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Company Name

Compliance Program Review OR SEC Preparedness and Compliance Gap Analysis

Findings and Recommendations Report

Date

Attorney-Client Privileged

**DRAFT**

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**I. Executive Summary**

Pursuant to the instructions of NAME OF LAW FIRM, ACA Group (“ACA”) appreciates the opportunity to describe its findings relating to its review of Adviser XYZ (“XYZ” or the “Company”), the on-site portion of which took place from Month Day, 20XX through Month Day, 20XX. ACA reviewed each of the following areas in relation to XYZ’s business activities:

[A. Portfolio Management 12](#_Toc32384669)

[B. Proxy Voting 14](#_Toc32384670)

[C. Trading 16](#_Toc32384671)

[D. Code of Ethics and Insider Trading 19](#_Toc32384672)

[E. Fees and Expenses 21](#_Toc32384673)

[F. Regulatory Filings and Disclosures 23](#_Toc32384674)

[G. Safeguarding Client Assets 26](#_Toc32384675)

[H. Books and Records 28](#_Toc32384676)

[I. Marketing and the Use of Solicitors 30](#_Toc32384677)

[J. Valuation and Pricing 33](#_Toc32384678)

[K. Privacy, the Safeguarding of Information, Cybersecurity, and Identity Theft Prevention 35](#_Toc32384679)

[L. Business Continuity Planning 37](#_Toc32384680)

[M. Compliance Program 38](#_Toc32384681)

ACA provided recommendations and suggested corrective action with respect to certain aspects of XYZ’s business activities as noted below in the “Findings and Recommendations” section.

<Right-click the preceding table and select “Update Field,” make sure “Page Numbers Only” is selected, and then click “Okay” to update the page numbers immediately prior to finalizing the report. Also, format those topics where ACA makes specific recommendations in bold.>

Based on ACA’s review, XYZ’s compliance program appears well-tailored and comprehensive relative to the scope and nature of the Company’s operations. XYZ appears to have created internal controls and risk management policies and procedures that are reasonably designed to address applicable compliance risks.

<Tailor the preceding language as appropriate.>

**II. Objectives and Approach**

## A. Objectives

ACA’s review of XYZ’s compliance program sought to identify issues relevant to the Company’s compliance with

* the Investment Advisers Act of 1940 (the “Advisers Act”),
* internal policies and procedures,
* industry best practices,
* common practices of XYZ’s peers, and
* anticipated regulatory expectations.

ACA’s review included an assessment of the adequacy and effectiveness of XYZ’s policies and procedures in each of the following areas:

* Portfolio management processes, including the fair allocation of investment opportunities and the consistency of portfolios with clients’ investment objectives and applicable regulatory restrictions
* Proxy voting practices
* Trading practices, including procedures by which the adviser satisfies its best execution obligation
* Proprietary trading of the adviser and personal trading activities of supervised persons
* The accuracy of disclosures made to clients, investors, and regulators, including account statements and advertisements
* The creation and maintenance of required records, including policies and procedures designed to protect against unauthorized access and premature destruction
* Marketing practices, including the use of solicitors
* Valuation and fee calculation practices
* Cybersecurity controls, including physical and electronic safeguards for the protection of sensitive information, including client and investor records and XYZ’s other proprietary information
* Safeguards for the protection of client assets from conversion or inappropriate use by advisory personnel
* Fee and expense practices, including expense allocations
* Disaster recovery and business continuity planning
* Other areas ACA deemed necessary based upon XYZ’s specific compliance and operational risks

<Tailor the preceding list to reflect the scope of your review.>

While ACA’s review addressed each of the areas noted above, ACA prioritized the areas that it believed presented the most risk to the Company and/or its clients.

**B. Approach**

ACA’s review of XYZ’s compliance program included the following actions:

* We reviewed certain books and records covering the time period from Month XX, 20XX through Month XX, 20XX (the “Review Period”). ACA’s document request list incorporated broad document requests in each of the following areas:
  + - * Advisory client information
      * Disclosure documents and agreements
      * Code of ethics
      * Trading and portfolio management
      * Risk management
      * Fees and expenses
      * Pricing and valuation
      * Advertising and solicitation
      * Committees, controls, and procedures
      * Safety of clients’ funds and assets
      * Client privacy and information security
      * Other documents and business activities

<Tailor the preceding entries to reflect the document request list that you use.>

* ACA reviewed XYZ’s written policies and procedures, as well as documentation demonstrating the way in which such policies and procedures were implemented.
* We interviewed the following personnel to gain additional insight into XYZ’s operations and to compare the Company’s written policies and procedures with its practices:
  + - * <Name, Title, Department>
      * <Name, Title, Department>
      * <Name, Title, Department>
* We analyzed the testing that XYZ uses to evaluate the adequacy and effectiveness of its compliance program, including ongoing reviews, forensic testing, and periodic and systematic analyses.
* We tested XYZ’s trading data for the Review Period using ACA’s Decryptex® Trade Blotter Review Tool.
* We reviewed XYZ’s Compliance Manual.
* We evaluated XYZ’s responses to issues noted during ACA’s prior review.
* We evaluated XYZ’s responses to issues noted during the most recent examination by the Securities and Exchange Commission, which took place in Month Year

**III. Material Business Changes**

The following material changes in XYZ’s business activities occurred during the Review Period:

* <Discuss any changes in key personnel, business lines, investment strategies, investment vehicles utilized, office locations, etc. If there are no changes, make that notation in the sentence above and delete this bullet. If there is only one change to note, place the text after the colon above, replace “changes” above with “change,” and delete this bullet. Consultants should be mindful of what clients considered “material” for ADV purposes when completing this section and may consider removing the references to materiality when discussing certain changes.>

**IV. Regulatory Changes and <Division of Examination/OCIE> Examination Priorities**

Many registered investment advisers responded to the following regulatory developments during the Review Period. <Certain of t/T>hese regulatory developments were authored by what was then known as the Securities and Exchange Commission’s (the “SEC” or the “Commission”) Office of Compliance Inspections and Examinations (“OCIE”). On December 17, 2020, OCIE announced it had been renamed as the Division of Examinations. This section of the report refers to OCIE (not the Division of Examinations) when discussing publications that were issued prior to December 17, 2020.

In addition to assessing actions taken by XYZ in response to regulatory developments, ACA evaluated XYZ’s ability to address OCIE’s 2020 examination priorities[[1]](#footnote-2) as set forth below.

* Examination Priorities – On January 7, 2020, OCIE released its examination priorities for 2020. Areas of interest to registered investment advisers include the following: <Consultants should tailor this list to include initiatives that are relevant to particular clients.>
  + - * Retail Investors, Including Seniors and Individuals Saving for Retirement
        + Fraud, Sales Practices, and Conflicts
* Recommendations and Advice Given to Retail Investors – Examinations will focus on advice given to seniors (particularly by advisers and individuals that target retirement communities), teachers and military personnel.
* Higher Risk Products – Examinations will focus on private placements and securities in new and emerging risk areas, such as those that: are complex or non-transparent; have high fees and expenses; or entail issuer affiliation.
* Outside Business Activities - Examinations will focus on disclosures and supervision of outside business activities and any conflicts that may arise from those activities.
* The Duties of Care and Loyalty - OCIE will assess whether advisers provide advice in the best interests of their clients and whether they have eliminated or disclosed conflicts of interest. OCIE will also continue to focus on risks associated with fees and expenses, and undisclosed or inadequately disclosed compensation arrangements.
* Retail-Targeted Investments - OCIE will continue to prioritize the examination of financial incentives provided to financial services firms and professionals that may influence the selection of particular mutual fund share classes.
* Standards of Care - After the applicable compliance date, OCIE intends to assess the content and delivery of Form CRS by advisers. OCIE has already integrated the Interpretation Regarding Standard of Conduct for Investment Advisers into its examination program.
  + - * Information Security
        + OCIE Examinations Generally – Examinations will focus on: the proper configuration of network storage devices; information security governance; and retail trading information security.
        + Adviser Examinations - OCIE will continue to focus on the protection of clients’ personal financial information. Particular focus areas will include: governance and risk management; access controls; data loss prevention; vendor management; training; incident response and resiliency; compliance with Regulations S-P and S-ID; controls surrounding online and mobile application access to customer brokerage account information; and safeguards around the proper disposal of retired hardware.
        + Third-Party and Vendor Risk Management - OCIE will focus on oversight practices related to certain service providers and network solutions, including those leveraging cloud-based storage.
      * Financial Technology (Fintech) and Innovation, Including Digital Assets and Electronic Investment Advice
        + Alternative Data – OCIE examinations will focus on the use of alternative data technologies and assess the effectiveness of related compliance and control functions.
        + Digital Assets – Examinations will assess: investment suitability; portfolio management and trading practices; safety of client funds and assets; pricing and valuation; effectiveness of compliance programs and controls; and supervision of employee outside business activities.
        + Electronic Investment Advice - Areas of focus include: SEC registration eligibility; cybersecurity policies and procedures; marketing practices; adherence to fiduciary duty, including adequacy of disclosures; and effectiveness of compliance programs.
      * Additional Focus Areas
        + Compliance Programs
* Broker-Dealer Arrangements – This examination priority relates to advisers that are dually registered as, or are affiliated with, broker-dealers, or that have supervised persons who are registered representatives of unaffiliated broker-dealers. Areas of focus will include whether advisers maintain effective compliance programs to address the risks associated with best execution, prohibited transactions, fiduciary advice, or disclosure of conflicts regarding such arrangements.
* Advisers That Use Third-Party Asset Managers - OCIE will assess, among other things, the extent of due diligence practices, policies, and procedures.
* New or Emerging Investment Strategies - OCIE has a particular interest in the accuracy and adequacy of disclosures provided by advisers that offer new types of or emerging investment strategies, such as strategies focused on sustainable and responsible investing, which incorporate environmental, social, and governance (ESG) criteria.
  + - * + Never-Before and Not Recently-Examined Advisers - In addition to new advisers, OCIE will prioritize examinations of advisers registered for several years that have yet to be examined, as well as advisers that have not been examined for several years.
        + Advisers to Mutual Funds and ETFs - Examinations will focus on: advisers that use third-party administrators to sponsor the mutual funds they advise or are affiliated with; and advisers to private funds that also manage a registered investment company with a similar investment strategy.
        + Advisers to Private Funds - OCIE will focus on private fund advisers that have a greater impact on retail investors, such as firms that provide management to separately managed accounts side-by-side with private funds. OCIE will assess: 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 affiliates to provide services to clients.

*Action Taken by XYZ in Response to the Examination Priorities* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the examination priorities. If the consultant has any comments regarding these priorities, make reference to further discussion later in the report.>

* Large Trader Obligations – In December 2020, OCIE issued a Risk Alert which was intended to assist investment advisers in reviewing and enhancing their compliance programs with respect to Rule 13h-1 under the Securities Exchange Act of 1934.[[2]](#footnote-3) OCIE encouraged investment advisers that transacted in applicable securities to review compliance policies and procedures pertaining to: identifying situations that could lead to an adviser becoming a “large trader”; the timely filing of Form 13H and amendments thereto; and notifying applicable broker-dealers of the adviser’s “large trader” status.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Accredited Investor Definition – In December 2020, the definition of “Accredited Investor” in Rule 501 under Regulation D was amended to: include various types of natural persons, entities and accounts that previously did not meet the definition; and to add the term “spousal equivalent” to the accredited investor definition so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Compliance Programs – In November 2020, OCIE issued a Risk Alert in which it provided an overview of notable compliance issues it had identified relating to Rule 206(4)-7 under the Advisers Act.[[3]](#footnote-4) These included: inadequate compliance resources; chief compliance officers with insufficient authority; deficient annual reviews; failures to implement actions required by written policies and procedures; failures to maintain accurate and complete information in policies and procedures; and failures to maintain or establish reasonably designed written policies and procedures.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Supervision, Compliance and Multiple Branch Offices – In November 2020, OCIE issued a Risk Alert in which it reported on its observations from a series of examinations that focused on investment advisers operating from numerous branch offices and with operations geographically dispersed from an adviser’s principal or main office.[[4]](#footnote-5) In the Risk Alert, OCIE discussed a range of practices with respect to branch office activities that advisers could find helpful in their compliance oversight efforts. The first such practice was adopting and implementing written compliance policies and procedures that: were applicable to all office locations and all supervised persons; included unique aspects associated with individual branch offices; and specifically addressed compliance practices necessary for effective branch office oversight. Further practices included: performing compliance testing or periodic reviews of key activities at branch offices at least annually, if not more frequently; establishing compliance policies and procedures to check for prior disciplinary events when hiring supervised persons and periodically confirming the accuracy of such disclosures; and requiring compliance training for branch office employees.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Safeguarding Client Accounts against Credential Compromise – In September 2020, OCIE issued a Risk Alert in which it publicized an increase in the number of cyber-attacks against investment advisers using credential stuffing, a method of cyber-attack to client accounts that uses compromised client login credentials, resulting in the possible loss of customer assets and unauthorized disclosure of sensitive personal information.[[5]](#footnote-6) In the Risk Alert, OCIE: encouraged firms to review their customer account protection safeguards and identity theft prevention programs to address this emergent risk; described various practices that firms have implemented to help protect client accounts; and set out other considerations in preparing for credential stuffing attacks.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers – In August 2020, the SEC published supplementary guidance regarding the proxy voting responsibilities of investment advisers under its regulations issued under the Advisers Act in light of the SEC’s amendments to the rules governing proxy solicitations under the Securities Exchange Act of 1934.[[6]](#footnote-7) Specifically, the guidance addressed: the consideration of additional information that may become more readily available as a result of these amendments; and, disclosure obligations and considerations that may arise when investment advisers use proxy advisory firms’ electronic vote management systems.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Ransomware – In July 2020, OCIE issued a Risk Alert noting an observed increase in the sophistication of ransomware attacks on SEC registrants, including investment advisers.[[7]](#footnote-8) In light of this threat, OCIE referred registrants to the Department of Homeland Security Cybersecurity and Infrastructure Security Agency (“CISA”) alert on ransomware published in June 2020[[8]](#footnote-9) and described how advisers are protecting against ransomware by implementing: (i) incident response and resiliency policies, procedures and plans; (ii) assessments of operational resiliency; (iii) awareness and training programs; (iv) vulnerability scanning and patch management; (v) access management; and (vi) perimeter security.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Form CRS Relationship Summary – Advisers to “retail investors” that were registered with the SEC before June 30, 2020 were required to file an initial Form CRS by no later than such date and begin delivering the Form to applicable clients thereafter.[[9]](#footnote-10) Previously, in April 2020, OCIE had issued a Risk Alert providing investment advisers with information about the anticipated scope and content of initial examinations of Form CRS compliance after the Form CRS compliance date.[[10]](#footnote-11)

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Private Fund Adviser Conflicts of Interest, Fees and Expenses, and Material Non-Public Information / Code of Ethics – In June 2020, OCIE issued a Risk Alert providing an overview of compliance issues and deficiencies observed in examinations of registered investment advisers that manage private funds.[[11]](#footnote-12) Among other things, OCIE highlighted situations where OCIE staff believed private fund advisers provided inadequate disclosures or failed to implement additional policies or controls to address potential conflicts or the potential receipt of material non-public information.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* LIBOR Transition Preparedness – LIBOR, a primary benchmark for global short-term interest rates, will cease to be published after year-end 2021. In June 2020, OCIE issued a Risk Alert on LIBOR transition preparedness noting that the discontinuation of LIBOR may present a material risk for certain market participants, including SEC-registered investment advisers.[[12]](#footnote-13) Specifically, OCIE stated it will review whether and how advisers have evaluated the potential impact of the LIBOR transition on the organization’s: (i) business activities; (ii) operations; (iii) services; and (iv) customers, clients, and/or investors.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Coronavirus Disease 2019 (COVID-19) – In 2020, many businesses, including investment advisory firms and their vendors, closed physical offices in response to the COVID-19 global pandemic. The new economic conditions, increased remote human interaction, and government policies and relief programs deriving from the COVID-19 global pandemic have refocused key compliance and risk considerations for many advisers. In response, the SEC has published guidance reminding advisers of their regulatory obligations during the COVID-19 global pandemic and provided limited relief, particularly pertaining to certain regulatory filings.[[13]](#footnote-14) In August 2020, OCIE issued a Risk Alert concerning COVID-19-related issues, risks, and practices relevant to investment advisers. OCIE’s observations and recommendations fell broadly into six categories: (i) protection of investors’ assets; (ii) supervision of personnel; (iii) practices relating to fees, expenses, and financial transactions; (iv) investment fraud; (v) business continuity; and (vi) the protection of investor and other sensitive information.[[14]](#footnote-15)

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development. Consider addressing XYZ’s remote supervision, business continuity planning, vendor management, or remote cybersecurity efforts as well as XYZ’s response to SEC guidance or relief.>

* Cybersecurity and Resiliency – In January 2020, OCIE published a report describing the cybersecurity and operational resiliency practices observed by OCIE staff when examining market participants, including investment advisers.[[15]](#footnote-16) The report discusses observed practices relating to: (i) governance and risk management; (ii) access rights and controls; (iii) data loss prevention; (iv) mobile security; (v) incident response and resiliency; (vi) vendor management; and (vii) training and awareness. OCIE concludes in the report that market participants, including investment advisers, should review their practices, policies and procedures with respect to cybersecurity and operational resiliency.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Principal and Agency Cross Trading – In September 2019, OCIE issued a Risk Alert describing the most common deficiencies identified by OCIE staff in connection with Section 206(3), which covers principal trades and agency cross trades when acting as a broker, and Rule 206(3)-2, which permits certain agency cross transactions without requiring the adviser to provide transaction-by-transaction disclosure and consent under certain conditions.[[16]](#footnote-17) Commonly identified deficiencies included: failing to obtain appropriate prior client consent for principal and agency cross trades; failing to provide sufficient disclosure regarding the potential conflicts of interest involved with principal trading; and failure to maintain documentation evidencing compliance with Rule 206(3)-2. OCIE staff also observed advisers that effected trades between advisory clients and an affiliated pooled investment vehicle but failed to recognize that the advisers’ significant ownership interests in the pooled investment vehicle would cause the transaction to be subject to Section 206(3).

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Guidance on Proxy Voting Responsibilities of Investment Advisers – In August 2019, the SEC provided guidance discussing the ability of registered investment advisers to establish a variety of different proxy voting arrangements with their clients and matters they should consider when they use the services of proxy advisory firms.[[17]](#footnote-18)

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

* Supervisory Oversight and Conflicts of Interest – In July 2019, OCIE issued a Risk Alert summarizing the findings of its “Supervision Initiative” conducted to assess the oversight practices of registered investment advisers.[[18]](#footnote-19) In addition to noting deficiencies related to supervisory oversight, disclosure and supervision of employees with disciplinary histories, and conflicts of interest; the Risk Alert outlined ways advisers that hire or employ supervised persons with disciplinary histories can improve compliance.

*Action Taken by XYZ in Response to the Regulatory Development* – <Consultant to complete a short summary of the action(s) taken by XYZ to address the regulatory development.>

**V. Report Structure**

This report contains specific observations and recommendations about XYZ’s operations, as well as more general context and summaries regarding certain Federal Securities Laws.[[19]](#footnote-20) For the sake of brevity and clarity, general commentary regarding the Federal Securities Laws does not fully describe every potentially applicable regulation.

The matrices included in this report are designed to (i) address the areas that ACA reviewed and (ii) identify any perceived weaknesses or potential compliance issues. Each matrix has the following sections:

* Issue – The “Issue” section is intended to identify the areas that ACA believes may require action from XYZ.
* Findings and Recommendations – This component of the report generally describes ACA’s observations and findings about the Company’s practices, as well as any perceived weaknesses or compliance issues. ACA supplements its findings with detailed recommendations that XYZ may choose to implement to mitigate the risks created by each finding noted. XYZ should be aware that ACA’s recommendations are not intended to represent the sole manner in which the Company may implement corrective action. ACA’s recommendations are generally based upon regulatory requirements but may also encompass industry best practices and/or anticipated regulatory expectations.
* Risk Level – Each risk level reflects ACA’s assessment of the potential regulatory risk of the relevant activity in light of the Company’s internal control processes and any other mitigating factors. Each risk level is subjective, based on the expertise of ACA, and has not been adopted or approved by any regulator, rating agency, or other outside party. ACA’s risk assessments should be interpreted as follows:
  + - * **LOW** risk levels generally reflect minor technical rule violations or recommended enhancements to XYZ’s policies and procedures. ACA believes that observations and/or findings that are assigned “Low” risk levels may be commented on as a result of an SEC inspection.
      * **MODERATE** risk levels are generally areas of concern that ACA believes could attract increased regulatory attention and may require moderate revisions to XYZ’s policies and procedures. In addition, ACA believes that observations and/or findings that are assigned “Moderate” risk levels are likely to be formally commented on as a result of an SEC inspection.
      * **HIGH** risk levels are generally areas of concern that ACA believes warrant the highest priority of attention from XYZ. Such matters may expose XYZ to increased regulatory and/or financial risk. If ignored, ACA believes that these issues may generate the highest level of attention from regulators.

The areas that ACA reviewed and for which it did not identify any notable compliance issues are set forth in summary form within each section of the report.

**VI. Findings and Recommendations**

## A. Portfolio Management

The final rule release relating to Rule 206(4)-7 under the Advisers Act, *Compliance Programs of Investment Companies and Investment Advisers*, *Advisers Act Release No. IA 2204* (December 17, 2003) (“*Release IA-2204*”), states that a registered adviser’s policies and procedures should address portfolio management processes. These include the allocation of investment opportunities among clients and the consistency of portfolios with clients’ investment objectives, disclosures by the adviser, and applicable regulatory restrictions. As part of an adviser’s fiduciary duty to its clients, the adviser must have a reasonable basis to believe that its investment recommendations are suitable. An adviser must act with prudence and exercise due care throughout the portfolio management process and must allocate investment opportunities and resolve any conflicts of interest in a manner that is fair to all clients. An adviser also has a duty to periodically review accounts under management to ensure that such accounts are invested consistently with clients’ mandates and the adviser’s disclosures.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to portfolio management resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written portfolio management policies and procedures
* Adherence to investment objectives and disclosed investment mandates
* Documentation of and compliance with client-mandated investment restrictions
* Compliance with internal investment risk management procedures
* Maintenance of due diligence and research files
* Supervision of sub-advisers and third-party managers
* Side-by-side management of client portfolios and allocation of limited investment opportunities
* Compliance with FINRA Rules 5130 and 5131 related to IPO eligibility
* Monitoring compliance with the safe harbor set forth in Rule 3a-4 under the IC Act regarding operating an unregistered investment company

ACA’s review of the portfolio management activity resulted in the following <comment OR comments>.

<Note to consultants: Throughout the report, generally order your comments from most serious to least serious unless it is better for the flow of the report to lead with a less-serious issue that lays the groundwork for other items.>

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| A.1 | EXAMPLE: Adherence to Investment Restrictions | EXAMPLE: While the adviser has implemented a written policy to monitor for adherence to investment restrictions, ACA noted that Account A appeared to purchase securities issued by a company that was included on a list of client-mandated investment restrictions. ACA recommends that the adviser review the trading in Account A to ensure that no other securities were purchased from the client-mandated restricted list. In addition, ACA recommends that the adviser determine whether any other advisory accounts may have breached investment restrictions. Finally, ACA recommends that the adviser review the cause of the breach and strengthen its written policy and procedures as necessary. | High |
| A.2 |  |  | **Moderate** |
| A.3 |  |  | **Low** |

## B. Proxy Voting

Rule 206(4)-6 under the Advisers Act requires that each registered investment adviser that exercises proxy voting authority with respect to client securities take the following actions:

* The adviser must adopt and implement written policies and procedures reasonably designed to ensure that the adviser votes client securities in the clients’ best interests. Such policies and procedures must address the manner in which the adviser will resolve material conflicts of interest that can arise during the proxy voting process.
* The adviser must disclose to clients how they may obtain information from the adviser about how the adviser voted with respect to their securities.
* The adviser must describe to clients the adviser’s proxy voting policies and procedures and, upon request, furnish a copy of the policies and procedures.

The Advisers Act lacks specific guidance regarding an adviser’s duty to direct clients’ participation in class action lawsuits. However, many investment advisers adopt policies and procedures regarding class action lawsuits.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to proxy voting resulted in no notable compliance issues with respect to the following areas:

* Adequacy of XYZ’s written proxy voting policies and procedures
* Identification, processing, and voting of proxies
* Maintenance of proxy voting records
* Responses to requests for proxy voting records
* Resolution of proxy voting conflicts of interest
* Involvement in class actions
* Oversight of third-party proxy advisory firms

ACA’s review of proxy voting and class action participation resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| B.1 |  |  | High |
| B.2 |  |  | **Moderate** |
| B.3 |  |  | **Low** |

## C. Trading

For most investment advisers, trading is a central function that warrants robust policies and procedures. Even advisers that do not invest in publicly traded securities should adopt and implement policies and procedures governing the implementation of their investment decisions. Below is a summary of various trading issues that are generally relevant to XYZ. <Note to consultants: Remove issues that were not applicable to the adviser.>

Best Execution/Brokerage Relationship Reviews – In *Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters*, *SEC Release 34-23170* (April 28, 1986), the SEC noted that “money managers should periodically and systematically evaluate the execution performance of broker-dealers executing their transactions.” The SEC also stated that

…a money manager should consider the full range and quality of a broker’s services in placing brokerage, including among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager. The Commission wishes to remind money managers that the determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account.

The duty to seek best execution applies in varying degrees to virtually all investment advisers, regardless of the amount or type of assets under management.

Soft Dollars – Section 28(e) of the Exchange Act provides a safe harbor that generally permits advisers with investment discretion to use commission dollars generated by client transactions to pay for brokerage services and research products. The Section 28(e) safe harbor is only available if, among other things, the adviser makes a good-faith determination that the amount of commissions paid is reasonable relative to the value of the brokerage and research services received. The Commission has issued several releases regarding the use of soft dollars, including *Commission Guidance Regarding Client Commission Practices under Section 28(e) of the Securities Exchange Act of 1934*, *SEC* *Release 34-54165* (July 24, 2006). Foreign financial regulators may impose restrictions on the use of soft dollars that differ from the guidelines included in Section 28(e) of the Exchange Act.

Trade Aggregation and Trade Allocation – Section 206 of the Advisers Act requires an investment adviser to allocate trades in a manner that is fair to all clients and consistent with the adviser’s disclosures. In a letter issued to *SMC Capital, Inc.* (September 5, 1995), the SEC’s Division of Investment Management indicated that a registered investment adviser could aggregate trades on behalf of all types of advisory clients (including separately managed accounts, mutual funds, pooled investment vehicles, and accounts in which advisory personnel maintain an ownership interest) provided that certain conditions were met. Among other things, the staff indicated that an adviser should (i) disclose its practice of aggregating trades to all current and prospective clients, (ii) avoid favoring any client over any other client, and (iii) ensure all clients pay the average price as well as their pro-rata share of any commissions.

Directed Brokerage – When certain clients restrict the trading discretion of an adviser, the adviser may delay implementing transactions for such clients until orders are executed for other clients without restrictions. The SEC indicated in *In the Matter of Mark Bailey & Co.*, *Release IA-1105* (February 24, 1988) that an adviser still has obligations relating to execution quality and disclosure when clients direct the brokerage activities of the adviser, including an obligation to disclose the potential loss of benefits associated with trade aggregation.

Trade Errors – The Advisers Act does not specifically address trade error corrections, and the SEC staff has provided only limited guidance regarding the correction of trade errors. However, in a letter to *Charles Lerner* (October 25, 1988) (“*Lerner*”), the SEC staff indicated that an investment adviser should bear any loss associated with correcting a trade error in a client account. Notably, *Lerner* does not address instances in which an adviser affirmatively discloses a policy of having clients bear the costs associated with trade errors.

Principal Trades – Section 206(3) of the Advisers Act prohibits an adviser and its affiliates from acting as the counterparty to an advisory client’s trade unless the client (i) receives written disclosure about the capacity in which the adviser is acting and (ii) consents to the transaction prior to the transaction’s completion. Separate written disclosures must be provided, and informed consent must be obtained with respect to each contemplated principal trade.

Agency Cross Trades – Agency cross trades involve an adviser or its affiliates acting as a broker-dealer with respect to a transaction that they recommend to an advisory client. Investment advisers may generally engage in agency cross trades if they (i) meet the trade-by-trade disclosure and consent requirements described in Section 206(3) or (ii) obtain prospective consent and provide certain trade-by-trade and periodic disclosures, as described in Rule 206(3)-2.

Other Cross Trades – An adviser is generally not prohibited from instructing an unaffiliated broker-dealer to cross securities between unaffiliated clients’ accounts. However, any such cross trades should be in the best interests of all participating clients and should be placed at prices that the adviser can demonstrate to be fair. Advisers that engage in cross trades should develop written policies and procedures governing this practice.

Other Trading Issues – An adviser may engage in myriad other trading practices that warrant formalized policies and procedures and/or comments in connection with ACA’s review.

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ACA’s review of XYZ’s internal control policies and procedures related to trading activities resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written trading policies and procedures
* Maintenance of compliant trade order memoranda
* Compliance with and fairness of trade allocation and trade aggregation procedures
* Analysis of best execution capabilities and brokerage practices
* Analysis of soft dollar arrangements and documentation
* Treatment and disclosure of trade errors
* Handling of principal and cross trades
* Observance of restrictions on short-selling activities
* Compliance with client-mandated directed brokerage arrangements

ACA’s review of XYZ’s trading activities resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| C.1 |  |  | High |
| C.2 |  |  | **Moderate** |
| C.3 |  |  | **Low** |

## D. Code of Ethics and Insider Trading

Investment advisers must maintain robust policies and procedures to encourage employees to behave ethically. Employees’ understanding of, and compliance with, such policies and procedures are critically important given the potential ramifications associated with noncompliance. Section 204A of the Advisers Act requires investment advisers to adopt and implement policies and procedures that are reasonably designed to prevent insider trading. Furthermore, Rule 204A-1 requires each registered investment adviser to establish, maintain, and enforce a written code of ethics that addresses certain additional topics. Below is a summary of topics that are typically addressed by an adviser’s code of ethics.

Standards of Business Conduct – An adviser’s code of ethics must set forth a standard of business conduct that the adviser requires of its supervised persons. The standard must reflect the fiduciary obligations of the adviser and its supervised persons.

Compliance with the Federal Securities Laws – An adviser’s code of ethics must require all supervised persons to comply with applicable Federal Securities Laws.

Personal Trading – An adviser’s code of ethics must require all access persons (as defined by Rule 204A-1) to report, and the adviser to review, certain information about such access persons’ personal securities transactions and holdings. Rule 204A-1 also states that all access persons’ investments in IPOs and private placements must be precleared by the adviser.

Reporting Violations – An adviser’s code of ethics must require all supervised persons to report any violations of the code of ethics to the adviser’s chief compliance officer (“CCO”) or a designee.

Distribution and Acknowledgement – An adviser’s code of ethics must require that the code of ethics and any amendments be distributed to all supervised persons and that all supervised persons provide a written acknowledgement of their receipt of the code of ethics and any amendments.

Recordkeeping – Rule 204-2 contains certain recordkeeping requirements associated with an adviser’s code of ethics. Specifically, paragraphs (a)(12) and (a)(13) require an adviser to keep its code of ethics and any amendments, documentation associated with any violation of the code of ethics, supervised persons’ acknowledgements of receipt, a list of current and former access persons and their associated personal trading reports, and documentation associated with IPO and private placement preclearance requests.

Insider Trading – Investment advisers must adopt and implement policies and procedures that are reasonably designed to prevent insider trading. Many investment advisers incorporate such policies and procedures into their codes of ethics.

Other Code of Ethics Issues – Many investment advisers include policies and procedures governing gifts, entertainment, and outside business activities in their codes of ethics because of the regulatory risks and conflicts of interest that may be associated with such activities. In particular, Rule 206(4)-5 may limit an adviser’s ability to generate fees from state or local government entities if the adviser or its employees have made certain kinds of political contributions or engaged in related political fundraising.

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ACA’s review of XYZ’s internal control policies and procedures related to personal securities trading, political donations, gifts and entertainment, outside business activities, and material nonpublic information (“MNPI”) resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written Code of Ethics (“Code”) and related policies and procedures
* Adequacy of XYZ’s written insider trading policies and procedures and related policies (such as processes to evaluate research providers, interactions with value-added investors, and use of expert networks, alternative data, and virtual data rooms)
* Documentation regarding employees’ receipt and understanding of XYZ’s Code
* Maintenance of XYZ’s Code of Ethics violations log
* Personal securities transaction reporting by employees (e.g., initial and annual holdings reports, quarterly transaction reports, trade preclearance requests, exempt account documentation)
* Maintenance of restricted, watch, and/or gray lists
* Political contributions and fundraising
* Gifts and entertainment
* Outside business activities
* Protection of MNPI

ACA’s review of XYZ’s Code and related compliance matters resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| D.1 |  |  | High |
| D.2 |  |  | **Moderate** |
| D.3 |  |  | **Low** |

## E. Fees and Expenses

Section 206 of the Advisers Act<, and Rule 206(4)-8 thereunder>, require<s> that investment advisers treat their clients and investors in their private funds fairly and provide full disclosure of any material conflicts of interest. Rule 206(4)-7 also requires registered investment advisers to have written policies and procedures that are reasonably designed to mitigate and/or ensure disclosure of applicable conflicts. The allocation of expenses between clients, or between an adviser and its clients, creates potential conflicts of interest. SEC examiners frequently compare the fees and expenses borne by clients and investors with the adviser’s disclosures and written policies and procedures. The SEC has supplemented these rules with numerous letters, releases, and other public documents regarding topics that include:

* Fee billing based on accurate account valuations;
* Billing advisory fees with proper frequency;
* Applying correct fee rates;
* Applying rebates and discounts correctly;
* Disclosing additional fees or markups; and
* Accurate allocation of expenses.

Advisers that recommend or select mutual fund investments for separate-account clients should seek to place clients in the lowest-expense share class in which they are eligible to invest, and should adopt policies and procedures requiring the adviser to do the same. Advisers should also disclose any Rule 12b-1 distribution fees they may receive from the mutual funds they recommend.

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ACA’s review of XYZ’s internal control policies and procedures related to fees and expenses resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written policies and procedures governing the calculation, allocation, and collection of fees and expenses
* Representations on Form ADV and in marketing materials
* Compliance with advisory contracts, private fund governing documents, and side letters
* Maintenance of work papers documenting correct fee and expense calculations and allocations
* Expense allocation methodologies

ACA’s review of XYZ’s policies and procedures related to fee and expense activities resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| E.1 |  |  | High |
| E.2 |  |  | **Moderate** |
| E.3 |  |  | **Low** |

## F. Regulatory Filings and Disclosures

Investment advisers are required to prepare, maintain, file, and/or deliver certain disclosure documents. The accuracy, completeness, and timeliness of these documents are critically important given the emphasis placed on full and fair disclosure by the Advisers Act. Below is a summary of relevant disclosure documents.

Form ADV – Rule 204-1(a) under the Advisers Act requires each registered investment adviser to file updated copies of Form ADV with the SEC at least annually within 90 days of the company’s fiscal year end. The rule also requires prompt amendments and re-filings if certain portions of Form ADV become inaccurate or if any portions become materially inaccurate. Registered investment advisers must also provide Part 2 of Form ADV and supplemental biographical information for certain employees at the start of an advisory relationship. On an annual basis, registered advisers must provide clients with Part 2 of Form ADV or a summary of material changes along with an offer to provide Part 2 upon request without charge.

Rule 204-5 under the Advisers Act requires a registered investment adviser to deliver Part 3 of Form ADV (Form CRS) to its retail investors. The rule defines a “retail investor” as “a natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family or household purposes”. A registered investment adviser required to deliver Form CRS to retail investors must also file Form CRS with the SEC and post Form CRS prominently on its website.

Privacy Notice – Regulation S-P requires a registered investment adviser to deliver (i) an initial privacy notice to new natural person customers not later than when the customer relationship is established and (ii) an annual privacy notice[[20]](#footnote-21) to all natural person customers.

Proxy Voting Summation – Rule 206(4)-6 under the Advisers Act requires each registered investment adviser to describe its proxy voting policies and procedures to clients, furnish a copy of such policies and procedures to clients upon request, and tell clients how they can obtain information from the adviser showing how the clients’ securities were voted.

Electronic Delivery of Disclosure Documents – In *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, *SEC Release IA-1562* (May 9, 1996), the SEC described its views regarding investment advisers’ use of electronic media to provide disclosures and obtain consents required by the Advisers Act. While investment advisers are generally permitted to provide disclosures and obtain consents electronically, the SEC has indicated that advisers should consider the following factors when communicating electronically with clients and prospects:

* Notice – If disclosures are posted on a website or made available through some other passive delivery system, the adviser should send the intended recipient an email or some other notice indicating that the disclosures are available.
* Access – Recipients of electronic information should be able to easily view, save, and print the information.
* Evidence of Delivery – An adviser should have reasonable assurance that the electronic communication was received by the intended recipient. An adviser may obtain an email return receipt for each message, or it may obtain the recipient’s informed prospective consent to receive information through a specified electronic medium.

Other Disclosure Documents – An investment adviser may include important disclosures in other documents, including investment advisory agreements, private placement memoranda or confidential offering memoranda, and solicitors’ disclosure statements.

Other Filings – An SEC-registered investment adviser may need to make notice filings or designate investment advisory representatives with various state regulatory agencies. Depending on its operations, an investment adviser may also be required to make other filings with the SEC, the Commodity Futures Trading Commission (“CFTC”), or other regulators.

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ACA’s review of XYZ’s internal control policies and procedures related to its regulatory filings and disclosure documents resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written disclosure policies and procedures
* Maintenance of Form ADV
* Delivery of Part 2 of Form ADV ,Part 3 of Form ADV (Form CRS) and the privacy notice, where applicable
* Applicable state licensing, registration, and notice filing requirements
* Disclosure of proxy voting summation
* Compliance with electronic document delivery requirements
* Investment management agreements
* Side letter provisions
* Delivery of separate written solicitor’s disclosure documents
* Initial and annual Form D filings
* Filing of Form PF
* Filing of Form 13F, Form 13H, Schedule 13G, Schedule 13D, and other relevant regulatory filings

ACA’s review of XYZ’s regulatory filing and disclosure activities resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| F.1 |  |  | High |
| F.2 |  |  | **Moderate** |
| F.3 |  |  | **Low** |

## G. Safeguarding Client Assets

Rule 206(4)-2 under the Advisers Act outlines certain provisions that registered investment advisers must follow if they have custody of advisory clients’ funds or securities. The rule defines “custody” as “holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them,” and includes several examples of practices that would give an adviser custody, including when an adviser acts in any capacity that gives it legal ownership of, or access to, the clients’ funds or securities. An adviser is generally prohibited from having custody of clients’ funds or securities unless such assets are held by one or more qualified custodians. Furthermore, an adviser with custody must (i) provide notices to clients detailing how their funds and securities are being held, (ii) provide account statements for clients detailing their holdings and (iii) conduct an independent verification of client funds and securities, unless an exception applies. The requirements imposed by Rule 206(4)-2 generally apply only to those funds and securities over which an adviser has custody.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to the safeguarding of client assets resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s policies and procedures regarding custody and safeguarding of client assets
* Capital control and asset reconciliation processes
* Use of qualified custodians
* Requirement for independent asset verifications
* Processing of investor subscriptions, redemptions, and transfers
* Delivery of quarterly account statements
* Notification to clients of new custodial accounts
* Inadvertent receipt of client assets
* Timely completion and delivery of accounting audits of private investment funds and special purpose vehicles
* Acting as trustee or signatory of a client account
* Maintenance of required books and records for advisers deemed to have custody of client assets

ACA’s review of this regulatory issue resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| G.1 |  |  | High |
| G.2 |  |  | **Moderate** |
| G.3 |  |  | **Low** |

## H. Books and Records

Rule 204‑2 under the Advisers Act requires an investment adviser to make and keep true, accurate, and current certain books and records relating to its advisory business. In *Release IA-2204*, the SEC stated that investment advisers should adopt and implement policies and procedures governing “the accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction.” The required documents covered under Rule 204-2 include, among others:

* General business records (paragraphs a.1 and a.2, a.4 to a.6, a.10, and e.2);
* Trading and account management records (a.3, a.7, and c.1);
* Communications and client relationship records (a.7 to a.10, and a.14);
* Marketing and performance records (a.7, a.11, and a.16);
* Compliance and internal control records (a.7 and a.17);
* Cash solicitation records (a.10 and a.15);
* The code of ethics and personal trading records (a.12 and a.13);
* Certain additional records for accounts over which the adviser has custody (b); and
* If applicable, proxy voting records (c.2).

Many required records must be kept for five years after the end of the fiscal year in which the record was created or last modified. Rule 204-2(e) describes the required retention periods for specific books and records.

Registered investment advisers are generally permitted to store required records electronically. In addition, Rule 204-2(g) has these specific requirements:

* Electronic records must be arranged and indexed in a way that permits easy location, access, and retrieval of any particular record.
* The adviser must promptly provide any of the following upon SEC examiner request:
  + - * A legible, true, and complete copy of the record in the medium and format in which it is stored
      * A legible, true, and complete printout of the record
      * Means to access, view, and print the records
* The adviser must separately store, for the time required for preservation of the original record, a duplicate copy of the record in a permissible medium (i.e., hard copy, electronic, or micrographic).
* The adviser must establish and maintain procedures
  + - * to maintain and preserve the records so as to reasonably safeguard them from loss, alteration, or destruction;
      * to limit access to the records to properly authorized personnel and the SEC; and
      * to reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to the creation and maintenance of required records resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written recordkeeping policies and procedures
* Ability of XYZ to produce complete records in a timely manner upon request
* Maintenance of XYZ’s financial statements
* Archiving and review of electronic correspondence
* Maintenance of books and records in electronic format
* Document destruction policies and procedures
* Maintenance of books and records for the requisite time period

However, ACA’s review of XYZ’s books and records resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| H.1 |  |  | High |
| H.2 |  |  | **Moderate** |
| H.3 |  |  | **Low** |

## I. Marketing and the Use of Solicitors

Marketing – Rule 206(4)-1 under the Advisers Act governs the manner in which investment advisers may advertise and generally prohibits advisers from publishing, circulating, or distributing any advertisement that contains any untrue statement or that is otherwise false or misleading. The Advisers Act generally defines an “advertisement” to include any communication addressed to more than one person that offers any investment advisory service with regard to securities.[[21]](#footnote-22) The SEC has supplemented the advertising rule with numerous letters, releases, and other public documents regarding topics that include;

* Presentation of gross-of-fees investment returns;
* Presentation of model or backtested performance results;
* Presentation of past specific recommendations;
* Use of partial client lists;
* Inclusion of client testimonials;
* Accuracy of performance calculations;
* Portability of investment returns achieved at a prior employer; and
* Use of websites.

Marketing a Private Fund – Rule 206(4)-8 generally prohibits an adviser to a pooled investment vehicle from making any untrue statement of material fact or otherwise misleading statement to any investor or prospective investor in the pooled investment vehicle. In addition, Rule 506(b) under Regulation D contains provisions that prohibit the general solicitation of private funds relying on this rule. Further, both Sections 3(c)(1) and 3(c)(7) of the IC Act prohibit public offerings in order to rely upon the applicable exemptions set out therein.

Use of Solicitors – Rule 206(4)-3 (“Cash Solicitation Rule”) under the Advisers Act prohibits advisers from paying a cash fee, directly or indirectly, for solicitation of a client unless the referral fee is paid pursuant to a written agreement and certain disclosures are made regarding the solicitor’s relationship with the adviser.[[22]](#footnote-23) The primary requirements of the Cash Solicitation Rule are detailed below:

* The individual or entity cannot be disqualified from acting as a solicitor.
* The solicitation fee must be paid pursuant to a written agreement to which the adviser is a party.
* The written agreement must include specific provisions regarding the solicitation arrangement.
* The Company must receive a signed and dated acknowledgement of the solicited client’s receipt of the solicitor’s separate written disclosure document as well as Part 2 of the adviser’s ADV filing (or other disclosure brochure).
* The solicitor’s separate written disclosure document must include specific disclosures regarding the solicitation arrangement.
* The Company must make a bona fide effort to ascertain whether the solicitor has complied with the written agreement.

Although the requirements of Rule 206(4)-3 generally do not apply to a solicitor that receives a cash fee solely for soliciting investors in a private fund, ACA recommends that, at a minimum, private fund advisers ensure that any solicited investors received full and fair disclosure that the solicitor was compensated for making the referral.[[23]](#footnote-24) Further, depending on the facts and circumstance, an adviser that wishes to compensate a solicitor in exchange for investor referrals may need to ensure that the solicitor is registered as a broker under Section 15(a) of the Exchange Act.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to the creation and distribution of marketing materials and the payment of referral fees resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written marketing and solicitation policies and procedures
* Marketing material approval process
* Maintenance and archival of XYZ’s website
* Calculation of performance results (e.g., actual results, model results, ported performance)
* Marketing of performance results (e.g., gross and net-of-fees results)
* Adequacy of marketing disclosures
* Review of marketing materials for various regulatory issues (e.g., superlative statements, partial client lists, past specific recommendations, misleading statements)
* Compliance with restrictions on the use of solicitors
* Lobbying activity associated with marketing advisory services
* Treatment of complaints
* Compliance with Securities Act and IC Act requirements regarding the methods of offering, level of investor accreditation, and issuer disqualification for private funds advised by XYZ
* Communications with the media

ACA’s review of XYZ’s marketing materials and solicitation arrangements resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| I.1 |  |  | High |
| I.2 |  |  | **Moderate** |
| I.3 |  |  | **Low** |

## J. Valuation and Pricing

In *Release IA-2204*, the SEC stated that investment advisers should adopt and implement processes to value client holdings and assess fees based on those valuations. The fair valuation of client investments can be an area of intense scrutiny during SEC examinations. An adviser’s performance and fee calculations are dependent upon the prices assigned to securities held in client accounts. Furthermore, security prices are important to most advisers’ portfolio management and trading processes. Advisers should adopt and implement policies and procedures that are reasonably designed to price securities in a manner that is fair, accurate, and consistent with any disclosures.

Securities that are frequently traded on public exchanges, such as many domestic equities, are relatively easy to price. However, the valuation of investments for which there is no readily available pricing information involves the exercise of the valuer’s judgment and cannot be subjected to a simple mechanistic formula. The SEC’s *Accounting Series Releases 113* and *118* explain how fair value methodologies should be used to determine the approximate amount that could be expected to be received upon the current sale of a security with no readily available market quotation. In addition, the SEC’s Division of Investment Management issued two letters to the *Investment Company Institute* (December 8, 1999, and April 30, 2001) regarding valuation issues. Additional guidance can be found in various enforcement actions that the SEC has brought over the years for advisers’ failure to reasonably supervise portfolio managers who were responsible for valuing clients’ portfolios.[[24]](#footnote-25) The Financial Accounting Standards Board’s Accounting Standards Codification (“ASC”) 820-10 (originally issued in September 2006 as Financial Accounting Standards Board’s Statement 157) also provides guidance regarding appropriate valuation methodologies. ASC 820-10’s recommended hierarchy of valuation metrics is summarized below in descending order of preference:

* Level 1 – Quoted prices in active markets for identical assets or liabilities
* Level 2 – Observable inputs other than quoted prices, such as the following:
  + - * Level 2a – Quoted prices for similar assets or liabilities in active markets
      * Level 2b – Quoted prices for identical or similar assets or liabilities in markets where there are few transactions, prices are not current, price quotations vary substantially over time or among market makers, or in which little information is released publicly
      * Level 2c – Inputs other than quoted prices that are observable for the asset or liability (such as interest rates, yield curves, implied volatilities, and credit spreads)
      * Level 2d – Inputs derived from or corroborated by observable market data by correlation or other means
* Level 3 – Unobservable inputs for the asset or liability

No matter which valuation metric is used, the fair value of a security should be the price at which an asset could be acquired or sold in a current transaction between willing parties in which the parties each acted knowledgeably, prudently, and without compulsion. Fair value should not be based on what can be obtained from an immediate “fire sale” disposition nor on what a buyer might pay at some later time or under more favorable circumstances.

In accordance with regulatory guidance and industry best practices, an adviser has the following primary obligations regarding fair valuation:

* The adviser should adopt written policies and procedures that require the adviser to monitor for circumstances that may necessitate the use of fair value pricing;
* The adviser should establish criteria for determining when market quotations are not reliable for a particular security;
* The adviser should establish a methodology or methodologies to determine the current fair value of a security; and
* The adviser should periodically review the appropriateness and accuracy of the methods used in valuing securities.

Ultimately each adviser, acting in good faith and exercising reasonable business judgment, must consider a broad array of factors to devise an appropriate approach to valuation.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to its valuation and pricing processes resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written valuation policies and procedures
* Adherence to written valuation policies and relevant disclosures
* Maintenance of documentation to support pricing and valuation of client investments
* Reasonableness of XYZ’s fair valuation techniques
* Occurrence of pricing errors, including the restatement of net asset value
* Termination or redemption of a client or investor during a billing period

ACA’s review of XYZ’s valuation and pricing processes resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| J.1 |  |  | High |
| J.2 |  |  | **Moderate** |
| J.3 |  |  | **Low** |

## K. Privacy, the Safeguarding of Information, Cybersecurity, and Identity Theft Prevention

Regulation S-P requires registered investment advisers to adopt and implement policies and procedures regarding the use and safekeeping of nonpublic information about clients who are natural persons. Advisers should adopt and implement reasonable controls to prevent the unauthorized use or taking of proprietary information, including such unauthorized use or taking by company insiders. Regulation S-P also requires that investment advisers deliver an initial privacy notice to new natural person customers and annual privacy notices to all natural person customers. However, the FAST Act provides an exception to the annual delivery requirement for any financial institution that (i) does not share nonpublic personal information with nonaffiliated third parties other than as allowed by subsection (b)(2) or (e) of 15 U.S.C § 6802, and (ii) has not changed its policies and practices from those that were disclosed in the most recent privacy notice distributed. Privately offered funds must comply with the Federal Trade Commission (“FTC”) privacy rules found in Part 313 of Title 16 in the Code of Federal Regulations. Generally, private funds can comply with the FTC rules and standards by following policies and procedures that are designed to comply with Regulation S-P.

Regulation S-AM prohibits a registered investment adviser from using information about an individual consumer that has been obtained from an affiliated entity for marketing purposes unless the information-sharing practices have been disclosed and the consumer has not opted out.

Regulation S-ID requires each financial institution and creditor that maintains one or more covered accounts to implement and maintain written policies and procedures designed to detect, prevent, and mitigate the effects of identity theft. Examples of SEC-regulated entities that would be considered financial institutions or creditors with covered accounts for purposes of Regulation S-ID include the following:

* Investment advisers with the ability to direct transfers or payments from accounts belonging to natural persons to third parties upon the individuals’ instructions[[25]](#footnote-26)
* Investment advisers managing private funds with natural person investors where the adviser or an affiliate has the authority to direct the individuals’ investment proceeds to third parties.

Programs implemented to comply with Regulation S-ID must, among other requirements, receive written approval from the adviser’s board of directors or a designated member of senior management (as applicable), address training of employees to identify red flags, ensure third-party service providers to covered accounts have their own reasonable red flags programs in place, and provide for an annual review of the adviser’s red-flags program.

Cybersecurity – The SEC has brought multiple enforcement actions against investment advisers for failure to adopt written policies and procedures reasonably designed to safeguard customer information. In various Risk Alerts, Releases and other public documents, the SEC has described industry practices and approaches to managing cybersecurity risk and maintaining operational resiliency <Discuss with Aponix before expanding upon the text>.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to client privacy and the safeguarding of information resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written privacy, information security, cybersecurity, and identity theft policies and procedures
* Initial and annual delivery of the privacy notice
* Processes to protect client information, including cybersecurity controls
* Processes to protect XYZ proprietary information
* Information sharing with affiliates
* Oversight of third parties with access to XYZ’s sensitive information

ACA’s review of this regulatory issue resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| K.1 |  |  | High |
| K.2 |  |  | **Moderate** |
| K.3 |  |  | **Low** |

## L. Business Continuity Planning

In *Release IA-2204*, the SEC stated that an adviser’s fiduciary duty to its clients includes the obligation to protect clients’ interests from being placed at risk by a business interruption, a natural disaster, or the loss of key personnel. In addition to regulatory expectations, the development and testing of business continuity plans is a prudent course of business.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s internal control policies and procedures related to contingency and disaster recovery planning resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s written contingency and disaster recovery plan
* Testing of the written contingency and disaster recovery plan
* Training on the written contingency and disaster recovery plan
* Monitoring of key service providers’ disaster recovery capabilities
* Adequacy of XYZ’s succession plan

ACA’s review of this regulatory issue resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| L.1 |  |  | High |
| L.2 |  |  | **Moderate** |
| L.3 |  |  | **Low** |

## M. Compliance Program

Pursuant to Rule 206(4)-7, each registered investment adviser must adopt and implement written policies and procedures that are reasonably designed to prevent the adviser or any of its supervised persons from violating the Federal Securities Laws. The rule requires advisers to consider their fiduciary and regulatory obligations and to formalize policies and procedures to address them.

Written Policies and Procedures – Rule 206(4)-7 requires each registered investment adviser to adopt and implement written policies and procedures that are tailored to reflect the adviser’s operations. Each adviser, in designing its policies and procedures, should identify conflicts and other compliance factors creating risk exposure for it and its clients in light of the adviser’s particular operations, and then design policies and procedures that address those risks. An adviser’s policies and procedures should be designed to prevent violations from occurring, detect violations that have occurred, and properly address any violations that have been detected.

Escalation and Resolution of Issues that Arise – Whistleblowing provisions in the Dodd-Frank Act and the associated rules adopted by the SEC are intended to ensure that investment advisers are proactive in identifying and promptly addressing any potentially serious regulatory deficiencies. Investment advisers should ensure that all employees understand their responsibilities regarding the identification and reporting of potential risk areas. Advisers should also evaluate the channels that employees can use to report concerns and the ways in which concerns that are reported will be investigated. Employees who report potential concerns in good faith should be protected from retaliation.

Annual Review – Rule 206(4)-7 requires each registered adviser to review its policies and procedures at least annually to evaluate their adequacy and the effectiveness of their implementation. The review should consider any compliance matters that arose during the previous year, any changes in the business activities of the adviser or its affiliates, and any changes in the Advisers Act or other applicable regulations that might require revisions to the policies or procedures. Advisers should also consider the need for interim reviews in response to significant compliance events, changes in business arrangements, or regulatory developments.

Chief Compliance Officer – Rule 206(4)-7 requires each registered investment adviser to designate a CCO to administer its compliance policies and procedures. An adviser’s CCO should be competent and knowledgeable regarding the Advisers Act and should be empowered with full responsibility and authority to develop and enforce appropriate policies and procedures. Thus, the CCO should have a position of sufficient seniority and authority within the organization to compel others to adhere to the compliance policies and procedures.

Forensic Testing – Where appropriate, advisers' policies and procedures should employ forensic tests to identify potential compliance issues, which tests may include analyses of (i) brokerage execution quality, (ii) portfolio turnover rates to identify possible overtrading of securities, and (iii) the comparative performance of similarly managed accounts to detect favoritism, misallocation of investment opportunities, or other breaches of fiduciary responsibilities, among other things.[[26]](#footnote-27) Forensic tests and monitoring also often provide meaningful metrics that may complement compliance program reviews.

<Note to consultants: Include the language below if there are any review areas where you have no findings and recommendations. Remove any areas that you did not review or that resulted in findings. The intention of the bulleted list is to inform clients of the areas that we reviewed but have no comment on.>

ACA’s review of XYZ’s compliance program resulted in no notable issues with respect to the following areas:

* Adequacy of XYZ’s compliance policies and procedures
* Completion of a formal risk-mapping process
* Process of formally reviewing XYZ’s compliance program
* Adequacy of forensic compliance testing, monitoring, and surveillance
* Evaluation of XYZ’s compliance resources
* Reasonableness of XYZ’s processes to supervise employees, including those working from branch offices
* Occurrence of periodic and regular compliance training
* Evaluation of key third-party service providers
* Monitoring for ERISA “plan assets”
* Monitoring the investor limitations of Section 3(c)1 and Section 3(c)7 of the IC Act
* Efforts to combat money laundering schemes
* Efforts to prevent elder abuse
* Issues raised from prior SEC examinations of XYZ
* Issues raised from prior ACA reviews of XYZ
* Efforts to identify and address conflicts of interest

ACA’s review of XYZ’s compliance program resulted in the following <comment OR comments>.

| Issue Number | Issue | Findings and Recommendations | Risk Level |
| --- | --- | --- | --- |
| M.1 |  |  | High |
| M.2 |  |  | **Moderate** |
| M.3 |  |  | **Low** |

**VII. Conclusion**

ACA believes that our review of XYZ’s books and records, together with oral representations from XYZ’s personnel, provides a reasonable basis for the findings and recommendations herein. ACA may have reviewed certain of the records, data, or information provided by XYZ on a sample basis. ACA’s findings and recommendations reflect applicable regulations, compliance requirements, and XYZ’s operations only as of the time of the engagement.

ACA’s findings and recommendations must be reviewed in totality. Certain of ACA’s recommendations may be predicated on the implementation of other recommendations. This report is supplemental to ACA’s oral discussions with XYZ’s Compliance and Legal Departments or NAME OF LAW FIRM.Not all findings and recommendations are necessarily memorialized in this report. Findings and recommendations made in prior ACA reports, to the extent not remediated by XYZ and to the extent not mitigated by subsequent developments or additional facts, remain outstanding and should be reviewed and addressed by XYZ.

ACA does not offer legal services, nor does ACA provide substitute services for those provided by legal counsel. Accordingly, ACA’s review does not provide a legal determination of XYZ’s compliance with any of the laws or regulations specified herein. It is the responsibility of XYZ to ensure compliance with those requirements. While ACA has identified issues and provided recommendations regarding XYZ’s compliance program, the operational implementation of an adequate and effective compliance program remains the sole obligation of XYZ. In addition, ACA does not provide any legal advice regarding XYZ’s agreements. To the extent that we have provided comments related to XYZ’s agreements, these comments are based upon regulatory requirements or relate to operational issues such as adherence to stated billing terms or compliance with stated investment mandates or restrictions.

ACA’s review was designed to help provide reasonable, but not absolute, assurance to XYZ that XYZ has, or will have, an adequate and effective compliance program with respect to the areas that were covered by the review. Because the review was designed to help provide reasonable, but not absolute, assurance and because ACA did not perform a detailed inspection of all of XYZ’s books and records, communications, and transactions, there is a risk that material issues or deficiencies, fraudulent activity, misappropriation of assets, or violations of law, which may exist, were not detected during the course of our review.

This report is intended solely for the information and use of XYZ or NAME OF LAW FIRM.

1. See “2020 Examination Priorities” <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf>. [↑](#footnote-ref-2)
2. See <https://www.sec.gov/files/Risk%20Alert%20-%20Large%20Trader%2013h.pdf> [↑](#footnote-ref-3)
3. See <https://www.sec.gov/files/Risk%20Alert%20IA%20Compliance%20Programs_0.pdf> [↑](#footnote-ref-4)
4. See <https://www.sec.gov/files/Risk%20Alert%20-%20Multi-Branch%20Risk%20Alert.pdf> [↑](#footnote-ref-5)
5. See <https://www.sec.gov/files/Risk%20Alert%20-%20Credential%20Compromise.pdf> [↑](#footnote-ref-6)
6. See “Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers” <https://www.sec.gov/rules/policy/2020/ia-5547.pdf> [↑](#footnote-ref-7)
7. See <https://www.sec.gov/files/Risk%20Alert%20-%20Ransomware.pdf> [↑](#footnote-ref-8)
8. See CISA Alert – Dridex Malware <https://us-cert.cisa.gov/ncas/alerts/aa19-339a> [↑](#footnote-ref-9)
9. See “Form CRS Relationship Summary; Amendments to Form ADV” <https://www.sec.gov/rules/final/2019/34-86032.pdf>. [↑](#footnote-ref-10)
10. See <https://www.sec.gov/files/Risk%20Alert%20-%20Form%20CRS%20Exams.pdf>. [↑](#footnote-ref-11)
11. See <https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf> [↑](#footnote-ref-12)
12. See <https://www.sec.gov/files/Risk%20Alert%20-%20OCIE%20LIBOR%20Initiative.pdf> [↑](#footnote-ref-13)
13. See “SEC Coronavirus (COVID-19) Response” <https://www.sec.gov/sec-coronavirus-covid-19-response>. [↑](#footnote-ref-14)
14. See <https://www.sec.gov/files/Risk%20Alert%20-%20COVID-19%20Compliance.pdf> [↑](#footnote-ref-15)
15. See “Report on OCIE Cybersecurity and Resiliency Observations” <https://www.sec.gov/files/OCIE%20Cybersecurity%20and%20Resiliency%20Observations.pdf>. [↑](#footnote-ref-16)
16. See <https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Principal%20and%20Agency%20Cross%20Trading.pdf>. [↑](#footnote-ref-17)
17. See “Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers” <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>. [↑](#footnote-ref-18)
18. See <https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Supervision%20Initiative.pdf>. [↑](#footnote-ref-19)
19. The “Federal Securities Laws” include the Securities Act of 1933, as amended (the “Securities Act”); the Securities Exchange Act of 1934, as amended (the “Exchange Act”); the Sarbanes-Oxley Act of 2002, as amended; the Investment Company Act of 1940, as amended (the “IC Act”); the Advisers Act, as amended; Title V of the Gramm-Leach-Bliley Act, as amended; the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”); any rules adopted by the SEC under any of these statutes; and the Bank Secrecy Act (the “BSA”) as it applies to investment companies and investment advisers, and any rules adopted thereunder by the SEC or the Department of the Treasury. [↑](#footnote-ref-20)
20. The Fixing America’s Surface Transportation Act (“FAST Act”), signed into law in December 2015, amended the Gramm-Leach-Bliley Act and provides an exception to the annual delivery requirement for any financial institution that (i) does not share nonpublic personal information with nonaffiliated third parties other than as allowed by subsection (b)(2) or (e) of 15 U.S.C § 6802, and (ii) has not changed its policies and practices from the policies and practices that were disclosed in the most recent privacy notice distributed. [↑](#footnote-ref-21)
21. In a letter issued to *Munder Capital Management* (May 17, 1996), the SEC staff stated that this broad definition encompasses materials designed to maintain existing clients or solicit new clients. [↑](#footnote-ref-22)
22. A “solicitor” is defined as any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser. [↑](#footnote-ref-23)
23. Please see the SEC staff letter issued to *Mayer Brown LLP* (July 15, 2008) for additional guidance about the applicability of the Cash Solicitation Rule to fees paid for the solicitation of investors in a private fund. [↑](#footnote-ref-24)
24. See *In the Matter of Springer Investment Management, Inc*., *Release IA-2434* (September 21 2005); *Van Kampen American Capital Asset Management, Inc.*, *Release IA-1525* (September 29, 1995); *In the Matter of Mitchell Hutchins Asset Management, Inc*., *Release IA-1654* (September 2, 1997); and *In the Matter of Western Asset Management Co. and Legg Mason Fund Adviser, Inc.*, *Release IA-1980* (September 28, 2001). [↑](#footnote-ref-25)
25. An adviser would not be deemed to have a covered account solely because it can withdraw money from an individual’s account to deduct its own advisory fees. [↑](#footnote-ref-26)
26. See Footnote 15 of the SEC’s Adopting Release for Rule 206(4)-7. [↑](#footnote-ref-27)