

4 SEC Hot Buttons to Address Immediately

The agency is in a prickly mood, and may compel advisors to reimburse clients if certain disclosures aren't met.

The Securities and Exchange Commission continues to be very aggressive, progressive and punitive and often seeks every opportunity to compel advisors to reimburse clients. Advisors need to stay on top of these hot buttons.

MARGIN INTEREST

If you have clients on margin, and bill on the higher margin value, *beware*. The SEC has been aggressively reviewing margin balances and seeking reimbursement to clients unless there is clear 2A Brochure disclosure.

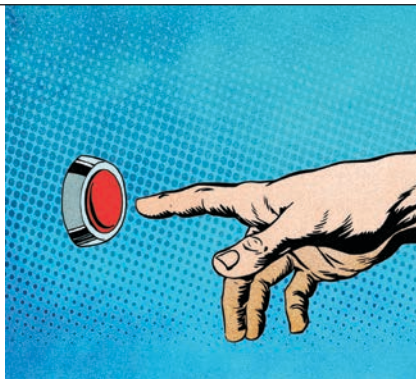
Thus, if you bill on the higher margin value, there should be unambiguous disclosure on your 2A Brochure indicating the same, including the conflict of interest that arises (i.e., because you earn a higher fee, there is a disincentive to encourage the client to trim or eliminate the margin balance).

In addition, because the SEC recently has sought express client acknowledgment of such a billing arrangement, consider a short corresponding Margin Acknowledgment to be executed by the client. Or, you can include the disclosure on the Fee Schedule to his Advisory Agreement in lieu of the Acknowledgment.

However, I prefer the Acknowledgment at the time that the client commences the use of margin because he may not use margin for a long time subsequent to the execution of the Advisory Agreement.

CASH BALANCES POLICY

Also *beware* if you bill on cash (i.e., money market funds). The SEC doesn't like that, especially in this very low-yield environment when your advisory fee is substantially higher than the yield.



To protect your firm, adopt a written policies and procedures document. The policy should state that you consider cash to be an asset class, and — as a result — you include it in your fee calculation, regardless of your fee model.

Also include corresponding disclosure on your 2A Brochure, including that at times (such as now) your fee will exceed the money market yield. Without the above clear disclosure — you continue to charge on cash at your peril.

WRAP PROGRAM SPONSORS

The SEC equally loathes wrap programs. The onus will continue to be on the advisory firm to prove that it does not economically benefit from sponsoring such programs. Clear and concise Part 2A and corresponding wrap brochure disclosures are a must.

Also, if you manage individual equities (including ETFs) as part of the wrap program, and utilize a custodian that has ceased charging transaction fees on such securities, the SEC could inquire as to why the firm did not correspondingly decrease the firm's advisory fee to its program clients.

We urge those affected wrap sponsors to contact us to discuss potential

mitigation issues. This includes a letter to clients and corresponding Part 2A disclosure, and whether, based upon the resulting amount of economic windfall to the advisor, the firm, during an upcoming examination, could be pressed by the SEC to reimburse clients.

Each of the above ADV amendments should be treated as material and should be provided to all affected clients.

BACK-TESTED HYPOTHETICAL PRESENTATIONS

The SEC despises these types of presentations and continues to review them aggressively. We have prepared disclosures for clients who use such presentations.

However, as a result of the SEC's posture, and corresponding issues raised by the new Marketing rule, all advisors who use such presentations should have them reviewed, as well as enhance the corresponding disclosures. This will help mitigate potential adverse SEC comments and reviews, which can be punitive.

There is a caveat. The SEC views all non-Global Investment Performance Standards-verified presentations aggressively, regardless of type (i.e., back-tested hypotheticals, representative accounts, composites, etc.). Therefore, some issues to address include: cessation of gross of fees performance, solicited vs. unsolicited presentations, maintaining a list of recipients, applicability to the recipient's objective and the impact of transaction/custodial fees. **IA**

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