
**SEC COMPLIANCE OUTREACH PROGRAM FOR INVESTMENT ADVISER AND INVESTMENT COMPANY SENIOR OFFICERS NATIONAL SEMINAR**

**APRIL 19, 2016**

**ORICAL LLC NOTES***



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## I. Opening Remarks, Chair Mary Jo White[1]

Good morning and thank you, Marc [Wyatt], for that kind introduction. It is my pleasure to be here today to welcome this distinguished group of professionals to the SEC's 2016 Compliance Outreach Program for Investment Advisers and Investment Company Senior Officers.

I am happy to see such a large turnout. We had more than 800 people register for today's conference within the first week after the registration period opened, and today we see the result – a large and very diverse cross-section of attendees – both here in-person in Washington, DC and through our webcast. Many of you are Compliance Officers, and we also have Chief Executive Officers, Chief Financial Officers, Chief Operating Officers and others here today. We very much welcome your attendance as a reflection of how important the work of your Compliance Officer and compliance personnel are to your entire organization.

No matter what your role, I think you will find that we have put together a great program with knowledgeable speakers and informative panels. Throughout the day, experts, both from the SEC staff and industry, will share their insights on a number of important issues that affect investment advisers and investment companies such as cybersecurity, liquidity management, and rulemaking initiatives in the Division of Investment Management ("IM"). Speakers include members from three SEC divisions and offices (OCIE, IM, and the Division of Enforcement) and staff from seven of our 11 regional offices. The agency-wide representation at this conference highlights the importance we place on robust communication and sharing of information within the SEC and with you that we believe is necessary to carry out the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

[1] The opening remarks were taken from the SEC website. Notes for the Panel remarks and Q&A sessions were compiled by Jim Leahy (jleahy@orical.org) and Vanessa Sasson (vsasson@orical.org) of Orical. We added "Editors Notes" by way of explanation of some of the panelist's remarks. We also added Exhibit A which provides a citation and brief explanation of selected enforcement actions and cases referred to during the various panels.

I have said this many times before, but it cannot be emphasized enough. You are critical to our mission of protecting investors and the integrity of the markets. Every day, millions of people invest their hard-earned dollars through your firms, hoping to educate their children, fund their retirements, and realize countless other dreams. These investors place their trust in you and your firms, not only for sound investment advice to help their assets grow, but also to safeguard those assets from misconduct and undisclosed risks. Their trust demands that your firms must not only have an unwavering commitment to investors' best interests, but also strong, comprehensive and effective compliance programs and cultures.

Investors are not the only ones who rely on you. We at the SEC also rely on you because, as much as we strive to be everywhere, we do not have the resources to actually be everywhere. OCIE's National Exam Program now has approximately 530 dedicated professionals who are tasked with examining nearly 12,000 registered advisers, who advise approximately 11,000 mutual funds and ETFs, and nearly 30,000 private funds. And the total amount of assets under management has grown to a staggering $66.8 trillion dollars.

As large as these numbers are now, they are increasing every day. In an effort not only to keep pace with this growth, but also to expand our exam coverage of investment advisers, OCIE is in the process of devoting more of its staff and resources to its investment adviser/investment company examination program by transitioning some staff from broker-dealer exams to investment adviser exams, as well as using our appropriations to augment exam staffing, with the goal of bolstering staffing levels in the IA/IC program by 20 percent.

With this larger team, OCIE hopes to do more national priority exams, such as the retirement-focused assessments announced last summer (known as OCIE's "ReTIRE" initiative") and reach more investment advisers and investment companies that have never been examined before.

Despite OCIE's efforts to optimize our resources, there is a need for significantly more OCIE resources if we are to fulfill our exam responsibilities to investors, which I continue to seek from Congress in our annual budget requests.

It goes without saying that you will always play a critical role as the first line of defense for investors in our markets. That is true whether your compliance functions are in-house or you rely on contractors, consultants, or other third-party vendors for assistance. You can draw on external assistance, but you cannot outsource your obligations. Regardless of the structure, each registrant is ultimately responsible for adopting and implementing an effective compliance program and is accountable for its own deficiencies.

Strong compliance must permeate your organization at every level. The right tone at the top and a strong CCO are crucial, but not sufficient. When firms do not implement and enforce a comprehensive set of policies, procedures, and systems to govern and supervise all of their employees, it is much more likely that investors will be harmed. And when firms do not fully and fairly disclose conflicts of interest, investors are deprived of the opportunity to make fully-informed investment decisions. Together we must make sure that does not happen.

One of the cornerstones of our National Examination Program is supporting your efforts to build and implement strong compliance programs and compliance cultures at your firms. We want to see firms foster an environment in which every individual, at every level understands the importance of the compliance program and believes in the compliance culture. And you are the ones most instrumental to achieving that.

Today's outreach conference is part of our effort to support you. This event and the others like it that we host throughout the year not only help promote a better understanding of OCIE's examination priorities and of common deficiencies we are finding, but also foster the type of constructive dialogue that we think is essential to building the effective compliance programs that we all want to see.

Closing

It is great to see so many of you here today to participate in this conference, and continue to work to ensure that our capital markets remain the strongest and most reliable in the world.

I hope that you will take the opportunity at this event today – and at all of our conferences – to ask questions, offer suggestions, and give us feedback on our efforts.

Thank you very much for being here and for all you do. Have a great conference.

## II. Introductory Remarks

Andrew Ceresney, Director, Division of Enforcement: We have 12 offices around the country, including the home office in Washington D.C. Priority areas for enforcement right now are: Conflicts; a recent enforcement action was brought against **JP Morgan**[2] for failure to disclose a preferential proprietary product. Other recent cases involve **BlackRock**[3], relating to the outside business activity of a portfolio manager and **Royal Alliance**[4] involving share classes that had expenses versus other share classes that did not. Investors were not appropriately told about the different level of expenses. In the Private Equity world we are focused on expenses. Valuation is a priority; a recent case involves **Equinox**[5]. Governance issues are of concern. Cyber Security is a focus. The **RT Jones**[6] case involves the failure to adopt policies and procedures relating to the safeguarding of personally identifiable information as required by Regulation SP. Performance Advertising is another focus; recent cases include **F-Squared**[7], **Virtus**[8] and

[2] JPMorgan Chase Bank, N.A. and J.P. Morgan Securities LLC, Investment Advisers Act of 1940 (IA) Release No. 4295 (December 18, 2015). See Exhibit A.
[3] BlackRock Advisors, LLC, IA Release No. 4065 (April 20, 2015). See Exhibit A.
[4] Royal Alliance Associates, Inc., IA Release No. 4351 (March 14, 2016). See Exhibit A.
[5] Equinox Fund Management, LLC, IA Release No. 4315 (January 19, 2016). See Exhibit A Valuation.
[6] R.T. Jones Capital Equities Management, Inc., IA Release No. 4204 (September 22, 2015).
[7] F-Squared Investments, Inc., IA Release No. 3988 (December 22, 2014). See Exhibit A.
[8] Virtus Investment Advisers, Inc., IA Release No. 4266 (November 16, 2015). See Exhibit A Performance.



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**Cantella**[9]. During the Q&A Mr. Ceresney indicated that a member of Enforcement will often participate in routine SEC exams. This could be for the expertise the Enforcement staff has or for training or it could be because there is some indication of misconduct. Also, with respect to CCO liability, Enforcement brings three categories of cases against CCOs: The CCO is involved in misconduct at the firm; the CCO misleads regulators; or there is a wholesale failure of the CCO to carry out his compliance responsibilities. The **BlackRock** case is an example of the last category.

David Brim, Director, Division of Investment Management: We have about 200 people. We are broken down into four basic groups: Disclosure (Registration Statements); Chief Counsel (no-action letters); Risk and Exams; and Rule Making.

Marc Wyatt, Director, Office of Compliance Inspections and Examinations (National Exam Program): We have a staff of 1000. We are 3 things: Transparent; Risk Based; and Data Driven. We do not make policy.

## III. Panel I: Program Priorities

Dianne Blizzard, Associate Director, Division of Investment Management

Jane Jarcho, Deputy Director, National Exam Program

Anthony Kelly, Co-Chief, Division of Enforcement, Asset Management Unit

Jane Jarcho: If you get notification that we are coming to your firm to do an exam you may think: "What does the SEC think that we did wrong?" That is not typically the case. We are risk based and your firm may trade a product or have a business line that we feel presents heightened risks to investors and we would like to learn more about it. We work with three data groups in OC that help us identify and prioritize exams. Now let me tell you about some of our current initiatives and priorities:

FILLER—Fixed Income Liquidity Risk Initiative: One current priority is the effect rising interest rates may have on bond prices and result in higher redemptions for fixed income funds. This may affect liquidity for certain funds. We are looking at disclosure in fund documents for these types of risks.

ReTIRE Initiative: The primary focus of exams conducted pursuant to this program is fee and account selection, sales practices, suitability and marketing. We have conducted about 200 exams in this area. 80% are for Registered Investment Advisers and about 20% for Broker Dealers. The emphasis on this program is retail, individual's retirement funds.

Exchange Traded Funds: ("ETFs"): The focus of these exams is compliance with Investment Company Act requirements in terms of exemptive relief. These exams also look at disclosure to investors.

Muti Branch Advisers: These exams focus on compliance, oversight and portfolio management. We start at the main office and determine what the base line compliance levels are and then venture out to

[9] Cantella & Co., IA Release No. 4338 (February 23, 2016). See Exhibit A Performance.

various branch offices to test the compliance program there. We look at compliance oversight, fee billing, custody, performance advertising, training, portfolio management, conflicts, trade allocation and principal trades, among other things.

Retail Investors: With respect to RIAs that offer various account types and fee arrangements, we need evidence that these arrangements are suitable and in the best interest of individual investors.

Share Class Initiative: This is applicable to mutual funds and 12b1 fees but also has applicability to RIAs. Need to disclose conflicts about which share class is recommended to a particular investor.

Bad Actor Initiative: Data driven to choose RIAs. Areas looked at in these exams include disclosure, marketing, fee billing and portfolio management.

Anthony Kelly: The SEC's Asset Management Unit breaks the industry into three categories: Registered Investment Companies ("RICs"), Private Funds, and Retail Accounts. We focus on specific priorities for each category. For RICs our priorities are: Governance, Valuation, Performance and Conflicts of Interest. With respect to Private Funds, Anthony Kelly mentioned the recent **BlackRock Advisors**, LLC[10] case having to do with conflicts of interest and outside business activities.

For Private Funds, general themes would be **Conflicts**, **Valuation**, and **Fees and Expense Allocation**.

1. **Alpha Titans LLC**. Santa Barbara based RIA.[11] April 2015. Used $450,000 to pay adviser's office rent, employee salaries and other overhead and operational expenses. The SEC indicated that Alpha Titans: "Did not make proper disclosures for clients to decipher that the funds were footing the bill for many of the firm's operational expenses." "Private fund managers must be fully transparent about the type and magnitude of expenses they allocate to the funds," said the SEC. The fund's auditor knew about certain irregularities with respect to related party disclosures and signed off on financial statements. Alpha Titans violated the Custody Rue by distributing financial statements that were not GAAP compliant. **Improper expenses charged to fund. Insufficient disclosure.**
2. **AlphaBridge Capital Management**.[12] Greenwich based RIA. July 2015. AlphaBridge fraudulently inflated RMBS prices and took much higher management fees and incentive. Lied to auditors. AlphaBridge created their own valuations and fed them to BDs who then passed them on to administrator and auditor as their own. As a result, AlphaBridge violated their own written valuation policy. **Valuation fraud leads to higher management and incentive**.
3. **KKR**[13] case involving improper allocation of broken deal expenses. A co-investment vehicle received deal allocations but not its share of broke deal expenses.

[10] IA Release No. 4065 (April 20, 2015). See Exhibit A.
[11] IA Release No. 4073 (April 29, 2015). See Exhibit A.
[12] IA Release No. 4135 (July 1, 2015). See Exhibit A. Related, IA Release No. 4136 (July 1, 2015).
[13] Kohlberg Kravis Roberts & Co., IA Release No. 4131 (June 29, 2015).

4. **Blackstone**[14] case involving a failure to disclose accelerated monitoring fees. In the press release to this case Andrew Ceresney said: "Full transparency of fees and conflicts of interest is critical in the private equity industry…"
5. **Fenway Partners LLC**.[15] NY based private equity. Nov 2015. **Failure to disclose conflicts of interest**. Rerouted portfolio company fees to an affiliate. The SEC indicated that "Fenway Partners and its principles failed to tell their fund client that they rerouted portfolio company fees to an affiliate and avoided providing the benefits of those fees to the fund client in the form of management fee offsets." "Private equity advisers must be particularly vigilant about conflicts of and disclosure when entering into arrangements when communicating with fund investors."

Anthony Kelly also mentioned that his group is looking at aberrational performance. Using risk analytics they are looking for performance outliers. They are also looking for undisclosed conflicts, trade allocations and misallocation of fees and expenses.

For Retail Accounts, priorities include failures to disclose conflicts as well as best execution. Recent examples of cases involving failure to disclose conflicts of interest include **Pekin Singer** and **Everhart**. Mr. Kelly also mentioned cases involving **Royal Alliance**, **RT Jones**, **JP Morgan**. In the performance advertising area he mentioned the **F Squared** case involving performance advertising as well as the subsequent cases **Vertus** and **Contella**. [See Exhibit A for a citation and brief summary of the cases.]

Undisclosed conflicts of interest including in the area of compensation are part of the SEC's Adviser Undisclosed Revenue initiative.

Gatekeeper cases include **Alpha Titans** and Summit. In these cases, outside auditors failed to comply with relevant professional standards.

Dianne Blizzard: The SEC is working on a number of rule making initiatives on liquidity, derivatives, stress testing, transition planning RIAs. The SEC will also be collecting risk data at the investment level for RIA's. Currently working on a new form to replace Form NSAR; they are also studying changes to Form ADV to collect aggregate information with respect to leverage and the use of derivatives as well as more data on separately managed accounts. They are considering changing the rules about performance disclosures to any person (not just 10) and also the records requirement. They are considering codifying umbrella registration (currently, advisers are relying on the 2012 ABA SEC No Action Letter with respect to Relying Advisers[16]). The SEC wants to do more stress testing on Advisers with greater than $10b under management. There are approximately 350 such organizations. The SEC is working on stress testing methodologies and a summary will be made public.

[14] Blackstone Management Partners L.L.C., IA Release No. 4219 (October 7, 2015). See Exhibit A.
[15] IA Release No. 4253 (November 3, 2015). See Exhibit A.
[16] January 18, 2012 SEC No-Action Letter to the American Bar Association, Business Law Section.

Third Party Compliance Reviews: The SEC is considering having third parties do some work on behalf of the SEC. They don't have the bandwidth to examine as many funds as they would like. Currently, there is a lot of discussion about what the scope of these reviews should be.

Other themes mentioned include: **Undisclosed Conflicts**, **Allocation of Trades**, **Performance Outliers** (the SEC is looking for aberrant performance compared to what an adviser discloses as, and the **R.T. Jones** case from last September (cybersecurity, Reg S-P violation).

Q&A

Maureen Dempsey, Assistant Director, National Exam Program, Chicago Regional Office

Ahmed Abdul-Jaleel, Exam Manager, National Exam Program, Chicago Regional Office

Sarah Buescher, Branch Chief, Division of Investment Management

William J. Delmage, Assistant Director, National Exam Program, New York Regional Office

Benjamin Faulkner, Attorney-Adviser, National Exam Program, Los Angeles Regional Office

Brian Fitzpatrick, Industry Expert, Division of Enforcement, Asset Management Unit

Melissa Gainor, Senior Special Counsel, Division of Investment Management

Christopher Mulligan, Senior Counsel, National Exam Program, Office of Chief Counsel

Alpa Patel, Branch Chief, Private Funds, Division of Investment Management

- Conflicts: William Delmage. Provide examples of conflicts and how should the CCO stay on top of this issue. In the context of dual registrants (RIA/BD) there are many conflicts with respect to the sale of proprietary products. Share class issues involve how is one share class (investor fees) chosen or recommended over another share class (no fees, for example). Where an adviser has different types of products with different types or levels of fees and or service, how do you select one over the other? What is your disclosure about conflicts in this area? Outside business activities and board of directors participation also pose a conflict. We like to see during examinations that firms have spent some time trying to identify conflicts. How does the CCO keep track of this issue? Well you should certainly ask traders and other firm employees if they have friends or family at service providers or counterparties. Ask them what outside business activities are they engaged in; what boards of directors are they serving on?

- Trade Allocation: **Welhouse**[17] case was mentioned—cherry picking investments to the detriment of clients.
- Policies and Procedures: Deviations from a firm's policies and procedures need to be documented. The SEC believes this will prevent conflicts and favoritism among clients.
- ROBO Advisers
- Conflicts are particularly prominent to dual registrants: registered as an investment adviser and as a BD. Information barriers.
- Ben Faulkner. Cybersecurity: Main points for advisers to consider at this point.
    - Have policies and procedures in place.
    - Do a periodic assessment of your program. Document what corrective actions you have taken.
    - Have the appropriate technology to protect your networks and clients' Personally Identifiable Information.
    - Conduct training.
    - Have timely detections of intrusions and events as well as appropriate disclosure.
- Private Equity Disclosure:
    - Chris Mulligan. As an adviser you are a fiduciary. Put yourself in your investor's shoes. What would I want to know as an investor? What would I want to know about conflicts, expenses and fees? In addition to having appropriate disclosure, the CCO needs to have robust policies in place to make sure that the policies are being followed in the area of travel expenses or portfolio expenses, as an example. Areas where the SEC has encountered problems involve calculation of carried interest, portfolio company expenses and fees, GP expenses and Fund expenses.
    - Brian Fitzpatrick. Ensure that your practices are consistent with the fund's formative documents.
- Ahmed Abdul Jaleel. Gifts and Entertainment: Rule 206 limits of $350 and $150. Gifts intended to influence need to be monitored. If you want to manage money for a public pension plan you need to check the state and local requirements. Be particularly concerned about any gifts or payments for lodging or travel. By way of example, Illinois has a $100 limit. Concern with respect to Rule 206 includes lobbying fees paid to third parties.
- Custody Rule
    - Alpa Patel. If a fund starts in November or December you still need to get an audit for that year.
    - Chris Mulligan. Use of SPVs. The first question should be is the entity a client? The 2009 SEC Custody Rule Release[18] indicates that the adviser either obtains a separate audit of the or SPV or disregard the SPV and have it covered in the fund's audit. In the 2014

[17] Welhouse & Associates, Inc., IA Release No. 4132 (June 29, 2015). See Exhibit A.
[18] Custody of Funds or Securities of Clients by Investment Advisers, Advisers Act Release No. 2968, Effective Date March 12, 2010.

Guidance[19], if the SPV has outside investors then the question is how are these outside investors covered? One audit does not protect these outside investors that are not invested in the fund because they will not receive the fund's audit, and even if they did the SPV may not be mentioned.

- Compliance Consultants/Outsourced CCO
    - Benjamin Faulkner. Compliance Consultants. The SEC has observed a wide range of roles.
    - William Delmage. Outsource CCO. The named CCO is responsible. If the SEC calls and asks for the named CCO and the receptionist does not know who that is, that's a red flag.
    - Ahmed Adbul Jaleel. Some outsourced CCOs work well. One was acting in that capacity for over 30 firms and was a consultant to an additional 70 firms. This did not work well.
- DOL Fiduciary Rules. We should read the rule. As a registered investment adviser you are already a fiduciary.
- Alpa Patel. AML Requirements. This is a Treasury Rule. Stay tuned. No timeline for implementation of this new rule that would bring private funds within the definition of "financial institution" for purposes of the Patriot Act.
- Brian Fitzpatrick. CCO Liability. The SEC is concerned with CCOs that wear multiple hats to ensure they have sufficient resources to fulfil the compliance function. The recent BlackRock case where the CCO was found culpable was cited. If there is a compliance failure the CCO is responsible especially where the CCO has been apprised of the failure, is fully aware of it and the problem is not solved.
- William Delmage. Preparation for the **Annual Compliance Review**. Don't assume it is a once per year task. It's an enormous amount of work for one or two people even in a small firm. Develop a calendar. Break this large task down into small more manageable tasks that are done more frequently. Some might be done on a daily, weekly or monthly basis. Stay organized; give the SEC lists of Compliance exceptions. Maintain documentation. If you have no exceptions, no trade errors for example, that raises red flags at the SEC. It is far better to say that the following issues have come up during the year and this is how we handled them. Leverage your Service Providers. They have systems and policies that can be helpful to you as CCO.
- 2012 ABA Letter with respect to Umbrella Registration. Schedule R. Single Advisory Business. SEC is considering codifying the rules set out in the 2012 No-Action Letter.
- Ben Faulkner. SEC Exam and Document Request List. How to communicate with the SEC staff. Ask questions so that the SEC can tailor its requests to your firm and how you conduct business. It's a dialogue. Ask us. Don't wait till the time mandated for a response has passed. Have a conversation up front.

## IV. Panel II: Private Fund Adviser Topics

[19] IM Guidance Update June 2014, Private Funds And The Application of the Custody Rule to Special Purpose Vehicles And Escrows.

Jennifer Duggins, Senior Specialized Examiner, Co-Head of the Private Funds Unit, National Exam Program

Brendan McGlynn, Assistant Director, Division of Enforcement, Asset Management Unit

Michael Neus, Managing Partner and General Counsel, Perry Capital LLC (Panel Moderator)

Alpa Patel, Branch Chief, Private Funds, Division of Investment Management

Adam Reback, Chief Compliance Officer, J Goldman & Co., L.P.

Igor Rozenblit, Senior Specialized Examiner, Co-Head of the Private Funds Unit, National Exam Program

Igor Rozenblit. If you are a registered investment adviser, there is an inherent conflict in allocating and shifting expenses. You need to carefully evaluate your disclosure when it comes to expenses. This is particularly a sensitive point when you are doing business with affiliates and they are providing services to your funds. This goes for Senior Adviser, and operating partners. If you are charging fees to portfolio companies, disclose that. If you are charging for back office services, disclose that. See the recent Blackstone case with respect to acceleration of fees. See the KKR case with respect to broken deal expense allocation. You need to allocate in line with what it says in your PPM.

KKR Kohlberg Kravis Roberts & Co.[20] June 2015. Did not allocate broken deal expenses (research costs, travel costs, professional fees and other expenses incurred in deal sourcing related to failed deals) to co-invest funds. They got the benefit of the trade allocation but did not share in the expenses. This is the first SEC case to charge a private equity adviser with misallocating broken deal expenses. **Failure to allocate expenses fairly**. Alpa Patel also emphasized that many enforcement actions, including **KKR**, involve failure to disclose as well.

It is ok to have a co-investment vehicle but you can't play favorites with your clients. And you need to disclose what you are doing. If you are lending funds to a portfolio company it's a conflict and it needs to be disclosed. If you have affiliated service providers and you say they charge you "below market rates", is it really below market? You need to document that claim.

SEC Exams:

- Andrew Ceresney. 10-15% of exams are referrals.
- Adam Reback. He does a mock exam each year—including interviews. He brings in a third party for these. As part of his Annual Compliance Review he goes through the SEC's recent document request lists. Everyone at the firm knows their role in an SEC exam, from the receptionist to the CEO. This way you can avoid panic.
- Igor. Every SEC examiner is different. Each has his own pet peeves. Take your time and answer the SEC's questions honestly. Explain your business. What is it that you do and how do you do it.
- Igor. Don't negotiate the SEC Document Request list and don't negotiate the examination findings letters.

[20]IA Release No. 4131 (June 29, 2015). See Exhibit A.

- Jennifer Duggins. The Private funds Unit operates thematically. Works with Division of Economic and Risk Analysis ("DERA") experts and quantitative analysts. They act as a think tank trying to figure out what are the risks in private funds. Where do we focus our limited resources? We expect the CCO to be the point of contact. But we often ask the same questions of many people at a firm to see if we get consistency in the answers. We have a plan when we go into the field.
- Jennifer Duggins. The SEC Exam period may be 1.5 to 2 years but the examiners will ask you for blacklines of ADVs, PPMs and Compliance Manuals going back 5 or more years. Also, we do talk with investors in your funds.
- **SEC Exam Document Request**. Ask the SEC questions if you do not understand the question or if you think it may not apply to you. It's a dialogue. Have a conversation up front.

Aberrational Performance:

- Brendan McGlynn. We are looking for suspicious performance as part of our Aberrational Performance Initiative ("API"). Since 2011 the SEC has received 14,000 whistleblower tips!
- Alpa Patel. We do use Form PF. We look at leverage and performance.
- Jennifer Duggins. We compare Form PF to Form ADV and look at any assumptions.

Insider Trading:

- Brendan McGlynn. Yes we are still looking at insider trading as an issue. The notion of "personal benefit" is only one element. Since the Newman[21] decision the SEC won a case against Benjamin Durant.
- Expert Networks and other sources of research. Where are research flows and information coming from in your firm? You as CCO should consider all sources of information and assess the relative risks from each source. You should have a diligence process and procedures around each source whether it is from corporate insiders, consultants, sell side sources or other source. Compliance should approve each source after considering what process is in place to minimize the chance of obtaining inside information. Compliance could review the source's policies and procedures as well as samples of their research. How is the source obtaining its information? What parameters and procedures are in place at the source? The CCO could look at all payments made from the firm to ensure the payment is to an approved source of research. Is the information source from Expert Networks? If so, is it coming only from approved experts? Consider an annual onsite due diligence visit to the expert network providers. Limit your analysts contact with experts. Need to have periodic chaperoning analyst/trader calls and meeting. Use Bridge Line so that the CCO can stop the call. You can't reasonably rely entirely on the investment

[21] United States Court of Appeals for the Second Circuit, U.S. v. Todd Newman, Anthony Chiasson, Defendants-Appellants, Decided: December 10, 2014.

staff on this issue. Need to ensure that your PMs and investment staff know what insider trading is and how to avoid and prevent it.

- Insider Trading. U.S. v Todd Newman, Anthony Chiasson (2nd Circuit) and US v Salman[22] (9th Circuit)
- Is **Insider Trading** still an issue post 2nd Circuit decision in Newman? Newman was a PM at Diamondback Capital Management and Andrew Chiasson a PM at Level Global Investors. Court reversed convictions. Improper jury charge. Issue is over "personal benefit". Newman court required the following elements: (i) the corporate insider was entrusted with a fiduciary duty; (ii) corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit; (iii) the tippee knew of the tipper's breach, that is, he knew the information was confidential and divulged for personal benefit; and (iv) the tippee still used that information to trade in a security or tip another individual for personal benefit.
- Since the Newman case, on April 6, SEC won a jury trial in the US District Court, S.D. of New York against Daryl Payton and Benjamin Durant. **SEC v. Payton and Durant**.[23]
- 9th Circuit Court of Appeals case **US v. Salman** will be heard by the US Supreme Court.

Cybersecurity:

- **R.T. Jones**[24] case. Regulation S-P violation. Need to have written policies and procedures; have periodic risk assessment (what corrective action is needed; Need appropriate technology to protect networks and personally identifiable information; training; timely detection and disclosure.

Disclosure:

- Private Equity Disclosure. You are a fiduciary. Put yourself in investor's shoes: What would I want to know about expenses, fees, and conflicts, carried interest, portfolio company expenses and fees; GP expenses and fund expenses.
- Disclosure Standard. If your mother was the client is it something you would want her to know? E.g. expenses, etc.
- Allocation of Investment Expenses and Investment Opportunities e.g. **KKR**. In the KKR private equity case there were co-investment vehicles and a misallocation of expenses. There was also a failure to disclose.

[22] United States Court of Appeals for the Ninth Circuit, U.S. v Bassam Yacoub Salman, Filed July 6, 2015.
[23] Litigation Release No. 23478, March 2, 2016. See Exhibit A.
[24] R.T. Jones Capital Equities Management, Inc., IA Release No. 4204 (Sept 22, 2015). There was a second more recent Regulation S-P case in the Broker Dealer context as well, **Craig Scott Capital, LLC**, Securities Exchange Act of 1934 Release No. 77595, April 12, 2016. See Exhibit A.

Panel II. Key theme is disclosure. Igor—Every SEC examiner is different. Each has his own pet peeves. Take your time and answer the questions accurately. Explain your business. What is it you do and how do you do it.

## V. Panel III: Registered Investment Company Topics

Thoreau Bartmann, Branch Chief, Division of Investment Management

Mary Keefe, Managing Director and Director of Regulatory Affairs, Nuveen Investments Inc.

Anthony Kelly, Co-Chief, Division of Enforcement, Asset Management Unit

Thomas Kirk, Assistant Regional Director, National Exam Program, Chicago Regional Office (Panel Moderator)

Nancy Morris, Chief Compliance Officer and Managing Director, Wellington Management Company

Several issues not relevant to Registered Investment Advisers are not included in these notes, particularly with respect to derivatives and liquidity risk management.

Anthony Kelly raised certain recent enforcement actions: **Blackrock** case and CCO liability discussed.

**F-Squared Investments, Inc**.[25] December 2014. **Errors in performance track record**. **Vertus** and **Cantella** cases.

**UBS Willow Management**.[26] October 2015. **Style drift** (strategies contrary to disclosure). Strategy change was not disclosed to investors.

Q&A Session 2 for Registered Investment Advisers

Mark Dowdell (Chair of Q&A), Assistant Director, National Exam Program, Philadelphia Regional Office

Thoreau Bartmann, Branch Chief, Division of Investment Management

Shane Cox, Attorney Adviser, Los Angeles Regional Office

Eric Elefante, Assistant Director, National Exam Program, Philadelphia Regional Office

Brian Fitzpatrick, Industry Expert, Division of Enforcement, Asset Management Unit

[25] F-Squared Investments, Inc., IA Release No. 3988 (December 22, 2014).
[26] UBS Willow Management L.L.C., IA Release No. 4233 (October 16, 2015).

Alpa Patel, Branch Chief, Private Funds, Division of Investment Management

Jim Reese, Assistant Director, National Exam Program, Office of Risk Analysis and Surveillance

Doug Scheidt, Associate Director and Chief Counsel, Division of Investment Management

- Mark Dowdell. What factors do you look at to assess the effectiveness of information barriers. When we do an information barrier exam we look at how the firm has purported to separate itself from related or affiliated entities. We look at what is material and we conduct testing, including communication testing; we review emails; we will conduct interviews to ensure that information is not being shared across the barrier.
- Allocation of Investment Opportunities. What if your PM passes on an opportunity, how should that decision be documented? Doug Scheidt: First, what is your policy on allocation of investment opportunities and did you follow it? What is your allocation method? Why did he pass? What documentation do you have to support his decision? Alpa Patel suggests that the CCO should conduct testing to ensure that the policy is being followed. Mark Dowdell indicates that the SEC will look at memos, emails, documents to support the conclusion that the PM gave you for passing on the deal. Our policy is ABC. This is an exception for XYZ. Mark said that if there is not documentation the SEC will definitely question the allocation decision. Exceptions to your policy should be documented. And it should not be a one word "Exception"; it needs to explain why the decision not to follow your policy was taken.
- Jim Reese. Risk and Strategy is a new office in OC. Peter Driscoll is the chair of Quantitative Methodologies. Goal of this new office is to align data analytics and quantitative methodologies across the various SEC offices with respect to exam strategies and themes. The group conducts exams and coordinates with Division of Economic and Risk Analysis. Mark: Enforcement numbers have gone up as we are now more targeted and risk based.
- The question goes to the applicability of the Advisers Act outside the United States. The specific example asked was how should the CCO go about ensuring compliance with the cash solicitation rule outside the US? Doug Scheidt: SEC does not apply the Advisers Act to a registered advisers foreign clients. The registered advisers dealings with foreign clients would not be subject to the cash solicitation rule. Mark Dowdell indicates that if we see something that foreign regulators would be interested in, something that looks fishy, we can make a referral through the Office of International Affairs. As a follow up question, would the SEC expect much from us in terms of compliance in our European offices? Alpa Patel: We would be very concerned about protecting European investors coming into a US fund. If there is a US investor or US fund involved we are concerned.
- What is the role of industry experts as part of the SEC examination team? Brian Fitzpatrick: Two big pools of experts (OC and Enforcement). They also help with training both the exam team and the enforcement team. Enforcement experts show up on exams but they also help out behind the scenes. Don't be automatically alarmed if an enforcement expert shows up on the exam. It gives the expert an opportunity to be exposed to the exam process.

- IM Guidance with respect to discretionary accounts and personal trade reporting. Doug Scheidt: Personal securities reporting—when is it that the employee has no discretion and therefore does not have to report or preclear those trades? If you have not given up the authority to direct certain trades then you still have to report. Follow up question: As a safeguard, should the CCO get monthly broker statements if an account is in a grey area. Mark says yes. You should review those statements.
- What are the main areas you are looking for when a RIA has an affiliated BD and has custody of client assets at the broker level? Shane Cox: We look at custody, best execution, and conflicts of interest. A related party has custody therefore you need a higher level of independence for the auditor (different for when not a related party). Also have to receive an internal controls report from the BD. Conflicts of interest with affiliated BD (incentive to churn); ensure policies to make sure that trades are in client's best interest and suitable. We are also interested in how best execution is satisfied to make sure fees and expenses in line.
- Expense Allocation: Alpa Patel: You should have written and detailed allocation procedures. If you don't have broken deal expenses, as an example, you do not need to cover that category. It sets the tone for your accounting employees. Shane Cox: Flagship Fund 1 at the end of its investment period and Fund 2 just starting, how do you allocate expenses.
- Doug Scheidt. Documentation of Annual Review pursuant to Section 206(4)-7. From a legal perspective the rule does not require any documentation. From a practical perspective you should have records when OC asks: What did you focus on in doing your Annual Review and what evidence do you have of your review? What problems did you encounter during the year? What changes did you make to your process as a result of the review? What factors did you look at to assess the effectiveness of information barriers (if applicable to your firm)? What is material at your firm? Where are the risks? You need to interview people and you need to look at their emails.
- Jim Reese. Risk Assessment. For large advisers (over $1b) is there a Chief Risk Officer at your firm? Who does he report to? Is there a Risk Committee? Who is empowered to do what? Is the Board of Directors involved in this aspect of the firm? Is there systems integration with the risk function? Who has access controls? Take inventory (including vendors), who has access to client information? You need to inventory your organization. How well are your systems integrated? What are your integration plans as you onboard new clients, assets, business lines?
- PE Expenses. Do you have authority in the PPM to deduct an expense? Do you do what you have disclosed as your policy and your procedure? Are investors getting the deal they signed up for? Are expenses disclosed? Are expenses being allocated fairly? [Underlying theme is the KKR case with respect to broken deal expenses and co-investment vehicles.] Doug Scheidt: Need to follow your disclosure. Are you doing what you said you would do and are you authorized to do it?
- Mark Dowdell: Looking at fee structures across the board including SMAs and other trade programs. We are looking at how clients are selected for each type of program (in the ReTIRE program, for example). Alpa Patel: In general we are always looking at reverse churning and when someone decides to push a certain type of account. Is it suitable? It often comes down to fees. Mark: We look at wrap fee structures and reverse churning activity. We use our quantitative tools.

What is the effect of not trading and the investor is being charged 2 to 3%? Is it a good deal for the investor?

- Shane Cox: How do you document your investment decisions? No set answer. Depends on the business. Mark: What was the process to make an investment decision? It's good to document the process.

## VI. Panel IV: Compliance Panel

Adam Aderton, Assistant Director, Division of Enforcement, Asset Management Unit

Chad Earnst, Vice President and Chief Compliance Officer, Prudential Investments (Adviser and Funds)

Daniel Kahl, Assistant Director, Division of Investment Management (Panel Moderator)

Bruce Karpati, Managing Director and Global Chief Compliance Officer, Kohlberg Kravis Roberts & Co. L.P.

Kristin Snyder, Associate Regional Director, National Exam Program, San Francisco Regional Office

Kristin Snyder. We are not always able to be transparent with you about what type of exam we are conducting. It should become apparent over time and in some cases if we are doing a sweep on a national level we are able to share that. In general, we are a risk based program and allocate scarce resources to the highest perceived risk. We may be interested in a particular product or business practice. We also conduct a lot of "cause" examinations. We get lots of tips from investors, whistle blowers and even other regulators. **Corrective Action Reviews**: we will come back to make sure you have corrected what we have identified during a prior examination. Only about 10-15% of exams get referred to Enforcement. There is almost always a **Deficiency Letter**. This letter is an opportunity not a burden. Kristin emphasized that compliance is a firm wide goal; it is not just for the CCO to be concerned about. The SEC is looking to ensure that all employees are trained and involved with the compliance function and understand their role. While not common, the SEC still conducts "surprise" exams and just shows up at your door. More commonly, you will get a call and a request list. SEC wants to be prepared before showing up at your firm. The best defense is to be well prepared! Be responsive and transparent. Build credibility with the SEC exam staff from the beginning, even before the staff arrives. Kristen suggests that it may be better to be up front and indicate that you have or had a particular issue and this is how we dealt with it as opposed to waiting until the SEC finds the issue. How up front a firm is with the staff in terms of issue identification and remediation can have a bearing on whether the matter is referred to Enforcement. With respect to the Document Request Letter, if something does not make sense, speak up and ask. The SEC will almost always request emails. This is a key point! We are very data driven.

A frequent pain point during the SEC exam is the ability of investment advisers to search and produce **emails overnight** in response to SEC requests.[27] The ability to produce all requested documents, including emails, will enable the SEC to more efficiently conduct the exam.

Books and Records. Use automation and technology to assist you in creating required records. Be organized and have all of your records in an easy to locate place. This helps the SEC be more efficient and finish the exam faster.

Enforcement perspective. Adam Ederton: Preparedness, transparency, self-reporting if you know you have a problem, all go a long way (rogue trader, for example). You know your business. When we are drafting document production requests we are in a certain sense "guessing" as to what we need. We are open to a dialogue as to what we are looking for. We are not trying to inflict production pain for no good reason. Therefore, we encourage an open dialogue.

Email reviews. Kristin: If a request would call for the production of a million emails we are open to trying to narrow the scope. Talk with us. There is not a trend to ask for more emails.

Sources of Enforcement referrals: 1. OCIE; 2. External Tips (Whistleblowers); 3. Risk Based or Data Driven initiatives (Aberrational Performance and Cherry Picking); 4. SEC exam sweeps; 5. Self reported—CCO comes across a rogue employee or trader. The SEC has enhanced expertise. They have hired more industry experts.

**Deficiency Letters**:

- Dodd Frank requires that a deficiency letter be delivered to each fund that is examined. This should be no surprise. The adviser needs to respond within 30 days. The SEC often conducts a **Corrective Action Review** 6 to 18 months following delivery of a Deficiency Letter. Follow through! Correct any deficiencies noted by the examiners.
- Recent Deficiencies identified by the SEC: Fees and expenses cases; Kristin Snyder cited disclosure as vital. Disclosure in ADV and OM. What benefits is the adviser taking to the detriment of its limited partners—conflicts cases.
- Can we disclose contents of an SEC deficiency letter? The SEC cited the **Aletheia Research and Management, Inc**. case, IA Release 3197 (May 9, 2011). In that case the SEC took exception to the fact that Aletheia was examined and the SEC found 6 deficiencies; however, in prospective investor requests for proposal ("RFP") Alatheia incorrectly stated that "there were no significant

[27] Editor's Note: We typically work with Smarsh and Global Relay as providers of email and instant message archive and search capability. We believe it is important to train supervised persons to only use approved email and IM portals to conduct firm business. If an email or IM search reveals the use of other personal email addresses or IM providers the SEC may request that they be searched as well. A regular, intelligent, forensic search of emails and IMs is an important part of an effective compliance program.

findings". The CCO was fined and censured as was the firm. You can't misrepresent SEC findings as "it's nothing" when in fact deficiencies were found.

Kristen indicates that she will be focusing on disclosure in her exams. What is disclosed in the offering documents and in the ADV? What are the firm's policies and procedures? Is the firm doing what it says it is doing?

Adam Ederton, from an enforcement perspective said that conflicts is the bread and butter of his cases. Disclosure based cases are often a subset of conflicts cases. This includes cases based on "fees" where fees are allocated to the adviser to the detriment of investors. Bruce Karpati responded that the message has been heard. How do you respond? How do you identify conflicts? How do you disclose those conflicts? How do you monitor and mitigate those conflicts? For larger firms, use technology

**Welhouse & Associates**. June 2015. **Cherry picking** investment opportunities. **Trade allocation**.

Subset of conflicts cases includes undisclosed interests in your portfolio investments is a problem. Any kind of a kickback or payment must be disclosed as well as any revenue sharing agreements. This is especially true of dually registered firms (RIA and BD).

**Valuation**. Kristen: SEC has valuation experts (some are in San Francisco). The SEC will look at your valuation methodology and see if it is consistently applied. If your policy says that you do A, B and C, either do A, B, or C or document why you did not. This is a perennial issue. **AlphaBridge** is a recent case where the fund enlisted BDs to feed quotes to the Administrator and the Auditor. The quotes appeared to be independent but they were not. In the **Summit**[28] case, the BD never owned the securities for which they were providing quotes. In the **Patriarch Partners**[29] case the PM used her own idiosyncratic approach to value positions which was at odds with what her CDO documents indicated. CCOs do not value securities or even necessarily understand the valuation. The CCO does need to ensure that your policy is being followed.

If this is what your fund's documents say you do make sure that is what is done. The SEC brings cases when the actual practice does not match the policy:

**Pekin Singer** June 2015 case where the CCO asked for resources to complete compliance responsibilities (such as the required annual review of the compliance program) and was denied those resources. Adam: We want CCO to have the resources to do the required job.

[28] Litigation Release No. 23334, September 4, 2015. Summit Asset Strategies Investment Management, LLC fraudulently inflated the value of investments in a private fund so they could take unearned management fees. The fund claimed it owned a specific asset that it did not. The SEC also charged the fund's auditor for a performing a deficient audit.

[29] Advisers Act Release No. 4053, March 30, 2015. Lynn Tilton and Patriarch failed to value CLO assets using the methodology described to investors in the offering documents.

Similar case, in 2013, **Carl Johns** on the BD side, the PM falsified personal trading records to deceive the CCO. Again, Adam says this is not what we want to see

Adam: In January of 2016 in an **Everhart**[30] case the SEC indicates that the CCO needs to be independent (not have any other responsibilities at the firm) for five years and complete 30 hours of training. SEC wants the CCO to have resources. The SEC expects CCOs to be up to speed and independent.

Kristin Snyder. Other common deficiencies: Risk areas for funds to focus on: **Custody** (Risk Alert March 2013); **Marketing and Advertising Performance** (use of hypothetical performance); need documentation to back up claimed performance; Compliance Programs that are understaffed and are under resourced. Most of these problem areas noted in exams do not result in an SEC enforcement action.

When is the exam officially over? Kristen says once you have responded to the Deficiency Letter is generally the end of the exam process.

## VII. Panel V: Hot Topics

Adam Aderton, Assistant Director, Division of Enforcement, Asset Management Unit

Michael Didiuk, Senior Counsel, Division of Investment Management

Wendy Fox, Vice President and Chief Compliance Officer, Ariel Investments LLC

Steven Levine, Associate Regional Director, National Exam Program, Chicago Regional Office (Panel Moderator)

Last session. Existential issues to your firm: CCO Liability and Cybersecurity.

Cybersecurity:

- Steven Levine. The SEC has published a Risk Alert in February 2015[31]; they have also provided IM Guidance[32] and there have been two enforcement actions.[33] We want avoid theft of client data and theft of funds as do you. Vendor management is an issue for funds. You should have provisions in your contracts with vendors that address cybersecurity issues and controls. Steven also detailed results of surveys taken with respect to BD v. fund cyber readiness. The BD community is generally ahead of the funds on this issue in terms of having appropriate policies and procedures and how to recover from an attack and having developed a plan as to how to

[30] Everhart Financial Group, Inc., IA Release 76897, January 14, 2016. See Exhibit A.
[31] See National Exam Program Risk Alert, April 15, 2014: OCIE Cybersecurity Initiative and National Exam Program Risk Alert, February 3, 2015: Cybersecurity Examination Sweep Summary.
[32] IM Guidance Update April 2015: Cybersecurity Guidance.
[33] R.T. Jones and Craig Scott Capital.

allocate losses from an attack. RIAs are also behind in using external standards such as NIST (National Institute of Standards and Technology), ISO (International Organization for Standardization) or FFIEC (Federal Financial Institution of Examination Council). Info sharing networks more commonly used by BD as to what the next cyber threat is. Two weak links: vendor contracts, risk assessment at vendors. On encryption the industry is pretty good. Your own employees is another weakness. You need to test to make sure they are complying.

- Funds need to designate a Chief Information Security Officer; a fund's own employees are a great source of risk (use of thumb drives or opening phishing emails, as an example).
- NIST is a good source of a framework to approach the cyber problem. You need basic controls; you need to update network access rights as employees job descriptions change or they leave; you need to keep track of user credential and you need to know if your employees are following your policies. You need to conduct training and to monitor what data is leaving the firm (for example, as email attachments). Another vulnerability is what are you doing to verify an investor request to transfer funds. You need an authentication process that goes beyond the face of the email request.
- Vendor Management is another area of concern for cybersecurity. Many firm breaches are facilitated through the fund's vendors. You need to conduct due diligence on your vendors. You need to monitor your vendors. Are they adhering to your contract provisions with respect to such things as controls and information security.
- On Cyber Exams the SEC tests five areas which are detailed in the IM Guidance: Governance and risk assessment; access rights and controls (basic controls to prevent unauthorized access); data loss prevention (monitor transfers by email by employees as an example; monitor for unauthorized data transfers); vendor management (due diligence and selection as well as monitoring to ensure adhering to contract terms); training and incident response. See published SEC guidance for details.
- Wendy Fox on Vendor Contracts: The industry is currently in the process of identifying risks, conducting risk assessments and vulnerability scans. Firms are developing Computer Security Response Teams and Table Top Cyber Security Teams. It is important to have employee training and to conduct Phishing Tests. Many funds are considering cyber insurance. How does the CCO get involved? Try to leverage off of the capabilities of your vendors and service providers. Conduct post mortems of any breaches.

As a footnote to the Custody Rule the CCO is required to ensure the safety of each client's assets and protection of a client's information. This requirement dovetails with Regulation SP. Going blindly into a vendor relationship without doing appropriate due diligence on a vendor, for example, is very risky for the CCO.

The SEC wants you to conduct training for your employees. You also need to conduct testing. One adviser's policy was to prohibit and disable the use of thumb drives. When the SEC asked for a simple demonstration and tested a flash drive, it worked. It wasn't supposed to. The Adviser had represented to the SEC exam staff that all portable media, including thumb drives had been disabled. You need to test every computer and lap top, otherwise you are just hoping that the IT department got it right. Another example, one investment adviser indicated that firm employees were permitted to access web based personal email accounts through the firm's network, despite the fact that this is a well known path for malware. The firm's management made a decision that for the convenience of the firm's staff it was an acceptable business risk. Steven Levine says that perhaps you should not take that risk for the convenience of your employees: "Sometimes the cybersecurity rules a real pain." "Your employees will want you to take the short cut, the easy way and the easy way will lead to a cybersecurity breach."

Adam Ederton discussed recent the two recent enforcement actions: One was the September 2015 **R.T. Jones** case and the other more recent case was against a BD, **Craig Scott Capital**. In RT Jones there were no required policies and procedures about protecting personally identifiable information as per Regulation S-P. In that case client personally identifiable information was hosted on a third party server and there were no written policies and procedures designed to protect that information. In the Craig Scott case (April 2016) the policies and procedures were grossly deficient. The firm received personally identifiable information on faxes using personal email addresses. The firm had procedures but did not designate a supervisor to oversee the policy. There was nothing in the policy about how to handle the faxes and there were blanks in the policy. It was in no way tailored to Craig Scott's business.

CCO Liability:

- Outsourced CCOs: (Steven Levine) See the November 2015 Risk Alert. The firm's responsibility for compliance cannot be outsourced. No matter who the CCO is this responsibility never leaves the firm, never goes away. Five core issues for the CCO: 1. Knowledge. The CCO needs to be knowledgeable about the firm and be empowered. 2. Authority. The CCO need to have the authority to establish, implement and test policies for all employees. 3. Resources. The CCO needs to have adequate resources to get the job done. 4. Communication. If the CCO does not physically work at the firm, how does that person communicate with employees? Is it via email only. The CCO needs to spend time at the firm. It is not enough to remotely fill out a checklist. 5. Does the CCO have access to all the documents, systems and people at the firm?
- Michael Didiuk. Outsourced CCO. A CCO that never visits the firm or meet the employees does not work. Off the shelf (one size fits all) template programs do not work. The Compliance Manual needs to be tailored for your business. If the outsourced CCO has employees that have access to all of your firm's information they (CCO included) need to be captured by the firm's policies and procedures. The outsourced CCO could be overextended. The CCO needs access to all information at the firm. The tone at the top matters.

- Wendy Fox mentioned that many aspects of the firm's business may be outsourced. You need to have oversight of the vendor and you need to ascertain what conflicts the vendor has and need to make sure that the vendor is acting in the best interest of your clients. Wendy Fox raised a few cases where the CCO was censured: For example, in **Blackrock** there were wholesale failures in the compliance program. The CCO was aware of (outside business activities which create a conflict) and a cause of the violations. In the **SFX**[34] case the PM misappropriated fund assets. The CCO was charged because the CCO failed to follow policies and procedures concerning cash movements that were disclosed in the ADV and Compliance Policies. In both cases the CCO had knowledge of a significant risk to the firm. In Blackrock, the CCO did nothing to create and implement policies and in SFX the CCO failed to ensure that the existing policies were followed. These are two of the five cases brought against CCOs in the past 13 years. These cases are particularly rare. Because the cases came out close together it created the impression that the SEC is targeting CCOs. The SEC is not looking to charge CCOs. The SEC views CCOs as a partner. When the CCO sees a problem the problem must be addressed. Alert the people in your firm with the ability to fix the problem.
- In **Pekin Singer**[35], June 2015, the adviser and executives were found liable but not the CCO. The CCO was asking for additional resources to do his job. Follow this example.
- In the **Everhart** case (earlier 2016), the business principals were obligated to appoint a CCO with one job and 30 hours of training. The SEC wants CCOs to have the resources to do the job.

Other areas of funds are often outsourced: operations, IT, Proxy Voting (IM Guidance on this subject), Advertising and Sales, CFO.

Vendor Oversight Program. Keep track of any additional conflict of interest that might arise. This may be the case with Proxy Service, for example. Look at your vendor contracts. Make sure that your firm and your clients are protected (cybersecurity, confidentiality, for example).

Steven Levine. Take away: SEC conducts 1100 IA exams per year; it brings 100s of enforcement actions. It has brought 5 enforcement cases in the last 13 years against CCOs.

Take away from conference: Disclose what you do in your PPM and Form ADV. Do what you disclose.

[34] SFX Financial Advisory Management Enterprises, Inc., IA Release No. 4116 (June 15, 2015).
[35] Pekin Singer Strauss Asset Management Inc., Advisers Act Release No. 4126, June 23, 2015.

VIII. Closing Remarks: Marc Wyatt, Director, National Exam Program

The SEC is trying to be transparent about what we do. We are data driven and risk based. We will put the program on our website in the next few weeks.

IX. Speaker Biographies

**Andrew Ceresney** Andrew Ceresney is the Director of the SEC's Division of Enforcement. Prior to joining the SEC, Mr. Ceresney served as a partner in the law firm of Debevoise & Plimpton LLP, where he was co-chair of the White Collar Group and focused on representing entities and individuals in white collar criminal and SEC investigations, complex civil litigation and internal corporate investigations. Prior to joining Debevoise, Mr. Ceresney served as an Assistant United States Attorney in the United States Attorney's Office for the Southern District of New York, where he was a Deputy Chief Appellate Attorney and a member of the Securities and Commodities Fraud Task Force and the Major Crimes Unit. As a prosecutor, Mr. Ceresney handled numerous white collar criminal investigations, trials and appeals, including matters relating to securities fraud, mail and wire fraud, and money laundering. Mr. Ceresney served as a law clerk to the Honorable Dennis Jacobs, Chief Judge of the U.S. Court of Appeals for the Second Circuit from 1997 to 1998. He served as law clerk to the Honorable Michael Mukasey, formerly Chief Judge of the U.S. District Court for the Southern District of New York, from 1996 to 1997. Mr. Ceresney is a graduate of Columbia College and Yale Law School.

**David Grim** David W. Grim is the Director of the SEC's Division of Investment Management. Mr. Grim joined the Commission in 1995 as a Staff Attorney in the Division's Exemptive Applications Office. In 1998, he moved to the Division's Chief Counsel's Office, where he served in a variety of positions, including as Assistant Chief Counsel from 2007-2013. Mr. Grim graduated cum laude with a degree in Political Science from Duke University and received his law degree from George Washington University, where he was Managing Editor of the George Washington Journal of International Law and Economics.

**Maurice (Marc) Wyatt** Marc Wyatt was named Director of the SEC's Office of Compliance Inspections and Examinations ("OCIE") in November 2015 after serving as OCIE's Acting Director since April 2015 and Deputy Director. Mr. Wyatt joined the SEC in 2012 as a Senior Specialized Examiner focused on hedge funds and private equity and was Co-Chair of the Private Funds Unit. Before joining the SEC, Mr. Wyatt was a Partner and Senior Portfolio Manager at Stark Investments (a global multi-strat hedge fund), where he served as the co-head of the London office and was responsible for all aspects of the London office's activities, including asset allocation, risk management, marketing, operations, and compliance. Prior to

working in the hedge fund industry, Mr. Wyatt was a senior investment banker at Merrill Lynch and Alex Brown. Mr. Wyatt began his career as an analyst in the restructuring group at Lehman. Mr. Wyatt is a CFA charterholder and earned a BS in Economics from University of Delaware and a MBA from Duke University. Panel I: Program Priorities Diane Blizzard Diane Blizzard is Associate Director for Rulemaking in the SEC's Division of Investment Management. Previously, she served as Managing Executive of the Division and as Senior Adviser to former Division Director Buddy Donohue. She rejoined the Commission in 2007. Earlier in her career, Ms. Blizzard held various positions in the Division, including Assistant Director of the Office of Regulatory Policy, and was an Associate Counsel with ICI Mutual Insurance Company. Ms. Blizzard received her undergraduate degree from Duke University and her J.D. from Georgetown University Law Center.

**Jane Jarcho** Jane E. Jarcho is the National Exam Program's Deputy Director and the National Associate Director of the Investment Adviser/Investment Company examination program. Since March 2013, she has overseen a staff of approximately 450 lawyers, accountants, and examiners responsible for inspections of U.S. registered investment advisers and investment companies. Prior to holding her current positions, Ms. Jarcho was an Associate Director in the Examination Program in the Chicago Regional Office. Ms. Jarcho began her SEC career in the Division of Enforcement and has held several positions including Branch Chief, Senior Trial Counsel, and Assistant Regional Director before joining the Office of Compliance Inspections and Examinations in 2008. She has a B.A. from Middlebury College and a law degree from the University of Wisconsin Law School.

**Anthony Kelly** Anthony Kelly is Co-Chief of the Asset Management Unit in the SEC's Division of Enforcement. Prior to being named Co-Chief, Mr. Kelly served as an Assistant Director in the Asset Management Unit. He joined the SEC in 2000 as a securities compliance examiner in the Office of Compliance Inspections and Examinations' Broker-Dealer Group. Mr. Kelly attended law school while working as an examiner and joined the Enforcement Division following graduation. He also served as a Special Counsel in the Division of Trading and Markets' Office of Trading Practices. Mr. Kelly earned his law degree from Georgetown University Law Center and his undergraduate degree with highest honors from George Washington University.

**Jennifer Duggins** Jennifer A. Duggins, IACCP® is a Senior Specialized Examiner and Co-Head of the Private Funds Unit within the SEC's Office of Compliance Inspections and Examinations. Prior to joining the SEC, Ms. Duggins was a Director in Regulatory Risk Consulting within the Advisory Practice of KPMG. Prior to joining KPMG, Ms. Duggins was Senior Vice President and Chief Compliance Officer of Chilton Investment Company. Prior to Chilton, Ms. Duggins was Vice President, Legal and Compliance at Andor Capital Management. Ms. Duggins has served as a Faculty Member and Director of the Board of the National Society of Compliance Professionals (NSCP) and served as a CCO Roundtable Steering Committee Member

with the Managed Funds Association during 2009 and 2010. Ms. Duggins has a B.A. in History from New York University and is a May 2016 candidate for a M.S. in Human Resource Management from Sacred Heart University. Ms. Duggins is also an Investment Adviser Certified Compliance Professional, IACCP®

**Brendan McGlynn** Brendan P. McGlynn is an Assistant Director in the Asset Management Unit in the SEC's Division of Enforcement based out of the Philadelphia Regional Office. Mr. McGlynn joined the SEC in 2000 after working for four years as a litigation associate at Kittredge, Donley, Elson, Fullem and Embick, and serving as a law clerk to the Honorable James R. Cavanaugh on the Superior Court of Pennsylvania. He received his J.D. from Catholic University's Columbus School of Law and his undergraduate degree from Mount Saint Mary's University.

**Michael Neus** Michael Neus is responsible for all legal, compliance, human resource and administrative matters at Perry Capital, L.L.C. Prior to joining Perry Capital in 2005, Mike was the Chief Operating Officer and General Counsel at RHG Capital, L.P., Chief General Counsel at Andor Capital Management, L.L.C., and General Counsel of Soros Private Funds Management LLC. Mike began his professional career as an associate at Coudert Brothers in Singapore and New York. Mr. Neus received his law degree from Columbia University School of Law and his B.A. from the University of Notre Dame.

**Alpa Patel** Alpa Patel serves as Branch Chief of the Private Funds Group of the Investment Adviser Regulation Office, a unit of the SEC's Division of Investment Management in Washington, DC. The Private Funds Branch focuses on regulations affecting private fund advisers and assists the Commission in developing policy relating to private funds. Prior to joining the SEC, she was an associate at Dechert LLP, where she advised clients on the structuring, formation, and private offering requirements of private funds and provided counsel to investment advisers and boards of directors in regulatory, compliance, and corporate matters. Ms. Patel received a J.D. from George Washington University Law School in Washington, DC and a B.B.A. from the Goizueta Business School of Emory University in Atlanta, GA.

**Adam Reback** Adam Reback joined J Goldman & Co., L.P. in 2006 as the firm's Chief Compliance Officer and has primary responsibility for all legal/compliance and regulatory matters, including the development, implementation and assessment of the firm's compliance programs. Prior to joining J Goldman & Co., L.P., Mr. Reback was the Chief Compliance Officer and member of the Senior Management Committee of BKF Asset Management, Inc. (formerly John A. Levin & Co., Inc.). Previously, Mr. Reback held management positions at Ladenburg, Thalmann & Co., Inc. and Gruntal & Co. Mr. Reback serves on the Board of Directors of The National Society of Compliance Professionals. Mr. Reback holds a B. A. degree from New York University.

**Igor Rozenblit** Igor A. Rozenblit is a Senior Specialized Examiner and Co-Head of the Private Funds Unit within the SEC's Office of Compliance Inspections and Examinations (OCIE). He originally joined the SEC in November 2010 as a Private Equity Fellow in the Asset Management Unit in the SEC's Division of Enforcement. Mr. Rozenblit has over ten years of private equity experience, having worked most recently as a Vice President for Credit Agricole Asset Management Capital Investors, a €2.2 billion fund-of-funds. Prior to joining Credit Agricole, Mr. Rozenblit was a Vice President of Seneca Partners, a private equity fund that focused on investments in the healthcare sector. Mr. Rozenblit started his career at Deloitte. Mr. Rozenblit holds an MBA from the University of Chicago's Booth School of Business and a bachelor's degree in Computer Science from the University of Michigan.

**Thoreau Bartmann** Thoreau Bartmann is a Branch Chief in the Investment Company Rulemaking Office at the US Securities and Exchange Commission. Since he joined the SEC more than ten years ago, Mr. Bartmann has been involved in all aspects of investment company regulation, leading a variety of rulemaking initiatives for the Division of Investment Management. Notably, Mr. Bartmann was the branch chief managing the effort that culminated in the 2014 adoption of major reforms to the $3 trillion money market fund industry. Recently, he has been managing work on the fund derivatives and liquidity rulemaking proposals issued by the Commission in 2015. He also has expertise in fund distribution issues, leading the Division's work on recently issued guidance on mutual fund distribution and sub-accounting fee issues. In his privacy work, he has assisted with efforts to adopt or amend the Model Privacy notice, Regulation S-P, and Regulation S-AM, and led the implementation of the Dodd-Frank Act required rulemaking that required investment companies and certain advisers to develop a program designed to detect and mitigate red flags of identity theft. Mr. Bartmann has also spoken and presented on a variety of fund regulatory issues, and was selected to provide in-depth training on many fund examination and regulatory topics for more than 80 Asian-Pacific securities regulators at a five day capacity building workshop in Ulaanbaatar, Mongolia. Before he joined the SEC, Mr. Bartmann was a securities enforcement associate at the law firm Fried, Frank, Harris, Shriver and Jacobson where among other things, he engaged in a top to bottom review of a top ten securities firm for conflicts of interests, and provided advice to hedge funds on issues related to late trading and market timing. Mr. Bartmann earned his J.D. from the University of North Carolina, Chapel Hill and a B.A from the University of Alabama, Birmingham.

**Mary Keefe** Mary E. Keefe is a Managing Director and Director of Regulatory Affairs for Nuveen Investments, Inc., a leading provider of diversified financial services. In this role, Ms. Keefe manages Nuveen's relationships with its regulators and assists Nuveen Senior Management to keep current in the rapidly changing regulatory environment in which Nuveen operates. From 2004 to 2013, Ms. Keefe served as Director of Compliance for Nuveen where she managed the Compliance Department and held the position of Chief Compliance Officer for Nuveen Asset Management and several of Nuveen's affiliated investment advisers and affiliated broker-dealer. Before joining Nuveen, Ms. Keefe served as the Director

of the Chicago Regional Office of the U.S. Securities and Exchange Commission for ten years from 1994 to 2003 where she managed the enforcement and examination programs and a staff of more than 200 for the SEC office which covered the nine Midwest states. Her career at the SEC spanned 21 years. Ms. Keefe earned her law degree at De Paul University College of Law and her undergraduate degree at Northern Illinois University.

**Anthony Kelly** Anthony Kelly is Co-Chief of the Asset Management Unit in the SEC's Division of Enforcement. Prior to being named Co-Chief, Mr. Kelly served as an Assistant Director in the Asset Management Unit. He joined the SEC in 2000 as a securities compliance examiner in the Office of Compliance Inspections and Examinations' Broker-Dealer Group. Mr. Kelly attended law school while working as an examiner and joined the Enforcement Division following graduation. He also served as a Special Counsel in the Division of Trading and Markets' Office of Trading Practices. Mr. Kelly earned his law degree from Georgetown University Law Center and his undergraduate degree with highest honors from George Washington University.

**Thomas Kirk** Thomas Kirk is an Assistant Regional Director in the National Examination Program (NEP) in the Chicago Regional Office of the SEC. Mr. Kirk oversees examination teams conducting inspections of SEC registered investment advisers and investment companies. He began his career at the SEC as an examiner in 1985. Prior to joining the SEC, he held internal audit and accounting positions with various financial services companies. He is a Co-Coordinator of the NEP's Investment Company Specialized Working Group and is a recipient of the NEP's Douglas R. Adams Award for his significant contributions to improving the effectiveness of the examination program through personal leadership. Mr. Kirk holds an M.B.A. with an emphasis in Finance and a B.S. in Accountancy. He is also a Certified Public Accountant.

**Nancy Morris** Nancy Morris is a Managing Director and Chief Compliance Officer of Wellington Management LLP. Ms. Morris joined Wellington Management in 2012 from Allianz Global Investors where she served as Chief US Regulatory Counsel. Prior to joining Allianz, she served as Secretary of the US Securities and Exchange Commission (2006 – 2008) and, prior to that, as an attorney-fellow in the Division of Investment Management. Earlier in her career, Nancy served at the SEC in various roles (1985 – 1992), including Deputy Chief Counsel in the Division of Investment Management. Prior to rejoining the SEC in 2004, she spent 10 years as Vice President and Associate Legal Counsel at T. Rowe Price Associates and two years at Fidelity Investments. Nancy also practiced law for two years with Sutherland. Nancy is a graduate of Hartwick College and the University Of Idaho School Of Law. Panel IV: Compliance Panel Adam Aderton Adam S. Aderton is an Assistant Director in the SEC Enforcement Division's Asset Management Unit. Mr. Aderton supervises investigations involving potential violations of the federal securities laws by firms and individuals in the asset management industry, including registered investment advisers. Mr. Aderton has conducted or supervised investigations involving conflicts of interest, trade execution,

valuation, misappropriation, misrepresentations and omissions, and failures to adopt and/or implement compliance policies and procedures. He received the Enforcement Division's 2012 Ellen B. Ross Award. Mr. Aderton received his B.A., summa cum laude, from Truman State University and his J.D. from the University of Virginia School of Law, where he was a member of the Virginia Law Review and inducted to the Order of the Coif.

**Chad Earnst** Chad Alan Earnst serves as chief compliance officer for Prudential Investments, the mutual fund manufacturing and distribution business of Prudential Financial, Inc. He also serves as the chief compliance officer for Prudential's mutual fund boards. Mr. Earnst has over a decade of SEC experience focused on investment advisers, registered investment companies, hedge funds, and private equity funds. Prior to joining Prudential, he was an assistant director in the Asset Management Unit of the SEC's Division of Enforcement, where he supervised a staff of attorneys and other professionals in investigations of compliance programs and issues relating to board governance, valuation, performance, insider trading, conflicts of interest, derivatives, and disclosures, among other things. Mr. Earnst also served as assistant regional director for the SEC's Miami Regional Office. He joined the SEC as senior counsel in 2003 and was promoted to branch chief in 2006 and assistant regional director in 2010. Prior to joining the SEC in 2003, Mr. Earnst was a litigation attorney with Zuckerman Spaeder, LLP, a law firm based in Washington D.C. He received a juris doctor, magna cum laude, from the University of Miami School of Law, and a bachelor of business administration from Middle Tennessee State University. Mr. Earnst is a Chartered Alternative Investment Analyst.

**Daniel Kahl** Daniel S. Kahl is the Associate Director and Chief Counsel for the Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission. Formerly, Mr. Kahl was Assistant Director in charge of the Investment Adviser Regulation Office in the Division of Investment Management at the SEC. Prior to joining the Commission in 2001, Dan worked for the Investment Adviser Association, FINRA, and the North American Securities Administrators Association. He received his B.S. from Penn State University, J.D. from Southern Methodist University, and LL.M. (Securities) from Georgetown University.

**Bruce Karpati** Bruce Karpati joined Kohlberg Kravis Roberts & Co. L.P. (KKR) in 2014 as the firm's Global Chief Compliance Officer and Counsel. Prior to joining KKR, Mr. Karpati was the Chief Compliance Officer of Prudential Investments, the mutual fund and distribution business of Prudential Financial. Mr. Karpati was previously the National Chief of the SEC's Asset Management Unit, supervising a staff of 75 attorneys, industry experts, and other professionals. Mr. Karpati joined the SEC as a staff attorney in 2000, was promoted to Branch Chief in 2002, Assistant Regional Director in 2005, and to Co-Chief of the SEC's Asset Management Unit in 2010. In 2007, he founded the SEC's Hedge Fund Working Group, a cross-office initiative to combat securities fraud in the hedge fund industry. He earned his JD from the University at Buffalo Law School, and his Bachelor's degree in International Relations from Tufts University.

**Kristin Snyder** Kristin Snyder is Associate Regional Director for Examinations for the SEC's San Francisco Regional Office. Ms. Snyder leads a staff of approximately 60 accountants, examiners, attorneys and support staff responsible for the examination of broker-dealers, investment companies, investment advisers, and transfer agents across Northern California and the Pacific Northwest. Previously, Ms. Snyder served as a Branch Chief and a Senior Counsel in the San Francisco Office's Enforcement Program. Prior to joining the SEC, Ms. Snyder practiced with Sidley Austin Brown & Wood LLP in San Francisco. She earned her law degree from the University of California Hastings College of the Law, and received her bachelor's degree from the University of California at Davis. Panel V: Hot Topics Adam Aderton Adam S. Aderton is an Assistant Director in the SEC Enforcement Division's Asset Management Unit. Mr. Aderton supervises investigations involving potential violations of the federal securities laws by firms and individuals in the asset management industry, including registered investment advisers. Mr. Aderton has conducted or supervised investigations involving conflicts of interest, trade execution, valuation, misappropriation, misrepresentations and omissions, and failures to adopt and/or implement compliance policies and procedures. He received the Enforcement Division's 2012 Ellen B. Ross Award. Mr. Aderton received his B.A., summa cum laude, from Truman State University and his J.D. from the University of Virginia School of Law, where he was a member of the Virginia Law Review and inducted to the Order of the Coif.

**Michael Didiuk** Michael Didiuk is Senior Counsel in the Division of Investment Management's Chief Counsel's Office at the SEC. He also served as Counsel to former Commissioner Troy A. Paredes. Mr. Didiuk has been at the Commission since 2010. Before joining the Commission, Mr. Didiuk was in private practice for eight years, most recently with Willkie, Farr & Gallagher. He received his J.D. from Catholic University, Columbus School of Law School and his undergraduate degree in accounting from Fairfield University. Prior to attending law school, Mr. Didiuk worked at KPMG LLP for four years as a tax specialist.

**Wendy Fox** Ms. Wendy Fox joined Ariel in 2004 as chief compliance officer of Ariel Investments, LLC and its affiliated broker-dealer, Ariel Distributors, LLC. In 2014, she was appointed chief compliance officer for Ariel Investment Trust. She is responsible for regulatory risk oversight and administration of compliance programs covering the investment adviser, broker-dealer and mutual funds. Ms. Fox works closely with senior management, the firm's external corporate directors and Ariel Investment Trust's independent trustees, advising on compliance matters and managing regulatory examinations. Prior to Ariel, Ms. Fox spent 16 years working for the U.S. Securities and Exchange Commission's regional office in Chicago, where she was attorney-adviser for the Branch of Investment Management Examinations, ethics liaison officer and senior attorney for the Division of Enforcement. Beyond Ariel, Ms. Fox is chairman of The ARK, a nonprofit organization providing free social and medical services to members of Chicago's Jewish community. Ms. Fox earned a BA in English literature from the University of Michigan and a JD from Washington University in St. Louis.

**Steven J. Levine** Steven J. Levine is an Associate Regional Director in the SEC's Chicago Regional Office. He is responsible for overseeing CHRO's Investment Management examination program. He had previously served as a Senior Special Counsel to that exam program, and before that spent a decade as a Trial Counsel in the Division of Enforcement. Prior to joining the SEC in 2000, Mr. Levine was a Senior Trial Attorney for the Equal Employment Opportunity Commission in Chicago for six years. He began his legal career as an associate at Cleary Gottlieb in New York. Mr. Levine is a recipient of the Frank J. McGarr Award from the Chicago Federal Bar Association in recognition of excellence in providing legal services for the United States Government. He received his J.D. from Yale Law School and his B.A. from Cornell University.

## X. Exhibit A: Selected Cases and Enforcement Actions Cited During the SEC Compliance Outreach Program

**Failure to disclose conflicts: JPMorgan** Chase Bank, N.A. and J.P. Morgan Securities LLC, Investment Advisers Act of 1940 (IA) Release No. 4295 (December 18, 2015). This case involved a failure to implement policies and procedures to identify and disclose conflicts of interest. Chase established a unified managed account platform that had a preference and economic incentive to use JPMorgan managed proprietary mutual funds. There were also share classes for certain funds with lower fees that investors were not properly disclosed.

**Failure to disclose conflicts**: **Royal Alliance**, among others, were cited for breaches of fiduciary duty and multiple compliance failures. Royal alliance failed to disclose in Form ADV or otherwise that they had a conflict of interest due to a financial incentive to place clients in higher fee mutual fund shares. They also failed to monitor advisory accounts for inactivity or "reverse churning". Royal Alliance Associates, Inc., IA Release No. 4351 (March 14, 2016).

**Improper Expense Allocation**: Investment Advisers Act of 1940 ("Advisers Act") Release No. 4073, April 29, 2015, **Alpha Titans**, LLC. Timothy McCormack, Alpha Titan's founder and CEO used fund assets to pay for adviser-related operating expenses in a manner not clearly authorized under the PPM and not accurately reflected in the fund's financial statements as related party transactions. SEC went after auditor as well (Advisers Act Release No. 4072, April 29, 2015).

**Fraudulent Valuation Scheme**: Advisers Act Release No. 4135, July 1, 2015, **AlphaBridge** Capital Management, LLC. AlphaBridge fed broker dealer quotes for thinly traded securities. The broker dealer passed these quotes off as independent. The auditor was misled. Richard Evans (Adviser Act Release 4136), registered rep of BD was also charged.

In an unrelated case, **Equinox** Fund Management was cited for charging management fees on notional trading value instead of on the NAV as disclosed to investors. This resulted in higher fees to investors and four distinct failure to disclose charges by the SEC. Equinox Fund Management, LLC, IA Release No. 4315 (January 19, 2016).

**Failure to disclose conflict of interest (improper fees) at Private Equity Firm:** Advisers Act Release No. 4253, November 3, 2015, **Fenway Partners**, LLC. Originally, certain fees charged portfolio companies were offset against management fees. Fenway set up a new affiliated entity to charge the same fees so that they were not offset. This arrangement was not disclosed.

**Blackstone** Group advisers failed to inform investors about benefits the advisers obtained from accelerating monitoring fees and discounts on legal fees. By accelerating the monitoring fees to Blackstone from portfolio companies the price of those companies was diminished prior to an initial public offering or sale to the detriment of the funds and investors. Blackstone breached its fiduciary duty and also failed to adopt and implement adequate written policies and procedures. Blackstone Management Partners L.L.C., IA Release No. 4219 (October 7, 2015).

**Misallocation (unfair) of broken deal fees**: Advisers Act 4131, June 29, 2015. KKR. KKR executives were in a co-investment vehicle. This vehicle was allocated a certain percentage of investment opportunities but did not receive its fair share of broken deal expenses. Third party compliance consultant discovered and it was corrected.

**Insider Trading**: SEC v. Daryl M. Payton et al., Litigation Release No. 23478, March 2, 2016. This US Southern District case is significant because the SEC lost the **Todd Newman** (2nd Circuit) case (tipper/tippee liability) which was decided on December 10, 2014 and the Supreme Court declined to hear the SEC's appeal. There is an interesting case which the Supreme Court has agreed to hear based on the **Salman** decision in the 9th Circuit. Andrew Ceresney, Director, Division of SEC Enforcement, touted the Payton/Durant case victory as significant because it applies the standard in the Newman case which the SEC lost. One of the facetious questions during the SEC Compliance meeting was whether the SEC was still interested in insider trading since losing Newman.

**Performance/Track Record Error**: Advisers Act Release No. 3988, December 22, 2014, **F-Squared** Investments, Inc. F-Squared published performance advertising material without back-up for performance, even after the issue was identified in a mock audit.

**Virtus** Investment Advisers, Inc was also cited for failure to adopt and implement written compliance policies and procedures with respect to performance and advertising as a result of F-Squared's errors.

They violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by publishing advertisement that contained untrue statements of material fact. They also failed to make and keep true, accurate and current records of the calculation of the performance or rate of return in violation of Section 204 and Rule 204-2(a)(16) thereunder. Virtus Investment Advisers, Inc., IA Release No. 4266 (November 16, 2015).

**Cantella** & Co., in another case related to F-Squared was cited for failing to take sufficient steps to confirm the accuracy of F-Squared's historical data and other information. Cantella & Co., IA Release No. 4338 (February 23, 2016).

**Style Drift**: Advisers Act Release 4233, October 16, 2015, **UBS Willow Management**, LLC. Fund disclosed it was a long fund in distressed debt. Post 2008 it purchased CDS and became net short (also lost money). Disclosure was not changed to indicate that it was now a net short fund.

**Cherry Picking; Trade Allocation**. Advisers Act Release 4132, June 29, 2015, **Welhouse** & Associates, Inc. Welhouse said he allocated trades pro rata. In fact he purchased SPY options and waited till end of day to see which made money. Winners went to him; losers to his clients. Division of Economic and Risk Analysis ("DERA") picked up on the aberration.

**CCO Liability**. CCO asked for help/resources (didn't get them and was not charged), Advisers Act Release 4126, June 23, 2015, **Pekin Singer** Strauss Asset Management Inc. [A number of SEC Commissioners recently weighed in on this topic; see, Commissioner Gallagher statement June 18, 2015 and Commissioner Aguilar statement June 29, 2015.]

**CCO Liability**. Advisers Act Release No. 4116, June 15, 2015, **SFX** Financial. CCO found liable. Firm found to have stolen client assets. Failure in policies; failure to supervise; improper ADV disclosure.

**CCO Liability**. Advisers Act Release No. 4065, April 20, 2015, **Blackrock Advisors**, LLC. Failure to adopt and implement policies; failure to disclose a conflict of interest of interest involving the outside business activity of one of its portfolio managers. The CCO knew of the conflict but failed to report it to the BlackRock funds' boards of directors or to BlackRock advisory clients. BlackRock failed to adopt and implement written compliance policies and procedures concerning the outside activities of its employees, including how they should be assessed and monitored for conflict purposes.

**CCO Liability**. Advisers Act Release No. 4314, January 14, 2016, **Everhart Financial Group, Inc**. The adviser steered investors into mutual funds that required the payment of 12(b)-1 fees when other share classes

were available without these fees. This is a best execution violation of Section 206. The adviser's owners received the 12(b)-1 fees and this conflict of interest was not disclosed to investors. Also the CCO failed to conduct an annual review of the adviser's compliance program in multiple years, a violation of Section 206(4). The SEC required that, among other things, the CCO not wear any other hats for at least 5 years and receive 30 hours of compliance training.

**Cybersecurity**. Regulation S-P. 34 Act Release No. 77595, April 12, 2016, **Craig Scott Capital**, LLC (Broker Dealer). This is the second Reg S-P case (first was **R.T. Jones** last fall). Failure to adopt policies and procedures reasonably designed to insure security and confidentiality of customer records and information. A lot of information was sent by fax and routed to personal email addresses.

**Cybersecurity**. Regulation S-P. Adviser Act Release 4204, September 22, 2015, **R.T. Jones** Capital. Failure to adopt written policies and procedures. Personally identifiable information stored on hacked website.

**Deficiency Letters**. **Aletheia** Research And Management, Inc. case, IA Release 3197 (May 9, 2011). The SEC took exception to the fact that Aletheia was examined and the SEC found 6 deficiencies; however, in prospective investor requests for proposal ("RFP") Alatheia incorrectly stated that "there were no significant findings". The CCO was fined and censured as was the firm.