

Morgan Lewis

Roundtable Road Show
2015 SEC Examination and Enforcement
Trends for Investment Advisers



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Overview

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- 2014 Enforcement Themes
 - OCIE and Enforcement Coordination
 - “Broken Windows” Enforcement
 - “Big Data” Analytics
 - SEC Whistleblower Program
- 2015 Examination Priorities
- Selected Enforcement Cases

2014 Enforcement Statistics

2014 Enforcement Statistics

- 755 cases brought, a record for the SEC
- \$4.16 billion in penalties and disgorgement, a 22% increase from FY 2013 and a record for the SEC
 - \$1.378 billion in civil penalties
 - \$2.788 billion in disgorgement
- Enforcement took 30 cases to trial, twice the number of cases tried in FY 2013
- Investigations opened – 995 (908 for FY 2013)
- Investigations closed – 822 (1,187 for FY 2013)
- Investigations ongoing – 1,612 (1,444 for FY 2013)

2014 Enforcement Statistics

Percentage of Investment Adviser, Investment Company, and Broker-Dealer Actions



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Type of Case	Number of Actions	Percentage
Broker-Dealer	166	22%
Investment Advisers and Investment Companies	130	17%
Securities Offering Cases	103	15%
Delinquent Filings	107	14%
Issuer Reporting and Disclosure	81	11%
Market Manipulation	63	8%
Insider Trading	52	7%
Miscellaneous	37	5%
FCPA	7	1%
Municipal Securities and Pension Plans	6	1%
Transfer Agent	7	1%

2014 Enforcement Themes

OCIE and Enforcement Coordination

- Enforcement specialized units have increased subject matter focus, expertise, and coordination
 - Asset Management Unit, Private Fund Initiative, Municipal Securities and Public Pensions Unit
- Joint planning and consultation at exam planning stage and risk assessments that result in initiation of examinations
- Enforcement may request that OCIE staff gather relevant information and documents and obtain interviews through examination

OCIE and Enforcement Coordination

- Particularly when an examination involves high-risk issues, provide responses assuming that there may already be Enforcement interest or inquiry
- Exam requests (including voluntary requests for information and documents outside the scope of exam authority) may be de facto Enforcement investigative requests
- In responding to deficiency letters, be strategic in avoiding admission of legal liability while providing evidence of remedial measures or enhancements designed to address OCIE staff concerns

“Broken Windows” Enforcement

- Strategic prosecution of smaller violations in an effort to send a broader deterrent message
- Facilitates Enforcement interest in smaller, more technical violations
 - Recidivist compliance deficiencies
 - Failure to make prompt reporting of Section 13 transactions and holdings
 - Rule 105 short-selling violations

“Big Data” Analytics

Big Data

- National Exam Analytics Tool (NEAT plus)
 - Allows OCIE to analyze large amounts of trading data quickly
- Palantir Platform
 - Links trading records and personal contact information from paid databases with tips and complaints the SEC receives

Signals of Potential Illegal Activity

- Recidivist representatives
 - Individuals with a track record of misconduct
- Microcap fraud
 - Pump-and-dump schemes and market manipulation
- Excessive and insider trading
- Anti-money laundering
 - Firms that have not filed SARs or have filed incomplete or late SARs; deposit/withdraw cash or provide direct access to markets from higher-risk jurisdictions

SEC Whistleblower Program

- The SEC's whistleblower program completed its fourth year of operation in fiscal year 2014
- In FY 2014, the SEC's Office of the Whistleblower received 3,620 tips, complaints, and referrals
 - Increase of 382 (or approximately 11%) from FY 2013
 - Majority of TCRs: corporate disclosure and financials (16.9%); offering fraud (16%); and manipulation (15.5%)
- In FY 2014, the SEC paid nine whistleblowers a combined total of \$1,932,864
- The largest award to date was authorized on September 22, 2014 in the amount of more than \$30 million

2015 Examination Priorities

Retail Investors and Saving for Retirement

- Fee Selection and Reverse Churning
 - Recommendation of advisory vs. brokerage accounts
 - Consideration of fees charged, services provided, and disclosures
 - Rep as portfolio manager programs
 - Inactive accounts
 - High-cash balance accounts
 - Trading away and best execution
- Sales Practices
 - Improper and misleading sales practices when recommending the movement of retirement assets from defined contribution plans to higher-risk or higher-fee investments
- Suitability
 - Recommendations to invest retirement assets into complex or structured products and higher-yield securities
 - Due diligence, disclosure, and suitability of recommendations

Retail Investors and Saving for Retirement

- Branch Offices
 - Supervision of representatives (RRs/IARs), including use of analytics to identify branches that may be deviating from centralized compliance policies
- “Alternative” Investment Companies
 - Leverage, liquidity, and valuation policies and practices
 - Adequacy of internal controls
 - Marketing of funds to investors
- Fixed-Income Investment Companies
 - Focus on whether funds have implemented policies and procedures and investment and trading controls consistent with their disclosures
 - Ensure that investment and liquidity profiles are consistent with disclosures

Market-Wide Risks

- Large Firm Monitoring
 - Focus on the largest U.S. broker-dealers and asset managers to assess risks at individual firms and identify industry-wide developments
- Cybersecurity
 - “Cybersecurity Examination Initiative” – Focus to continue on investment advisers and broker-dealers and expand to include transfer agents
 - Cybersecurity Examination Sweep Summary (Feb. 3, 2015)

Other Initiatives

- Municipal Advisors
 - Examinations of newly registered municipal advisors
- Proxy Services
 - Examination of select proxy advisory service firms, including how they make recommendations and disclose and mitigate conflicts
 - Investment advisers' compliance with fiduciary duty in voting proxies on behalf of investors
- Never-Before-Examined Investment Companies
 - Focused, risk-based examinations of selected registered fund complexes
- Private Fund Fees and Expenses
 - High rate of deficiencies in connection with fees and expenses

Selected Enforcement Cases

Selected 2014 Enforcement Cases

- Pay-to-Play
 - TL Ventures Inc. (June 20, 2014)
- Compliance Policies and Internal Controls
 - Barclays Capital Inc. (Sept. 23, 2014)
 - Wells Fargo Advisors, LLC (Sept. 22, 2014)
- Custody
 - Sands Brothers Asset Management LLC (Oct. 29, 2014)
 - Water Island Capital LLC (Feb. 12, 2015)

Selected 2014 Enforcement Cases

- Revenue Sharing
 - The Robare Group, Ltd. (Sept. 2, 2014)
- Private Funds – Expense Allocations
 - Clean Energy Capital, LLC (Feb. 25, 2014)
 - Lincolnshire Management, Inc. (Sept. 22, 2014)

Selected 2014 Enforcement Actions

- Performance Advertising
 - F-Squared Investments, Inc. (Dec. 22, 2014)
- Principal Trades and Cross-Trades
 - Western Asset Management Co. (Jan. 27, 2014)
 - Paradigm Capital Management, Inc. (June 16, 2014)
 - Strategic Capital Group, LLC (Sept. 18, 2014)
- Whistleblowers
 - Paradigm Capital Management, Inc. (June 16, 2014)

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