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 CCOOutreach 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?
"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/IA

- 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