

REGULATORY COMPLIANCE Watch

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FOR FINANCIAL SERVICES PROFESSIONALS

A rundown of hot topics being displayed in recent SEC exams

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'Tis the season for joy – and it seems OCIE exams of advisers. We've heard the same thing from many people across the country over the last few weeks: **SEC** examiners are busy.

There has been a "huge uptick in exams" recently, says a compliance consultant on the east coast, echoing the views of others. Many of these exams have been so-called "correspondence" reviews, in which examiners don't visit onsite but ask questions from afar and request multiple documents, says **Janaya Moscony**, president of **SEC3 Compliance Consultants** in Philadelphia.

Perhaps all this activity launched before the SEC's FY 2016 ended helped OCIE hit its 11% exam target for the year ([IA Watch](#), Nov. 17, 2016).

A CCO at a hedge fund advisory firm in New York notes that his ongoing exam has been led by examiners based in the Big Apple, while a nearby peer got visited by a Washington, D.C.-based exam team. The "general themes of the exams are similar," says the CCO, adding examiners are focused on expenses, valuation and compliance P&Ps. Oddly, he's received no questions about cybersecurity.

Examiners are hitting advisers hard about their due diligence of service providers, a lesson from the **F-Squared** case ([IA Watch](#), Sept. 1, 2016). They're asking "very exacting questions" about what the adviser does to judge its business partners, says **Michelle Jacko**, managing partner of **Jacko Law Group** and CEO of **Core Compliance & Legal Services** in San Diego. Examiners are applying even more intense pressure about due diligence to private fund advisers, she stresses.

Jacko also confirms what other sources have told us – that the SEC has issued subpoenas to some private fund valuation firms as the agency looks into their methods of valuing assets.

Big data at work

Another trend being reported is the Commission's inquiry into specific investments. **Chuck Daly**, principal of **Constellation Advisers** in Princeton, N.J., cites three recent cases. One targets an entity on the other end of a specific trade while the other two appear to be looking for signs of potential insider trading at advisory firms.

"The staff is finally learning to interpret the mountains of data that they're taking in through [Form] 13H and through broker reporting," Form PF and other reports, says Daly. These data are spurring "forensic investigations," he analyzes.

It could take some advisers by surprise to receive a call from the Enforcement Division questioning the reasons behind a specific trade. The takeaway is to be able to share documentation supporting your trades.

"There's no script to this," says Daly. He tells of one client who uses software to record trades and had quick and ready access to answer the SEC inquiry. Another client lacked written documentation and struggled to impress its questioners.

Advisers Act [rule 204-2](#) (books and records) suggests trading records to keep, which we've itemized in the past ([IA Watch](#), April 21, 2014).

Daly recommends you maintain a research file on each security purchased. Be consistent in what you place in

these files. "Whatever you feel is informative," he says. If you elect to rely on written notes or to print out Internet information, date these documents, he adds.

Brexit sweep

Another CCO at a New York firm reports the SEC conducted a quick sweep exam after the UK Brexit vote. The interest was directed at firms that trade in funds likely to be most affected by Britain leaving the EU. She also states that some examiners are calling firms out of the blue and describing a cybersecurity scenario and testing the CCO on the spot for how the firm would respond to such an occurrence.

The homework examiners do on firms before an exam shows in a new way, according to **Michelle Kennedy**, a consultant with **Compass Compliance Services** in Greenville, S.C. At the start of exams, "they're naming the people they want to talk to," she says. The requested interviews seem based on a firm's org chart. Kennedy also says examiners are "picking broader topics" to explore, "things that we haven't seen in the past," such as operations and research. In a few cases, the examiners leave the firm after their interviews conclude.

For one California CCO, the exam's spotlight shone on asset verification. This can place CCOs in a difficult spot. Be aware that a client's custodial bank may ignore examiner requests to verify assets because the SEC isn't the bank's regulator. The advisory firm holds little sway over the bank as well since its customer is the adviser's client, not the firm.

A CCO at a firm in the south leaves his recent exam with this advice for you: move toward electronic documents. Examiners preferred these over paper records and be careful how you calculate your AUM. Another takeaway: If you don't have a full cybersecurity P&P yet, point to your BCP.

Here are other takeaways from recent OCIE exams:

- ✓ Strike non-disparagement clauses in separation agreements. Examiners could read these as conflicting with the whistleblower rule's intent that staff be free to report potential wrongdoing to the agency.
- ✓ Expect a deficiency if you lack adequate records to support the RAUM reported in your Form ADV.
- ✓ Be sure fee disclosures match across your various documents.
- ✓ Disclose in your Form ADV any soft dollar benefits you receive. Sources tell us the enforcement division has launched a sweep looking at **Pershing's** use of soft dollars to help a new adviser breaking away from his brokerage firm purchase software.

New to our **Compliance Toolbox**: A source shares a copy of the SEC's so-called "["Unicorn" sweep exam letter](#)". This went to mutual fund advisers and inquired about their holdings in some big pre-IPO entities, such as **Uber** and **Snapchat**.

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