

*The Money Management Institute*

*SEC Exams of Separately  
Managed Accounts*

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# *SEC Conduct of SMA Exams*

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- Persons Interviewed
- Topics Covered
- Areas Reviewed
- Warning Signs
- SEC SMA Exams 2006

# *SEC Exams of SMAs*

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- SEC official:
  - “Dropped off the radar screen”
- Major SMA program sponsor:
  - “In for weeks/months but didn’t really look at anything”

# *Persons Interviewed*

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- Portfolio Managers
  - To understand approach to suitability and best execution
- Compliance Officers
  - To understand compliance processes
- Traders
  - To understand how orders are placed
- Sponsor's Account Executives
  - To understand how clients are obtained, what type of disclosure is provided to clients and suitability

# *Topics Covered*

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- Suitability
- Client Disclosure
- Best Execution
- Conflicts
- Fiduciary Responsibilities
- Compensation Arrangements
- Marketing/Performance

# *Areas Reviewed*

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- Roles and responsibilities of the various parties
- Sponsor's disclosure document to ensure it contains required Schedule H information
- Contracts between the sponsor and portfolio managers
- Sample client contracts
- All marketing materials and performance information provided to prospects
- Compensation Arrangements
  - What is the total fee paid by clients?
  - What does this fee include?
  - What portion of the fee goes to each party?
  - How is the fee paid?
  - Who calculates the fees?

# *Areas Reviewed*

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- What best execution review is conducted & documentation maintained?
- What account information do clients receive & from whom?
- Does the SMA program seem generally suitable for clients?
- What factors does the sponsor consider when making client specific suitability judgments?
  - Is any periodic review done to ensure ongoing suitability?
- Are clients allowed to restrict their accounts?
  - How are restrictions implemented and monitored?
- Can clients contact the portfolio manager?

## *Areas Reviewed – SMA Sponsors*

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- What due diligence does the sponsor perform on portfolio managers – both initially and ongoing?
- Does the sponsor have the authority to hire and fire portfolio managers?
- Have any portfolio managers been removed from the program (and why)?
- Does the sponsor perform independent calculations of manager performance?

# *Areas Reviewed – Portfolio Managers*

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- Differences between managed SMA and non-SMA accounts with similar objectives
  - Order execution
  - Differences in holdings and trades
- Portfolio manager's ability to effect trades through broker-dealers other than the sponsor
  - Any additional fees?
  - Frequency?
  - What factors are considered?
  - How do the sponsor's commissions compare to other broker-dealers?
- Did the portfolio manager provide any inducements to the sponsor to be included in the SMA program?
  - Directing order flow for non-SMA clients
  - Other forms of soft-dollar payment

# *Warning Signs*

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- Failure to follow client restrictions
- Long delays in starting to invest client accounts
- Blowing out securities at inception then repurchasing them shortly afterwards
- Dispersion in performance of program accounts in relation to manager's performance elsewhere
- Timeliness of manager allocation instructions
- Large number of trade errors
- Complaints
- Clients charged fees when program fees should have covered them
- Sponsor and manager do not review best execution
- Manager providing kickbacks to sponsor?

# *SMA Exams 2006*

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- Expanded Focus
  - Best execution
    - Sequence of trades
  - Performance presentations
    - NASD Rule 2210 issues with “related performance” & sound basis / balance requirements
  - 3a-4 & accommodation of reasonable restrictions
  - Suitability
    - A la fee-based brokerage cases
- New Focus
  - Relationship between sponsor and managers
  - Distribution & Sales Practices
    - Use of intermediaries, loads & differential compensation
  - ERISA issues
    - Use of sponsor affiliates as managers & redeployment of assets in MDA accounts

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