



# Due Diligence Primer

## Registered Investment Advisers and Broker-Dealers

James T. Conversano, CFE, CFA



**Disclaimer. The opinions expressed in this presentation are those of the individual author and do not represent the opinions of Berkeley Research Group or its other employees and affiliates. The information provided in this presentation is not intended to and does not render legal, accounting, tax, or other professional advice or services, and no client relationship is established with Berkeley Research Group by making any information available in this publication, or from you transmitting an email or other message to us. None of the information contained herein should be used as a substitute for consultation with competent advisors.**

- This presentation will explore a number of online tools that are available to conduct due diligence of registered broker-dealers and investment advisers.
- These online tools leverage the information provided in various regulatory filings and disclosures.

- Active registration status provides access to useful information.
- However, active registration status does not equal a regulatory “seal of approval.”



- SEC Registration Requirements
  - Section 15 of the Securities Exchange Act of 1934
- Additional Oversight by Financial Industry Regulatory Authority (FINRA)
  - Self-regulatory organization for broker-dealers
- SEC Form BD
  - Uniform Application for Broker-Dealer Registration

- Useful information on Form BD
  - Legal status
  - Ownership
  - Affiliates
  - Regulatory History
  - Key executives
  
- Form BD provides the foundation for establishing “who the firm is” and “what it does.”

- Central Registration Depository (CRD)
  - CRD is a computerized database operated and used by regulators that contains information about brokers, their representatives, and their employers.
- SEC suggests that you obtain information from CRD from:
  - FINRA
  - State securities regulator

# Central Registration Depository

- State regulator may provide more comprehensive information than FINRA
  - Example: Investor complaints





- Online database established to make information available to the public
  - CRD is the source for much of the information used to generate FINRA BrokerCheck reports
  - BrokerCheck is **free**
  - BrokerCheck does not require registration
- FINRA Rule 8312 (FINRA BrokerCheck Disclosure)

- Information available on registered representatives:
  - Current employers
  - 10-year employment history
  - Outside business
  - Licenses, registrations
  - Exam information
  - Felony charges and convictions
  - Investment-related misdemeanor charges and convictions



- Information available on registered representatives:
  - Disciplinary actions and investigations by regulators
  - Investment-related civil judicial actions and proceedings
  - Consumer complaints
  - Arbitration proceedings and civil litigations
  - Unsatisfied judgments and liens
  - Bankruptcy proceedings
  - Employment terminations for allegations of certain misconduct
  - Sanctions imposed by regulators

- Information available on firms:
  - Administrative information
  - 10-year history of felony charges and convictions, and investment-related misdemeanor charges and convictions
  - Regulatory disciplinary history
  - 10-year history of investment-related civil judicial actions and proceedings

- Information available on firms:
  - Bankruptcy proceedings
  - Unsatisfied judgments and liens
  - Summaries of arbitrations awards
  - For former FINRA-registered firms, the date business ceased

- Search results summary page includes:
  - Firm name
  - CRD#
  - SEC#
  - Address
  - Report summary
  - Firm profile
  - Firm history
  - Firm operations
  - Disclosure of arbitration awards, regulatory events, etc.

- Things to look for:
  - Is this brokerage firm currently suspended with any regulator? (Yes/No)
  - Are there events disclosed about this firm? (Yes/No)
- Detailed report:
  - In the upper right-hand corner, look for the solid blue icon titled “GET DETAILED REPORT.”

- Recent changes:
  - Hyperlinks to individual's info.
  - Records have expanded to 10 years
  - Formal procedure for challenging errors
  
- Proposed changes:
  - Unify search terms for broker-dealer and investment adviser databases
  - Add educational content
  - Ability to search zip codes



- Termination Disclosures
  - Although terminations appear frequently, it seems as though no one ever gets “fired” in the securities industry.
  - Typically, no useful detail is provided regarding such departures.

- New resource available to search arbitration awards
  - Search by case number, keyword, date, etc.
  - Court orders relating to arbitration awards
  - Access to database is **free**
  - No registration required

- Exchange Act Rule 17a-5
  - BD audit reports must be periodically submitted
  
- Rule 17a-5(d)(6)
  - Annual audit report must be filed with the regional or district office of SEC
  
- FOCUS Reports (Form X-17A-5)
  - Financial and Operational Combined Uniform Single Report
  - Available online via EDGAR database, or can be requested through a FOIA request to the SEC

- FOCUS reports provide information regarding the net worth, revenue, and profitability of the firm, which is often useful to forensic accountants and investigators.
- Careful review may identify inconsistencies and/or red flags.

- Dodd-Frank Wall Street Reform and Protection Act
  - Granted the PCAOB new oversight authority over audits of broker-dealers
    - Inspections
    - Enforcement
    - Standard setting

- Financial statements of broker-dealers filed with the SEC after 2008 must be certified by a PCAOB-registered accounting firm.
- PCAOB website lists all currently registered accounting firms by name and location and may provide useful information on the registration status of accounting firms that audit broker-dealers.

- Investment advisers are regulated by the SEC pursuant to the Investment Advisers Act of 1940.
- SEC regulates investment advisers with assets under management (AUM) > \$100 million.
- The states regulate investment advisers with AUM < \$100 million (previously was \$25 million).

- SEC Form ADV
  - Used by investment advisers to register with the SEC and states
  - Annual updates required
  - Exempt Reporting Advisers still must provide limited disclosures



- Form ADV Part 1 requires the following:
  - Business description
  - Ownership
  - Clients
  - Employees
  - Business practices
  - Affiliations
  - Disciplinary history

# Form ADV Part 2 (Brochure)

- Form ADV Part 2 requires the following:
  - Narrative brochure written in “plain English”
    - Types of services
    - Fees
    - Disciplinary history
    - Conflicts of interest
    - Management backgrounds

## Form ADV Part 2 (Brochure)

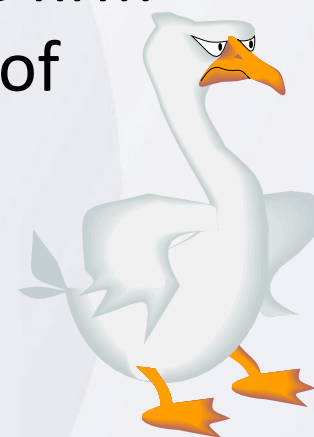
- This brochure is the primary disclosure document that investment advisers provide to clients.
- Should be considered required reading for anyone conducting due diligence of a registered investment adviser.

## Form ADV Part 2 (Brochure)

- However, Form ADV Part 2 is **not required** to be filed electronically and made available online.
- When filed electronically, brochures are available on the Investment Adviser Public Disclosure website.
- Registered investment advisers are required to provide clients with an annual summary of material changes to the brochure.

## Form ADV Part 2 (Brochure)

- What if the brochure is not online?
  - Contact the registered investment adviser directly and request a current copy.
- Don't be surprised if requests for prior versions of Form ADV Part 2 “ruffle feathers” at the firm where the request was made (due to fear of litigation).



- Amendments to the custody rule under the Investment Adviser Act of 1940
- Annual surprise exams required for investment advisers that have custody of client assets
- Form ADV-E serves as a cover page for a certificate of accounting of securities and funds the investment adviser has custody over

# Surprise Exam Report

- Following the surprise inspection, a surprise exam report is created by the independent public accountant.
- Form ADV-E filings and surprise exam reports are made available to the public on [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

- Investment Adviser Registration Depository (IARD)
  - Electronic filing system for investment advisers
  - Sponsored by the SEC and the North American Securities Administrators Association (NASAA)
  - FINRA is the developer and operator
- IARD system collects and maintains registration and disclosure information for investment advisers.
- FINRA does not have regulatory authority over investment advisers. [Yet?]



- SEC Investment Adviser Public Disclosure (IAPD)
  - Established and maintained by the SEC
  - Includes SEC and state registered investment advisers
  - Includes limited information for exempt investment advisers
  - Also includes information for investment advisers no longer registered
- Access is **free**
- No registration required

- On the website, you can:
  - Search for an investment adviser firm
  - View current Form ADVs
  - Check registration or reporting status
  - Search for a representative
  - View backgrounds
  - View representative's registration status
  - Link to relevant state regulator's website
  - Link to FINRA BrokerCheck

- IAPD does not contain information about advisers that:
  - Are exempt from registration and **not** required to file reports as Exempt Reporting Advisers
  - Have filed unapproved applications for registration with the SEC or state

- Quick tips:
  - Use the navigation panel on the left
    - Look for “Part 2 Brochure”
    - For disciplinary history, click on “DRP” (Disclosure Reporting Page)
    - “View All” to view and print \*almost\* all disclosures
  - Should also conduct a search of each representative
  - Note that the SEC (and states) have not approved information filed on Forms ADV

- Following through with due diligence on investment advisers
  - Information is not centralized with one regulator or website
  - Often necessary to request information from state regulators
- The North American Securities Administrators Association provides contact information for each state:

[www.nasaa.org/about-us/contact-us/contact-your-regulator/](http://www.nasaa.org/about-us/contact-us/contact-your-regulator/)

- Requesting information from the states involves:
  - Phone calls
  - Email requests
  - There is no automated online process
- State regulators use CRD and are able to provide information not always available on BrokerCheck.

- As states proactively strive to ensure investor protection, they routinely conduct background checks of individual registered representatives of investment advisers.
- The SEC and FINRA cannot perform this background function as they do not register individual registered representatives of investment advisers.



**Q&A**

**Thank You!**



“Association of Certified Fraud Examiners,”  
“Certified Fraud Examiner,” “CFE,” “ACFE,” and  
the ACFE Logo are trademarks owned by the  
Association of Certified Fraud Examiners, Inc.  
The contents of this paper may not be  
transmitted, re-published, modified, reproduced,  
distributed, copied, or sold without the prior  
consent of the author.