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2016 INVESTMENT MANAGEMENT CONFERENCE

Hot Topics in Enforcement

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OVERVIEW OF PRESENTATION

- Impact of the Election Results on SEC Enforcement Activities and Priorities
  - Transitions on the Commission, Enforcement Division and Asset Management Unit
  - Pressures from the Left and Right
- Looking Back – 2016 Hot Topics and Developments
  - Administrative Procedure Rule Changes
  - Whistleblower Developments – Rule 21F-17 and Anti-Retaliation Cases
  - Cybersecurity Enforcement Actions
  - Chief Compliance Officer Liability
- Looking Back – 2016 Results and Key Enforcement Actions Affecting the Investment Management Industry
- Looking Forward – SEC Enforcement Priorities for 2017
  - The Use of “Big Data” in Investigations and Examinations
- Tips for Dealing with SEC Enforcement Staff Should You Ever Need To!

Election Impacts on Enforcement Activities

ANTICIPATED TRANSITIONS

- Lame Ducks or Starting Over? Two Commissioner Nominations Still Pending Senate Approval
- Will Chair White Step Down? If Yes, Who Else?
- New Heads of Asset Management Unit Appointed in 2016 – How Will Anthony Kelly And C. Dabney O'Riordan Make Their Mark?
- The New President's Agenda Regarding Regulation of the Financial Services Industry and Enforcement Activities

PRESSURES FROM THE LEFT AND RIGHT

- Senators Elizabeth Warren and Bernie Sanders will be pushing for like-minded, consumer and investor-friendly appointments and legislation
  - Senator Warren and incoming Democratic Leader Chuck Schumer have expressed their lack of confidence for Chair White
- Who controls House and Senate?
- Coalition building across the aisle will be difficult but every vote counts
- New transition of power throughout White House and all federal agencies

Looking Back
2016 Hot Topics and Developments

HOT ENFORCEMENT TOPICS IN 2016

- Admissions Policy in SEC Settlements
  - While there was no widespread trend away from no admit or deny settlements, there were more cases requiring admissions, including against investment advisers.
- More Enforcement Actions to Be Litigated through Administrative Proceedings rather than U.S. District Court
  - The SEC's amended rules provide for more discovery and longer preparation times prior to administrative hearings.
- Expansion of Whistleblower Anti-Retaliation Enforcement
- "Credit for Cooperation" Still a Factor
- Insider Trading – Salman v. U.S. Supreme Court arguments
- Fiduciary Duties of Advisers and Conflicts of Interest

AP RULE CHANGES

- The final rule, which adopted changes "designed to add flexibility to administrative proceedings" went into effect in September, including:
  - Extending prehearing periods, up to a maximum of 10 months for 120-day initial decision proceedings
  - Granting the right to hold depositions in 120-day proceedings
  - Expanding admissibility exclusions for "unreliable" evidence
  - Simplifying the appeal request procedure
- The process, however, is still heavily weighted in the SEC's favor.

WHISTLEBLOWER DEVELOPMENTS

- The SEC's program surpassed $100 million in awards.

- The SEC brought four cases under Rule 21F-17.

  - Merrill Lynch, Exchange Act Release No. 78141 (June 23, 2016)
  - BlueLinx Holdings, Exchange Act Release No. 78528 (Aug. 10, 2016)
  - Health Net, Exchange Act Release No. 78590 (Aug. 16, 2016)
  - Anheuser-Busch InBev, Exchange Act Release No. 78957 (Sept. 28, 2016)

  - The Rule has been used against certain confidentiality provisions.
  - Remedies include notifying former employees of a violation.
  - OCIE announced that it will search for violations of the Rule.

WHISTLEBLOWER DEVELOPMENTS (CONT.)

- The SEC brought its first "stand-alone" anti-retaliation case.
  - International Game Technology, Exchange Act Rel. No. 78991 (Sept. 29, 2016)
    - An employee raised an ill-founded concern over internal accounting.
    - The SEC found that the Company retaliated by sidelining the employee during an internal investigation, and by terminating him afterwards.
  - Compare to Paradigm Capital Management, Advisers Act Rel. No. 72393 (June 16, 2014).

CYBERSECURITY - GUIDANCE

- **April 2015 Division of Investment Management Guidance**
  - Describes measures funds and advisers "may wish to consider"
  - Offers periodic assessment considerations
  - Suggests strategies to prevent, detect and respond to threats
  - Suggests implementation measures
  - States that "[i]n the staff's view, funds and advisers should identify their respective compliance obligations under the federal securities laws and take into account these obligations when assessing their ability to prevent, detect and respond to cyber attacks"

CYBERSECURITY – EXAM SWEEPS

- **April 2014 National Exam Program (NEP) Risk Alert**
  - Announced the SEC's first cybersecurity examination sweep
  - Included an Appendix of anticipated topics and questions, partially drawn from the NIST "Framework for Improving Critical Infrastructure Cybersecurity"
- **February 2015 NEP Risk Alert**
  - Presented summary statistical findings of positive responses
  - Designed to discern basic distinctions regarding preparedness
- **September 2015 NEP Risk Alert**
  - Announced the SEC's second cybersecurity examination sweep
  - Also included an Appendix of anticipated topics, which is more detailed and focused on controls and implementation

CYBERSECURITY – ENFORCEMENT

- **R.T. Jones Capital Equities Management, Advisers Act Rel. No. 4204 (Sept. 22, 2015)**
  - An adviser stored unencrypted PII on a third-party server.
  - The SEC cited the firm for failing to conduct periodic risk assessments, employ a firewall, encrypt PII, or establish response procedures.
- **Craig Scott Capital, Exchange Act Rel. No. 77595 (Apr. 12, 2016)**
  - Broker-dealer personnel e-faxed and emailed records to personal accounts.
  - The SEC found that the firm's policies and procedures were missing key information and were not tailored to its actual practices.
- **Morgan Stanley Smith Barney LLC, Exchange Act Rel. No. 78021, Advisers Act Rel. No. 4415 (June 8, 2016)**
  - An employee placed stolen customer information on his personal server.
  - The SEC cited the firm for failures to implement effective access controls, audit and test controls, and monitor employee use of applications.

Looking Back
2016 Results and Key Cases

FY 2016 ENFORCEMENT RESULTS

- **868** Enforcement Actions
  - **548** Stand-Alone Cases (*i.e.* not "follow-on actions") for $4 billion in disgorgement & penalties
  - **Most ever cases against investment advisers or investment companies (160 cases including 98 stand-alones)**
  - Eight Actions against Private Equity Advisers (total of 11 over 2 years)
  - 21 new FCPA cases including the first against a hedge fund
- $57 million distributed to whistleblowers in FY2016

FY 2016 ENFORCEMENT RESULTS (CONT.)

- So far, 5 District Court trial wins for SEC including 4 jury verdicts and 1 bench trial with1 trial loss
  - ***Compare*** to:
    - 2015 — 6 federal trials in 2015 with no outright losses by SEC (4 favorable verdicts and 2 mixed verdicts)
    - 2014 – 17 trials resulting in 7 losses, 5 mixed verdicts and only 5 wins by SEC
- So far, about 80% win rate in litigated administrative proceedings
  - ***Compare*** to:
    - 2015 85% win rate in litigated administrative proceedings (2 of 13)
- ALJs more favorable to the SEC than Federal Judges
  - 90% win rate before ALJs vs. 69% win rate in federal court trials between October 2010 to March 2015

SOURCES FOR ENFORCEMENT ACTIONS

- SEC Asset Management Unit and Staff Initiatives
  - Aberrational Performance, Distribution-in-Guise, DERA
- Referrals from SEC OCIE Examinations
- Anonymous tips
- Whistleblowers and disgruntled former employees
  - Dodd-Frank Bounties – 10 to 30% of what SEC collects
- SRO Surveillance and consolidated data
- Media
- Competitors
- Short Sellers/Issuers

2016 BUZZWORDS AND HIGHLIGHTS

- **First-of-their-Kind Cases from 2015 Stand Alone**
  - No new Distribution-in-Guise enforcement actions since *First Eagle Investment Management & FEF Distributors* in 2015, but guidance and OCIE focus
  - No new enforcement actions against Fund Trustees in 2016, but Trustees as Gatekeepers and §15(c) of the Investment Company Act still an area of focus:

    "These cases [*Commonwealth & Morgan Keegan*] have generated some controversy and concern that the Commission acted too aggressively. I don't agree. . . .The message of these cases is simply that independent directors must be familiar with and carry out their responsibilities. . . . Most directors do their jobs, carefully reviewing the briefing materials they receive, asking questions instead of rubber-stamping management recommendations, investigating potential inaccuracies, and following up on unfulfilled requests. And, for the funds to serve their investors' interests, directors must discharge their important gatekeeper function, assuring that proper procedures are followed and that the interests of investors are served. Our enforcement cases, while rare, serve to assure that these responsibilities are fulfilled."

    Commission Chair Mary Jo White, The Fund Director in 2016: Keynote Address at Mutual Fund Directors Forum 2016 Policy Conference (Mar. 29, 2016)

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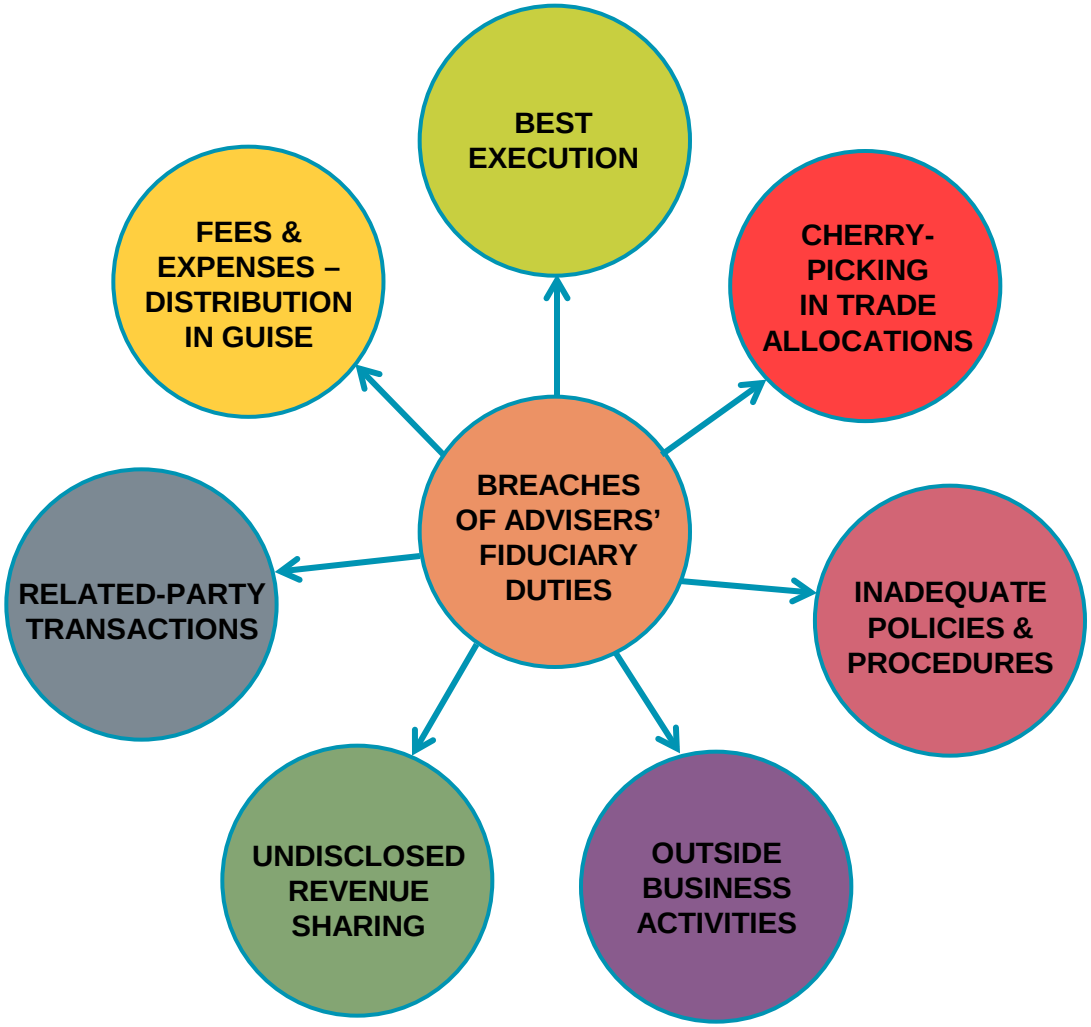
2016 TOPICS FOR SEC ENFORCEMENT ACTIONS AGAINST INVESTMENT ADVISERS, REGISTERED AND/OR PRIVATE FUNDS

- Conflicts of Interest
- Disclosure Failures
- Misallocated or Undisclosed Fees and Expenses
- Valuation
- False Performance Advertising
- Breach of Fiduciary Duties by Municipal Advisers
- Gatekeeper Failures
- Parking
- FCPA
- Cherry-picking on allocations of trades or fees and expenses

"CONFLICTS, CONFLICTS EVERYWHERE"



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FAILURE TO DISCLOSE CONFLICTS OF INTEREST

- *In the Matter of JPMorgan Chase Bank, NA & J.P. Morgan Securities LLC*, Admin. Proc. File No. 3-17008 (Dec. 18, 2015)
  - IA breached fiduciary duties by failing to disclose to clients that IA preferred investing assets in their proprietary firm-managed mutual funds and hedge funds
  - IA failed to disclose that clients were invested in a more expensive class of proprietary mutual funds, and that it preferred third-party managed hedge funds that made payments to an affiliate of the adviser
  - Conflicts not adequately disclosed on Form ADV
  - Bank failed to disclose conflicts of interest to private bank clients
  - "Clients are entitled to know whether their adviser has competing interest that might cause it to render self-interested investment advice."
  - **Admissions** of Facts and Violations of §§ 206(2), 206(4) and 207, and Rule 206(4)-7 of the Advisers Act by IA and §§ 17(a)(2) and 17(a)(3) of the Securities Act by bank
  - $127.5 MM disgorgement, $127.5 civil monetary fine, $11.815 prejudgment interest
  - Censure and cease & desist order
  - $40 MM fine by Bank from CFTC

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CONFLICTS OF INTEREST

In the Matter of Royal Alliance Associates, Inc., SagePoint Financial, Inc., and FSC Securities Corp., Admin. Proc. File No. 3-17169 (Mar. 14, 2016)

- 3 AIG affiliates paid $9.5 MM in sanctions including disgorgement of fees for failing to disclose to clients conflicts of interest
- Clients placed in 3 share classes that charged 12b-1 fees for marketing and distribution even though clients were eligible to purchase shares in fund classes that lacked such fees
- Firms breached fiduciary duties to clients in selecting the higher fee shares and thus earning $2 MM in extra 12b-1 fees
- Firm failed to monitor advisory accounts to prevent reverse churning and failed to implement its compliance policies and procedures
- Firms violated §§ 206(2), 206(4) and 207, and Rule 206(4)-7 of the Advisers Act

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CONFLICTS OF INTEREST

In the Matter of First Reserve Management, L.P., Admin. Proc. File No. 3-17538 (Sept. 14, 2016)

- Private equity fund advisory firm failed to disclose two conflicts:
  - Firm created 2 entities to provide investment management services to a pooled investment vehicle in which its funds invested. Firm caused expenses to funds by using a significant portion of the funds' invested capital to pay expenses relating to the formation of the entities;
  - The firm arranged for a discount on the legal fees charged by its outside counsel but did not arrange for a discount for similar services provided by counsel to the funds.
- Firm violated §§ 206(2) and 206(4), and Rules 206(4)-7 and 206(4)-8 of the Advisers Act
- Civil monetary fine of $3.5 MM
- Order recognizes cooperation and remedial efforts by firm including $8 MM in voluntary reimbursement of expenses and discounts to fund

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FALSE PERFORMANCE CLAIMS
F-SQUARED BY 13

- Sweep of investment advisory firms following 2014 enforcement actions against investment manager F-Squared Investments which admitted inflating performance data for its strategy for trading ETFs
- 13 firms sanctioned for violating §§ 204 and 206(4) of the Advisers Act by adopting F-Squared inflated performance data and passing it along to their own investors
- Advisers were negligent in not seeking sufficient documentation to substantiate advertised performance
- "When an investment adviser echoes another firm's performance claims in its own advertisements, it must verify the information first rather than merely accept it as fact." *Andrew Ceresney, August 25, 2016*
- Sanctions ranged from $100,000 to $500,000 in penalties
- More of these cases may be brought

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PARKING FAVORS SOME CLIENTS OVER OTHERS

In the Matter of Morgan Stanley Investment Management Inc, et al., Admin. Proc. File No. 3-17016 (Dec. 22, 2015); *In the Matter of SG Americas Securities LLC et al.*, Admin. Proc. File No. 3-17017 (Dec. 22, 2015)

- Portfolio manager engaged in prearranged trading ("parking") which favored certain advisory clients over others
- Portfolio manager arranged with brokerage firm trader to sell mortgage-backed securities held in IA's managed accounts at highest bid and repurchased at small mark-up from sales price
- Although adviser owed fiduciary duties to both purchasing and selling clients, portfolio manager did not cross trades at midpoint between best offer and bid and allocated full benefit of the market to purchasing and not selling clients
- Sanctions of $8.8 MM in fines to RIA and $1 MM to b-d; fines & industry bars for portfolio manager and trader with right to reapply after 5 & 3 years
- Violations of §§ 17(a)(2) and (3) of the Securities Act, § 10(b) of the Exchange Act and §§ 206(1) and (2) of the Advisers Act

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CHERRY PICKING PROFITABLE TRADES

In the Matter of Laurence I. Balter d/b/a Oracle Investment Research, Admin. Proc. File No. 3-17614 (*Oct. 4, 2016)*

- Ongoing litigation against adviser who carried out trades for his clients and himself in an omnibus account and allocated disproportionately profitable trades to himself and unprofitable trades to client accounts
- Allocations were performed after trades had been executed and adviser was aware of their value
- Practice was contrary to disclosures to clients which had indicated that client trades would take priority over personal or proprietary trading
- Adviser alleged to have materially misrepresented in fund offering documents the management fees to be charged to the advised fund, and the concentration and diversification limitations which would be applied
- Alleged violations of anti-fraud provisions of Exchange Act, Securities Act and Advisers Act

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GATEKEEPER FAILURE BY FUND ADMINISTRATOR

In the Matter of Apex Fund Services, Admin. Proc. File Nos. 3-17299; 3-17300 *(June 16, 2016)*

- Private fund administrator failed to detect "red flags" of fraud even after detecting undisclosed brokerage and bank accounts, margin and loan agreements, and inter-series and inter-fund transfers made in violation of fund offering documents
- Administrator failed to correct materially false accounting records and capital statement and sent monthly account statements to clients which it knew or should have known contained a material overstatement of investors' true holdings
- Sanctioned $350,000 for failing to heed red flags and correct faulty accounting by 2 clients

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MUNI ADVISORS ON THE RADAR FOR UNDISCLOSED CONFLICTS AND BREACHES OF FIDUCIARY DUTY

In the Matter of School Business Consulting and Terrance Bradley, Admin. Proc. File No. 3-17288 (June 13, 2016); *In the Matter of Keygent LLC*, Admin. Proc. File No. 3-17287 (June 13, 2016)

- Muni adviser provided confidential information to adviser seeking hiring as muni adviser to same school district
- Unauthorized exchange of confidential client information provided muni adviser candidate with improper advantage over other candidates
- Violations of Dodd-Frank resulting in penalties ranging from $100,000 to $20,000

In the Matter of Central States Capital Markets, LLC, Admin. Proc. File No. 3-17170 (March 15, 2016)

- Muni adviser served as both underwriter and municipal adviser to Prairie Village, Kansas
- Conflict of interest in violation of MSRB Rules G-17 & G-23 and Dodd-Frank § 975, with disgorgement of fees, penalties and bars

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PLAIN VANILLA FRAUD

SEC v. Martin Shkreli et al., Lit. Rel. No. 23433 (Dec. 17, 2015)

- Shkreli alleged in complaint to have committed a number of violations while acting as a portfolio manager for two hedge funds, including:
  - misappropriating about $120,000 from to unlawfully pay for personal expenses,
  - misleading investors in one fund about the fund's size and performance, claiming sizable returns when in fact the fund generated sizable losses,
  - falsely stating that a fund had $35 million in assets under management, when in fact it had less than $1,000 in assets in its bank and brokerage accounts,
  - lying to a fund's executing brokers about the fund's ability to settle a sizeable short sale, which resulted in losses of more than $7 million to the executing broker who had to cover the short position in the open market,
  - misappropriating $900,000 from one fund to settle claims asserted by another fund's executing broker arising out of the losses suffered in the short selling transaction, and
  - fraudulently inducing a company he controlled to issue stock and make cash payments to certain disgruntled investors in his hedge funds who were threatening legal action.

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PLAIN VANILLA FRAUD

SEC v. Aequitas Management LLC et al., Lit. Release No. 23485 (March 11, 2016)

- Investment group and executives charged with soliciting and raising more than $350 MM from more than 1,500 investors
- Ponzi scheme involving in
- Litigation pending in Oregon federal district court

SEC v. Thomas D. Conrad, Jr. et al., Lit. Rel. No 23597 (July 15, 2016)

- directed preferential redemptions and other reimbursements to himself and his family and certain favored investors while telling others that redemptions were suspended,
- increased his compensation by appointing himself to be a sub-manager for a fee, and did not disclose the fee or the conflict to investors, and
- failed to disclose his disciplinary history, which included an industry bar.

SEC v. Hope Advisors, LLC and Just Hope Foundation, Lit. Rel. 23551 (June 1, 2016)

- Complaint and interim consent order in which SEC alleged that, to circumvent the funds' fee structure under which the firm is entitled to fees only if the funds' profits that month exceed past losses, Respondents orchestrated certain trades that enabled the funds to realize a large gain near the end of the current month while guaranteeing a large loss to be realized early the following month.
- Without the fraudulent trades, adviser would have received almost no incentive fees.

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PLAIN VANILLA FRAUD

SEC v. Richard W. Davis, Jr. et al., Lit. Rel. No. 23554 (June 2, 2016)

Allegations that adviser breached fiduciary duty to investors by:

- misrepresenting that investments in unregistered pooled investment vehicles, purportedly to be used to fund short-term fully secured loans to real estate developers, were in fact partially invested in his own companies,

- failing to inform investors of loan losses on the loans; failing to reappraise the value of a loan after it had gone into default; and failing to inform investors that he transferred funds into his own entities, which were then depleted. Instead, Davis falsely reported to investors that their investments were growing in value.

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FIRST OF ITS KIND FCPA ACTION AGAINST HEDGE FUND, ADVISER AND PRINCIPALS

In the Matter of Och-Ziff Capital Management Group LLC et al., Admin. Proc. File No. 3-17595 (Sept. 16, 2016)

- Hedge Fund, its adviser and principals found to have engaged in bribery of foreign officials in Libya and Congo including to induce the Libyan Investment Authority sovereign wealth fund to invest in its fund
- Fund found to have violated anti-bribery, books and records and internal controls provisions of Exchange Act; its adviser violated anti-fraud provisions of Advisers Act §§ 206(1) and (2)
- Disgorgement of $200 MM to SEC
- Parallel criminal investigation resulting in deferred prosecution agreement with DOJ and $213 MM in criminal penalty
- Undertakings and Corporate Monitor

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VALUATION –THE ROAD TO HIGHER MANAGEMENT FEES

In the Matter of Equinox Fund Mgmt, LLC, Admin. Proc. File No. 3-17057 (Jan. 19, 2016)

- Alternative fund manager found to have violated Securities Act §§ 17(a)(2) and (a)(3) and Exchange Act § 13(a) in making material misstatements and omissions respecting the methodology for calculating management fees and valuing certain investments held by futures fund.
- Registration statement stated that fees were calculated as a percentage of each series' NAV but fees were actually calculated based on value of the notional assets managed in each series of the fund.
- Manager failed to disclose the early liquidation of an option that constituted about 30% of a fund series' total assets as a material subsequent event for Q2 2011.

- Manager agreed to refund the excessive management fees plus $600,000 in interest and pay $400,000 civil monetary penalty.

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VALUATION – THE "DIVA OF DISTRESSED INVESTING" TRIAL CONTINUES

- Lynn Tilton of Patriach Partners, the Adviser to Zohar Funds, allegedly failed to properly value distressed loans in funds' portfolio (CLO's) in accordance with disclosed valuation policies
- Improper valuation resulted in over $200 MM in management fees to adviser
- Breach of adviser's fiduciary duties
- Litigated action pending against adviser and related entities and Firm's CEO
- Case known for challenge by Tilton to administrative proceeding process but substantively a valuation case. *In the Matter of Lynn Tilton, Patriarch Partners, et* al., Admin. Proc. File No. 3-16462 (Mar. 30, 2015)

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PRIVATE EQUITY—FAILURES TO DISCLOSE FEES & CONFLICTS OF INTEREST

In the Matter of Apollo Mgmt. V, L.P. et al., Admin. Proc. File No. 3-17409 (Aug. 23, 2016)

- Allegations that advisers failed to adequately disclose fees and conflicts of interest, which left the investors "unable to gauge the impact on their investments." SEC did not allege that the fees and conflicts at issue were fraudulent or manipulative.
- Lack of disclosures relating to: arrangement for tax deferral of carried interest; and fees from monitoring agreements between adviser and portfolio companies owned by Apollo-advised funds, allowing Apollo advisers to charge fees for providing consulting and advisory services to the portfolio companies. When those portfolio companies were sold or taken public, advisers would terminate the monitoring agreements and accelerate payment of future monitoring fees.
- Violations of Advisers Act §§ 206(2) and 206(4) & Rules 206(4)-7 and 206(4)-8, with $37.5 MM disgorgement and $2.7 MM in interest to investors, plus $12.5 MM civil penalty.
- Credit for Apollo advisers' cooperation and remedial actions taken prior to the settlement were stated as basis for not imposing more severe penalties: "Apollo was extremely prompt and responsive in addressing staff inquiries."

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PRIVATE EQUITY—FAILURES TO DISCLOSE FEES & CONFLICTS OF INTEREST

In the Matter of WL Ross & Co. LLC, Admin. Proc. File No. 3-17491 (Aug. 24, 2016)

- For 10 years adviser had practice of allocating certain transaction fees among the funds it advised, including based on deal events, closings, financial advice, and investment banking transactions. Under fund policies, the funds allocated higher transaction fees would have to pay adviser less in management fees
- But adviser in practice allocated transaction fees in ways inconsistent with its disclosures and earned about $10.4 MM in management fees than it would have by simply allocating the transaction fees pro rata among the funds
- Adviser found to have violated Advisers Act §§ 206(2) & 206(4) and Rule 206(4)-8 and fined $2.3 million penalty

SEC POSITION ON CCO LIABILITY

- The SEC's position is unchanged.
- Speeches by SEC Chief of Staff Andrew "Buddy" Donoghue in October 2015 and Director of Enforcement Andrew Ceresney in November 2015 contained common themes on chief compliance officer (CCO) liability:
  - The SEC is not targeting CCOs.
  - CCOs who perform their responsibilities "diligently" need not fear enforcement.
  - SEC actions against CCOs tend to involve compliance officers who:
    - Affirmatively participated in the underlying misconduct,
    - Helped mislead regulators, or
    - Had clear responsibility to implement compliance programs and wholly failed to carry out that responsibility.
- These speeches followed a dissent and response in June 2015 by Commissioners Gallagher and Aguilar, respectively.

RECENT CCO LIABILITY CASES

- **BlackRock Advisors, LLC, Advisers Act Rel. No. 4065, Investment Co. Act Rel. No. 31558 (Apr. 20, 2015)**
  - Employees engaged in outside business activities, including a senior portfolio manager who had a significant family business that posed a conflict of interest with investments held by his fund.
  - The SEC found that the CCO failed to develop policies and procedures to assess and monitor outside activities and disclose conflicts of interest to the Blackrock funds' boards and advisory clients.
- **SFX Financial Advisory Management Enterprises, Inc., Advisers Act Rel. No. 4116 (June 15, 2015):**
  - An employee withdrew money from client accounts for over five years.
  - The SEC found that the CCO was responsible for implementing the firm's policy to review cash flows in client accounts, but had not ensured that any such review occurred.

RECENT CCO LIABILITY CASES (CONT.)

- **Sands Brothers Asset Management (Kelly), Advisers Act Rel. No. 4274 (Nov. 19, 2015)**
  - The firm repeatedly violated the custody rule by not providing audited financial statements of its private funds to its investors.
  - The firm was in violation of a previous cease-and-desist order for violations of the custody rule.
  - The SEC found that the CCO failed to implement any procedures or safeguards to ensure compliance with the rule, either by disseminating audited financial statements as required or submitting to a surprise examination to verify client assets.

Looking Forward
2017 Enforcement Priorities

LOOKING AHEAD - CYBERSECURITY

- The proposed adviser business continuity and transition plan rule – 206(4)-4 – will require greater cybersecurity planning.

- Cybersecurity continues to be an examination priority; expect more examinations with greater sophistication, and a focus on controls and implementation.

LOOKING AHEAD – "BIG DATA"

- Expect the Asset Management Unit to continue pursuing the "Aberrational Performance Initiative."
- OCIE intends to scrutinize Forms ADV and other data to select for examination advisers who have hired persons with disciplinary histories.
- The investment company reporting modernization rules will allow OCIE to more closely scrutinize and compare funds and advisers.

LOOKING AHEAD – CASES TO BE BROUGHT

- Valuation
- Undisclosed fees and Expenses
- Conflicts of Interest
- Distribution in Guise
- Cherry-Picking
- ETFs
- Uniform Fiduciary Rule
- Robo-Advisers
- Unicorn Companies and Private Equity

Tips for Dealing with Enforcement Staff

SEC ENFORCEMENT: EVERYTHING YOU ALWAYS WANTED TO KNOW, BUT WERE AFRAID TO ASK (1 OF 2)

- From Day One of an enforcement investigation, try very, very hard to understand the staff's (unstated) goals and priorities, as well as their unique investigative tools, resource constraints, personalities and processes.

- When you look back and reflect, what steps will you wish you'd taken (but only long after it is too late)?

- Now the AUSA and the FBI have shown up! What does this mean, and how should I react?

SEC ENFORCEMENT: EVERYTHING YOU ALWAYS WANTED TO KNOW, BUT WERE AFRAID TO ASK (2 OF 2)

- Okay. We have exposure and the facts and law are not good – Now what?? What can I say to get out of this??
- Hurry up and wait! Why do settlement discussions take so long? Who are my allies? Who is really the biggest threat to me?

Q & A

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