

## Compliance can save a firm trouble by checking answers provided on DDQs/RFPs

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Many firms maintain a library of pre-approved answers that can be inserted into an incoming due diligence questionnaire (DDQ) or request for proposal (RFP). This technique punctuates the importance of being careful in completing such disclosures, as attested to by recent enforcement cases.

The Chicago firm [Calhoun Asset Management](#) no longer exists ([IA Watch](#), July 16, 2012), in part because it fibbed on due diligence questionnaires. The [Form ADV brochure](#) of **Aletheia Research and Management** in Santa Monica, Calif., contains the entire SEC enforcement order in a case involving the failure to completely disclose its exam history to clients. The enforcement action may have affected the firm's AUM, which has plummeted from \$7.2B to \$4.2B. The firm didn't respond to [IA Watch's](#) inquiry.

A charge of failure to disclose information on a compliance questionnaire dearly cost former **Morgan Stanley** reps **John** and **Kathleen Mullins** in an [enforcement case](#) earlier this year.

"The bar is higher" now because of heightened attention by the SEC on disclosures, says **Helene Morrison**, GC/CCO at **Hall Capital Partners** (\$22B in AUM) in San Francisco. "Compliance people have to be ultra sensitive to the environment," she says.

"Any document that leaves the firm that goes to an investor or prospective investor ... undergoes compliance review," says a New York CCO, who repeated what many of her peers said: they treat DDQ/RFP responses as advertisements. "There is nothing that leaves this office that doesn't pass my eyes," she adds.

### Customized questionnaires

Potential investors are sharing individualized DDQs or RFPs that are challenging RIAs that have relied on their libraries of canned and compliance-approved answers. "I think that's the trend," says **Porter Durham**, COO/GC with **Global Endowment Management** (\$3.5B in AUM) in Charlotte, N.C. Investors are taking the answers provided by various firms that they queried, pouring them into a spreadsheet and comparing the responses before selecting an adviser, he adds.

Global's pre-approved DDQ answers "have been vetted and cleared through compliance," says Durham. Any new answers taken from the library and tweaked prompts a return to compliance. "It's as if it's been reviewed and approved twice," he says.

**CBRE Clarion Securities** (\$19B in AUM) in Radnor, Pa., also maintains a "response directory," says CCO **Robert Tull**. Various departments create the answers - the operations team drafts the operations responses, the investment team completes the investment answers, etc. "They're reviewed by compliance and approved," he says. "Then the completed RFP comes back to compliance for a full review and approval." Besides an edit for correct responses, compliance also makes sure each question is being answered "in its fullest context."

"You have to be exact but you can't be misleading at the same time," states **Jason Daniel**, senior counsel with **Akin Gump** in Dallas. "You can't lead the reader to an incorrect conclusion."

This can be a challenge. Write clearly and straightforwardly, counsels Hall Capital's Morrison. Daniel suggests you expunge modifiers and adjectives that could spark trouble. For instance, some RIAs may answer, in response to a question about past SEC exams, that "there were no significant deficiencies." Who's to determine what's meant by "significant"?

### Exam answer

"We refuse to" provide a summary of the firm's last exam when asked, says Tull. The firm uses stock language that tells the reader the dates of the last exam and that it has concluded. "We won't even tell them" that it was a routine exam with no findings. Instead, the reader is informed that the firm would share the exam correspondence should the person wish to schedule a due diligence visit.

If you have a history of regulatory issues, be honest about it, says a CCO at another Pennsylvania firm. "I take the time to write a good explanation" that presents the facts but also puts the firm in the best light by emphasizing compliance's response to the situation, says the CCO. The punishment for being caught in a lie is too great, she says. You'll never get their business again and word could spread throughout the industry, dooming your firm, she adds.

"At the end of the day, if you can't answer the question truthfully, maybe it's an opportunity you want to pass on," says **Rob Seco**, CCO at **HPM Partners** (\$2.5B in AUM) in New York. Sometimes, as a compliance officer, you must "throw yourself on your sword" and tell the business people that they can't respond to an RFP, he says.

Some questioners request client or staff names, says Durham. The firm informs the requester that the information could be shared only if the person signs a confidentiality agreement. "I think that's always a good procedure," he says. "That allows for controlled transparency."

The New York CCO struggles with questions about the expense ratio for the firm's new fund and

whether it has ever been contacted by the SEC. It answers yes to the latter question, adding that the correspondence only confirmed the RIA's new registration.

"I encourage people to say more" than just answer what was asked, recommends **Michele Gibbons**, of counsel at **Jones Day** in Houston. Don't forget to include your typical disclaimers that you have inserted into other documents, e.g., your Form ADV. "When they answer on the RFP, they forget that," she says. "It's fodder for the SEC examiners to say 'this was inaccurate.'" Like an advertising piece, double-check your numbers and put documentation in your files to verify the information provided, she continues.

If marketing hassles you over your stance, take the issue upstairs, suggests Seco. Gibbons says you "can wave these enforcement actions" in their faces to stress the importance of proper disclosure. With work, you can meet marketing's needs as well as your own, believes Morrison.

Don't forget to review your library of canned responses from time to time to ensure they remain current, offers **Michelle Kennedy** with **Compass Compliance Services** in Greenville, S.C.

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