Compliance Advisor Professionals, LLC ™

Investment Advisor Training Module

Regulatory Exams

What to Expect and How to Prepare

Speaker Biography

Ellen M. Bruno, CPA/PFS, CGMA
Compliance Advisor Professionals, LLC

Ellen M. Bruno is President of Compliance Advisor Professionals, LLC. She leads CAP's compliance consulting services to the Investment Adviser Industry. Ms. Bruno is a Certified Public Accountant, Personal Financial Specialist, and a Chartered Global Management Accountant. She has been involved in the securities industry for over thirty-two years and has extensive experience in the areas of compliance, risk management, back-office operations, finance, and accounting.

She is the former Chair and a current a member of the Legislative/Regulatory Task Force of the Personal Financial Planning Executive Committee of the American Institute of Certified Public Accountants (AICPA). She is a member of the AICPA, the Massachusetts Society of Certified Public Accountants, and the National Society of Compliance Professionals, where she currently serves on the Education Committee. She previously served on the AICPA Personal Financial Planning Executive Committee. She is frequently invited to speak on securities industry compliance matters and investment adviser compliance regulations. Ms. Bruno holds a BS in Management / Accounting from the University of Massachusetts.

Topics to be Covered

- **Overview**
- Current Exam Landscape
- Who Gets Examined
- Types of Exams
- Purpose and Scope of Exams
- Preparation and Management of the Exam
- Exam Focus and Common Deficiencies
- Potential Exam Outcomes
- Additional Resources

Regulatory Exam Overview

- Who, What, Why, Where, When and How

NASAA

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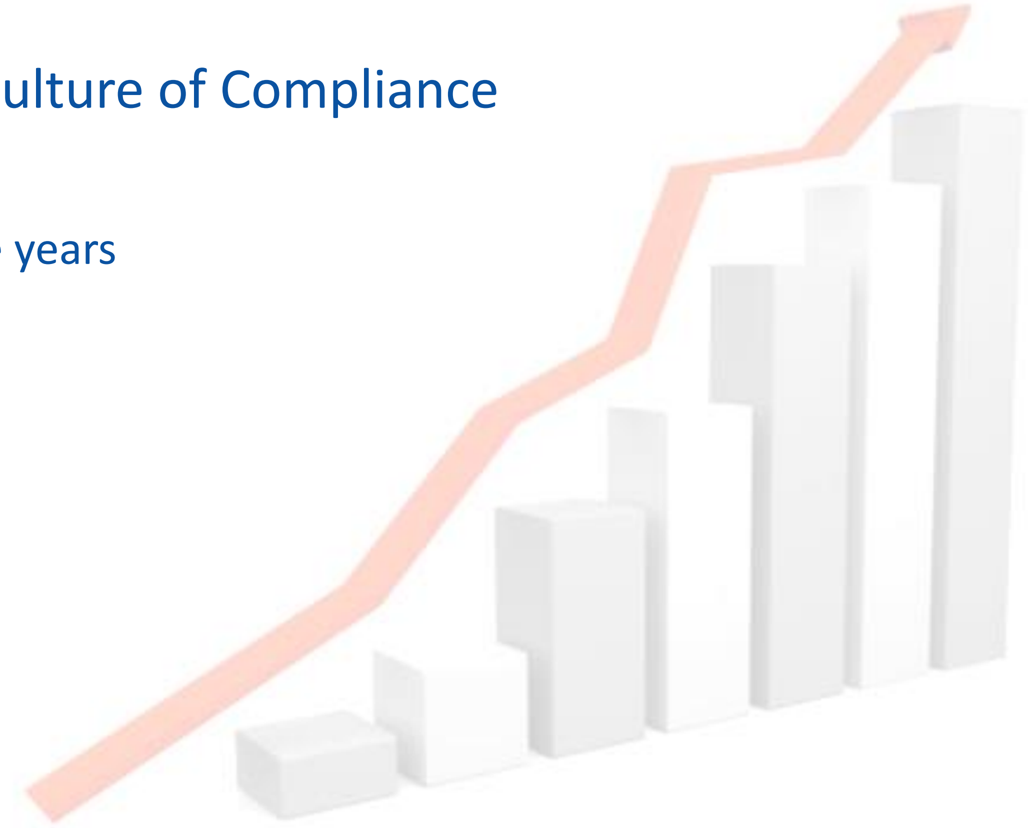
Current Exam Landscape

- SEC OCIE Name Change
- Commitment to Goal of Industry-Wide Culture of Compliance
- Industry Shift to Independence
  - ✓ Increase in RIAs from 12K to 13.9K in just five years
  - ✓ Oversight of nearly $100TN in AUM
  - ✓ Challenges faced by Regulators
    - ✓ Staffing
    - ✓ Pandemic



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Who Gets Examined/How is Information Gathered

- Risk Assessment
  - ✓ New Firm
  - ✓ Never Before Examined
  - ✓ Years Since Last Exam
  - ✓ New Disclosures/Enforcement Action
- Quantitative Analysis
  - ✓ Type of Firm
  - ✓ Size of Firm
  - ✓ Lines of Business

Who Gets Examined/How is Information Gathered

- Information Gathering
  - ✓ IAPD
  - ✓ Form ADV Part I
  - ✓ Regulatory Form Filings – 13F, U4s
  - ✓ Online
    - Websites
    - Social Media
    - LexisNexis
    - Google

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Type of Exams

- Full On-Site Exam
- Limited
  - ✓ Onsite
  - ✓ Offsite
- “For Cause”
- Presence/Sweep
  - ✓ Emerging Threats
    - ✓ Cybersecurity
    - ✓ Privacy
  - ✓ Updated Requirements
    - ✓ Form CRS
    - ✓ State-specific requirements (i.e., published fee schedules)

Topics to be Covered

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- **Purpose and Scope of Exams**
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Purpose and Scope

Why Exams Exist

- Keeping the Industry up-to-date on Emerging Threats
- Ensure Adequate Understanding of Rules/Regulations, Industry-Wide
- “Setting the Tone at the Top”
- Detection of Potential Violations
- Identifying Issues Before they Become Endemic

Purpose and Scope

Why Exams Exist

- Ever-Evolving Product Landscape
  - ✓ New Products
  - ✓ New Suitability
  - ✓ New Guidance
- Ever-Evolving Technology
  - ✓ How Business Gets Done
  - ✓ Overall Investment Environment
  - ✓ Industry Communication
- Ever-Changing Rules
  - ✓ Based on Examination Findings
  - ✓ Clarifying/Exemplifying
  - ✓ Determining whether to amend, draft or guide

Purpose and Scope

Why Exams Exist

- Taking Industry Temperature
  - ✓ Awareness
  - ✓ Engagement
  - ✓ Understanding
- Protect the Public
  - ✓ Not Always Seeking Bad Actors
  - ✓ Ensuring Consumer Understanding
  - ✓ Guiding Advisor Understanding
- Gather Information

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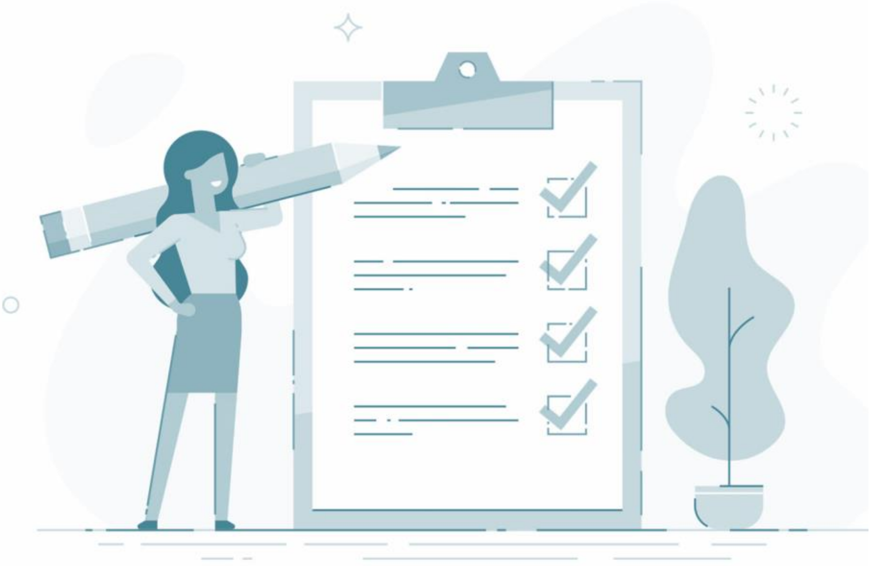
Preparation and Management of the Exam

Notification of Exam (unless Unannounced)

- Initial Call, then Email/Written Notification
- Examination Request List to Follow
- Questions to Ask upon Receipt:
  - ✓ Expectations for Timing – Arrival/Commencement
  - ✓ Exam Period – Dates to be Covered by Exam
  - ✓ Expected Duration of Exam
  - ✓ Location of Exam (on- or off-site)

Preparation and Management of the Exam

What to do when the Regulator Arrives



- Designate a Primary Liaison: Chief Compliance Officer
  - ✓ Engage – Be Available, Proactive and Communicative
  - ✓ Be Prompt and Respectful
- Notify Staff of Expectations
  - ✓ Behavior/Availability
  - ✓ Participation Requirements/Urgency
  - ✓ Information (Discussed/Provided)
- Request Examination Request List (if not provided prior to arrival)
  - ✓ Review and Understand
  - ✓ Triage to Create Consistent Review Workflow for Regulator

Preparation and Management of the Exam

Requested Documents

- Organization Chart
  - ✓ Current Personnel
  - ✓ Terminated/Resigned Personnel
- Corporate Financial Documents
  - ✓ General Ledger, Balance Sheet, Trial Balance, etc.
  - ✓ Loan Documents (Granted or Received – Including PPP Loans)
  - ✓ Bank and/or Brokerage Statements for Advisers
  - ✓ Revenue and/or Expense Sharing Agreements
- Litigation Records
  - ✓ Corporate Entity
  - ✓ Advisers/Executives/Owners
  - ✓ Any Supervised Persons

Preparation and Management of the Exam

Requested Documents

- Committee List
- Joint Ventures
- Outside Business Activities
- Affiliated/Unaffiliated Key Service Providers
- Subadvisors

Preparation and Management of the Exam

Requested Documents

- Current Regulatory Filing Documents
  - ✓ ADV I
  - ✓ ADV 2
  - ✓ ADV 2A – Wrap Brochure
  - ✓ ADV 2B for All Supervised Persons
  - ✓ Form CRS
  - ✓ Fee Schedule (as required on a state-by-state basis)
  - ✓ Privacy Policy
  - ✓ U4s/U5s

Preparation and Management of the Exam

Requested Documents

- Three-Pegged Stool
  - ✓ Compliance Manual and/or Policies and Procedures Manual
    - ✓ Annual Personnel Attestation
  - ✓ Code of Ethics
    - ✓ Quarterly Personnel Forms
  - ✓ Business Continuity Plan + Evidence of Testing

Preparation and Management of the Exam

Requested Documents

- Security Documents
  - ✓ Cybersecurity Policy + Evidence of Audit/Testing
  - ✓ Written Information Security Policy
    - ✓ Annual Personnel Attestation
  - ✓ Risk Assessment

Preparation and Management of the Exam

Requested Documents

- Documents Pertaining to Clients, Including:
  - ✓ Complete Client List with Account Types and Inception Dates
  - ✓ Advisory Fee Rates by Account/Household
  - ✓ Status as Wrap Account
  - ✓ eDelivery Authorizations where Applicable
  - ✓ Discretionary Trading Authority Status + Limited POA, as Applicable
  - ✓ Trusteeship/Executorship/Full POA of Company Personnel on Client Accounts
  - ✓ Custody/Possession Status
  - ✓ Statement Attestation by Account Custodian
  - ✓ Written Investment Strategy and Account Portfolio Manager
  - ✓ Account Values + How Value is Determined for Billing Purposes
  - ✓ Records Pertaining to the Assessment of Performance Fees
  - ✓ Additional Information as Requested

Preparation and Management of the Exam

Requested Documents

- Lost Advisory Client List + Reason for Termination
- Trade Blotter
- List of Trading Errors
- Securities/Holdings List
- Employee/Personnel-Related Trading Records
- Log of Principal and/or Cross-Agency Transactions

Preparation and Management of the Exam

Requested Documents

- Company Agreements:
  - ✓ Custodial
  - ✓ Advisory
  - ✓ Discretionary Trading Authority
  - ✓ Financial Planning
  - ✓ Referral
  - ✓ Solicitor
  - ✓ Soft Dollar Arrangements

Preparation and Management of the Exam

Requested Documents

- Marketing and Advertising Records + Social Media
- Third-Party Service Provider List + Evidence of Due Diligence Reviews
- Records Relating to Company or Personnel Non-Compliance
- Records of Internal Annual Compliance Review Meeting

Preparation and Management of the Exam

Delivering Documents

- Understanding Delivery
  - ✓ Consider the Purpose of the Request
  - ✓ Know what Constitutes full Delivery of the Requested Document
- Formatting
  - ✓ Keep it Simple
  - ✓ “Native Format”
  - ✓ Naming Scheme
  - ✓ Neatly Organized
- Encrypted Electronic Delivery Options
  - ✓ SEC kiteworks Secure Delivery System
  - ✓ Secure Email
  - ✓ Other Secure Method as Determined

Preparation and Management of the Exam

Delivering Documents

- Not Applicable Responses
  - ✓ No Documentation Available
  - ✓ Does Not Apply
  - ✓ Identify Items and Provide Thorough Rationale
  - ✓ Must Respond to Every Item

- Submission Guidelines
  - ✓ Request FOIA Confidentiality Treatment
  - ✓ Bates Numbering
  - ✓ Additional Labeling of PDF Documents
  - ✓ Privilege Claims

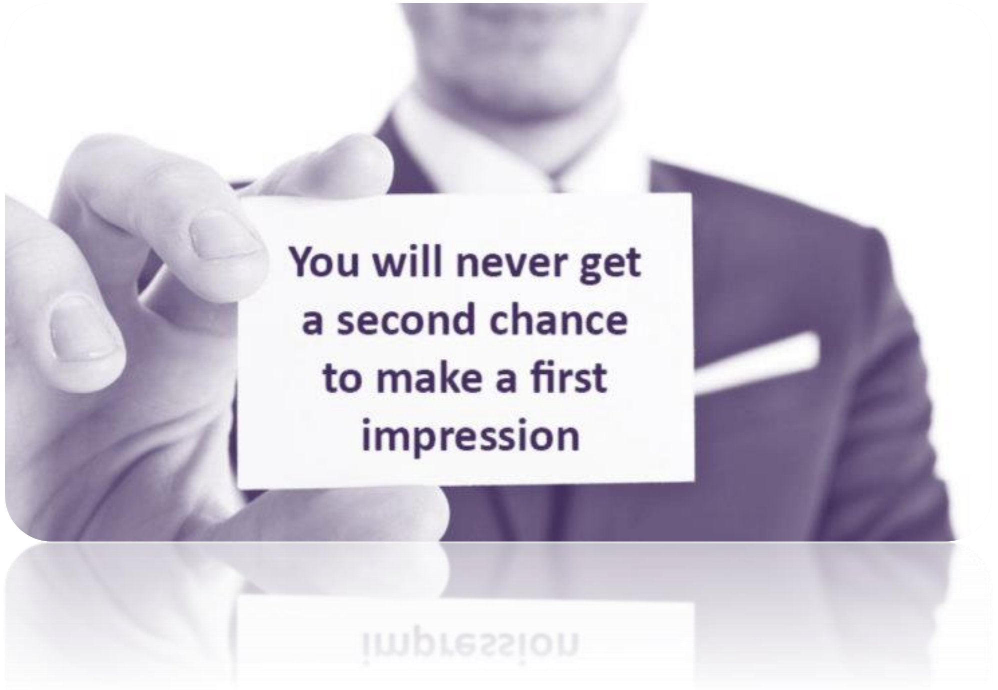
Preparation and Management of the Exam

First Impressions – Day One of the Exam

- Introduction of Parties Involved
  - ✓ Provide Brief Presentation, Memo or Narrative to Examiner
    - Offer Organizational Chart
    - Outline Products and Services Offered

- Setting the Tone at the Top – The Interview Process

- CCO/Senior Management Demonstrate "Culture of Compliance"



Preparation and Management of the Exam

First Impressions – Day One of the Exam

- Set the Ground Rules for Interaction with Examination Staff
  - ✓ Establish Location for Examiner/Team away from Business Operations
  - ✓ Primary Liaison to Serve as Main Point of Contact
  - ✓ Primary Liaison to Engage Frequently with Examiner/Team
  - ✓ Company Personnel Expectations for Professionalism
    - Language
    - Dress
    - Responding to Requests
  - ✓ Provision of ONLY the Information Requested

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Exam Focus and Common Deficiencies

Company Compliance Program

- Three-Pegged Stool
  - ✓ Compliance Manual
  - ✓ Code of Ethics
  - ✓ Business Continuity Plan

- Security Documents/Procedures
  - ✓ Written Information Security Plan
  - ✓ Cybersecurity Program
  - ✓ Annual Compliance Meeting

Exam Focus and Common Deficiencies

Company Compliance Program

- Disclosure Documents
  - ✓ Accuracy
  - ✓ Completeness
  - ✓ Timeliness of Filing
  - ✓ Evidence of Delivery:
    - ADV 1 and 2
    - Wrap Program Brochure, if Applicable
    - Form CRS
    - Privacy Policy

Exam Focus and Common Deficiencies

Advertising and Marketing

- Internet Presence and Passive Marketing
  - ✓ Website Content + Evidence of Compliance Review
    - Third-Party Websites that Contain Performance/Marketing Information
    - If Login Required to Access Client Content, Provision of Temporary Login to Examiner
  - ✓ Social Media – Corporate/Personal
    - Electronic Captures of "Communication"
    - Evidence of Review of Static Content
    - Review of Personal Social Media for All Personnel

Exam Focus and Common Deficiencies

Advertising and Marketing

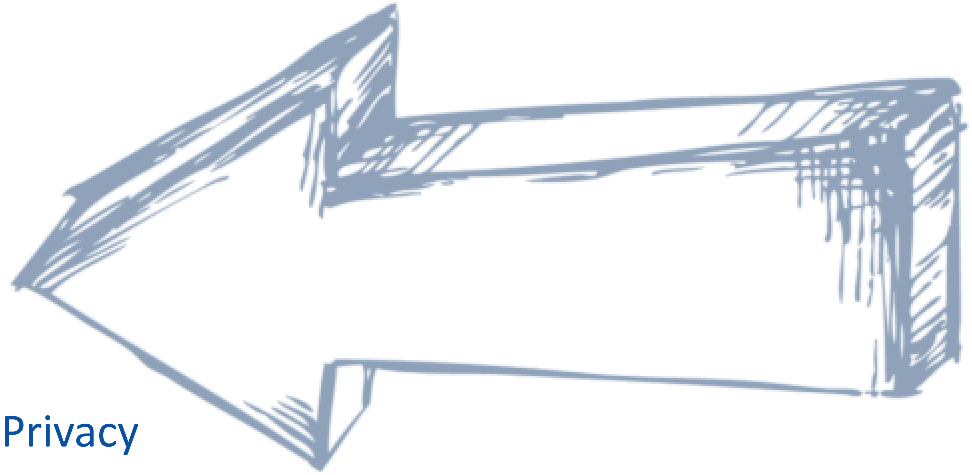
- Material Facts Guideline + Demonstrated Understanding

- "Published" and Active Marketing
  - ✓ Pitch Books
  - ✓ Newsletters + Annotated Reviews/Disclosures
  - ✓ Performance Reporting + NET Performance
  - ✓ Use of Redacted Client Statement for Presentation Purposes
  - ✓ Testimonials
  - ✓ Disclosures
  - ✓ Cold Calling Scripts + Do Not Call List
  - ✓ Presentations, Seminars and Workshops
  - ✓ RFP Responses

Exam Focus and Common Deficiencies

Annual Exam Priorities

- Published Annually
- Informed by Prior Exams
- Emerging and Evolving Guidelines
  - ✓ 2021: Regulation Best Interest and Form CRS
  - ✓ 2021: Fiduciary Duty, Duty of Care, Loyalty
  - ✓ 2021: COVID Pandemic and Business Continuity Plans
  - ✓ 2021: Heightened Cybersecurity Risks, Data Protection, Privacy



Exam Focus and Common Deficiencies

Ongoing Exam Priorities

- Trading, Investments and Client Suitability
  - ✓ Adequate Documentation of Client Objectives and Suitability
  - ✓ Adequate Documentation of Security Valuation
  - ✓ Meme Stocks, Cryptocurrency, Microcap Securities and Highly Speculative Investing
  - ✓ ETF Risk Disclosure (Particularly Highly-Leveraged)
  - ✓ Allocation of Limited Investment Opportunities/IPOs
  - ✓ Record of Best Execution Reviews
  - ✓ Disclosure of Soft Dollar Arrangements

Exam Focus and Common Deficiencies

Ongoing Exam Priorities

- **Client Notes, Profiles and File Information**
  - ✓ Incomplete
  - ✓ Non-Existent
  - ✓ Out-of-Date
- **Fees and Billing**
  - ✓ Documented Review of Accuracy
  - ✓ Documented Fee Exceptions where Inconsistencies Exist
- **Agreements and Contracts**
  - ✓ Applicability and Accuracy
  - ✓ Presence and Consistency

Exam Focus and Common Deficiencies

Ongoing Exam Priorities

- ADV Disclosures
  - ✓ Up-to-Date and Accurate
  - ✓ Full Disclosure of Necessary Information
- Custody
  - ✓ Trustee or Executor
  - ✓ Check Writing Authority
  - ✓ Password Access
  - ✓ SLOAs
- Solicitor’s Arrangements
  - ✓ Transparency
  - ✓ Documented Client Disclosure

Exam Focus and Common Deficiencies

Ongoing Exam Priorities

- Books and Records
  - ✓ Immediate Accessibility
  - ✓ Retention Time Periods
  - ✓ Retained Formats
- Supervision
  - ✓ Remote or Satellite Offices
  - ✓ Home Office Environments
    - Privacy
    - Security
    - Network Access

Exam Focus and Common Deficiencies

Ongoing Exam Priorities

- Anti-Money Laundering Programs and Education
  - ✓ Adequate Documentation of Education
  - ✓ Evidence of Independent Testing
  - ✓ Evidence of CIP and SAR Filing Obligations
    - New and Ongoing Client Relationships
  - ✓ Evidence of Client/Customer Due Diligence

Exam Focus and Common Deficiencies

SEC vs. State Securities Authority

- SEC
  - ✓ Broad Industry Rules and Regulations
  - ✓ “Universality” of Application

- States
  - ✓ Unique Guidelines
  - ✓ May be More Stringent OR Lax
  - ✓ May Pattern off of SEC Regulations

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Potential Examination Outcomes

- Exit Interview
  - ✓ Best Possible Outcome
  - ✓ Largely a Summary of Examination
  - ✓ Little, if any Follow-Up

Potential Examination Outcomes

- Deficiency Letter
  - ✓ Respond Promptly and Completely
    - Include Evidence of Corrective Action
    - Bring Errors/Inconsistencies to Light
  - ✓ Follow Through on Any Responding Requests

- For Accepted Deficiencies
  - ✓ Explain Circumstances
  - ✓ Outline Planned/Taken Remedial Measures

- For Contested Deficiencies
  - ✓ Outline Validation for Contesting
  - ✓ Provide Legal Arguments/Law or Regulation Interpretation

Potential Examination Outcomes

- Administrative Proceeding
  - ✓ Formal Multi-Stage Inquiry
- Enforcement
  - ✓ Understanding of Fines, Censures, Sanctions or Other Punishments
  - ✓ Recognition of Terms to Regain Good Standing, if Possible

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Additional Resources

Where can an Advisor Obtain Additional Information?

- SEC Division of Examinations – Additional Information:
  - https://www.sec.gov/exams
  - https://www.sec.gov/files/2021-exam-priorities.pdf
- Information for Newly-Registered investment Advisers:
  - https://www.sec.gov/about/offices/ocie/iainfo.htm
- NASAA Links:
  - https://www.nasaa.org/industry-resources/investment-advisers/
  - https://www.nasaa.org/wp-content/uploads/2021/09/2021-Coordinated-IA-Exams-Public-Final-9-10-21.pdf

In Closing

- If you have questions about any of the information contained in this training module, please contact your Chief Compliance Officer

- If you have suggestions for future web-based training module topics, please email Ellen Bruno at info@complianceadv.com