



2022

35TH NATIONAL RISK MANAGEMENT TRAINING CONFERENCE

MATT BANKSTON, CFP®
&
BART J. MCDONALD

TRUST RELATED RIA OVERSIGHT
RISKS AND HOT TOPICS
MAY 3, 2022

Agenda

- ▶ Introductions
- ▶ FIRMA Feud
- ▶ Breakout Session
- ▶ Scaling Controls
- ▶ Select 2021-2022 OCIE Risk Alerts & SEC Guidance
- ▶ Select New Rules
- ▶ Open Questions

Introductions

2022

➤ **Bart McDonald**

- **Executive Vice President and Chief Operating Officer of Renaissance Regulatory Services, Inc**

➤ **Matt Bankston**

- **Managing Director, Platform Innovation and Strategy at Choreo**

➤ **John Clark**

- **Exam Manager, Truist Bank**

FIRMA Feud

2022

➤ **Let's get some volunteers!!!**

Breakout Session

2022

➤ Risk Control Matrix

- Now that you have identified key risks, what are you going to do about it?
- Break into small groups to discuss possible controls
- We will be walking around helping your teams discuss how to use a risk control matrix to effectively document risks, controls and tests of those controls

Scaling Control

2022

➤ Goal

- Design a system that aggregates data from all of your various systems so you may identify exceptions daily rather than random testing on a much less frequent basis

➤ It all starts with the Data

- Start simple. Identify a person to download data each day
 - Identify a common place to store your daily data downloads from all your different systems
 - Use an existing resource or hire an analyst that can build business intelligence reports that refresh automatically every day using a tool such as Microsoft Power BI, Tableau, etc....
- As you grow, consider outsourcing the creation of a data warehouse that is populated each day from all your data sources (eliminate the need for the manual daily download of data)
- Eventually you may want to have database admins and developers on staff

Scaling Control

2022

➤ Benefits

- The investment into this type of a platform and the people to support it will allow you to grow without having to continue to add compliance, operations and audit staff
- Data quality will increase because of the greater transparency into how things are coded
- Risk will be reduced because instead of testing samples, you can now test the entire organization daily and follow up on exceptions, rather than spending time reviewing files that are in good order
- Frees up time for all parties involved

Scaling Control

2022

➤ Examples of Daily Automated Testing

- International Addresses
- Client address matches either an office address or employee address
- Purchases into unapproved securities in discretionary accounts
- Below Investment Grade Bonds held in discretionary accounts
- Portfolios with variances from investment objective exceeding threshold
- High cash balances that sit for extended periods of time with no explanation
- Cross Trading
- ADV Values
- 13F
- 13H
- RCT Values
- Government Entities added as clients
- Fee Reductions/Changes
- Etc...

SEC 2022 Examination Priorities

2022

➤ Overview

- Five key risk areas with a focus on crypto-assets, information security threats, and protecting retail investors

➤ Private Funds

- Focus on compliance programs, fees and expenses, custody, fund audits, valuation, conflicts of interest, disclosures of investment risks, and controls around material nonpublic information investors
- Conflicts and disclosures related to portfolio strategies, risk management, and investment recommendations and allocations

SEC 2022 Examination Priorities

2022

➤ ESG Related Advisory Services

- Mutual funds, ETFs, private funds
- Accuracy of ESG investing approach
- Proxy voting alignment with ESG related disclosures and mandates
- Procedures to monitor disclosures, portfolio management practices, and proxy voting

➤ Retail Investors and Working Families

- Recommendations and advice in their best interest
- Focus on how firms are satisfying Regulation BI and/or the Advisers Act fiduciary standard and not placing firm/rep interest ahead of retail investor
- Consideration of investment alternatives, management of conflicts, disclosures, account selection, and account conversions and rollovers

SEC 2022 Examination Priorities

2022

➤ Information Security and Operational Resiliency

- Interruptions to critical services and protection of investor information, records and assets
- Measures to: safeguard customer accounts; prevent account intrusions; oversee vendors; address malicious email activities (phishing or account intrusions); respond to incidents (including ransomware); red flags related to identity theft; and address dispersed workforce
- BCPs with focus on the impact of climate risks and major disruptions to business

➤ Emerging Technologies and Crypto Assets

- Consideration and disclosure of unique risks
- Standard of conduct owed in context of robo advisors
- Custody issues related to crypto, along with how sold

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022)**
 - Fiduciary Principals
 - Obligation to act in the retail investor's best interest
 - Obligation to not place adviser's interest ahead of the investor
 - Raises particular issues for dual hat employees to consider
 - Reasonably available alternatives
 - Cost
 - Conflicts of interest

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Dual hat obligations when recommending accounts
 - **Which Standard:** IA fiduciary standard requires recommendation to be in the investors best interest and can not to place interest of firm/rep ahead of investor
 - **Which Standard:** Must have sufficient information to form a reasonable basis to believe the account recommendation is in the investors best interest (KYC)
 - **Capacity:** Advisers have a duty of loyalty to disclose all material facts relating to the relationship
 - **Capacity:** Investor must know what hat you are wearing and while you determine that, all standards apply

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Dual hat obligations when recommending accounts
 - **Account Alternatives:** Reasonable basis to believe the account is in the investor's best interest
 - **Account Alternatives:** Consider all eligible accounts you offer
 - **Account Alternatives:** *Cannot recommend an account not in an investor's best interest solely based on your firm's limited product menu or arising from limitations on licensing (disclose limitations)*
 - **Account Alternatives:** Limited offerings and license restrictions should be considered along with services, fees and conflicts

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Factors to consider when recommending an account
 - **Investor Characteristics:** Reasonable understanding of investor's investment profile
 - **Investor Characteristics:** Financial situation – income, needs, assets, debts, marital status, tax status, age, time horizon, liquidity needs, risk tolerance, investment experience, investment objectives, goals (NAF)
 - **Investor Characteristics:** preference for making own investment decision, need or desire for account monitoring/management

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Factors to consider when recommending an account
 - **Unavailable Information:** Do you have sufficient understanding to evaluate if any account recommendation is in the investors best interest?
 - **Unavailable Information:** If not, guidance appears to indicate you should decline making any recommendations until you do
 - **Account Characteristics:** Consider services and products provided, projected costs, and alternatives available to meet investor's stated needs
 - **Account Characteristics:** Are these factors consistent with investment profile and goals?

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Consideration of costs in account recommendations
 - **Always Relevant:** Always a factor but does not need to be determining factor
 - **Costs to Consider:** Total potential costs and indirect costs
 - **Factors other than Cost:** Special requests, tax advantages, potential benefits and risks, time horizon – all in light of investors needs, investment objectives, and preferences
 - **Factors other than Cost:** *It is the staff's view that it may be difficult for a firm to assess periodically the adequacy and effectiveness of its policies and procedures or to demonstrate compliance with its obligations to retail investors without documenting the basis for such conclusions*

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Retirement Account Rollover Recommendations
 - **Additional Factors:** Rollover itself and account recommended must be in best interest of investor
 - **Additional Factors:** fees, investment options, ability to withdrawal assets, protection from creditors, holdings of employer stock, etc.
 - **Option of leaving account where it is:** must consider if applicable
 - **Option of leaving account where it is:** Documentation of basis of recommendation

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Making an account recommendation on basis of investor preference
 - Should be considered, but would not satisfy standards by itself
 - However, you would not be required to refuse to accept the investors direction
 - Document, document, document
 - Documentation of the basis for the account recommended
 - No specific “Rule” but must evidence the adequacy and effectiveness of your policies and procedures

Trading & Markets Staff Bulletin

2022

- **Staff Bulletin: Account Recommendations for Retail Investors (March 2022) - Continued**
 - Best practices in meeting account recommendation obligations
 - Avoid compensation thresholds that disproportionately increase compensation
 - Minimize or eliminate incentives (comp and non-comp)
 - Procedures to monitor rollovers and transfers
 - Adjust compensation for failure to comply (hit them in the wallet)

OCIE Risk Alerts

2022

- Risk Alert: Division of Examinations Observations: Investment Advisers' Fee Calculations (November 2021)
 - SEC reviewed accuracy of fees charged; adequacy of disclosures; effectiveness of advisers' compliance programs and accuracy of their books and records
 - Noted Deficiencies
 - Charged fees were different from contractually agreed-upon rates
 - Incorrect fee schedules being utilized
 - Errors in fee percentages manually entered into the portfolio management systems
 - Advisory fees were double-billed
 - Failure to convert all clients to a new or updated fee schedule
 - Breakpoint or tiered billing rates not correctly calculated
 - Householding of client accounts were not correctly calculated
 - Incorrect client account valuations were used (e.g., assets that disclosures stated would be excluded from the fee calculations, such as legacy positions; Incorrect valuation dates for client billings)
 - Failure to refund prepaid fees on terminated accounts or did not assess fees for new accounts on a pro-rata basis

OCIE Risk Alerts

2022

➤ Risk Alert: Division of Examinations Observations: Investment Advisers' Fee Calculations (November 2021) - Continued

- False, misleading or omitted disclosures
 - Did not reflect current fees charged or whether fees were negotiable
 - Did not accurately describe how fees would be calculated or billed
 - Were inconsistent across advisory agreements and Form ADV Part 2A
 - Cash flows and their effect on fees being disclosed in a manner inconsistent with the advisers' practices
 - Timing of advisory fee billing being inaccurate or not disclosed in any manner
 - Valuations for fee calculations being inaccurately disclosed, such as using the month-end account values rather than the disclosed average daily account values
 - Minimum fees, extra fees and discounts disclosed incorrectly by advisers

OCIE Risk Alerts

2022

- Risk Alert: Division of Examinations Observations: Investment Advisers' Fee Calculations (November 2021)
 - Continued
 - Better practices
 - Adopting and implementing written policies and procedures addressing fee-billing processes and validating fee calculations – e.g. the supervision, calculation, review and billing of advisory fees
 - Centralizing the fee-billing process and validating that the fees charged to clients are consistent with compliance procedures, advisory contracts and disclosure

OCIE Risk Alerts

2022

- Risk Alert: Observations Regarding Fixed Income Principal and Cross Trades by Investment Advisers from An Examination Initiative (July 2021)
 - Common deficiencies
 - Compliance policies and procedures that were inconsistent with advisers' practices, disclosures and/or regulatory requirements
 - Procedures were not implemented to confirm that principal/cross trades were completed consistent with advisers' disclosures to clients and procedures
 - Provision of disclosure and receipt of client consent not received prior to completing a transaction
 - Advisers maintained policies and procedures providing that advisers did not engage in principal/cross trades when in fact advisers did engage in such trading activity
 - Compliance policies and procedures that lacked necessary specificity and guidance to adequately assist supervised persons with compliance (e.g., Policies and procedures did not specify the factors that should be considered when deciding that a principal/cross trade is in the best interest of a client and did not provide a form to document a best-interest determination)
 - Lack of testing of compliance policies and procedures

OCIE Risk Alerts

2022

- **Risk Alert: Observations Regarding Fixed Income Principal and Cross Trades by Investment Advisers from An Examination Initiative (July 2021) - Continued**
 - Good standards
 - Transactions should be fair and equitable to all participating clients (cross and principal trades)
 - Pricing methodologies used to execute the transactions are prescribed (cross and principal trades)
 - Trades received best price and best execution, including the performance of periodic evaluations of the quality of execution (cross and principal trades)
 - Periodic reporting to legal or compliance department occurs (cross and principal trades)
 - Clients receive written information regarding the capacity in which the adviser acted (cross and principal trades)
 - Portfolio managers or traders get advanced written approval from senior management or compliance personnel in order to execute trades (cross and principal trades)
 - Clients must provide written consent prior to the completion of each transaction (principal trade)
 - No involved client accounts are ERISA accounts (cross and principal trades)
 - The adviser and its supervised persons may not receive commissions or other compensation related to the trades (cross and principal trades)

OCIE Risk Alerts

2022

- **Risk Alert: Observations Regarding Fixed Income Principal and Cross Trades by Investment Advisers from An Examination Initiative (July 2021) - Continued**
 - Good disclosures
 - How the adviser addressed conflicts of interest that were identified (cross and principal trades)
 - The circumstances under which advisers may engage in these transactions (cross and principal trades)
 - Any cost, including describing pricing methodologies used by advisers to value the securities (cross and principal trades)
 - Total amount of commissions or other remuneration to be received by advisers or any affiliated people (cross and principal trades)
 - The option for clients to revoke their written blanket consent to execute cross trades without penalty at any time by written notice (cross trades – blanket consent not permitted for principal trades)

NEW RULES

2022

➤ New Marketing Rule

- High level summary:
 - Compliance Date is November 2022
 - Combines old advertising and solicitation rule
 - Creates more principles-based prohibitions
- Definition has two prongs:
 - Any direct or indirect communication an investment adviser makes to more than one person, or to one or more persons if the communication includes hypothetical performance, that offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser
 - Any endorsement or testimonial for which an investment adviser provides compensation, directly or indirectly, but does not include any information contained in a statutory or regulatory notice, filing, or other required communication, provided that such information is reasonably designed to satisfy the requirements of such notice, filing or other required communication

NEW RULES

2022

➤ New Marketing Rule - Continued

- Rule relaxes certain restrictions on marketing content, but also introduces several new obligations
 - Advisers must ensure that marketing activities related to private funds adhere to the requirements of the Marketing Rule, even when fund interests are distributed by a placement agent or other intermediary
 - The rule expressly permits past specific recommendations, testimonials, and third-party ratings under certain conditions
 - Testimonials and endorsements made by third parties will be considered advertisements of the investment adviser if the adviser compensates the third-party for these activities
 - Hyperlinks and layered disclosures will be permitted subject to certain conditions
 - Rule-based framework for performance advertising similar to the current framework, but also contains some prescriptive requirements
 - No formal preapproval of most communications with clients and prospects
 - One-on-one communications tailored to a single prospective investor are excluded from the requirements of the Marketing Rule, unless the communications include hypothetical performance

NEW RULES

2022

➤ New Marketing Rule - Continued

- General prohibitions – cannot include:
 - Include any untrue statement of a material fact, or omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading
 - Include a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand by the SEC
 - Include information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the investment adviser
 - Discuss any potential benefits to clients or investors connected with or resulting from the investment adviser's services or methods of operation without providing fair and balanced treatment of any material risks or limitations associated with the potential benefits

NEW RULES

2022

➤ New Marketing Rule - Continued

- General prohibitions – cannot include:
 - Include a reference to specific investment advice provided by the investment adviser where such investment advice is not presented in a manner that is fair and balanced
 - Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced
 - Otherwise, be materially misleading

NEW RULES

2022

➤ New Marketing Rule - Continued

- Performance highlights– cannot include:
 - Gross performance results (including hypothetical performance and extracted performance presented on a gross basis) unless the advertisement also presents net performance results (i) with at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance results; and (ii) calculated over the same time period, and using the same type of return and methodology, as the gross performance results
 - Any performance results, unless they are provided for one-, five- and ten-year time periods or are the performance results of a private fund

NEW RULES

2022

- Department of Labor (DOL) fiduciary rule (Prohibited Transaction Exemption (PTE) 2020-02)
 - The (DOL) reimagined the fiduciary rule that was vacated in 2018 by releasing PTE 2020-02, Improving Investment Advice for Workers & Retirees
 - The new fiduciary rule is deeply rooted in best interest and fiduciary principles, and expands the definition of fiduciary advice under Employee Retirement Income Security Act (ERISA) to include recommendations on rollovers and individual retirement account investments
 - PTE 2020-02 is currently effective, but the disclosure requirement for PTE 2020-02 will not be enforced until June 30, 2022
 - We are still hearing that this may be extended or even repealed (but clock is ticking)
 - Many firms are taking a wait and see approach but creating forms to document the recommendation of rollovers
 - Rollovers are also a current SEC focus area

A photograph of a man and a woman shaking hands in a professional setting. The man is on the left, wearing a brown sweater, and the woman is on the right, wearing a light-colored blouse. They are both smiling. The background is a bright, modern office space with a potted plant on a desk. The image is overlaid with a blue gradient on the right side.

OPEN COMPLIANCE QUESTIONS

QUESTIONS?



THANK YOU!



Bart McDonald

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Matt Bankston

Managing Director, Platform Innovation and Strategy at Choreo

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