



Be in the Know: SEC Examination Priorities and Compliance Expectations for 2021

Presenter:

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Agenda

- SEC Examination Hot Topics and Priorities
 - ❖ In the Spotlight: Advisory Fees and Expenses
 - ❖ Standards of Care: Performance Advertising and Forms ADV Disclosures
 - ❖ Business Continuity Plans and Cybersecurity
- COVID-19 Regulatory Challenges Identified by the SEC Staff
 - ❖ Teleworking and Remote Supervision Exam Focus Areas
 - ❖ Guidance from SEC *Risk Alerts*
- Looking Ahead: The New Marketing Rule
 - ❖ Compliance Tips on Operational and Organizational Considerations
- Q&A



SEC Examination Hot Topics and Priorities

- ❑ Exam priorities letter not yet released! Anticipated to be very similar to 2020
- ❑ Focus areas continue to be retail investors, seniors, military, teachers and those saving for retirement
- ❑ Other retail examination areas include:
 - ❖ Advisory Fees and Expenses
 - ❖ Standards of Care – Form CRS and ADV Disclosures
 - ❖ Compliance Programs
- ❑ Information Security – 6th Year on the Priorities List
 - ❖ Business Continuity
 - ❖ Teleworking Controls
 - ❖ Data Safeguarding and Loss Prevention

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SEC Examination Hot Topics and Priorities

- ❑ In the Spotlight: Advisory Fees and Expenses Focus Areas
 - ❖ How are client assets valued and by whom (e.g., as of the last day of the calendar quarter as calculated by the qualified custodian)?
 - ❖ Does the adviser aggregate accounts by household?
 - ❖ How is a household defined (e.g., by all persons living at the same residential address or by relational definition – husband/wife/partner and minor offspring)?
 - ❖ What is the process for reimbursing terminated and deceased client accounts?
 - ❖ Does the firm disclose additional expenses that it may impose on clients (e.g., an additional client reporting fee)?
 - ❖ Does the adviser document exceptions for fees charged differently than the published tiered fee schedule - where and how?
 - ❖ How do IARs present the concept of fee aggregation and related conflicts of interest to clients?

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SEC Examination Hot Topics and Priorities

- ❑ Standards of Care: Performance Advertising and Social Media
 - ❖ When you are showing Performance Advertising, have you:
 - Shown performance through the most recent calendar quarter?
 - Taken steps to ensure that material information is included in the disclosure (especially in the case of hypothetical performance and representative accounts)?
 - Maintained all backup documentation related to the performance shown?
 - ❖ How has your Social Media Changed during the Pandemic?
 - Has social media usage increased, decreased or remains about the same?
 - Have you forensically tested postings?
 - Are disclosures in close proximity to the post?

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SEC Examination Hot Topics and Priorities

- ❑ Standards of Care: Form CRS & ADV Disclosures Focus Areas
 - ❖ Have you promptly delivered Form CRS when:
 - Opening a new retail investor account;
 - Opening a new account for an existing retail investor that is different from the retail investor's existing account;
 - Recommending a R/O of assets from a retirement account into a new or existing account;
 - Making a new investment recommendation or providing a new advisory service that would not be held in an existing account (such as a direct-sold mutual fund through a "check and app" process)?
 - ❖ Does your Form CRS describe your fees and costs, how financial professionals are compensated, conflicts of interest and whether the firm or its financial professionals have disciplinary history?

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SEC Examination Hot Topics and Priorities

- ❑ Business Continuity Plan and Cybersecurity Examination Focus Areas
 - ❖ What are your capabilities of and safeguards for working remotely?
 - ❖ How were client portfolios invested (i.e., was there style drift)?
 - ❖ Have client investment behaviors changed and if so, how did the adviser respond?
 - ❖ What was the frequency and type of communications during COVID-19, particularly related to teleworking and how to reach firm personnel?
 - ❖ How robust are the firm's policies and procedures for *current* business operations and teleworking?
 - ❖ What technology challenges did the firm face during COVID-19?

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COVID-19 Regulatory Challenges Identified by the SEC Staff

- Teleworking and Remote Supervision Exam Focus Areas:
 - ❖ How did the firm assess risks of employees working remotely
 - ❖ Were teleworking policies developed to address remote responsibilities (e.g., privacy safeguards and protections at home, network/remote access, firewall security, etc.)
 - ❖ What were the security measures taken for virtual teleconferences, books and records maintenance and safeguarding client and company data
 - ❖ What updates to Policies & Procedures occurred during COVID-19 (e.g., how you are remotely supervising EEs/IARs)

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COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Management Tip #1: Have You Modified Your Supervisory Structures?

- We are in a virtual world – have you developed new protocols for:
 - ❖ Conducting branch office exams?
 - ❖ Supervising marketing and sales activities?
 - ❖ Implementing and using compliance technologies to survey activities?
 - ❖ Conducting Annual Reviews, Risk Assessments and Mock SEC Exams without physically being in the office?



COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Management Tip #2: Are You Prepared for a Correspondent Regulatory Examination?

- First impressions mean everything
 - ❖ Embrace video teleconferencing (“VTC”); voices alone do not necessarily convey sincerity and genuineness
 - ❖ Utilize a PowerPoint presentation to introduce the firm and its compliance program
 - ❖ Demonstrate systems when it makes sense
- Exams Heavily Focus on Document Production
 - ❖ Take time to double-check all submissions for accuracy
 - ❖ Spend time reviewing your response to COVID-19 as a firm and document what you did and when; be able to demonstrate heightened controls



COVID-19 Regulatory Challenges Identified by the SEC Staff

The Importance of Risk Alerts

- SEC examinations are primarily based on “risk factors” of the firm
- Risk Alerts* provide insight from the staff and reminders to registrants about their obligations based on SEC rules and regulations and how to improve internal controls, including policies, procedures and systems
- Recent SEC *Risk Alerts* include topics such as:
 - ❖ Compliance with Form CRS (Apr. 2020)
 - ❖ COVID-19 Compliance Risks and Considerations for Investment Advisers (Aug. 2020)
 - ❖ Cyber: Safeguarding Client Accounts Against Credential Compromise (Sep. 2020)
 - ❖ Observations from OCIE’s Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices (Nov. 2020)
 - ❖ OCIE Observations: Investment Adviser Compliance Programs (Nov. 2020)



COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Alert (Aug. 12, 2020) - COVID-19 Compliance Risks and Considerations for Investment Advisers

- The **Need to Protect Investor Assets** by picking up checks daily, taking additional steps to identify clients for disbursements and making sure a trusted contact is in place
- Supervision of Personnel** and the need to modify P&Ps for working remotely (such as for monitoring recommended securities that have heightened risks or inability to do onsite due diligence visits)
- Fees, Expenses and Financial Transactions** should be evaluated with enhanced monitoring for sales practice concerns (such as taking loans from clients, inaccurately calculating tiered fees and not refunding prepaid fees for terminated accounts)

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COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Alert (Aug. 12, 2020) - COVID-19 Compliance Risks and Considerations for Investment Advisers

- Re-evaluate **Business Continuity**, make changes to related policies and procedures, and provide disclosures to investors if their operations are materially impacted, as appropriate; and document steps taken in response to COVID
- Protection of Sensitive Information** where firms pay particular attention to the risks regarding access to systems, investor data protection, and cybersecurity



COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Alert (Nov. 9, 2020) – *Observations from OCIE’s Exams: Supervision, Compliance & Multiple Branch Office*

- Oversight and Supervision of Supervised Persons and disclosure of disciplinary events
- Advertisements, particularly of branches under a DBA with omission of disclosures, superlatives or unsupported claims
- Code of Ethics and complying with reporting and other requirements
- 50% of the examined advisers had issues related to portfolio management and oversight of investment decisions, disclosure of conflicts and trading allocation issues

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COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Alert (Nov. 9, 2020) – Observations from OCIE’s Exams: Supervision, Compliance & Multiple Branch Office

- ❑ Geographic dispersed personnel could be challenged because of different practices or disparate ways of communicating compared to the main office
 - ❖ According to the *Risk Alert*, 50% of advisers with multiple branches had inaccurate (outdated) or inadequately implemented policies and procedures (P&Ps)
 - Custody issues included commingling of assets, serving as TTEE for client accounts and receiving and depositing client checks with the client’s custodian
 - Fee and expense issues included not identifying and remediating instances of undisclosed fees charged to clients (e.g., misapplied tiered fee structures)

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COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Alert (Nov. 19, 2020) – OCIE Observations: IA Compliance Programs

- Inadequate Compliance Resources
- Insufficient Authority of CCOs
- Annual Review Deficiencies
 - ❖ Evidence of annual review
 - ❖ Identification of risks
 - ❖ Review of significant aspects of adviser’s business
- Implementing Actions Required by Written Policies and Procedures
- Maintaining Accurate and Complete Information in Policies and Procedures



COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Alert (Nov. 19, 2020) – *OCIE Observations: IA Compliance Programs*

- Maintaining or Establishing Reasonably Designed Written Policies and Procedures
 - ❖ Portfolio management and trading practices
 - ❖ Safeguards for client privacy
 - ❖ Marketing
 - ❖ Required books and records
 - ❖ Safeguarding of client assets
 - ❖ Disclosures
 - ❖ Business continuity plans
 - ❖ Advisory fees and valuation

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COVID-19 Regulatory Challenges Identified by the SEC Staff

Risk Management Tip #3: Compliance Tips for Supervisions (During COVID – and Beyond)

- Use Zoom and Go-to-Meetings for Annual Reviews, Risk Assessments and Branch Office Exams
 - ❖ Inability to Physically Come in Office
 - ❖ Conducting Examinations Off-Site Through Correspondence
- Host VTC Meetings Whenever Possible (vs. Daily Interactions)
 - ❖ Challenges for Oversight/Participation
- Forensically Test Social Media Posts/Websites
- Evaluate Evolving Sales Practices and Activities
- Rely on Compliance Technologies to Survey Activities



Looking Ahead: The SEC's New Marketing Rule

A Quick History – 60 Years in Coming!

- ❑ The New IA Advertising Rule provides modernization of an antiquated rule that dates back to 1961
 - ❖ It is meant to provide consolidated and clear guidance and support the change to a principles-based regulation
 - ❖ It also modifies the definition of “advertisement” to be more evergreen, in light of ever-changing electronic media and mobile communications
- ❑ Amendments create a single rule and will replace the current advertising and cash solicitation rules
 - ❖ The SEC will withdraw certain no-action letters and other guidance addressing these rules, as they will no longer provide or are incorporated into the final rule (to be available on the SEC website)
- ❑ Related amendments are made to Form ADV and the books and records rule



Looking Ahead: The SEC's New Marketing Rule

What Doesn't Change – the Anti-Fraud Standards / Ads Can't be Misleading

- Cannot make an untrue statement or omission of a material fact
- Must have a “reasonable basis” for making a material statement of fact that the adviser can substantiate upon demand by the SEC
- Cannot include information that would cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the adviser
- Must be fair and balanced when:
 - ❖ Discussing potential benefits; must also provide associated risks and limitations
 - ❖ Referencing specific investment advice provided by the adviser
 - ❖ Including or excluding performance results or presenting performance time periods
- Catch-all: Cannot include information that is otherwise materially misleading



Looking Ahead: The SEC's New Marketing Rule

Compliance Timetable – Unknown!

- ❑ Jan. 20, 2021 – White House Chief of Staff Ron Klain instructs all agencies to not implement any rulemaking that has not already posted to the Federal Register. Appears Klain's prohibition will not affect the SEC and the ad rule
- ❑ The New Rule's Compliance date is 18 months after the effective date
 - ❖ This is 60-days after publication in the Federal Register
 - ❖ As of today, this has not yet occurred
- ❑ An adviser may elect to comply sooner than 18-months
- ❑ If it does so, the adviser will have to comply with all requirements of the Rule, not just some



Looking Ahead: The SEC's New Marketing Rule

Compliance Tips on Operational and Organizational Considerations

- The New Rule Governs Traditional Advertisements and Compensated Testimonials or Endorsements
 - ❖ New disclosures are required, as are written endorsement agreements
 - ❖ Will need to consider target audience sophistication and “substantiate” material facts
 - ❖ Need to adopt new P&Ps, new ADV disclosures, new record requirements
- For performance advertising, must show both gross and net performance and present performance results for 1-, 5-, and 10-year periods (or since inception, as applicable), each presented with equal prominence and as of the most recent calendar year-end
- Reference to specific investment advice (e.g., a past or a current recommendation) is now expressly permitted; must *be fair and balanced*
- Must consider use of composites**; exception exists if not performance not materially different



Supplemental Materials

Articles

- IAA Newsletter: Social Media in 2021 – Are Advisers Subject to the Old Rules or New Rules? And What Then?*
- NSCP Currents: Why Advisory Fees and Expenses Remain a Continued Regulatory Focus*
- JLG Risk Management Tip: How Risk Alerts Can Help You Prepare for Your Next Examination*

Risk Alerts

- Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers (Aug. 2020)*
- Cybersecurity: Safeguarding Client Accounts Against Credential Compromise (Sep. 15, 2020)*
- Observations from OCIE’s Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices (Nov. 9, 2020)*
- OCIE Observations: Investment Adviser Compliance Programs (Nov. 19, 2020)*



Questions? Let us know how we can help!



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