



Michigan Guide to **Investment Adviser Examination Program**

ENRICH

EDUCATE

CORPORATIONS, SECURITIES & COMMERCIAL LICENSING BUREAU (CSCL)



TABLE OF CONTENTS

Examinations 3

Registration 6

Books &
Records 6

Supervision/
Compliance
Issues 7

Contracts 7

Fees and
other Billing
Issues 8

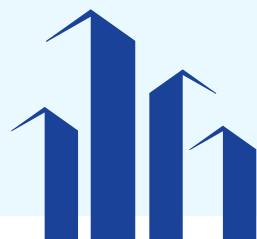
Custody 8

Financial
Matters 9

Advertising 9

Cybersecurity 10

Third Party
Services
Providers 11



EXAMINATIONS

Explained

Staff of the Corporations, Securities, and Commercial Licensing Bureau (“the Bureau”) performs examinations of state registered investment advisers (“IA”). Advisers ***may be selected randomly*** for an examination ***or for cause***. The exam may be conducted at the adviser’s place of business, or through a “**desk audit**” conducted remotely where certain records are required to be provided to Bureau staff without an in-person component.

Examinations may be “announced” or “unannounced”. If the examination is **announced**, staff will contact the investment adviser in advance to schedule the examination and provide a list of documents to have ready for the examiner to review. The examination may be “**unannounced**” meaning that the examiner will not schedule the examination ahead of time and will arrive at your place of business without contacting you prior to the examination.


TIME FRAME

➤ Examinations may last from one day to several weeks or more depending on the complexity of the adviser’s business and the issues encountered on the examination.

LOCATION

➤ The examiner may be onsite at your place of business during the entire examination period, or may perform some of the examination at your office and then continue the examination through email correspondence and telephone or video-chat follow-ups.





During the examination, staff will review books and records to determine compliance with relevant laws and regulations and to detect potential concerns. As part of the examination process, staff may also interview employees regarding the operations of the investment adviser.

Bureau staff may review any records pertaining to an investment adviser's business during an examination. The records reviewed will include, but are not limited to:



- Financial records
- Client Records
- Correspondence and Billing Records
- Complaint, Arbitration and Litigation Files
- Advertising files
- Compliance Manuals
- Personnel Records
- The Firms Form ADV and Brochures
- Third Party Agreements



AFTER EXAMINATION



After the examination is completed, staff may sit down with the investment adviser or call the investment adviser to discuss any problems or areas for improvement identified by the examiner. If deficiencies are identified, a follow-up letter will be sent to the investment adviser. The letter may require the adviser to respond to the Bureau in writing identifying how the deficiencies were corrected.

RESOLUTION



The resolution of problems identified during an examination will be contingent on the severity of the issue. Resolution may range from simply correcting the issues to possible administrative enforcement action, which may include censuring, suspending, limiting, conditioning, or revoking a registration, and potentially the imposition of civil fines.

Learn More: [Examination Authority: Section 451.2411](#)
[Recordkeeping Requirements: Rule 451.4.24](#)
[NASAA State Investment Adviser Examination Sweep Findings](#)



TYPES OF DEFICIENCIES IDENTIFIED

Registration

We continue to see general registration issues as the most noted deficiency on our exams of state-registered IA firms. In general, these issues consist of inconsistent or inaccurate Forms ADV 1, 2A, 2B, and Form U4s.

Learn More:

- [Form ADV Instructions](#)
- [Form U4 Instructions and Resources](#)
- [Rule 451.4.19 Investment Adviser Brochure Rule](#)

Books & Records

Missing, outdated, or inaccurate client suitability information tops the list of Books & Records concerns when conducting exams. Firms fail to properly memorialize suitability information for the clients that they provide investment advice to.

Other Books & Records issues include failing to produce or provide evidence of contract revisions, updates, or amendments to those documents when material changes have occurred to the services or fees provided.

Learn More:

- [Rule 451.4.24 Investment Adviser Recordkeeping Rule](#)
- [NASAA IA Compliance Guide: Record Keeping Preparation](#)
- [NASAA IA Compliance Guide: Documenting Suitability](#)

Supervision/Compliance Issues:

Since the expanded rules regarding policies and procedures were implemented in 2022, we are seeing some firms struggle to update or expand upon their Written Supervisory Procedures (“WSP’s”) to address these new rules on Business Continuity/Succession Planning, Privacy Policy, Code of Ethics, and Cybersecurity. In many cases, such WSP’s are not tailored to the Adviser’s business model or are not current or updated. In other cases these policies and subsequent updates are not properly communicated to relevant stakeholders in the firm.

Learn More:

- [Rule 451.4.21 Investment adviser policies and procedures](#)
- [NASAA Compliance Guide: Business Continuity and Succession Planning](#)
- [SEC: Questions Advisers Should Ask While Establishing or Reviewing Their Compliance Program.](#)

Contracts:

Regarding contracts, we continue to see instances of contracts that were not properly executed in the first place (lacking required signatures, etc.) and situations where the documents were not properly updated to reflect material changes. In some cases, fee formulas or explanations of fee calculations were not properly stated in the contract. In other instances, we see examples of where the Adviser failed to update the agreement to properly reflect any updates to the fee arrangement (either to reflect a fee increase or a discount of some type since the inception of the agreement).

Learn More:

- [Rule 451.4.26 Investment Adviser Contracts](#)

Fee and other Billing Issues:

We continue to see instances where fees charged to a client do not match what was contractually agreed upon or what is stated in Forms ADV 1 and 2. We see examples of miscalculated fees or failure to provide a refund of prepaid fees if warranted. When working with 3rd party managers, we often see instances of inadequate fee disclosures (how the fee will be calculated, who will receive which portion of the fee, which party will actually collect the fee, etc.)

Learn More:

- [NASAA IA Compliance Guide: Clear and Reasonable Disclosure of Fees](#)
- [NASAA Fee Guidance](#)

Custody:

We see examples of inadvertent forms of custody (typically where a password or other log-in credentials have been provided to the Adviser from the client in order to access an outside website or platform containing information on the client's held-away assets such as a 401k account or other non-managed account). Such access presents potential custody concerns for the Adviser as well as concerns over privacy.

- We also see other custody concerns with Advisers who are named trustee or executor over a client's estate.
- Standing Letters of Authorization: An investment adviser with power to dispose of client funds or securities for any purpose other than authorized trading has access to the client's assets. Such letters of instruction or other similar asset transfer authorization arrangement with a qualified custodian would constitute an arrangement where an investment adviser is authorized to withdraw client funds or securities maintained with a qualified custodian upon its instruction to the qualified custodian. An investment adviser that enters into such an arrangement with its client would therefore have custody of client assets and would be required to comply with applicable custody rules.

- [Rule 451.4.13 Custody Prohibitions, Limits, and Conditions](#)

Learn More:

- [SEC Staff Responses to Questions about the Custody Rule](#)

Financial Matters:

We see instances of inadequate net worth and other potential solvency issues for advisers. We also note instances where financial statements have been prepared incorrectly or not updated as required. For Advisers who must maintain a surety bond, we have identified issues of insufficient bond coverage or instances of no surety bond on file with this office. Finally, we note cases where IA's have been unable to produce a required balance sheet when requested to do so, or the balance sheet has not been prepared in accordance to GAAP standards.

Learn More:

- [Rule 451.4.17 Minimum Financial Requirements for Investment Advisers](#)
- [Rule 451.4.14 Bonding Requirement for Certain Investment Advisers](#)
- [Rule 451.4.18 Financial Statements](#)

Advertising

This is an emerging issue for us since the passage of the new SEC rules on marketing. We are beginning to see some of our state registered IA's explore areas of advertising that they generally stayed away from before: primarily around the use of testimonials and holding out performance numbers in their advertising or marketing materials. As these issues can get complicated very quickly, we are recommending that those firms interested in pursuing such forms of advertising work with professionals to ensure that any such testimonials or performance advertising is done in such a way that is in compliance with the relevant rules and regulations on these subjects.

Advisers should also be aware that compensating an individual to provide a testimonial or endorsement, even if in compliance with advertising rules, may cause the compensated person to fall within the definition of “investment adviser representative” and implicate registration requirements under the Act.

- Learn More:*
- [Rule 451.4.25\(2\)\(n\) Prohibited Practices of Investment Advisers and Investment Adviser Representatives](#)
 - [SEC Small Entity Compliance: Investment Adviser Marketing](#)

Cybersecurity:

In general, there is an increased need for state-IA firms to keep up with the ever-evolving world of cybersecurity. Primarily, we note WSP’s that are inadequate and in many cases fail to address general steps and practices to ensure compliance with rules and regulations on cybersecurity and safeguarding of client information. Advisers need to transmit data via secure means, ensuring encryption is used as appropriate. Advisers should be able to demonstrate adequate protection of sensitive data files, properly backed-up data, using secure off-site storage facilities for such information, and procedures to frequently change passwords. Many of our smaller IA firms fail to allocate sufficient resources to address issues involving cybersecurity and must do more to confront the myriad of security concerns facing business today.

- Learn More:*
- [NASAA Cybersecurity Checklist for Investment Advisers](#)

Third Party Services Providers:

State-IA firms frequently engage third party vendors to provide various services to the adviser's business. The reasons include the adviser's limited expertise in performing certain functions, time and cost savings, or a recognition that certain services may be more efficiently provided by an outside vendor. Outsourcing functions does not, however, relieve an adviser of its fiduciary obligations to clients, or of its obligations to comply with its regulatory requirements. Advisers should ensure that their policies and procedures adequately address due diligence of third-party service providers to minimize risks to the adviser's business and to its clients. Policies and procedures should be designed, implemented, and enforced on an ongoing basis, and not only at the time a third-party is hired to provide a service.

Learn More: • [FINRA Guidance on Third Party Provider Cybersecurity Risks](#)

This guide is intended to provide an overview of examinations conducted pursuant to the [Michigan Uniform Securities Act](#) and [the rules](#) under the Act. This guide and linked resources are not intended to replace the Act and rules and do not purport to cover all aspects of the industry or all regulatory requirements. You are urged to review the Act and the rules under it and to speak with an attorney if you do not understand the requirements that they impose. A link to the Act and rules is available on the Bureau website at www.michigan.gov/securities.

[Back to Table of Contents](#)



Phone: 517-335-5237

Phone #: 517-335-5237

Address: PO Box 30018, Lansing, MI 48909

Email: LARA-CSCL-Securities-Audit@michigan.gov

Corporations, Securities & Commercial Licensing Bureau (CSCL)