

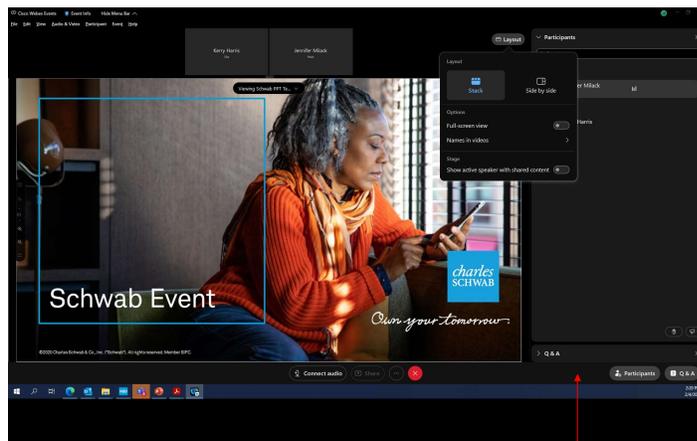
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# Be in the Know: New SEC Priorities & How to Prepare in 2023

**Presenter:**

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## Agenda

- SEC Examination Priorities in 2023
  - ❖ Significant Focus Areas for Investment Advisers
  - ❖ Standards of Conduct: Regulation Best Interest and Fiduciary Duty
  - ❖ Information Security and Operational Resiliency
  - ❖ Crypto Assets and Emerging Financial Technology
- The Latest SEC *Risk Alerts*
  - ❖ Prevention of Identity Theft
  - ❖ New Investment Adviser Marketing Rule FAQ
- Proposed Rules on Regulation Best Execution and Outsourcing by Investment Advisers
- Tips for Evolving Your Compliance Program
- Q&A



## SEC Exam Priorities in 2023

### Highlights of EXAMS Staff Message

- The four pillars of the EXAMS mission include:
  - ❖ Promote compliance
  - ❖ Prevent fraud
  - ❖ Monitor risk
  - ❖ Inform policy
- Published 7 Risk Alerts in Fiscal Year 2022
- Examined 2,250 RIAs, 1,750 Broker-Dealers and Returned More than \$50 Million to Investors
- Enforcement Referrals Include: Actions Alleging Violations of Reg BI, Deficiencies to Prevent Customer Identity Theft and Private Fund Custody Violations



## SEC Exam Priorities in 2023

### Significant Focus Areas for Investment Advisers

- ❑ Advisers Act Rule 206(4)-1 (Marketing Rule)
  - ❖ Assessing RIAs' adoption and implementation of NMR policies and procedures and compliance with substantiation requirements
- ❑ Investment Company Act Rule 18f-4 (Derivatives Rule) and Rule 2a-5 (Fair Valuation Rule)
  - ❖ Implementation of respective risk management programs, board oversight and adjustment to disclosures and policies
- ❑ Advisors to Private Funds
  - ❖ Conflicts of Interest
  - ❖ Calculation and allocation of fees and expenses (including valuation)
  - ❖ Compliance with NMR and Custody Rule (delivery of audited financials)



## SEC Exam Priorities in 2023

### Standards of Conduct

- ❑ Regulation BI and Fiduciary Duty
  - ❖ Assessing investment advice and recommendations related to products, investment strategies and account types
    - To consider complex, illiquid and proprietary products and recommendations to seniors and retirees
  - ❖ Disclosure of material facts and conflicts of interest
    - To consider whether client provided informed consent to the conflict
  - ❖ Processes used for making BI evaluations, including assessment of alternatives, costs and risks
  - ❖ Factors considered in light of the client's investment profile, economic incentives to the firm and use of hedge clauses



## SEC Exam Priorities in 2023

### Information Security and Operational Resiliency

- Efforts on protection of customer information, records and assets
  - ❖ Consider resiliency to market events, geopolitical concerns, and ransomware attacks
    - To consider policies and procedures, governance practices and responsiveness
    - Focus on Regulation SP and S-ID
  - ❖ SEC Staff to review security and integrity of third-party vendors and their products and services
  - ❖ Operational resiliency planning to be evaluated, including efforts to address climate-related risks



## SEC Exam Priorities in 2023

### Crypto Assets and Emerging Financial Technology – IA Focus Areas

- ❑ Exams to focus on RIAs Investing in Crypto Assets and Providing Automated Digital Investment Advice
  - ❖ Consider online solutions, internet advisers and automated investment tools
  - ❖ Staff to assess advice related to and trading in crypto assets
    - Were standards of care met when making recommendations
    - Were compliance disclosures and risk mitigation practices implemented
  - ❖ NBE Registrants offering crypto or recommending crypto assets to be a focus



## The Latest SEC Risk Alerts

### Observations from Broker-Dealer and Investment Adviser Compliance Exams Related to Prevention of Identity Theft

- SEC found that RIAs failed to identify covered accounts, new and additional covered accounts and failed to conduct risk assessments
- Reg S-ID Programs are not tailored to the business or did not cover all required elements of Reg S-ID
- In some instances, firms did not have reasonable policies and procedures to identify and respond to red flags or did not update procedure to take into account new account opening processes (e.g., online customer portal)



## The Latest SEC Risk Alerts

### Observations from Broker-Dealer and Investment Adviser Compliance Exams Related to Prevention of Identity Theft (cont.)

- The Reg S-ID Program was not appropriately administered
  - ❖ Firms did not provide sufficient information to the board or designated senior management through periodic reports
  - ❖ There was inadequate training of employees to identify red flags
  - ❖ No evaluation of service providers and their monitoring for identity theft



## The Latest SEC Risk Alerts

### New Investment Adviser Marketing Rule FAQ

- ❑ Guidance Provided to Advisers to Private Funds and Prescribed Time Periods for Performance Advertising
  - ❖ Interim performance information acceptable in advertisements until able to comply with calendar year-end 1-, 5-, and 10-year performance
- ❑ Focus on Gross v. Net Performance
  - ❖ In the case of a group of investments in a private fund or other extracted performance, must show net numbers
    - Must be presented in a “fair and balanced” manner
    - Must disclose if cash was allocated to the extracted performance or not, and the effect that has on performance results



## Proposed Rule on Regulation Best Execution (Dec. 2022)

This Rule Proposal Would Impact Equity Markets and Broker-Dealers

- Broker-dealers would need policies and procedures for:
  - ❖ Obtaining and assessing information concerning relevant markets
  - ❖ Identifying material potential liquidity sources
  - ❖ Incorporating liquidity sources into order handling practices
- Additional controls would be needed for principal transactions and transactions with affiliates
- Execution quality to be reviewed by the broker-dealer quarterly
- Annual reviews and reports to be provided to the board / management
- Heavy emphasis on executions at the midpoint of the best bid and offer



## Proposed Rule on Outsourcing by Investment Advisers (Oct. 2022)

Designed to Ensure that Obligations to Clients are Met

- The Five Minimum Requirements for Outsourcing “Covered Functions”
  - ❖ Due diligence, monitoring, books and records, third-party recordkeeping and Form ADV reporting
- “Covered Functions” Are Necessary Functions for the RIA
  - ❖ Such functions, if not performed or performed negatively, would impact the adviser’s ability to provide investment advisory services
    - Adviser, sub-adviser, portfolio management, investment guidelines
    - Client servicing
    - Cybersecurity
    - Portfolio accounting, pricing, reconciliation, trading, allocation, valuation
    - Regulatory compliance



## Proposed Rule on Outsourcing by Investment Advisers (Oct. 2022)

### Operational Considerations - What Will Need to Get Done (Cont.)

- New Form ADV Disclosures
  - ❖ To disclose which services are outsourced and provide:
    - Service provider's name and address
    - Whether the service provider is a related person
    - Date first engaged
- Ongoing monitoring to apply to existing arrangements on the compliance date
- Policies and procedures will need to be adopted to address how the RIA is conducting due diligence of new service providers, monitoring existing relationships and adhering to books and records requirements



## What's on the Forefront: Cybersecurity

### Proposed Cybersecurity Rule 206(4)-9 Anticipated for 2023

- ❑ Rule is Designed to Provide a Comprehensive Framework to Address Cyber Risks
  - ❖ Focus on response and recovery from a cyber event
  - ❖ Establishes a mandatory 48-hour incident reporting requirement (Form ADV-C)
  - ❖ Other impacts to the compliance program include:
    - Annual risk assessments
    - Disclosure of cyber risk and incidents to investors
    - Recordkeeping requirements (including formal written reports to describe the cyber annual review, assessments performed, control tests and policy changes)
    - Monitoring, limiting user access and vendor management



## Tips for Evolving Your Compliance Program

### Step 1: Review the SEC's 2023 Exam Priorities List

- Consider Which Priorities Impact Your Business
- Once Identified, Outline What Steps You Must Take
  - ❖ Are disclosures to investors adequate?
  - ❖ Should policies and procedures be reviewed and updated / expanded upon?
  - ❖ Do personnel require additional or new training?
  - ❖ Are new supervisory controls needed to survey activities and monitor risks?



## Tips for Evolving Your Compliance Program

### Step 2: Review Your 2022 Annual Review Report

- ❑ Develop a Project Plan for All Action Items to be Addressed
  - ❖ Ensure actions taken are documented
  - ❖ Involve senior management in the process
- ❑ Consider If Higher Risks Identified Are Addressed by Policies, Procedures, and Internal Controls
  - ❖ If conflicts were identified, be sure that they are mitigated and disclosed in your annual updates to Form ADV



## Tips for Evolving Your Compliance Program

### Step 3: Consider Recent Risk Alerts

- Have You Recently Reviewed Your Regulation S-ID Controls In Light of the Guidance Provided By the SEC?
- How Is the Implementation of the NMR Emanating Throughout the Organization?
  - ❖ Have you sunset certain advertising materials?
  - ❖ Are you able to substantiate performance and statements?
  - ❖ Are you complying with net of fee performance data for specified periods?
  - ❖ Have you updated other policies affected by the NMR, such as gifts and entertainment, social media activities and use of solicitors?



## Tips for Evolving Your Compliance Program

### Step 4: Consider The Latest SEC Proposed Rules

- ❑ Consider Guidance Provided by the SEC Proposed Rules on Outsourcing, Best Execution and Cybersecurity
  - ❖ Consider fiduciary duties owed to clients
    - Regardless if the proposal goes into effect, should you consider some of the internal controls discussed for your own compliance program?
    - Have you spoken to senior management about the impact that the proposed rule could have on the organization and planned ahead?

*Risk Management Tip:* Consider what training and resources are needed



## Tips for Evolving Your Compliance Program

### Step 5: Map Compliance Program Documents

- Consider What Changes Are Made In Form ADV Amendments
- Be Sure That ALL Client Facing Documents are Amended, As Needed
  - ❖ Consider investment policy statements, client contracts and disclosures made in your Privacy Notice, website and social media sites
- If Disclosures Are Made, Consider if Policies and Procedures Need to be Created or Updated
- Effectively Communicate Disclosure Updates to Investment Adviser Representatives and Employees



## Tips for Evolving Your Compliance Program

### Compliance Questions Asked Pre-Conference

- What Compliance Events Would You Suggested in 2023?
- What Should RIAs Do Regarding Email Retention?
- What Should RIAs Do if a Client Makes a Recommendation on Google, but the Firm Prohibits Testimonials?
- What Should RIAs Do if They Receive an Incorrect Negative Review (i.e., Meant for Another Company)?
- How Often Are RIAs Currently Audited?
- What Social Media Guidelines Do You Suggest?



## Supplemental Materials

### SEC 2023 Examinations Priorities

#### SEC Proposed Rules

- Proposed Regulation Best Execution (Dec. 14, 2022)
- Proposed Outsourcing by Investment Advisers (Oct. 26, 2022)
- Proposed Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure (Mar. 9, 2022)

#### SEC Risk Alerts

- Risk Alert: Observations from Broker-Dealer and Investment Adviser Compliance Examinations Related to Prevention of Identity Theft Under Regulation S-ID (Dec. 5, 2022)
- Marketing Compliance Frequently Asked Questions (Jan. 11, 2023)

### Core Compliance Firm Overview



## Questions? Let us know how we can help!



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## Presentation Link:

[Schwab Advisor Solutions Session - Be in the Know: New SEC Priorities & How to Prepare in 2023 - Core Compliance \(corecls.com\)](#)

# Thanks For attending!

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