
sifma
Investment Advisors –
Institutional Issues (MA-4)
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Investment Advisors – Institutional Issues (MA-4)

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Key Regulatory and Policy Areas for Asset Managers - Systemic Risk

- **Financial Stability Oversight Council (FSOC)**
  - *Notice Seeking Public Comment on Asset Management Products and Activities*
    - Focus on four areas: (1) liquidity and redemptions; (2) leverage; (3) operational risk; and (4) resolution
- **Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO)**
  - *Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (NBNI G-SIFIs)*
    - Identifying "NBNI financial entities whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity at the global level."

Key Regulatory and Policy Areas for Asset Managers – Enhanced SEC Oversight

- **SEC - Considering what additional changes may be necessary to make the asset management industry "safer"**
  - *Chair White's December 11 Speech: focused on "regulatory issues" in the asset management industry, including fund portfolio compensation risks and operational risks*
    - **Portfolio Compensation Risk: liquidity and leverage**
    - **Operational Risk: inadequate or failed internal processes and systems**
    - **"Proactive Initiatives"**
      - Expanded Data Collection and Reporting
      - Risk Management
      - "Transition Planning"
    - **Stress Testing Rulemaking (Dodd-Frank Requirement)**

Key Regulatory and Policy Areas for Asset Managers – Fixed Income Market Structure and Bond Liquidity

- **Post-Dodd-Frank - Totality of the regulations is leading to increased liquidity bifurcation**
  - *Market-makers are changing their strategies and liquidity is reducing in the secondary markets for some securities*
    - **Results in upward pressure on trading costs**
    - **Widening bid-ask spreads**
    - **Activity concentrated in the most liquid instruments and deteriorating in the less liquid ones**
  - *Lack of liquidity may ultimately increase market volatility and create a new normal that asset managers need to navigate*

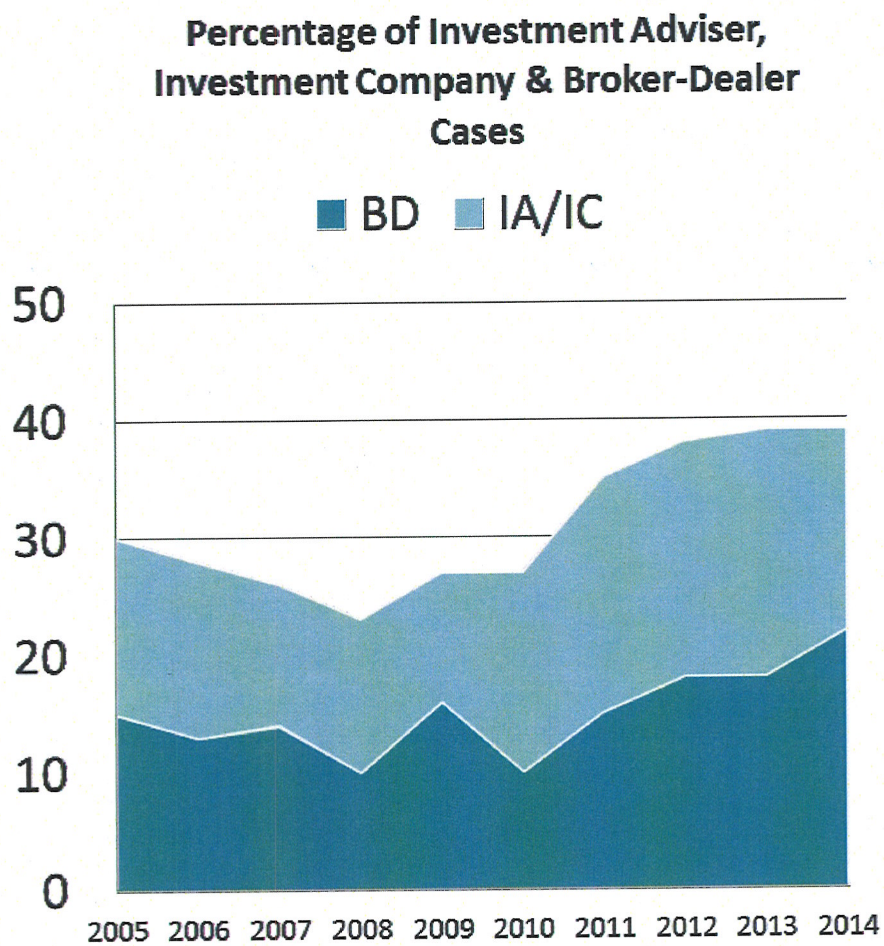
Key Regulatory and Policy Areas for Asset Managers – Global Derivatives Regulation

- **US Derivatives Regulation**
  - *CFTC finalizing and implementing many derivatives rulemakings*
  - *SEC behind in process of finalizing derivatives rulemakings*
- **International Regulation**
  - *Europe continues to implement derivatives regulations under EMIR, MiFID II, etc*
  - *Asia, Australia, and other jurisdictions are just beginning to consider regulations*
- **Some proposed regulations will be restrictive and/or costly on the buy-side**
  - *e.g., SEF/trade execution requirements, margin requirements, the treatment of FX transactions, and commodity position limits*
- **Other concerns - implementation timetable and cross-border harmonization**

SEC Exam Priorities and Sweeps

- **Retail Investors**
  - *Trading away and best execution*
- **"Alternative" Investment Companies**
  - *Leverage, liquidity, and valuation policies and practices*
  - *Adequacy of internal controls*
  - *Marketing of funds to investors*
- **Fixed-Income Investment Companies**
  - *Focus on whether funds have implemented policies and procedures and investment and trading controls consistent with their disclosures*
  - *Ensure that investment and liquidity profiles are consistent with disclosures*
- **Large Firm Monitoring**
  - *Focus on the largest U.S. broker-dealers and asset managers to assess risks at individual firms and identify industry-wide developments*
- **Cybersecurity**
  - *"Cybersecurity Examination Initiative" – Focus to continue on investment advisers and broker-dealers and expand to include transfer agents*
  - *Cybersecurity Examination Sweep Summary (Feb. 3, 2015)*
- **Never-Before-Examined Investment Companies**
  - *Focused, risk-based examinations of selected registered fund complexes*

2014 Enforcement Statistics



Type of Case	Number of Actions	Percentage
Broker-Dealer	166	22%
Investment Advisers and Investment Companies	130	17%
Securities Offering Cases	103	15%
Delinquent Filings	107	14%
Issuer Reporting and Disclosure	81	11%
Market Manipulation	63	8%
Insider Trading	52	7%
Miscellaneous	37	5%
FCPA	7	1%
Municipal Securities and Pension Plans	6	1%
Transfer Agent	7	1%

Selected 2014 SEC Enforcement Cases

- **Pay-to-Play**
  - *TL Ventures Inc. (June 20, 2014)*
- **Compliance Policies and Internal Controls**
  - *Barclays Capital Inc. (Sept. 23, 2014)*
  - *Wells Fargo Advisors, LLC (Sept. 22, 2014)*
- **Custody**
  - *Sands Brothers Asset Management LLC (Oct. 29, 2014)*
  - *Water Island Capital LLC (Feb. 12, 2015)*
- **Performance Advertising**
  - F-Squared Investments, Inc. (Dec. 22, 2014)
- **Conflicts of Interest**
  - *Revenue Sharing*
    - The Robare Group, Ltd. (Sept. 2, 2014)
  - *Private Equity – Fund Expense Allocations*
    - Clean Energy Capital, LLC (Feb. 25, 2014)
    - Lincolnshire Management, Inc. (Sept. 22, 2014)
  - *Hedge Funds*
    - Steven R. Markusen, Jay C. Cope, and Archer Advisors LLC (Sept. 8, 2014)
- **Principal Trades and Cross-Trades**
  - *Western Asset Management Co. (Jan. 27, 2014)*
  - *Paradigm Capital Management, Inc. (June 16, 2014)*
  - *Strategic Capital Group, LLC (Sept. 18, 2014)*

Trading Issues

- **Cross transaction issues**
- **Dark pools (and related confidentiality, conflict and other issues)**
- **Trade allocation issues**
  - *Possible SEC staff*
  - *SEC sweep focusing on trading away*
- **Soft dollar issues**
  - *ESMA Technical Guidance*
  - *Complications related to global trading desks)*

SEC's Focus on Broker Status of Advisors

- **Two areas of focus**
  - *PE fund fundraisers*
  - *PE managers receiving deal fees*
- **Implications**
- **Where things stand**

Continued Focus on Complex Product

- **Sale of Alternative Mutual Funds: regulatory reviews have focused on:**
  - *Adequacy of disclosures*
  - *Investor suitability, particularly considering leverage and liquidity*
  - *Internal controls, e.g., banker training*
- **Coco Bonds (a.k.a Claim-elimination securities)**
  - *Are these suitable for retail investors at all, including HNW?*

Alternative Mutual Funds - Managing the Sale & Distribution

- **Citi established a retail policy which outlines the requirements for offering Alternative Mutual Funds**
  - *Training specific to Alternative Mutual Funds*
  - *Clients must have knowledge and experience in hedge funds*
  - *Client and internal communications requirements to ensure clarity*
  - *Used as a diversification vehicle, i.e., focus on concentration risk*
  - *Product risk ratings are higher than long-only funds*
  - *Products must meet certain due diligence standards and approvals are set within established parameters*

Claim Elimination Securities (Coco bonds)

- **Citi established a global policy on offering Coco Bonds to the retail (individual) investor (well ahead of FCA publication of product intervention rules)**
- **Created specific banker training to educate sales force on the security**
- **Specific, additional risk disclosures and sales approval forms**
- **Target market restrictions based on type of Coco bond:**
  - *Client's net worth (e.g., investments > $1mn)*
  - *Client's knowledge and experience (e.g. with hybrid securities)*
  - *Additional limitations where Citi acts as lead underwriter*
- **UK FCA put out paper advising Cocos are unsuitable per se for retail investors**
  - *Prohibition on sale to retail clients in EEA*

Managing Conflicts of Interest

- **Clear policy, training, proper escalation and resolution mechanics, monitoring and communication are the tools to properly manage conflicts**
  - *"Tone from the Top" – Communications from Management, not a one-time topic*
  - *Conflicts of Interest Governance Framework and Quarterly Conflicts Report*
  - *Creation of Conflicts Committee to provide effective forum for the oversight of conflicts*
  - *Inventory of conflicts, mapped to controls, mitigation, training and reporting*
  - *Effective disclosures to clients*
  - *New Product Review Committee and Operational Due Diligence*

Conduct Risk

- **Regulators are increasingly concerned about the behavior of firms and their employees and how they treat their customers:**
  - *2011 US Dodd Frank introduces the Consumer Financial Protection Bureau*
  - *2012 UK Financial Conduct Authority was created*
  - *2013 Australia introduces reforms*
  - *2013 HKMA issued its Treat Customers Fairly Charter*

Citi's Conduct Risk Program

- **Purpose is to manage, minimize and mitigate the firm's exposure to conduct and behaviors resulting from conduct risk**
- **Conduct risk is the risk that Citi's employees or agents may – intentionally or through negligence – harm customers, clients, or the integrity of the markets, and thereby the integrity of the firm**
  - *Corporate policy detailing risks and procedures for identifying, managing and reporting conduct risks*
  - *Program governance structure*
  - *Clearly defined roles and responsibilities across 3 lines of defense: Business, Compliance, Internal Audit*
  - *Identify the risks and establish mitigating controls*

Institutional Advisor Issues

- SEC issues regarding private equity
  - *Drew Bowden's May 2014 speech*
- Discussion of alternative investments
- Private advisor/hedge fund issues