

Being an SEC registered investment adviser

June 1, 2018

CompliGlobe Limited

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

- Full and fair disclosure: tell the truth: prove that you're doing what you said you'd do and 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

Materiality

- Information is “material” if a reasonable investor would consider it significant and it would alter the mix of information publicly available

TSC Industries Inc v Northway Inc, 426 U.S. 438 (1976); and *Basic v Levinson*, 485 U.S. 224 (1988). See *Chandrashekhar Gopinathan*, Admin Proc 3-13470 (July 27, 2009) (materially misleading statements and omissions in private placement offering materials)

- The SEC will investigate and bring enforcement actions for materially deficient disclosures or omissions
- “Half-truths” might be actionable: true statements that create a materially misleading impression would support claims for securities fraud. *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d. Cir. 1965)

What is an “investment adviser”?

- Under the Advisers Act, an investment adviser is any person that
 1. for compensation
 2. is engaged in the business of providing investment advice about securities or investments
 3. to others
- Must satisfy all three elements
- If a non-U.S. person does this using the “means of interstate commerce” (post, fax, e-mail, visit, instant messaging, social media, telephone or web site access), it becomes amenable to the SEC’s jurisdiction and must satisfy an exemption, register with the SEC or cease the activity – or face possible SEC enforcement action

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 an Private Fund Adviser
- You want to manage U.S. money directly (segregated account), 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 directly *and also* 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”
- Under Advisers Act Section 208(d), it is unlawful to do indirectly something that you cannot do directly

Who is a “U.S. person”?

- The SEC uses the Regulation S definition of “U.S. person”, which is based on ***residence***
 - Individuals: where they *reside*
 - Partnerships and companies: where incorporated
 - if not organised 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 U.S. Securities Act of 1933, 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, &c: the location of trustees, executors
 - Investment managers: where the clients reside

Release IA-3222 and Rule 203(m)-1 – Private Fund Adviser exemption: “A client will not be considered a United States person if the client was not a United States person at the time of becoming a client of the adviser.”

Release IA-3222 and Rule 203(m)-1 – Foreign Private Adviser exemption: “A person who is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, each time the investor acquires securities issued by the fund.”

Regulatory assets under management

- Includes *all* securities portfolios subject to continuous and regular management by the adviser, including:
 - Proprietary assets
 - Assets managed for no compensation
 - Assets of non-U.S. clients
- In the case of a private fund:
 - Uncalled capital commitments of a private fund
 - Leveraged assets
 - All assets, regardless of the type of assets held by that fund
- Sub-adviser must include only assets over which it actually provides advisory services
- Value private fund assets at fair value

Fiduciary duties

- Every 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)

- Duties of loyalty and care
- Obligations that flow from the fiduciary duty
 - Disclose *all* material facts, including conflicts of interest and the means to address them
 - Suitable advice
 - Reasonable basis for recommendations
 - Best execution

This may change re SEC rulemaking!

Disclosure – 4Cs compliant

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

“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 them
- 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
- Code of Ethics, Rule 204A-1
- Monitoring and forensic testing
- Business Continuity and Cybersecurity Plan – current and tested regularly
- Reg. S-P and Identity Theft Red Flags (data protection) – if applicable
- 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, and record all of this
- 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. He or she 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 U.S. 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
- 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
- Valuation
- Brochure delivery
- Form ADV filings
- Exchange Act filings (13D, 13G, 13F)
- Proxy voting
- Advertising
- Use of solicitors
- Confidentiality
- Privacy
- Anti-money laundering
- Gifts & entertainment
- Political contributions: pay to play
- Supervisory functions
- Role of chief compliance officer
- Maintenance of books and records
- Business continuity plan
- Bribery and foreign corrupt practices
- Whistleblowers
- Cybersecurity
- Identity theft red flags

“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 the CEO, management and the directors
- A key consideration that OCIE 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

“Not less than annual” review

- Must *at least* review annually the adequacy of the WPPs and their effectiveness
- Should consider
 - Any compliance matters that arose during the previous year
 - Any changes in the business activities of the adviser or its affiliates
 - Any changes in the Advisers Act or applicable 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!

Risk management – the CRI

- 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 clear and concrete so that a reasonable prospect or client understands clearly the conflict and how it is addressed
- Tough SEC enforcement actions up the stakes for 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. See e.g. *SEC v. Gabelli*, 2011 WL 3250556 (2d Cir. August 1, 2011)
- Advisers will be sued for failure to disclose conflicts and using “precatory” language – “may” or “might” (*Robare*, November 7, 2016)

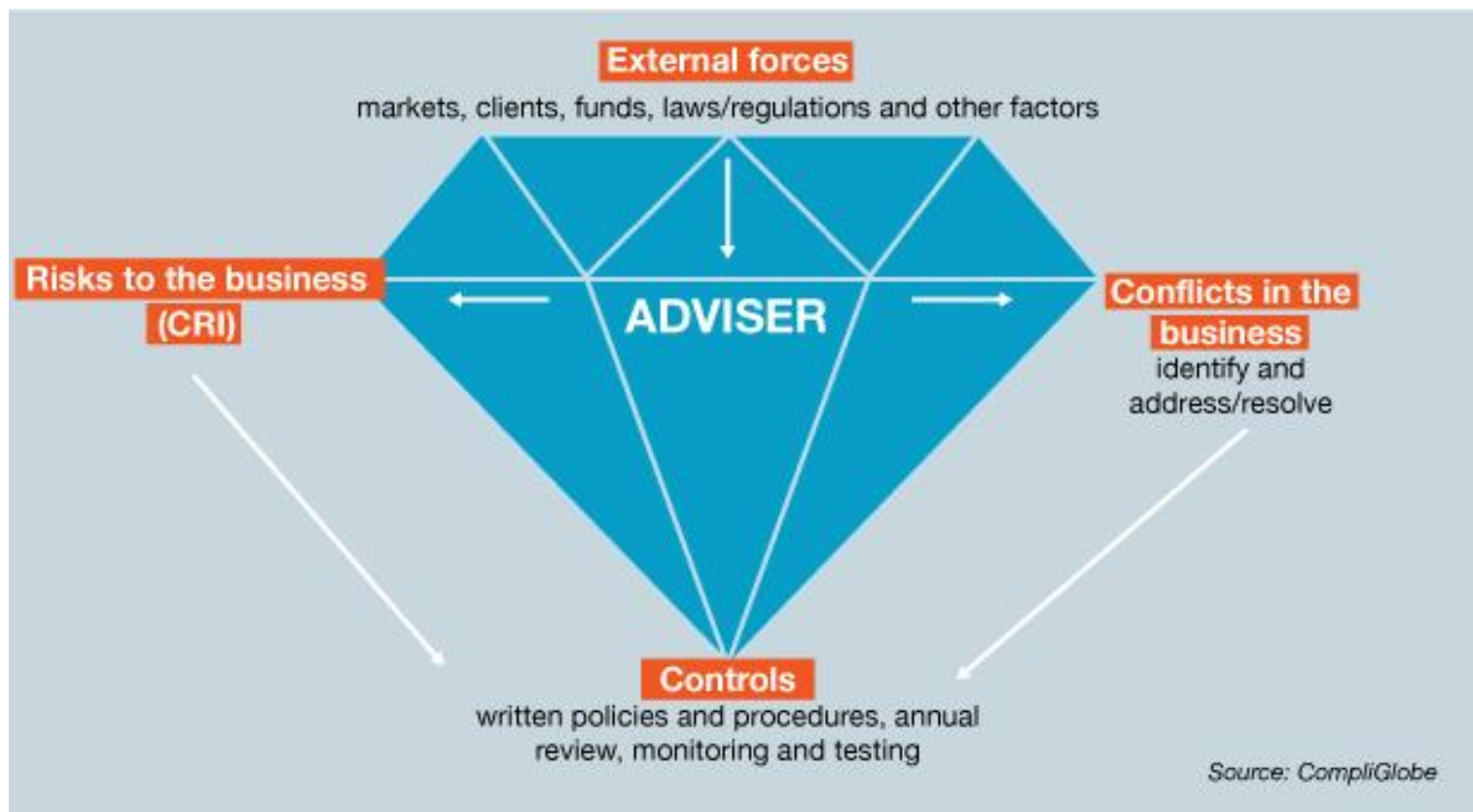
Examples of conflicts involving advisers

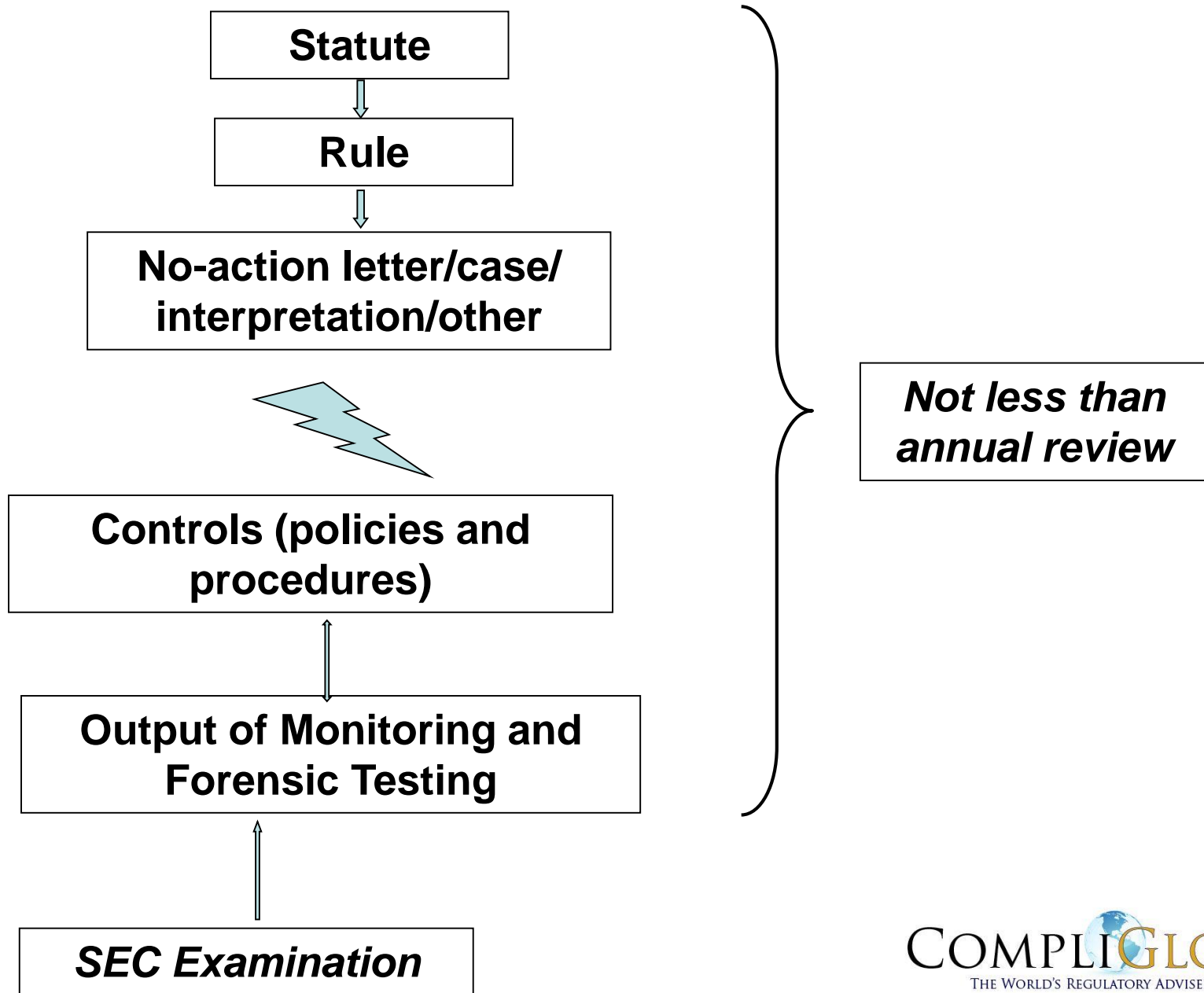
- Outside Business Interests
 - *In the Matter of BlackRock Advisors*, IA Rel. No. 4065 (April 20, 2015)
- Front Running
- *In the Matter of Roger W. Honour*, IA Rel. No. 14259 (September 25, 1995)
- Expenses and Fees
- Misuse of Client Brokerage
 - Jack Allen Pirrie, IA Rel. No. 1284 (July 29, 1991) (use of soft dollar brokerage credits for error correction losses)
- Favouring Some Clients
 - *Monetta Financial Mgmt.*, IA Rel. No.1702 (February 26, 1988) (allocation of scarce investment opportunities to favoured clients)
 - *Highland Capital Management, LP*, IA Rel. No. 3939 (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



Risk-based 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





Failure to supervise

- Under Advisers Act Section 203(e)(6), must supervise with a view to *preventing* violations of the federal securities laws
- Nearly every violation of the Advisers Act and the rules thereunder may well involve a failure to supervise
- What you must do
 - Implement and administer procedures and systems reasonably designed to supervise with a view to preventing violations of law
 - Keep evidence that supervisor reasonably discharged the duties and obligations under such procedures without reasonable cause to believe they were not being complied with

Who are supervisors?

- An individual is a supervisor when the adviser or its organizational documents identify them as another person's supervisor
- The CEO and management supervise, as does the board of directors
- A person is a supervisor when asked or instructed to be responsible for another person, or takes charge under instructions or on their own
 - Ex: one “delegates” responsibilities
 - Ex: “watch out for him/her/it and let me know if anything comes up”
- This is a “facts and circumstances” test: does a person have the responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue
- CCOs are not supervisors
 - Except for the compliance staff that they actually supervise
 - Not for the business
- Note the *Morgan Keegan* enforcement action, where the eight former directors of this RIA were personally sued for supervisory failures to address red flags and oversee/address asset valuation issues

CCOs and supervision

- A CCO is not a supervisor by nature of his position
- A CCO may be found to have supervisory responsibilities where CCO has the “responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue.”
- Avoid supervisory liability by
 - Acting as a consultant to line supervisors and escalating if they fail to act
 - Clearly designating responsibility to business line personnel
- *Frequently Asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act (30 September 2013 – legally relevant to RIAs*

Failure to supervise

- *Comprehensive Capital Management, Inc.* (July 2013)
 - Failure to implement compliance policies related to protection of client assets
 - failure to supervise associated person, leading to multiple violations of the custody rule, Rule 206(4)-2 and the theft of more than \$16 million of client assets
- *GLG Partners, Inc.* (2013)
 - Mis-valuing fund assets because of internal control failures
- *Equitas Capital Advisors, LLC* (2013)
 - Compliance program deficiencies, billing errors and liability of CCO
- *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
 - supervisory policies and procedures were deficient
 - She was not properly trained and did not understand responsibilities
 - was negligent in supervision

Best execution

- Every SEC registered investment adviser has a 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 of the elements involved in seeking best execution – Form ADV Part 2A – as well as broker selection
- 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 disclosure factors
- Failure to disclose is actionable under *Fidelity*

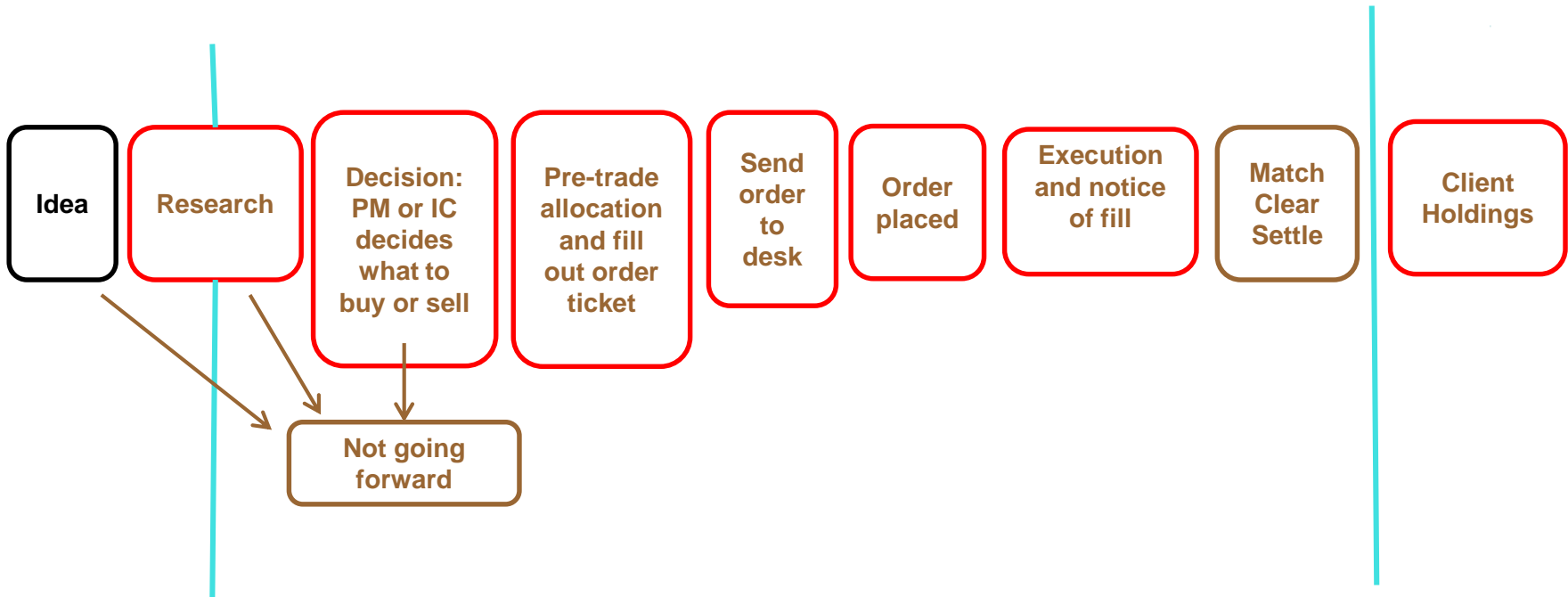
Books and records

- 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”
- 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

Life Cycle of a trade by an RIA exercising discretion



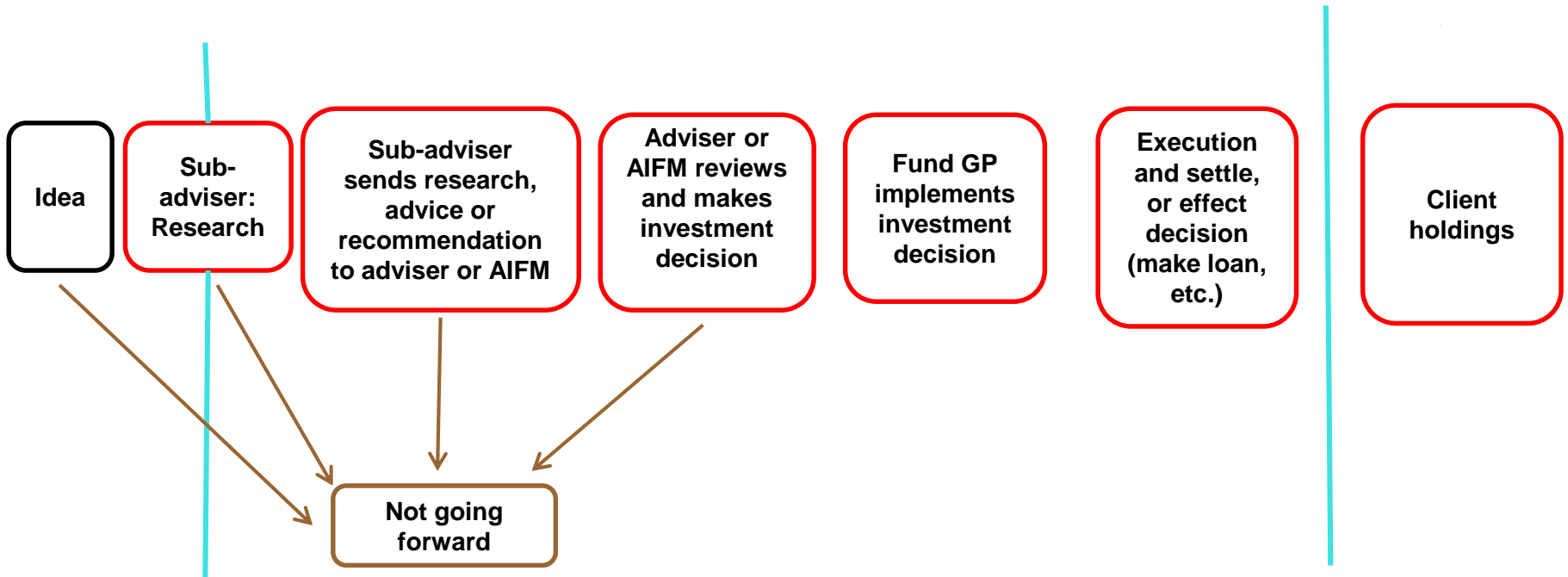
“Nonpublic Information” or
“confidential client information” – Rule
204A-1
Pipeline



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



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



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

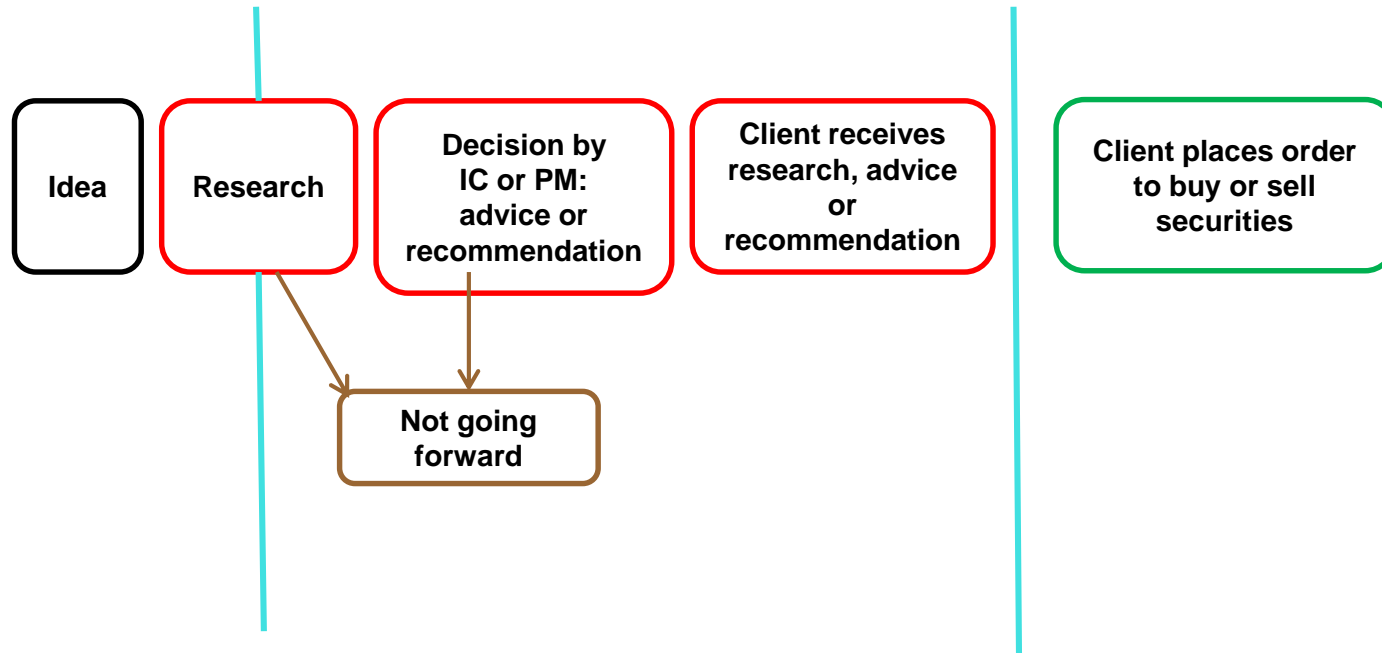


"Nonpublic Information" or
"confidential client information" – Rule
204A-1
Pipeline



Investment advice

Brokerage



Code of Ethics

- Covers “Supervised Persons”
- Personal account dealing (“PAD”) activity reaches “Access Persons”
- For the Adviser
 - Define standards of conduct to be observed (based on fiduciary duty)
 - Require compliance with U.S. federal securities laws
 - Adopt, implement, issue code 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)
 - 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 “nonpublic 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

PAD

- Access Persons and, through beneficial ownership, Connected Persons
- Access Persons are responsible for their Connected Persons
- Requirements
 - Initial holding of “reportable securities” and accounts
 - Quarterly transaction report – can satisfy by providing to the CCO reports of all transactions 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

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**

Affiliates and Third Parties Having Confidential Client Information ("CCI")

Unaffiliated Third Parties

- Client consents to third party having CCI
- Third party must safeguard CCI to an extent that the RIA derives comfort from same

Affiliate that is a Client of the RIA

- No Participating Affiliate Agreement
- Access to client data only

Non-Integrated non-Client Affiliate

- No Participating Affiliate Agreement

Treat as Unaffiliated Third Party

Affiliate that is "Integrated" with the RIA

- May or may not be a client of the RIA
- No Participating Affiliate Agreement
- Must have Advisers Act-compliant Code of Ethics
- Must register with SEC as an RIA

Participating Affiliate

- Provides research, advice or recommendations to RIA for RIA to use for its U.S. clients
- Must comply with PAA SEC Staff No-Action letters
- Associated persons treated as access persons

“Inside information”, “trading” and “tipping”

- It is illegal to trade or tip when in possession of material, non-public information - *“inside information”*
- 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
- One may be sued by the SEC (civil liability) or prosecuted by the authorities in the USA or in your 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

Advertising

- Defined in Advisers Act Rule 206(4)-1 under Section 206(4), an antifraud provision, as
 - any written (or electronic) communication
 - to two or more persons
 - to maintain existing clients or solicit new clients
- Broadly defined and applied
 - Published materials, PowerPoint presentations, DQQs, RFPs, e-mail blasts, brochures, flip books, booklets and extracts from them, “re-used e-mails”, “internal use only” documents given to clients or prospects
 - Web sites and materials available on them – including hyperlinked information – and social media
 - Just about everything - *if in doubt, it's probably an advertisement!*
- What is not advertising?
 - Oral communications
 - Bespoke materials that will not be used again
 - Replies to specific *bona fide* unsolicited queries on performance

Advertisement “Golden Rules”

1. No material misrepresentation of fact or material omission – be 100% truthful, with no “half statements”
 - Examples : performance exaggerations, resume “enhancement”
2. Testimonials prohibited – rankings, articles, awards, &c., permitted subject to conditions
3. Special considerations for the use of past specific recommendations
 - Use specific, objective non-performance based criteria to select
 - Since this refers to “past specific recommendations”, includes securities bought and sold and bought and still held
4. Can’t say that a chart, graph or formula can by itself be used to determine what securities to buy and sell
5. Can’t say something is free unless it really is
6. Performance figures must generally be net, not gross
7. Anything that leaves the building must be compliance cleared
8. Must keep records

IMA

- Must contain a provision prohibiting assignment without consent of client
- If organized as partnership must include provision that adviser will notify clients of changes in membership
- Must NOT contain hedge clause that purports to waive compliance with Advisers Act
- If advisory fees are substantially higher than other advisers, must disclose
- Performance fees only to persons meeting qualifications
- Termination restrictions are inconsistent with fiduciary duty and may violate anti-fraud provisions

Investment objectives

- Trade i/a/w stated objectives and restrictions – when given initially and when changed
- Ensure these are clearly recorded and given to relevant staff
- Monitor and test 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 they are and how they work and who approves
- Monitor and test

Cross trades

- Must exercise discretion for both of the clients involved
- The transaction is effected at the independent current market price of the security – best execution applies
- Adviser 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 with affiliated funds – take competent advice

Trading practices

- Cannot engage in *any* form of market abuse – fraud, manipulation or deceit
- Note Advisers Act Rule 206(4)-8 that has a negligence standard
- Note conditions on proprietary trading and possible 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 Adviser bears all losses
 - Do not net gains with losses

Valuations

- Advisers required to disclose the policies and procedures used to
 - obtain prices and value holdings
 - calculate fees owed to RIA based on valuations by it, an affiliate or third party
- Risks: accurate disclosures? *SEC v Beacon Hill Asset Management LLC*,
<http://www.sec.gov/litigation/litreleases/lr18745a.htm>
- If adviser or a related person values or calculates fees, address risks and conflicts of interest
- Accurate prices obtained and used for individual portfolios as well as private funds – account statements checked
- Procedure to challenge prices *and estimates*
- Mapping trading and prices
- Procedures for illiquid or hard to price securities, side pockets
- Independent assessment of process
- *GLG Partners*, Admin Proc 3-15641, December 12, 2013
<http://www.sec.gov/litigation/admin/2013/34-71050.pdf>

Fees

- Disclose in Form ADV Part 2A Item 4
 - who calculates fees
 - Which valuations are used
- If the RIA or an affiliate does this, it is a conflict of interest to be disclosed in Form ADV Part 2A Item 10, with the means to address this
- 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 least 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 (13 January 2017),
<https://www.sec.gov/litigation/admin/2017/34-79794.pdf>

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

Solicitors/referrals

- Must have written agreement and clearly state fees involved
- Solicitor/referrer
 - can't be subject to statutory disqualification
 - Must deliver Form ADV
 - Obtain written acknowledgment from client a receipt of Form ADV and solicitor's written disclosure document
- Must exercise supervisory oversight
- Full and fair disclosure – do not hide the facts! Note *Rafal* and *Essex Financial*
 - Rafal secretly paid a lawyer for referring a legal client's account but disguised the payments. After it was discovered and stopped, Rafal continued to secretly pay the lawyer using other accounts that he controlled
 - During the SEC investigation, Rafal sent e-mails to Essex clients falsely stating that the SEC had “fully investigated all matters” and cleared him
 - Rafal lied to SEC, concealed the additional payments and falsely indicated that the lawyer had returned all the money

<https://www.sec.gov/news/pressrelease/2017-3.html>

Custody

- Custody is holding or having authority over client cash or assets
- 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
 - If no operational independence, surprise audit
 - 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. *See In the Matter of Parallax Investments, LLC, John P. Bott, II, and F. Robert Falkenberg, Administrative Proceeding 3-15626 (November 26, 2013)*
- SEC Staff’s FAQs on custody: www.sec.gov/divisions/investment/custody_faq_030510.htm

Identity theft “red flags”

- If you deal with individual investors/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 manner in which the adviser does business
- Quarterly review and report to the Board of Directors

“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

Cybersecurity

- The SEC and Cybersecurity: www.sec.gov/spotlight/cybersecurity
- Cybersecurity: Ransomware Alert”, OCIE Risk Alert (May 2017): www.sec.gov/files/risk-alert-cybersecurity-ransomware-alert.pdf
- “OCIE Cybersecurity Initiative” (April 2014):
www.sec.gov/ocie/Cybersecurity+Risk+Alert++%2526+Appendix+-+4.15.14.pdf
- “OCIE Report on Cybersecurity examinations (February 2015):
www.sec.gov/ocie/cybersecurity-examination-sweep-summary.pdf
- “Investment Management Update (April 2015) www.sec.gov/im-guidance-2015-02.pdf
- “2015 Cybersecurity Examination Initiative” (September 2015):
www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf

Integration

- Integration is a concept under Advisers Act Section 208(d). It was discussed in Release 3222 and featured in three SEC enforcement actions
- Advisers Act Section 208(d) provides that no person can do indirectly or through another person that which it would not be lawful to do directly. The SEC stated in Release 3222 that it would treat as a single adviser two or more affiliated advisers that were separately organised but operationally integrated. Integration is a facts and circumstances test

Integration cases

- *Penn Mezzanine Partners Management, L.P.*, Admin Proc 3-15939 (June 20, 2014) and *TL Ventures Inc.*, Admin Proc 3-15940 (June 20, 2014) – two ERAs were separately incorporated but operationally dependent. The factors cited : common control; operational dependence; common ownership (equity securities); overlapping employees, some of who gave investment advice to clients of both firms; duplicative policies and procedures but no controls to keep operations separate; common marketing (strengths of the group, etc.); and using one e-mail address to conduct business for both companies
- Bradway Financial, LLC (“Bradway”), Bradway Capital Management and CEO Brian Case (“Case”). In relevant part, “[Bradway] was not entitled to rely on [the Private Fund Adviser] exemption because Bradway Financial and Bradway Capital were under common control and operationally integrated. For example, Bradway Financial and Bradway Capital: were both owned by Case, shared the same employees, operated in the same office, shared the same technology systems, and failed to maintain policies and procedures addressing registration or exemption from registration as an investment adviser.”

Applicability of the Advisers Act

| | <i>Registered</i> | <i>ERA</i> | <i>Foreign Private Adviser</i> |
|------------------------------------------------------------------|-------------------|------------------------------|--------------------------------|
| Form ADV, Part 1 | Yes | Yes (limited disclosure) | No |
| Form ADV, Part 2 (brochure) | Yes | No | No |
| Form PF (systemic risk reporting) | Yes | No | No |
| Examination | Yes | "For cause" | No |
| Rule 204-2 (books and records) | Yes | For exemption and disclosure | No |
| Section 206 - antifraud | Yes | Yes | Yes |
| Rule 206(4)-1 (advertising) | Yes | No | No |
| Rule 206(4)-2 (custody) | Yes | No | No |
| Rule 206(4)-3 (cash solicitation) | Yes | No | No |
| Rule 206(4)-5 (pay to play) | Yes | Yes | Yes |
| Rule 206(4)-7 (compliance rule) | Yes | No | No |
| Rule 206(4)-8 (fraud by pooled investment vehicles, if relevant) | Yes | Yes | Yes |
| Rule 204A-1 (code of ethics) | Yes | No | No |

“Participating Affiliates”

- An affiliate of an RIA that gives research, advice or recommendations to the RIA for it to use for or give to its U.S. clients
- Must establish bona fide affiliation through “control”
- Cannot “engineer” a participating affiliate relationship to avoid registration – this is doing indirectly what cannot be done directly (Advisers Act Section 208(d))

Participating Affiliates are established through a series of SEC Staff no-action letters, reaffirmed by the SEC itself in Release 3222

Mercury Asset Management plc (16 April 1993); *Kleinwort Benson Investment Management Limited, et al.* (15 December 1993); *Murray Johnstone Holdings Limited, et al.* (7 October 1994); *ABN AMRO Bank N.V., et al.* (1 July 1997); and *Royal Bank of Canada, et al.* (3 June 1998).

What is required for Participating Affiliates?

- “Participating affiliate” does not have to register with SEC
 - Must sign a participating affiliate agreement
 - Relevant personnel are “associated persons” that comply with the RIA’s Code of Ethics personal account dealing requirements
 - May give only research, advice and recommendations
 - Must keep records of what it does for the RIA
 - SEC must have adequate access to trading and other records of the participating affiliate
 - Form ADV Part 2 disclosure of associated persons
- SEC registered adviser must exercise oversight over and supervise the participating affiliate in its role – failure to supervise is actionable under Advisers Act Section 203(e)(6)
- The participating affiliate no-action letters were issued by the Staff of the SEC’s Division of Investment Management (“IM”) pursuant to delegated authority
 - The no-action letters only deal with matters arising under Advisers Act Sections 203 and 208(d)
 - Because the letters were issued by IM pursuant to delegated authority and not the Staff of the SEC’s Division of Market Regulation (“MR”, now Trading and Markets), IM had no authority to act on matters outside the Advisers Act – in particular, the Exchange Act and brokerage. This would have required action by MR and MR took no position in these letters. As such, it does not appear possible under these letters for associated persons to give orders to buy or sell securities or manage assets on a discretionary basis

Form ADV requirements

Disclosures in Form ADV must be correct - no material misstatements or omissions

Annual Amendment for Parts 1 and 2A

- Amend Form ADV 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 corresponding sections of Schedules A, B and D

Other-than-Annual Amendment for Parts 1 and 2A

- You must amend Form ADV by filing additional amendments promptly if
 - information in Items 1, 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.) or 11 becomes inaccurate in any way
 - information in Items 4, 8, or 10 becomes materially inaccurate
 - Information in Part 2A (brochure) becomes materially inaccurate

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

U.S. regulatory disclosure obligations ...

- Beneficially owning 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
 - “qualified institutional investors” (passive investors, money managers) file Schedule 13G – 10 day or 45 day rule, depending upon circumstances
- Beneficially owning 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)
 - Subject to short swing profit liability under Section 16(b)
- Exercising discretion over more than \$100m in Exchange Act Section 12 registered securities
 - File Form 13F

Brokerage

- The term “broker” is defined in Exchange Act Section 3(a)(4)
- This includes a non-U.S. person that, using the “means of interstate commerce”
 - solicits and/or effects transactions in securities for the account of others
 - receives transaction-based compensation
 - holds itself out as such (e.g. directly or by being amenable ...)
- Such person 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
- Covers ...
 - Trading
 - M&A activities
 - Soliciting the purchase or sale of 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*
- See *First Atlantic Advisory Corp.* (20 February 1974), *McGovern Advisory Group, Inc.* (7 August 1984) and *In Touch Global LLC* (14 November 1995)

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*
- See e.g. *PRA Securities Advisers LP* (3 March 1993)

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 broad definition remains in place today. "Registration Requirements for Foreign Broker-Dealers", Exchange Act Release 27017, 54 FR 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

Non-U.S. adviser solicits U.S. prospect to buy the securities of a non-U.S. private fund

- Under the IA-3222 interpretation, this would be brokerage
- Options:
 - if available, rely upon Rule 3a4-1
 - use Rule 15a-6 for “major U.S. institutional investors” – still requires an SEC registered broker-dealer to intermediate trades
 - get an SEC registered broker to chaperone (issue research and intermediate the trade) for “U.S. institutional investors”
 - have an SEC registered broker-dealer handle the transaction entirely for all other persons
 - register as a broker
 - avoid the U.S. markets

“Issuer’s exemption”: Exchange Act Rule 3a4-1

- Extremely narrow, limited safe harbour
- For issuers that propose to market their securities by one of its “associated persons”
- This is not available for an RIA or ERA that is not an associated person
- The associated person
 - cannot be subject to a statutory disqualification
 - must have other significant duties apart from marketing
 - cannot receive commissions or other transaction-based compensation
 - cannot be an associated person with a broker or dealer at the time of the sale
- Associated persons are partners, officers, directors and employees of the issuer, the GP of a partnership or an LLP or the MD of an LLC
 - only associated persons may engage in such marketing
 - the associated person must have other substantial duties apart from marketing
 - limited class of institutional investors
 - one offering per 12 month period
- Passive sales activities – written communications or delivering PPM, responding to queries and ministerial or clerical work

“Rules of the road” for Rule 3a4-1

- Satisfy the requirements of this rule (as above)
- Keep detailed records
- Do not do indirectly something that you could not do directly
- Do not engage in a discussion of specific fund performance
- Statements must be 100% correct. Correct mistakes on the spot. Remember that the antifraud provisions of the U.S. federal securities laws apply
- Avoid communications with the media
- Be aware of and demonstrate compliance with the prohibition on “general solicitation” in Regulation D under the U.S. Securities Act of 1933 (your fund will if sold in the United States, probably use Regulation D)
- Ensure the fund is exempt from being an investment company under Sections 3(c)(1) or 3(c)(7) of the 1940 Act

SEC sues four India-based brokers – November 2012

- The SEC sued four India-based brokers for engaging in brokerage with U.S. residents and not registering with the SEC as a broker, or not using Rule 15a-6
 - [SEC Order: Ambit Capital Pvt. Ltd.](#)
 - [SEC Order: Motilal Oswal Securities Limited](#)
 - [SEC Order: JM Financial Institutional Securities Private Limited](#)
 - [SEC Order: Edelweiss Financial Services Limited](#)
- Key SEC finding:
 - “Sponsored conferences in the U.S.
 - Had employees travel regularly to the U.S. to meet with investors.
 - Traded securities of India-based issuers on behalf of U.S. investors
 - Participated in securities offerings from India-based issuers to U.S. investors.”
- Solicitation played a key role in these cases

SEC v Credit Suisse - 2014

- In February 2014, the SEC sued Credit Suisse Group AG for, *inter alia*, soliciting cross border brokerage (and investment advisory services) without being registered with the SEC as a broker-dealer and an investment adviser. The SEC alleged that this involved as many as 8,500 accounts, more than 100 trips to the United States to meet clients. It was also noted that while Credit Suisse did implement controls to prevent such violations (after the *UBS AG* enforcement action), it took several years before the activities ceased and Credit Suisse ceased to collect fees

In the Matter of Credit Suisse Group AG, Admin Proc 3-15763 (21 February 2014),
<http://www.sec.gov/litigation/admin/2014/34-71593.pdf>

In the Matter of HSBC Private Bank (Suisse) SA - 2014

- The SEC sued HSBC for, *inter alia*
 - visiting and soliciting hundreds of U.S. residents to effect transactions in securities and not registering as a broker-dealer *and*
 - visiting and giving investment advice to thousands of U.S. residents and not registering as an investment adviser
 - failing to register despite express knowledge of requirements
- HSBC admitted its wrongdoing and consented to (1) a censure (2) cease-and-desist from further violations of U.S. law and (3) payment of \$12.5m in disgorgement

In the Matter of HSBC Private Bank (Suisse), SA, Admin Proc 3-16288 (25 November 2014),
www.sec.gov/litigation/admin/2014/34-73681.pdf

Bank Leumi – *October 2016*

- The SEC sued three Bank Leumi entities (Luxembourg, Tel Aviv and Zurich) for, from 2002 through 2013
 - visiting and soliciting hundreds of U.S. residents to effect transactions in securities and not registering as a broker-dealer *and*
 - visiting and giving investment advice to hundreds of U.S. residents and not registering as an RIA
- These firms were aware of the RIA and BD registration requirements and, despite being told that this activity was illegal and attempting to cease the activities, “violations of [the policies and procedures of these firms] and the federal securities laws continued”
- These entities admitted wrongdoing for wilful violations and consented to (1) a censure, (2) a cease-and-desist order, (3) disgorgement and (4) a fine
- This was separate from a deferred prosecution agreement with the U.S. DoJ “waiving charges that [certain Bank entities] voluntarily, intentionally, and knowingly sought to willfully aid and assist in the preparation and presentation of false income tax returns and other documents”

In the Matter of Bank Leumi le-Israel B.M., Leumi Private Bank and Bank Leumi (Luxembourg) S.A, Admin Proc 3-17631 (18 October 2016) (<https://www.sec.gov/litigation/admin/2016/34-79113.pdf>)

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>

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](#)

FCPA

A Resource Guide to the U.S. Foreign Corrupt Practices Act

By the Criminal Division of the U.S. Department of Justice and
the Enforcement Division of the U.S. Securities and Exchange Commission



the 100 metre sprint in Beijing, BHP's joint venture in Burundi had been in real danger of losing a nickel exploration permit. The project required a near-term financial investment or the government to approve an amended licence.

In late 2007 and early 2008, BHP executives negotiated directly with Ndayiragije to extend and modify the mining project's nickel exploration permit. Under Burundi law, the mines minister was responsible for reviewing the mining permit and presenting the application to the poor African country's Council of Ministers for final approval.

Despite the apparent conflict of interest, BHP staff never reviewed the appropriateness of the Olympic invite after the high-stakes negotiations began.

The case is one of four examples published in the SEC's findings into BHP's hospitality offerings to influential government officials from Congo, Guinea, the Philippines and Burundi.

At the conclusion of the six-year probe,

The response from MinEx was an emphatic "No." History shows the minister enjoyed the hospitality while presiding over a decision critical to BHP's nickel mine.

A common thread between the cases is that BHP's internal anti-corruption processes, including rules specifically drawn up for the Olympics, were insufficient.

The SEC said early in planning for the Olympics, BHP identified the risk that inviting government officials might potentially violate anti-corruption laws and the company's own Guide to Business Conduct. Yet it failed to act properly on its own concerns.

SEC's director of the division of enforcement, Andrew Ceresney, said BHP footed the bill for foreign government officials to attend the Olympics while they were "in a position to help the company with its business or regulatory endeavours".

"BHP Billiton recognised that inviting government officials to the Olympics created a heightened risk of violating anti-corruption laws, yet the company failed to implement sufficient internal controls to address that heightened risk," Ceresney said in a statement.

BHP recognised that
inviting officials

response BHP's Guinea country president sent an email admitting "of course" there would be further negotiations with the government over a bauxite mining concession held by BHP.

An internal communications bungle at BHP meant the red flag was not formally passed to the ethics committee and the minister accepted the invitation in January 2008. He cancelled the trip shortly before the Games began.

Separately in 2009, Guinea's ruling military junta that seized power via a coup, arrested and charged the former prime minister (Ahmed Tidiane Souare) and two former mines ministers (Louceny Nabe and Ousmane Sylla) for alleged embezzling money from state mining funds.

The charges may have been politically motivated and the country has been racked with violence and political instability on the path to democratic elections in December 2010.

In another example published by the SEC, in the Philippines in July of 2007, BHP's local joint venture partner

Examinations

- Section 204 of the Advisers Act gives the SEC authority to examine the books and records that advisers are required to keep
- Types of examinations
 - **Risk-based** (based upon expanded Form ADV data)
 - **Cause** – tips, complaints, whistleblower information, referrals from non-U.S. regulators
 - **Thematic** – to address on a cross-sectional basis compliance issues that are in need of staff attention
 - **“Presence”** examinations
 - **Correspondence** examinations
- Even if a non-U.S. SEC registered adviser does not manage U.S. client assets, it is still subject to SEC examination

Which advisers are to be examined?

- Identified through risk analysis
- Sources of information used in the decision-making process
 - OCIE Risk Analysis Group
 - Division of Investment Management priorities
 - Division of Enforcement Asset Management Unit
 - Prior exam results
 - Publicly available information
 - Changes in an adviser's profile – new CCO, more assets, new private funds – *or* no changes over a period of time
 - Tips from other regulators or “TCRs” received by the SEC
 - Other areas of the SEC
- Analysis
 - Systematic (Form ADV disclosures) by industry
 - Tactical (abberational performance, events, &c.)

Focus of examinations

- Risk identification and conflicts controls, relative to the adviser's business
 - Strength or weakness of a compliance program
 - CCO not doing his or her job
 - No compliance tone at the top
 - Monitoring and testing: using or ignoring results?
 - Affiliations
 - Changes implemented when and as required
 - Responses to breaches and developments
 - Be dynamic, not static
 - Fix it, find out what it happened and take proper action
 - If things are not being caught, why?
 - Control environment
-
- Understand the Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers: www.sec.gov/ocie/risk-alert-5-most-frequent-ia-compliance-topics.pdf

Core risks commonly examined

- Conflicts of interest
- Performance advertising
- Safe-keeping of clients' assets (custody)
- Undisclosed compensation arrangements
- Deal allocations among clients
- Brokerage arrangements and trading
- Code of ethics and personal dealing
- Valuation of clients' positions
- Marketing and promotional activities

Work performed

- Document request
 - Compliance related
 - Operational related
- Discussions with key managers and staff
- Analysis of information
- Documentation of examiners' findings
- Conduct exit interview
- Send written communication to complete examination.
 - No-further action letter
 - Examination summary letter
- Situations involving suspected serious breaches or fraud are referred to Enforcement for further consideration

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)

“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](#)

Are we in or out of the U.S. Commodity Exchange Act?

- The Dodd-Frank Act amended the definition of "commodity pool" to include any type of pooled investment vehicle that trades commodities interests
 - This includes non-security-based swaps, futures, options, options on futures, FX forwards, certain CDSs
 - Also under the CFTC's jurisdiction are broad-based security indices (10 or more component securities)
 - Shares jurisdiction with the SEC for "mixed" swaps that are interests with both swap and security-based swap components

What are CTAs and CPOs?

What is a Commodity Trading Advisor?

- CTAs advise managed accounts and pooled investment vehicles, such as commodity pools
- CTAs are usually the investment adviser
- For a separately managed account or a single investor entity, there is only a CTA
- *USE AN EXEMPTION WHERE AVAILABLE*

...an individual or organization which, for compensation or profit, advises others as to the value of or the advisability of buying or selling futures contracts, options on futures, or retail off-exchange forex contracts.

<http://www.nfa.futures.org/nfa-registration/cta/index.html>

What is a Commodity Pool Operator?

- CPOs manage commodity pools
- A CPO solicits or accepts funds, securities or property from prospective investors in the commodity pool
- CPOs can make trading decisions on behalf of the pool or they can retain the services of a CTA to do so
- CPO can be the adviser or the GP
- *USE AN EXEMPTION WHERE AVAILABLE*

...an individual or organization which operates a commodity pool and solicits funds for that commodity pool. A commodity pool is an enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures contracts, options on futures, or retail off-exchange forex contracts, or to invest in another commodity.

<http://www.nfa.futures.org/nfa-registration/cpo/index.HTML>

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