COLORADO
Department of Regulatory Agencies
Division of Securities

Colorado Division of Securities
2022 Investment Adviser Examination Priorities

The Colorado Division of Securities (the "Division") 2022 investment adviser examination priorities appear below.[1] While not an exhaustive list of compliance issues covered during an examination, the priorities reflect a focus by the Division staff (the "Staff") on common deficiencies and trends that are concerning for consumer protection. The Division has also released an Investment Adviser Guide to assist state-licensed firms in their compliance with the Colorado Securities Act and attendant rules (each, a "Rule").

Throughout 2022, the Division expects to continue to allocate extra time and resources to these prioritized items. However, priorities may be adjusted during the year in light of information learned from examinations, complaints, referrals, current events, ongoing risk assessments, coordination with other regulators and other developments.

Note: Statutes and rules governing the Division's examination authority is located on the Division's website at Statutes and Rules.

I. Supervision

Rule 51-4.6(IA)(18) requires investment advisers to have written procedures to supervise the activities of all representatives. Single person firms are not exempt from this Rule and must also have written procedures. Firms should review and update procedures regularly, including specifically addressing:

- **Rule 51-4.14(IA) Investment Adviser Cybersecurity:** Cybersecurity has been a priority of the Division for several years and continues to be an increasing threat to all businesses. Firms must annually assess the risk of cyber threats including conducting an annual assessment and due diligence on any third-party vendors that maintain or have access to confidential information or customer data. Firms should have a written and up-to-date cybersecurity policy and adhere to it.

[1] The views expressed herein are those of the Examination Staff of the Colorado Division of Securities (the "Staff") and intended to be informational and not all inclusive of your firm's responsibilities. Your firm is responsible for and must comply with all required rules and regulations. This document does not supersede any part of the Colorado Revised Statutes, Securities Act, or Rules. The contents of this document do not constitute legal advice.

- **Rule 51-4.12(IA) Business Continuity and Succession Planning:** Investment advisers must implement and maintain written procedures relating to business continuity and succession planning. Unavailability of key personnel and minimizing service disruptions should be addressed.
- **§11-51-1001, C.R.S. Protection of Vulnerable Adults from Financial Exploitation Act:** Investment advisers are mandatory reporters in Colorado and therefore must immediately report when there is a reasonable belief that financial exploitation may be occurring. Written procedures should reflect these responsibilities.

II. Financial Requirements

Rule 51-4.6(IA)(A)(6) requires your firm to maintain financial statements according to Generally Accepted Accounting Principles ("GAAP"), which requires all internal audit working papers to be prepared utilizing the accrual basis, not cash basis. Complete financial statements consist of a balance sheet, trial balance, general ledger, cash receipts and disbursements journal, income statement, and cash flow statements. The Division continues to see firms failing to maintain adequate financial statements.

The staff will generally utilize firm's financial statements to determine whether the firm maintains an adequate net worth. **Rule 51-4.13(IA)** sets out firm liquid net worth requirements, which vary depending on the structure of your investment advisory firm. The required liquid net worth amount can range from a positive net worth to a specific dollar amount of liquid net worth.

III. Invoice Itemization

Rule 51-4.10(IA)(B)(2) requires investment advisers to provide itemized invoices to the clients they serve, as they provide an accurate and itemized record of the charges the client must pay. The Division continues to cite advisers for this deficiency. For either asset management or financial planning, the invoice must specifically state the formula used to calculate the fee, the amount of assets under management or investment advisory services the fee is based on, the amount of time charged and the time period covered by the fee. Just providing a line entry is not sufficient. The services that were provided (if billed in arrears) or will be provided (if billed in advance) should be itemized in a way that clearly outlines those services and assists the client in understanding what has been completed and the tasks that remain to be completed under the contract.

IV. Fund Advisers: Requirements for Registration of Securities and Custody

When offering a pooled investment vehicle or a private fund, investment advisers and broker-dealers must carefully review the registration process as all securities offered

in Colorado must be registered or exempt under the **Colorado Securities Act, §11-51-301, C.R.S.**

Subsequently, when managing the respective fund, investment advisers must engage an independent representative to preapprove all fees, expenses, and capital withdrawals from the pooled accounts pursuant to the **Rule 51-4.10(IA)(B)(3)** Custody and Safekeeping.

V. Investment Adviser Marketing

All state licensed firms must comply with **Rule 51-4.8(IA)(M),** which states that dishonest and unethical conduct includes publishing, circulating, or distributing any advertisement which does not comply with Rule 206 (4)-1 under the Investment Advisers Act of 1940. In December 2020 the Securities and Exchange Commission ("SEC") amended Rule 206(4)- in order to modernize rules that govern investment adviser advertisements that were previously prohibited by the SEC. Most notably, this reform will allow investment advisers to utilize testimonials and endorsements in their advertisements.

Firms should update their written supervisory procedures before engaging in any new advertising practices. This change will add an extra layer of disclosures for those advisers who wish to publish testimonials and endorsements. These disclosures include statements regarding the status of the “promoter,” whether compensation is paid to the promoter, and the existence of material conflicts of interests. These required disclosures must be set forth “clearly and prominently” within the advertisement. In addition, the investment adviser must have a reasonable basis for believing that the testimonial or endorsement complies with the requirements of the rule and a written agreement with any person giving a testimonial or endorsement that describes the scope of the agreed-upon activities and the terms of compensation for those activities. There are also additional requirements that impact the use of third-party ratings and performance information.

The Division will be reviewing adviser's marketing during examinations to ensure they are complying with the new changes to the rule. For more information regarding the compliance and requirements for advertising and marketing, refer to Rule 206 (4)-1 under the Investment Advisers Act of 1940.