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IA Compliance: Master Emerging Challenges

Sept. 16, 2019 | Philadelphia, PA

UPCOMING WEBINARS

Conquering Current Compliance Challenges

Sept. 11, 2019 | 2:00 - 2:30 PM EST

RECORDED WEBINARS

Conquering Current Compliance Challenges

Recorded: August 14, 2019

HANDBOOKS

Private Equity Enforcement Lessons Learned: Compliance Guidance for the PE Business Model

Includes: Best Practices, Key Regulatory Issues and Compliance Tips

The SEC Examinations Priorities Handbook (2019 Edition)

Includes: Best Practices, Document Request Letters and OCIE Risk Alerts

The Adviser's Guide to SEC Advertising and Marketing Rules

Includes: 23 Best Practices, 5 Peer-tested tools and 15 No Action Letters

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Taking time to think about your firm's money flow could pay big dividends

Published on: 8/15/2019 Content area: Investment Adviser

Comments?

It's happened again. The SEC Aug. 13 settled [an enforcement action](#) – this time against an exempt-reporting adviser – for failing to disclose conflicts related to received revenues.

The recent enforcement action against **Commonwealth Financial Network** (\$85B in AUM), and the new case testify again to the agency's ongoing interest in how advisers disclose revenue sharing conflicts (**IA Watch**, Aug. 1, 2019).

While Commonwealth "vehemently denies the allegations," leaving the courts to settle that matter, there's no question that the SEC's focus won't vanish anytime soon.

"You cannot spend enough time evaluating your conflicts of interest if you're an investment adviser," says **Karen Huey**, president of **Professional Compliance Assistance** in Woodstock, Ga. Regularly quiet the commotion of your office to sit in silence to ask "where does every dollar in this firm come from? Where does every dollar go?" she suggests.

Fiduciary duty

The SEC accuses Commonwealth of breaching its fiduciary duty to clients "by failing to disclose certain conflicts of interest" over several years related to revenue sharing. Commonwealth "failed to tell its clients that some investment choices generated additional multi-million dollar revenues" for the firm, according to the SEC's complaint. "The undisclosed conflicts of interest at issue in this case created incentives for Commonwealth to select and hold investments for advisory clients that financially benefited Commonwealth over the interests of its clients," the agency continues.

The adviser did change its Form ADV brochure. Here's a portion of the firm's current brochure disclosure related to revenue sharing:

"A conflict of interest exists because Commonwealth and your advisor have a greater incentive to make available, recommend, or make investment decisions regarding investments that provide additional compensation to Commonwealth that cost clients more than other available share classes in the same fund that cost you less."

"These conflicts are going to be addressed by [Form CRS](#)," says Huey, believing new Form ADV, Part 3, which takes effect next year, will require advisers to plainly state their conflicts (**IA Watch**, June 13, 2019).

Possible adviser conflicts

Huey shares her list of possible conflicts that could occur at an advisory firm:

1. Having a registered rep of a broker-dealer on staff
2. Having an IAR or other staff member who sells insurance
3. Participation in a custodian's adviser platform
4. Having affiliated service providers
 - a. Broker/dealer
 - b. Insurance company
 - c. Accounting firm
5. Managing a private fund or a registered mutual fund
6. Soft dollar arrangements
7. Referral arrangements (whether you pay or are paid)
8. Government-related clients (pay-to-play issues)
9. Proxy voting conflicts

- a. Identify if your clients have any conflicts (i.e., are they on a board of a publicly traded company in which clients invest?)
- 10. Service by any advisory affiliate (officer, director, employee, etc.) on a board of directors
- 11. Sponsoring a wrap program
- 12. Block trades
 - a. Are employees included in these trades?
 - b. How are shares/units allocated in a partial fill?
 - i. Consider client allocations (how do you decide which clients are included/excluded?)
 - ii. Consider how participating employee accounts are treated
- 13. Trade rotation among different executing brokers (especially if there are soft dollar arrangements)
- 14. Trade error correction procedures
 - a. Are clients always made whole?
 - b. Does the adviser net out gain and loss errors?

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The information contained herein was current as of the publication date.

Indexed by: Compliance Best Practices | Conflicts of Interest |

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