

Compliance Newsletter

2019, Fourth Quarter

Because compliance is constantly changing and evolving, we prepare this newsletter to keep you apprised of the latest rulings, guidance, proposals and more from the most recent quarter.

If you would like to speak to a compliance expert on any of these topics, please contact us at info@joot.io.

Summary of This Quarter's Topics

SEC Proposals

- Updating the advertising and cash solicitation rules for investment advisers
- Updating the Accredited Investor definition
- Modernizing the regulation of derivatives by mutual funds and other registered investment companies

Reports

- FINRA releases its annual exam guidance report
- SEC and CFTC release their annual enforcement division reports

FAQs

- Form CRS
- Disclosure of investment adviser compensation

Alerts

- FINRA issues cybersecurity alert for cloud-based email accounts
- SEC issues risk alert on exam findings of mutual funds and other registered investment companies

Guidance and Rulings

- CFTC issues guidance on annual affirmation for CPO and CTA registration exemption

Other Announcements

- SEC announces extension of temporary measure to facilitate cross-border implementation of the European Union's MiFID II's research provisions

SEC Proposals

SEC proposes to update the Advertising and Cash Solicitation rules of Investment Advisers

What you need to know: The SEC has proposed amendments to modernize the rules regarding advertising and cash solicitation. The proposals would permit the use of testimonials, endorsements, and third-party ratings, each subject to certain conditions. It also includes tailored requirements for performance presentations that is based on the advertisement's intended audience (e.g., retail versus institutional). The proposed changes to the cash solicitation rule include covering arrangements involving all forms of compensation (not just cash) and expanding the solicitation rule to private funds. From our perspective, the changes to these rules are welcome by the industry, and long overdue. Let's hope the final rule is passed and reflects the industry's comments.

For more information: [SEC Rule Proposal: Advertising and Solicitation](#)

SEC proposes to update the Accredited Investor definition

What you need to know: The SEC has proposed amendments to expand and update the definition of accredited investor, which is one of the tests for who is eligible to participate in private offerings. The proposal would allow more individuals to qualify as accredited investors based on attributes such as professional knowledge, experience, or certifications. Limited liability companies (that meet certain conditions), registered investment advisers, and rural business investment companies would be added as accredited investors under the proposal. These amendments could have a significant impact on the private securities market, opening it up to a whole new set of investors. It will be interesting to see, if passed, whether the expansion of the potential investor market leads to more private offerings.

For more information: [SEC Rule Proposal: Accredited Investor Definition](#)

SEC proposes to modernize regulation of derivatives by mutual funds and other registered investment companies

What you need to know: The SEC has proposed a new rule to enhance the regulation of derivatives used by mutual funds, ETFs, closed-end funds and BDCs. Proposed Rule 18f-4 of the Investment Company Act would require a fund to implement a written derivatives risk management program and limit the fund's leverage risk. Leveraged or inverse funds would follow a set of alternative conditions outlined in the proposed rule. The proposed rule would also require confidential reporting to the SEC via Form N-LIQUID if the fund is out of compliance with the leverage risk requirements of the rule. The SEC released a similar proposed rule back in 2015. The industry pushed back on many of the proposals in the 2015 rule, so we would expect the same reaction this time around.

For more information: [SEC Rule Proposal: RIC Derivatives Regulation](#)

Reports

FINRA releases its annual exam findings report

What you need to know: FINRA releases this report each year and it is a good summary of what the regulator is focusing on during exams. The 2019 report distinguishes between findings (which constitutes a determination that a firm/person has violated a law) and observations (suggestions to a firm about how it could improve its control environment - aka best practices).

For more information: [FINRA Exam Findings Report](#)

The SEC and CFTC release their annual enforcement division reports

What you need to know: The SEC and CFTC release these reports at the end of each year. It is a reminder that the regulators continue to seek out enforcement actions and that you need to review your firm's compliance program regularly to ensure you don't end up on the list(s). Considering the consistent increase in the number of enforcement actions over the past few years (at least for the SEC), it appears it doesn't matter what administration is in the White House when it comes to enforcing the federal securities laws.

For more information: [SEC Enforcement Report](#) | [CFTC Enforcement Report](#)

FAQs

SEC issues frequently asked questions on Form CRS

What you need to know: The SEC released a set of frequently asked questions for the new Form CRS, which has a compliance date of June 2020. The questions cover topics such as the format of the summary document and the delivery requirements. If you haven't thought about Form CRS yet, now is the time to start drafting the document so it's ready for June 2020.

[For Joot's technology customers, we will help you draft your Form CRS. Send an email to info@joot.io with a request for assistance.]

For more information: [Form CRS FAQ](#)

SEC issues frequently asked questions on disclosure of Investment Adviser compensation

What you need to know: The SEC released a set of frequently asked questions on disclosure of certain financial conflicts related to investment adviser compensation. The questions provide examples of fact patterns that the SEC expects investment advisers to disclose properly to investors in disclosure documents such as Form ADV. Topics include revenue-sharing arrangements and mutual fund share class selection. Based on this FAQ and the SEC's recent share class selection disclosure initiative, it's evident that disclosure and transparency are a key focus of the SEC - so make sure your firm's compensation and potential conflicts are disclosed properly.

For more information: [Compensation Conflicts FAQ](#)

Alerts

FINRA issues cybersecurity alert for cloud-based email accounts

What you need to know: As a result of several member firms reporting email account takeovers (“ATOs”) while using cloud-based email platforms (such as Microsoft Office 365), FINRA released an alert on the issue. The alert outlines how attackers have executed ATOs and how to prevent ATOs from occurring. Its yet another reminder of making sure your firm’s cybersecurity program is being reviewed and implemented appropriately.

For more information: [FINRA Cybersecurity Alert](#)

SEC issues risk alert on exam findings of mutual funds and other registered investment companies

What you need to know: OCIE issued a risk alert providing the most cited deficiencies observed in recent exams of registered investment companies. Common deficiencies included inadequate procedures, written policies not being followed, and inadequate annual reviews. These are also common deficiencies that occur in investment adviser and broker-dealer exams. The risk alert also touched on deficiencies with Code of Ethics and 15(c) processes.

For more information: [SEC Risk Alert for RICs](#)

Guidance and Rulings

CFTC issues guidance on annual affirmation for CPO and CTA registration exemption

What you need to know: This guidance issued by the CFTC provides instructions on how to complete the annual affirmation if you are registered as exempt from CPO or CTA registration. The guidance also provides a set of frequently asked questions. Don’t forget to complete this annual process if you are registered as exempt.

For more information: [CPO/CTA Annual Exemption](#)

Other Announcements

SEC announces extension of temporary measure to facilitate cross-border implementation of the European Union's MiFID II's research provisions

What you need to know: The industry has been waiting for the SEC to address this expiring no-action letter - and they delivered. The no-action letter, originally dated October 26, 2017, provides relief to broker-dealers receiving payments in hard dollars or through research payment accounts from clients subject to the MiFID II rules. This helps U.S. based investment advisers to continue to utilize “soft dollar” arrangements in the same manner they have been accustomed to regardless of the changes that could affect broker-dealers by MiFID II. The extension period of the no action relief runs through July 3, 2023.

For more information: [SEC Extends MiFID II No-Action Letter](#)

About Joot

Joot is a fintech company that provides web-based technology and services to registered investment advisers, broker-dealers and funds. Joot has over 40 clients around the U.S. who collectively manage over \$33 billion. Joot's clients include retail advisers, institutional managers, private fund managers and mutual fund advisers.

We hope this newsletter is informative and valuable.

For more information about us, please visit our website at www.joot.io or contact us at info@joot.io.