



SEC Exam Survival Guide Prepare in 12 steps

THOUGHT LEADERSHIP WRITTEN IN PARTNERSHIP WITH **FOCUS** 
ASSOCIATES

An SEC exam can be a stressful experience, but some basic advance preparation can make the entire process far less of an ordeal. This paper was written in partnership with [Focus 1 Associates](#), a leading SEC compliance consulting firm that provides a range of consulting, examination and forensic testing services.

Sink or swim

The SEC can conduct an exam of a federally registered investment adviser at any time, for any reason. Exams are typically announced in advance but may occasionally be unannounced. It can be a stressful experience for a firm, with significant time and labor costs and the potential for business disruption. Compliance deficiencies can result in fines or other action and can even land a firm on the SEC's watch list for greater scrutiny. Much of that stress, disruption, and expense can be mitigated if a firm is prepared for an exam.

Firms may feel that if they have policies, procedures, and controls in place to protect client assets, maintain records, and avoid conflicts of interest, they are prepared for an exam. But being compliant in and of itself is not the same as being prepared for an exam. Knowing what to expect and how to prepare will help you avoid panic when you receive that phone call or hear that knock on the door.

Preparation for an exam is not a one-time event. The worst time to try and prepare is between the notification of an exam and the examiners' arrival at the door. Instead, your goal should be a constant state of preparedness. This document is intended to help you get there, with tips, suggestions, and recommendations compiled from SS&C Advent's partners, consultants and clients as well as the SEC itself. It provides an overview of the SEC's exam program and its purpose, spells out the key current priorities in the SEC's focus (see also the accompanying Exam Priorities Matrix), and gives you a 12-step guide for managing the exam process once it is initiated. It does not constitute legal advice, and a review of your own compliance situation with your legal counsel is strongly recommended. It will, however, give you a sense of how prepared you are and help to identify any critical gaps in your compliance program.

Key planning principles

Exam preparation

The best way to prepare for an exam is to know which regulations apply to your firm and have well designed and properly implemented policies, procedures, and internal controls.

Mindset and attitude

Regulatory examinations are labor intensive and stressful. However, they are also extremely important, and while hard to imagine at the time, it can be a rewarding experience. Compliance personnel often are judged by, and may have a portion of their compensation tied to, exam performance. On occasion, the SEC examination staff has noted in the deficiency letter that the Chief Compliance Officer is not adequately trained for the position. You must be mentally prepared and determined to produce a favorable outcome to the exam. This may entail long hours and hard work but nothing short of your best effort is required. Regulatory examinations are a very high priority, with the outcome often dependent on the attitude of the firm's people.

Clear communication

When an exam is scheduled, make sure everyone in your firm is aware of it and fully appreciates its importance. When the SEC examination staff has identified the individuals to be interviewed, notify them and encourage them to be very familiar with the firm's Form ADV and written policies and procedures covering their duties at the firm, and consider conducting mock interviews to help prepare them even more. During the exam, have daily discussions with senior management to update them on progress and any supplemental requests. Demand responsiveness from all employees and praise them for their effort when the exam is completed.

Be proactive

Start collecting data the moment you learn of the exam and receive the Information Request List. SEC request lists are available through various online resources, and you can request such from [Focus 1](#), so make it a priority to become familiar in advance with the SEC's exam priorities, the types of exams being conducted, and the typical items being requested. This will make the process much easier and less stressful.

The worst time to try and prepare is between the notification of an exam from the examiners and their arrival at the door. Instead, your goal should be a constant state of preparedness.

Requests for items not on the typical request list may help identify specific areas where the SEC is focused.

The likelihood of an examination

Given the SEC's statutory inspection authority, every federally registered investment adviser will eventually be examined. Compliance professionals should prepare for a regulatory exam as rigorously as their firms prepare for business continuity events.

With that said, it's very difficult to predict when your firm will be examined by the SEC.

The population of investment advisers continues to grow at a steady pace and has reached another record high. In just the last five years, the number of RIAs OCIE oversees increased from about 11,500 to 13,475, and the assets under management of RIAs increased from approximately \$62 trillion to \$84 trillion.

Noteworthy Update: (4/1/2020): The S&P 500 closed down 20% for the first quarter of 2020, its biggest decline since 2008, while the Dow Jones Industrial Average closed down more than 23% for the quarter, its worst since 1987—the year when the “Black Monday” stock market crash occurred. Meanwhile, the Nasdaq composite index closed down more than 14%. While the first quarter's impact to the assets under management of RIAs is more evident, the impact to the number of RIAs will likely become more evident in the months ahead.

According to the 2019 Evolution Revolution report, there were 12,993 SEC-registered investment advisers (net increase of 3.3% over FY 2018) managing approximately \$83.7 trillion in regulatory assets (a 1.4% increase over FY 2018) for over 43 million clients (up from 34 million in 2018).

Released on January 7, 2020 the SEC's Office of Compliance Inspections and Examinations announced its 2020 examination priorities. OCIE completed 3,089 examinations in FY 2019, which was a 2.7% decrease from FY 2018 (this relatively minor decrease was attributable to the approximate month-long suspension of virtually all examination activity due to a lapse in appropriations). Of

the 3,089 examinations OCIE conducted in 2019, examinations of registered investment advisers remained strong at approximately 2,180. OCIE issued more than 2,000 deficiency letters. Examinations of investment companies increased this year to over 150, increasing by approximately 12%.

OCIE says it will continue to leverage data analysis to identify potentially problematic activities and firms as well as to determine how best to scope the examinations of those activities and firms.

In his Keynote remarks at the Mid-Atlantic Regional Conference on June 4, 2019, Jay Clayton added “data analytics is an increasingly important part of OCIE's risk-based program and OCIE has developed proprietary tools for analyzing data in support of the program.”

NEAT. OCIE's National Exam Analytics Tool, allows examiners to collect and analyze large datasets of trading records to identify potentially problematic activity and better understand a firm's business during examinations.

HAL. OCIE's High-Frequency Analytics Lab, has enhanced the SEC's capabilities in examinations and oversight of market microstructure including high-frequency trading.

ATLAS. Can be used by OCIE, for example, to evaluate activity prior to a particular equity event for possible insider trading; research historical securities prices for litigation; and to assess an entire blotter for serial insider trading.

In support of these efforts, the SEC requested an additional \$20 million in FY 2020 to ensure its systems remain relevant to changing needs.

OCIE has increased its examination coverage of RIAs over the past several years from 10% in FY 2014 to a high of 17% in FY 2018. OCIE's coverage of RIAs in FY 2019, a year in which the RIA population continued to increase and the SEC experienced a 35-day lapse in appropriations, was 15%. The SEC, Congress, and many industry participants still believe that is not often enough, but is a significant step in the right direction.

Three basic types of examinations

Administered by the Office of Compliance Inspections and Examinations (OCIE), the SEC's exam program is designed to:

- Prevent fraud
- Improve compliance
- Monitor risk
- Inform regulatory policy

With the objectives of being data-driven and risk-based, the SEC has incorporated data analytics into the vast majority of its examination initiatives to identify industry practices and/or registrants that appear to have elevated risk profiles.

An SEC examination typically involves an on-site visit to your office, in which the examiners will request and review documentation and interview appropriate staff members. You may also receive supplemental requests to provide specific information electronically

The SEC has been doing an increasingly good job assessing initial advisory firm risk via its “limited scope” examination. The limited scope exam is generally intended for newer registrants, but has also been used for firms that have not been examined for a substantial period of time. The primary objective of the limited scope exam is for the SEC to assess a firm's level of risk and correspondingly determine when a full examination of the advisory firm should be conducted.

There are essentially three broad categories of examinations:

1. Cause exams

The highest priority SEC exam, a cause exam results from investor complaints, reliable tips, complaints, or referrals (TCRs), a surveillance-identified issue, media reports, or the SEC's own risk assessment process for identifying questionable activity. Cause exams are focused on—but not restricted to—getting to the bottom of the alleged or suspected impropriety. As such, they are frequently unannounced to prevent the destruction of documents and the disappearance of client assets.

2. Routine exams

A routine exam is not triggered by any underlying suspicion of a compliance breach. This is the exam for which advisers should prepare. Firms that are higher in the SEC's risk-based rankings—firms with high AUM, a history of regulatory problems, other signs of poor controls (such as incorrect or incomplete entries on a Form ADV), or have not been previously examined—will receive greater scrutiny than those at the lower end. Firms that are lower on the risk scale may be selected at random for examination, but as previously noted, firms can expect to be examined on average every seven years. Since higher risk advisers may be examined on a one-to three-year cycle, less risky firms may be examined less often.

3. Sweep exams

The SEC conducts sweep exams when it identifies a pattern of emerging or resurgent risks based on routine exams or its internal risk assessment process. These examinations are focused on a specific industry issue (for example, Pay to Play or soft dollars) rather than an issue specific to any particular registrant. The objective is to determine how the industry is handling specific industry-wide issues regarding practices or products. This will help the SEC determine what action, if any, should be taken to deal with the issue.

During FY 2019, OCIE published eight risk alerts, which represent the most risk alerts in a year since it began publishing them in FY 2011. The purpose of risk alerts is to remind advisers of their obligations under certain rules and regulations, and to help advisers improve their systems, policies, and procedures by sharing OCIE's observations from examinations.

OCIE's eight Risk Alerts from 2019:

- [Investment Adviser Compliance Issues Related to the Cash Solicitation Rule](#)
- [Risk-Based Examination Initiatives Focused on Registered Investment Companies](#)
- [Observations from Investment Adviser Examinations Relating to Electronic Messaging](#)
- [Transfer Agent Safeguarding of Funds and Securities](#)

The systems you use and the way you use them can give examiners greater confidence that you are exercising due diligence and have the controls in place to properly monitor your activities for compliance.

- [Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P—Privacy Notices and Safeguard Policies](#)
- [Safeguarding Customer Records and Information in Network Storage—Use of Third Party Security Features](#)
- [Observations from Examinations of Investment Advisers: Compliance, Supervision, and Disclosure of Conflicts of Interest](#)
- [Investment Adviser Principal and Agency Cross Trading Compliance Issues](#)

As part of your compliance readiness efforts, be sure you are aware of the compliance issues OCIE identified in deficiency letters to SEC-registered investment advisers.

SEC announced 2020 examination priorities

The scope of an examination is generally limited to the issues and business practices of the registrant that are perceived by the examining staff to present the highest risks to investors and the integrity of the market. That means the scope of exams will vary from registrant to registrant.

OCIE considers dozens of potential risk factors, which can include: products and services offered, including certain products identified as higher risk; compensation and funding arrangements; prior examination observations and conduct; disciplinary history of associated individuals and affiliates of a registered firm;

changes in firm leadership or other personnel; and, whether a firm has access to investor assets, i.e., custody.

On January 7, 2020, the SEC's National Examination Program ("NEP") published its examination priorities to communicate with investors and registrants about areas that are perceived to have heightened risk, and to support the SEC's mission to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.

The SEC's 2020 priorities are broken down into seven categories

1. Matters of importance to retail investors, including seniors and those saving for retirement

- Fraud, Sales Practices, and Conflicts
- Retail-Targeted Investments
- Standards of Care

OCIE will again emphasize the protection of retail investors, particularly seniors and those saving for retirement, with examinations focused on RIA's and BD's that serve retail investors.

2. Information Security

- OCIE will continue to prioritize information security in each of its five examination programs.
- Specific to RIAs, OCIE will continue to focus its examinations on assessing RIAs' protection of clients' personal financial

information. Particular focus areas will include: (1) governance and risk management; (2) access controls; (3) data loss prevention; (4) vendor management; (5) training; and (6) incident response and resiliency.

[Noteworthy Update \(April 2, 2020\):](#)

Regulators Respond to an Unprecedented Confluence of Events—call it [“The Perfect Storm.”](#) Learn more about what the SEC is requesting (in late March 2020) as part of their examination process.

3. Fintech and innovation, digital assets and electronic investment advice.

Risk-Based Examinations—Investment advisers, investment companies, broker-dealers and municipal advisors.

- OCIE remains focused on keeping abreast of these developments in sources of new data being used by registered firms, and examinations will focus on firms’ use of these data sets and technologies to interact with and provide services to investors, firms, and other service providers and assess the effectiveness of related compliance and control functions.

4. Additional focus areas involving RIA’s and Investment Companies

- RIA Compliance Programs
- OCIE will continue to review the compliance programs of RIAs, including whether those programs and their policies and procedures, are reasonably designed, implemented, and maintained.
- Never-Before and Not Recently Examined RIA’s
- OCIE will continue to conduct risk-based examinations of RIAs that have never been examined, including new RIAs and RIAs registered for several years that have yet to be examined. OCIE will also prioritize examinations of RIAs that were previously examined but have not been examined for a number of years to focus on whether the RIAs’ compliance programs have been appropriately adapted in light of any substantial growth or change in their business models.

- Mutual Funds and ETF’s
- RIA’s to Private Funds
- Along with a review of firms that provide management to separately managed accounts side-by-side with private funds, OCIE will assess compliance risks, including controls to prevent the misuse of material, non-public information and conflicts of interest, such as undisclosed or inadequately disclosed fees and expenses, and the use of RIA affiliates to provide services to clients.

5. AML Programs

- OCIE will continue to prioritize examining broker-dealers for compliance with their AML obligations, including whether they are meeting their SAR filing obligations, implementing all elements of their AML program, and robustly and timely conducting independent tests of their AML program.

6. Market Infrastructure

7. Focus on FINRA and MSRB

- Examinations of FINRA will continue to focus on FINRA’s operations and regulatory programs and the quality of FINRA’s examinations of broker-dealers and municipal advisors that are also registered as broker-dealers.
- Given MSRB’s broad responsibility to regulate municipal securities transactions, OCIE will continue to conduct inspections of MSRB to evaluate the effectiveness of MSRB’s policies, procedures, and controls.

In Summary

The 2020 Examination Priorities reflect OCIE’s assessment of risks, issues, and policy matters derived from developments in the markets and in the regulation of those markets, information gathered during examinations and from tips, complaints, and referrals, and coordination with other SEC Divisions and Offices, as well as other regulators.

The basis of these priorities is the feedback received from OCIE’s examination staff and input and advice from the SEC Chairman and other Commissioners, staff of other SEC divisions and offices, and other regulators.

However, the list is not exhaustive. OCIE can and will look at other areas as well. While the 2020 Priorities will drive OCIE’s examinations, the scope of any examination is determined through a risk-based approach that includes analysis of an examined entity’s business, operations, services, products offered, and other risk factors, including its regulatory history. OCIE also solicits comments and suggestions relating to its mission, and requests those who suspect or observe activity that may violate the federal securities laws or otherwise harm investors to notify the SEC.

To provide some perspective on [OCIE’s historical exam priorities](#), we’ve provided a comparison of the exam priorities published since 2013, and while some have been around a long time, some are new and others no longer identified. Sometimes looking back is as important as looking forward.

The basis of these priorities is the feedback received from OCIE’s examination staff and input and advice from the SEC Chairman and other Commissioners, staff of other SEC divisions and offices, and other regulators.

You'll have a good start on preparedness if you have addressed the most basic issues likely to set off alarm bells with the SEC.

Compliance and risks in critical market infrastructure

SEC staff will conduct examinations of Clearing Agencies, National Securities Exchanges, and Transfer Agents as necessary, in collaboration with the Division of Trading and Markets and other Regulators, as applicable.

Entities Subject to Regulation Systems Compliance and Integrity

Regulation SCI was adopted by the Commission to strengthen the technology infrastructure of the U.S. securities markets. Among other things, it requires SCI entities to establish, maintain, and enforce policies and procedures designed to ensure that their systems' capacity, integrity, resiliency, availability, and security are adequate to maintain their operational capability and promote the maintenance of fair and orderly markets. If certain events occur, these entities are required to take corrective action as soon as reasonably practical and immediately notify the SEC of the occurrence. OCIE will continue to examine SCI entities to evaluate whether they have effectively implemented written policies and procedures required by Regulation SCI.

Focus on FINRA and MSRB

FINRA

FINRA is a primary regulator of the vast majority of SEC-registered broker-dealers. As a self-regulating organization (SRO), FINRA adopts and enforces rules governing the conduct of its members, including approximately 3,800 brokerage firms, 156,000 branch offices, and 630,000 registered

representatives, through examinations, enforcement, and surveillance. Additionally, FINRA provides a forum for securities arbitration and mediation, conducts market regulation by contract for numerous exchanges, reviews broker-dealer advertisements, administers the testing and licensing of registered persons, and operates industry utilities such as Trade Reporting Facilities.

Examinations of FINRA focus on FINRA's operations and regulatory programs, and on the quality of FINRA's examinations of broker-dealers and municipal advisors that are also registered as broker-dealers.

MSRB

MSRB regulates the activities of broker-dealers that buy, sell, and underwrite municipal securities, and also regulates municipal advisors. MSRB establishes rules for municipal securities dealers and municipal advisors, supports market transparency by making municipal securities trade data and disclosure documents available, and conducts education and outreach regarding the municipal securities market. Examination staff examines the MSRB to evaluate the effectiveness of select operational and internal policies, procedures, and controls.

Digital Assets

The digital asset market has grown rapidly and may present risks to retail investors. The number of digital asset market participants, including broker-dealers, trading platforms, and investment advisers, continues to increase. Given the significant growth and risks presented in this market, OCIE will continue to monitor the offer and sale,

trading, and management of digital assets, and where the products are securities, examine for regulatory compliance. Through high level inquiries, OCIE will take steps to identify market participants offering, selling, trading, and managing these products or considering or actively seeking to offer these products and then assess the extent of their activities. For firms actively engaged in the digital asset market, OCIE will conduct examinations focused on, among other things, portfolio management of digital assets, trading, safety of client funds and assets, pricing of client portfolios, compliance, and internal controls.

Every firm must designate an individual to be responsible for the oversight and review of the firm's policies and procedures—a Chief Compliance Officer.

Some red flags to avoid

You'll have a good start on preparedness if you have addressed the most basic issues likely to set off alarm bells with the SEC. These include:

Misleading advertising and marketing materials

Use a disclosure checklist to ensure you have included all necessary (SEC and GIPS, if applicable) disclosures, and have an understanding of relevant no-action letters to ensure you have addressed all relevant guidelines (See the [Clover no-action letter](#), Oct 28, 1986, an oldie but a goodie, still quoted in deficiency letters).

Noteworthy Update (November 4, 2019): The SEC published proposed amendments (the "proposed amendments" or "proposed rule") to Rule 206(4)-1 (the "Advertising Rule") under the Investment Advisers Act of 1940 (the "Advisers Act"). The proposed amendments are the first substantive amendments to the Advertising Rule since its adoption in 1961, and are intended to address evolving marketing practices in light of advancements in technology and changes within the asset management industry and its investor base.

The proposed amendments would replace the current Advertising Rule's broadly drawn prohibitions on certain content, such as past specific recommendations, with a combination of new principles-based provisions and more tailored requirements intended to address certain practices that may pose a higher risk of misleading investors.

[Proposed reforms of two rules under the Advisers Act relating to how advisers advertise to and solicit clients and investors.](#)

Outdated or xyz templates

Do not use off-the-shelf template policies and procedures that are not specific to the firm or that are outdated and do not address current regulations.

Inconsistencies

Reconcile differences between your Form ADV Part 1 and Part 2, and as compared to the firms' policies and procedures and the firm's marketing materials.

A new filing in 2020 is [Form CRS](#) (ADV Part 3)—yet another part of your ADV to confirm consistency. See also [FAQ's on Form CRS](#).

Lack of a code of ethics

Every firm must have its own written code of ethics, and it should be specific to the firm's own policies and practices, not generic or off-the-shelf. The code of ethics should be distributed to all "supervised persons," who in turn must acknowledge their receipt and understanding of the code and any amendments. The SEC takes each firm's code of ethics literally and certain terms as required in rule 204A-1 must be exact in the code.

Lack of written policies and procedures

The firm also needs to have written policies and procedures in place that are reasonably designed to prevent violations, by you and your supervised persons, of the Act and the rules that the SEC has adopted under the Act. As with the code of ethics, these written policies must be specific to the firm, and reviewed on at least an annual basis.

Lack of oversight on compliance

Every firm must designate an individual to be responsible for the oversight and review of the firm's policies and procedures (Chief Compliance Officer) and document the review of the policies at least annually to ensure effectiveness and adequacy.

See [Risk Alert](#) from July 23, 2019: Observations from Examinations of Investment Advisers: Compliance, Supervision, and Disclosure of Conflicts of Interest

Deficient email and IM retention policy

The SEC treats emails and instant messages the same way it treats printed, signed correspondence. All business-related email must be retained and accessible on demand for a minimum of five years from the end of the fiscal year in which it was created, and in some cases longer. Look into technology designed to capture, store, and index email for retrieval.

See [Risk Alert](#): Observations from Investment Adviser Examinations Relating to Electronic Messaging

Unclear best execution practices

The SEC expects firms to execute transactions in a manner that maximizes the client's proceeds to the extent possible, which places some burden of interpretation on the firm. It does not necessarily mean "lowest price." There are a number of methodologies for determining best execution, which should include both qualitative and quantitative aspects. The SEC

mainly wants to know that you have a policy and that you follow it, and that your trading practices are not influenced by broker relationships or other conflicts.

See [Risk Alert](#) from July 11, 2018: Most Frequent Best Execution Issues Cited in Adviser Exams

Recognizing whether you have Custody

Advisers with custody of client cash or securities must comply with the Custody Rule. An adviser has custody if it or its related person holds, directly or indirectly, client funds or securities or has any authority to obtain possession of them. At this point, the SEC expects you to understand whether (and how) you are deemed to have custody, to properly disclose it and to have good policy and procedures in place to monitor such.

Another great resource is [OCIE's Risk Alert](#) from February 7, 2017 outlining "The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers."

[Risk Alert](#) from March 4, 2013—Significant Deficiencies Involving Adviser Custody and Safety of Client Assets

[IM Guidance Update](#), February 2017, Inadvertent Custody: Advisory Contract versus Custodial Contract Authority

October 12, 2017, [Staff Responses to Questions About the Custody Rule](#)

[IM Information Update](#), June 2018, Updates to Custody Rule FAQ's

Every firm must designate an individual to be responsible for the oversight and review of the firm's policies and procedures—a Chief Compliance Officer.

Examining the Chief Compliance Officer

Among the many factors the SEC will look at in an exam, an important one is the Chief Compliance Officer (CCO). Examiners will want to know the CCO has the experience and qualifications, familiarity with the regulations, knowledge of the firm's operations and, above all, the independence and authority to implement and enforce an effective compliance program.

The CCO should be prepared to answer tough questions delving into all areas. Membership in professional associations, credentials and certifications, attendance at industry and SEC forums, and publication subscriptions are all evidence of competence, commitment, and current knowledge. The firm must also be prepared to demonstrate that the CCO has the backing of senior management.

The effectiveness of the CCO begins with a firm-wide understanding that protecting the client's best interest is in the firm's best interest (a culture of compliance). The firm's policies and procedures must be designed first and foremost to protect the investor. The CCO's job is to oversee this program and, in so doing, protect the firm from running afoul of the SEC.

Prepare in 12 steps

The exam process typically starts with a telephone call or, in some instances, an email to the CCO or firm principal notifying the firm that it has been selected for an examination and to schedule the visit. In most cases, unless it is a surprise inspection it is typically two weeks between the initial notification and the examination, which could be on-site or via off-site/remote correspondence, especially in light of the COVID-19 pandemic.

Noteworthy Update (March 23, 2020): In light of health and safety concerns and other circumstances, OCIE has moved to conducting examinations off-site through correspondence, unless it is absolutely necessary to be on-site. Read [OCIE's "Statement on Operations and Exams."](#)

The on-site exam process typically starts with a telephone call or, in some instances, an email to the CCO or firm principal notifying the firm that it has been selected for an examination and to schedule the visit.

In the interim, you will likely be asked to upload certain documents electronically to the SEC's secure portal, in advance of a visit or further requests for information.

If you have familiarized yourself with the SEC's current examination priorities, and have addressed them along with any noted deficiencies from any previous examinations and the red flags cited earlier, and you can prepare and produce, in a timely fashion, the items outlined on the SEC's initial request list, you should be well prepared for the examiners' visit. But don't expect the process to take care of itself. You will need to be both responsive and proactive throughout the process.

Below are 12 steps, presented more or less in chronological order, that will help you avoid last-minute scrambling and business disruption.

1. Acknowledge the notification

It is important that the firm's CCO, principals and key staff be on hand during the examination. If the SEC's proposed examination date poses a material conflict (for instance, the CCO is scheduled to be on vacation), don't be afraid to mention this to the SEC. Although not typical, examiners may be flexible on this point, but it's ultimately their decision. Apprise senior management as well as legal counsel of the forthcoming exam.

2. Assign the CCO to lead

Make it clear to both parties that the CCO is the primary communication channel and will be present for all meetings and discussions

with the examiners. All interview requests should flow through the CCO, and the CCO should attend all interviews.

3. Make key staff available

The firm's top executives, department heads, senior advisors, and compliance staff should all be on hand and prepared for interviews. If any are not able to be in the office, they should be available telephonically.

4. Assign additional responsibilities

Before you ever get the call, it is a good practice to have already assigned staff to prepare certain requested documents. Confirm with those individuals that nothing has changed or will prevent this information from being produced in a timely manner.

5. Inform and educate employees

Have a firm-wide meeting to inform your staff of the impending exam. Make sure the staff understands that the firm probably falls in a risk-based category that is examined regularly, or that the firm was selected at random for an examination—not for cause. Discuss the possibility of being interviewed and provide tips on how best to respond. For instance, make sure people know what's being asked before answering, and ask for clarification when necessary. They should answer honestly but limit their answers to what is being asked. They should not offer opinions, nor volunteer information that has not been requested, nor answer questions outside their areas of responsibility. If they are asked a question for which they do not know the answer, "I don't know" would be the appropriate response. Under no

conditions should personnel guess on responses. If several persons are asked the same question and different answers are received, you have a problem. Remind everyone at the firm that the SEC examiners are Federal agents, and lying to them is a crime, so we don't ever guess. Personnel should make sure their responses are consistent with the firm's written policies and procedures. During the on-site examination, personnel should not discuss the firm's business in the hallways, elevators, restrooms, lunchroom, or reception area.

6. Respond to requests promptly

You will receive a request list, usually by fax or email. It will identify the documents to be provided before and during the exam. Review the request list. It will give you a better idea of the focus of the exam. Compare the request list you've received with others you may have obtained from other industry sources, to identify any requests that appear to be outside of the norm. Documents provided in advance may include your advisory agreement form, current client list, organizational chart, financial statements, code of ethics, marketing materials, and your written compliance program and policies and procedures. If any requested documents will take additional time to retrieve, advise the examiners when they can expect them in your initial response. You should expect additional documents to be requested as the examination progresses.

7. Have a method for organizing and tracking documents

Prepare a spreadsheet listing all documents to be provided with numbers assigned that match those on the request list. Check off every document and complete the process in advance of the examiners' arrival. All documents should have a final review by the CCO.

Make a separate folder for each document produced (there will be several throughout the exam). This way you will have a copy of all information that was produced. Examiners may request that you upload the documents requested to the SEC's secure document uploading system.

Generally, the examiners will send you an email with a link granting access to this system. It is wise to print screen shots of any information you uploaded to the SEC to keep with your exam records.

Although there is no standard for numbering documents, the best practice is to place an identifying notation on each page of each document to indicate the request list item and the number of pages in each document submitted.

Throughout the entire process, from the initial contact and subsequent communication through the end of the exam, remember, it pays to be courteous, professional, cooperative, and, above all, honest.

8. Generally the examiners will communicate with you electronically through the SEC's secure email server

This system provides additional encryption that is generally more robust than most other email programs. There are limitations to this system, however, and you should print or make PDFs of all correspondence with the staff when using this system, as you will not be able to access the information after the examination is completed.

9. Keep investment advisory records separate from other business

The SEC is there to review your investment advisory business. Provide only what is requested and nothing more.

10. Prepare a background presentation

You should be prepared for an introductory meeting (an "entrance interview") to give the examiners an overview of your firm, its services, the scope of its business, the key personnel, and your compliance program. You may want to consider a brief slide presentation. The purpose is to be proactive, establish a professional tone to the dialogue, provide context for the exam, and make a positive first impression.

Include discussion of your internal compliance review process and key controls. This is an opportunity to exercise an appropriate measure of control over the exam process without trying to "stonewall" or dictate the outcome.

11. Request an exit interview

Generally, the examiners will offer to discuss their findings at the conclusion of their visit, but if they do not, you should request an exit interview. This is an opportunity to learn of any identified deficiencies and to reconcile any misunderstanding or miscommunication that may have occurred during the examination, and to coordinate or provide any additional documentation that may be necessary to satisfy their requests. If you think you have provided everything the SEC has requested, get confirmation from the examiners. If you have not provided all of the requested documents, provide the SEC with an expected timeline for the delivery of those documents and make sure you follow it.

Throughout the entire process, from the initial contact and subsequent communication through the end of the exam, remember, it pays to be courteous, professional, cooperative, and, above all, honest.

12. Consider requesting an exclusion from the Freedom of Information Act

Protect your information from third parties by requesting your documents not be disclosed publicly. Under the Privacy Act of 1974, you may send a written request for privacy of your records or their correction to the FOIA/Privacy Office by email (foiapa@sec.gov), fax (202-772-9337), or mail FOIA/ PA Office (100 F Street NE, Mail Stop 5100, Washington, DC 20549).

Include information that will assist the SEC's staff in identifying the records you are seeking to protect. They will notify you in writing within 30 days. Throughout the entire process, from the initial contact and subsequent communication through the end of the exam, remember, it pays to be courteous, professional, cooperative, and, above all, honest. Just because examiners appear not to understand your business, don't assume that they don't. It may be a ruse to draw more information from you.

Nobody's perfect: Understanding and responding to deficiencies

Do not be surprised when, in spite of your best efforts to root out deficiencies in advance, you are told you have some. The majority of examinations result in official deficiency letters (also known as "examination summary letters"), even if only one deficiency is cited. This is rarely a cause for alarm, but it requires immediate attention. If you follow the 12-step exam survival guidelines, you will learn about the most glaring if not all deficiencies before the letter arrives.

The letter will give you a deadline for correcting the deficiencies and responding to the SEC, generally within 30 days. Correct the deficiencies as quickly as possible and notify the SEC, in writing, that you have done so. If for any reason you cannot meet the deadline, you should respond immediately and explain how you plan to address the deficiency and why you need additional time. If the examiners understand that you recognize the issue and fully intend to address it, they will usually grant the extra time required to resolve the issue.

Do not be surprised when, in spite of your best efforts to root out deficiencies in advance, you are told you have some. The majority of examinations result in official deficiency letters.

Maintaining constant preparedness

Although you may shift into high gear upon receiving notice of an exam, you should continually operate as though that call is coming any day. Review your policies and procedures regularly, and as part of your annual review. Be sure all employees have been provided a copy of the manual and understand the requirements. Make sure such basic information as names of key staff— especially the CCO—are current. Review your internal compliance process and be sure it can pass the test of Rule 206(4)-7. Check your Form ADV for accuracy, consistency and thoroughness. Double-check all previous correspondence from the SEC to make sure prior deficiencies, if any, have been addressed. Maintain copies of any no-action letters on which the firm is relying and verify on an annual basis that they still apply and that you are following the steps outlined in the no-action letter.

Many firms bring in outside consultants to review their operations, often former regulators or CCOs. If you choose to do so, make sure they have significant experience with the examination process. It is also suggested to conduct a periodic internal audit or undergo a "mock exam" by a compliance consultant to test preparedness.

The best foundation for preparing for an exam, of course, is a strong culture of compliance and adherence to the principle of protecting the clients' interest, backed by a CCO with knowledge of the rules and the authority to enforce them. An exam is an ordeal, but it is far less so for firms that are prepared.

Do not be surprised when, in spite of your best efforts to root out deficiencies in advance, you are told you have some. The majority of examinations result in official deficiency letters.

The role of technology in supporting compliance

Just as technology plays an increasingly important role in investment operations, it also figures more prominently in compliance and examinations. Regulators are interested to know whether a firm is following best practices, particularly in trading, account reconciliation, and overall books and records retention.

Today's investment technology can help you reduce the labor and expense associated with an examination. It helps you confirm the accuracy of your data and maintain audit trails. It makes it easier to locate and retrieve the documentation the examiners are requesting, and to report it in a clear format. The systems you use and the way you use them can give examiners greater confidence that you are exercising adequate due diligence and have the controls in place to properly monitor your activities for compliance.

The most advanced portfolio management, trading, and accounting systems on the market today have features that support compliance built in.

Technology solutions exist today that enable you to turn many aspects of your policies and procedures into automated processes, notably pre-and post-trade checking and portfolio monitoring to adhere to the firm's and clients' investment guidelines. Besides relieving staff of the tedious and error-prone burden of checking for compliance, these systems and the information they contain will make it easier to demonstrate compliance when an audit occurs.

On the day of the exam

- A professional appearance counts. Offices should be clean and uncluttered. Staff should be punctual.
- Ask the examiners for their business cards if they do not offer them to figure out who is in charge of the exam. Do not keep the examiners waiting. This will also enable you to determine if any Enforcement personnel are with the examination team.
- Be sure to have uploaded the information requested by the SEC to their portal prior to the examiners arriving.
- The CCO should relocate temporarily to a desk or office adjacent to the examiners' work space.
- The CCO should confirm the schedule of meetings with specific individuals and let the examiners know he or she will be present for all interviews.

All requests for additional information or photocopies during the exam should flow through the CCO. Ask for those requests to be in writing, so you can keep track of them, and you and the examiners agree on the items requested. For any copies they request, if not requested in electronic form, make an additional copy for yourself. Make copies for the examiners, rather than giving them access to a copier, to better keep track of documents provided to them.

If deficiencies are called to your attention during the course of the exam, do everything you can to address them (Issues corrected while the examiners are on-site may not show up in a deficiency letter.) If you believe an issue has been cited in error, confer with legal counsel and make sure you have a strong case.

Putting compliance into practice

An SEC examination is hardly ever painless, but proactive planning can lessen the pain substantially and enable you to continue conducting your daily business without undue disruption.

To recap, you should:

- Assume an exam is inevitable; operate as though the call could come tomorrow.
- Know the SEC's current exam priorities and common red flags.
- If a new SEC Rule has a compliance date in the near future, expect to be asked what actions you have taken to prepare.
- Conduct an annual review of your exam preparedness, perhaps including an internal audit or independent mock exam.
- Be familiar with Risk Alerts put out by OCIE, usually identifying concerns noted on recent exams and in many cases suggesting a remedy.
- Have an action plan for the day you are notified that you have been targeted for an exam. The plan should encompass both preparation of documents and preparation of staff.
- Conduct yourself with professionalism, confidence, and courtesy during the exam.
- Take advantage of current technology to ensure that your firm's information is accurate and thorough, to make data easy to locate and retrieve, and to demonstrate best practices in books and records retention.

Above all, infuse your everyday business with a strong culture of compliance, as evidenced by your people, your policies, and your processes. And make it readily apparent to examiners when they walk in the door.

Above all, infuse your everyday business with a strong culture of compliance, as evidenced by your people, your policies, and your processes.

ABOUT SS&C ADVENT

SS&C Advent, a business unit of SS&C, is helping over 4,300 investment firms in more than 50 countries—from established global institutions to small start-up practices—to grow their business and thrive. Delivering unparalleled precision and ahead-of-the-curve solutions for more than 30 years, we help our clients minimize risk, work together seamlessly, and shape the future of investment management.

For more information, visit: www.advent.com or contact us at (800) 727-0605 or info@advent.com.

ABOUT FOCUS 1 ASSOCIATES

Focus 1 Associates is a leading SEC compliance consulting firm that provides a range of consulting, examination and forensic testing services. The firm serves an international client base of registered investment advisors of all shapes and sizes, strategies and philosophies.

For more information, visit www.focus1associates.com or contact Toby Cochran at (541) 200-7001 or toby@focus1associates.com.

©2020 SS&C Technologies Holdings, Inc.

This communication is provided by SS&C Advent for informational purposes only and should not be construed as or relied on in lieu of, and does not constitute, legal advice on any matter whatsoever discussed herein. SS&C Advent shall have no liability in connection with this communication or any reliance thereon.