

IA Watch Conference – March 7-8, 2019 – Washington, DC

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At IA Watch's 21st Annual IA Compliance: The Full 360° View East conference, industry leaders gathered together to discuss the latest topics involving regulatory changes and best practices to help to strengthen investment advisers' compliance programs. The conference spanned two days in the first week of March, and was held at the Mayflower Hotel in Washington, D.C.

The following are summaries of some of the conference's most interesting sessions.

Day 1

Keynote Address: Deputy OCIE Director Daniel Kahl

Speaker: Daniel Kahl

The first session of the conference kicked off with some insights from Daniel Kahl of the SEC's Office of Compliance Inspections and Exams ("OCIE"). Mr. Kahl, who is Deputy Director of the SEC's second largest division (Enforcement being the largest), centered his discussion on some of OCIE's 2019 Examination Priorities, namely matters of importance to retail investors (such as seniors and retirement programs) and Cybersecurity. Regarding Cybersecurity, Kahl asserted that it is likely to be an SEC exam priority forever. He also emphasized that when it comes to Cybersecurity-focused examination sweeps, examinees should not fear OCIE itself, but instead should fear the potential harm that could be done to their firm's assets, reputation, etc. Some of OCIE's focus areas include internal controls, Reg S-P considerations for retail clients and assimilation of systems for advisers with multiple locations. Ultimately, OCIE wants to support investment advisers' compliance function and prefers to see those compliance teams uncover issues before the SEC does. But for those advisers who don't get the message, Mr. Kahl pointed out that there will be cyber incident-related enforcement cases based on violations of Reg S-P. The parting message was that the SEC wants compliance programs "empowered" to resolve issues before an examiner walks in the door.

Get Ready for What's Coming Your Way from Washington

Speakers: Diane Blizzard (former Associate Director for Regulatory Policy and Investment Adviser Regulation, SEC Division of Investment Management), Sara Cortes (Assistant Director, Investment Advisor Regulation Office, SEC's Division of Investment Management), Doug Schiedt (former Associate Director and Chief

Counsel, SEC Division of Investment Management), Jen Suellentrop (VP/Associate General Counsel, Fidelity Investments, Smithfield, RI)

For the second session of the conference, IA Watch brought in some current and former members of the SEC's Division of Investment Management to discuss their top rulemaking priorities looking forward into this year. As expected, the Fiduciary Duty and Advertising Rule were at the top of their list. While the federal government is struggling to push through their version of the Fiduciary Rule, they are beginning to sense some growing conflict with state regulators as interpretation of the Rule appears to be up for grabs by any one of them (the speakers cited [Nevada](#) and [New Jersey](#) as examples of this). As for the Advertising Rule, the Division's goal is to revise the Rule to bring it into the 21st century since it was last reviewed over 50 years ago! Ms. Cortes noted that SEC Chair Jay Clayton is pushing "regulatory flexibility" when it comes to reevaluating rules, in particular for the admittedly antiquated Advertising Rule. Although she noted that an update of the Rule is on the SEC's "short term agenda", there was no indication as to when the industry can expect an update. As the session wound down with a discussion on share class allocation issues and other conflicts of interest, the speakers broached the contentious Robare case, which is currently on appeal in the D.C. Circuit Court (*The Robare Group, et al. v. Securities and Exchange Commission*, No. 16-1453, (D.C. Cir.)). Their big takeaway from *Robare*: the SEC will always view all conflicts as material, and the use of the word "may" in your Form ADV may not be appropriate to use in disclosing such conflicts.

Strategies for Serving Senior Clients as OCIE's Focus Intensifies

Speakers: Charles Koretke

(Assistant Director, Office of Risk Analysis and Surveillance, SEC Office of Compliance Inspections and Examinations, Washington, D.C), Judith Shaw, (Securities Administrator, Maine Department of Professional & Financial Regulation, Augusta, Maine), Wendy Vasquez, (CCO, Cypress Capital, Franklin, Tenn), Karen Huey (President, Professional Compliance Assistance, Woodstock, Ga.)

This session focused on the SEC's recent initiative surrounding an ever-growing area of regulatory concern: investment advisers serving senior clientele. In 2019, OCIE will be moving forward with their initiative focusing on protecting senior investors, and their examinations will target retirement accounts, annuity products and fee disclosures. The speakers warned that advisers should make sure their policies and procedures are up to snuff before the SEC arrives – they should provide answers to questions such as: how does the adviser handle accounts of clients with diminished capacity? How does the adviser handle a client's account upon his or her death? Wendy Vasquez discussed her learning experience from a recent SEC exam deficiency involving a lack of sufficient policies and procedures addressing senior clients. In addition, Judith Shaw provided an update with her work with the NASAA on the SeniorSafe Act and the importance of training advisers to recognize elderly exploitation red flags.

Mastering the Latest Twists to the SEC's Custody Rules

Speakers: Laura Grossman (Associate General Counsel, Investment Adviser Association, Washington, D.C.), Stephen Councill, Attorney, Rogers & Hardin,

Atlanta, Christina Sears, CCO, American Beacon Advisors, Irving, Texas), Lauri London, Attorney, Cohen & Buckmann, New York)

The panel, which included the Associate General Counsel of the Investment Adviser Association (“IAA”), came together to give an update on the status of the Custody Rule, and the brief history of the development of the Rule. The panel began by describing the SEC’s 2017 Custody Guidance, which came in the form of a no-action letter issued to the IAA regarding third-party transfer authority, IM Guidance, and a series of updated FAQs, all of which clarify different scenarios in which an adviser would be deemed to have custody over client assets. The panel also discussed certain key exceptions to the Custody Rule, in which advisers would not need a qualified custodian (for example, private funds, on the condition that their financial statements are audited and delivered to investors each year) or in which an adviser has inadvertent custody (for example, when an adviser receives a check directly from a client, on the condition that the check be promptly returned to the sender and the event be documented). Toward the end of the discussion, the panel emphasized key Custody Rule requirements, such as the timely engagement of an accountant to conduct a “surprise audit” upon the adviser’s accounts over which it has custody.

Day 2

Meet Your Regulatory: Co-Chief of the Division of Enforcement’s Asset Management Unit Dabney O’Riordan

During the first session of the second day, Dabney O’Riordan, Co-Chief of the SEC’s Enforcement Division, set out to precisely define the differentiating characteristics that her division holds compared to any other SEC division such as, for instance, their broad-based subpoena power, or their authority to depose persons of interest. The Enforcement Division, generally speaking, becomes involved in an examination or launches an investigation when there has been a violation of law, and their focus in recent years has been drawn to the asset management industry, namely private funds and registered investment advisers. Ms. Riordan identified themes running through some recent signature cases that Enforcement has brought against these firms, such as fee & expense allocation and disclosure issues, share class issues and violations of the Custody Rule. Ms. Riordan warned that firms under investigation should not expect credit for merely ‘cooperating’ with Enforcement, as that is the minimum standard expected by the Division. However, when it comes to rewarding firms for good behavior before an investigation even commences, Ms. Riordan admitted that self-reporting is a huge credit to firms, depending on the severity of the conduct for which they are reporting themselves.

Beyond Bits and Bytes: Cybersecurity Guidance to deter Continuing Threats

Speakers: Kimberly Kiefer Peretti (Partner, Alston & Bird, Washington, D.C.), David Dunn (Managing Director, FTI Consulting, Philadelphia, PA), Wes Stillman (CEO, RightSize Solutions, Lenexa, TX)

This session focused on the current cyber threat environment that affects the financial services industry. The panelists began the session by identifying the threats that are most relevant to RIA businesses: business e-mail compromises (which could lead to unauthorized wire transfers), ransomware and phishing, and breaches of vendor/third-party cybersecurity. The panelists then turned their focus toward the future, noting that in addition to the threats that are currently in place, the industry can expect an increased risk coming from nation states, such as Russia, Iran and North Korea, who have already been widely prosecuted for using phishing and spear phishing to penetrate companies. The panelists also advised that firms do not necessarily need to experience a loss of client funds or compromise of client PII to be subject to a cybersecurity-related enforcement action. Cyber enforcement, rather, is also focused on the overall design of policies and procedures.

With the SEC's third Cybersecurity examination sweep just about to gear up, the panelists urged advisers to focus on ensuring that their policies and procedures are both risk-based and narrowly tailored to their own firm, and to keep in mind the SEC's six core areas of focus for building a strong Cybersecurity program: 1) governance and risk assessments; 2) consideration of access rights and controls; 3) data loss prevention; 4) vendor management and due diligence; 5) training; and 6) incident response planning.