

REGULATORY EXAMS

Are you prepared?

The investment advisory industry is highly regulated and member firms should expect to be examined every 3 to 5 years. Regulatory agencies, such as the SEC or FINRA, can conduct an exam at any time or for any reason. However, most exams are routine in nature and follow a very specific pattern from start to finish.



Introduction

Cipperman Compliance Services, LLC (“Cipperman”) provides chief compliance officer services to money managers, broker-dealers, registered funds, and private equity firms. Cipperman has grown to be one of the largest and most experienced teams of compliance professionals focused exclusively on the investment management industry.

Our professionals include senior lawyers and experienced compliance professionals who have real-world compliance experience and have been through several dozen regulatory exams.

We have outlined some best practices and pointers that if followed, should help you and your firm to a smooth, stress-free exam.

Please also visit our website or click to view the [video series](#).



**Freedom to
Accelerate.**

Our Services

CHIEF COMPLIANCE OFFICER

RELATIONSHIP MANAGER

POLICIES & PROCEDURES

ANNUAL REVIEW

COMPLIANCE CALENDAR

REGULATORY FILINGS

ADVICE, GUIDANCE & SUPPORT

EMPLOYEE LICENSING

CODE OF ETHICS

MARKETING MATERIALS

EDUCATION & TRAINING

EMAIL REVIEW

COMPLIANCE COMMITTEE

REGULATORY EXAMS

RISK ASSESSMENT

CYBERSECURITY

ON-SITE TESTING

Announcement & Initial Notification of Exam

The Chief Compliance Officer is typically notified by a phone call from the regulator’s exam staff. The phone call is then followed up with a letter that outlines the timeline of the exam and contains a request for documents and information. Upon notification to senior management, your firm’s initial reaction may be:

Why is my firm being examined? Although the examiners rarely let you know why your firm is being examined, here are a few reasons— newly registered or never examined firm, risk-based selection, targeted exam from whistleblower complaint or regulatory reason, or industry sweep on a topic specific to your firm.

How should I respond to the request for information? First, perform a cursory review of the documents being requested and determine if there is a consistent theme. This will help you frame your answers accordingly. Secondly, assess the timeline and ensure that the timeline and deadlines are manageable. Next, assign a gatekeeper as the primary person to exchange data with the exam team. Be sure you clearly understand the what the examiners are asking for; provide answers and information that directly address their request. Also, ensure that the gatekeeper has identified the best person to provide answers or information.

BEST PRACTICES FOR REGULATORY EXAMS

Make a Good First Impression

Empower CCO

Articulate Your

Compliance Competency

Demonstrate Strong

“Tone at the Top”

Anticipate Follow-Ups

Educate & Prepare

Employees

**ORGANIZE RESOURCES TO
DISCUSS CYBERSECURITY**

Deliver Direct &

Timely Responses

*Understand Conflicts
of Interest*

Perform Quality Control Review of Documents & Information Provided

Our Mission

An element of our mission is to prepare each of our clients for the inevitable regulatory exam.

Our goal is to demonstrate to the regulator that we have taken compliance seriously, implemented the necessary policies and procedures, and stress test those procedures every year.

We also want to show robust ongoing monitoring.



Managing the Exam

Once the exam has kicked off, you must have a plan as to how the exam will be managed. This includes the coordination of any meetings, onsite visits, deadlines, etc.

Develop Agenda with Examiners. Determine what hours the exam team will be in the office and who will be onsite. Establish protocol for information exchange—how and what platform to use. Determine the format of documents being requested. Schedule periodic meetings with the gatekeeper and exam team to review outstanding items. Provide status updates and gather additional or clarifying information related to requests.

How can I prepare for the onsite exam?

- Re-review compliance policies & procedures
- Familiarize your team with previous exam findings
- Implement clean desk policy & security measures
- Tone-down “hallway conversations”
- Put exam team in secluded office space
- Hold practice meetings with key persons
- Plan and prepare general responses
- Provide complete, accurate answers to questions
- Don’t volunteer information not being requested
- Prepare business overview with senior management



Communicating the Firm’s Strategy

It is important to ensure the exam staff has a clear understanding of your business and how it is portrayed to the stakeholders of the firm. Examiners tend to build preliminary assumptions about your business based off regulatory disclosures, websites, and other information provided to them ahead of time. They will then focus their attention on areas that they believe need further examination or sometimes where their experience lies.

One way to ensure the examiners are seeing the firm through the eyes of management is for the firm executives to take them through a high-level presentation of the firm’s business at the outset of a regulatory exam.

Handling Deficiencies

Most firms and compliance personnel only see the negative aspects of the “D” word— deficiency. Our approach to handling deficiencies has always centered on being able to demonstrate proactiveness when it comes re-designing policies or updating disclosures.

Not all deficiencies are bad. Most deficiencies are a result of human error or mistakes made as a result of your procedures. These can be resolved by updating your policies and re-educating your employees. Effectively designed policies are a key element to a successful exam.

In most cases, regulatory examiners find deficiencies around policies and procedures that are not being followed while conducting your business operations. This is a result of either inadequate procedural education of employees or a demonstrated reluctance to comply by personnel.

When deficiencies come to light in the midst of an exam, they are communicated in a few different ways:

Informal Discussions with Examiners. The examiners may bring to your attention a possible deficiency during the onsite portion of the exam or shortly after they leave your office. It is best to absorb as much information as possible to ensure that you can pinpoint the issue and begin formulating a response plan.

Exit Meeting. The exam team will hold an exit meeting when the fieldwork or onsite portion of the exam has wrapped up. Often times the team will indicate potential deficiencies during this meeting. It is best to listen and not overreact during the exit meeting. Do not be defensive until the deficiencies are finalized.

Deficiency Letter. Typically, within 3-6 months after the onsite, the firm will receive a written exam findings letter that may or may not contain deficiencies the exam staff has noted. This letter will require a formal response from the firm within a specified period of time.

deficiency noun

de-fi·ciency | \ di-'fi-shən-sē  \

plural deficiencies

Definition of *deficiency*

- 1: the quality or state of being defective or of lacking some necessary quality or element.
- 2: an amount that is lacking or inadequate

COMMON DEFICIENCIES

Custody Rule Violations

Inadequate Regulatory Filings

Weak Code of Ethics

Misleading Advertisements

Inaccurate Form ADV

Non-Customized Policies

Overbilling Clients

Inconsistent Trade Allocations

Lack of Cybersecurity

Conflicted CCO (Dual Hat)

Non-Transparent Performance

Weak Fair Value Policy

Stale Compliance Policies

Regulatory Outlook

The regulators continue to focus on disclosure issues related to **revenue sharing payments** from cash sweep products. Advisers must properly disclose payments from their clearing brokers when selecting cash sweep products for their clients.

Every adviser should review their disclosures on client fee structures. Advisers offering **wrap fee programs** that cover management fees and brokerage services are being targeted for utilizing order routing practices that incur additional trading costs.

Firms should reassess their policies and investment practices related to **retail investors** for potential misconduct in areas such as insider trading, financial fraud and issuer disclosure. This should also include a review of the disclosures and conflicts of interests on retail focused products – mutual funds and ETFs.



Strengthen the **administration of compliance programs**. Ensure your compliance policies are customized and reasonably designed, the CCO has adequate knowledge and competency, and that adequate resources are allocated to the compliance program as a whole.

Further scrutiny over your **Cybersecurity** program. Firms should continue to build on its cyber environment for the protection of its clients' sensitive information through the seven areas of focus: governance/risk assessment, access controls, mobile security, data loss prevention, vendor due diligence, training, and incident response plan.

For FinTech firms, policies should be updated for the review of suitability, trading, and supervision of **digital assets**, which also includes automated investment offerings such as robo-advisers.

Advisory firms have **Anti-Money Laundering** obligations to assess whether their brokers/banks and investment companies have established adequate Customer Identification Programs (CIP), Know Your Customer policies, SAR filing obligations, and a robust AML testing program.

Broker-Dealers should set out to improve policies over their **Sales Practices & Supervision**. Specifically, the regulators will continue their focus on: Regulation BI and Form CRS disclosures; how the firm communicates with the public; cash management and sweep programs; sales of IPOs; and trading authorization.

FINRA

The regulators are focused on the continued **integrity in the financial markets**. This means broker-dealers should pay close attention to their direct market access controls, best execution, order routing disclosures, and the vendor display rule.

Adequate **Financial Management** controls continue to be a focus of the regulators. Revisit how your firm manages digital assets, assesses its liquidity, identifies any contractual commitments from underwriting activities, and is managing the LIBOR transition.

Please be sure to review
our video series by

[Clicking here](#)

CIPPERMAN
COMPLIANCE SERVICES

480 E. Swedesford Road, Suite 220, Wayne, PA 19087
610-687-5320

For more information,

Contact Us