



**2018 Investment Management  
Compliance Testing Survey**  
June 14, 2018

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# Presenters

**Enrique Carlos Alvarez**  
**Senior Principal Consultant**  
**ACA Compliance Group**

Enrique Alvarez is an ACA Senior Principal Consultant working out of Charlotte, North Carolina. He has led or participated in over 200 client engagements that include SEC inspection responses, annual compliance reviews, mock examinations, compliance manual development, initial SEC registration, focused email and marketing reviews, fee recalculation audits, and training presentations of investment advisers (including hedge funds, private equity funds, family offices, and separate account managers).

Enrique joined ACA in July 2007 as a Compliance Trading Analyst. In that position, he conducted quarterly personal securities transaction reviews, semi-annual best execution analyses, and assisted in annual compliance reviews and mock examinations for ACA clients.

Enrique earned his B.S. in Economics from Vanderbilt University. He minored in English and Art History.



## Presenters

**Sarah A. Buescher**  
Associate General Counsel  
Investment Adviser Association

Sarah joined the IAA in October 2017. She is responsible for ERISA and pension issues as well as core Investment Advisers Act issues. Before joining the IAA, Sarah served in the Investment Adviser Regulation Office in the SEC's Division of Investment Management. She also worked in the SEC's Office of the General Counsel and started her legal career in the SEC's Division of Investment Management. Sarah also has industry experience. Between 1999 and 2009, she worked at Vanguard.



# Presenters

**Sanjay Lamba**  
**Assistant General Counsel**  
**Investment Adviser Association**

Sanjay has over 19 years of experience regarding all aspects of investment management law and regulation. Prior to joining the IAA in 2013, Sanjay worked at the SEC for 10 years, beginning his service in the rulemaking office of the Division of Investment Management before transferring to the Office of Chief Counsel (Legal Branch) in the Office of Compliance Inspections and Examinations in 2010. Sanjay started his career in private practice advising investment companies and investment advisers in securities related matters.



## Survey Areas

- Fees & Expenses
- Investment Mandates
- Data Analytics
- Custody
- Best Execution
- Soft Dollars
- Advertising/Social Media
- Individual Clients
- Cryptocurrency

### **Trend Updates:**

- Cybersecurity
- Pay-to-Play
- Form ADV
- “Hot” Compliance Topics

## Notable Findings

- Cybersecurity continued to be the hottest compliance topic for 2018 (**81%**) – 5<sup>th</sup> year in a row
- Over **77%** of firms have not decreased testing; most significant increase is in cybersecurity
- Close to **70%** use some form of technology in their compliance program: most common usage is for guidelines, gifts, code of ethics; over half believe increase in technology is coming
- Over half of firms do not accept directed brokerage and over **20%** set limits (e.g. <25%); about **20%** of firms directed go last
- Over half of firms do not consider ESG
- Despite the SEC's focus on crypto, virtually all respondents do not trade in crypto; majority of codes don't contemplate crypto; only **10%** require pre-clear for ICOs
- Most common advertising controls: Written P&Ps (**86%**) and formal pre-approvals required by CCOs (**67%**)
- **32%** of firms are not using social media; Firms that do, mostly on a very limited "business card" basis
- Vast majority of firm's have pay-to-play P&Ps (**80%**); **79%** reporting no changes
- SMA reporting on new Form ADV most onerous (**71%**)

# Survey Demographics & Compliance Program Statistics

## Survey Demographics

- **454** firms responded to the survey. Thank you for your participation!
- **Established firms** (5-25 years in business) constituted **52%** with **long-timers** (more than 25 years) making up **38%** of respondents. **Relatively new** firms (1 to 5 years in business) made up **10%** of respondents.
- **45%** of respondents had assets under management (AUM) between \$1b and \$10b, the rest of respondents were relatively evenly represented.
  - **17%** Under \$500 Million
  - **13%** \$500 Million to Under \$1 Billion
  - **45%** \$1 Billion to Under \$10 Billion
  - **11%** \$10 Billion to \$20 Billion
  - **14%** Over \$20 Billion

# Survey Demographics

Diverse group of respondents who provide services in multiple ways:

- **39%** Retail individuals (typical account size \$1mm or less)
- **70%** High net worth individuals (typical account size \$1mm or more)
- **29%** Family office
- **66%** Institutional clients
- **55%** ERISA assets/pension consultant
- **35%** Registered investment company
- **47%** Private fund (e.g., private partnership, hedge fund, private equity fund)
- **8%** Other (Foundations, Wrap, UCITS)

# Compliance Program: Testing

- Respondents that have done a mock SEC exam (**2018** | **2017**)
  - **43%** | **32%** Yes
  - **17%** | **35%** Plan to, but have not done so yet
- Top 10 Areas of Increased Testing (**2018** | **2017**)
  - **65%** | **76%** Cybersecurity
  - **39%** | **40%** Advertising/marketing
  - **35%** | **27%** Custody (material breaches)
  - **32%** | **28%** Fee calculation/billing
  - **31%** | **38%** Disaster recovery planning
  - **29%** | **30%** Best execution
  - **27%** | **24%** Personal trading/code of ethics (material breaches)
  - **22%** | **29%** Electronic communications surveillance
  - **21%** | **22%** Books and records (material breaches)
  - **20%** | **21%** Social media
- **78%** of respondents said they did not decrease testing in any area (**4%** reduced proxy testing)

# Compliance Program: Culture

Generally respondents are “driving tone from the top” & demonstrating a corporate culture of compliance

- **92%** Provide the annual compliance program review report to senior management
- **91%** The firm conducts annual (or more frequent) employee compliance training
- **82%** The CCO or designee attend various committee meetings
- **79%** The CEO/President is immediately apprised of material compliance issues
- **75%** The CCO meets periodically with the CEO or President to discuss compliance
- **69%** The CCO is one of the most senior executives.
- **67%** Senior management participates in SEC inspections, such as by participating in the opening interview
- **64%** The CCO reports directly to the CEO or President

Documented annual compliance program review results in:

- **65%** Lengthy written Reports
- **51%** Work papers (evidencing tests)
- **33%** Short memorandum
- **23%** Informal notes (summarizing tests)

# Compliance Program: Resources

- Compliance Staffing Size
  - **20%** reported that they employed more than 6
  - **39%** of firms reported employing between 2 to 5 legal and/or compliance professionals
  - **35%** employ only 1
- CCO's Hats
  - **34%** Solely a CCO
  - **20%** CCO + General Counsel/legal counsel
  - **46%** CCO has two or more hats and performs other non-CCO/legal roles

## Compliance Program: Budget

- Budget as a percentage of revenue
  - **45%** Under 5%
  - **20%** 5% to under 10%
  - **7%** Over 10%
  - **28%** Did not know
- What makes up 20% or more of your compliance budget
  - **84%** Compliance personnel
  - **30%** Technology
  - **28%** Outside legal counsel
  - **7%** Third-party compliance consultants
  - **6%** Compliance industry memberships and subscriptions

**Note:** Above results are substantially similar to that of 2017

# Compliance Program: Automation/ Technology

- **67%** of respondents use automated/electronic compliance systems, with the most common automated tasks related to (**2018** | **2017**):
  - **78%** | **81%** Personal trading/code of Ethics (72%)
  - **49%** | **54%** Gifts and Entertainment (25%)
  - **42%** | **47%** Political contributions/Pay-to-play (20%)
  - **41%** | **35%** Client guidelines (29%)
  - **31%** | **24%** Cybersecurity (16%)
- Most (**56%**) respondents believe they will increase the use of automated/electronic compliance systems (**21%** believe that they will not)
- **67%** of respondents do not use automation in the investment management process
- **11%** use investment algorithms that generate recommendations

# Fees & Expenses

# Fees and Expenses

Which types of fees does your firm charge to clients? (check all that apply):

- **97%** Asset-based management fee
- **47%** Incentive fee/performance allocation/carried interest
- **24%** Fixed fees
- **5%** Commissions/sales charges
- **3%** Subscription fees

# Fees and Expenses

Most common controls for accurate fee billing

- **55%** of respondents conduct periodic testing on a sample basis of fee calculations
- **47%** of respondents require more than one person to sign off on advisory fee bills and invoices
- **33%** test all fee calculations

**72%** of respondents had no significant change in fee and expense policies and procedures since January 1, 2017

# Fees and Expenses

<b>Most Frequently Billed</b>		<b>Last Year's Rank</b>
Custodial fees	48%	2
Brokerage fees	45%	1
Third-party (outside counsel) legal fees	38%	3
Third-party accounting fees	38%	5
Third-party administrator fees	38%	4
Fund Board of Director fees	30%	10
Organizational expenses	26%	7
Insurance premiums	24%	8
Research expenses	23%	6
Travel expenses (e.g., for research, due diligence, fundraising)	21%	9

<b>Least Frequently Billed</b>	
Gifts for clients/investors	2%
Compliance costs (other than compliance consultants, staff salaries)	2%
Industry memberships/associations	3%
In-house investment staff salaries	3%
In-house compliance staff salaries	3%
Firm overhead (e.g., rents, utilities, IT, HR)	3%
Entertainment expenses	4%
In-house legal salaries	4%
In-house accounting salaries	5%
In-house administrator salaries	5%

# Fees and Expenses

Top testing for expenses charged to clients

- **47%** If expenses billed to clients are **in line with the terms of their advisory contracts**
- **45%** If expenses billed to clients/investors **are explicitly disclosed in Form ADV, Part 2A**
- **41%** If expenses billed to investors are **in line with the terms of the offering documents of a fund**
- **32%** If expenses billed to clients are correct and appropriately allocated **in accordance with stated policies and procedures** (i.e., among clients or between the adviser and clients)
- **22%** Periodically **review regulatory actions and guidance** to ensure that inappropriate activities are not conducted by our firm
- **22%** If **appropriate approvals** were obtained
- • **21%** Do not specifically test expenses charged to clients
- **21%** If prospects/clients were provided with **adequate disclosures**
- **14%** If expenses billed to clients are **within an expense cap**
- **11%** If **expenses paid by clients directly benefit such clients** (e.g., insurance paid completely by the fund does not also benefit the adviser)
- **10%** Perform an **internal expense mapping exercise** testing expenses for reasonableness and consistency with policies and disclosures



# Investment Mandates

## Investment Mandates: ESG

- **46%** of respondents do consider environmental, social and governance (“ESG”) factors in managing client portfolios
- **27%** of “ESG advisers” signed to the United Nations-supported Principles for Responsible Investment (“PRI:”) Initiative and **10%** considering doing so
- Of the “ESG advisers” that do not intend to sign the PRI Initiative:
  - **15%** Formally consider ESG factors for ALL accounts
  - **35%** Formally consider ESG factors for some designated socially responsible investment (“SRI”) client portfolios
  - **18%** Informally consider ESG factors for ALL accounts
  - **32%** Informally consider ESG factors for some designated SRI client portfolios

## Investment Mandates: ESG

- ESG advisers include the following as part of their program:
  - **62%** Our investment team analyzes all relevant ESG inputs and reaches reasoned conclusions on an independent basis
  - **39%** Have written ESG policy and procedures
  - **32%** Subscribe to a service that supplies ESG research
  - **26%** Our proxy voting policy and procedures address ESG matters
  - **19%** Disclose our ESG policy on our website
  - **13%** Perform ESG training for employees
  - **18%** Compliance reviews portfolios to confirm compliance with our policy and procedures and related disclosures
  - **3%** Utilize ESG consultants to review investment targets
  - **4%** ESG screens and/or restricted lists
  - **4%** Other (utilize sub-advisers, dedicated ESG committee/employee)
- MSCI was the most referenced ESG research vendor, and a 4 way tie for second by Sustainalytics, RepRisk, Trucost, and Bloomberg

## Investment Mandates: ESG

- In making investment decisions, investment teams
  - **74%** Integrate ESG factors into the investment process as part of a wider evaluation of risk and return
  - **22%** Incorporate ESG factors to benchmark corporations to peers or to identify “best in class” investment opportunities based on ESG issues
  - **21%** Actively seek to include companies that have stronger ESG policies and practices in their portfolios
  - **19%** Actively exclude or avoid companies with poor ESG track records
- **57%** of respondents said their approach to ESG has not changed since 1/1/2017, but **19%** of those respondents specifically indicated that ESG has been a definitive part of their process for years
- Remaining respondents indicated it has been increasingly more important in various ways:
  - Formalizing ESG (new policies, including in marketing material, etc.)
  - Adding staff
  - Creating new portfolios/strategies/products

# Investment Mandates: Objectives & Restrictions

- **93%** of respondents said they have policies and procedures in place to ensure that portfolios are managed in accordance with client objectives and restrictions
- **4%** of advisers said that they do not test our portfolio management policies and procedures
- Comparing results from 2009 it appears that SEC's focus areas has played a factor in types of tests. For example, no longer top 10 tests (**2018** | **2009**):
  - **27%** | **40%** Generate cash holdings reports to identify any large or unnecessary cash balances
  - **23%** | **38%** Contact clients to ensure that objectives and restrictions are current

# Investment Mandates

Top 10 controls regarding investment management (2018 | 2009)

- **66%** | **70%** Compare account holdings against client investment guidelines and/or restrictions
- **59%** | **59%** Compare account transactions against client investment guidelines and/or restrictions
- ➔ • **42%** | **34%** Use a front-end automated compliance system
- **37%** | **51%** Compare performance of similarly managed client accounts to detect any favoritism, misallocation of investment opportunities, or other breaches of fiduciary responsibility
- ➔ • **37%** | **30%** Use a back-end automated compliance system
- **36%** | **47%** Review client accounts to ensure that all investments and associated risks are appropriate for the client
- **34%** | **34%** Compare the list of restrictions used by the portfolio manager or automated front-end compliance system against the restrictions in client contracts or other documents
- **34%** | **34%** Test compliance with any applicable fund portfolio diversification requirements
- **34%** | **53%** Compare performance of accounts with like objectives to determine consistency of portfolio management
- **33%** | **41%** Review trades over a period of time to identify trends that indicate front running, insider trading, or other improper trading activities

# Investment Mandates: Sub-Advisers

- **62%** of respondents do not utilize sub-advisers (vs **59%** in 2009)
- Only **55%** of the respondents that utilize sub-advisers have applicable policies and procedures (vs **50%** in 2009)
- Testing and oversight of sub-advisers in (**2018** | **2009**)
  - **46%** | **47%** Conduct the same type of portfolio testing as we do for our own client accounts
  - **44%** | **59%** Distribute and review questionnaires
  - **43%** | **53%** Review sub-adviser policies and procedures related to portfolio management compliance
  - **42%** | **58%** Obtain certifications from sub-advisers regarding compliance with client objectives and restrictions
  - **42%** | **48%** Require notification of compliance breaches by sub-advisers regarding portfolios they manage for our clients
  - **40%** | **68%** Visit each of our sub-advisers and interview key personnel
  - **37%** | **35%** Review each sub-adviser's annual compliance program review report
  - **34%** | **37%** Perform risk-based reviews of sub-advisers
  - **19%** | **36%** Conduct limited portfolio testing
  - **7%** | **12%** Require sub-advisers to have SSAE 18 or other types of audits of its control systems



# Data Analytics

# Data Analytics: Alternative Data Research

- The collection and use of data generated by the inter-networking of physical devices, sensors, drones, satellites and other surveillance devices, websites (i.e. data mining or web scraping), or networks (collectively, “Alternative Data”) is a growing trend among investment advisers because it can provide useful guidance to investment advisers in its research and portfolio management process. However, such collection (either by investment advisers or a third-party provider) and use of Alternative Data can present various regulatory, legal and contractual risks
- **70%** of respondents do not use alternative data research, and of those that do only **18%** have respondents have adopted policies and procedures relating to Alternative Data research
- Policies and procedures state that the use of alternative data research
  - **84%** Requires CCO or General Counsel approval
  - **15%** Employees can engage in alternative data research at their discretion

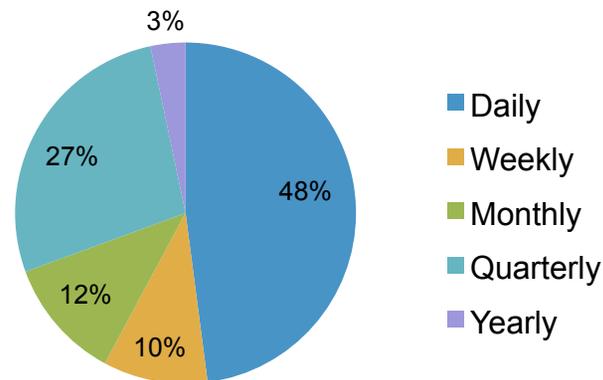
# Data Analytics: Alternative Data Research

Respondents indicate that alternative data research is vetted by the CCO or General Counsel in the following ways:

- **43%** Review service agreements with the source
- **40%** Review the source's terms of service or conditions of use
- **38%** Review confidentiality agreements with the source
- **25%** Consult with outside counsel
- **9%** Review the source's national copyright law
- **6%** Review international copyright law

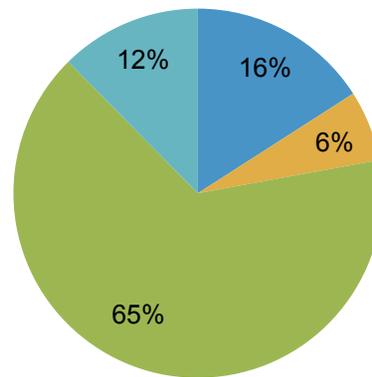
# Data Analytics: Trading Surveillance

- **67%** of respondents do not use trading data analytics to monitor the firm's trading activity
- Of the respondents that do about half used automated trading data analytics third-party software and the other half used internal trading data surveillance
- Nearly half of respondents conducted the trading surveillance daily



# Data Analytics: Trading Surveillance

What are the triggers to flag an item of interest?



- Large price movement
- Volume
- A combination of large price movement and volume
- Other

# Data Analytics: Trading Surveillance

The main inputs for the trading surveillance among respondents:

- **90%** Firm trading activity
- **68%** Employee trading activity
- **62%** Firm restricted lists (i.e. black lists)
- **38%** Firm watch lists (i.e. gray lists)
- **30%** Corporate announcements and/or marketing moving news
- **21%** Employee calendars regarding meetings with corporate employees/representatives
- **20%** Canceled trading activity
- **17%** Employee calendars regarding meetings with expert networks
- **10%** Employee calendars regarding meetings with political consultants

## Data Analytics: Trading Surveillance

- Respondents said that they used trading surveillance to review for:
  - **58%** Use of MNPI
  - **56%** Best execution exceptions
  - **49%** Misallocation among clients
  - **48%** Market abuse
  - **6%** Other (trade errors, client guidelines, broker performance)
- Monitoring and flagging trade responsibility initially lies with:
  - **50%** Other compliance personnel
  - **18%** CCO
  - **8%** Head trader
  - **8%** Other trading personnel
  - **8%** Other (Risk, combination of senior management or division heads, CEO)
  - **6%** Other operations personnel
  - **2%** COO



# Custody

# Custody

How respondents have custody of client assets

- **64%** Authority to deduct advisory fees
- **25%** Serve as a general partner (or managing member) and an adviser to a pooled investment vehicle
- **20%** Have access to or the ability to withdraw funds from client accounts
- **15%** Have access to, or authority to access, client funds or securities
- **14%** Have bill-paying or check-writing authority
- **13%** Have a general power of attorney
- **11%** Affiliate serves as a general partner (or managing member) to a pooled investment vehicle under our management
- **9%** Act, or an affiliate (e.g., an employee) acts, as trustee and adviser to a trust (except as a result of a family, personal relationship or other exception)
- **6%** Affiliate physically possesses client funds or securities in connection with advisory services we provide to clients
- **6%** Related person (e.g., an officer or director) acts as trustee of our firm's retirement plan, and we or our related person acts as an investment adviser to the plan or any investment option available under the plan
- **5%** Other (SLOA mentioned by a few respondents)
- **3%** We physically possess client funds or securities

# Custody

## Top 10 Controls to Safeguard Client Assets & Prevent Misappropriation

- **55%** Conduct **background and credit checks on employees** who have access (or could acquire access) to client assets to determine whether it would be appropriate for those employees to have such access
- **52%** **Provide custodians with a list of employees authorized** to provide instructions
- **51%** **Limit the employees who are authorized to transmit trade orders** for client accounts
- **43%** Established **segregation of employee duties**
- **42%** Require the **authorization of more than one employee** before the movement of assets within, and withdrawals or transfers from, a client's account
- **37%** **Limit the number of employees who are permitted to interact with custodians** with respect to client assets
- **30%** Test **reconciliation of account statements prepared by our firm with account statements prepared by the custodians**
- **27%** Use **special passwords for employees with respect to electronic trading software and systems**
- **22%** **Review the signatory authorities** on client accounts
- **20%** **Monitor employees' ability to become trustees** for client accounts

# Custody

## Controls to Avoid Inappropriate Fee Deductions

- **60%** ensure that clients' assets under management on which advisory fee is billed is accurate and has been reconciled with the AUM on client custodial statements (up from **54%** in 2014)
- **47%** review client contracts to determine that they bill in accordance with the terms of client contracts
- **44%** conduct periodic testing on a sample basis of fee calculations for client accounts to determine their accuracy
- **25%** reconcile invoices with deposits made by custodian(s) into proprietary bank account to confirm that accurate fee amounts are being deducted

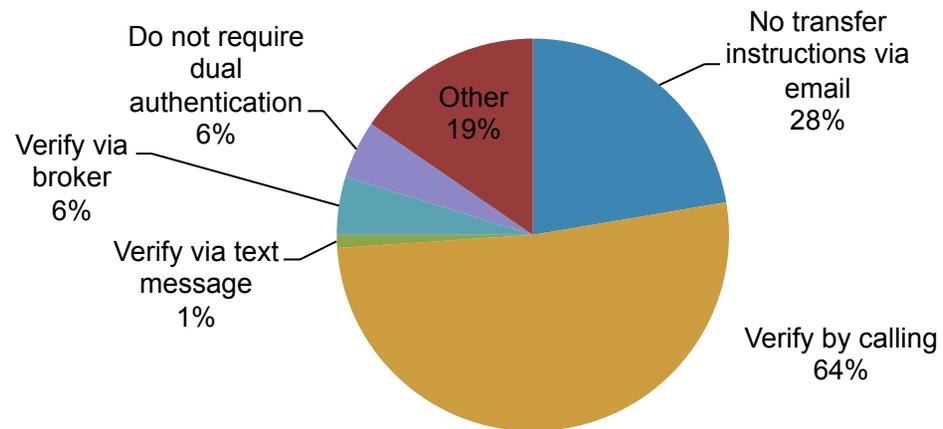
# Custody

How do you have a reasonable basis that custodians are sending statements?

- **30%** rely on custodian to mail or email a duplicate copy of the account statement at the same time it mails or emails statement to client
- For **25%**, the custodian makes custodial account statements sent to the firm's clients available on the custodian's website, and the firm accesses and reviews the account statements on the custodian's website in addition to taking additional steps to determine whether account statements were sent to clients, or that clients obtained statements through the website
- **23%** rely on a notice from the custodian that it has mailed or e-mailed client account statements and has made copies available on the custodian's website

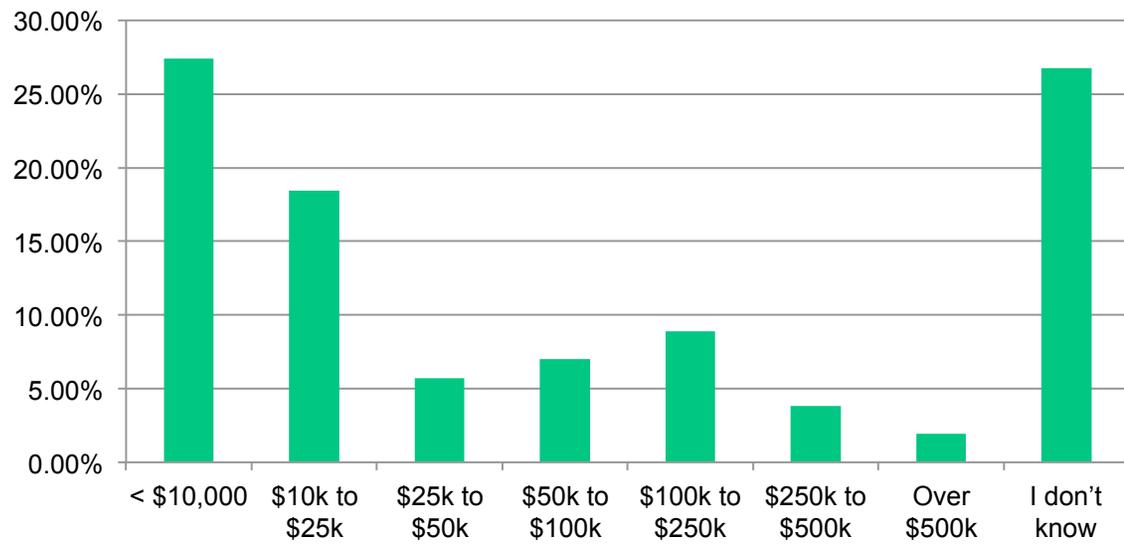
# Custody

How does your firm test the legitimacy of client requests for transfers of funds out of their accounts? (check all that apply)



# Custody

Total custody-related compliance costs in 2017  
(estimate)



# Custody

Have you taken any of the following steps to avoid or limit having custody since January 1, 2017?

- **44%** Monitor our business activities to confirm whether we continue to not have custody
- **32%** Do not act as trustee to a trust (except under a family, personal relationship or other exception)
- **15%** Invoice advisory fees rather than deduct them
- **14%** Other
- **11%** Do not act as trustee to our in-house retirement plan
- **10%** Periodically require certifications from our employees
- **8%** The legal document governing private funds restrict the general partner's ability to transfer money

Several respondents mentioned complying with SLOA no-action letter and conducting due diligence on inadvertent custody to avoid or limit having custody



# Best Execution

## Best Execution

- **12%** of respondents said they do not evaluate best execution, compared to **18%** in 2012 which was the last time we covered best execution, and for those that did their reviews included (**2018** | **2012**):
  - **81%** | **76%** Equities
  - **44%** | **43%** Fixed income
  - **18%** | **17%** Derivatives
  - **17%** | **14%** Foreign currency transactions
  - **5%** | **9%** Other
- Frequency of best execution committee meetings
  - **48%** Quarterly
  - **15%** Annually
  - **10%** Ad Hoc
  - **3%** Monthly
  - **23%** Do not have a best execution committee

## Best Execution

### Top 10 controls on equity trades

- **56%** An approved brokers list is periodically reviewed
- **47%** Confirm that only approved brokers were used
- **42%** Review brokerage commission reports prepared in-house
- **30%** Attempt to negotiate commission rates with our brokers
- **28%** Evaluate execution quality using benchmarks (e.g., Volume-Weighted Average Price)
- **28%** Identify outliers where commission rates paid appear to be higher and follow up with trading personnel to determine the reason why
- **27%** Review disclosures regarding execution policies with actual practices
- **27%** Review brokerage commission reports provided by our brokers
- **27%** Review brokers' execution quality against the quantity of brokerage allocated to each broker
- **26%** Review allocations of brokerage among brokers for reasonableness (without reference to specific target allocations)

## Best Execution: Testing on FX Trades

- **32%** Post-trade basis, spot check documentation regarding contemporaneous dealer quotes
- **31%** Pre-trade basis, seek additional quotes for each trade
- **25%** Post-trade basis, review using comparable trades made by our firm
- **24%** Post-trade basis, review using TRACE data
- **10%** Post-trade basis, review using MSRB data
- **8%** Pre-trade basis, seek additional quotes for a sample of trades
- **6%** Other
- **2%** Review brokerage reports provided by our counterparties

Note **8%** of respondents said they do not review fixed income transactions for best execution

## Best Execution: Third-Party Services

- **70%** of respondents said they do not use third-parties to review best execution, while **7%** are contemplating doing it
  - **16%** Quarterly
  - **2%** Annually
  - **2%** Once, probably won't again
  - **2%** Once, probably will do it again but nothing planned
- Third-parties evaluated:
  - **85%** Equities
  - **24%** Fixed income
  - **15%** Foreign currency transactions
  - **13%** Other
  - **11%** Derivatives
- **48%** of respondents that did use third-party services found it helpful, **41%** somewhat, **10%** did not find it helpful at all

## Best Execution: Directed Brokerage

- **53%** of respondents never accept client directed brokerage, **24%** almost always (w/o limits), and **23%** yes occasionally or with limits.
- Of those of the respondents that do accept directed brokerage **38%** trade exclusively with the direct broker, while the remainder will do otherwise in the following situations:
  - **24%** Step out minimally to achieve best execution
  - **10%** Step out frequently to achieve best execution
  - **13%** Trade away minimally to achieve best execution
  - **16%** Trade away frequently to achieve best execution
  - **5%** Other (up to a limit, fixed income only)
- **33%** of respondents said that they did not have specific policies in regards to trade order entry
  - **32%** We rotate, so in some cases, client-directed accounts may go first
  - **23%** Client-directed accounts always go last
  - **5%** Other (Same time, FIFO, Trader discretion)

## Best Execution: Directed Brokerage

- **47%** of respondents said that no additional testing or monitoring was done on directed brokerage transactions, those that did test:
  - **28%** Sample files of clients with directed brokerage arrangements for documentation evidencing that those clients have received appropriate initial disclosures regarding how directed brokerage can affect their execution
  - **24%** Compare average client commissions for client-directed accounts with average client commissions for non-directed accounts
  - **16%** Sample transactions in client- directed accounts to determine whether we have traded away or used step outs to seek best execution where appropriate
  - **14%** Sample files of clients with directed brokerage arrangements for documentation evidencing that clients have received periodic disclosures regarding how directed brokerage can affect their execution (e.g., informing them that we have negotiated lower commission rates with other brokers)
  - **4%** Other



# Soft Dollars

## Soft Dollars: Usage

- Use of soft dollars
  - **39%** Receive broker proprietary research and other products and services from our full-service broker-dealers
  - **33%** Do not actively seek out third-party soft dollar products and services
  - **29%** Receive outside research and other products and services from third-party independent research providers, paid for by our broker-dealers
  - **29%** Do not engage full-service broker-dealers and we do not receive proprietary research
  - **2%** Use client brokerage commissions to pay for referrals and other products and services outside the Section 28(e) safe harbor
- **34%** Of respondents do not test soft dollars
  - **27%** test annually, **27%** quarterly, **6%** monthly, and **3%** semi-annual

## Soft Dollars: Testing Best Practices

- **49%** Review soft dollar disclosures against our actual practices
- **41%** Review soft dollar commission reports that we prepare in-house
- **40%** Review each soft dollar product and service to confirm that it is “brokerage or research” covered by Section 28(e)
- **34%** Review each soft dollar product and service requested or obtained for reasonableness
- **30%** Compare soft dollar brokerage allocations against target allocations
- **27%** Review soft dollar broker-dealer quality of executions against quantity allocated to each broker
- **27%** Review soft dollar commission reports prepared by our broker-dealer partners
- **17%** Informally discuss soft dollar commission ratios with our industry peers to assure that we are paying a reasonable soft dollar ratio
- **9%** Market shop soft dollar commission ratios to assure that we are paying a reasonable soft dollar ratio
- **8%** Look for quarter-end skewing of allocations and other indications of our traders attempting to hit a soft dollar target

## Soft Dollars: MiFID II Implications

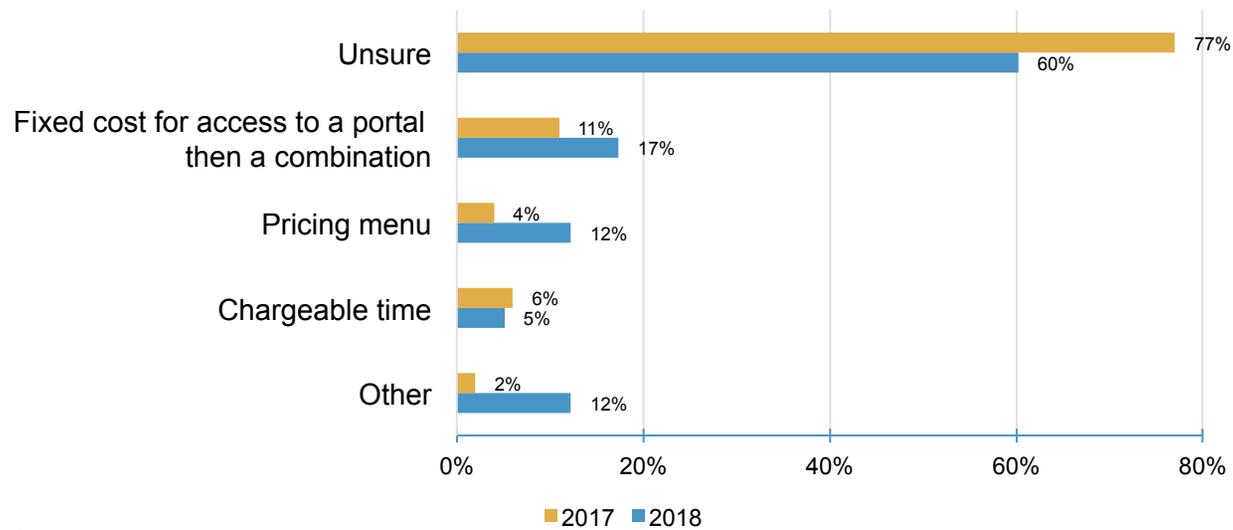
- **73%** No business dealing inside the EU or with an MiFID-regulated firm
  - **18%** Are indirectly affected (e.g., via outsourcing or delegation agreements with a MiFID II firm)
  - **8%** Located in the EU and are directly effected
- Paying For Research post MiFID II (**2018** | **2017**):
  - **26%** | **58%** Unsure
  - **24%** | **9%** Direct payment from the firm's P&L
  - **11%** | **4%** Commissions based charge to client(s) collected alongside transaction commissions
  - **5%** | **8%** Direct charge to client(s) to fund a research payment account (RPA).
  - **14%** | **11%** A combination of the above
  - **8%** | **-** Excluded affected clients, restricted research purchases of research from MiFID firms

## Soft Dollars: MiFID II Implications

- **48%** of respondents said clients have not contacted them regarding payment of research
  - **33%** EU clients have requested confirmation of compliance with MiFID but have not directed how we specifically comply
  - **11%** EU domiciled clients have requested that we pay for research from the firm's P&L
  - **2%** Non-EU domiciled clients requested that we pay for research from the firm's P&L
  - **2%** No communication at all
  - **1%** We reached out
- Only **15%** of respondents said MiFID II significantly impacted their soft dollar program and **5%** said it was the "End of Soft Dollars as we Knew it"
  - **30%** Not Applicable: We didn't have a soft dollar program so no impact
  - **24%** No Changes Here: MiFID II has had no impact on our soft dollar program
  - **19%** Still Unsure: We haven't heard from all EU clients
  - **5%** Minimal impact
  - **3%** Moderate impact

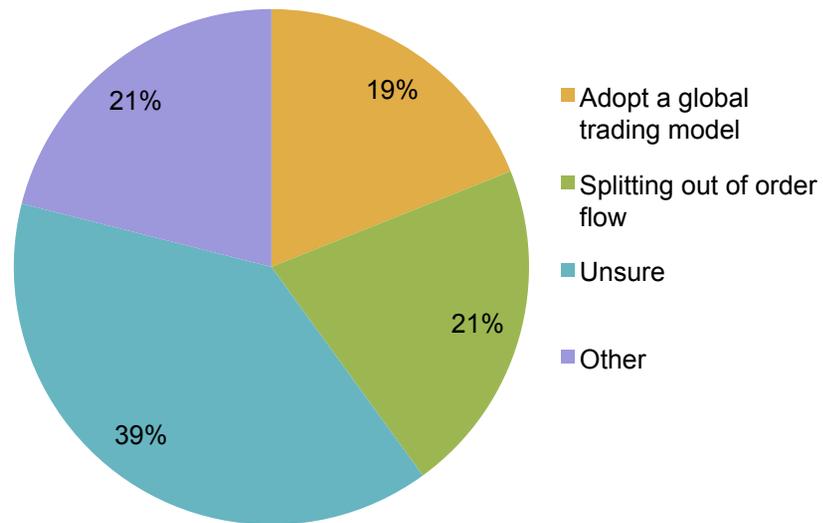
# Soft Dollars: MiFID II Implications

Charging structure offered by sell-side counterparties  
opting for in relation to research services



# Soft Dollars: MiFID II Implications

Respondents that are subject to different requirements for paying for research across different jurisdictions





# Advertising/Social Media

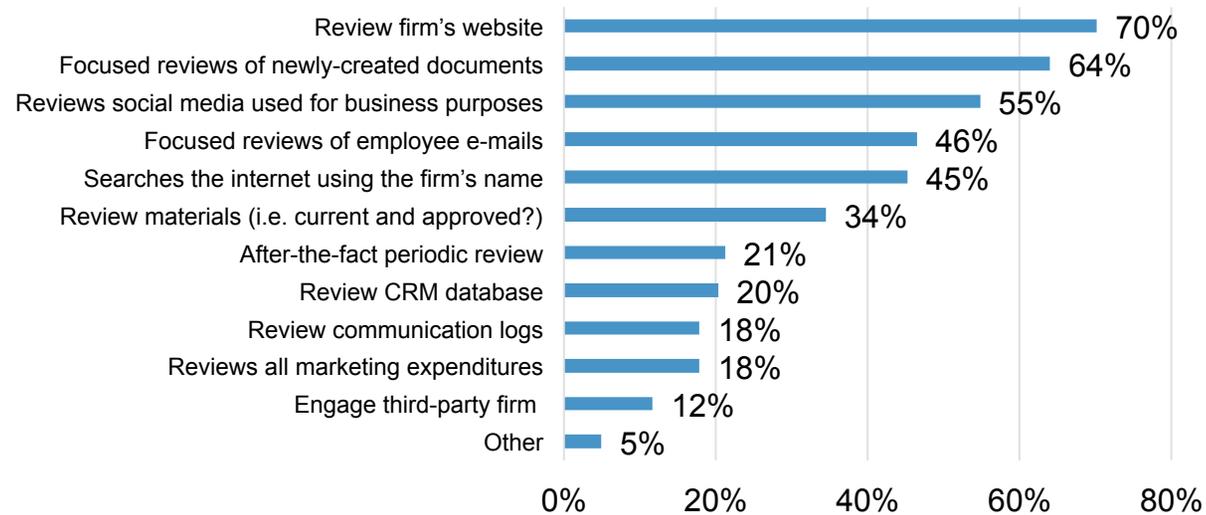
## Advertising

Top 10 controls relating to marketing/advertising:

- **86%** Written P&Ps
- **67%** CCO pre-approval
- **54%** Pre-clear interactions with media
- **52%** Log used
- **43%** Pre-clear participation at third-party conferences/seminars
- **39%** Compliance approves all third-party solicitation agreements
- **36%** RFP responses require CCO approval
- **35%** Compliance involved in new business/product meetings
- **33%** Marketing materials require approval by another individual (other than CCO or preparer's supervisor)
- **32%** Approval and review of reprints

# Advertising

Respondents testing of marketing/advertising activities



# Advertising

How do you test performance advertising?

- **50%** Confirm required disclosures included
- **46%** Net-of-fees or gross in compliance with no-action relief
- **43%** Consistency of benchmarks over time (no cherry picking)
- **42%** Back up documentation maintained

# Advertising

How do you test performance advertising?

- Only **32%** reviewing composites to ensure all similar accounts included
- **35%** claiming **GIPS** compliance with most obtaining an annual verification; **15%** getting performance composites examined
- **Less than 1/3** have second internal review

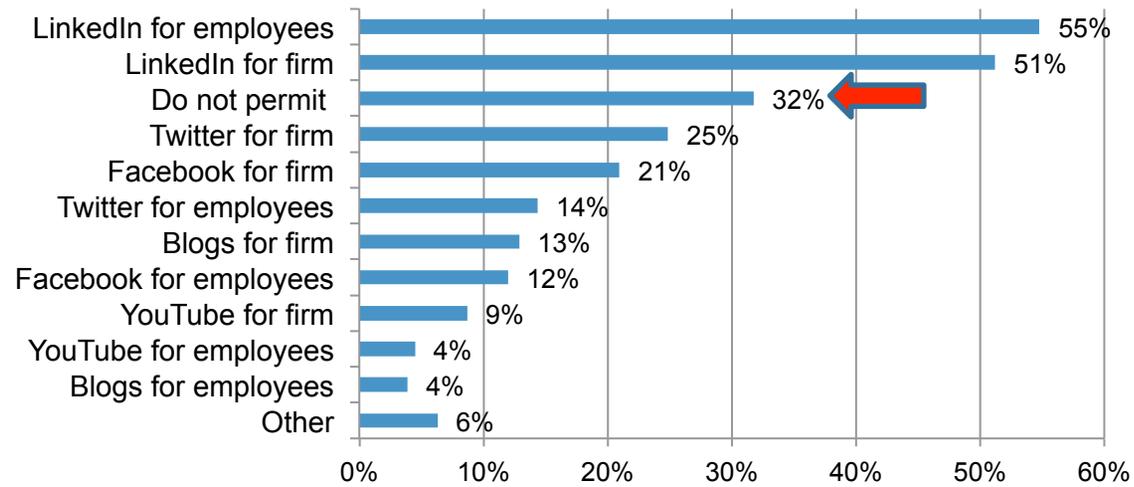
# Advertising

How do you test ***third-party*** performance advertising?

- Vast majority do NOT market performance calculations of third-parties (**68%**)
- Of the firms that do, **4%** engage an external reviewer; **16%** test internally; and **16%** do not test calculations of third-parties

# Social Media

Types of activities that are permitted/engaged in by respondents



## Social Media

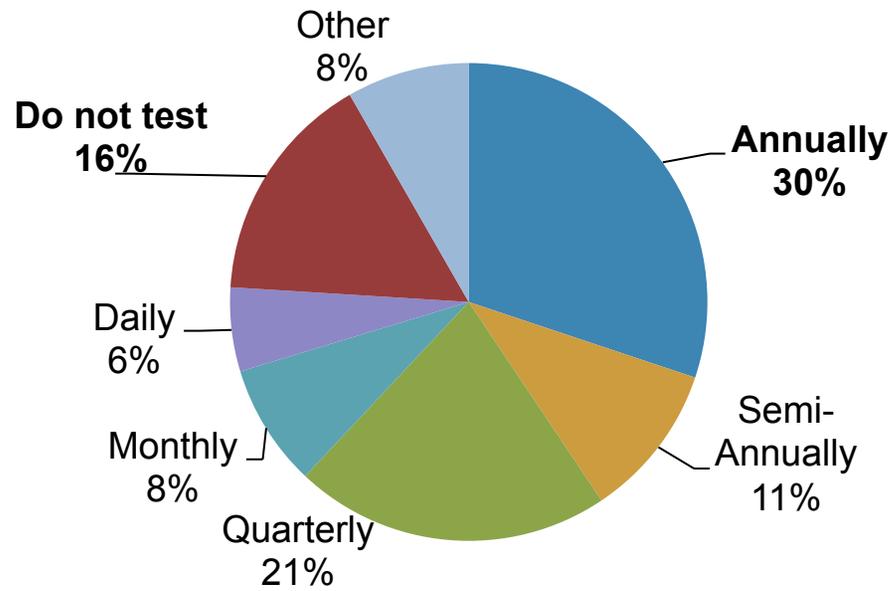
Which controls has your firm adopted?

Written stand-alone policy	37%
Policies included in other written P&Ps	62%
Informal unwritten policy	6%
Require employees "friend" compliance	14%
Review and maintain employee e-mails from personal or social media hosted accounts on company-issued computers	20%
Require employees to use their business e-mail on social media platforms	23%
Require employees pre-clear social media content	33%
Limit employee's company-related content on LinkedIn to only providing employer name and work title	38%
Limit employee's company-related content on other social media platforms	40%
Do not limit an employee's social media content	3%
No controls with respect to social media	2%
Other	7%



# Social Media

Frequency of social media testing



# Advertising

Recommendations for amending the advertising rule:

- Remove *per se* prohibitions on past specific recommendations and testimonials
- No more rulemaking by no-action letters
- Factor in social media usage
- Allow for more flexibility with institutional clients

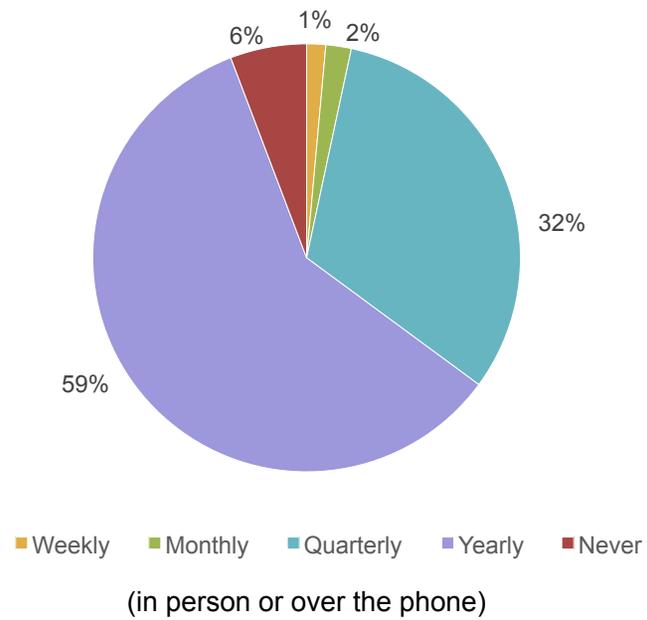


# Individual Clients

## Individual Clients

- **60%** of respondents provide advisory services to individual clients (e.g. retail, high net worth, trusts)
- Specific processes when providing advisory services to individual clients:
  - **62%** Employees formally document their meetings with clients
  - **39%** Client retirement plan is documented
  - **37%** Client marital status/planning is documented
  - **30%** Client executors and any planned changes are documented
  - **21%** Material medical issues are documented
  - **20%** Final invoices terminated due to death are reviewed

# Individual Clients: Formally Meeting Frequency



# Individual Clients: Death & Diminished Capacity

- Dealing with complications of death & diminished capacity
  - **45%** Client beneficiaries/contingent beneficiaries and any planned changes are documented
  - **35%** Require authorized persons to notify firm of a death/diminished capacity of a client
  - **35%** Conduct employee training regarding identifying signs of diminished capacity
  - **35%** Adopted policies and procedures relating to diminished capacity or death of clients
- Methods of verifying legitimacy death & diminished capacity
  - **46%** death certificate
  - **27%** court documents
  - **18%** contacting client's beneficiaries and/or contingent beneficiaries
  - **12%** contacting client's lawyer



# Cryptocurrency

# Cryptocurrency

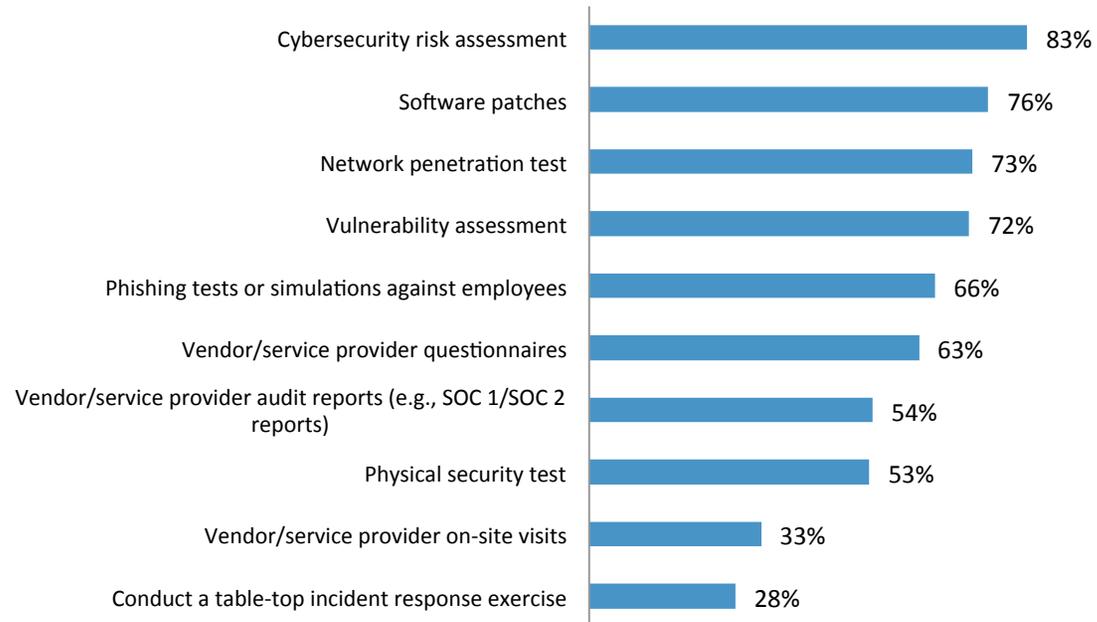
- **99%** of respondents do not trade cryptocurrencies on behalf of clients
- **74%** of respondents' policies and procedures do not contemplate cryptocurrencies for personal trading
- Respondents required employees to preclear of:
  - **10%** initial coin offerings
  - **7%** any transactions in any cryptocurrency that is a security
  - **5%** any cryptocurrency transactions
- Only **1%** of respondents strictly prohibited employees from personal trading in any cryptocurrencies:
  - **3%** Allow trading in only certain cryptocurrencies
  - **8%** Allow trading in all cryptocurrencies
- Only **5%** of respondents required employees to report all personal cryptocurrency transactions:
  - **7%** Required reporting of transactions of cryptocurrencies that are securities
  - **7%** Required reporting of all initial coin offerings

# Trend Updates

Cybersecurity  
Pay-to-Play  
Form ADV  
“Hot” Topics

## Trend Update Cybersecurity

### Types of cybersecurity assessments

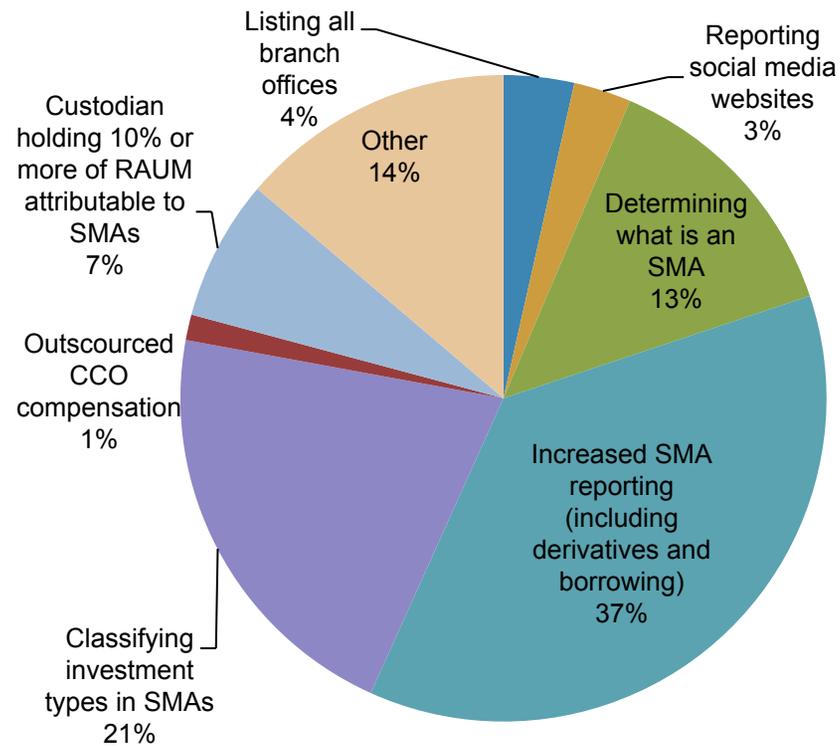


## Trend Update Pay-to-Play

- Only **4%** flatly prohibit political contributions
- Most firms (**40%**) test annually
- Most firms (**79%**) did not make any changes to P&Ps; top change made - requiring pre-clearance of all political contributions (**8%**)

## Trend Update Form ADV

**Which part of the new Form ADV  
did you find most onerous?**



## Trend Update “Hot” Topics

Topics	2012	2013	2014	2015	2016	2017	2018
<b>Custody</b>	12%	20%	23%	18%	10%	26%	28%
<b>Advertising/Marketing</b>	26%	34%	27%	23%	19%	17%	29%
<b>Fraud Prevention</b>	11%	12%	13%	13%	9%	11%	5%
<b>Disaster Recovery</b>	X	X	16%	17%	8%	20%	9%
<b>AML/FCPA/Anti-Bribery</b>	8%	10%	10%	8%	24%	14%	9%

Trend Update  
“Hot” Topics

<b>Cybersecurity</b>	<b>81%</b>
<b>Advertising/marketing</b>	<b>29%</b>
<b>Custody</b>	<b>28%</b>
Privacy	27%
Fiduciary Duty	22%
MiFID II	16%
GDPR	15%
Social Media	11%
Valuation	11%
Regulatory reporting	10%

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