

The SEC hosted its Fourth National Seminar of the CCO Outreach program for fund and adviser CCOs in Washington D.C. Thursday, November 13. We participated via webcast, and have summarized key points made by SEC staff during the seminar. We hope you find the following helpful as you continue to manage your risk-based compliance programs.

Background

The SEC's goal with its CCO Outreach Program is to improve compliance by opening the lines of communication between CCOs and SEC staff.

The National Seminar is held annually at SEC headquarters in Washington, D.C. and covers various broad topics. The presentations at this year's National Seminar were in a panel format, which generally consisted of two SEC staff members and two CCOs (one from a larger firm and one from a smaller firm).

SEC Staff Comments

1. SEC Chairman, Christopher Cox in his opening address expressed his concerns about firms' decreasing their compliance program budgets given the fact that the current financial crisis was in part created because of a lack of transparency and disclosure about the financial risks in many companies. The link to the Chairman's speech on the SEC's website is included here: <http://www.sec.gov/news/speech/2008/spch111308cc.htm>
2. Andrew "Buddy" Donohue, SEC Director, Division of Investment Management, expressed that during uncertain market times firms should be back-testing their compliance programs to see what worked and what did not work. In his address to the participants Buddy said that firms should "go back, go back, go back" and review their policies and procedures, valuation methods, disclosures, risk assessments and all other aspects of their compliance programs to ensure these are practices that continue to be effective.
3. Lori Richards, SEC Director, Office of Compliance Inspections and Examinations, stressed the importance for firms to remember their fiduciary duty to protect their clients. Lori reminded the group that desperate times often create desperate actions. Therefore, compliance officers should watch staff in the high risk areas of the firm, while still keeping a focus on other areas of responsibility.

SEC Current Areas of Focus

1. Valuation of securities continues to be an important focus area of the SEC. Proposed guidance on valuation may come out next year, but it was emphasized that the current guidance is still valid. It was suggested firms should conduct, at a minimum, an annual due diligence review of their pricing service providers. As an example, pricing service providers could be invited to attend a fund board meeting to give the board an overview of their processes in valuing securities, which would assist the board in their oversight responsibilities.
2. From a fund perspective, redemptions and liquidity are key concerns. Funds need to have confidence in the valuation procedures of their pricing service providers or pricing committees to value securities, especially those with less liquidity. Funds may wish to consider whether their policies and procedures should include provisions to work with shareholders regarding redemptions.
3. Firms should consider conducting due diligence visits and re-evaluating relationships with service providers, brokers, custodians and counterparties. Consider reviewing agreements, the financial status of these businesses, and the selection processes to ensure the firm has given due consideration to the potential risks involved in these relationships.
4. Examiners will be focusing on firm's disclosures in their Form ADV Part II, prospectuses, marketing materials, websites, and advertisements. They will be looking for consistency throughout the written documents and in the execution of those disclosures. Are your business practices what you disclose them to be?
5. Are the investments in your client portfolios and funds consistent with their risk tolerances and investment objectives? Are portfolio managers taking undue risks to recoup some of the losses experienced due to the down-turn in the market place? The SEC will be looking at the securities in portfolios and funds to ensure they are appropriate and suitable investments. Are securities that were formerly thought to be safe and very liquid still meeting those criteria?
6. SEC staff will be looking at firm's forensic and back-testing documentation. Are funds discovering trends and then putting changes into place to address those areas? The staff will be reviewing adviser's 10-15 most profitable trades to see if they may have involved market manipulation or insider trading information. For these same reasons the staff may also ask to review the 10 least profitable transactions and cross trades executed, to determine if one client was harmed in an effort to produce better results for another client.
7. Does the firm have a sound compliance program and are employees following the policies and procedures that have been put into place? The SEC staff will be checking to see that the firm has reasonable controls around preventing fraudulent behavior and unethical activities committed by staff. Firms can have monitoring provisions in place and written directives, but in the end it comes down to that culture of compliance. Everyone at the firm should truly believe that compliance with regulations is *their* responsibility and they have to be involved in the process of ensuring that everyone at the firm acts in an ethical manner to protect the firm, the clients, and shareholders.
8. The results of recent sweep exams conducted by SEC staff on the spreading of rumors and misleading information will soon be posted on the SEC's website.

SEC Examinations and Enforcement

1. The decision to refer a firm to enforcement is determined by many factors and the factors have not really changed much over the years. Some of the factors considered include whether fraud was involved and if so, was it intentional. The SEC staff looks at the behavior to see if there is a pattern, previous enforcement actions, or if the activity was repeated or recidivist in nature. Staff will evaluate whether shareholders or investors were harmed as a result of this activity, and if the firm benefited financially as a result. The SEC will also refer violations to other regulatory agencies upon discovery, such as the FINRA, DOL, FinCEN or the IRS.
2. There are also situations where the SEC would not refer a firm to enforcement, such as:
 - a. When the firm discovers a violation, it self reports to the SEC, and explains the processes they have put into place to prevent this situation from reoccurring;
 - b. If a firm promptly resolves a problem discovered during an examination and shows the SEC that they have resolved the problem; and
 - c. If a firm can show the SEC they have appropriate policies and procedures in place, they are effective, and the violation was not as a result of inadequate oversight.
3. The SEC staff continues to focus on e-mail and IM review processes. Proposed amendments to the books and records rule should soon be available on the SEC's website and the proposal will include e-mail. If the SEC staff sees that a firm is not reviewing e-mail and IM, or it is doing a very high level survey, this will bring the firm's entire compliance program under the scrutiny of SEC staff.
4. The SEC staff wants to be sure in the firm's evaluation of each employee's conflicts of interest and potential fraudulent activities, that firms are considering the entire family relationship to assess potential conflicts.

We will be including SEC proposed guidance and regulation in our Hot Industry Topics ("HIT") List which will be updated and sent out later this month. The HIT list provides a brief description of topics and initiatives along with internet links to the source, which may include articles or speeches. The HIT list is designed to help keep you informed of ongoing SEC proposed and final rules, along with SEC initiatives and industry best practices.

As always, please contact us with questions, or if we can be of further assistance.

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