



**COLORADO**

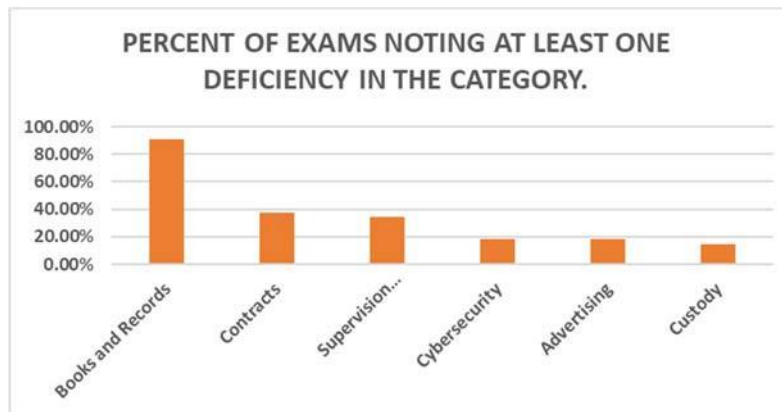
Department of  
Regulatory Agencies

Division of Securities

## Colorado Division of Securities 2023 Investment Adviser Examination Priorities

The Colorado Division of Securities (the “Division”) 2023 investment adviser examination priorities appear below.<sup>1</sup> While not an exhaustive list of compliance issues covered during an examination, the priorities reflect a focus by the Examinations Staff of the Colorado Division of Securities (the “Staff”) on common deficiencies and a series of new rules adopted by the Commissioner that will likely become effective in early 2023.

**Common Deficiencies:** The Staff expects to continue to focus on common deficiencies that have been consistently identified over the last several years. To assist firms in evaluating their compliance programs, the Staff is providing a list and summary of the most frequently identified compliance areas cited in deficiency letters that were sent to Colorado licensed investment advisers in 2022.



### 1. Books and Records Rule 51-4.6(IA)

The Books and Records Rule requires advisers to keep and maintain certain books and records relating to their investment advisory business. Many advisers examined by the Division did not maintain all required books and records or provided records that were inaccurate and outdated or not readily available for the Division’s review. The most common records deficiencies included failing to provide a complete set of financial statements, written supervisory procedures, and updated comprehensive client suitability information including notes from client meetings that serves as the basis for

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<sup>1</sup> The views expressed herein are those of 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.

every recommendation. **See a summary of adopted changes to Rule 51-4.6(IA) below.**

## **2. Contracts Rules 51-4.6(IA)(10) and 51-4.8(IA)(P)**

The Contract Rules require advisers to enter and maintain written advisory contracts with every client. The contracts are required to include certain material terms and cannot be inconsistent with the ADV Part 2. Staff frequently identified deficiencies under this rule involving firms that failed to update contracts with material changes such as a change in fees or a change in services. Another serious deficiency involved invoiced fee calculations that were not consistent with the advisory contract. Firms should take the time to compare their advisory contract, Form ADV Part 2 Item 5, and actual fee billing practices to ensure all are consistent. It is also advisable for firms to review whether new and terminating clients' fees are being properly prorated for partial billing periods. **See a summary of adopted changes to Rule 4.8(IA)(P) below.**

## **3. Supervision Rule 51-4.6(IA)(18)**

The Supervision Rule requires advisers to maintain written policies and procedures to ensure compliance with the securities laws. The most common deficiencies in this area concerned advisers not maintaining procedures relevant to their business model, using generic templates that were insufficiently customized, or having procedures that lacked detail on the actions taken to complete a compliance task. Another frequently identified issue involved advisers not following the practices as outlined in their written compliance manuals. **See a summary of newly adopted Rule 4.12(IA) below.**

## **4. Cybersecurity Rule 51-4.14(IA)**

The Cybersecurity Rule requires advisers to establish and maintain written procedures to ensure cybersecurity. Common deficiencies identified by the Staff in this area involved firms not including cybersecurity as part of an annual risk assessment or not disclosing to clients the risks of using electronic communications.

## **5. Advertising Rule 51-4.8(IA)(M)**

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 that does not comply with Rule 206 (4)-1 under the Investment Advisers Act of 1940. The SEC Marketing Rule became effective in 2022 and has many complexities that advisers should review. A deficiency commonly identified by Staff involved advisers' websites or social media sites containing outdated and/or inaccurate information inconsistent with the firm's practices. Another common deficiency involved firms failing to disclose whether they were licensed investment advisers in Colorado.

## **6. Custody Rule 51-4.10(IA)**

The Custody Rule requires advisers that directly deduct fees or have any authority to obtain possession of clients' fund or securities to send the client an invoice specifying

and itemizing the fee. Advisers need to ensure that clients receive itemized invoices in all instances, including when a third party asset manager deducts fees. A common deficiency the Staff identified in this area concerned third party asset managers providing insufficiently detailed invoices. The adviser is responsible for detailed invoices and must either directly provide the itemized invoices or ensure that the third party asset manager provides the sufficiently itemized invoice.

**New Adopted Rules:** The Staff expects that one of the Division's top examination priorities in 2023 will be assisting advisers in complying with new rules. The Securities Commissioner has recently adopted several new rules that are expected to Colorado investment advisers and investment adviser representatives' recordkeeping requirements. A summary of the adopted rules can be found below. Advisers should start considering how they will comply with these new requirements. Statutes and rules governing the Division's examination authority and books and records requirements are located on the Division's website at [Statutes and Rules](#).

### **Sales Representative Unfair and Dishonest Dealings and Reg BI**

- 51-4.7(C) was amended to incorporate U.S. Securities & Exchange Commission Regulation Best Interest and include a violation of the rule as unfair and dishonest dealings.

### **Investment Adviser Representative Continuing Education**

- 51-4.4.1(IA) creates a continuing education requirement for all licensed investment adviser representatives. The first reporting period is expected to begin in 2024, and the Division will be providing further information to firms. This rule adopts a North American Securities Administrators Association (NASAA) model rule.

### **Books and Records Rules 51-4.6(IA)**

- 51-4.6(IA)(3) will require firms to keep additional information on their memorandum of trade orders (trade blotter). In the memorandum, firms with non-discretionary trading authority will now be required to document information concerning the client approval of trades including the date and the method by which the adviser received the client approval. Additionally, firms will be required to document trade orders entered in error including the actions the adviser took to correct the orders entered in error.
- 51-4.6(IA)(5) will require firms to also maintain copies of "invoices" in addition to bills and statements of the investment adviser.
- 51-4.6(IA)(6) clarifies that investment adviser's financial statements prepared in accordance with GAAP, must include an income statement and a cash flow statement in addition to a balance sheet.
- 51-4.6(IA)(7) expands the records requirement of firms to *all* written communications relating to the business of the investment adviser.

- 51-4.6(IA)(8) will require firms as part of their obligation to maintain a record of all clients and accounts which should include the value of each account, a list of the services provided, and identification of those accounts in which the adviser has discretionary authority.
- 51-4.6(IA)(16) will require firms to maintain a written summary of all *oral* complaints in addition to the current requirement to maintain written communications concerning litigation and customer complaints.

#### **Dishonest and Unethical Conduct Rules 51-4.8(IA)**

- 51-4.8(IA)(P) provides clarity on the information that firms are required to disclose in investment advisory contracts with clients. It will be dishonest and unethical conduct for advisers to enter into or renew any investment advisory contract unless such contract is in writing and discloses the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or non-performance, whether the contract grants discretionary power to the adviser and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract. This rule adopts a NASAA model rule.

#### **New Investment Adviser Written Policies and Procedures Rules**

- 51-4.12(IA)(A) clarifies the written policies and procedures that a firm must maintain and will make it unlawful for firms to provide investment advice to clients unless the firm establishes, maintains, and enforces written policies and procedures for compliance, supervision, physical and cyber security, a code of ethics, material non-public information, and business continuity and succession planning.
- 51-4.12(IA)(B) requires advisers to review, no less frequently than annually, the adequacy of the policies and procedures required by this section and the effectiveness of implementation. These rules adopt a NASAA model rule.

**Getting Started:** If you are a newly licensed adviser that does not currently have a compliance program or an adviser that could improve your current program, the Division released an [Investment Adviser Guide](#) (“Guide”) in 2021 that may be helpful for you to get started or to review your recordkeeping practices. The Guide is designed to assist state-licensed firms in their compliance with the Colorado Securities Act and rules.

**Reach Out:** Investment Advisers can always call the Division with questions. Ask the main desk to speak with an examiner. We interact with hundreds of firms every year and while the Staff cannot offer legal advice, we can offer best practice recommendations on complying with certain regulations and direct you to relevant rules to review. The Division can be reached at 303-894-2320 or by email at [dora\\_SecuritiesWebsite@state.co.us](mailto:dora_SecuritiesWebsite@state.co.us).