

INVESTMENT ADVISERS: HOT TOPICS IN ADVISER REGULATION

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AGENDA

- ⦿ RESOURCES AVAILABLE
- ⦿ BASIC REGULATORY FRAMEWORK
- ⦿ HOT TOPICS
- ⦿ ADVISORY BUSINESS MODELS

RESOURCES AVAILABLE

- ⦿ List of Resources handout
- ⦿ Testing whitepaper handout
- ⦿ Website www.40ActLawyer.com
- ⦿ Law firm alerts
- ⦿ CLEonline.com IM-related seminars
- ⦿ Compliance roundtables across the country
 - Including outreach / inreach

REGULATORY FRAMEWORK

- Federal: Investment Advisers Act of 1940
- State: Uniform Securities Act or other
- NASAA model provisions
- NSMIA (National Securities Markets Improvement Act)
- Definitions: “adviser” “rep” “security”
- **EVOLVING ISSUES**: SRO, BD/IA harmonization, SEC/CFTC harmonization, SEC/DOL fiduciary duty
- **RESOURCE**: “Running the Traps”
whitepaper

Hot Topics

RISK MANAGEMENT / ERM

- ⦿ Relationship to compliance
- ⦿ KEY QUESTION: What is the adviser's own risk assessment process?
- ⦿ BEST PRACTICE: Adviser maintains a risk inventory (what has and has not been considered) and documentation "mapping" the significant risks to specific policies and procedures.

Hot Topics

ASSET VERIFICATION

- Interrelationship with custody
- Verification through custodian
- Verification through direct client contact
- Omnibus / commingled accounts
- RESOURCE: 2009 CCO Outreach handout on Asset Verification

Hot Topics

INSIDER TRADING

- ⦿ Oversight of firm and personal trading
- ⦿ Relationship with Code of Ethics
- ⦿ HOT ISSUE: Use of “expert networks”
- ⦿ KEY QUESTIONS:
 - What is adviser’s assessment of risk?
 - What accounts are being reported?
 - What securities are being reported (including derivatives)?

Hot Topics

TRADING PRACTICES

- ⦿ Aggregation / allocation / cherrypicking
- ⦿ Aggregation – which accounts are included in the trade?
- ⦿ Allocation – how are trades divvied up among included accounts?
 - Cherrypicking – profitable trades are allocated to favored accounts
- ⦿ **RESOURCE:** Look at Testing whitepaper for ideas on monitoring trading.

Hot Topics

SOFT DOLLARS

- “We don’t do soft dollars”
- Definition: Brokerage commissions “paid” in exchange for research or brokerage...or other benefit
- Section 28(e) safe harbor permits “paying up”
- Raises conflicts of interest
- KEY QUESTIONS: What do disclosures say? What do records show about value of research?
- RESOURCE: Seminar on soft dollars

Hot Topics

PRIVACY / CONFIDENTIALITY / ID

- Federal: Reg. S-P
- State privacy laws are NOT pre-empted
- Data breaches (notification requirements)
- ID theft “red flags” rules
- KEY QUESTION: How is the adviser’s IT system designed and supported?

Hot Topics

SOCIAL MEDIA

- ⦿ Overlaps with many areas:
 - Advertising
 - Anti-fraud
 - Electronic media / privacy / security
 - Recordkeeping
- ⦿ **EVOLVING ISSUE:** How to evidence effectiveness of prohibitions on use?
- ⦿ **RESOURCE:** List of Resources handout identifies guidance and industry surveys

Hot Topics

BUSINESS CONTINUITY PLANNING

- Disaster planning
- Succession planning
- Interrelationship with IT issues and custody
- KEY QUESTION: When and how has adviser tested its business continuity plan?
- RESOURCE: Seminar on BCP

Hot Topics

ADVERTISING / MARKETING

- ⦿ “We don’t advertise”
- ⦿ Performance presentations
- ⦿ GIPS compliance
- ⦿ Designations and certifications (seniors)
- ⦿ Solicitors
- ⦿ KEY QUESTION: What controls are in place to vet materials before use?

Hot Topics

CONFLICTS OF INTEREST

- ⦿ “We don’t have conflicts”
- ⦿ To identify conflicts...“follow the money”
- ⦿ Disclosure
- ⦿ HOT ISSUE: When is disclosure not enough?
- ⦿ KEY QUESTION: How does adviser identify conflicts in its risk assessment process?

Hot Topics

CCOs

- ⦿ Qualifications / support
- ⦿ Outsourcing
- ⦿ EVOLVING ISSUE: “Supervisor” status / personal liability
- ⦿ KEY QUESTIONS:
 - What is the CCO’s background in compliance?
 - What sources of support are available to the CCO and on what basis?

Hot Topics

FRAUD

- ⦿ Federal versus state definition
- ⦿ Relationship with disclosure
- ⦿ Implications of violation
- ⦿ **OBSERVATION:** The federal versus state boundaries over fraud have not been ironed out under NSMIA

Hot Topics

FIDUCIARY DUTY

- ⦿ Scope / meaning
- ⦿ Duty of care
- ⦿ Duty of loyalty
- ⦿ EVOLVING ISSUE: Adviser versus broker-dealer versus DOL
- ⦿ RESOURCE: Whitepaper on fiduciary duty

Hot Topics

ALTERNATIVE INVESTMENTS

- ⦿ Non-traditional assets
- ⦿ Non-traditional strategies
- ⦿ KEY QUESTIONS:
 - How is valuation supported?
 - Does disclosure explain both risk and reward?
 - Do both adviser and client understand the investment?

Advisory Business Models

FINANCIAL PLANNERS

- ⦿ Are planners “advisers”?
- ⦿ Fee-only versus fee-based versus other
– conflicts of interest
- ⦿ Scope of relationship / obligation
- ⦿ KEY QUESTION: How are issues explained to clients?

Advisory Business Models

ACCOUNT MANAGERS

- Separate accounts (discretionary / non-discretionary)
- Separately managed accounts (wrap accounts, UMAs and similar programs)
- Pension accounts and consultants
- HOT ISSUE: AUM versus RAUM
- KEY QUESTION: How are incentives managed to avoid or mitigate conflicts?

Advisory Business Models

FUND MANAGERS

- Public funds versus private funds
- Funds-of-funds
- Hybrid / other
- EVOLVING TOPIC: Multiple advisers reporting on one Form ADV
- KEY QUESTION: How are newly registered private fund advisers coping with new regulatory requirements?

Advisory Business Models

MANAGERS-OF-MANAGERS

- Interface / scope of responsibilities of adviser versus sub-adviser / portfolio manager
- Oversight of sub-advisers
- Indemnifications / limitations of liability
- KEY QUESTION: Who is responsible for and oversees compliance?
- RESOURCE: Whitepaper on Advisers Overseeing Sub-Advisers (and others)

Advisory Business Models

DUAL REGISTERED BD/IAs

- Evolution of “hybrid” model
- Account, product & fee alternatives reflecting both BD and IA paradigms
- KEY QUESTIONS:
 - How does client get directed to a brokerage accounts versus an advisory account?
 - What do clients understand about fees, conflicts, fiduciary duty / disclosures?

Advisory Business Models

CONSOLIDATORS / NETWORKS

- Also roll-ups and aggregators
- Many disparate advisers, accounts and operations functioning under one umbrella
- KEY ISSUES:
 - Operations / oversight at two levels
 - Disclosure delivery
 - Vicarious liability
 - Compliance
 - Registration
 - Client understanding

RECAP

- Resources
- Regulatory Framework
 - Hot Topics
- Advisory Business Models

ADDITIONAL TOPICS

- Custody (rule and disclosure)
- Advisory contracts
 - Exculpatory / hedge clauses
 - Mandatory arbitration clauses
- Advisory and other fees
 - Performance fees
 - Fees for other services (fund share distribution, solicitation, revenue sharing, etc.)
- Changes of control
- Adviser reporting – 13F, 13H, 13D/G, PF
- Municipal / government / union / ERISA clients
 - Pay to play
 - Reporting