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## OCIE Issues Risk Alert Regarding Adviser Fees and Expenses

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On April 18, 2018, the Office of Compliance Inspections and Examinations (the “OCIE”) released a Risk Alert on the most frequent compliance issues relating to advisory fees and expenses.<sup>[1]</sup> As a general matter, the OCIE explained that advisers that do not comply with the compensation terms of their advisory agreements or Form ADV disclosures, or otherwise engage in inappropriate fee billing or expense practices, may violate the Investment Advisers Act of 1940 (“Advisers Act”), including its antifraud provisions. <sup>[2]</sup> The Risk Alert then identified the following six compliance issues as the most observed deficiencies related to fees and expenses:

- Fee-Billing Based on Incorrect Account Valuations. The OCIE observed advisers using a metric or process to value a client’s account that was different from the metric or process stated in the advisory agreement.<sup>[3]</sup> In some instances, this led the adviser to assess an incorrect advisory fee.<sup>[4]</sup>
- Billing Fees in Advance or with Improper Frequency. The OCIE observed advisers billing on a monthly basis when the advisory agreement or Form ADV Part 2 stated that clients would be billed quarterly, or billing in advance when the advisory agreement stated that clients would be billed in arrears.<sup>[5]</sup> The OCIE also found advisers that failed to pro-rate fees and charges, when the advisory agreement or Form ADV Part 2 stated fees and charges would be subject to proration.<sup>[6]</sup>
- Applying Incorrect Fee Rates. The OCIE observed advisers applying an incorrect fee rate when calculating advisory fees for certain clients. Examples provided by the OCIE included double-billing clients and charging performance fees to non-qualified clients.<sup>[7]</sup>
- Omitting Rebates and Applying Discounts Incorrectly. The OCIE observed advisers failing to apply discounts or rebates in the manner described in the advisory agreement. Examples provided by the OCIE included failing to aggregate account values for members of the same household, failing to reduce the fee rate once a client reached a prearranged breakpoint level, and charging additional fees to a client participating in a wrap program.<sup>[8]</sup>
- Disclosure Issues Involving Advisory Fees. The OCIE observed advisers using Form ADV Part 2 disclosures that were inconsistent with the adviser’s actual practice ( e.g., the Form ADV stated a maximum fee rate, which was not applied by the adviser in practice), and advisers failing to disclose certain additional fees.<sup>[9]</sup>
- Adviser Expense Misallocations. The OCIE observed private and registered fund advisers misallocating

expenses to clients in contravention of advisory agreements, operating agreements and disclosure documentation.<sup>[10]</sup>

The Risk Alert puts advisers on notice that the SEC takes fee and billing disclosures and contractual arrangements seriously, and the myriad of inconsistencies the SEC observed in recent exams will result in a greater emphasis on, and potentially greater consequences for, advisers that do not follow their disclosures and agreements going forward. Because disclosure and advisory agreement inconsistencies can be difficult to uncover, particularly with documents that have been in use for years, advisers may wish to have counsel review their advisory agreements, fund offering documents, and Form ADV disclosures to ensure that each reflects current fee and expense billing practices and policies.

If you have any questions related to fee practices or investment adviser regulation generally, please feel free to contact us.

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<sup>[1]</sup> SEC Office of Compliance Inspections and Examinations, *Overview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers* (Apr. 18, 2018), available at <https://www.sec.gov/ocie/announcement/ocie-risk-alert-advisory-fee-expense-compliance.pdf>.

<sup>[2]</sup> *Id.*

<sup>[3]</sup> *Id.*

<sup>[4]</sup> *Id.*

<sup>[5]</sup> *Id.*

<sup>[6]</sup> *Id.*

<sup>[7]</sup> *Id.*

<sup>[8]</sup> *Id.*

<sup>[9]</sup> *Id.*

<sup>[10]</sup> *Id.*