



Changing Regulatory Landscape and How to Survive an SEC Exam



Financial Planning Association of Southern Wisconsin

Financial Planning Symposium

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Today's Objectives

- Changing Regulatory Landscape
 - Timeline: 2004 – present
 - Impact of regulatory landscape on the SEC
 - Changes at the SEC
 - SEC focus areas
 - Recent enforcement actions
 - Impact on YOU, the investment adviser
- How to Survive an SEC Exam
 - Types of exams
 - SEC exam process
 - Preparation for the exam
 - Dos and Don'ts
- Wrap-up/Questions

Timeline: 2004 – 2008

- October 5, 2004: Compliance Rules.
- January 7, 2005: Code of Ethics.
- September 15, 2008: Lehman files for bankruptcy.
- September 16, 2008: The Reserve Fund breaks the buck.
- Fall 2008: Several rules/proposals/amendments to reign in short selling.
- December 11, 2008: Madoff arrested.

Timeline: 2009

- 2009: Massive Restructuring
 - Proposals
 - Amendments to the Custody Rule.
 - Facilitating shareholder director nominations.
 - Money market reform.
 - Proxy disclosure and solicitation enhancements.
 - Pay-to-play measures.
 - Adoptions
 - Summary Prospectus Rule.
 - Regulation S-AM.
 - Interim rule requiring the disclosure of certain money market portfolio holdings.
 - Proposed restructuring of the regulatory structure.

Regulatory Shake-Up

“With all the requests for sweeping reform, not only are particular regulations being discussed, but the *entire regulatory structure seems to be on the table.*” - Quote from SEC Commissioner Luis Aguilar in a April 17, 2009 speech at the 2009 Independent Directors Conference Workshop

- Regulation harmonization between the SEC and the CFTC.
- White House white paper on regulatory reform.
- Extensive changes at the SEC focusing on:
 - o Leadership
 - o Structure
 - o Specialization
 - o Training
 - o Resources

Changing of the Guard

- Mary Schapiro, sworn in as Chairman of the SEC on January 27, 2009.
- Robert Khuzami, named Director of the Division of Enforcement, February 19, 2009.
- Lori Richards, Director of the Office of Compliance and Inspections (“OCIE”), resigned July 8, 2009.
- John Walsh, OCIE Associate Director - Chief Counsel serving as Acting Director of OCIE.
- Lori Schock, named Director of the Office of Investor Education and Advocacy, October 5, 2009.

Picking up the Pieces – Structural Initiatives

Division of Enforcement

- Currently undergoing “the unit’s biggest reorganization in at least three decades.”
 - Creation of 5 investigative group focused on: (1) asset management; (2) structured products; (3) municipal securities; (4) foreign corrupt practices; and (5) market abuse.
 - Reducing management by 40% to create a flatter organizational structure.
 - Creation of Chief Operating Officer position.
 - Improved complaints, tips and referral management.
 - Increased resources.

OCIE

- Reforms designed to reshape the examination program including improved: (1) fraud detection; (2) procedures and internal controls; (3) staffing of examination teams; (4) oversight and communication; (5) recruiting efforts; and (6) training efforts.

Specialization, Training and Resources

- Specialization
 - Industry and Market Fellows Program.
 - Investor Advisory Committee.
 - New hires – Senior Specialized Examiner.
- Training
 - Sessions focused on (1) forensic technology; (2) financial fraud; (3) market manipulation; (4) Ponzi schemes; and (4) coordination within the SEC.
 - Joint training programs with other regulators.
 - Certification programs such as CFE, CFA and CAIA.
 - Performance evaluations.
- Resources
 - \$10M in funding to hire 100 new investigators and attorneys over the next 2 years.
 - Proposal could lead to a 75% budget increase.
 - Improved operational efficiencies.
 - Databases logging staff background and experience.

Putting Training into Action

- SEC Focus Areas
 - Custody of Client Assets and Surprise Third-Party Audits.
 - Oversight of Vendors and Third Party Providers.
 - Disclosures.
 - Security Valuation.
 - Registration of Hedge Fund Advisers.
 - Money Market Reform.
 - Short Sales.
 - Credit Rating Oversight.

The Proof is in the Pudding

SEC Actions	2008	2009
Open investigations	1,290	1,377
Formal orders of investigation	143	335
Emergency Temporary Restraining Orders	25	57
Actions filed	359	458

Data for each year is for the period January 1 – September 10.

Recent Enforcement Actions

- PAX World
- Countrywide Financial
- Reserve Fund
- Various Ponzi schemes
- New York State Common Retirement Fund
- Millennium Partners
- General Electric
- Terex Corporation
- Abusive short selling

So What Does This Mean for You?

“...we’re past the implementation stage and compliance with the Compliance Rule is no longer a “new” obligation. SEC examiners will be reviewing the adequacy of firms’ compliance programs with the expectation that firms will have fully-operational, effective, **compliant** compliance programs.” - Remarks before the IA Compliance Best Practices Summit 2009 from former Director of the OCIE, Lori Richards, on March 12, 2009

SEC Expectations

- Evergreen compliance programs.
- Conflicts of interest monitoring program.
- Formal risk assessments, testing, and annual review processes.
- Documentation.

You Should Expect

- Improved communication.
- Faster turnaround on enforcement cases.
- Larger and more frequent fines and penalties.
- Longer exams.

How to Survive an SEC Exam

Types of SEC Exams

- Risk-Based Exams (Routine Exams)
 - High – 3 years, Medium 5 – years, Low – 10 years.
- Sweep Exams
 - Support the SEC's specialization initiative.
- Cause Exams
 - Typically generated by a tip or complaint.
- Half-Day Exams
 - New advisers, by phone or in person, typically within the first 6 months of operations.
- Surprise Exams
 - Little to no notice, focused on interviews with staff, limited documentation requests, occurring more often for RIAs with hedge funds.
- Concurrent Exams
 - Investment adviser, mutual fund, broker dealer exams – not new, although gaining in popularity.

SEC Exam Process – What to Expect

- Improved communication, coordination and follow through.
- More examiners.
- Longer exams.
- Documentation requests.
 - Increased requests.
 - Timeliness.
 - Privileged information.
- Fewer passes.
- Focus on new areas.

Hot Topics

- Follow the \$\$\$
 - Custody
 - Valuation
 - Account reviews
 - Reconciliations
 - Financial records
 - Performance fees
 - Trading activities
 - Personal trading
 - Insider trading
- Compliance process
- Marketing
- Service provider oversight
- Personnel changes

How to Survive an SEC Exam

- Step 1 – Prepare before you receive the call.
- Step 2 – Preparation upon notification.
- Step 3 – Preparation for the on-site exam.
- Step 4 – On-site review.
- Step 5 – Exit interview and post on-site exam expectations.

Step 1 – When Your Ears are Ringing

- Step 1: Prepare before you receive the call.
 - Maintain an evergreen compliance program.
 - Review past deficiency letters and responses – this is the SEC’s starting point when coming on-site.
 - Review examination request lists available on the SEC’s website and determine how you would provide each item requested.
(<http://sec.gov/info/cco/requestlistcore1108.htm>)

Step 2 – Pre-Examination Preparation

- Step 2: Preparation upon notification.
 - Create an Information Request Log.
 - Maintain two sets of documents either in binders or folders – one for you, one for the SEC.
 - Label each tab/folder with the applicable reference number identified within the log.
 - Request FOIA protection, consult with counsel.

Step 3 – Ready or Not, Here They Come!

- Step 3: Preparation for the on-site exam.
 - Clean up work areas and lock up confidential client information.
 - Read and understand the compliance policies and procedures related to your function.
 - Read and understand Form ADV Parts 1 and 2 including the Schedule F disclosures.
 - If you discover an issue as you are preparing for the exam, talk to the CCO right away so that it can be addressed appropriately.
 - Meet with staff to prepare for interviews.

Step 4 – They're Here!

- Step 4: On-site review.
 - President to lead kick-off meeting.
 - Establish one point of contact to lead the exam, set the tone, and to attend every meeting (typically CCO).
 - Designate a comfortable conference room for the examiners.
 - Provide an outbox in the examination room for additional document requests.
 - Require all additional requests of the SEC to be submitted in writing and routed through one person.
 - When the SEC requests further documentation, make two copies.
 - Log the document within the examination log.
 - Be mindful of your conversations in the kitchen, lobby, hallways, restrooms, etc.

Step 4, cont. – There's More....

- Step 4: On-site review, continued.
 - Keep your schedule as open as possible to assist in responding to requests.
 - Don't respond to requests at your desk and don't offer for the examiners to seek you out if they have additional questions.
 - Don't provide access to the copy machine or your computer and files. Employees should make all copies of information.

Step 5 – Whew!

- Step 5 – Exit interview and post on-site exam expectations.
 - Request an “exit interview” – the SEC should outline any issues they have identified so far.
 - Additional requests for information may come in the weeks/months following the on-site review.
 - Assuming you are not referred to the Enforcement Division of the SEC, the “deficiency letter” is normally received within a few months after the exam is completed.
 - Once received, you must respond in writing within 30 days.

Interview – Do's

- The CCO should be present at all meetings.
- Be prompt, bring notepad.
- Know the policies/practices related to your function inside out/backwards.
- Answer only questions asked - “Less is more.”
- Ok to narrow the scope of the questions, say “I don’t know,” or “I’ll check and get back to you.”
- Ask for clarification if necessary – don’t offer what you have or say “would you like this” or “would you like that.” Sometimes they like to fish to see what they can catch!
- Expect “how” questions.
- Select straightforward examples.
- Expect examiners to ask the same questions more than once.
- Expect examiners to ask for records they already have.
- Expect examiners to make mistakes when describing rule/policy requirements.
- Expect examiners to play good cop/bad cop.

Interview – Don'ts

- Don't take their questions personally or as an attack on your practices.
- Don't make something up or give quick answers.
- Don't debate things or hash it out during the interview.
- Don't correct someone in the interview unless it is significant.
- Don't answer a question related to something you don't do.
- Don't theorize or discuss "what if" scenarios.
- Don't use this as an opportunity to air a grievance or complain about regulations/government.
- Don't offer a walk-through or demonstration of a specific practice unless you clear it with the CCO.
- Don't expect to receive advice/guidance from the SEC.
- Don't expect them to approve of your practices/policies/program.
- Don't discuss current day/week issues.
- Don't second guess what you know.

Questions?

Helpful Resources

- Robert Khuzami, Director – Division of Enforcement and John Walsh – Acting Director – OCIE, “Testimony Concerning the SEC’s Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance”
<http://www.sec.gov/news/testimony/2009/ts091009rk-jw.htm>
- Lori Richards, former SEC Director - OCIE, "Compliance in Today's Environment: Step Up to the Challenge"
<http://www.sec.gov/news/speech/2009/spch031209lar.htm>
- Luis A. Aguilar, SEC Commissioner, “Making Investors a Priority in Regulatory Reform”
<http://www.sec.gov/news/speech/2009/spch041709laa.htm>
- Vista360 Hot Industry Topics List – July 2009
http://www.vista360llc.com/pdf/VISTA360_HIT_LIST_2009-07.pdf
- Vista360 Perspectives
<http://www.vista360llc.com/vista360-news.htm>
- Email jharris@vista360llc.com to be added to our distribution list.

Speaker Biography

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Caroline is responsible for assisting investment advisers and funds with compliance and strategic matters including compliance program development, testing, annual reviews, due diligence reviews and service provider searches. Prior to joining Vista360, LLC, Caroline served as the Chief Financial Officer of Ziegler Capital Management, LLC, North Track Funds, Inc. and Ziegler Exchange Traded Trust. Caroline earned a bachelor's degree in economics and Spanish from the University of Wisconsin.

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