

## REGULATORY UPDATE

April 1, 2021

*Provided by Hardin Compliance Consulting LLC*

### Regulatory Spring Cleaning! SEC Publishes Marketing Rule FAQ and 2021 Examination Priorities, and EXAMS Risk Alert Tackles Bitcoin and Other Digital Assets: Regulatory Update for April 2021

#### For Investment Advisers & Broker-Dealers

- **Risk Alert - Division of Examinations' Continued Focus on Digital Asset Securities.** The popularity of Bitcoin and other cryptocurrencies grew exponentially in 2020, while financial regulators struggled to get up to speed. First disregarded by many mainstream financial service firms, digital assets are being embraced as innovative. Regardless, it is essential to recognize and address these assets' unique risks to financial service firms and investors. The SEC's Division of Examinations released a Risk Alert on February 26, 2021, discussing the compliance challenges raised by investments in digital assets and observations made by the Division's staff during recent examinations.

Digital assets come in many different flavors. For example, Bitcoin and Ethereum are considered currencies that take the form of tokens or coins and are issued and transferred using blockchain technology. Generally, these cryptocurrencies are not considered securities and are subject to SEC regulation. Other digital assets may, however, be considered securities if they meet the traditional *Howey* test, which requires an (i) investment of money, (ii) in a common enterprise, (iii) with an expectation of profits primarily from the efforts of other. For investment advisers, the most significant risks include understanding the nature of the digital asset (e.g., whether it is a security or a currency) and its execution and settlement risks. Advisers should also develop compliance policies and procedures to deal with the unique risks associated with custody, disclosure, and valuation of digital assets. For broker-dealers, the SEC identified the risks of (1) safekeeping of funds and operations; (2) registration requirements; (3) Anti-money laundering; (4) offerings; (5) disclosure of conflicts; and (6) outside business activities. Although the alert provides little practical guidance, EXAMS has provided a broad outline of the categories that should be addressed by firms dealing in digital assets. *Contributed by Rochelle A. Truzzi, Managing Director.*

#### For Investment Advisers

- **SEC Presents its 2021 Examination Priorities.** The SEC's Division of Examinations (the "Division" or "EXAMS") marked its 25<sup>th</sup> anniversary and, for the ninth year in a row, published its examination priorities. What is striking about this year's report is the admission that EXAMS seems to be losing ground in its quest to police the industry. "[I]n just the last five years, the number of RIAs the

Division oversees increased from about 12,000 to more than 13,900, and the assets under management of RIAs increased from approximately \$67 trillion to \$97 trillion.” With approximately 1,000 employees, EXAMS examined about 15 percent of the RIA population, or 2,952 RIAs in 2020, down 4.4 percent from 2019. Despite its best efforts, the Division admitted that its “coverage rates will likely not keep pace with the continued growth in the population and complexity, without corresponding staffing increases.”

The exam priorities echoed those from 2020, with a few new ones:

1. Protection of retail investors, including investors and those saving for retirement. Like other years, EXAMS will focus on advice given to retirement community residents, teachers, military personnel, and others saving for retirement.
2. Compliance with Regulation BI (for dual registrants) and an investment adviser’s fiduciary duty.
3. NEW: Turnkey asset management programs (TAMPs). EXAMS will be focusing on advisers that use TAMPs to make sure all fees and revenue sharing arrangements are disclosed.
4. Fees, fees, and more fees. The SEC will continue looking at how investment advisers are calculating and charging fees. Look at your process to make sure you (i) exclude unmanaged assets from fee calculation, (ii) apply breakpoints and discounts for aggregated accounts, and (iii) refund prepaid fees for terminated accounts per client agreements and other disclosures.
5. Complex products sold to retail investors, such as leveraged and inverse ETFs.
6. Selection of mutual fund share classes.
7. Cybersecurity, including controls surrounding online and mobile application access to investor account information, electronic storage of books and records, and personally identifiable information maintained with third-party cloud service providers.
8. Business continuity and disaster recovery. EXAMS wants to know about changes your firm has made to deal with new risks resulting from a work-from-home environment.

EXAMS will continue to focus on the disclosure of fees and expenses and conflicts of interest. Based on the exam priorities, here are my recommendations for RIAs:

- 1. Document the process for evaluating securities products, accounts types, and advice provided to clients.** Exam staff will be taking a close look at the process firms use to determine which products and services to offer, how recommendations are made, and how conflicts are addressed. The SEC wants to see documentation proving you are acting in your clients’ best interest. Compliance officers should be reviewing the firm’s mutual fund share class selection process and the firm’s revenue sources to determine whether conflicts have been adequately disclosed. Firms should also review whether IARs gather and document sufficient information about a client’s financial situations, risk tolerance, and investment goals.

2. **Cover basic compliance blocking and tackling.** The SEC’s exams will continue to focus on compliance program basics, such as custody, best execution, fees and expenses, portfolio management, and valuation of client assets. Dual registrants should expect special attention from regulators on disclosure and management of the conflicts associated with best execution and providing fiduciary advice. RIAs that offer investment strategies focused on ESG (environmental, social, and governance) factors should expect lots of questions from staff.
  3. **Review clients’ holdings for potential problems.** Compliance professionals should periodically check client holdings for securities that give regulators heartburn, such as inverse or leveraged ETFs, municipals, microcap securities, and C shares of mutual funds. There may be good reasons for clients to hold these assets; make sure they are documented.
  4. **Document updates to your Information Security Program resulting from working from home and increasing cyberattacks in 2020.** The SEC will be looking at how firms are managing the operational risks with employees working remotely. Consider implementing training programs to reinforce lessons on how to identify phishing attacks or other malicious email activities. Additionally, EXAMS will “focus on controls surrounding online and mobile application access to investor account information, the controls surrounding the electronic storage of books and records and personally identifiable information maintained with third-party service providers, and firms’ policies and procedures to protect investor records and information.” *Contributed by Jaqueline M. Hummel, Partner and Managing Director.*
- **[SEC Says New Marketing Rule is “All or Nothing.”](#)** As many adviser marketing teams have begun to salivate about finally being able to use client testimonials, the SEC has thrown a regulatory wet blanket over their enthusiasm. In its FAQ on the new marketing rule, the SEC made it clear that compliance is an all-or-nothing proposition. Even though the new rule is effective May 4, 2021, advisers must continue to rely on the existing versions of Rule 206(4)-1 (the advertising rule) and Rule 206(4)-3 (the solicitation rule) until they can meet all of the new rule’s requirements. Advisers have until November 22, 2022 to prepare. *Contributed by Jaqueline M. Hummel, Partner and Managing Director.*
- **[SEC Updates 13F FAQ to Reflect Amended Reg S-T and the Use of Electronic Signatures on EGAR filings.](#)** Until the November 2020 adoption of amendments to Regulation S-T (“Reg S-T”) and related rules, filers of Form 13F and other EDGAR Filings were required to manually sign a signature page or other document (known as an “Authentication Document”) before or at the time of the filing. Filers were also required to retain those Authentication Documents for five years and provide a copy to the SEC upon request.

The Authentication Document may now be signed electronically subject to certain conditions. To be clear, firms that are still happy maintaining Authentication Documents with manual signatures may continue to do so with no change to their practices resulting from these amendments. Want to start using electronic signatures on your Authentication Documents? Below are the requirements:

1. The Authentication Document may still be a signature page or other document authenticating, acknowledging, or otherwise adopting their signature that appears in typed form within the electronic filing. It must still be signed by each signatory to the electronic filing.
2. If signed electronically:
  - A signatory must first manually sign a document attesting that the use of such electronic signature constitutes the legal equivalent of the individual’s manual signature.
  - This manually signed document must be retained for as long as the signatory uses the electronic signature and at least seven years after the most recently signed authentication document.
  - An electronically signed Authentication Document is also subject to new requirements in the [EDGAR Filer Manual](#). More specifically, the document must:
    - Contain a physical, logical, or digital credential that authenticates the signatory’s identity;
    - Reasonably provide for non-repudiation of the signature;
    - Contain electronic signatures that are attached, affixed, or otherwise logically associated with the Authentication Document being signed; and
    - Include a timestamp to record the date and time of signature.

In recognition of these amendments, the SEC recently updated its [FAQ to Form 13F](#) filings to reflect the new electronic signature requirements. *Contributed by Cari A. Hopfensperger, Managing Director.*

## For Broker-Dealers

- [Reg Notice 21-10, Private Placement Filer Form](#). FINRA Rules 5122 and 5123 require member firms that participate in private placement offerings to adhere to certain disclosure and filing requirements about each offering. The Filer Form is submitted through FINRA Gateway and provides information about the selling member, the issuer, and the offering information (including offering documents). Effective May 22, 2021, the Filer Form will include new questions and clarifications to existing questions and requests for information. For example, FINRA added questions to address contingency offerings, disciplinary histories, the intended use of proceeds, and private securities transactions subject to FINRA Rule 3280. FINRA designed these updates “to enhance oversight in particular areas of risk in the private placement market.”

As a bonus, FINRA included as [Attachment B](#) a copy of the Unregistered Offering List Request Template. Firms should leverage the template when reviewing their current process to ensure they capture and report on the information request. *Contributed by Rochelle A. Truzzi, Managing Director.*

## For Mutual Funds

- [SEC Publishes Small Entity Compliance Guide on Good Faith Determinations of Fair Value](#). In conjunction with the adoption of the Investment Company Act (the “Act”) Rule 2a-5 (the “Valuation Rule”) on December 3, 2020, the SEC has published a guide to assist registered investment companies, their boards, advisers, and sub-advisers as they plan for compliance. Under the Act, firms must price securities with readily available market quotations at their market value, and the

Valuation Rule provides a new clarification of what constitutes “readily available.” By comparison, fund boards must make a good faith determination of fair value for securities that do not have readily available market quotations, and the Valuation Rule establishes certain requirements for investment companies when establishing a fair value, which include:

- Periodically assessing and managing valuation risk;
- Establishing and applying fair value methodologies;
- Testing fair value methodologies; and
- Overseeing pricing services.

The SEC also adopted a new rule (Rule 31a-4) with record-keeping requirements for fair value determinations. The new rules, which end a 50-year stretch since the last regulatory changes on valuation, are effective March 8, 2021, and have an 18-month runway to comply by September 8, 2022. Although this compliance guide targets smaller entities, it provides a helpful summary for any impacted firm. *Contributed by Cari A. Hopfensperger, Managing Director.*

## Lessons Learned

- [Private Fund Manager Blows Private Offering Exemption and Gets Banned from Industry.](#) The SEC found that private fund manager and real estate development firm, Ettro Capital Management Corp. (“ECM”) made material misstatements and omissions to prospective investors about (1) the past performance of their Fund; (2) capital raised and assets under management; and (3) ECM’s investment management and real estate development experience. ECM also blew its private offering exemption by advertising a private real estate fund offering its unrestricted website. Peter Ettro, ECM’s founder, received an industry bar and a \$60,000 fine. The lesson learned is that unregistered advisers are still subject to the SEC’s jurisdiction. Moreover, the SEC does not look kindly on firms that tell investors fairy tales about their track record, capital raised and fund investments. *Contributed by Rochelle A. Truzzi, Managing Director.*

## Worth Reading, Watching and Hearing

- [Broker-Dealers - 2020 Regulatory Year in Review.](#) Check out this excellent summary by Hardin senior compliance consultant, Doug MacKinnon. It’s a nice companion piece to this summary by Ulmer & Berne [FINRA’s 2021 Exam Priorities.](#)
- [SEC Continues Focus on Digital Asset Securities.](#) Akin Gump offers its views on the SEC’s latest risk alert. Schneider Downs Wealth Management also weighs in with [Bitcoin Bitcoin Read All About it.](#)
- [NASAA IAR Continuing Education Model Rule FAQ.](#) NASAA launched this FAQ resource to assist firms and states with its Investment Adviser Representative (IAR) Continuing Education Model Rule.
- [U.S. Department of Labor Releases Statement on Enforcement of its Final Rules on ESG Investments, Proxy Voting by Employee Benefit Plans.](#) On March 10, the Department of Labor’s Employee Benefits Security Administration (EBSA) announced that, pending additional updates, “it will not enforce recently published final rules on “[Financial Factors in Selecting Plan Investments](#)” (also referred to as the “ESG Rule”) and “[Fiduciary Duties Regarding Proxy Voting and Shareholder Rights.](#)” EBSA plans to conduct more outreach with stakeholders about these rules and share additional information with the public on its new [webpage](#) as it becomes available.

- [Virginia Consumer Data Protection Act Becomes Law](#). Ropes & Gray offers [this summary](#) of the latest state to adopt its own Consumer Data Protection Act. Thompson Hine offers [its assessment](#) of the topic.
- [SEC Announces Division of Enforcement Task Force Focused on Climate and ESG Issues](#). Acting Deputy Director of Enforcement, Kelly L. Gibson, will lead the task force and stated: “This task force brings together a broad array of experience and expertise, which will allow us to better police the market, pursue misconduct, and protect investors.”
- [FINRA Gateway Updates](#). On March 17, 2021, FINRA published an announcement highlighting several significant registration filing milestones taking place in the coming weeks. U4 and U5 filers should find this update helpful. FINRA is also looking for comments on those starting to access Disclosure Letters via the Gateway.

## Filing Deadlines and To-Do List for April 2021

### **INVESTMENT ADVISERS**

- [Form 13H](#): Following an initial filing of Form 13H, all large traders must make an amended filing to correct inaccurate information promptly (within ten days) following the quarter-end in which the information became stale (unless they are on Inactive Status). Recommended due date: **April 10, 2021**. (Note: Neither the SEC nor its staff has provided guidance on the definition of “promptly” for Form 13H.)
- [Form ADV Part 2A](#): Registered investment advisers are required to distribute to each client an updated Form ADV Part 2A or a summary of material changes with an offer and information on how to obtain the updated Form ADV Part 2A, within 120 days of fiscal year-end. Due **April 30, 2021**.
- [Form ADV Part 2B](#): Registered investment advisers should review their Form ADV Part 2B Brochure Supplements to ensure continued accuracy.

### **HEDGE/PRIVATE FUND ADVISERS**

- [Form PF for Large Liquidity Fund Advisers](#): Large Liquidity Fund Advisers must file Form PF with the SEC on the IARD system within 15 days of each fiscal quarter-end. Due **April 15, 2021**.
- [Blue Sky Filings \(Form D\)](#). Advisers 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. Did you know that Hardin Compliance Consulting offers a convenient and economical blue sky filing service to help firms manage this complicated monthly task? [Learn more here](#) and give us a call to discuss your needs further. Due **April 15, 2021**.
- [Distribute Audited Financial Statements for Private Funds](#): Private fund investment advisers should have their funds audited by an independent, PCAOB-registered accountant and deliver the audited financial statements to the funds’ investors within 120 days of the end of the funds’ fiscal year (for funds with December 31, 2020 year-end, the date is **April 30, 2021**). The deadline for private funds

that are fund of funds is 180 days of the funds' fiscal year-end. That's June 29, 2021, for funds with December 31 year-end.

- [Form PF Annual Amendment](#): Form PF Annual Amendment is due within 120 days of fiscal year-end for all private fund advisers other than "large hedge fund advisers" and "large liquidity fund advisers." The due date is **April 30, 2021**.
- [Form PF Quarterly Update](#): Form PF quarterly update is due for "large hedge fund advisers" and "large liquidity fund advisers" who did not submit information relating to their other private funds with their fourth-quarter filing. Due **April 30, 2021**.

## ***BROKER-DEALERS***

- [Annual Reports for the Fiscal Year-End January 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 Date April 1, 2021**.
- [Annual Entitlement User Account Certification](#): FINRA requires firms to conduct an annual review of the FINRA application user accounts established for firm personnel and ensure that access and entitlements are appropriate for the personnel's role and responsibilities. The certification period typically begins in early January and ends approximately 30 days later. The Super Account Administrator ("SAA") is responsible for conducting the review, amending and deleting user accounts/entitlements as necessary, and submitting the certification through WebCRD. Only the SAA has access to this certification. Failure to complete the certification by the established deadline will result in all user accounts associated with the firm to be suspended until the certification is complete. **The 2021 certification period is April 19-July 19, 2021**.
- [FINRA Accounting Support Fee](#): Quarterly invoice to support the GASB budget. Based on the municipal securities the firm reported to the MSRB. De Minimis firms (that owe less than \$25) will not receive an invoice. Invoices are sent to the firm via WebCRD's E-Bill. **Due date TBD**.
- [Customer Complaint Quarterly Statistical Summary](#): For complaints received during the first quarter. FINRA Rule 4530 requires Firms to submit statistical and summary information regarding complaints received during the quarter by the 15<sup>th</sup> day of the month following the calendar quarter. **Due April 15, 2021**.
- [Quarterly FOCUS Part II/IIA Filings](#): For Quarter ending March 31, 2021. FINRA requires that member firms file a FOCUS (Financial and Operational Combined Uniform Single) Report Part II or IIA quarterly. Clearing firms and firms that carry customer accounts file Part II and introducing firms file Part IIA. **Due April 23, 2021**.
- [Quarterly Form Custody](#): SEC requires that member firms file Form Custody under Securities Exchange Act Rule 17a-5(a)(5) for the quarter ending March 31, 2021. **Due April 23, 2021**.
- [Supplemental Statement of Income \("SSOI"\)](#): For the quarter ending March 31, 2021. FINRA requires firms to submit additional, detailed information regarding the categories of revenues and expenses reported on the Statement of Income (Loss) page of the FOCUS Report Part II/IIA. **Due**



## **April 28, 2021.**

- [Supplemental Inventory Schedule \(“SIS”\)](#): For the month ending March 31, 2021. 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 April 28, 2021.**
- [Annual Reports for Fiscal Year-End February 28, 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 April 29, 2021.**
- [SIPC-3 Certification of Exclusion from Membership](#): For firms with a Fiscal Year-End of March 31 **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 April 30, 2021.**
- [SIPC-6 Assessment](#): For firms with a Fiscal Year-End of September 30, 2018. 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 April 30, 2021.**
- [SIPC-7 Assessment](#): For firms with a Fiscal Year-End of February 28th. 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 the Fiscal Year-End. **Due April 30, 2021.**
- [Form OBS](#): For the Quarter ending March 31, 2021. Unless subject to the de minimis exception, all clearing, self-clearing, and carrying firms and those firms that have a minimum dollar net capital requirement equal to or greater than \$100,000 and at least \$10 million in reportable derivatives and other off-balance sheet items must submit Form OBS as of the last day of a reporting period within 22 business days of the end of each calendar quarter via eFOCUS. Firms that claim the de minimis exemption must affirmatively indicate through the eFOCUS system that no filing is required for the reporting period. **Due April 30, 2021.**

## **MUTUAL FUNDS**

- [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 April 7, 2021.**



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## **Partner with Hardin Compliance**

Have a compliance question or want an independent review of your compliance program? Hardin Compliance can help! Call us today at 1.724.935.6770, or visit our website at [www.hardincompliance.com](http://www.hardincompliance.com) for more information.

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