

Morgan Lewis

collaborate  
Advisor Regulatory Panel

September 14, 2009

# First Clearing LLC Fall 2009 Compliance Roundtable

Ron Long – Wells Fargo Advisors, LLC

Patricia Centeno – Wells Fargo Advisors, LLC

John Ayanian - Morgan, Lewis & Bockius LLP

Jennifer Klass – Morgan, Lewis & Bockius LLP

- [www.morganlewis.com](http://www.morganlewis.com)

# Discussion Topics

- SEC Examination Process
- SEC Examination Priorities
- SEC Regulatory Priorities
  - IA-BD Harmonization
  - Custody
  - Pay-to-play
  - Hedge fund registration

# SEC Examination Process

- Managing a SEC exam post-Madoff
  - Manage process, communications and expectations
  - Prompt production of requested information
- Changes to OCIE examination oversight designed to “detect fraud”
  - Includes focus on firms with “higher potential risk profiles” – affiliated custody, hedge funds with “smooth” or outlier returns, unknown auditor, disciplinary history
- Changes to SEC enforcement program

# SEC Examination Priorities

- Custody
  - “Do you in fact have the assets that your clients think you have”
  - Feb 2009 Sweep – Request for independent confirmation of assets
- Non-public information
  - Insider trading and information “leakage”
  - Proprietary and employee personal trading
- Portfolio management
  - Adherence to investment objectives and suitability

# SEC Examination Priorities

- Compliance program
  - Ongoing review and response to significant compliance events, business arrangements and regulatory developments
- Performance claims
  - Accuracy of performance numbers, composite construction, records to substantiate performance
- Disclosure
  - Is the firm's disclosure (Form ADV, performance disclosures, marketing materials, etc.) adequate?
  - Are the firm's practices consistent with its disclosures?

# SEC Regulatory Priorities – Dual Registrants

- IA-BD reform
  - “Investor Protection Act of 2009”
    - *Introduced by Treasury on July 10, 2009*
  - Harmonization – Grants SEC authority to create a single standard of conduct for broker-dealers and investment advisers
    - *Fiduciary duty based on activity performed, instead of legal distinctions*
  - “Simple and clear” disclosure regarding the terms of investor’s relationships with investment professionals
  - SEC authority to “examine and ban” forms of compensation that promote sale of products that are not in the investor’s best interest
  - Point of sale disclosure
  - Restriction on mandatory pre-dispute arbitration

# SEC Regulatory Priorities – Dual Registrants

- Custody
  - Proposed amendments to Advisers Act Rule 206(4)-2 on May 20, 2009
  - Expansion of annual surprise examination of client assets – including advisers with authority to deduct fees and dual registrants
  - Custody by related persons requires a internal control report
    - *Opinion as to internal controls, including safeguarding of funds and securities and tests of operational effectiveness*
  - Designation of an “independent” accountant

# SEC Regulatory Priorities - Other

- Pay-to-play
  - Proposed new Advisers Act Rule 206(4)-5 on August 3, 2009
    - *Applies to registered and unregistered advisers*
    - *“Look through” to pooled investment vehicles in which a government entity invests or is solicited to invest*
  - Prohibition on receiving compensation for providing investment advice for two years after a contribution
  - Ban on use of third-party consultants to solicit government clients
  - Restriction on soliciting and coordinating contributions

# SEC Regulatory Priorities - Other

- Hedge Fund Regulation
  - “Private Fund Investment Advisers Registration Act of 2009”
    - *Introduced by Treasury on July 15, 2009*
  - Private fund advisers with over \$30 million would be required to register with SEC
  - Reporting about AUM, leverage, counterparty credit risk exposures, trading and investment positions and trading practices relating to private funds