

Tips on How to Prepare for Your Next Examination: Part 2

By Michelle L. Jacko

“Tips on How to Prepare for Your Next Examination” is a two-part series that began in [March](#) and concludes this month, in which we address how to use the SEC’s Risk Alerts to prepare for future regulatory examinations.

Steps You Can Take to Help You Prepare for Your Next Examination

Ensuring you have ample time to prepare is one of the most important things investment advisers can do prior to the SEC staff’s arrival. Below are best practices to consider before and during the actual examination.

1. First Impressions

Establish and Revisit Your Tone at the Top. The SEC’s examination program focuses strongly on the firm’s compliance culture, including the “tone at the top” and the effectiveness of the compliance program. During your preparations, meet with senior management to discuss how the business has changed since the last examination, the compliance and internal controls the firm has put in place, and the type of interaction that senior management has with one another, particularly as it relates to addressing higher risk areas. The SEC staff frequently reviews various items, such as firm e-mail communications (particularly to and from senior management team members), the compliance program’s Annual Review report, lists of material and/or repeat minor violations unveiled by the firm during the examination period, and actions taken by the firm to address violations and higher risk areas (such as enhancements to the policies and procedures manual). Think about how the firm has supported compliance efforts and be able to articulate this in your opening meeting with the staff.

Employee Preparations. It is critical for key employees to be prepared and understand the examination process. In particular, senior management must be able to demonstrate their knowledge about the firm’s policies and procedures for the areas in which they oversee and be able to articulate how they supervise that area and hold personnel accountable. Generally, the SEC examiners will ask to interview various personnel, including those who oversee portfolio management and trading, sales and marketing, compliance, cybersecurity, finance and billing and operations. Prior to meeting with the staff, it is important to identify which employee is the most appropriate and well-informed person to speak about processes, systems, documentation, supervisory controls and tests used for that subject area. Also, firms should consider conducting a “practice” interview, with particular focus on higher risk areas and exam priority initiatives to help better prepare employees for Staff questions. This will provide employees an opportunity to identify areas that they should review prior to the staff’s arrival so that they can clearly articulate internal controls within their respective areas of management. Mock interviews also allow employees the opportunity to acclimate to the Staff interview process so that they know what to expect. Remind them to always be honest and forthcoming with the SEC.

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The Opening Presentation. First impressions say a lot about the firm and its culture toward compliance. The opening interview often sets the tone for the examination. Firms are at an advantage when they prepare an opening presentation. Often in the form of a PowerPoint presentation, having an “opening ceremony” allows the firm to showcase what they do – and do not do. Generally, topics cover an overview of the organization and its vision and mission statements; the products and services offered; information related to your affiliates; the firm’s internal control environment (often segmented by

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departments, such as portfolio management and trading, compliance, operations and sales and marketing); and a synopsis of your firm's culture of compliance and training efforts.

Initial Document Production. For your document production, make sure that your production is responsive to what the staff is requesting. Using the Accellion system,¹ you can upload all files in a secure environment. Be sure that documents are clearly labeled and in the requested order of the SEC staff. Remember, the goal of your document production is to demonstrate the effectiveness of the policies and procedures within your firm's compliance program; therefore, documentation should reflect how your daily processes, routines, and workflows help achieve compliance within your firm and align within industry regulations. In many cases, a brief memo or narrative is needed to help describe the production and provides purposeful details related to the firm's internal controls.

2. Setting Ground Rules

Often prior to the staff's arrival, the SEC will notify the firm of the department managers they wish to interview. If this occurs, be proactive and provide the SEC staff with an interview schedule. This will enable the staff to be efficient in the interview process and help them to plan accordingly. It also helps to set expectations with your own team, to enable them to prepare. Preparations could include reviewing the Form ADV, policies and procedures and speaking with support team members.

At the initial introductory meeting, do not hesitate to set the ground rules for the examination process. This includes establishing the point(s) of contact for the staff, who will escort the staff throughout the firm, who will demonstrate various systems and controls, what specific days and times senior management team members will be available to meet with the staff and who must be present for the interviews (e.g., the CCO, legal counsel, etc.). Also, do not hesitate to ask the expected duration of the Staff's in-house examination and who from the SEC will be present during the onsite portion of the exam.

If the staff asks for additional documentation, determine whether the firm will provide copies in hard or e-copy format. In either case, it is important to track what you delivered and when. In the event that hard copies are provided, duplicate copies of all documents produced to SEC examiners so that they can be referenced by you and the firm's counsel if anything becomes escalated. Ideally, for initial and supplemental production, remember that all documents should be Bates stamped and Freedom of Information Act stamped for ease of reference. These numbers will be referred to by the Staff during the exam and will be referenced on your firm's privilege logs.

3. Role of the CCO During the Exam

During the examination process, the CCO typically has three roles: that of educator, gatherer and provider.

Educator. Often the CCO serves as the primary point of contact for examiners and is generally present for all interviews. The CCO can help to educate the staff about the firm, including the products and services offered, and what within the organization has changed since the last SEC examination. Understanding these expectations, the CCO typically liaises with department managers and answers staff follow-up inquiries and finds the answers to questions that the firm's employees may not readily know. During the initial meeting, the CCO helps to readily establish the firm's internal control and risk management environment at the onset. This is accomplished by:

- Demonstrating how the firm has updated its policies and procedures to correct, detect and prevent violations of the federal securities laws;
- Evidencing where the compliance program enhanced its tests that were done previously; and
- Explaining the type of testing performed on various policies and procedures (transactional, periodic and forensic).

Gatherer. Throughout the examination process, the Staff will request new or supplemental documents. It is generally the responsibility of the CCO and Compliance Department to gather, review and organize the responsive documents. But beware, on occasion examiner requests may involve documents from non-regulatory members in your group of companies that the firm may not be obligated to produce. CCOs should carefully review each document request prior to production and should, when appropriate, question the Staff about relevance or applicability, should it appear the request goes outside the scope of the examination. As a best practice, the CCO should carefully review the disclosure documents that the SEC provides at the onset of the exam, as they will assist the CCO to better understand the SEC's lawful reach and prepare the CCO to recognize when it is exceeded.

1. <https://www.sec.gov/about/offices/ocie/accellionguide.pdf>

Provider. As a primary liaison, the CCO is responsible for providing important information to the examiners and firm senior management team. Therefore, the CCO must be aware of all moving parts during the examination, which includes, among other things:

- Location and daily schedules of the Staff;
- Which firm personnel is to be interviewed and when;
- The scope of all Staff interviews;
- List of documents requested by the Staff;
- Location of duplicate copies of documents produced to the Staff;
- Persons to be present during the exit interview; and
- How to reach outside counsel, if needed.

4. Demonstrating Competency and Knowledge

Finally, it is critical for firm members to demonstrate competency and knowledge of the firm's compliance program, particularly for their personal areas of responsibility. Firms should ensure that questions from the Staff can be addressed as comprehensively as possible. Consider:

- Can firm supervisors clearly articulate their risk controls, oversight and supervision of critical practice areas?
- Do managers understand their roles, responsibilities and escalation processes within the organization?
- Can employees express the firm's e-mail and CRM etiquette – on what to say or include and what perhaps not to say or escalate?
- Do personnel know how the firm communicates newly adopted firm policies – through departmental meetings, trainings, e-news bulletins or teleconferences?

In her 2004 speech, “The New Compliance Rule: An Opportunity for Change,” Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations, provided the following guidance.

“Compliance staff should continually be asking: Are we detecting problematic conduct with this policy? Based on what we've detected, should we alter our policy? Is there a better way to detect problematic conduct?... Were the actions we took, once problematic conduct was detected, adequate to deter problematic conduct by this individual or others?”²

Being able to answer these questions articulately and competently is essential to today's examination process. Given the complexity of today's business models and processes, many advisers elect to conduct a mock SEC examination to help them prepare and gain the competency (and confidence) on how to best approach the examination process. Mock regulatory examinations assist firms to identify areas of risk, and thereafter, mitigate such risks and provide essential training to further enhance the compliance program. Knowledge of not only what gaps exist within the compliance program, but moreover, being able to articulate and demonstrate how the firm has improved its policies, provided ongoing training and deterred problematic conduct from occurring are essential components for establishing your firm's core competencies with the staff.

Risk Management Tip:

Today's regulatory environment is both complex and complicated. The National Examination Program's *Risk Alerts* provide a valuable tool in alerting advisers about where to focus compliance program efforts. Consider conducting a mock regulatory examination which incorporates the topics outlined in recent *Risk Alerts*. This will allow senior management the opportunity to assess the strength and readiness of the firm's compliance program, and provide the firm an opportunity to improve policies, procedures and internal controls governing the business.

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2. See <https://www.sec.gov/news/speech/spch063004lar.htm>.