

OCIE to investment advisers: focus on these five problem areas

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Abstract

Purpose – *To explain a Risk Alert published on February 7, 2017 published by the Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) describing the five compliance topics most frequently identified in deficiency letters sent to investment advisers after the completion of an OCIE examination.*

Design/methodology/approach – *Discusses deficiencies noted by the OCIE relating to the Compliance Rule, required regulatory filings, the Custody Rule, the Code of Ethics Rule, and the Books and Records Rule.*

Findings – *The OCIE published the Risk Alert with its noted deficiencies only one month after releasing its exam priorities for the year.*

Practical implications – *All investment advisers should consider reviewing their compliance practices, policies and procedures in light of the deficiencies and weaknesses identified in the SEC Risk Alert.*

Originality/value – *Practical guidance from experienced lawyers specializing in asset and funds management.*

Keywords U.S. Securities and Exchange Commission (SEC), Custody Rule, Books and Records Rule, Code of Ethics Rule, Compliance Rule, Required regulatory filings

Paper type Technical paper

Only one month after releasing its exam priorities for this year, on February 7, 2017, the Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) published a Risk Alert describing the five compliance topics most frequently identified in deficiency letters sent to investment advisers after the completion of an OCIE examination.

The five compliance topics addressed in the SEC's Risk Alert are as follows:

1. Rule 206(4)-7 (the Compliance Rule) under the Investment Advisers Act of 1940. (the Advisers Act);
2. Required regulatory filings;
3. Rule 206(4)-2 under the Advisers Act (the Custody Rule);
4. Rule 204A-1 under the Advisers Act (the Code of Ethics Rule); and
5. Rule 204-2 under the Advisers Act (the Books and Records Rule).

In connection with preparing for a potential examination by the OCIE, registered private fund advisers should consider the following deficiencies noted by the OCIE:

1. The compliance rule

Use of overly generic or “off-the-shelf” compliance manuals. Compliance manuals were not reasonably tailored to the investment adviser’s business practices. For example, compliance manuals did not take into account important individualized business practices, such as: investment strategies, types of clients, trading practices, valuation procedures and advisory fees.

Annual reviews of compliance policies and procedures not performed or not properly performed. Investment advisers did not perform annual reviews of compliance policies and procedures. When annual reviews were performed: (i) reviews did not address the adequacy of the investment advisers’ policies; (ii) reviews did not address the effectiveness of their implementation; and (iii) investment advisers did not address or correct problems identified in their annual reviews.

Compliance policies and procedures not followed. Investment advisers did not perform internal reviews of their practices and failed to adhere to the marketing, expenses or employee behavior practices required by their compliance manual.

Compliance manuals not current. Compliance manuals contained information or policies that were no longer current, such as: (i) investment strategies that were no longer pursued, (ii) personnel no longer associated with the investment adviser, and (iii) stale information about the firm.

2. Required regulatory filings

Inaccurate disclosures on Form ADV Part 1A and Part 2A brochures. Investment advisers did not properly disclose: (i) investment custody information, (ii) regulatory assets under management, (iii) disciplinary history and (iv) types of clients and conflicts.

Late Form ADV filings. Investment advisers did not: (i) promptly amend their Form A DVs when certain information became inaccurate, or (ii) timely file their annual updating amendments.

Incorrect Form PF filings. Investment advisers did not complete Form PF accurately.

Incorrect and untimely Form D filings. Investment advisers did not accurately complete and timely file Form Ds on behalf of their private fund clients.

3. The custody rule

Advisers did not recognize that they may have custody as a result of certain authority over client accounts. Investment advisers frequently did not recognize that they may have custody over client accounts as a result of having (or related persons having) powers of attorney authorizing them to withdraw client cash and securities. Other examples of custody that appeared frequently unrecognized include when investment advisers or their related persons: (i) served as trustees of clients’ trusts or (ii) served as general partners of client pooled investment vehicles.

For advisers not relying on the audit exemption: surprise audit examinations did not meet the requirements of the Custody Rule. When independent public accountants performed surprise examinations, investment advisers did not provide a complete list of accounts over which the investment adviser has custody or otherwise provide information to permit the accountants to timely file accurate Form ADV-Es. OCIE also observed indications that surprise examinations may not have been conducted on a “surprise” basis (e.g., exams were conducted at the same time each year).

4. The code of ethics rule

Access persons not identified. Investment advisers did not identify all of their access persons (e.g., certain employees, partners or directors) for purposes of reviewing personal securities transactions.

Untimely submission of transactions and holdings. Access persons submitted transactions and holdings less frequently than required by the Code of Ethics Rule.

Codes of ethics missing required information. Codes of ethics did not: (i) specify the review of the holdings and transactions reports, or (ii) identify the specific submission timeframes.

No description of code of ethics in Form ADVs. Investment advisers did not: (i) describe their codes of ethics in their Form ADVs (Part 2A), or (ii) indicate that their codes of ethics are available to any client or prospective client upon request.

5. The books and records rule

Failure to maintain all required records. Most commonly, investment advisers did not maintain: (i) trade records, (ii) advisory agreements and (iii) general ledgers.

Books and records were inaccurate or not updated. Books and records had errors and omissions, such as: (i) inaccurate fee schedules, (ii) inaccurate client records and (iii) stale client lists.

Inconsistent recordkeeping. Investment advisers maintained contradictory information in separate sets of records.

6. Next steps for investment advisers

As an investment adviser starting to prepare your annual updating amendments to Form ADV and conduct your annual compliance reviews, you should consider whether your compliance programs need improvements in any of these areas. All investment advisers should consider reviewing their compliance practices, policies and procedures in light of the deficiencies and weaknesses identified in the SEC Risk Alert. Where advisers observe deficiencies in their own practices adjustments should be made. A copy of the SEC's Risk Alert entitled "*The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers*" may be found at www.sec.gov/ocie/Article/risk-alert-5-mostfrequent-ia-compliance-topics.pdf

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