

Managed Accounts – Regulatory/Compliance Update

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Broader Policy Issues

- Broader SEC Policy Agenda
 - Broad Demands of the Dodd-Frank Act
 - New JOBS Act Demands
 - Managed Accounts
 - The Fiduciary Duty Debate
 - Forthcoming DOL ERISA Investment Advice / Fiduciary Rule Proposal
 - Rule 3a-4 Reconsideration?

Dodd-Frank Act

- Fiduciary Duty
 - SEC Concept Release – Next Year?
 - Policy challenge is formidable, with lots of open issues and gaps in guidance to address
 - For example, brokers often give non-discretionary advice
 - Yet this is the area least addressed by SEC guidance
 - Resolution of open issues is critical to accommodate potential for five different standards
 - Spillover into Managed Accounts
- Possible SRO for Investment Advisers?

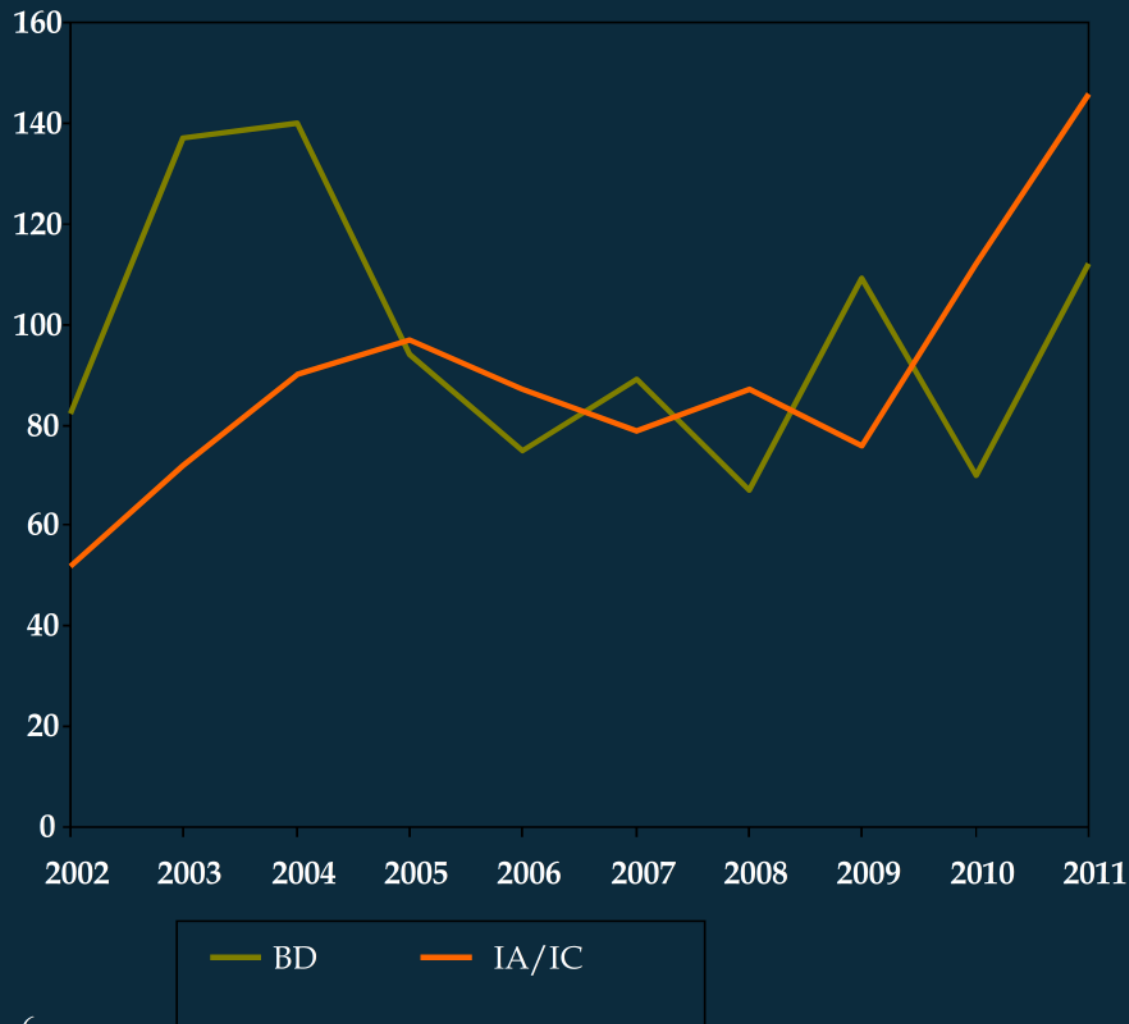
Dodd-Frank Act

- OTC Derivatives (OTC options and currency options)
 - Huge focus for institutional segments, retail segments now assessing
 - Retail impacts include
 - Requirement that OTC swaps are only sold to eligible contract participants (or ECPs), including natural persons with \$10 million
 - Broadening applicability of CTA registration requirements
 - Many complications for foreign exchange, many forms of which will be considered swaps (currency options, cash settled currency swaps and non-deliverable forwards)
 - These impact provide an added impetus to move low-end institutional accounts serviced in retail into Institutional so their DFA procedures are applied

SEC Focus in Managed Accounts

- Risk Analytics and “Aberrational Performance”
- Backgrounds and Qualification of Managers
- Systems Related Issues
- Disclosure
- Testing (e.g., inactivity, uninvested cash, use of affiliated products, performance dispersion)
- Conflicts

SEC Enforcement



- **146** cases against investment advisers and investment companies
- **30%** increase over FY 2010
- **92%** increase from FY 2009
- 112 cases against broker-dealers (70 in FY 2010)
- Cases against investment advisers, investment companies and broker-dealers represent 35% of SEC's total enforcement docket

FINRA

- Complex Products
 - RN 12-3 may be among the most important of 2012, but may be most cited in enforcement actions to come
 - Thematic approach to what had previously been articulated piecemeal on a product-by-product basis
 - Focus on Account Approval
 - FINRA “encourages” firms to consider prohibiting their sales force from recommending some complex products to retail investors not been approved for options trading
 - Alternatively, FINRA states that firms should develop “other comparable procedures” to ensure their sales force does not solicit retail customers for whom complex products are unsuitable and be “prepared to demonstrate” the basis for allowing recommendations of complex products to retail investors not approved for options
 - Recommendations
 - Review of Product Approval Procedures
 - Review of Products in the Field
 - Training and Supervision
 - Customer Communications
 - Account Opening and Documentation

FINRA

- FINRA's New Suitability/KYC Rules
 - The New Framework
 - Coverage Now Includes Recommended Transactions and Investment Strategies
 - Detailed Customer Information
 - Stricter Approach regarding Institutional Sales
 - Express Components of Suitability (Reasonable-Basis; Customer-Specific; Quantitative)

FINRA

- FINRA's New Public Communication Rules
 - The New Categories of Communications
 - Impact on Templates/ Fund Fact Sheets
 - Controls Over For Internal Use Only Material
 - Developments with Hypothetical Performance
 - Divergent SEC and CFTC approaches
 - Affect on Managed Accounts

SEC/FINRA

- Developments Re SEC/ FINRA Focus On Fee-Based Accounts
 - FINRA's General Reach Into BD Affiliate Activity
 - Recent FINRA's Exam Priority Letters (As well as Other Statements) Evidence a Significant Interest in Advisory Activity
 - Growing frequency of FINRA Examination with Respect to BD Advisory Activity
 - Suitability Considerations Regarding Fee-Based versus Commissions

SEC/FINRA

- Specific Areas of SEC/FINRA Exam Focus Re Fee-Based Accounts
 - Unassigned (“Orphaned”) Advisory Accounts
 - Infrequent Trading (Rep as Portfolio Manager Programs)
 - Commission-Products included in Fee-Based Accounts
 - Inclusion of funds with Trading Fees

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