



Be in the Know: SEC Examination Priorities

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Agenda

Part 1: Be in the Know: SEC Examination Priorities (February 17, 2021)

In this session, we will highlight new exam priorities and recent SEC guidance to enable you to prepare for your next SEC examination

Part 2: Compliance Expectations for 2021 (March 17, 2021)

In our next session we will focus on “new rules” and compliance program expectations for 2021. During this webinar, we will discuss:

- The New Marketing Rule – How it may impact the way you do business
 - ❖ Testimonials, social media, performance advertising and solicitation
- Internal controls to develop based on the new SEC exam priorities
- Compliance best practices for remote supervision
- Tips and considerations for implementing the new Advertising Rule requirements



Today's Agenda

- SEC Examination Hot Topics and Priorities
 - ❖ In the Spotlight: Advisory Fees and Expenses
 - ❖ Standards of Care: Form CRS and ADV Disclosures
 - ❖ Business Continuity Plans
 - ❖ Remote Supervision
- Recent SEC Risk Alerts
- Case Study: COVID-19 SEC Examination Focus Areas
- Looking Ahead: The New Marketing Rule
- Q&A

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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: 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 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 change 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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SEC Examination Hot Topics and Priorities

- 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 record 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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Risk Management Tip #1 – Review Your Supervisory Structure

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?



Risk Management Tip #2 – How to Prepare for an SEC Exam During a Pandemic

Correspondent Regulatory Examinations

- ❑ First impressions mean everything
 - ❖ Embrace video conferencing; 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



Recent SEC Risk Alerts

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)



Select COVID-19 Compliance Risks and Considerations for Investment Advisers

Risk Alert (Aug. 12, 2020)

- 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)



Select COVID-19 Compliance Risks and Considerations for Investment Advisers

Risk Alert (Aug. 12, 2020)

- 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



Observations from OCIE's Exams: Supervision, Compliance & Multiple Branch Offices

Risk Alert (Nov. 9, 2020)

- 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



Working Remotely and Modified Supervisory Structures

Risk Alert (Nov. 9, 2020)

- ❑ 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)



OCIE Observations: Investment Adviser Compliance Programs

Risk Alert (Nov. 19, 2020)

- 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



OCIE Observations: Investment Adviser Compliance Programs

Risk Alert (Nov. 19, 2020)

- 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



Risk Management Tip #3 – Compliance Tips for Supervision (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



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)

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Questions? Let us know how we can help!



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