

Detailed Timeline of 2016 Form ADV Inconsistencies Sweep

Overview

In July 2016, the Minnesota Department of Commerce Securities Section (the “Section”) examination team identified several common deficiencies noted during the examinations that they had conducted to date. The team focused on four deficiencies they could “test” for utilizing data analytics. To test for these deficiencies, Section staff pulled Excel reports from the CRD/IARD database. The reports aggregated data from Forms ADV Parts 1 and 2 submitted by Investment Advisers (“IAs”) registered in Minnesota.

When reviewing this data, staff noted inconsistencies in how IAs completed certain fields on the Forms. These inconsistencies were not, alone, indicative of violations of Minnesota law; however, they suggested that the IA had either made a mistake in completing the Forms, or was engaging in a practice that did not comply with Minnesota regulations. (In some cases, there were valid explanations for the inconsistency that neither suggested an error or a violation.) The below table provides a break-down of these inconsistencies.

Inconsistency Title	Description of Inconsistency in Registrant’s Form ADV	Minnesota Statute/Rule at Issue
Bond Requirement	The registrant disclosed that it maintains discretion and/or custody of client assets, but failed to disclose information demonstrating it had posted the required surety bond.	Minn. R. 2876.4115
Client Invoice	The registrant disclosed that it directly deducts fees from client accounts, but does not send invoices to the clients at the same time it sends invoices to custodians.	Minn. R. 2876.4116, subp. 1.F.
IAR Registration	The registrant discloses that it has more individuals performing investment advisory functions than it has registered IARs.	Minn. Stat. 80A.58
Form ADV Renewal	The filing date of the Form ADV is more than one year old.	Minn. Stat. § 80A.61(d) Minn. R. 2876.4061

Staff utilized Excel formulas to create a report identifying each IA registered in Minnesota that exhibited one or more of these inconsistencies (the “July Inconsistencies Analysis”). Staff then utilized the July Inconsistencies Analysis to conduct a two-part sweep exam (collectively, the “2016 Sweep”) of all IAs registered in Minnesota.

I. Targeted Sweep

One effort targeted those IAs that triggered all four of the inconsistencies described above. Staff also targeted those IAs that had never filed a Form ADV Part 2 (a “Brochure”) with the Department. Utilizing the July Inconsistencies Analysis, staff identified six IAs exhibiting all four inconsistencies, and five IAs that had never filed a Brochure, for a total of 11 IAs.

On August 17, 2016, the Section sent a letter to each IA exhibiting four inconsistencies notifying them of potential compliance deficiencies. On August 31, 2016, the Section sent a letter to each registrant that had not filed a Brochure notifying them of the requirement to do so. Staff then followed up with each of these targeted IAs to achieve the following results:

- targeted IAs withdrew their Minnesota registration
- targeted IAs worked with the Department to address deficiencies

II. Combined Sweep

Beginning in September 2016, the Section sent a letter to all 404 IAs registered in Minnesota notifying them of the four inconsistencies described above, and providing information on what IAs must do to address potential deficiencies (the “September 6, 2016 Letter”).

The September 6, 2016 Letter prompted follow-up contact with 20 IAs, either because the letter was returned as undeliverable to the Department or because the IA contacted the Department seeking guidance or clarification. Staff then worked with these IAs to address questions and monitor the IAs’ efforts to take action to address any deficiencies.

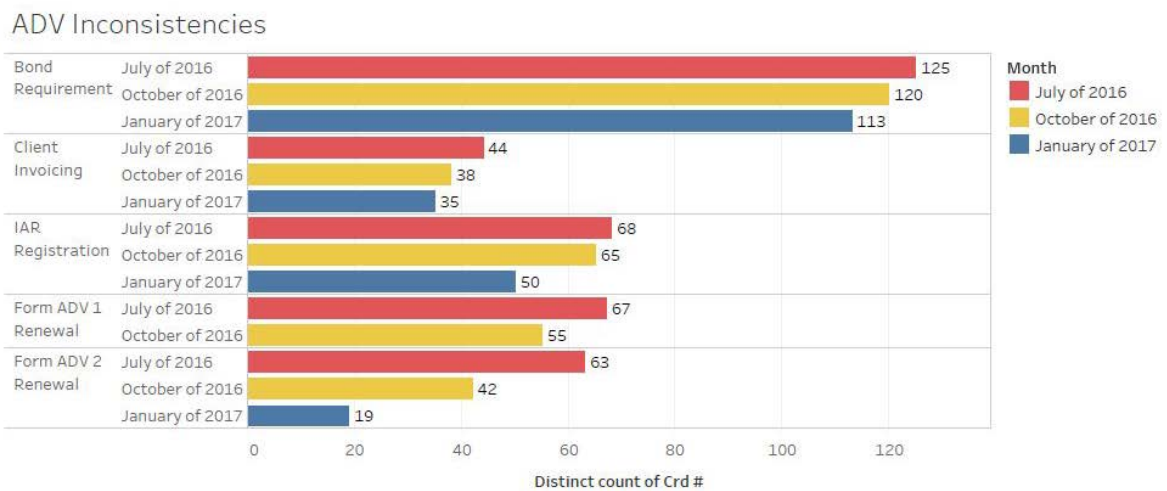
In October 2016, staff replicated the process they had utilized to create the July Inconsistencies Analysis, but with fresh registration data extracted from the CRD/IARD database. This analysis (the “October Inconsistencies Analysis”) showed a decrease in the number of IAs exhibiting each of the four inconsistencies. The October Inconsistencies Analysis also showed that there were no longer any IAs that triggered all four of the inconsistencies.

Staff utilized the October Inconsistencies Analysis to identify 14 IAs that still triggered three of the four inconsistencies. On November 4, 2016, after conducting a preliminary analysis of CRD/IARD records for each of the 14 IAs, staff sent targeted letters to these 14 IAs

notifying them of the specific inconsistencies that they exhibited and directing the IAs to respond with an explanation or to take corrective action. As a result of each of the efforts described above, the Combined Sweep led to the following results :

- 4 IAs were referred to enforcement with requests to open new investigations
- 1 IA was referred to enforcement with information to supplement an existing investigation
- 3 IA withdrew their Minnesota registration
- 2 IAs were confirmed for examination (having previously been assigned to an examiner)
- 21 IAs worked with the Department to address deficiencies

Finally, in January 2017 staff again replicated the process they had utilized to create the July and October Inconsistencies Analyses, but with fresh registration data extracted from the CRD/IARD database. The overall decreases in inconsistencies are reflected in the chart below.



Distinct count of Crd # for each Month broken down by Inconsistencies. Color shows details about Month.

Overall Impact

Overall, the 2016 Sweep led to four new enforcement investigations, eight registration withdrawals, two confirmed examinations, and 27 cooperative efforts to bring IAs into compliance with four common deficiencies. The number of IAs with outdated Brochures was reduced by nearly 70%. The amount of IAs exhibiting inconsistencies regarding bond requirements, client invoices, IAR registration, and Form ADV renewals was reduced by an average of 18%. Finally, the sweep allowed the Department an opportunity to touch all IAs registered in Minnesota to supplement the Securities Section’s examination program as the Section continues to struggle with limited resources.

¹ The results tallied in this section describe actions taken regarding 31 IAs. This number is less than the 34 IAs that the Department contacted in the Combined Sweep following its September 6, 2016 letter. The three IAs not accounted for in the final results included IAs that had questions, but did not need to take corrective action, or that had not initially received the September 6, 2016 letter due to a mailing address error.