



**American Banker & Money Management  
Institute – 4th Annual Separately Managed  
Accounts Conference**  
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## **Regulatory Focus: Issues Unique to the SMA Bank Channel**

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# Regulatory Focus: Issues Unique to the SMA Bank Channel

1. Securities Regulators' Focus on SMAs
  - SEC Exam Issues
  - Other Typical SMA Issues
2. Bank Channel Structures: Choice of Sponsors
3. Conflict Issues
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# Securities Regulators' Focus on SMAs

- **Overselling Customization**
  - SMAs marketed as having tax-advantages but in reality do very little in the way of tax analysis
- **Suitability Issues**
  - Recommending SMA accounts when a mutual fund may offer the same (or similar) strategy for less
- **Excessive Fees and “reverse churning” issues**
- **Manager Due Diligence & Conflicts**
- **Misleading Advertising**
- **Point of Sale Issues**

# SEC Exam Issues

- **Disclosure - 72% of 105 firms examined had 1+ disclosure issues**
  - Form ADV delivery (initial delivery & annual offer)
  - Substance of disclosure
- **Brokerage issues - 58% raised brokerage issues**
  - Best execution and related issue
  - Failure to do systematic evaluation of broker arrangements & selection

# SEC Exam Issues

- Performance advertising - 54% raised performance advertising
  - Manager profiles distributed to SMA program clientele
  - Impermissibly showing gross of fee performance to retail clients
- Portfolio Management - 53% raised portfolio management issues
  - Consistency of portfolio management with client restrictions
- Code of Ethics - 48% raised code of ethics & personal securities trading related issues
- 97 firms got deficiency letters & 8 firms were passed to Enforcement

# Other Typical SMA Issues

- Suitability, Individualization
- Rule 3a-4 and “Investment Company Status”
  - Bank collective funds exception
- Sponsor Due Diligence of Portfolio Managers
- Special ERISA Issues for SMA Accounts
- Current Best Execution, Trading and Investment Opportunity Issues

# Bank Channel Structures: Choice of Sponsors

## 1. Dually Registered Broker/ Investment Adviser

- Bank affiliate or third party
- Referral program with bank – Comparable to “network” arrangements

## 2. Registered Investment Adviser

## 3. Bank - Under Exemption from

- Broker registration
  - Subject to GLBA & Reg B & State law
- Investment adviser registration, where available
- Service should be provided & supervised by the bank as a bank
  - Fiduciary/trust platform
  - Agency/private client platform

# Broker Sponsor – “Network” Arrangement

- Section 3(a)(4)(B)(i), Bank Interagency Guidelines & NASD Rule 2350
  - Written agreement between bank & broker
  - Clear identification of sponsoring broker
  - Where practical, conduct away from deposit area
  - Unlicensed bank employees
    - Perform only clerical tasks
    - Receive only nominal, one-time referral fees
  - Promotional materials
    - Broker as provider
    - Non-Bank Product Disclaimer
      - Not FDIC insured
      - Not bank deposits/not guaranteed
      - Subject to loss of principal
  - Customer disclosure & written acknowledgement that securities
    - Non-Bank Product Disclaimer

# Broker Sponsor

- **NASD Advertising Rule Issues**
  - Related & Performance
  - Blended Performance
  - Target, Projected and Assumed Rates of Return
  - Investment Analysis Tools (NASD Conduct Rule IM-2210-6)
  - Mutual and Hedge Fund Performance
  - Index Performance
- **Scrutiny of Recommendations on Use of Bank Products**
  - Loans to purchase securities
- **SIPC v. FDIC Coverage**

# Conflict Issues (OCC 9.12)

- Bank Affiliated Portfolio Managers
- Bank Affiliated Mutual Funds
- Bank Collective Investment Funds (OCC 9.18)
- Bank Affiliate Bank Sweep (OCC 9.10)
  - Demand deposit accounts
  - Mutual funds
- Differential compensation for referrals versus product sales

# Compliance & Internal Control Regimes

- Anti-Money Laundering
- Privacy & Information Sharing
  - GLBA
  - State Law
- Data Breach
  - State Law
- Outsourcing

# Claims & Litigation Perspective

- **Suitability**
  - SMA Program
  - Asset Allocation
  - Portfolio Manager Selection
  - Portfolio Manager Oversight
  - Ongoing Suitability Review
- **Compensation Arrangements**
  - Fiduciary Responsibilities
  - Suitability Rules
  - Antifraud Statutes and Common Law
- **ERISA**



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