



SEC Hot Topic: Compliance Tips for Evaluating Your Firm's *Advisory Fees and Expenses*

Presenter:

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Agenda

- Takeaways from the SEC *Risk Alert* (Apr. 12, 2018)
 - ❖ Disclosure
 - ❖ Exam Observations
 - ❖ What to Expect in an Exam
 - ❖ Common Exam Document Requests
- Advisory Fees and Expenses - Case Study
- Are You Prepared to Answer These New Exam Questions?
- Key Takeaways
- Questions



Advisory Fees and Expenses

Risk Alert: The Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers (Apr. 2018)

- ❑ The SEC is concerned about the disclosures clients received regarding advisory fees and expenses
 - ❖ Typically, fees and expenses are detailed in advisory contracts and Form ADV
 - ❖ Examinations find that advisers are not adhering to the terms of the agreement or disclosures are inappropriate with actual practices

3



Advisory Fees and Expenses

Risk Alert: Advisory Fee and Expense Compliance Issues (cont.)

- ❑ Exam observations include:
 - ❖ Fee-Billing on Incorrect Account Valuations
 - ❖ Billing Fees in Advance or with Improper Frequency
 - ❖ Applying Incorrect Fee Rate
 - ❖ Omitting Rebates and Applying Discounts Incorrectly
 - Not aggregating “households” for fee-billing purposes
 - Not adjusting for “breakpoints”
 - ❖ Disclosure Issues Involving Advisory Fees
 - Not disclosing certain additional fees, markups or revenue share
 - Adviser Expense Misallocations

4



Advisory Fees and Expenses

- ☐ What to Expect in An Exam
 - ❖ Examiners are reviewing policies and procedures from two (2) to five (5) years ago related to advisory fee billing protocols
- ☐ Common Exam Document Requests Include:
 - ❖ A description of current fee billing processes, including:
 - Identity of person(s) who calculates advisory fees
 - Who sends the invoice to the custodian
 - Who tests advisory fee calculations
 - Which software programs or systems are used in calculating fees
 - Description of reconciliations
 - Whether any of the processes have changed in the last five years

5



Advisory Fees and Expenses

- ☐ Recent SEC Fee and Expenses Document Requests (cont.)
 - ❖ Provide all current standard contracts or agreements
 - ❖ For the last billing period provide a spreadsheet that includes advisory fee calculations for each advisory client, including:
 - Billing rate
 - Market value used to calculate the advisory fee
 - Total nominal fee billed
 - Which accounts were grouped together for fee billing purposes
 - From which account was the advisory fee paid
 - ❖ Provide a copy of any ongoing analysis during the last year of fee billing analysis to ensure clients were billed correctly
 - ❖ Provide a list of revenue sharing and expense sharing agreements

6



Advisory Fees and Expenses – Case Study

During the onsite exam, Chuck learns that Exposed has been in business since 2000. Since that time, the firm has used three different investment management agreements (“IMAs”), all of which have differing disclosures and advisory fee structures. In the beginning, Bobby Axe wanted to charge all clients a flat rate of 100 bps. Over time as the firm came to service higher net worth families, Exposed moved to a tiered schedule; but in all IMAs the firm never disclosed whether they householded assets for fee billing purposes. In practice, it was left to each adviser to determine which accounts would be aggregated together. Chuck asks for the oldest client account and to review all IMAs associated with the account. Chuck is provided with one IMA, which provides a fixed 1% AUM billing fee. However, when reconciling the billing of the account with Finance, Chuck discovers that the account is being billed 1.1%.

7



Advisory Fees and Expenses – Case Study

Chuck asks Finance why the client is being invoiced this amount and he receives the following reply, “In 2008 we moved to a tiered fee billing schedule and based on assets, this family should be charged 1.1%.” Chuck asks Taylor to pull all reconciliation documents on Exposed’s fee billing practices for this and 10 other accounts. Taylor replies, “It may take a few days as I have not gotten to this yet.”

Q1: What issues do you see?

Q2: What actions should Exposed take?

8



Are You Prepared to Answer these New Exam Questions?

- How does the firm handle fee billing for deceased clients and terminated client accounts?
- Has the firm's supervisory oversight of fees and expenses changed due to COVID-19 or as a result of a merger or acquisition?
- What controls are in place to monitor fee billing in remote branch offices?
- How do you document "exceptions" to your disclosed fee structure?

9



Advisory Fees and Expenses – Takeaways

- Inventory all advisory fee revenue sources of the firm on what fees are received for any and all products and services
- Next, review your disclosures for how the firm describes its advisory fees and expenses
 - ❖ If you find that clients have been assessed fees inappropriately (due to overbilling, non-aggregation of assets or inadequate disclosures), contact legal counsel and consider if fee rebates are appropriate
- Implement supervisory checks and balances at all points where advisory fees are entered and calculated
 - ❖ Through account opening, in billing and operations and compliance audits

10



Advisory Fees and Expenses – Takeaways

- Ensure that policies and procedures articulate how the firm determines and calculates advisory fees and what protocols are in place to ensure that advisory fees are correctly billed to clients
 - ❖ TIP: Inventory your advisory contracts to look for legacy “customization” where fees and expenses are atypical to ensure there are no “smoking guns”

11



Q&A – Let’s Discuss and Thank You for Attending!



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12