OCIE Issues Risk Alert on Advisory Fees and Expense Compliance Issues Identified in Deficiency Letters

On April 12, 2018, the staff of the SEC’s Office of Compliance Inspections and Examinations (OCIE) published a National Exam Program Risk Alert (the Risk Alert) about the most frequent advisory fee and expense compliance issues identified in deficiency letters sent to registered investment advisers. These issues were gathered from over 1,500 adviser examinations completed by OCIE staff during the past two years. The “key takeaways,” according to the Risk Alert, are that registered investment advisers “should review their practices, policies, and procedures to ensure compliance with their advisory agreements and client representations in light of the fee and expense issues noted in [the] Risk Alert.”

The most frequent deficiencies identified by OCIE staff relating to advisory fee and expenses were categorized as follows:

• Fee-Billing Based on Incorrect Account Values. OCIE staff observed that advisers incorrectly valued assets in client accounts, resulting in the over-billing of asset-based advisory fees. For instance, advisers used a different valuation methodology or process than the one specified in the client’s advisory agreement.

• Billing Fees in Advance or with Improper Frequency. OCIE staff noted discrepancies between an adviser’s billing practices and the methodology set forth in a client’s advisory agreement or disclosed in Form ADV Part 2. Examples noted in the Risk Alert included advisers billing on a monthly basis in situations in which the advisory agreement provides for billing on a quarterly basis, and billing in advance for an entire billing period when the advisory services commenced or terminated other than at the beginning of a billing period.

• Applying Incorrect Fee Rate. OCIE staff observed instances in which a client was billed at a higher rate than provided for in the advisory agreement or in which a non-qualified client was charged a performance-based fee.

• Omitting Rebates and Applying Discounts Incorrectly. OCIE staff observed circumstances in which advisers omitted or did not correctly apply certain discounts or rebates to a client’s account, resulting in clients being overbilled. Examples identified in the Risk Alert include failure to aggregate related client accounts—which would have qualified such clients for discounted fees—and failure to reduce a client’s fee rate when the value of that client’s account reached a prearranged breakpoint level. Another example of an inappropriate fee practice cited in this category is charging a wrap fee program client additional fees, such as brokerage fees, when the transactions should qualify for the wrap fee program’s bundled fee.

• Disclosure Issues Involving Advisory Fees. OCIE staff also noted issues with respect to disclosure of an adviser’s fees and billing practices. For example, OCIE observed that advisers contracted for an advisory fee in a client’s advisory agreement that exceeded the maximum fee rate disclosed in the client’s Form ADV. OCIE staff also observed advisers that failed to disclose certain additional fees or markups, in addition to advisory fees, including situations in which advisers collected expenses from a client for third-party execution and clearing services that exceeded the actual fee charged for those services by the outside clearing broker.

• Adviser Expense Misallocations. OCIE staff observed instances in which advisers to private funds and registered funds misallocated certain expenses to clients; for example, marketing expenses, filing fees and travel expenses.
OCIE’s objective in publishing the Risk Alert was “to encourage advisers to assess their advisory fee and expense practices and related disclosures to ensure that they are complying with the Advisers Act, the relevant rules, and their fiduciary duty, and review the adequacy and effectiveness of their compliance programs.”

The Risk Alert concluded by noting certain remedial measures taken in response to OCIE’s observations, including reimbursement of clients by the overbilled amount of advisory fees and expenses, enhancement of policies and procedures and implementation of periodic internal testing of billing practices.


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