

Being an SEC registered investment adviser

September 25, 2025

CompliGlobe Limited

Introduction to the U.S. Investment Advisers Act of 1940

- Full and fair disclosure: (1) tell the truth, (2) prove that you're doing what you said you'd do (3) how you disclosed you would do it
- Fiduciary duties
- Substantive obligations in, under and arising from the Advisers Act, other U.S. federal securities laws and the rules thereunder
- Other requirements/issues
 - Supervision
 - SEC examinations
 - Enforcement
 - Brokerage
 - CFTC scope

Who is a “U.S. person”?

- This definition is based on *residence*, as defined in [Rule 902](#) of Regulation S under the U.S. Securities Act of 1933
 - Individuals: where they *reside*
 - Partnership or corporation:
 - if not organized in a U.S. state, it is not a U.S. person; *however*
 - it *would* be a U.S. person if it was (i) organized or incorporated under the laws of any foreign jurisdiction and (ii) formed by a U.S. person principally for the purpose of investing in securities not registered under the Securities Act, unless it was organized or incorporated, and owned, by accredited investors (as defined in Regulation S who are not natural persons, estates or trusts)
 - Trusts, estates, etc: the location of a trustee, executor
 - Investment managers: generally, where its clients reside

What is an “investment adviser”?

- Under the Advisers Act, an investment adviser is any person who
 1. for compensation
 2. is engaged in the business of providing investment advice about securities: **giving or acting upon research, advice or recommendations**
 3. to others: **private fund or separately managed accounts (“SMA”)**
- Providing investment advice is
 - Discretionary: **decisions taken and effected by the adviser, no client involvement**
 - Advisory: **active client involvement - discussions and giving research, advice or recommendations but no trading: client trades on their own**
- As adviser, sub-adviser, AIFM, fund GP, trust trustee or LLC managing member
- If a non-U.S. person uses the “means of interstate commerce” (post, fax, e-mail, visit, instant messaging, social media, phone or web site access), it becomes amenable to SEC jurisdiction and must satisfy an exemption, register with the SEC, cease the activity or face an enforcement action
- A “participating affiliate”, if compliant with SEC Staff no-action letters, does not register with the SEC as an RIA

If you want to manage assets for U.S. persons?

- No involvement with the United States?
 - No need to register as an investment adviser with the SEC under the Advisers Act (“RIA”) or file a report to become a Private Fund Adviser
- You want to manage U.S. money directly in a separately managed account (“SMA”), not via a private fund
 - Satisfy the Foreign Private Adviser exemption or become an RIA
- You want to manage U.S. money *only* in a private fund
 - Use the Private Fund Adviser exemption, be an “Exempt Reporting Adviser” (“ERA”) or become an RIA
- You want to manage U.S. money in an SMA *and* in a private fund
 - If you have 15 or more U.S. clients (direct and in a private fund) or more than \$25m from any or all of these clients, you must become an RIA
- If you are not SEC registered but have an affiliate that is an RIA
 - Become a “participating affiliate”
- If eligible, use “umbrella registration” (requires compliance with five conditions)
- Under Advisers Act Section 208(d), it is unlawful to do something indirectly that you cannot do directly

U.S. regulatory disclosure obligations ...

- Beneficially own more than 5% of a class of equity security registered with the SEC under Section 12 of the Exchange Act
 - Those exercising control file Schedule 13D
 - Others file Schedule 13G
 - If one switches from passive to active, re-file on Schedule 13D
- Beneficially own more than 10% of a class of equity security registered with the SEC under Section 12 of the Exchange Act
 - File reports under Section 16(a) – Forms 3, 4 and 5
 - Subject to short swing profit liability under Section 16(b) – can't buy and sell or vice versa in a six-month period and make a profit
- Exercise discretion over more than \$100m in Exchange Act Section 12 registered securities
 - File Form 13F
- Trading over certain limits, frequency
 - File 13H
- Possible corporate action filings

Fiduciary duties

- Every investment adviser* subject to the Advisers Act is a fiduciary

“[t]he Investment Advisers Act of 1940 reflects a ... congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.”

“[I]nvestment advisers are fiduciaries of their clients, and therefore owe those clients “an affirmative duty of utmost good faith.”

SEC v Capital Gains Research Bureau, 375 U.S. 180 (1963)

- This duty arises under Section 206, the Advisers Act antifraud provision
- Duties of loyalty *and* care
- Note the June 2019 Standard of Conduct Interpretation and the August 2022 Guidance

* Whether or not SEC registered

Fiduciary duties of loyalty and care*

- The duty of care includes, among other things
 - duty to provide advice that is in the best interest of the client: suitability and a reasonable basis for recommendations
 - duty to seek best execution
 - duty to provide advice and monitoring over the course of the relationship
- The duty of loyalty requires that an adviser not place its own interest ahead of its client's interests
 - full and fair disclosure of all material facts relating to the advisory relationship
 - eliminate or at least make full and fair disclosure of all conflicts of interest and the means to address (mitigate) them

* 2019 Standards of Conduct Interpretation

Disclosures – 4Cs compliant

- All your disclosures and documents must be 4Cs compliant
 - Current
 - Materially Correct
 - Clear
 - Concise

Materiality

- Information is “material” if “there is a substantial likelihood” that a reasonable investor would consider it significantly altered the “total mix” of information available. *Basic v Levinson*, 485 U.S. 224 (1988) and *TSC Industries Inc v Northway Inc*, 426 U.S. 438 (1976)
- The SEC will investigate and bring enforcement actions for materially deficient disclosures or omissions – in a Form ADV or where there is a private fund Advisers Act Rule 206(4)-8
- “Half-truths” are actionable
- True statements that create a materially misleading impression would support claims for securities fraud
- Information about one company that is material to it may also be material to another company if there is a sufficient market connection - “shadow insider trading”. See *SEC v Panuwat*, (N.D. Cal, November 20, 2023)

“Key aspects” of a Compliance program

- Board-level commitment and management buy-in: “compliance tone at the top”
- Based on the adviser’s business
 - Identify risks and record these in the Compliance Risk Inventory (“CRI”)
 - Identify material conflicts of interest and the means to address (mitigate) them, record them in the Conflicts Log and reconcile to Form ADV disclosures
- Have written policies and procedures (“WPPs”) that reflect Advisers Act requirements, risks, conflicts and your own policies and procedures - the Compliance Rule, Rule 206(4)-7
- Disclosure: Form ADV Parts 1, 2A and 2B, Form CRS and the Reg S-P Privacy Statement
- Annual review
- Code of Ethics, Rule 204A-1
- Monitoring and forensic testing
- Conduct, document and keep records of your annual review
- CCO: empowered and Advisers Act knowledgeable and competent
- Business Continuity and Cybersecurity Plans – current and tested regularly
- Compliance training

Compliance program architecture overview

- “Compliance tone at the top”: set by management, must be demonstrable and capable of being evaluated
- CRI: your Advisers Act Compliance program must reflect the risks particular to you. Must identify and inventory your compliance risks
- Conflicts Log: you must identify, disclose and address the material conflicts of interest related to your advisory business and the means to address these, record all of this and disclose in Form ADV Part 2A
- Written policies and procedures: “reasonably designed” to prevent violations of the Advisers Act by you and your supervised persons. Reflects Advisers Act requirements, relevant rules, identified risks and conflicts of interest and the means to address them and internal policies and procedures
- CCO: this person must be knowledgeable and competent in the federal securities laws and have the authority to administer the SEC Compliance program. They can delegate duties but not responsibilities
- Code of Ethics: you will need a Code of Ethics that complies with Advisers Act Rule 204A-1. It covers: standards of conduct; personal account trading and review; requirement to comply with the federal securities laws; receipt of the Code, acknowledgment and compliance with it; and report violations

- Form ADV Part 1: factual information about you. This includes disclosure items such as AUM, disclosure of affiliates and other “control persons.” File annually and for a material change
- Form ADV Part 2A: this is the “Plain English” narrative of your business, fees, conflicts and the means you take to address or mitigate these conflicts and other key disclosures. This is a public document. File this annually and for a material change
- Form ADV Part 2B: covers persons who perform the investment advisory function
- Form CRS: Client Disclosure, “plain English” supplement
- Regulation S-P Privacy Statement
- Training: you will need compliance training and periodic “reinforcement” training on your policies and procedures, as well as “hot topics”.
- Annual Review: you will have to conduct an annual review of the adequacy and effectiveness of your written policies and procedures, including the CCO. This includes analysis and testing
- Compliance calendar: this will help you organize and set out the tasks that you would perform that comprise your compliance program, including the tests that comprise your monitoring and forensic testing program
- Monitoring and forensic testing: these are the tasks and tests that you perform that help validate your written policies and procedures

Possible Compliance policies and procedures ...

- Protect Confidential Client Information
- Prevent misuse of Inside Information
- Code of Ethics and personal trading
- Safekeeping of client assets
- Brokerage selection
- Trading: best execution, aggregation, allocation of orders, cross trading
- Adherence to investment objectives
- Ban against certain principal transactions
- Research and softing arrangements
- Breaches
- Trade errors
- Fees and valuations
- Form ADV and Form CRS filing and delivery
- Exchange Act filings (13D, 13G, 13F, 13H, Section 16, Form PF, others)
- Outside activities
- Private fund disclosures
- Form PF
- Proxy voting
- Risk and conflicts of interest disclosure and management
- Advertising
- Use of solicitors
- Confidentiality
- Privacy and Reg S-P
- Anti-money laundering/financial crime
- Gifts and entertainment
- Political contributions: pay to play
- Supervisory functions
- Role of CCO
- Maintenance of books and records
- Business continuity plan and remote working
- Bribery and foreign corrupt practices
- Whistleblowers
- Cybersecurity
- Identity theft red flags
- *Others that are bespoke to you*

“Compliance Tone at the Top”

- The environment a firm's leadership establishes in which compliance is a bedrock value and a critical component of every employee's job
- It is *demonstrated*, not discussed, by management and the directors
- A key consideration that the Division of Examinations (“EXAMS”) will look for in an adviser
 - is there a tone at the top? What is it and its framework, in terms of culture, environment, discharge of fiduciary duty? How is it documented?
 - what are a firm's "lines of defence"? For business units, who must supervise, how are they responsible for compliance (noting that the CCO is the "trusted adviser")? What does compliance do? What is the role of audit and/or oversight? How does senior management "backstop" this?
 - in sum, "who is responsible for "record keeping", "pre-trade allocation", "best execution monitoring and testing" and so on, and who checks *these* people?"

The Compliance Rule – Rule 206(4)-7

1. Adopt and implement written policies and procedures *reasonably designed to prevent* violation by the adviser and its supervised persons of the Advisers Act and the rules thereunder
2. Designate a CCO (under an SEC interpretation, the CCO must be competent, knowledgeable and empowered with responsibility and authority)
3. Review “not less than annually” the adequacy and effectiveness of the Compliance program and its policies and procedures

Risks and conflicts of interest

“Each adviser, in designing its policies and procedures, should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm’s particular operations, and then design policies and procedures that address those risks.”

“Compliance Programs of Investment Companies and Investment Advisers”, Advisers Act Release 2204, 68 F.R. 74714, at 74720 (December 24, 2003), <https://www.sec.gov/rules/final/ia-2204.pdf> (“Compliance Release”)

SEC v Brite Advisors USA, Inc., No. 23-cv-10212 (S.D.N.Y. November 21, 2023), <https://www.sec.gov/files/litigation/complaints/2023/comp25900.pdf>

Western Asset Management Company, Admin Proc 3-15689 (January 27, 2014), <https://www.sec.gov/litigation/admin/2014/ia-3763.pdf>.

Risk management – the CRI

- The with conflicts of interest management, the “*reasonably designed*” language in Rule 206(4)-7
- Links the business to the controls
- Each risk is addressed/mitigated in a control
- Review regularly the controls to ensure they continue to address risks
 - How significant a risk of a violation of the Advisers Act and rules?
 - Cost-benefit analysis to address each risk
 - What is changing and how do we keep up with change?
- Update controls when required
- Conduct “mock SEC examination”
 - Considered to be a control
 - Anticipate inspection
- Failure to respond to issues means bad controls

Conflicts of interest

- Identify material conflicts, the effect(s) that they have on the adviser and its clients and the means to resolve them
- Disclosure in Form ADV Part 2A must be 4Cs compliant so that a reasonable prospect or client understands clearly the conflict and how it is addressed
- Disclosures in the Conflicts Log and Form ADV Part 2A must match
- Tough SEC enforcement actions for no or deficient disclosure or failure to act in accordance with disclosures
 - Conflicts are everywhere!!!! <http://www.sec.gov/news/speech/conflicts-everywhere-full-360-view.html#.VPXI-VhybKY>
- Advisers may be sued if their disclosures are materially incorrect, in particular, there is a material omission, such as an undisclosed conflict of interest
- Advisers can be sued for failure to disclose conflicts and using “precatory” language – “may” or “might”

Examples of conflicts involving advisers

- Outside Business Interests
 - *In the Matter of BlackRock Advisors* (April 20, 2015)
- Front Running
 - *SEC v Lawrence Billimet et al*, (December 2022)
- Expenses and Fees
- Misuse of Client Brokerage
 - Jack Allen Pirrie (July 29, 1991) (misuse of soft dollar credits for error correction losses)
- Favouring Clients
 - *Monetta Financial Mgmt.* (February 26, 1988) (allocation of scarce investment opportunities to favoured clients)
 - *Highland Capital Management* (September 15, 2014) (cross-trading)
- Other financial industry activities and affiliates
 - Personal and proprietary trading
 - Side-by-side management
 - Allocation of trades and investment opportunities
 - Allocation of expenses and undisclosed compensation
 - Referrals
 - Proxy voting

Outside activities

- Purpose
 - Identify, address (mitigate) conflicts of interest and disclose same in Form ADV Part 2A
 - Prevent misuse of MNPI and Confidential Client Information
- Adopt outside activities policies and procedures - SEC enforcement actions suggest that these should (a) address permitted activities, (b) require prior disclosure and clearance of outside activities (if material and under the instructions to Form ADV Part 2A Item 4), (c) state when disclosure to clients may be required and (d) mandate supervision
 - *Hamilton Investment Counsel LLC* (June 30, 2022) (CCO “knew or should have known that [the RIA’s] compliance program was inadequately implemented. Despite this, he did not make sufficient changes to the design and implementation of [the RIA’s] compliance program” Further, CCO “received communications from a [PM] regarding an [outside activity (“OBA”)] ... but did not require the [PM] to complete and submit the formal reporting form required for OBAs ... and did not conduct sufficient review to determine whether the OBA presented any conflicts of interest, as he was required to under the compliance manual. Furthermore, [CCO] did not take sufficient steps to verify ... [the OBA] was disclosed to clients ... ” or ensure compliance with the RIA’s WPPs)
 - *BlackRock Advisors, LLC*, (April 20, 2015) (no outside activities WPPs; portfolio manager involved in family energy business formed joint venture with publicly traded company held by mutual fund and other clients of adviser; CCO inaction)

“Not less than annual” review

- Must *at least* review annually the adequacy and effectiveness of the WPPs
- Should consider
 - Any compliance matters that arose during the previous year
 - How you responded to breaches and trade errors
 - Any changes in the business activities of the adviser or its affiliates
 - Any changes in the Advisers Act or applicable laws, rules or regulations
 - Output of monitoring and testing
- Approaches
 - Rolling topical review
 - Event-driven review: compliance event, business event, &c
 - “At one time” annual review
- Based on your risks and business, use the approach that works for you
- Document and learn from it!

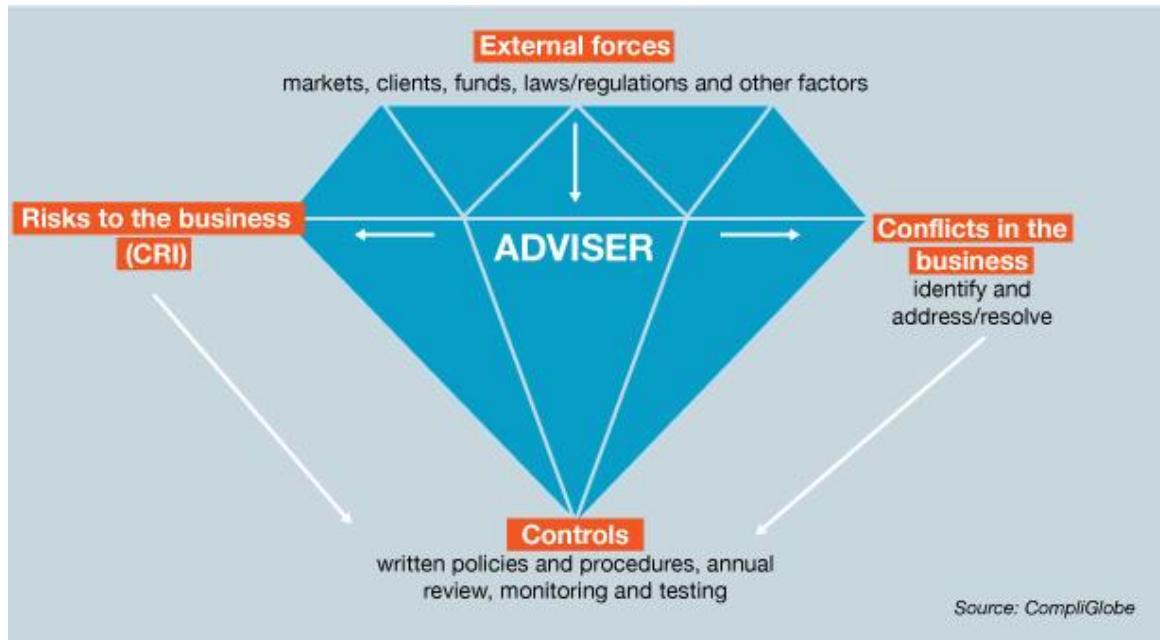


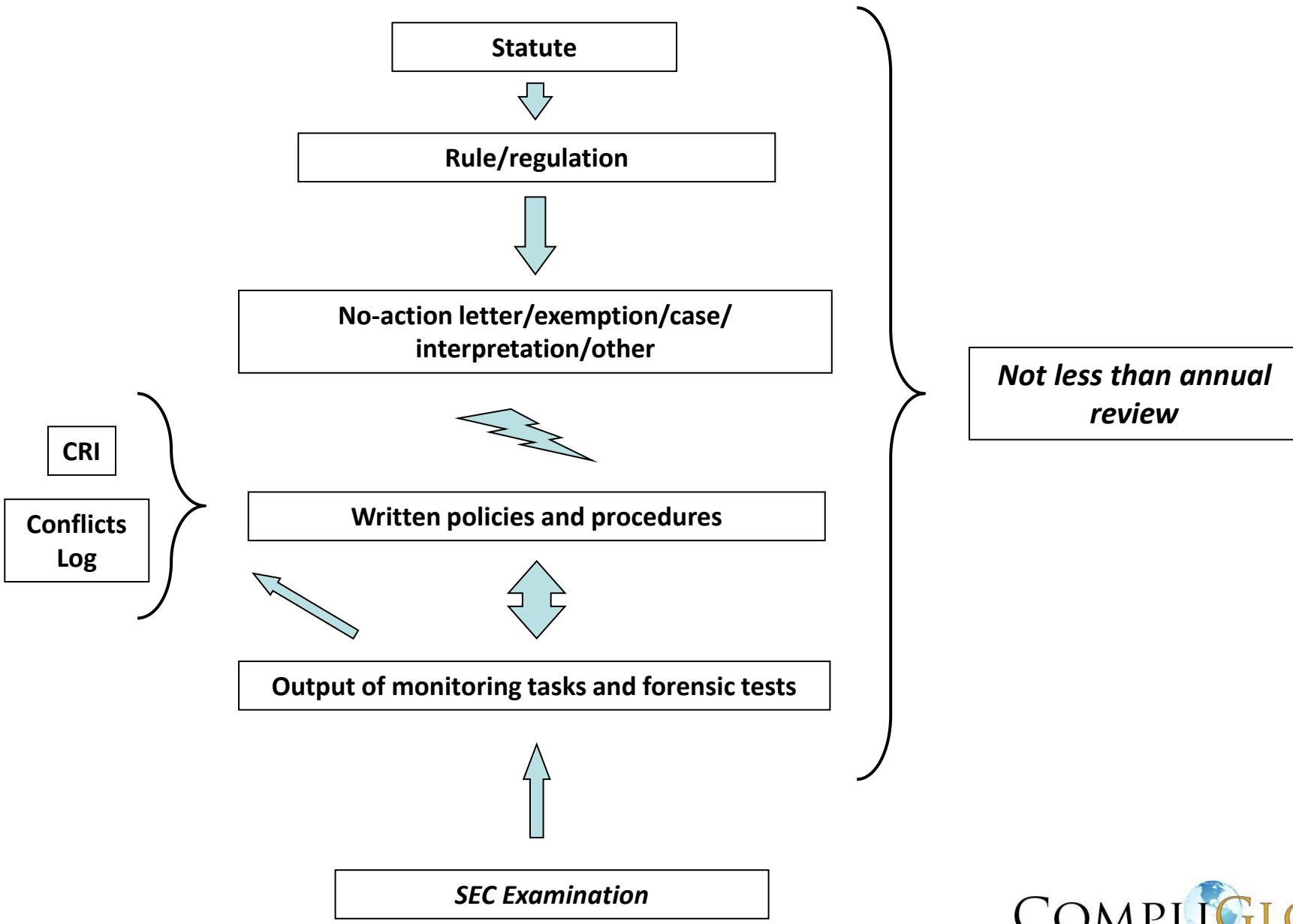
Monitoring and testing

- Monitoring and testing should
 - Generate data to prove that a control addresses a risk
 - Confirm whether we have the right control, generating right data, finding patterns and/or exceptions and addressing the results
 - Looking for the right things? Generating wrong data?
- Review the output of monitoring and testing
 - Look for patterns and outliers
 - Cross test e.g., personal trading against gifts and entertainment, recommendations, orders, trading and allocations
- Lack of testing demonstrates ineffective controls
- Failure to spot or respond to issues means bad controls
- Address issues *when* they arise
- Never ignore anything
- Change when required

Chief Compliance Officer

- Designation of a single individual
- Advisers Act competent and knowledgeable
- Empowered with full responsibility and authority
- When is a CCO personally liable?
 - Principal actor – cause the breach
 - Aider and abettor
 - Ignored *Red Flags*
 - “Dual hatting” (operations, marketing or even legal) and violation in the other area
 - Dropped the ball – note *Hamilton Investment Counsel*
 - Failure to supervise? - note FAQs on liability of Compliance and Legal Personnel
- When “not liable”
 - When they attempted to mitigate the risk or rectify the situation, documented efforts and did not stop until the situation was rectified
 - When they reported resource or other concerns to management , documented efforts and did not stop until the situation was rectified





Failure to supervise

- Under Advisers Act Section 203(e)(6), must supervise with a view to *preventing* violations of the U.S. federal securities laws
 - All persons acting on your behalf
 - Includes associated persons of a participating affiliate, solicitors, third parties and affiliates providing services to the adviser
 - Each violation of the Advisers Act and the rules thereunder may be a failure to supervise
- Under Advisers Act Section 203(f), the SEC may bar or suspend *individual supervisors* for their supervisory failures and violations of Section 203(e)(6)
- President, managing director/partner, CEO and partners/directors responsible unless they have reasonably and properly delegated responsibilities to another person and document they do not know/have reason to know that such person is not properly performing their duties
- What you must do
 - Implement and administer policies and procedures reasonably designed to prevent and detect violations of law
 - Implement and administer policies and procedures reasonably designed to ensure proper supervision and document same
 - Keep evidence that supervisor discharged the duties and obligations under such procedures without reasonable cause to believe they were not being complied with

Who are supervisors?

- Every supervisor – and persons in an affiliate if they have responsibilities for RIA staff
- An individual is a supervisor when you or your organizational documents identify them as another person's supervisor
- A person is a supervisor when asked or instructed to be responsible for another person, or takes charge under instructions or on their own
- This is a “facts and circumstances” test, asking whether a person has the responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue
- CCOs are not supervisors in or for the business - except for the Compliance staff that they actually supervise
- Cannot “delegate” the responsibilities inherent in supervision
- Cannot say: “watch out for him/her/it and let me know if anything comes up” – requires follow up and a degree of involvement

Enforcement actions and failure to supervise

- *Senvest* (April 2024)
 - Enforcement action against an RIA involving off-channel communications, Code of Ethics personal account dealing breaches and failure to supervise
 - According to the SEC, *“Senvest failed to enforce the policies and procedures contained in the code of ethics section of its compliance manual requiring employees to obtain pre-clearance for all personal securities transactions and requiring supervisory review of employees’ quarterly transaction and holdings reports. By failing to adequately implement these policies and procedures, Senvest failed to timely detect pre-clearance failures. Between January 2019 and January 2021, certain Senvest employees traded securities in personal accounts without obtaining pre-clearance. In one quarter in 2020, for example, a managing director effected numerous securities transactions in a personal account without pre-clearance, including transactions in a security owned by a Senvest-managed fund.”*
- WhatsApp/“off-channel communications” cases (April and February 2024, August and September 2023, September 2022 and December 2021)
 - Dozens of firms and over \$2 BILLION in penalties
 - All had WPPs to prohibit the use of WhatsApp and other chat services
 - Yet all did little to nothing to prevent the use of WhatsApp and other off-channel communications, thus failing to keep books and records of those communications and failing to supervise those conversations
 - Management and supervisors violated firm WPPs and used off-channel communications themselves
- *Sciens Investment Management* (May 2023)
 - Failure to adopt and implement WPPs concerning the valuation of private fund portfolio investments, particularly with respect to Level 3 (hard-to-value) assets
 - Firm’s auditors had identified concerns and issued qualified opinions in the fund’s annual financial statements

Enforcement actions (cont'd)

- *Horter Investment Management* (November 2022)
 - Firm and its CEO failed to implement heightened supervision of a high-risk representative with multiple red flags
 - Firm and CEO failed to conduct supervisory inspections of branch/remote offices, despite warnings from SEC examiners and compliance consultant
 - CEO's attempts to delegate supervisory authority were unreasonable and ineffective, and CEO retained liability
 - CCO avoided liability because she advised the firm of concerns and the need for additional WPPs
- *Frontier Wealth Management* (September 2021)
 - Failure to adopt and implement suitability policies for sale of complex products (private feeder fund) to clients
 - Failure to implement adequate supervisory system, failure to assign a supervisory responsibility for review and monitoring, and failure to train staff and supervisors on suitability and fiduciary obligations
- *In the Matter of Dawson-Samberg* (August 2000)
 - Treasurer responsible for administering soft dollar program failed to uncover misuse of soft dollars, failed to disclose truthful soft dollars uses and failed to manage travel agent and staff on use of company credit card with respect to proper expenditures
 - Could not use the Advisers Act Section 206(e)(6) affirmative defence because the supervisory policies and procedures were deficient and she was negligent in supervision
 - Could not use this defence because she was not properly trained, did not understand responsibilities
- *First Western Capital Management* (July 2020)
 - Liability under Section 203(e)(6) and Rule 206(4)-7 from violations of other securities laws (Securities Act of 1933 prohibition on sales of Rule 144A restricted securities to non-QIBs)

Director liability

In the Matter of J. Kenneth Alderman, CPA; Jack R. Blair; Albert C. Johnson, CPA; James Stillman R. McFadden; Allen B. Morgan Jr.; W. Randall Pittman, CPA; Mary S. Stone, CPA; and Archie W. Willis III, Admin Proc 3-15127 (December 10, 2012)

- Individual directors were sued
- “The Directors did not specify a fair valuation methodology pursuant to which the securities were to be fair valued. Nor did they continuously review the appropriateness of the method to be used in valuing each issue of security in the company’s portfolio. Instead, the Directors delegated their responsibility to determine fair value to a valuation committee without providing any meaningful substantive guidance on how those determinations should be made. In addition, they made no meaningful effort to learn how fair values were actually being determined.”
- “These failures were particularly egregious given that fair valued securities made up the majority—and in most cases upwards of 60%—of the Funds’ net asset values (“NAVs”).”

Best execution

- Every RIA has a fiduciary duty to seek best execution
- Key criterion is “whether the adviser selects the transaction which “represents the best qualitative execution for the ... account”.”

In the Matter of Fidelity Management & Research Company and FMR Co., Inc., Administrative Proceeding 3-12976 (5 March 2008) (citing various authorities) (“*Fidelity*”)

- Adviser has fiduciary duty to disclose all the elements involved in seeking best execution as well as broker selection – Form ADV Part 2A
- Must engage in forensic testing to prove that
 - best execution elements and disclosures (Form ADV Part 2A) are correct, current and being followed
 - Best execution was sought according to evaluation factors
- Failure to disclose is actionable under *Fidelity*

Books and records

- Section 204 of the Advisers Act and Rule 204-2 require that an adviser makes and keeps “true, accurate and current records relating to its business”
 - currently in effect
 - in effect any time during the past five years
 - Keep five years, first two in office
- Includes all Code of Ethics books and records, including action taken against persons that breach the Code of Ethics
- Be clear which are kept in hard copy or electronically, and protect
- Includes records of communications with clients regarding investment recommendations/advice and orders placed (off-channel communications cases)
- Treatment of books and records requirements for non-U.S. RIAs with U.S. clients and non-U.S. clients – note the Form ADV signature page certification to provide books and records directly to the Staff in an exam on request

Life cycle of a trade by an RIA exercising discretion

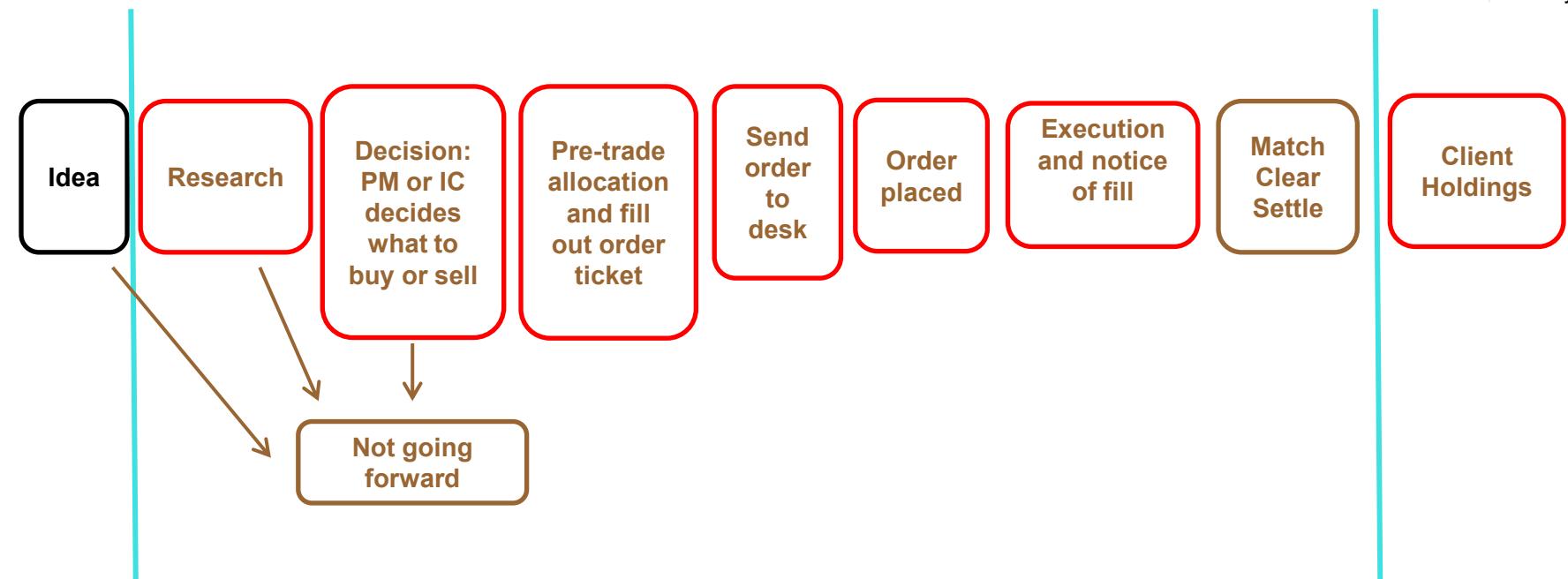


"Non-public Information" or "confidential client information" – Rule 204A-1



Pipeline

Post blackout period – X number of days



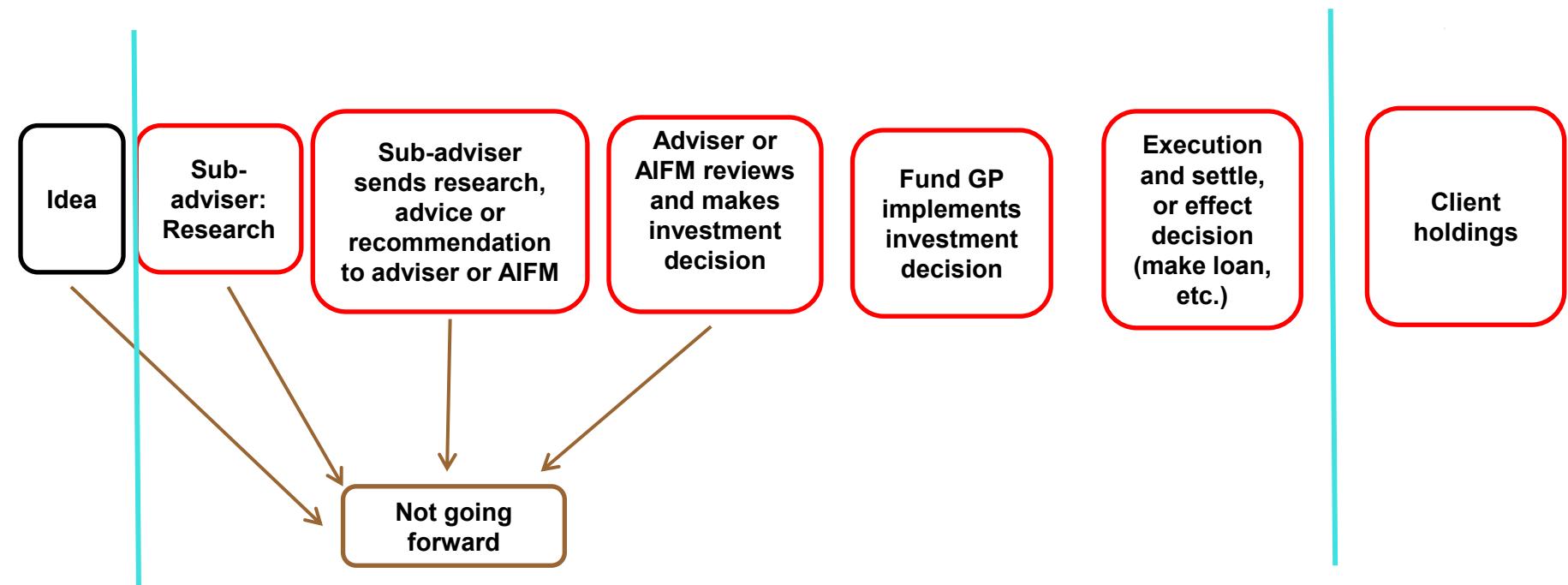
Life cycle of a trade by an adviser with a sub-adviser



"Nonpublic Information" or
"confidential client information" – Rule
204A-1
Pipeline



Pipeline



Life cycle of research, advice or recommendation for a non-discretionary client

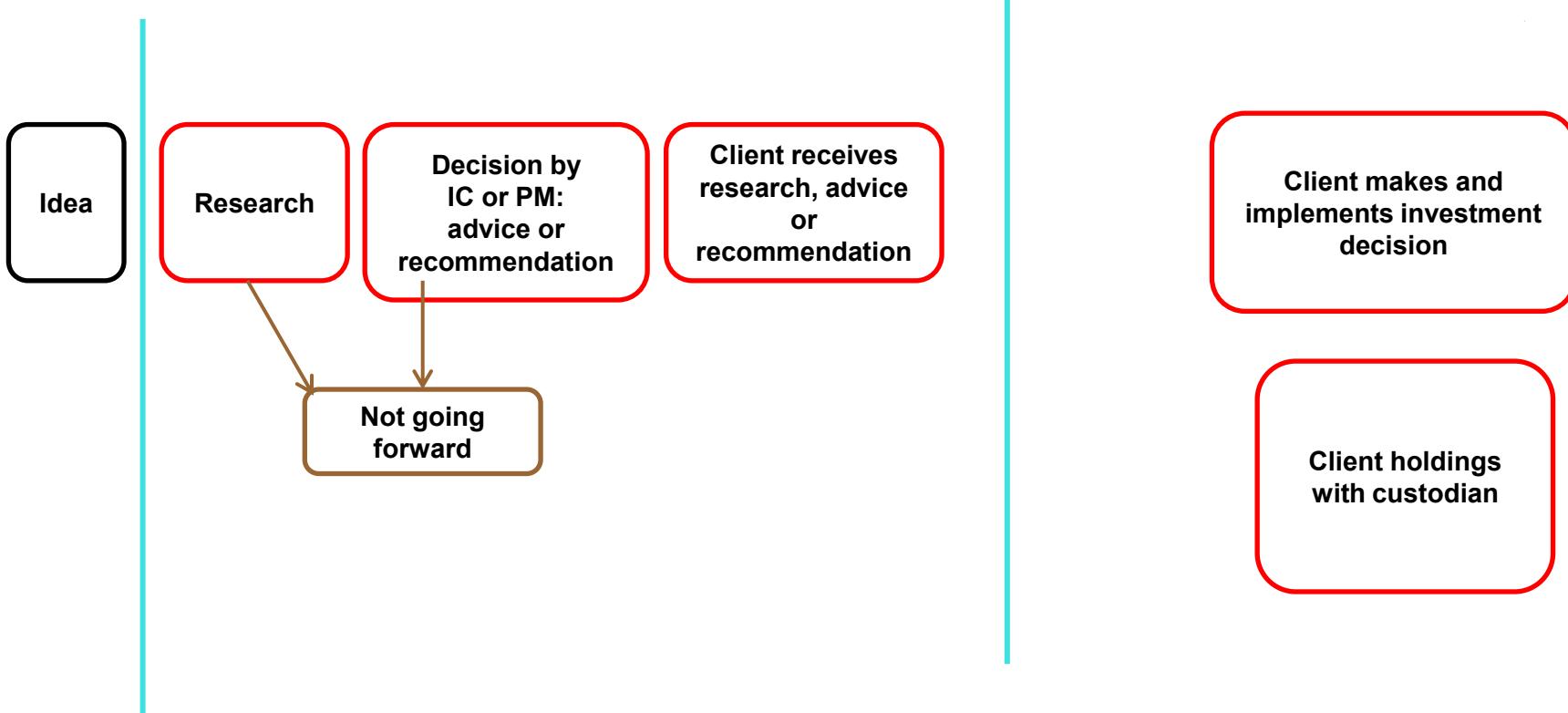


"Nonpublic Information" or "confidential client information" – Rule 204A-1



Pipeline

Investment advice



Life cycle of research, advice and/or recommendation, and brokerage, discretionary investment management



"Nonpublic Information" or
"confidential client information" –
Rule 204A-1
Pipeline

**Investment advice/
portfolio management
Advisers Act**

Idea

Research, advice or recommendation

Make decision (IC or PM) based on research, advice or recommendation

IM acts on recommendation, complete order ticket

Place order to buy or sell securities

Not going forward

Code of Ethics

- For the Adviser
 - Establish standards of conduct to be observed (based on fiduciary duty)
 - Require compliance with federal securities laws
 - Adopt, implement, issue to Supervised Persons and enforce the Code
 - Record keeping for all Code matters
 - Review of Code activities
- For Supervised Persons
 - Comply with Code
 - Comply with U.S. federal securities laws
 - Acknowledge receipt of Code (in writing)
 - Report Code violations to the CCO
- For Access Persons (and Connected Persons with whom they share beneficial ownership), Associated Persons of a Participating Affiliate and persons working for an affiliate that have access to the RIA's Confidential Client Information
 - PAD requirements

Key terms

- “*Supervised Persons*”: officers, employees and directors, plus others who provide advice and the adviser supervises or other persons who have “Confidential Client Information”
- “*Access Persons*”: Supervised Persons with Confidential Client Information
- “*Beneficial ownership*”: direct or indirect “pecuniary interest” in securities – who can get the proceeds of sales
- “*Confidential Client Information (in Rule 204A-1, called “non-public information”)*”: under Rule 204A-1 and interpretive positions in this rule’s adopting release, non-public information about purchases or sales of securities for clients (orders being worked), client holdings, portfolio holdings of affiliated funds and research, recommendations and advice given to or being used for clients
- “*Connected person*”: (a) immediate family members (b) living in the same household and (c) sharing beneficial ownership in securities – usually includes others such as live-in partners
- Persons at an affiliate that have or have access to Confidential Client Information should be treated as if they were Access Persons
- Associated persons of a Participating Affiliate caught by PAD requirements

PAD

- Access Persons and, through beneficial ownership, Connected Persons
- Access Persons are responsible for their Connected Persons
- “Reportable Securities”
 - Generally, all securities/investments
 - Includes ETFs
 - Includes certain bitcoin/digital/cryptocurrencies (fact specific)
 - Different treatment for certain U.S. and non-U.S. open-end and closed-end funds
- Requirements
 - Initial report of holdings of Reportable Securities and accounts
 - Quarterly transaction report – quarterly confirmation or providing to the CCO reports of all transactions in Reportable Securities as they occur and confirming this quarterly
 - Annual report of holdings of Reportable Securities and accounts
 - Pre-clear securities transactions
 - CCO to review and analyze all activities
- Treatment of discretionary accounts – on the RIA’s terms, must prove no control, influence or giving orders



(1) Do you or your connected person have the ability to direct individual investment decisions or have the ability to influence the decision-making third party who manages the account

Supervised Persons and Access Persons

Supervised Persons are:

- Officers
- Directors/Partners
- Employees
- Persons the RIA supervises in the giving of investment advice or recommendations to the RIA's clients

Access Persons are:

Supervised Persons that have or have access to nonpublic information (also called confidential client information)

Confidential Client Information is information about:

- Research
- Advice or recommendations given to or used for clients
- Orders being worked for clients
- Client holdings
- Portfolio holdings of reportable funds

Advertising

- Covered in the slide deck on the Marketing Rule

U.S. person IMA

- Must contain a provision prohibiting assignment without consent of client
- If a partnership, must include provision that adviser will notify clients of changes in membership
- Fiduciary duty cannot be waived
- Should not contain hedge clause (liability disclaimer) that purports to limit or waive any claim or cause of action against the adviser under state or federal law
- If advisory fees are substantially higher than other advisers, must disclose
- Performance fees only to persons meeting qualifications
- Termination restrictions cannot be inconsistent with fiduciary duty or may violate anti-fraud provisions – terminable at will for both parties

Investment objectives

- Trade in accordance with stated objectives and restrictions – when given initially and when changed
- Ensure these are clearly recorded and given to relevant staff
- Monitor and test (and document) to prove that trading is consistent with what the client specifies

Allocation

- Have clear written policy for bunching and allocations
- When trading for more than one account or portfolio, record how you propose to allocate *before placing the order*
- If you permit changes after execution, state clearly what is allowed, how it works and who approves
- Monitor and test – look for forensic evidence of cherry picking and, if found, address without delay

Cross trades

- Involve conflicts of interest (favor one client over another)
- Risk that securities may be dumped from one client account to another*
- Must exercise discretion for both clients
- The transaction is effected at the independent current market price of the security – best execution applies
- Disclosure in Mandate and Form ADV
- RIA continues to be subject to the duty to act in the best interests of its clients, including the duty to obtain best price and execution for any transaction
- Do not cross client trades with those of the RIA or affiliated funds – take competent advice

* See, e.g., Risk Alert (July 2008). See also, *Morgan Stanley Investment Mgmt. Inc.* Advisers Act Release 4299 (December 22, 2015)

Trading practices

- Cannot engage in *any* form of market abuse – fraud, manipulation or deceit, or misusing MNPI
- Note Advisers Act Rule 206(4)-8 that has a negligence standard
- Note conditions on proprietary trading and trading with clients – Advisers Act Section 206(3)
- Clear trading errors policy and procedures
 - Disclose in Form ADV Part 2A
 - Monitor and test
 - When an error arises, address it immediately
 - Keep accurate log
 - Each leg of a trade error is to be handled separately – the “wrong” trade and any corrective trades
 - Clients receive gains for each leg, the RIA bears all losses and do not net gains with losses

Valuations

- Have policies and procedures for who generates prices and values holdings
- Disclose these policies and procedures
- If the RIA or an affiliate does this, it's a conflicts of interest and must be addressed
- Risks: accurate disclosures? *SEC v Beacon Hill Asset Management LLC*,
<http://www.sec.gov/litigation/litreleases/lr18745a.htm>
- Procedure to challenge fees, valuations and *estimates*
- Mapping trading and prices
- Procedures for illiquid or hard to price securities, side pockets
- Independent assessment of process
- *GLG Partners*, December 12, 2013, www.sec.gov/litigation/admin/2013/34-71050.pdf

Fees

- Disclose in Form ADV Part 2A Item 5
 - who calculates fees
 - which valuations are used
- If the RIA or an affiliate does this, it is a conflict of interest to be disclosed with the means to address this in Form ADV Part 2A
- Record fee information in the IMA and enter correctly into systems – check it constantly
- If there are changes, note them promptly
- Always review fee information in records and systems (at last quarterly) to ensure that it is correct and current
- Address errors when they arise

Equitas, Admin Proc 3-15585 (23 October 2013) www.sec.gov/litigation/admin/2013/34-70743.pdf

In the Matter of Morgan Stanley Smith Barney, LLC, Admin Proc 3-17773 (January 13, 2017),
[https://www.sec.gov/litigation/admin/2017/34-79794.pdf](http://www.sec.gov/litigation/admin/2017/34-79794.pdf)

In the Matter of Citibank Global Markets Inc, Admin Proc 3- 17817 (January 26, 2017)
[https://www.sec.gov/litigation/admin/2017/34-79882.pdf](http://www.sec.gov/litigation/admin/2017/34-79882.pdf)

Custody

- Custody is holding or having authority over client cash or assets
- Most RIAs do not have custody
- If you have custody
 - Client assets must be held by a “qualified custodian”
 - Must have a reasonable basis to believe that the custodian is sending client account statements at least quarterly
 - If a related person has custody, must comply with additional requirements
 - Internal control report – annually
 - If no operational independence, surprise audit - annually
 - If adviser manages private funds, must provide audited financial statements to investors
 - Make sure audit is performed by PCAOB registered auditor and financial statements are provided in a timely manner
- Caution if you act on client INXS to move money or securities
- SEC Staff's FAQs on custody: www.sec.gov/divisions/investment/custody_faq_030510.htm

Identity theft “red flags” – only for consumer clients

- If you deal with consumers, you must have policies and procedures to guard against identity theft
- Risk-based assessment of advisers' activities
- Policies and procedures must be risk-based and commensurate with the way the adviser does business
- Review and report to the Board of Directors
- See e.g., Risk Alert: Safeguarding Customer Records and Information in Network Storage - Use of Third Party Security Features, May 23, 2019, www.sec.gov/ocie/risk-alert-network-storage

Regulation S-P

- Protect client information – akin to GDPR
- All clients receive Reg S-P Privacy Notice and post this on website
- See e.g.,
 - Amendments to Regulation S-P: “Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information”, 89 F.R. 47688 (June 3, 2024), <https://www.govinfo.gov/content/pkg/FR-2024-06-03/pdf/2024-11116.pdf>
 - Risk Alert: Safeguarding Customer Records and Information in Network Storage - Use of Third Party Security Features, May 23, 2019, www.sec.gov/ocie/risk-alert-network-storage
 - Risk Alert: Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P - Privacy Notices and Safeguard Policies, April 16, 2019, [https://www.sec.gov/files/ OCIE%20Risk%20Alert%20-%20Regulation%20S-P.pdf](http://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Regulation%20S-P.pdf)

Cybersecurity

- Spotlight, "Cybersecurity, the SEC and You", www.sec.gov/spotlight/cybersecurity
- "Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies", Advisers Act 5956 (February 9, 2022), <https://www.sec.gov/rules/proposed/2022/33-11028.pdf>
- "Cybersecurity: Safeguarding Client Accounts against Credential Compromise", Sept. 15, 2020, <https://www.sec.gov/files/Risk%20Alert%20-%20Credential%20Compromise.pdf>
- "Cybersecurity: Ransomware Alert" (July 10, 2020), <https://www.sec.gov/files/Risk%20Alert%20-%20Ransomware.pdf>
- "Cybersecurity and Resiliency Observations", OCIE Report (January 27, 2020), <https://www.sec.gov/files/OCIE-Cybersecurity-and-Resiliency-Observations-2020-508.pdf>
- *In re Voya Financial Advisors Inc*, Advisers Act Release 5048 (September 26, 2018), <https://www.sec.gov/litigation/admin/2018/34-84288.pdf>
- "Commission Statement and Guidance on Public Company Cybersecurity Disclosures", Securities Act Release 10459 (February 21, 2018), <https://www.sec.gov/rules/interp/2018/33-10459.pdf>.
- Risk Alert, "Observations from Cybersecurity Examinations" (August 7, 2017), <https://www.sec.gov/files/observations-from-cybersecurity-examinations.pdf>
- Risk Alert, "Cybersecurity: Ransomware Alert" (May 17, 2017), <https://www.sec.gov/files/risk-alert-cybersecurity-ransomware-alert.pdf>

“Pay to play”: Rule 206(4)-5

- Designed to prevent U.S. local or state political contributions from affecting the selection of adviser or fund
- Applies to any advisers (registered or unregistered) that provide or seek to advise U.S. state or municipal governments, including pension plans
- Includes advice through a pooled investment vehicle
- Three elements:
 - Two-year time out after contribution
 - Ban on use of a solicitor or “placement agent” that is not a “regulated person” – basically, an SEC registered broker or adviser
 - Prohibits “bundling” of contributions

Form ADV and Form CRS

Disclosures must be materially correct and 4Cs compliant - no material misstatements or omissions

Annual amendment for Form ADV

- Amend each year by filing an annual updating amendment within 90 days after the end of your fiscal year
- Update responses to all required items, Part 1A: 1, 2, 3, 6, 7, 10, and 11, including Schedules

Other-than-annual amendments required promptly (seven calendar days) if

- information in Items 1, 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.) or 11 becomes inaccurate
- information in Items 4, 8, or 10 becomes materially inaccurate
- Information in Part 2A (brochure) becomes materially inaccurate

Distribute Part 2B when account is opened, and amend and distribute when information changes

Form CRS

- amend annually and when required
- Comply fully with form requirements, <https://www.sec.gov/news/statement/staff-statement-form-crs-disclosures-121721>, or face an enforcement action, <https://www.sec.gov/news/press-release/2022-27>

Deliver when account is opened, annually and when these are amended – post on website as required

What is a “broker”?

- The term “broker” is defined in Section 3(a)(4) of the Exchange Act as “any person engaged in the business of effecting transactions in securities for the account of others”
- According to the SEC and the SEC Staff, if a firm uses the means of interstate commerce to, for U.S. persons
 - solicit and/or effect transactions in securities
 - receive unsolicited orders to buy or sell securities (beyond Rule 15a-6 FAQ 9)
 - receive transaction-based compensation, direct or indirect
 - hold itself out as such (e.g., directly or by being amenable ...)it would be a “broker” and, absent an exception, exemption, rule or no-action letter, must (1) cease the activity, (2) use an SEC registered broker-dealer or (3) register as a broker-dealer with the SEC – or face being sued by the SEC
 - Even not taking transaction-based compensation might suffice based on other activities in which the firm is engaged – in particular, solicitation
- Covers ... trading, M&A activities, soliciting the purchase or sale of the securities of a private fund

Relevant SEC Staff no-action letters

Under delegated authority, SEC Staff issued no-action letters providing that an Adviser that transmits orders to brokers/banks for execution, does not hold client funds or securities, does not solicit a client for an order, does not send the client research with the purpose of receiving an order *and* does not receive transaction-based compensation for these activities is not required to register with the SEC as a broker-dealer

- *This posits no client involvement in the process of effecting a transaction – from research through formation of advice or recommendation to placing the order, execution and matching, clearing and settlement*

No-action relief denied where the adviser's activities were more extensive e.g., soliciting brokerage or sending research

- *Client-facing involvement to obtain, receive or effect an order to buy or sell securities*

Facts and circumstances test

Exemption from BD registration: Rule 15a-6

- Exemption from SEC broker-dealer registration for non-U.S. entities that engage in certain activities with U.S. investors
- Rule 15a-6 permits (subject to conditions)
 - Sending research to and soliciting *major U.S. institutional investors*
 - Soliciting and executing trades with or for *U.S. institutional investors* - restrictions on calling, visiting and sending research
 - Executing unsolicited transactions with U.S. persons – hard to establish and, despite Rule 15a-6 SEC Staff FAQ 9 permitting “more than one” such transaction, not possible for expanded brokerage activities or solicitations
 - Engaging in “principal to principal” trades directly with registered broker-dealers and certain other entities
- Generally, Rule 15a-6 is not available when dealing with individuals – only the two enumerated types of institutions
- A U.S. person cannot rely upon Rule 15a-6

Key definitions for Rule 15a-6

- The SEC defined "*solicitation*" in 1989 when it adopted Rule 15a-6 and gave it a broad meaning – even a single act to open an account or encourage a person to buy or sell a security is a solicitation. This definition remains in place today. "Registration Requirements for Foreign Broker-Dealers", Exchange Act Release 27017, 54 F.R. 30013 (July 13, 1989)
- *Major U.S. institutional investor*: any entity that owns, controls or has under management more than \$100m in aggregate financial assets
- *U.S. institutional investor*: 1940 Act registered investment company; a bank, savings and loan association, insurance company, business development company, small business investment company or employee benefit plan defined in Securities Act Regulation D Rule 501(a)(1); a private business development company defined in Rule 501(a)(2) of Regulation D; an organisation described in Section 501(c)(3) of the U.S. Internal Revenue Code of 1986, as amended; or a trust defined in Rule 501(a)(7) of Regulation D

Selling the securities of a private fund

- In IA Release 3222 (2011) adopting the Dodd-Frank exemptions from Advisers Act registration, the SEC stated that “persons who market interests in a private fund may be subject to the registration requirements of section 15(a) under the [Exchange Act]” and that “[s]olicitation is one of the most relevant factors in determining whether a person is effecting transactions”
- This was issued by the Commission itself, not the Staff
 - The focus was the solicitation of the securities of private funds
 - It was silent on transaction-based compensation
 - It was silent on whether/if it applies in other contexts – such as the solicitation of brokerage, direct or indirect, or a client giving an adviser an order
- Firms should proceed on basis that this Commission interpretation might “trump” Staff no-action letters on brokerage and that solicitation by itself might be enough to kick-off the broker-dealer registration requirements - enforcement actions will “clear the way”

SECURITIES AND EXCHANGE COMMISSION	6. No
17 CFR Part 275	7. Rep Cap
[Release No. IA-3222; File No. S7-37-10]	8. Is a
RIN 3235-AK81	9. Ap
Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers	10. Gr
AGENCY: Securities and Exchange Commission.	B. Exe Sole \$15 Man
ACTION: Final rule.	1. Adv 2. Priv 3. Ass 4. Uni C. For 1. Clie 2. Priv 3. In t 4. Pla

80a-3), but for section 3(c)(1) or 3(c)(7) of that Act.”

⁹ Interests in a private fund may be offered pursuant to an exemption from registration under the Securities Act of 1933 (15 U.S.C. 77) (“Securities Act”). Notwithstanding these exemptions, the persons who market interests in a private fund may be subject to the registration requirements of section 15(a) under the Securities Exchange Act of 1934 (“Exchange Act”) (15 U.S.C. 78o(a)). The Exchange Act generally defines a “broker” as any person engaged in the business of effecting transactions in securities for the account of others. Section 3(a)(4)(A) of the Exchange Act (15 U.S.C. 78c(a)(4)(A)). *See also Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, Exchange Act Release No. 44291 (May 11, 2001) [66 FR 27759 (May 18, 2001)], at n.124 (“Solicitation is one of the most relevant factors in determining whether a person is effecting transactions.”); *Political Contributions by Certain Investment Advisers*, Investment Advisers Act Release No. 3043 (July 1, 2010) [75 FR 41018 (July 14, 2010)], n.326 (“Pay to Play Release”).

Finders

- Finders or solicitors must be registered as a broker with the SEC
- Be aware of the *Ranieri* case (March 2013) and its implications
 - A consultant solicited investors for a fund and was paid fees for this, but never registered with the SEC as a broker
 - It was argued that the consultant did no more than make initial introductions
 - According to the SEC, the consultant went “far beyond” that

“[the finder] sent private placement memoranda, subscription documents, and due diligence materials to potential investors, and urged at least one investor to consider adjusting portfolio allocations to accommodate an investment with [the adviser]. [The finder] provided potential investors with his analysis of the strategy and performance track record for [the funds], and also provided confidential information identifying other investors and their capital commitments.”

William M. Stephens, <http://www.sec.gov/litigation/admin/2013/34-69090.pdf>

Ranieri Partners LLC and Donald W. Phillips, <http://www.sec.gov/litigation/admin/2013/34-69091.pdf>

- Expect the SEC to issue a concept release/rulemaking proposal on finders in Q4 2025

“Inside information” (“MNPI”), “trading” and “tipping”

- It is illegal to trade or tip when in possession of MNPI
- It relates to *any* activity involving securities, whether trading or in the context of a merger, tender offer or exchange offer – and it also extends to derivatives
 - whether listed or unlisted securities
 - Sound Point Capital Management, Advisers Act Release 6666 (August 26, 2024) <https://www.sec.gov/files/litigation/admin/2024/ia-6666.pdf> (misuse of MNPI in connection with trades in private CLOs)
 - Marathon Asset Management, Advisers Act Release 6737 (September 30, 2024) <https://www.sec.gov/files/litigation/admin/2024/ia-6737.pdf> (misuse of MNPI obtained from bankruptcy creditors committees for distressed corporate debt)
 - whether trading or in the context of a merger, tender offer or exchange offer, bankruptcy proceedings (also extends to derivatives)
 - Silver Point Capital L.P., Litigation Release 26202 (December 20, 2024) <https://www.sec.gov/enforcement-litigation/litigation-releases/lr-26202> (misuse of MNPI received in connection with its role on bankruptcy creditor committees for public debt)
- One may be sued by the SEC (civil liability) or prosecuted by the authorities in the USA or in a home country (criminal prosecution), or both
- In the United States, this is not “unpublished price-sensitive information”
 - U.S. law focuses on the information itself
 - Impact on the price is not applicable
 - No “specific or precise” test

Financial crime

- Generally
 - Fraud, manipulation and deception
 - AML: RIAs not subject per se to AML requirements, save for reporting suspicious transactions
 - Follow home country AML and financial requirements
- See also FCPA, OFAC requirements and terrorist financial controls

Foreign Corrupt Practices Act

- It's an anti-bribery statute
- It's a books and records and controls statute
- It requires internal controls
- Paying or offering to pay anything of value directly or indirectly to any "foreign official" to influence corruptly any official act or decision; inducing a violation of a lawful duty; or securing any improper advantage in order to obtain or retain business for any person



Bribery offense

- *Paying or offering to pay*
- Anything of value
- *Directly or indirectly to*
- Any "*foreign official*" to
- *Corruptly influence* any official act or decision inducing a violation of a lawful duty or securing any improper advantage
- In order to *obtain or retain business for any person*

[PRESS RELEASE](#)



SEC Charges BHP Billiton With Violating FCPA at Olympic Games

FOR IMMEDIATE RELEASE

2015-93

Washington D.C., May 20, 2015 — The Securities and Exchange Commission today charged global resources company BHP Billiton with violating the Foreign Corrupt Practices Act (FCPA) when it sponsored the attendance of foreign government officials at the Summer Olympics.

BHP Billiton agreed to pay a \$25 million penalty to settle the SEC's charges.

An SEC investigation found that BHP Billiton failed to devise and maintain sufficient internal controls over its global hospitality program connected to the company's sponsorship of the 2008 Summer Olympic Games in Beijing. BHP Billiton invited 176 government officials and employees of state-owned enterprises to attend the Games at the company's expense, and ultimately paid for 60 such guests as well as some spouses and others who attended along with them.

Sponsored guests were primarily from countries in Africa and Asia, and they enjoyed three- and

Related Mat

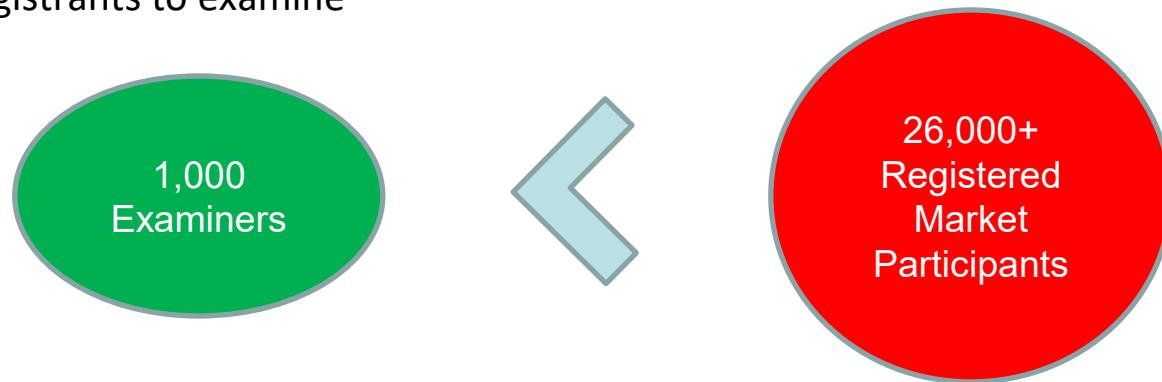
- [SEC order](#)
- [Summaries](#)
- [Spotlight on](#)

Examinations

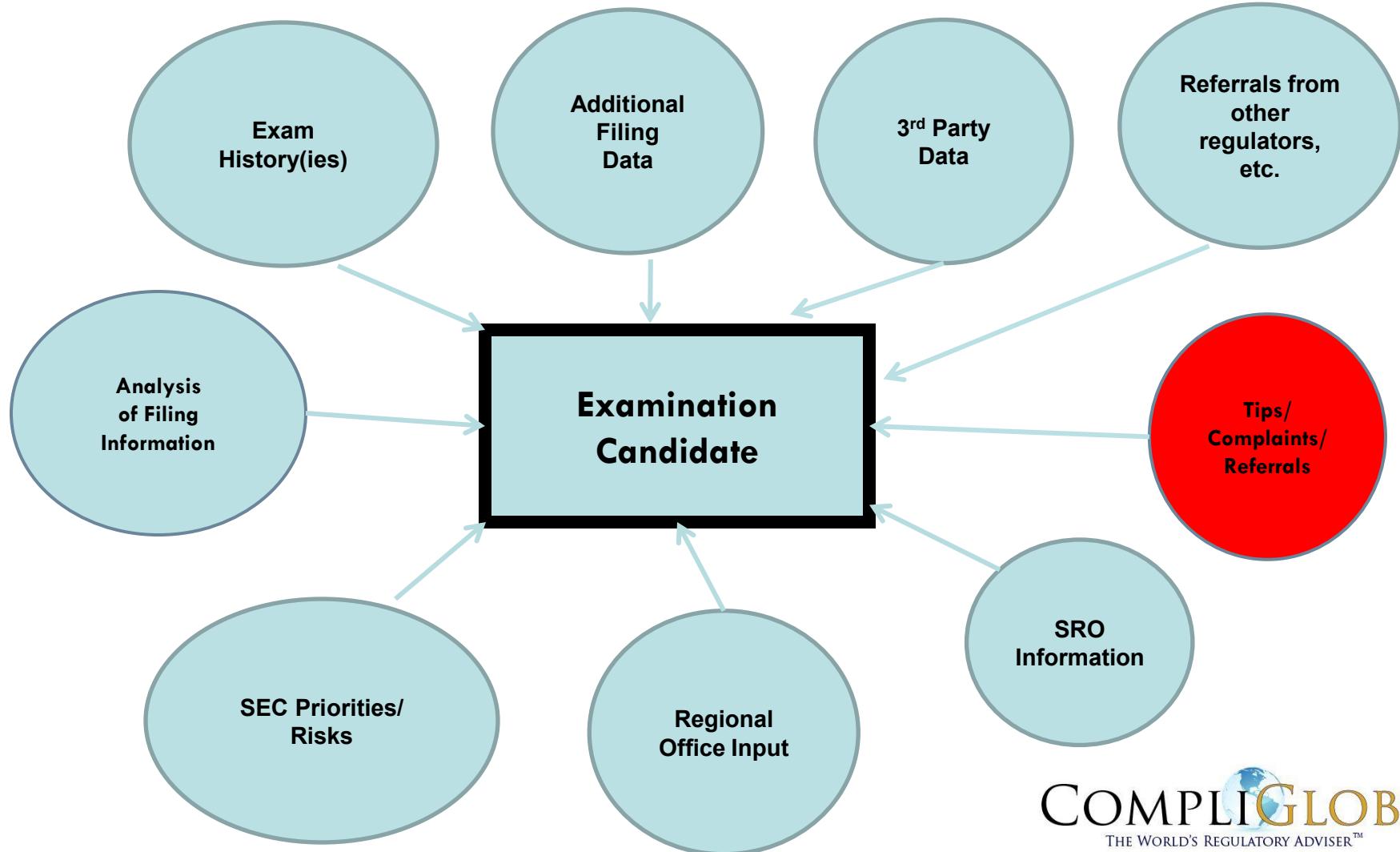
- Section 204 of the Advisers Act gives the SEC authority to conduct examinations of records advisers are required to keep
- SEC has used this authority to establish a National Examination Program (“NEP”) to analyze and evaluate advisers’ compliance with regulatory requirements
- Examinations are performed by the Division of Examinations (“EXAMS”)
- Why examine firms?
 - Prevent/detect fraud and other violations of federal securities laws
 - Promote compliance with federal securities laws
 - Inform policy (e.g., evaluating the application of new rules and role of new products)
 - Monitor risk: gather information on industry trends, risks

Determining which advisers to examine

- “Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents”, September 6, 2023 <https://www.sec.gov/files/risk-alert-ia-risk-and-requesting-documents-090623.pdf>
- Risk based approach
- Risks to focus on – constantly being reviewed
- Data analytics - which firms exhibit an elevated risk profile given their business activities, conflicts and regulatory history
- NEP considers the Examination Priorities priorities as well as information from multiple sources, including tips and complaints, to identify focus areas to review and which registrants to examine



Selecting the firm – risk assessment



Types of examinations

- Risk-priority exams
 - High risk business activities/practices
 - Previous examination/enforcement results
 - Material changes in operations
 - Outlier data/information
 - Surveillance of information
- Cause exams (Tips, Complaints, Referrals)
- Thematic/sweep reviews
- Never before examined – presence exams – newly registered firms
- *Risk assessment and corrective action reviews (follow up from previous exam)*

Focus of examinations

- Scope of examinations based on identified risks, such as:
 - Weaknesses in compliance and controls
 - Registrant's business model (revenue streams, profit centers, products, business plans).
Private fund advisers are a current focus
 - Affiliations and conflicts of interest
 - Evidence of bad or questionable conduct
- Additional risk assessment occurs to determine the scope of the exam, such as selecting particular areas of the business that examiners will review
 - The scope of an exam and the documents requested will vary from one exam to another depending on the firm's business model, associated risks and the reason for conducting the examination
- Critical for every RIA to have documented its compliance risks and conflicts of interest and mapped these to its Form ADV disclosures and policies and procedures
- Goals: understand the adviser's conflicts of interest and procedures for monitoring, mitigating and managing risks

Core risks commonly examined

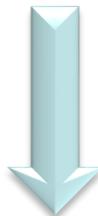
- Safekeeping of clients' assets (custody)
- Advisory fee billing
- Undisclosed compensation arrangements
- Deal allocations among clients
- Brokerage arrangements and trading
- Code of ethics and personal dealing
- Valuation of clients' positions
- Fee calculations
- Marketing and promotional activities

Selecting the firm/data considered

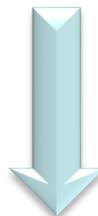
- Tip, complaint or referral
- Material change in business activities
- Compensation concerns
- Change in personnel
- News/media concern
- Outside business activities of firm or personnel
- Selling or providing advice re high-risk investment products
- Supervisory concerns
- Compliance culture concerns
- Financial stress
- Disclosure history
- Recidivist activities
- Outlier activities (e.g., performance, fees)
- Length of time since registration or last examination
- Heightened SRO or other regulator concern
- Newly registered RIA
- Gatekeeper/service provider risk
- Safety of assets/funds

Due diligence/scoping

RISK FRAMEWORK
DATA ANALYSIS



Qualitative Due
Diligence



Candidate Selection
and Exam Scoping

- Pre-exam research/developing examination scope- obtain a general understanding of the firm, its business activities, management and operational structure, and affiliates:
 - review of disclosure documents (e.g., Form ADV Parts 1 and 2A and Form CRS) and marketing activities (e.g., firm's website)
 - recent news and events
 - previous SEC and FINRA examination reports
 - review of firm and individual disclosures
 - review of relevant tips, complaints and referrals as well as enforcement activities
 - discussion with staff from other SEC offices (where applicable)
 - review any other SEC filings
 - public record search
- adjustments to scope during examination
 - adjustments made given real-time analysis of documents and information observed from interviews and business operations while on-site

Exam priorities to consider

- Examining matters of importance to retail investors and investors saving for retirement
 - Fraud, sales practices and conflicts
 - Retail targeted investments
 - Mutual funds and ETFs
 - Municipal securities and other fixed income securities
 - Microcap securities
 - Standards of care – Form CRS
- NBEs and advisers that have not recently been examined
- Conflicts of interest and the means to address (mitigate) them
- Disclosures of the cost of investing – fees
- Cybersecurity
- FinTech- and innovation-related matters
- RIAs to private funds
- RIA compliance programs
- Digital assets
- Information security
- Electronic investment advice
- Focusing on risks specific to elderly and retiring investors
 - Public pension advisers (“PPI”)
 - Senior investors
 - ReTIRE
 - Variable insurance products
 - Target date funds (“TDF”)
 - Fixed income cross trades (“FIX”)
- Assessing market-wide risks

What do we do to prepare for an examination?

- Always be ready!
- Form and prepare the exam team
 - The CEO, the CCO and key staff
 - Conduct refresher compliance training and mock interviews
 - Confirm all systems are operational and all records are available
 - Do not change or hide anything and do not delete or alter any records
 - Know the practical implications of the exam – this is “our opportunity to shine” and not “they’re here to catch us out or find something”
- Understand the document request and clarify what you do not understand
- Ensure documents are covered by confidentiality
- Provide materials promptly and keep a duplicate set of documents
- DO NOT IMPEDE AN EXAM – provide all documents and answer questions promptly
- Ensure that everyone will be present during the exam or are available for a video interview
- Do the “30 minute drill”
 - Review all Code of Ethics materials, reports, reviews and breaches
 - Review the breaches log and trade errors log
 - Review output from the last two annual reviews

Arrival

- ✓ Offices
 - Staff visits both headquarters and branch offices
- ✓ Identification
 - Present IDs
 - Warn firm about the danger of impersonation
- ✓ Questions and complaints
 - Give supervisor's name and contact information
- ✓ Does the Staff ever arrive by surprise?
 - Yes when:
 - Examiners want a candid look at the firm's operations
 - Examiners are worried records may be destroyed

Explanation of the exam process

- ✓ Staff provides a plain language explanation of the examination process
- ✓ Goal:
 - Provide firms with an understanding of why examiners are there and what may happen during the exam
 - Reduce mystery and fear
 - Increase cooperation
- ✓ Exam brochure includes:
 - Purpose of exams
 - Exam process
 - Completing the exam
 - Contact information for comments, questions, or concerns

Notice of authority

- ✓ In every exam the staff provides the firm with an official notice of the SEC's authority to conduct the exam
 - The Notice provides the bases for mandatory requests, with citations to applicable law
 - The Notice also states that the production of information in response to other requests is voluntary
- The form includes information about:
 - Penalties for failing to supply information
 - Penalties for false statements and documents
 - How SEC may use the information

Opening interview

✓ Discuss the firm including:

- Brief history of firm
- Organization and affiliated entities
- Nature of business services
- Description of compliance process and reports
- Types and number of clients serviced
- Employee compensation

✓ Request a tour after the interview

What do we do during the examination?

- Ensure that everyone is present in person or by phone
- Have the CEO and the CCO welcome the examination team
- Have a secure room prepared for the examination team with secure guest internet access, water and coffee
- Give them a floor tour and introduce them to key players
- Be proactive
- Agree “ground rules”
 - Designated point person for all examiner inquires and requests
 - One off questions or requests to other personnel?
 - Full access to point person to ensure examination moves quickly
 - All document requests numbered and in writing
 - Daily end-of-day meeting with examiners
 - Who copies documents?
 - Confirm whether the examiners want to talk to or receive information from or about affiliates, related persons, etc.

What do we do? (cont'd)

- During each interview
 - Have the CCO and the person(s) being interviewed in the room, relaxed
 - Write down every question and every answer and record them in a master log
 - Answer questions in a concise, clear manner – if you do not know something, say so and give the answer as quickly as possible thereafter
 - Correct any misimpressions or wrong answers on the spot
 - Do not contradict colleagues
- Review documents or materials you propose to give to the exam team
 - Do not change documents
 - Do not market the firm as the examiners will already know who you are
- If you need time to deliver additional requested documents or records, tell the examiners and give them a delivery date and time – deliver per what you say
- Follow up, follow up, follow up
- At the end of each day, ask how things went and if anything else is needed

Request for documents: Part 2

electronic documents

- ✓ When requesting:
 - Avoid
 - Hard-copy prints
 - Pdf formats
 - Request
 - Native format
 - Include meta-data
 - Functionality available to firm
 - E-mail header info
 - Loadable into e-discovery system or data analysis tool like excel
- ✓ When reviewing:
 - Use of search terms
 - Use of item-by-item reviews
 - Use of screening and sorting by data point

Onsite examination work

- During exams, examiners
 - Discuss issues with all levels of firm's staff
 - Obtain and analyze information about conflicts of interest, disclosures to clients, sales practices, controls and operational issues
 - Drill down in areas where controls are weak
 - Establish a non-public risk-based rating for each adviser – high, medium or low risk – which governs timing of our next exam
 - Bring to adviser's attention compliance issues examiners find for prompt corrective action by the adviser

Data analysis

- Transaction data (trade blotters)
 - Front-running, manipulation, insider trading
- Financial transactions (revenue, expenses, etc.)
 - “Follow the money”
- Client information
 - Location, duplicate addresses, PO boxes
- Instrument valuations
 - Fair values, stale values
- E-mail searching
 - Key words, who's talking to whom, etc.
- PAD activity/outside business activities
 - Compare to trade blotter of client trades/holdings

Information validation/verification

- Identify independent, 3rd party source to validate and reconcile the information presented
- Independent custodians (clearing/carrying firms, banks), customers, and counterparties (OTC transactions)
- Information should come directly from the 3rd party and not via the entity, organization or individual of interest
- It's not always easy. It may involve going to multiple sources and linking multiple records
 - Records used for verification may be found in various locations
 - Provided by managers, brokers, banks, mutual funds, insurance companies, administrators, accountants, etc.

Information validation/verification

1. Is there a relationship?
 - Legitimate business on the other side?
2. Did the transaction occur?
 - Verify with the exchange/counter-party
3. Do the assets exist?
 - Verify with the custodian/counter-party

Post field work

- Continue document review
- Continue analysis of data
- Follow up requests
- Establish a non-public risk-based rating for each adviser
 - High, medium or low risk
 - Governs timing of the next exam

Exit conference

- ✓ In most cases, examiners provide the firm with an exit conference
 - The only exceptions are when Enforcement asks the staff not to have one; or when the staff fears assets or records may be lost or destroyed
 - ✓ In the exit conference the examiners will discuss their findings, which will be memorialized in a deficiency letter sent to the firm
-
- ✓ Questions to consider:
 - How long will it take the examiners to finish the exam?
 - Will the examiners negotiate in the exit conference?
 - What if the firm disagrees with an identified finding?
 - What if the firm fails to implement corrective measures?

After the examination

- Comply promptly and fully with additional requests for documents and information
- Review, consider and accept the findings
 - Query them for a better understanding
 - The Deficiency Letter will set forth the relevant Advisers Act positions and why a comment or deficiency is being raised
- Don't "challenge" or fight findings – if you disagree, state your position clearly with support
- Take on board findings – start to address them before the exam team leaves!
- **Respond to every point raised within the stated time frame**
- Remember – the exam team will come back to see how you are doing, so be prepared!

Disposition types

- No Further Action Letter
- Deficiency Letter
 - Highlights findings
 - Requests corrective action be taken
- Referrals
 - SRO
 - other regulator or criminal authorities
 - To Enforcement

SEC cannot give a clean bill of health, a clearance or an approval

Examination red flags

- Staff can't understand or answer questions
- Information doesn't "make sense"
 - Documents provided
 - Interviews conducted with personnel
 - Information in the public domain
- Impeding exam
- Compliance programs/supervisory controls seem weak
- Domineering/controlling portfolio manager or head of firm
- "Light touch" response to breaches
- Minimal disclosures
- Multi-hat positions
- Questionable "tone at the top"
- Financial issues - can't "follow the money"
- Disclosures do not match
- Can't link WPPs to disclosures to actions taken
- No monitoring and testing
- Cursory or no annual review
- No CRI, no Conflicts Log
- Failed to follow WPPs or advice

Common findings

- Can't respond to red flags
- Ignored Risk Alerts, relevant Enforcement actions – ignored “lessons learned”
- Failure to comply with the Compliance Rule
- Regulatory filings are misleading, false, filed late or omit material information
- Failure to comply with the Custody Rule
- Code of Ethics deficiencies
- Books and records issues
- Misleading or false performance advertising and marketing materials
- Failure to monitor and retain off-channel communications

Problems and conflicts of interest

- Disclosures made to clients are incomplete, misleading or false as to
 - Risks taken in managing client portfolios
 - Past performance of fund/client accounts
 - Fees and expenses charged
 - Relations and transactions with related persons
 - Background of persons managing accounts
 - Business activities
- Not complying with one or more of the regulatory requirements that apply to it
- Undisclosed personal benefits based on management of client assets
 - Kickbacks from brokers
 - Front-running client trades
 - Personal transactions based on inside info
 - Theft of investment opportunities
 - Misallocation of trades and cherry-picking
 - Mis-valuation of assets to increase AUM

Problems and conflicts of interest

- Adviser effects transactions with clients
 - Adviser buys from or sells securities it owns to clients at other than market prices
- Adviser steals or misuses client assets
 - Theft
 - Borrowing
 - Illegally increasing revenue stream from assets managed
- Adviser intentionally allows inappropriate, undisclosed activities that harm clients

Some lessons learned from examinations ...

- Tell the truth, do not impede and do not withhold documents
- Poor compliance policies alone will be a basis for an enforcement referral
- Follow your Compliance policies and procedures
- Policies and procedures must evolve as your business grows and changes
- Complete a proper annual review and have sound internal controls
- Resolve examination issues with the SEC
 - Failure to do so makes future exam findings “recidivist,” and makes it more likely any future exam findings will be referred to Enforcement

Select key enforcement actions

- Failure to disclose principal trades with affiliated broker-dealer. Trades effected to reduce client's taxes. Conflict of interest in that general partner of client fund who owned the adviser could not provide effective consent for the fund.
Paradigm Asset Management (June 2014)
- Policies and procedures must be bespoke and evolve
In the Matter of Feltl & Company (November 2011)
- You must have and follow your compliance policies and procedures
Wunderlich (May 2011)
- Complete your annual reviews and address internal control issues *as they arise*
In the Matter of Equitas Capital Advisers (October 2013)
- Understand relationships with affiliates and be respectful of integration
TL Ventures and Penn Mezzanine (both February 2014)
- Monitor the use of social media
Navigator Money Management, Inc. (January 2014)
- File timely Forms 13D, 13G and 13F filings
P.A.W. Capital Partners; Ridgeback Capital Management LLP (September 2014)
- Do not misallocate expenses with a private fund
Lincolnshire Management, Inc. (September 2014)

Remember

- The SEC Staff knows who you are and have formed ideas and views about you
- The examination will help confirm their views or uncover new items
- Ask the examiners questions – you can learn from them as they learn about you

“The Reality of CCO and GC Liability”

RCA Asset Management Thought Leadership Symposium

- “The SEC has cautioned that it intends to bring enforcement actions against fund manager principals in hopes of sending a message to the hedge fund industry stressing the importance of continuous oversight of a firm’s compliance program.”
- During the panel, “Emerging Landscape of CCO and GC Liability”, Mark Berman, CEO of CompliGlobe, advised CCOs and GCs to take a proactive approach to ferreting out potential deficiencies by conducting mock examinations. He cautioned: *“CCOs and GCs should not be hearing about compliance deficiencies for the first time when the SEC visits a firm’s offices to conduct an examination.”*

[RCA Asset Management Thought Leadership Symposium Highlights Regulators’ Examination and Enforcement Priorities, the New SEC Examination Paradigm and Liability Concerns for CCOs and General Counsels](#)

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