

Frequent Fee Follies: OCIE Identifies Most Frequent Advisory Fee Compliance Issues

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Last week, the Securities and Exchange Commission's Office of Compliance Inspections and Examinations ("OCIE") released a Risk Alert covering the most frequent advisory fee and expense compliance issues identified in over 1,500 deficiency letters sent to registered investment advisers during the past two years.

The alert highlighted six categories of compliance risks frequently observed by the OCIE. The majority of the errors stemmed from advisers not strictly complying with the language of the advisory agreement or taking actions contrary to the disclosures found in the adviser's Form ADV. While the alert focuses on the findings in examination deficiency letters, references throughout to violations of the antifraud provisions signal the scrutiny that the SEC is giving to fees and charges to advisory clients and highlight the possibility that examination deficiencies may lead to enforcement proceedings.

OCIE's National Exam Program has been conducting a number of sweep initiatives focused on fees and expenses charged to advisory clients. Clients are encouraged to consider how the firm would fare in an examination in each of these categories highlighted in the Risk Alert:

1. **Fee-Billing Based on Incorrect Account Valuations** – OCIE staff identified numerous instances of advisers incorrectly valuing assets or valuing client accounts using a different process than the one specified in the advisory agreement. Since fees are normally assessed as a percentage of the value of the assets, an incorrect valuation can lead to overcharging clients.
2. **Billing Fees in Advance or with Improper Frequency** – OCIE staff identified billing practices that did not match up with the timing or frequency outlined in the advisory agreements. Staff also identified problems related to advisers not prorating fees appropriately when required to under the advisory agreement.
3. **Applying Incorrect Fee Rate** – OCIE staff identified advisers who either applied a rate of fees higher than stated in the agreement or double-billed clients.
4. **Omitting Rebates and Applying Discounts Incorrectly** – OCIE staff identified advisers who failed to apply discounts or rebates listed in the advisory agreement. Examples included advisers not applying fee reductions when the value of the account reached a pre-arranged breakpoint level, and advisers failing to aggregate accounts from the same household when determining fees.
5. **Disclosure Issues Involving Advisory Fees** – OCIE staff identified advisers who made disclosures on their Form ADV that did not accurately reflect their actual practices.

6. Adviser Expense Misallocations – OCIE staff identified expenses that were misallocated to funds, such as marketing and travel expenses being allocated to clients rather than to the adviser.

The stated purpose of the Risk Alert is to encourage registered advisers to take a closer look at fee and expense practices, along with related disclosures in the firm's marketing materials, client agreements, and Form ADV, to make sure the practices do not run afoul of the Advisers Act or other relevant rules or laws. The alert encourages registered advisers to review compliance programs to ensure that fees and expenses are reviewed periodically along with the adviser's disclosures and that the review process is effective at identifying any issues within the highlighted areas.

Advisers who conduct reviews and find that clients may have been overcharged or otherwise incorrectly billed should take steps to correct any errors and proactively reimburse clients. Not only have such steps been encouraged by OCIE in the Risk Alert and by officials in the exam program, prompt corrective action can operate to avoid or lessen the possibility of an enforcement referral.