

The background of the slide is a photograph of a modern glass skyscraper. A vertical yellow bar is on the left side. The Mayer Brown logo is in the top left. The text '15th Annual Investment Management Regulatory University' is in the center, and 'Webinar Series' is below it. The date 'September 21, 2021' is in the bottom right. The title 'Enforcement Trends Affecting Investment Advisers and Other Fiduciaries' is at the bottom.

MAYER | BROWN

15<sup>TH</sup> ANNUAL

# Investment Management Regulatory University

WEBINAR SERIES

September 21, 2021

## Enforcement Trends Affecting Investment Advisers and Other Fiduciaries

# Speakers



**Stephanie Monaco**

Partner  
+1 202 263 3379  
smonaco@mayerbrown.com



**Matthew Kluchenek**

Partner  
+1 312 701 8700  
mkluchenek@mayerbrown.com



**Richard Rosenfeld**

Partner  
+1 202 263 263 3130  
rosenfeld@mayerbrown.com



**Glenn Vanzura**

Partner  
+1 213 229 5109  
gvanzura@mayerbrown.com



# SEC Regulatory

- SEC Regulatory Flex Agenda – 49 Items, including
  - Rule 10b5-1 Plans
  - Climate Change Disclosure and Investment Company/Investment Adviser ESG Claims
  - SPACs
  - Amendments to Custody Rule
  - Form PF
  - Rule 17a-7 Amendments
  - Money Market Fund Reforms
  - Pay vs. Performance
  - Proxy Voting Advice



# Division of Examinations

- Division of Examinations – It Grew-some, now a full Division
  - Change in Tone
  - 10 Risk Alerts in the last year
  - 2000 Deficiency Letters in 2020
  - Division verifies existence of Assets with Custodians
  - Custody remains Top Priority
  - Form CRS filings and deliveries – 21 IA Cases/6 BD Cases
  - Fee Miscalculations



# Division of Examinations (con't)

- Standards of Conduct, including Regulation BI, RIA 2019 Fiduciary Interpretation, account types, fullness/fairness of disclosure, risks of fees, expenses, best execution, undisclosed compensation arrangements
- Focus on TAMP platforms
- Perennial fee calculation errors
- Digital Assets



# Division of Examinations (con't)

- Enforcement Referrals (130 last year) involving, among others, higher cost mutual fund shares, failure to disclose conflicts of interest, fraudulent inflation of NAV and performance results of managed funds, violations of the custody rule
- Enhancing Event and Emerging Risk Examination Team (EERT)
- Raising importance of supervision, especially with continued remote work environment
- Priorities remain on retail investors, teachers, seniors, military, retirement savers

# CFTC Enforcement

## **CFTC enforcement remains strong with a record-setting fiscal year.**

- More enforcement actions
- More penalties
- More individual accountability
- More partnering with criminal law enforcement
- More coordination with other regulators, particular the SEC and FINRA
  - FY 2020 CMPs of \$1.3 billion
  - FY 2017 CMPs of \$412 million





# CFTC Enforcement

## Areas of Focus:

- Disruptive trading (spoofing and manipulation)
- Insider trading – can be violated when one trades while in possession of material, non-public information (MNPI), where such MNPI was obtained in breach of a duty or through fraud or deception.
  - Client orders, positions, strategies, etc. are confidential
- CPO and CTA registration failures
- Wash trades
- Swaps

# DOJ Commodities Enforcement

- The DOJ, via main Justice or a US Attorney's office, has the power to prosecute criminal conduct
- DOJ's Fraud Section has a commodities and securities task force
- 16 actions filed in parallel with the CFTC
- Areas of focus:
  - Spoofing and manipulation
  - Insider trading
- Recent high-profile convictions and settlements
- Limitations period can extend to 10 years with wire fraud affecting a financial institution charge.



# Supervision

- **Compliance as Front-line Defense:**

“Because companies stand as the first line of defense to prevent misconduct, we expect their compliance function to serve as a meaningful check—and to ensure proper systems are in place to detect misconduct when it occurs, and make sure it does not happen again.”



Copyright ©2014 R.J. Romano.

“It’s just the new Compliance Officer. Administration wanted him to have more visibility with the staff.”

# Supervision

- **Framework**

- Qualified personnel
- Resources
- Tailored policies and procedures
- Training and education (scenarios?)
- ***Surveillance systems/tools***
- Escalation process
- Recordkeeping





# Compliance

- In 2020, DOE issued its “**Guidance on Evaluating Compliance Programs in Connection with Enforcement Matters**,” outlining the factors it will consider when evaluating compliance programs in connection with enforcement matters.
- Guidance is the first of its kind issued by the DOE.
- DOE considers whether a compliance program was reasonably designed and implemented to:
  - prevent the underlying misconduct at issue
  - detect the misconduct
  - remediate the misconduct
- Risk-based analysis, taking into consideration the specific entity involved, its role in the market, and the potential market or customer impact of the underlying misconduct.



# Recent SEC Enforcement Actions

- Failing to adequately disclose investment risks
- Failing to adequately disclose conflicts of interest
- Failing to adequately disclose fees, fee calculations or compensation
- Miscalculating fees
- Misallocating expenses
- Inflating net asset values and performance results of managed funds
- Failing to supervise registered representatives who made unsuitable recommendations to retail customers
- Failing to report suspicious activity reports
- Failing to adequately safeguard MNPI
- Failing to adequately implement cybersecurity policies
- Failing to implement or follow other policies and procedures



# Recent SEC Enforcement Actions

- Failing to adequately disclose investment risks
  - *In re American Portfolios Financial Services* (Nov. 13, 2020): Five settled actions against investment advisory firms. In connection with sales of complex exchange-traded products to retail investors, offering documents made clear that the short-term nature of these products made investments in the products more likely to experience a decline in value when held over a longer period. However, firm representatives recommended their clients buy and hold the products for longer periods. Charged with failure to implement written policies and procedures reasonably designed to prevent IAA violations, and failure to supervise reps. (Similar allegations were made in a more recently settled action with *UBS Financial Services Inc.* (Jul. 19, 2021)).



# Recent SEC Enforcement Actions

- Failing to adequately disclose potential or actual conflicts of interest
  - *SEC v. GPB Capital Holdings, LLC* (Feb. 4, 2021), *SEC v. FF Fund Management, LLC* (Apr. 23, 2021), and *SEC v. UCB Financial Services, Ltd.* (Jun. 17, 2021)
  - Examples of Enforcement Division’s continued focus on matters involving “traditional” fraud involving alleged misrepresentations (e.g., re: fund strategy and investments; re: fees and compensation), failing to eliminate or disclose conflicts of interest, and/or misappropriating fund assets (e.g., allocating trading profits to preferred accounts; misallocating expenses).



# Recent SEC Enforcement Actions

- Failing to adequately disclose potential or actual conflicts of interest
  - *In re BlueCrest Capital Management Limited* (Dec. 8, 2020): Settled charges arising from inadequate disclosures, material misstatements, and misleading omissions concerning its transfer of top traders from flagship client fund to proprietary fund benefitting its own personnel, and replacement of those traders with an underperforming algorithm. \$170 million penalty.
  - *In re TIAA-CREF Individual & Institutional Services LLC* (Jul. 13, 2021): Did not adequately disclose compensation practices that incentivized the firm and its advisers to recommend to participants in TIAA record-kept employer-sponsored retirement plans that they roll over their retirement assets into a managed account program.



# Recent SEC Enforcement Actions

- Failing to adequately disclose fees or compensation
  - *In re Rialto Capital Management, LLC* (Aug. 7, 2020): Represented to its funds that its in-house professionals charged rates at or below those available from unaffiliated third parties, but had not updated those disclosures despite not performing any market rate analyses for previous several years. \$350,000 penalty.



# Pause to Highlight Section 204A Violations

- SEC's Increasingly Aggressive Approach to Insider Trading/MNPI
  - Purchase or sale of securities on the basis of MNPI in breach of a duty arising out of a fiduciary relationship or other relationship of trust and confidence
  - Over the past 10-15 years, primarily targeted broker dealers with 15(g)
- Section 204A of the Investment Advisers Act of 1940
  - Requires Investment Advisers to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of their business, to prevent its misuse of MNPI
  - No harm, no misuse required



# Recent SEC Enforcement Actions

- Failing to adequately safeguard MNPI
  - *In re Ares Management LLC* (May 26, 2020)
  - SEC found that Ares had “failed to implement and enforce policies and procedures reasonably designed to prevent the misuse of material nonpublic information.”
    - Inadequate written policies and procedures ensuring Ares-designated directors on boards of publicly traded portfolio company did not possess MNPI when Ares funds traded company shares
  - 204A: The “SEC’s order f[ound] that Ares violated the compliance policies and procedures requirements of Sections 204A and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-7 thereunder.”
  - \$1,000,000 penalty



# Recent SEC Enforcement Actions

- *Ares* continued:
  - Compliance relied on directors' judgment re: materiality, and had no reliable process to evaluate directors' conclusions
    - Inadequate documentation to show Compliance had independently inquired
  - No reliable process to wall-off MNPI from *Ares* investment decisions
    - Walls were used only on an *ad hoc* basis
  - No evidence that directors actually exercised incorrect judgment or that MNPI was used to make trading decisions



# Recent SEC Enforcement Actions

- Cases outside the investment manager context are instructive
  - Section 15(g) body of law and SEC comment instructs:
    - Information Barriers: See 2012 OCIE “Barrier Report”
      - Electronic and Physical
    - SEC says that the industry typically includes:
      - Training in legal and firm requirements;
      - Review and restrictions on trading;
      - Formal over-the-wall procedures prior to sharing information;
      - Conflict of Interest review; and
      - Surveillance



# Recent SEC Enforcement Actions

- *In re Cetera Advisor Networks LLC* (Aug. 30, 2021)
  - Eight firms targeted and settled
  - Email account takeovers exposing the personal information of thousands of customers and clients at each firm
  - Core SEC allegation: inadequate measures to protect client data
    - Failed to adopt and implement firm-wide enhanced security measures for cloud-based email accounts
    - Failed to adopt written policies and procedures requiring additional firm-wide security measures
    - Failed to protect accounts against cyber breach in a manner consistent with the firm's policies



# Recent SEC Enforcement Actions

- *In re Cetera Advisor Networks LLC* (cont'd.)
  - SEC cited violations of the so-called safeguards rule, which requires registrants to have written policies and procedures that protect customer records and information
    - "It is not enough to write a policy requiring enhanced security measures if those requirements are not implemented or are only partially implemented, especially in the face of known attacks"
  - Six-figure penalties and fines for each firm
  - Numerous Examinations staff helped uncover the alleged violations, demonstrating that Examinations and Enforcement are working together to detect and pursue violations



# SEC Enforcement Actions: Key Takeaways

- Expect increased Enforcement focus on:
  - Disclosing both actual and potential conflicts
  - Implementing appropriate policies and procedures to identify and mitigate conflicts
  - Acting consistently with those policies and procedures
- In the SEC's view, a conflict of interest does not require that an investor be harmed by the conflict, or that the adviser intended to cause harm to the investor
- SEC holding investment managers to a high standard, requiring detailed, robust disclosures
- SEC's continued focus on investor protections means spotlight on investment manager's protection of MNPI and client information maintained on cyber systems



# Upcoming Webinars in this series

- September 30, 2021: Attorney Conduct Rules & Escalation of Issues



[Americas](#) | [Asia](#) | [Europe](#) | [Middle East](#)

[mayerbrown.com](https://www.mayerbrown.com)

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website. "Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown. © Mayer Brown. All rights reserved.