REGULATORY UPDATE: December 2021

December 7, 2021

For Investment Advisors

- **SEC Withdraws Several No-Action Letters Related to Marketing Rule.** On December 22, 2020, the SEC adopted amended Rule 206(4)-1 under the Investment Advisers Act of 1940 ("Advisers Act"). This amended Marketing Rule replaces both the current Advertising Rule and the Cash Solicitation Rule. In the adopting release for the new Marketing Rule, the SEC stated that it would be withdrawing various No Action Letters ("NALs") superseded by the new rule. In October, the Commission finally issued Information Update 2020-10 formally withdrawing those NALs. In total, 203 NALs are being either withdrawn or modified. Given the number of NALs at issue, there are too many to discuss individually, but there are a few notable NALs. Specifically, the Clover Capital NAL deals with the requirements for performance advertising, the DALBAR NAL addresses the use of ratings and rankings in advertisements, and the Horizon NAL discusses advertising the performance of a predecessor advisory firm.

Included in the 203 NALs listed in the Information Update are 6 NALs that are **modified** but not withdrawn in their entirety. The modification to these NALs withdraws those statements relating to the Advertising Rule while leaving the remainder of the NAL still in effect. For example, one of the letters discusses which fees to include in a "net of fees" presentation. Presumably, that aspect of the letter remains applicable while the specific discussion relating to advertising performance is withdrawn.

Similarly, 5 NALs are **modified** concerning to statements involving the Solicitor Rule. Of note is the NFL Players Association NAL. For example, in this instance, the discussion concerning whether the NFLPA meets the definition of "investment adviser" likely remains applicable. In contrast, the discussion of whether the organization meets the definition of "solicitor" is withdrawn.

These eleven NALs should not be confused with the last group of 12 NALs listed in the exhibit to the Information Update, i.e., those NALs relating to advertising, solicitation, ***and*** some other topics. That group is withdrawn altogether. Those other topics include Investment Adviser Definition and Registration Requirements (Sections 202(a)(11) and 203 of the Advisers Act); Prohibited Transactions (Section 206 of the Advisers Act); General Prohibitions (Section 208 of the Advisers Act); Definition of Investment Company (Sections 3(a) and 3(c) of the Investment Company Act of 1940); and Definitions (current Section 2(a)(1) of the Securities Act of 1933)). Additionally, the 2014 Staff Guidance on the Testimonial Rule and Social Media is also withdrawn.

Finally, one other group of NALs bears mentioning – those that granted relief from the disqualification provisions for solicitors, the "bad actor" disqualifications. The Commission noted there could be NALs that granted relief to individuals who would otherwise have been disqualified. Since those NALs are now withdrawn, individuals relying on them previously could fall into the disqualification provisions of the new Marketing Rule. However, the SEC noted that it had not identified any specific letters like that, so it was not planning to issue any statement addressing this. However, it encourages individuals with a disqualifying event that falls within the Marketing Rule's ten-year lookback period to review their compliance policies and procedures in light of that rule's requirements. *Contributed by Alan Foxman, Managing Director.*

- **2021 Compliance Outreach Program Regional Seminars for Investment Advisor and Investment Company Senior Officers.** The SEC's regional office in New York held a CCO Outreach webinar on November 2nd. The event tackled a broad agenda, including common examination deficiencies and exam priorities and initiatives, as well as IAR registration requirements in New York. One item of particular interest was a discussion of "CCO deficiencies." These ranged from the CCO lacking knowledge of applicable regulatory requirements to the CCO having limited access to or information-sharing with other members of senior management, effectively excluding the CCO from "key information channels" or "critical compliance information." The SEC updated its 2021 Regional Outreach webpage on November 19th – at the time of this publication, a recording of the New York event was not yet available. *Contributed by Cari Hopfensperger, Senior Director.*

For Investment Advisors to Mutual Funds

- Risk Alert – Observations from Examinations in the Registered Investment Company Initiatives. The SEC's Division of Examinations (EXAMS) highlighted key findings identified during recent examinations of over 200 mutual funds and 100 advisors. The scope of this examination initiative closely parallels the types of funds and ETFs noted in EXAMS' 2021 examination priorities, namely: "(1) index funds that track custom-built indexes; (2) smaller ETFs and ETFs with little secondary market trading volume; (3) mutual funds with higher allocations to certain securitized investments; (4) mutual funds with aberrational underperformance relative to their peer groups; (5) mutual funds managed by advisors that are relatively new to managing such funds; and (6) advisors that provide advice to both mutual funds and private funds, both of which have similar strategies or are managed by the same portfolio managers." At the heart of these exams is a focus on areas impacting retail investors, including: (1) the effectiveness of policies and procedures to address risks, such as disclosures, conflicts of interest, and portfolio compliance; (2) disclosures made by funds in shareholder communications; and (3) fund governance practices, including those used by boards to oversee advisors. The alert identifies deficiencies and best practices related to perennial topics such as monitoring investment restrictions, best execution, soft dollars,

principal and cross trading, and advertising. It also calls attention to more specific policies and procedures to monitor senior securities, asset segregation, and compliance with the Fund Names Rule. In each case, mutual fund advisors should consider whether their policies and procedures are sufficiently developed and customized to address these areas. Firms should also consider whether they are properly maintaining their liquidity risk management program and overseeing the use of any liquidity classification vendor. On the valuation front, assess policies and procedures that guide fair value determinations. Don't forget to address potential conflicts of interest (such as when a portfolio manager is permitted to provide input into a valuation determination) and implement procedures to oversee third-party pricing vendors.

Consider other potential conflicts of interest too, especially those that exist between a fund and its service providers, such as where an index fund's advisor is also the index provider. The alert singles out policies and procedures to oversee fees and expenses – firms should specifically evaluate how expenses are allocated between the fund and advisor, including any expense waiver in place, and compare fees charged against disclosures. Board oversight policies and procedures should address shareholder servicing fees paid by funds, and how exceptions to the valuation policy are handled, among other areas noted in the alert.

The high-level best practices highlighted in the alert are not novel but serve as important reminders. Conducting periodic reviews of policies and procedures, comparing them to current business practices, and conducting testing designed to evaluate if they are operating as intended are all key steps to maintaining an effective compliance program. Funds, boards, and advisors would be wise to consider the recommendations within the risk alert as they review their compliance plans for the coming year. *Contributed by Cari Hopfensperger, Senior Director.*

For Broker-Dealers and Investment Advisors

The Renewal Process Continues. Preliminary Statements were made available to firms in November. If you have not done so already, you should retrieve your statement and remit payment in full.

- **Mark your calendar with these important dates**:
  - December 13, 2021 – Payment Due Date. Preliminary Statements must be paid-in-full.
  - December 26, 2021 – CRD/IARD System shuts down at 6:00 PM Eastern Time.
- Post-dated Forms U5 and BR terminations as early as October 18th. Starting November 1, Firms can initiate post-dated Form BR terminations, Forms U5, BDW, and ADV-W filings.
- If the firm has sufficient funds in its Flex-Funding Account to cover the renewal fee, the funds will be transferred to its Renewal Account. If not, firms are encouraged to submit renewal payments by **December 10, 2021,**to ensure payments are processed timely.
- For more detailed information about the 2022 Renewal Program, including

the full timeline, payment methods, helpful tips, and FAQs, check out the following:
    - **FINRA Annual Renewal Overview**
    - **IARD Renewal Program Overview**

NOTE: Failure to remit payments timely will result in late fees. Additionally, jurisdictions may automatically terminate registrations, resulting in the firm's inability to conduct securities business in those jurisdictions as of January 1, 2022. *Contributed by Rochelle Truzzi, Senior Director.*

Lessons Learned

- The War on "May" Continues: SEC Charges Advisor and Dual-Hatted CCO Over Inadequate Disclosures About Fee Mark-Ups. The SEC charged a California-based advisor, its affiliated broker-dealer, and its CEO, CCO, and president with making materially false and misleading statements and omissions related to fee markups charged to the advisor's clients. The CEO wore nearly every executive hat across the organization, including CEO and CCO of the advisor. The advisor used its affiliated firm as introducing broker-dealer for client trades and a third-party firm for clearing and custody. As part of the clearing firm arrangement, the affiliated broker-dealer was allowed to charge fee markups on trades placed on the clearing firm's platform. The CEO instructed its clearing firm to charge markups of up to 360%, depending on security type.

The complaint alleges that the advisor's ADV disclosed that its affiliated broker-dealer "**may**" receive additional compensation resulting from fee mark-ups charged by the clearing firm when certain markups were charged 60% of the time and that disclosures misled advisory clients that these fees were "normal fees charged by the clearing broker" and for things like "wire fees, postage, clearing fees, and ticket charges." The ADV failed to disclose a conflict of interest because the advisor's affiliated broker-dealer received fee mark-ups when it acted as the introducing broker for the advisor's clients. This additional compensation created a conflict of interest because it could influence the advisor to use its affiliated introducing broker over another broker who did not provide the same compensation. Further, the dual-hatted CEO/CCO failed to implement written policies and procedures reasonably designed to prevent the sorts of violations that arose from its affiliated broker-dealer charging and receiving these fee markups from its advisory clients.

The SEC requires that the ADV Part 2A is clearly written, meaningful, and reflects current disclosures of business practices, conflicts of interest, and material facts. The CCO and other business leaders should review Form ADV to ensure the information is true, accurate, and not misleading, with special caution against the use of "may" in conflict disclosures. Finally, it's worth noting this complaint provides another case study in the ongoing industry-wide conversation over CCO liability, as well as a suggested sample disclosure for this conflict: "The firm has a conflict of interest because it charges and receives fee markups when its affiliate acts as the introducing

broker for the advisor's clients. This additional compensation creates a conflict of interest for the CEO and the advisor because it influences their choice to use its own affiliate as the introducing broker over another broker who does not provide them with the same additional compensation."
Contributed by Andrea Penn, Senior Director.

- Form CRS Violations Continue. The SEC recently fined two more advisors for Form CRS violations similar to 27 enforcement actions brought against broker-dealers and advisors in July.

In the first matter, the SEC ordered a New York-based RIA to pay $25,000 for failing to file the Form CRS and delivering the Form CRS to clients by the regulatory deadlines. EXAMS contacted the advisor's CCO in October 2020, to alert her that the firm had failed to file Form CRS. In January 2021, EXAMS again contacted the CCO, but this time to announce an examination relating to the firm's failure to file Form CRS. The advisor finally filed Form CRS, delivered it to existing retail clients, and posted to the website on March 30, 2021.

In the second matter, another New York-based RIA was ordered to pay $10,000 for failing to file the Form CRS and delivering it to clients by the regulatory deadlines. Similar to the prior case, the advisor finally filed the form with the SEC, delivered it to clients, and posted it to its website in May 2021.

CCO's should ensure the Form CRS complies with the SEC instructions, is filed timely, is delivered to clients and prospects timely, and is prominently posted to the RIA's website. Further, the CCO should make certain that RIA's policies and procedures address the following: 1) the process for updating and filing the firm's s relationship summary within 30 days after any information becomes materially inaccurate; 2) how to communicate these changes to retail investors within 60 days after the updates are made; 3) highlighting for retail investors the most recent changes, including an exhibit that summarizes material changes; and 4) maintaining appropriate records regarding Form CRS. *Contributed by Andrea Penn, Senior Director.*

Worth Reading, Watching, and Hearing

- SEC Pulls Years of No Action Letters Replaced by Marketing Rule. Another analysis of the Division of Investment Management's move to withdraw and modify related no-action letters, this time from Foreside Managing Director, Jaqi Hummel.
- Cybersecurity: Meeting the Emerging Challenge. In this recent speech, SEC Commissioner Elad Roisman outlines cybersecurity challenges faced by SEC registrants. Check out this recent blog post by Foreside on the same topic.
- How to Nail Your Executive Presentation – 5 Best Practices to Gain Leadership Support. In a nod to soft skills that can be instrumental to a CCO, this piece by Laura Danysh of the Compliance & Ethics Blog offers practical tips to help achieve buy-in.
- Ted Lasso Is Reinventing Leadership and Proving That Nice Leaders Can (and Should) Finish First. With the Thanksgiving holiday and the

opportunity to reflect on the lessons of another year upon us, Nick Hobson of Inc. shares a few lessons from goofy but lovable coach, Ted Lasso, that we can all be grateful for.
- Finding Your Career Path in Compliance. Working your way through annual performance evaluations? Check out this recent episode of The Securities Compliance Podcast: Compliance in Context, by Patrick Hayes of Calfee, Halter & Griswold LLP, and the National Society of Compliance Professionals, for some inspiration.

Filing Deadlines and To-Do List for October 2021

INVESTMENT ADVISORS

- Annual Renewal Program for IARD System: The IARD Renewal Program facilitates the annual renewal of investment advisor (IA) firms and their IA representatives' (IARs) registrations with jurisdictions/states. Preliminary renewal statements for the IARD system were available on **November 8, 2021,** and are accessible only through the E-Bill System. Renewal statements reflect the registration renewal fees and annual system processing fees for all IARs and state-registered IA firms. The deadline for the receipt of the preliminary statement payment is **December 13, 2021**. Questions? Keep an eye out for 2022 FAQs.

HEDGE/PRIVATE FUND ADVISORS

- Blue Sky Filings (Form D. Advisors to private funds should review fund blue sky filings and determine whether any amended or new filings are necessary. Generally, most states require a notice filing ("blue sky filing") within 15 days of the first sale of interests in a fund, but state laws vary. Due **December 15, 2021**.

BROKER-DEALERS

- Statement Regarding Independent Public Accountant: Due no later than December 10th of each year, unless your engagement is continuing, providing for successive engagements. **Due December 10, 2021**
- 2022 Preliminary Renewal Statement is due in full. Consult the FINRA website for specific **Due December 13, 2021.**
- Rule 17a-5 Monthly and Fifth FOCUS Part II/IIA Filings: For the period ending November 30, 2021. For firms required to submit monthly FOCUS filings and those firms whose fiscal year-end is a date other than a calendar quarter. **Due December 23, 2021.**
- Supplemental Inventory Schedule ("SIS"): For the month ending November 30. The SIS must be filed by a firm that is required to file FOCUS Report Part II, FOCUS Report Part IIA, or FOGS Report Part I, with inventory positions as of the end of the FOCUS or FOGS reporting period, unless the firm has (1) a minimum dollar net capital or liquid capital requirement of less than $100,000; or (2) inventory positions consisting only of money market mutual funds. A firm with inventory positions consisting only of money market mutual funds must affirmatively indicate through the eFOCUS system that no SIS filing is required for the

reporting period. **Due December 29, 2021.**

- Annual Reports for Fiscal Year-End October 31, 2021: FINRA requires that member firms submit their annual reports in electronic form. Firms must also file the report at the regional office of the SEC in which the firm has its principal place of business and the SEC's principal office in Washington, DC. Firms registered in Arizona, Hawaii, Louisiana, or New Hampshire may have additional filing requirements. **Due December 30, 2021.**
- SIPC-3 Certification of Exclusion from Membership: For firms with a Fiscal Year-End of November 30 ***AND*** claiming an exclusion from SIPC Membership under Section 78ccc(a)(2)(A) of the Securities Investor Protection Act of 1970. This annual filing is due within 30 days of the beginning of each fiscal year. **Due December 30, 2021.**
- SIPC-6 Assessment: For firms with a Fiscal Year-End of May 31. SIPC members are required to file for the first half of the fiscal year a SIPC-6 General Assessment Payment Form together with the assessment owed within 30 days after the period covered. **Due December 30, 2021.**
- SIPC-7 Assessment: For firms with a Fiscal Year-End of October 31. SIPC members are required to file the SIPC-7 General Assessment Reconciliation Form together with the assessment owed (less any assessment paid with the SIPC-6) within 60 days after FYE. **Due December 30, 2021.**

MUTUAL FUND ADVISORS

- Form N-MFP. Form N-MFP (Monthly Schedule of Portfolio Holdings of Money Market Funds) reports information about the fund's holdings as of the last business day of the prior calendar month and must be filed no later than the fifth business day of each calendar month. **Due December 7, 2021.**