

# THIS MONTH IN COMPLIANCE

## RECENT FAILURES ON FORM CRS DELIVERY

### REVIEW OF JULY RISK ALERTS

#### **MONTHLY COMPLIANCE TASKS**

Please be sure to check your SmartRIA CCO portal to keep up with your monthly Compliance tasks or utilize the CCO Scorecard included in our This Month in Compliance email. Please contact the following for:

- **Login and Portal Requests:** Sara Sparks: [ssparks@thecomplianceresource.com](mailto:ssparks@thecomplianceresource.com)
- **Task Related Questions:** Nancy Harry: [nharry@thecomplianceresource.com](mailto:nharry@thecomplianceresource.com)  
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#### **AUGUST FOCUS: Form CRS Delivery**

On July 26, 2021, The Securities and Exchange Commission announced that 21 investment advisers and 6 broker-dealers have agreed to settle charges that *they failed to timely file and deliver their client or customer relationship summaries – known as Form CRS – to their retail investors.*

Last year, the SEC required SEC-registered investment advisers and SEC-registered broker-dealers to file their respective Forms CRS with the SEC, begin delivering them to prospective and new retail investors by June 30, 2020, and deliver them to existing retail investor clients or customers by July 30, 2020. *The SEC also required firms to prominently post their current Form CRS on their website, if they had one.* According to the SEC's orders, each of the firms charged missed those regulatory deadlines. *The orders find that none of the firms filed or delivered its Form CRS, or posted it to its website, until being twice reminded of the missed deadlines by their regulators—in the case of investment advisers, by the SEC's Division of Examinations, and in the case of broker-dealers, by the Financial Industry Regulatory Authority.*

The SEC's orders find that the investment advisers violated Section 204 of the Investment Advisers Act of 1940 and Advisers Act Rules 204-1 and 204-5, and that the broker-dealers violated Section 17(a)(1) of the Securities Exchange Act of 1934 and Exchange Act Rule 17a-14. Without admitting or denying the findings, the firms agreed to be censured, to cease and desist from violating the charged provisions, and to pay the following civil penalties ranging from \$10,000 to \$97,523.

#### **CCO TAKEAWAYS:**

- REVIEW CURRENT VERSION FORM CRS IS POSTED ON FIRM WEBSITE
- COPIED BELOW ARE ACTUAL SEC EXAM DOCUMENT REQUESTS REGARDING FORM CRS:
  - *Copies of all versions of Form CRS, amended Form CRS, and any disclosures communicating Form CRS changes to clients. BE SURE TO MAINTAIN COPIES FOR YOUR FILES, FIRMS ARE REQUIRED TO SEND OUT CHANGES TO CLIENTS WITHIN 60 DAYS OF AN UPDATE.*
  - *Form CRS Delivery. The dates each Form CRS, and any amendments to Form CRS, was given to each client and the method of delivery. If Form CRS was delivered to any client electronically, provide a copy of the email (or other electronic delivery method) sent to one of those clients. MAINTAIN COPIES OF COMMUNICATION TO CLIENTS FOR YOUR FILES AND LIST OF WHO IT WAS SENT TO! SAMPLE LOG TO ASSIST WITH TRACKING IS INCLUDED IN THIS MONTH'S EMAIL*
  - STATE REGISTERED FIRMS – CHECK WITH CRP to see if your STATE HAS ADOPTED A VERSION OF REG BI!

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#### SEC RISK ALERT ISSUED IN JULY

CLICK ON HEADING TO VIEW THE WHOLE RISK ALERT AS PUBLISHED BY THE SEC

(IMPORTANT FOR ONLY THOSE FIRMS OFFERING A WRAP FEE PROGRAMS)

#### Observations from Examinations of Investment Advisers Managing Client Accounts That Participate In Wrap Fee Programs

The Division of Examinations ("The Division") focused on wrap fee programs because of the continued growth of investor assets participating in such programs and the conflicts and disclosure practices observed during previous examinations. ***This Risk Alert discusses the most frequently cited deficiencies and other staff observations from the Division's Wrap Fee Initiative examinations.*** The SEC's Division of Examination assessed more than 100 advisors and broker-dealers using wrap fee programs and found frequent deficiencies in areas including the tracking and monitoring of the programs and disclosures regarding conflicts, fees, and expenses, according to an alert issued by the agency. The ***agency said it is scrutinizing wrap fee programs because they are attracting more investor assets and have a history of issues regarding conflicts and disclosures.*** Clients in wrap fee programs pay an asset-based "wrap fee" that covers investment advice and brokerage services. The wrap fee is generally based on a percentage of the value of the client's account in the wrap fee program, the SEC said. The staff also found that advisors routinely recommended the wrap fee programs without assessing whether the programs were in the best interests of clients, the SEC said. Advisors' ongoing assessments of clients were also rendered inadequate because the reviews only considered a small sample of client accounts, the agency said.

#### CCO TAKEAWAYS:

- **Fiduciary duty and recommendations not made in clients' best interests**
  - *Advisers did not monitor the trading activity in clients' accounts, or their monitoring activities were ineffective.* Infrequent trading in wrap fee accounts was also identified at several examined advisers, raising concerns that clients whose wrap fee accounts are managed by portfolio managers with low trading activity are paying higher total fees and costs than they would in non-wrap fee accounts.
  - *Advisers did not have a reasonable basis to believe that the wrap fee programs were in the clients' best interests.* The staff observed instances where the examined advisers routinely recommended that their clients participate in wrap fee programs without conducting any assessments as to whether programs were in the best interests of clients (initially, on-going, or both).
- **Potentially Misleading or Omitted Disclosures**
  - The staff observed that many of the examined advisers had omitted or provided inadequate disclosures, particularly disclosures regarding conflicts of interest, fees, and expenses. Examples of these disclosure issues are described below.
- **Compliance Programs**
  - Advisers omitted or had inadequate compliance policies and procedures.
    - Examples of areas where advisers had informal practices included: (1) conducting best interest reviews of client accounts; (2) conducting best execution analysis for wrap fee accounts (when appropriate); and (3) selecting separate portfolio managers to advise portions of clients' wrap fee accounts.
    - In other cases, the policies and procedures touched on certain key risk areas, but did not fully address the applicable risks, such as in the areas of: (1) reviewing the trading activity in wrap fee accounts for trading-away practices; (2) determining suitability of wrap fee accounts versus other types of advisory or, if applicable, brokerage accounts; (3) conducting best execution analysis; (4) identifying accounts over which the firms maintained custody; and (5) delivering disclosure documents.

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#### **Review of one of this Month's Tasks: Terminated Investment Adviser Representatives**

Another SEC Request that will appear on almost all exams.... a list of former employees. When someone leaves the company, supervisors are quick to grab the company issued laptop and/or phone. But what about the data on other equipment? How can the organization know what is on his/her mobile devices? Are firms aware of what websites and cloud-based software the IAR has access?

CRP has developed a *SAMPLE Terminated SP Checklist* to assist with the review of Terminated IARs. This will help CCO's with documenting the review of what steps were taken when an IAR of the firm departs.

*Examples of some of the access levels to consider when terminating an IAR:*

- *Internal IT network*
- *Firm phone, laptop, building access cards*
- *External website access - banking systems, website analytics, blogs, stock photo sites, social media sites*
- *Client account access, trading access*
- *Access to the custodian, third party billing system*

#### **CCO TAKEAWAYS:**

- TAILOR AND DEVELOP A TERMINATED SP CHECKLIST TO ENSURE A PROCESS IS IN PLACE FOR REVIEW OF TERMINATED PERSONS (*REFER TO OUR ATTACHED SAMPLE CHECKLIST*)
- CREATE, MAINTAIN ON FILE, AND REGULARLY UPDATE A CENTRAL DATABASE SYSTEM THAT RECORDS ALL THE ACCESS RIGHTS GRANTED TO AN IAR/EMPLOYEE