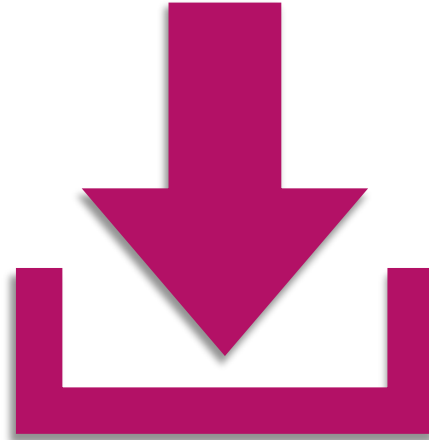




## SEC 2023 Exam Priorities

# Download Our Slides

<https://www.ria-compliance-consultants.com/SEC-2023-Exam-Priorities>



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If Approved, RCC Will  
Contact Attendees About  
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- ▶ **Attendance Codes** - As you watch the live presentation, you will receive two attendance codes, each containing three alphanumeric characters. Save these codes. You will need to enter the full six-character attendance code prior to accessing the final quiz.
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# Content Questions & Technical Help

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[ContEd@ria-compliance-consultants.com](mailto:ContEd@ria-compliance-consultants.com)

# Your Instructor



Bryan Hill, President  
RIA Compliance Consultants, Inc.

Bryan has over 28 years of experience working with investment advisers, broker-dealers and investors as a compliance consultant, attorney and executive.

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877-345-4034 x 101

# Course Overview

- ▶ SEC's 2023 Exam Priorities & Selected Best Practices
  - ▶ New Marketing Rule
  - ▶ RIA to Private Funds
  - ▶ High-Risk Private Funds
  - ▶ Fiduciary Duty
  - ▶ Form CRS
  - ▶ Custody/Valuation/Management/Execution
  - ▶ Fees
  - ▶ Alternative Revenue/Cash Sweep
  - ▶ Text Messaging
  - ▶ Due Diligence of Service Providers
  - ▶ Never Examined/Not Recently Examined
  - ▶ ESG
  - ▶ Info Security & Ops Resiliency
  - ▶ Crypto
  - ▶ Emerging Financial Technology
- ▶ Questions

# Regulatory Resources

- **SEC 2023 Examination Priorities (2/7/23)**
- Final Rule Release for SEC's New Marketing Rule
- Staff Bulletin: Standards of Conduct for BDs & IAs Account Recommendations for Retail Investors
- Risk Alert: Observations From BDs & IAs Compliance Exams Re Prevention of Id Theft Under Reg S-ID (12/5/22)
- Risk Alert: Examinations Focused on the New Investment Adviser Marketing Rule (9/19/22)
- Investment Adviser MNPI Compliance Issues (4/26/22)
- Observations from Examinations of Private Fund Advisers (1/27/22)
- Division of Examinations Observations: Investment Advisers' Fee Calculations (11/10/21)
- Observations from Examinations of Advisers that Provide Electronic Advice (11/9/21)
- Observations Regarding Fixed Income Principal and Cross Trades by IAs from an Exam Initiative (7/21/21)
- Observations from Exams of IAs Managing Client Accounts That Participate in Wrap Fee Programs (7/21/21)
- The Division of Examinations' Review of ESG Investing (4/9/21)
- The Division of Examinations' Continued Focus on Digital Asset Securities (2/26/21)

# Exam Priority

## SEC's New Marketing Rule

- Whether an RIA has adopted and implemented written policies and procedures that are reasonably designed to prevent violations of the new Marketing Rule; and
- Whether an RIA has a reasonable basis for believing
  - (a) it will be able to substantiate material statements of fact and
  - (b) satisfied with the requirements for performance advertising, testimonials, endorsements and third-party ratings.

# Action Steps

## P&P Update for Advertising/Marketing

- ▶ Remove References to Old Rules & No-Action Letters in the Advertising & Solicitor Sections of Compliance Manual
  - No Rule 206(4)-3
  - Term “Solicitor” Has Been Redefined as “Promoter” Which Includes Clients Giving Testimonials and Non-Clients Giving Endorsements
  - Remove Reference to “Clover” No-Action Letter – Withdrawn by SEC



# Action Steps

## P&P Update for Advertising/Marketing

- ▶ Add General Advertising Prohibitions to New Advertising Section of Compliance Manual
  - Must Document & Maintain Source for Each Material Fact (Fact File for Each Ad)
- ▶ Include Other Criteria for Approving New Advertising
- ▶ Determine Which Type of Advertising Will Be Permitted & Incorporate Requirements Into Compliance Manual Section
  - Past Investment Recommendations
  - Third-Party Ratings
  - Testimonials & Endorsements (Compensated versus Uncompensated)
  - Investment Performance (Hypothetical Performance)



# Action Steps

## Update Form ADV for Advertising/Marketing

- ▶ Form ADV Part 1 Item 5, Sub-Section L
  - An adviser will be required to state whether any of its advertisements include performance results, a reference to specific investment advice, testimonials, endorsements, or third-party ratings
  - An adviser will be required to state yes or no as to whether the adviser pays or otherwise provides cash or non-cash compensation, directly or indirectly, in connection with the use of testimonials, endorsements, or third-party ratings
- ▶ Form ADV Part 2A Item 14
  - Remove Reference to Rule 206(4)-3
  - Add Description of New Promoter Arrangements

# New Marketing Rule – Testimonial/Endorsement

- ▶ Client Testimonials Are No Longer Prohibited But Rather Are Regulated Along with Non-Client Endorsements (f/k/a Solicitors)
- ▶ Current Client Testimonial or Non-Client Endorsement:
  - Subject to Clear & Prominent Disclosure At Time of Testimonial/Endorsement
    - ❖ Regarding Status of Party Giving Testimonial/Endorsement, Compensation (Cash & Non-Cash) Provided & Any Conflicts of Interest
  - Written Agreement (Only Applies to Testimonial/Endorsement for Cash/Non-Cash Compensation > \$1,000 During Past 12 Months)
  - Person Giving Testimonial/Endorsement Isn't Subject to Disqualifying Event (Only Applies to Testimonial/Endorsement for Cash/Non-Cash Compensation > \$1,000 During Past 12 Months)

# Action Steps

## Promoter (Solicitor) Arrangements

- ▶ Inactive Arrangements – Terminate
- ▶ Active Pre-Existing Arrangements - Need to Contact Them In Writing About Obligation to Follow New Marketing Rule When Making Endorsements (After 11/3/22)
  - Include Copy of SEC's New Marketing Rule
  - Include Applicable Section of Advertising Manual About Disclosure Obligations
  - Include New Separate Promoter Disclosure Statement for Client to Sign
    - Request Promoter to Identify Any Endorser Conflict of Interest Disclosure Which Needs to Be Added
  - Hold Training Call with Active Promoters to Review New Requirements
    - Focus on Clear & Prominent Disclosures and Endorser Conflict of Interest Disclosure
  - Require Promoters to Sign Acknowledgement of the New Requirements & Re-Verify Not Disqualified
- ▶ Execute an Updated Promoter (Solicitor) Arrangement Agreement to Satisfy New Requirements

# Action Steps

## Uncompensated Client Testimonial

- ▶ Make Sure Clients Have Acknowledgement & Release
  - Need Attestation that Testimonial Is True
  - Confirmation of No Payment – Release from Any Royalty
  - Authorization to Share Client’s Testimonial with Public
  - Reaffirm that Client Can Revoke Testimonial by Notifying Advisor
- ▶ Implement Procedures to Verify Testimonial Is Still Accurate Over Time

# Exam Priority

## RIA to Private Funds

### Focus On Issues Related to RIAs to Private Funds:

- Conflicts of interest;
- Calculation and allocation of fees and expenses, including the calculation of post-commitment period management fees and the impact of valuation practices of private equity funds;
- Marketing Rule including performance advertising, testimonials and endorsements;
- Policies and practices regarding the use of alternative data and compliance with Advisers Act Section 204A; and
- Custody Rule including timely delivery of audited financials and selection of permissible auditors.



# Exam Priority

## High Risk Private Funds

Also, will focus on RIAs to private funds with specific risk characteristics such as the following:

- Highly leveraged private funds;
- Private funds managed side-by-side with BDCs;
- Private equity funds that use affiliated companies and advisory personnel to provide services to their fund clients and underlying portfolio companies;
- Private funds that hold certain hard-to-value investments, such as crypto assets and real estate-connected investments, with an emphasis on commercial real estate;
- Private funds that invest in or sponsor Special Purpose Acquisition Companies (SPACs); and
- Private funds involved in adviser-led restructurings, including stapled secondary transactions and continuation funds.

**Exam Priority**

**Fiduciary  
Duty**

***Dual RIA/BD and IAR/RR***

Continued concern about dually licensed RIAs/BDs and RIAs with supervised persons who are dually licensed as IARs/RRs.



# Exam Priority

# Fiduciary Duty

## ***Conflicted Investment Advice***

Continue to focus upon the following:

- ❑ Investment advice and recommendations with regard to ***products, investment strategies, and account types***;
- ❑ Disclosures made to investors and whether such disclosures include all material facts relating to the ***conflicts of interest*** associated with the advice and recommendations;
- ❑ Processes for making ***best interest evaluations***, including those for reviewing reasonably available alternatives, evaluating costs and risks, and identifying and addressing conflicts of interest;
- ❑ Factors considered in light of the investor's investment profile, including investment goals and account characteristics, and
- ❑ Whether the ***conflicts of interest*** disclosures are sufficient such that a client can provide informed consent to the conflict.

**Exam Priority**

**Fiduciary  
Duty**

## Types of Investments

Concentrate on advice or recommendations regarding:

- Complex products, such as derivatives and **leveraged ETFs**, ETNs, and other ETPs;
- High cost and illiquid products, such as variable annuities and **non-traded REITs**;
- **Proprietary products**;
- Unconventional strategies that purport to address rising interest rates; and
- Microcap securities.

## Exam Priority Fiduciary Duty

### **Types of Clients/Accounts**

Focus on recommendations or advice to certain types of investors or account recommendations:

- Seniors
- Retirement Savers
- IRA Rollovers
- 529 Plans

# IRA Rollovers - DoL PTE 2020-02

- ▶ *Investment Adviser and rep acknowledge their fiduciary status under ERISA in writing,*
- ▶ *Exemption is only available for non-discretionary advice*
- ▶ *Disclose their services and material conflicts of interest,*
- ▶ *Adhere to Impartial Conduct Standards requiring that they*
  - ✓ *Investigate and evaluate investments, provide advice, and exercise sound judgment in the same way that knowledgeable and impartial professionals would,*
  - ✓ *Act with undivided loyalty to retirement investors when making recommendations,*
  - ✓ *Charge no more than reasonable compensation and comply with federal securities laws regarding “best execution,” and*
  - ✓ *Avoid making misleading statements about investment transactions and other relevant matters,*
- ▶ *Adopt P&P to ensure compliance with the Impartial Conduct Standards and to mitigate conflicts of interest;*
- ▶ *Document and disclose the specific reasons that any rollover recommendations are in the client’s best interest; and*
- ▶ *Conduct an annual retrospective compliance review*

# Exam Priority – Fiduciary Duty Economic Incentives

- ▶ Will seek to identify the economic incentives that an RIA and its supervised persons have to recommend products, services, or account types.
- ▶ Will focus on revenue sharing arrangements, use of services from affiliates, and proprietary products. As part of this inquiry, SEC will focus on the following questions.
  - Does the RIA have written policies and procedures for identifying conflicts of interest?
  - Are the P&P sufficiently tailored to the RIAs business model, compensation structure, and product menu and customer base?
  - How does the RIA manage conflicts of interest (i.e., mitigate, eliminate)?

Exam Priority

## Hedge Clauses in Client Agreements

- ▶ SEC Challenging Limitations of Liability Which Conflict with an Investment Adviser's Fiduciary Duty
- ▶ Savings Clause (Nothing in this Agreement waives a Client's rights under federal or state law) No Longer Is Acceptable
- ▶ SEC Argues that the Limitation of Liability Language Is Intended or Results in Misleading the Client and Violates Section 206 of IAA '40

See <https://www.sec.gov/litigation/admin/2022/ia-5943.pdf> .



# Actual Hedge Clause Challenged by SEC Despite Savings Clause

- ▶ “Risk - Except as may otherwise be provided by law, **Advisor will not be liable to Client for any loss (i) that Client may suffer as a result of Advisor’s good faith decisions or actions where Advisor exercises the degree of care, skill, prudence and diligence that a prudent person acting in a fiduciary capacity would use;** (ii) caused by following Client’s instructions; or (iii) caused by the custodian, any broker or dealer to which Advisor directs transactions for the Account or by any other person. Federal and state securities laws impose liabilities under certain circumstances on persons who act in good faith, and this Agreement does not waive or limit Client’s rights under those laws.
- ▶ Limitation of Liability - Client acknowledges that the services rendered under this Agreement are advisory in nature and **Client expressly agrees that Advisor shall not be held liable relating to the performance of the services hereunder, as long as those services are rendered in good faith and in accordance with applicable federal and state securities laws and rules and regulations thereunder. Neither Advisor nor the Custodian nor any of their respective officers, directors, employees or affiliates shall be liable for any loss incurred with respect to the Account except where any such loss results directly from such person’s negligence or willful misconduct.** Client releases and holds Advisor and Custodian and their respective officers, directors, employees and affiliates harmless against any losses, expenses (including reasonable attorney’s fees and costs) and liabilities incurred as a result of investment of the Account at the direction of Client. Client understands that nothing in this Section is intended to be a waiver of any rights of action Client may have under applicable securities laws or of Client’s rights in the event Advisor breaches any fiduciary duty owed to Client, if any.” [Emphasis added]



## Exam Priority – Form ADV Part 3/Form CRS

Will Assess RIAs on Whether

- ▶ Delivering Form ADV Part 3 to Retail Investors
- ▶ Filing Form ADV Part 3 via IARD System
- ▶ Posting to Firm's Public Website

# Exam Priority

## Custody/Valuation/Mngt/Execution

The SEC will review compliance programs and disclosures related to

- custody and safekeeping of client assets,
- valuation,
- portfolio management, and
- brokerage and execution.

# Exam Priority - Fees

Will review for compliance issues and the oversight and approval process related to RIA fees and expenses including:

- calculation of fees
- excessive fees

# Action Steps for Fee Calculations

## Quarterly Audits – Common Issues

- Inaccurate Percentages Were Used to Calculate Advisory Fees
  - Different from Contractually Agreed Rate
  - Incorrect Fee Schedule
  - Failed to Convert All Clients to Their New or Updated Fee Schedule
  - Errors in Manually Entering Fee % in Portfolio Management System
- Breakpoint or Tiered Rates Not Applied Correctly
- Householding of Accounts Not Done Correctly

# Action Steps for Fee Calculations

## Quarterly Audits – Common Issues

- Incorrect Account Valuations
  - Included Assets Supposed to be Excluded
  - Stale Account Balance Info
  - Incorrect Valuation Dates Used
  - Incorrect Values Due to Timing Differences in Electronic Data Fee Related Cash & Dividends
- Failure to Refund Prepaid Fees
  - Requiring Refund Requests to Be in Writing
  - Delaying Prompt Refunds
- Failure to Pro-Rate Fee for Initial Period Started in Mid-Term

# Action Steps for Fee Calculations Review for Inaccurate Disclosures

- Misleading or False Disclosures
  - Whether Mid-Period Deposits/Withdrawals Are Charged/Refunded Fees
  - Timing of Fee Billing – Advance vs. Arrears
  - Value Date – Average Daily Balance vs. Account Balance on Specified Date
  - Platform Admin Fees That Could Be Avoided by Not Using Platform
  - Minimum Fees
  - Failing to Disclose Negotiability and Factors
  - Householding Eligibility
  - Fees Related to Participating in Wrap Fee Programs

## Exam Priority

### Alternative Revenue Sources & Cash Sweep

The SEC will review conflicts of interest associated with alternative ways that an RIA may try to maximize revenue, including revenue earned on clients' bank deposit sweep programs.



## Exam Priority

Text  
Messaging

SEC will review policies and procedures for retaining and monitoring electronic communications.

# Best Practices for Text Messaging

- ▶ Review & Update (As Necessary) Policies & Procedures Regarding Communicating with Clients and Traders Using Text Messaging & Messaging Apps
- ▶ To Extent Texting/Messaging Is Permitted, Verify Firm Is Supervising and Archiving Such Texts/Messages
- ▶ Train (or Re-Train) Supervised Persons on RIA's P&P on Using Text Messages and/or Message Apps
- ▶ Require Supervised to Confirm in Writing Have Read and Understand New P&P on Communicating Via Texts & Message Apps
- ▶ Survey Annually that Supervised Person Is Complying with Texts/Messaging Apps P&P
- ▶ Sample Preserved Communications for Any Red Flags that Texts/Message Apps Are Being Used In Violation of RIA's P&P

Exam Priority

Due  
Diligence of  
Service  
Providers

The SEC will examine policies and procedures of RIAs for selecting and using third-party service providers.

# Best Practices for Due Diligence of Service Providers

## Issues for Consideration When Conducting Due Diligence

- ▶ Nature & Scope Of Services
- ▶ Risks Related To Service Provider Performing Service & How to Mitigate
- ▶ Service Provider's Competence, Capacity & Resources
- ▶ Service Provider's Material Subcontracting Arrangements
- ▶ Compliance with Securities Laws
- ▶ Orderly Termination Of Service Provider's Services

See <https://www.sec.gov/files/ia-6176-fact-sheet.pdf>

## Exam Priority

Never  
Examined  
& Not Recently  
Examined

- ▶ The SEC will prioritize RIAs that have never been examined including new firms and those that have not been examined for several years.

# Best Practices for Never/Not Recently Examined

- ▶ Re-Review & Update (If Necessary) Compliance Manual
  - Check with Your Compliance Consultant for Any Section Updates
- ▶ Study Most Recent SEC Exam Priorities & Relevant Risk Alerts
- ▶ If Not Recently Examined, Review & Correct Prior Deficiencies from Last Exam
- ▶ Obtain an Information/Document Request List Used Recently in an Exam
  - Check with Your Compliance Consultant for Applicable Examples
- ▶ Complete an Annual Review of Compliance Program or Mock Exam
  - Check with Your Compliance Consultant for DIY Spreadsheet/Tool or a Consultant-Led Review
- ▶ Review Best Practices Checklist & Recorded Webinar on How to Interact with Exam Staff



# Exam Priority

## ESG Investing

The SEC will focus on ESG-related advisory services of RIAs including whether

- (a) funds are operating in the manner set forth in their disclosures,
- (b) ESG products are appropriately labeled, and
- (c) recommendations of such products for retail investors are made in investors' best interest.

# Action Steps and/or Best Practices ESG Investing

- Must Satisfy Fiduciary Duty When Making ESG Recommendations/Decisions
- Only Utilize ESG Investing If Requested & Authorized in Writing by Client
- Carefully Document Client's Desire and Instructions to Use ESG Factors/Metrics
- Make Full Disclosure of All Material Facts Related to ESG Investing
- Add Disclosures to Form ADV Part 2A Item 8 - ESG Factors/Metrics and Risks
- Review Advertising & Responses to RFPs and Presentations Referencing ESG Investing
- Review Any Communications to Clients Regarding ESG Investing
- Establish ESG Investment Policy Which Addresses Implementing a Client's ESG Preference & Exercising Shareholder Voting Rights
- Review ESG Policies at Least Annually
- Verify that Portfolio Manager Is Managing in Manner Consistent ESG Criteria/Policy

# Exam Priority

## Information Security & Operational Resiliency

- Compliance with Regulations S-P and S-ID.
- Cybersecurity policies and procedures, governance practices, and response to cyber-related incidents.
  - Are policies and procedures reasonably designed to safeguard customer records and information?
  - Has the location of customer records been properly disclosed to the SEC?
- Practices to prevent account intrusions and safeguard customer records and information.
- Cybersecurity issues associated with the use of third-party vendors.
- Unauthorized use of third-party providers (e.g., transition assistance when departing RIA personnel attempt to migrate client information to another firm).
- Operational resiliency planning and consider/address climate-related risks.

# Best Practices for Cybersecurity Risk Assessment

- ▶ Categorize & Prioritizes Cybersecurity Risks
- ▶ Identify Vendors That Receive, Maintain Or Process Client Info & Associated Cyber Security Risks
- ▶ Memorialized In Writing
- ▶ Informs RIA's Senior Officers Of Specific Risks
- ▶ Risk Assessment Used To Develop Cybersecurity P&P
- ▶ Periodically Re-Assess



# Best Practices for Cybersecurity

- ▶ User Security & Access
  - Multi-Factor Authentication & Password Expiration/Reset
  - Limit Access & Information to Individuals on Need to Know/Use Basis
  - Secure Remote Access
  - Regularly Monitor for Unauthorized Users
  - Monitor for Unauthorized Login Attempts, Lock-Outs, and User ID/Password Changes
- ▶ Ongoing Monitoring of Threats and Vulnerabilities
  - Review Network and Application Vulnerabilities
    - ✓ Limit Mobile Devices Approved for Remote Access
    - ✓ Monitor All Files on End Point Like Mobile Telephone
    - ✓ Scans of Networks for Threats
    - ✓ Patch & Updates Manager for All Computers/Devices

# Exam Priority - Crypto

- ▶ Will assess whether RIA involved with crypto or crypto-related assets:
  - (1) met and followed its fiduciary duty when making recommendations, referrals, or providing investment advice; and
  - (2) routinely reviewed, updated, and enhanced their compliance, disclosure, and risk management practices.
- ▶ Will focus on new or never before examined registrants offering crypto or crypto-related assets.



# Exam Priority

## Emerging Financial Technology

For RIAs that employ digital engagement practices and related tools/methods, the SEC will assess whether:

- Recommendations were made or advice was provided (e.g., through the use of social media marketing and social trading platforms);
- Representations are fair and accurate;
- Operations and controls in place are consistent with disclosures made to investors;
- Any advice or recommendations are in the best interest of the investor taking into account the investor's financial situation and investment objectives; and
- Risks associated with such practices are considered, including the impact these practices may have on certain investors, such as seniors.

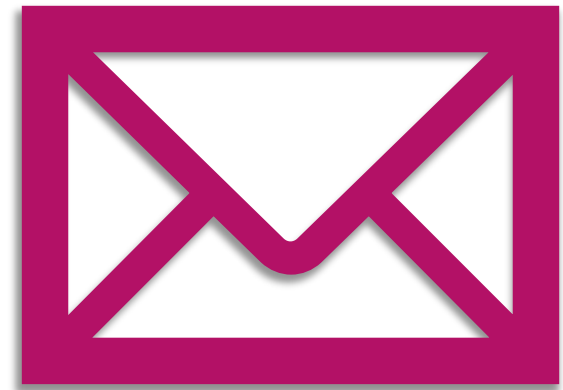
# NASAA Coordinated Exams Best Practices

- Review Agreements for Consistency & Hedge Clauses
- Maintain Books & Records – Document Checks Forwarded
- Maintain Written Profiles/Suitability Info on Each Client
- Prepare Due Diligence File for Each Recommended Investment
- Prepare/Maintain Compliance Manual with Specific References to Primary State Regulator’s Rules & BCP/Due Diligence Sections
  - Include Policy, Who, Does What, How Often, How Often
- Prepare & Maintain Privacy Policy
- Do Not Transmit Confidential Info in Unsecured Manner
- Keep Financials Current
- Financial Annual Financial Statements if Required by State
- Maintain Surety Bond or Net Worth as Required by State
- Calculate (and Document) Fees in Accordance with Client Agreement and Form ADV
- Review All Website & Social Media Accounts for Accuracy
- Prepare & Send Invoices if Deduct Fees from Account & State Requires
- Add P&P for Senior & Vulnerable Clients

# Questions

Please submit any question online or email with any questions about the content of this course.

[ContEd@ria-compliance-consultants.com](mailto:ContEd@ria-compliance-consultants.com)



Thank You

