</td>
</tr>
<tr>
<td>No business continuity/succession planning</td>
<td>4.09%</td>
</tr>
<tr>
<td>General and auxiliary ledgers</td>
<td>4.01%</td>
</tr>
<tr>
<td>Delivery and offering dates of brochures</td>
<td>3.13%</td>
</tr>
<tr>
<td>No/Inadequate: Maintenance of Books and Records</td>
<td>2.89%</td>
</tr>
<tr>
<td>Electronic storage – Stores backup copies separate from originals</td>
<td>2.73%</td>
</tr>
<tr>
<td>Checks forwarded log</td>
<td>2.57%</td>
</tr>
</tbody>
</table>
Contracts

- Fee formula is not clearly stated: 17.32%
- Contract contains impermissible hedge clause(s): 12.43%
- Contracts not in writing: 11.83%
- Contract is not properly executed (proper signatures and dates): 9.32%
- Fee is not clearly stated: 8.24%
- Other contract state-specific requirements: 7.53%
- No clause giving client 48 hours to review ADV before executing contract or 5 days to rescind...: 4.66%
- Services in contract are inconsistent with ADV: 3.58%
- Discretionary or non-discretionary authority is not clearly stated: 3.58%
- Contract does not contain a description of services to be provided: 3.23%

Other Contracts Issues:
- Contract governance
- E-communication clause
<table>
<thead>
<tr>
<th>Issue Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>No/Inadequate: Protection of Vulnerable Clients</td>
<td>17.72%</td>
</tr>
<tr>
<td>No/Inadequate: Maintenance and Review of Supervisory/Compliance Procedures</td>
<td>9.16%</td>
</tr>
<tr>
<td>Failure to follow supervisory/compliance procedures</td>
<td>7.54%</td>
</tr>
<tr>
<td>No/Inadequate: Business Continuity Plan</td>
<td>6.31%</td>
</tr>
<tr>
<td>Not current/up-to-date</td>
<td>5.19%</td>
</tr>
<tr>
<td>Not tailored to state jurisdiction</td>
<td>4.68%</td>
</tr>
<tr>
<td>Other supervisory/compliance issues</td>
<td>4.48%</td>
</tr>
<tr>
<td>No/Inadequate: Information Security Procedures</td>
<td>3.97%</td>
</tr>
<tr>
<td>No Written Supervisory Procedures</td>
<td>3.97%</td>
</tr>
<tr>
<td>No/Inadequate: Updates to Form ADV/Form U4</td>
<td>2.95%</td>
</tr>
<tr>
<td>Not reasonably designed to prevent misuse of material non-public information</td>
<td>2.85%</td>
</tr>
<tr>
<td>Not tailored to adviser’s business</td>
<td>2.65%</td>
</tr>
<tr>
<td>Other Supervisory/Compliance</td>
<td></td>
</tr>
<tr>
<td>Senior designations/certifications</td>
<td></td>
</tr>
<tr>
<td>Business Continuity Plan doesn’t address death or incapacitation of key persons</td>
<td></td>
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<tr>
<td>BCP not kept in hard copy and distributed to key personnel</td>
<td></td>
</tr>
</tbody>
</table>
Untrue or misleading statements or omissions – qualifications, services, or fees (UBP) – 22.63%
Insufficient website disclaimer – 14.70%
Other untrue or misleading statements or omissions (UBP) – 13.35%
Testimonials (UBP) – 8.32%
Untrue or misleading use of professional designation (UBP) – 3.68%
Untrue or misleading statements or omissions – exaggerated claims (UBP) – 2.90%
Misuse of "RIA" or "IAR" – 2.71%
Misleading charts, graphs, formulas or other devices (UBP) – 1.55%
Offers reports, analysis, or other services as "free" when costs or other conditions are actually... – 0.97%
Guarantees of specific results or against loss (UBP) – 0.97%
Untrue or misleading statements or omissions – performance advertising (UBP) – 0.77%

Found in:
- Website
- Business Cards/Stationary
- Social Networking Sites
- Newsletters
## Fees

<table>
<thead>
<tr>
<th>Issue</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Fee charged doesn't match contract or ADV</td>
<td>36.13%</td>
</tr>
<tr>
<td>Charging miscalculated fees</td>
<td>10.72%</td>
</tr>
<tr>
<td>OTHER Asset management fee issues/concerns</td>
<td>10.02%</td>
</tr>
<tr>
<td>Unreasonable/Excessive fee (UBP) - Higher than average asset-based fees for similar account management</td>
<td>5.59%</td>
</tr>
<tr>
<td>Unreasonable/Excessive fee (UBP) – Retainer fees, concierge fees, or other ongoing fees associated with financial planning and other services</td>
<td>3.96%</td>
</tr>
<tr>
<td>Fee charged for financial planning or other services doesn't match contract or ADV</td>
<td>2.80%</td>
</tr>
<tr>
<td>Unreasonable/Excessive fee (UBP) - Charging on non-managed assets (cash, cash equivalents, fixed income)</td>
<td>2.33%</td>
</tr>
<tr>
<td>Higher or lower fees for some clients without disclosure that fees are negotiable</td>
<td>2.33%</td>
</tr>
<tr>
<td>OTHER financial planning or other services fee issues/concerns</td>
<td>2.10%</td>
</tr>
<tr>
<td>Failure to disclose higher fees than the norm</td>
<td>2.10%</td>
</tr>
<tr>
<td>Failure to delineate asset management fee from other fees</td>
<td>2.10%</td>
</tr>
</tbody>
</table>

### Other Asset Mgmt. Fee Issues
- Fees on top of wrap fee or 3rd-party manager

### Other Financial Planning fee Issues
- Evidence of work product to justify fees
Custody

- Inadvertent Custody: Failed to keep records documenting the return of inadvertently received funds or forwarding 3rd-party checks (8.85%)
- Ability to use client identity (username/passwords) to obtain customer funds or securities without complying with custody requirements (7.21%)
- Direct Fee Deduction: Failed to dual invoice client and custodian (6.23%)
- Safekeeping: No notice to administrator on ADV that the adviser has custody (4.26%)
- Safekeeping: Account statements from adviser – No Independent CPA annual surprise audit (2.95%)
- Inadvertent Custody: Failed to either return inadvertently received funds or forward 3rd-party checks within 3 business days (2.95%)
- General Power of Attorney: Failed to follow custody requirements (2.95%)
- Safekeeping: Account statements from adviser – improper statements (2.62%)
- Other custody issues/concerns (8.85%)

Other Custody Issues

Signatory on client account Trustee/Executor
Training content did not discuss the need to protect the privacy and integrity of the individual customer of the adviser.

The adviser failed to provide the training to all appropriate personnel.

Training content was not maintained by the adviser.

No training provided regarding suspected financial exploitation of vulnerable persons.

No policies/procedures for suspected financial exploitation.
Evidence of lending to customers (UBP)
Insufficient or no bond (Adviser has custody without a waiver)
No audited financial statements (If required)
Evidence of borrowing from customers (UBP)
Inadequate net worth (Adviser has custody without net worth waiver)
Insufficient or no bond (Adviser has discretion)
Inadequate net worth (Adviser has discretion)
Poor financial condition (Insolvency or possible inability to continue operations)
Inadequate net worth (Adviser bills greater than 6 months in advance & greater than $500)
Evidence that financial statements are not prepared in accordance with GAAP
Inadequately prepared audited financial statements
Commingling outside business or personal business with the IA business accounts

Other Financial Issues
Misclassification of assets
Non-allowable assets
Omitted liabilities
Privacy

- No evidence of annual delivery of privacy policy: 30.13%
- No evidence of initial delivery of privacy policy: 17.95%
- Inadequate privacy policy: 17.95%
- No privacy policy: 15.38%
- Other privacy issues: 10.26%
- No opt-out of information sharing: 3.85%
- No opt-in to information sharing (if required in the jurisdiction): 1.92%
- Disclosed confidential client information without proper authorization (UBP): 1.92%
- No confidentiality agreements with third parties: 0.64%

Other Privacy Issues
- Transmission of confidential information via unsecure email
OK, so what now?
Recommendations to Investment Advisers

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

• Review and update all contracts. Be aware of e-communications hedge clauses.

• 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. Maintain due diligence file for recommended products or strategy.

• Prepare a written compliance and supervisory procedures manual relevant to the type of business to include business continuity plan and information security policies/procedures. 1) Policy 2) Who 3) Does what 4) How often 5) How evidenced
Recommendations to Investment Advisers

• Prepare and distribute a privacy policy initially and annually. Be aware of confidential information transmitted via unsecure means.

• 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 social media for accuracy.

• Implement appropriate custody safeguards, especially for direct fee deduction. Prepare and send appropriate fee invoices to clients.

• Add policies/procedures for seniors/vulnerable persons to include training of personnel.
Questions/Contacts

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