

Regulatory Alert

SEC Finds RIA Willfully Violated Custody Rule

On June 26, 2026, the SEC settled with Northeast Financial Group, Inc. (“Northeast”) after finding Northeast willfully violated provisions of Section 206(4) and Rule 206(4)-2 (the “Custody Rule”) of the Investment Advisers Act of 1940 (“Advisers Act”) by failing to obtain audits or independent verification for pooled investment vehicles it advised for multiple years.

Northeast’s “Related Person” (any person directly or indirectly controlling, controlled by, or under common control with, an investment adviser) was the managing member of the pooled investment vehicles, which triggered the Custody Rule. The SEC concluded that from fiscal years ended December 31, 2015 through December 31, 2024 (varying by fund), Northeast was deemed to have “Custody” of the funds’ assets (see below), yet failed to satisfy the Custody Rule’s independent verification requirements for the funds. Specifically, it did not:

- a) obtain annual surprise examinations by an independent public accountant, or
- b) have audited financial statements prepared in accordance with US GAAP and distributed to investors in the funds within 120 days of the respective funds’ fiscal year end.

Northeast consented (without admitting guilt) to: a cease-and-desist order (prohibiting future violations of the Custody Rule); public censure; and a civil money penalty of \$75,000.

WHY IT MATTERS

This case represents a directional signal that the SEC will pursue Custody Rule compliance failures, especially long-running audit/distribution deficiencies, without showing investor harm.

OPTIMA RECOMMENDED ACTIONS

Advisers should review Custody Rule requirements. Under the Custody Rule, a registered investment adviser has Custody of client assets if it, or its Related Person, holds (directly or indirectly) client funds (cash) or securities or has the authority to obtain possession of those assets.

A Registered Investment Adviser (“RIA”) holding Custody of client funds or securities must comply with the following:

1. **Qualified Custodian**

Client assets must be maintained with a “Qualified Custodian” defined as a bank, broker-dealer, or other institution meeting regulatory standards.

2. Client Notification

Clients must be notified in writing of any accounts opened by the adviser at a Qualified Custodian on the client's behalf.

3. Quarterly Account Statements

The adviser must have a reasonable basis to believe the Qualified Custodian sends account statements to clients at least quarterly. For private funds where a Related Person is managing member or general partner, statements must go to each individual member or limited partner. If the adviser sends account statements directly to the client, the notification provided to that client must urge the client to compare the account statements from the Qualified Custodian with those from the adviser.

4. Annual Surprise Examination

Client funds and securities must be verified by an independent public accountant at a time chosen by the accountant - with no prior notice to the adviser.

ALTERNATIVE PATH FOR POOLED INVESTMENT VEHICLES - AUDITED FINANCIALS

Advisers to limited partnerships, LLCs, or other pooled vehicles can satisfy the above requirements by meeting all three of these conditions:

CONDITION	CONDITION REQUIREMENT(S)
Annual Audit	<ul style="list-style-type: none"> The fund must be audited at least once per fiscal year. Funds formed during the fiscal year must prepare stub period audits.
PCAOB Auditor	<ul style="list-style-type: none"> The auditor must be registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board (PCAOB).
120-Day/180-Day Distribution	<ul style="list-style-type: none"> Audited, US GAAP-compliant financial statements must be distributed to all investors within 120 days of the respective fund's fiscal year end, or 180 days for a fund of funds.

RIA's should evaluate which entities other than the adviser may have access to clients' funds and securities. Once an entity has been confirmed to have Custody under the Custody Rule, the adviser should ensure that financial statements are timely delivered to investors.

Although the SEC has indicated that its focus has shifted to enforcing regulation when investors are harmed, this settlement suggests that the SEC will continue to bring actions against registrants who demonstrably ignore their obligations under the Advisers Act's rules and regulations.