2018 INVESTMENT MANAGEMENT CONFERENCE

Chicago, November 13, 2018

Examination and Enforcement Priorities

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OVERVIEW

- Direction of the SEC
- Examination Priorities for SEC and FINRA
- SEC Regulation Best Interest
- SEC Enforcement Priorities
- FINRA Enforcement Priorities
- SEC Cybersecurity Developments
- DOJ, CFTC and NFA Enforcement
- CPO / CTA Developments

DIRECTION OF THE SEC

CHANGES UNDER CHAIRMAN JAY CLAYTON

- Shift away from broken windows and admissions cases
- A more conciliatory approach to enforcement
- Focus on capital formation issues
- Focus on ICOs and the role of gatekeepers
- Focus on retail frauds and regulatory concerns

EXAMINATION PRIORITIES

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2018 SEC EXAMINATION PRIORITIES

- OCIE's annual priorities letter articulates five themes:
  - Matters of importance to retail investors, including disclosure of investing costs, electronic investment advice, wrap fee programs, senior investors and retirement accounts and products, mutual funds and ETFs; and crypto issues
  - Compliance and risks in critical market infrastructure
  - FINRA and the MSRB
  - Cybersecurity
  - Anti-Money Laundering Programs

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SEC EXAMINATION PRIORITIES AND FACTS

- 15% of registered advisers were examined in fiscal year 2017, up from 8% just five years ago
- OCIE's Private Funds Unit remains active
  - Private fund managers should remain diligent
- Exams are risk-based (routine), sweep, or for cause
  - OCIE is increasingly relying on data analytics to select exam candidates
- Visiting never-before-examined advisers remains a priority
  - Chair White commented in 2013 that 40% of advisers had never been examined
- We have observed more truncated exam request lists recently
- 7-9% of OCIE examinations lead to Enforcement referrals

NOTABLE SEC RISK ALERTS

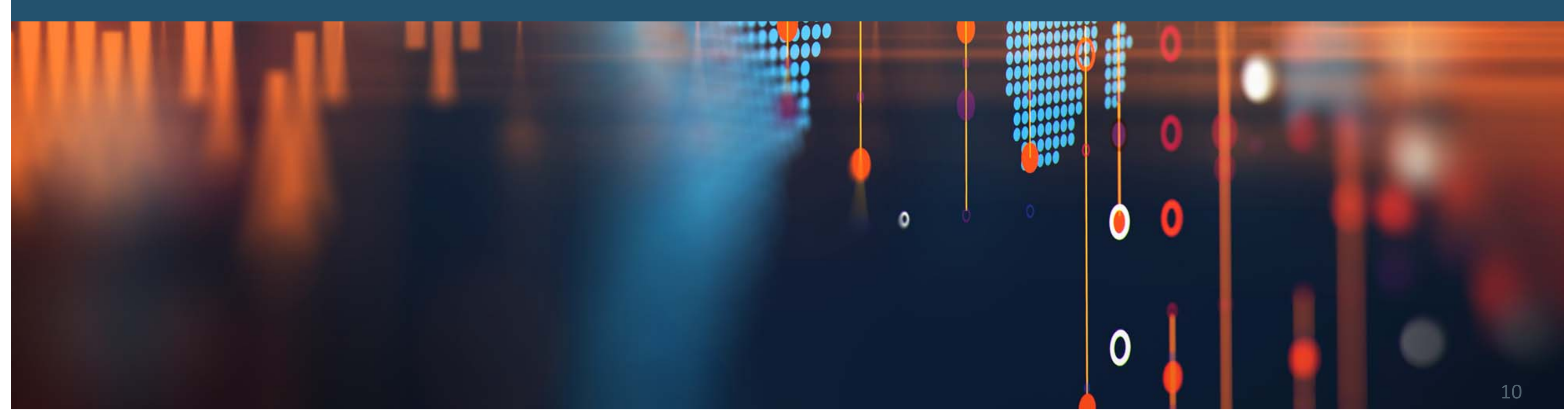
- Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers (Apr. 12, 2018)
  - Areas cited include: fee-billing based on incorrect account valuations; billing fees in advance or with improper frequency; applying incorrect fee rates; omitting rebates and applying discounts incorrectly; disclosure issues; and expense allocations
- Most Frequent Best Execution Issues Cited in Adviser Exams (July 11, 2018)
  - Areas cited include: not performing best execution reviews; not considering relevant factors during best execution reviews; not seeking comparisons from other brokers; disclosure issues; soft dollar issues; and weak policies and procedures

2018 FINRA EXAMINATION PRIORITIES

FINRA's annual priorities letter emphasizes six broad areas of focus:

- Fraud
- High-risk Firms and Brokers
- Operational and Financial Risks
- Sales Practice Risks
- Market Integrity
- New Rules

Fiduciary Duty of Advisers and Brokers – SEC Regulation Best Interest



SEC REGULATION BEST INTEREST

- *Regulation Best Interest, Securities Exchange Act Release No. 83062*, available at https://www.sec.gov/rules/proposed/2018/34-83062.pdf
  - **Essentially an SEC 'Fiduciary Rule' for Brokers**
  - Background: Rulemaking proposal advanced by the SEC in April 2018 to "enhance the quality and transparency of investors' relationships with investment advisers and broker-dealers while preserving access to a variety of types of advice relationships and investment products"
  - Congressional Mandate: Dodd-Frank Section 913 directed the SEC to study the implications of different standards for broker-dealers and investment advisers and adopt a uniform fiduciary standard. Section 913(f) specifically authorized rulemaking to address "regulatory standards of care … for providing personalized investment advice" to retail customers

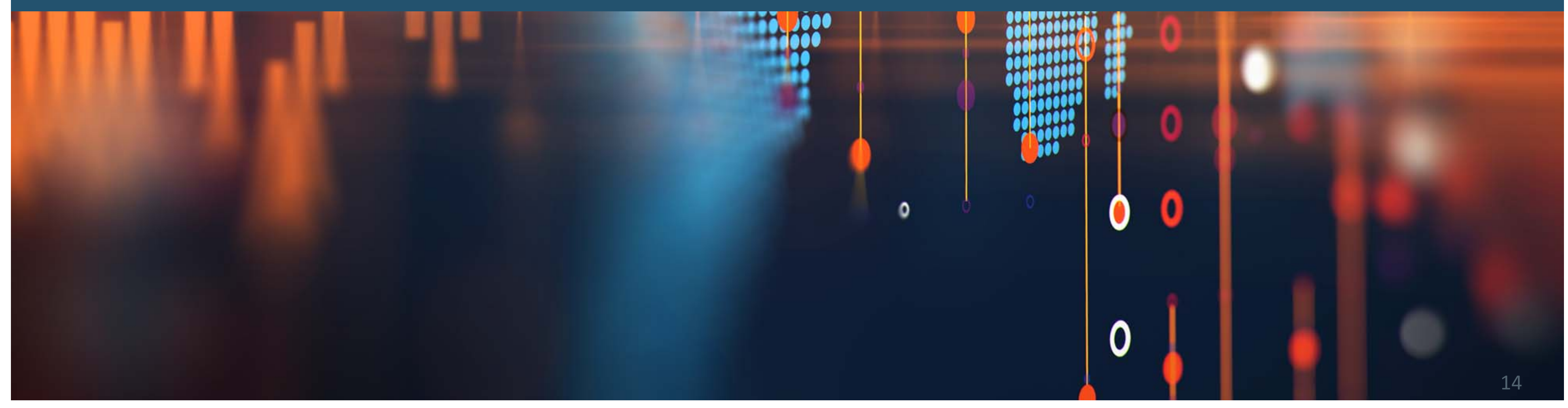
SEC REGULATION BEST INTEREST (CONT'D)

- The proposed rule provides that a broker-dealer will be required to act in the **best interest of its retail customers**
- "Best Interests" is a higher standard of conduct than current "suitability" standards applicable to broker-dealers and associated natural persons, but applies only when making recommendations to retail customers
- Requires that a broker avoid placing the financial or other interest of the broker-dealer or an associated natural person making the recommendation ahead of the interest of the retail customer
- "Best Interest" is assessed **at the time** a recommendation is made

SEC REGULATION BEST INTEREST (CONT'D)

- The proposed rule provides that a broker-dealer will be deemed to have acted in the best interest of its customer if:
  - It **discloses in writing** prior to a recommendation the material terms of the relationship between the broker and the customer, as well as fees and charges and material conflicts related to the recommendation
  - It **exercises reasonable diligence, care, skill and prudence** to evaluate the recommendation and conclude that it is in the best interest of the customer
  - It establishes, maintains and enforces **policies and procedures reasonably designed to** (i) identify and disclose or eliminate material conflicts of interest associated with the recommendation and (ii) identify, disclose and mitigate (or eliminate) material conflicts of interest related to the financial incentives of the broker-dealer and its associated persons

CLIENT RELATIONSHIP SUMMARY ("FORM CRS")



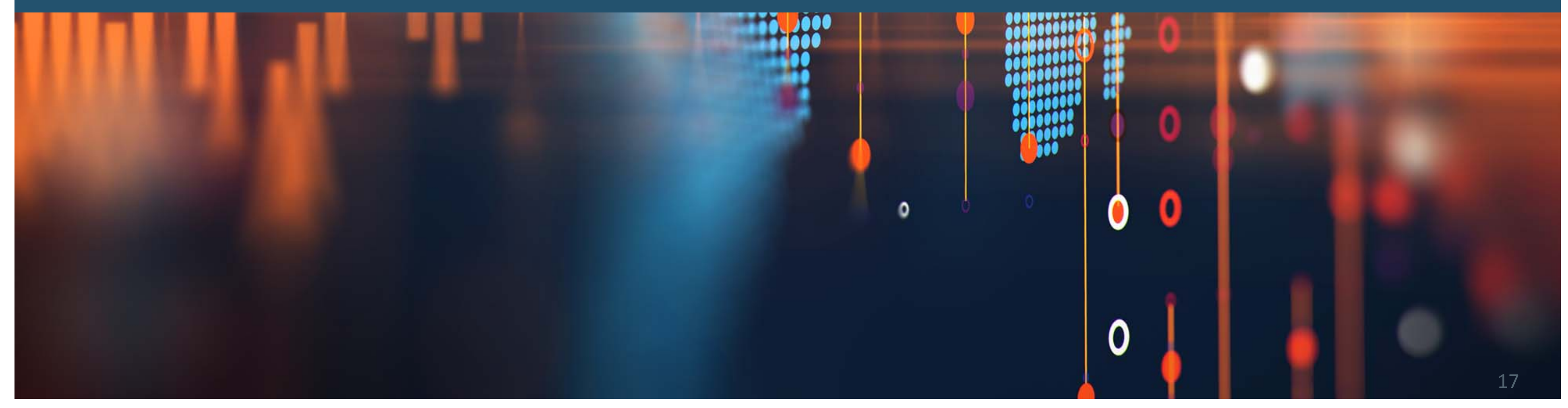
CLIENT RELATIONSHIP SUMMARY ("FORM CRS")

- *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles*, Securities Exchange Act Release No. 83063, *available at* https://www.sec.gov/rules/proposed/2018/34-83063.pdf
- The Client Relationship Summary ("Form CRS") is a proposed form that broker-dealers and investment advisers would provide to their "retail" customers and clients
- Form CRS is intended to provide retail investors with a short disclosure document with information about, among other things, the services the firm offers, the standard of conduct applicable, the fees and costs associated with the services, and conflicts of interest

FORM CRS - INDUSTRY COMMENTS & CONCERNS

- As to proposed Form CRS, commenters have identified the following concerns, among others:
  - Institutional investors should not require delivery of Form CRS or similar disclosures
  - Questions about additional cost and complexity; additional need to engage in investor testing of Form CRS to evaluate usefulness and alternative approaches
  - Disclosure should focus on key aspects of relationship rather than comparisons between broker-dealers and investment advisers
  - Allow firms greater flexibility to tailor content to customer needs and relationship expectations
  - Disclosures must work in tandem with other required disclosures like Form ADV

INVESTMENT ADVISER INTERPRETIVE GUIDANCE



INVESTMENT ADVISER INTERPRETIVE GUIDANCE

- *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation*, Investment Advisers Act Rel. No. 4889, *available at* https://www.sec.gov/rules/proposed/2018/ia-4889.pdf
- Proposed investment adviser interpretive guidance was designed to reaffirm and "in some cases" clarify the fiduciary duty that an investment adviser owes to its clients under section 206 of the Investment Advisers Act of 1940 (the "Advisers Act")

INVESTMENT ADVISER INTERPRETIVE GUIDANCE (CONT'D)

- Also includes three areas of potential "enhancement" where the SEC asserts the broker-dealer framework now provides investors with protections that may not have counterparts in the adviser context:
  1. Federal **licensing and continuing education** requirements for advisory personnel
  2. Mandated delivery of **account statements** to advisory clients and
  3. **Financial statement requirements** for SEC-registered investment advisers, including **fidelity bonds**

INVESTMENT ADVISER INTERPRETIVE GUIDANCE (CONT'D)

- As to the SEC's investment adviser interpretive release, from an industry perspective there are some notable items:
  - Proposed rule does not meaningfully differentiate between retail and institutional clients unlike under securities law (e.g., "qualified clients" and "qualified purchasers")
  - Assertion that certain conflicts are so extensive and/or complex that disclosure could not cure them without distinctions in type of client, scope and nature of relationship, nature of conflict, and complexity of investments and conflicts
- These items among others have received significant comment from industry participants

INVESTMENT ADVISER INTERPRETIVE GUIDANCE – INDUSTRY COMMENTS AND STATUS

- "Fiduciary duty" is a higher standard than suitability
- There is already established precedent defining "fiduciary duty" and the proposals go beyond this
- The Advisers Act release is too retail focused
- Disclosure may be sufficient to address conflicts in certain circumstances
- Fiduciary duty is always construed in relation to the agreement with the client

INVESTMENT ADVISER INTERPRETIVE GUIDANCE – INDUSTRY COMMENTS AND STATUS (CONT'D)

- Allocation of investment opportunities - fair and equitable over time
- The release will raise investment costs and limit client choices
- Exclude private fund offerings from Regulation Best Interest

ENFORCEMENT PRIORITIES

SEC ENFORCEMENT PRIORITIES

- The Five Enforcement Principles articulated by Enforcement Division Co-Directors Avakian and Peikin for 2017 and 2018:
  - Focus on the Main Street investor
  - Focus on individual accountability
  - Keep pace with technological change
    - Manifested in the focus on ICOs
  - Impose sanctions that most effectively further enforcement goals
    - Emphasis on equitable relief through undertakings
  - Constantly assess the allocation of our resources

SEC ENFORCEMENT CONDITIONS

- Budget constraints and a hiring freeze are affecting investigations
  - Co-directors' emphasis on quality not quantity of enforcement actions
  - Slight increase in standalone actions for 2018 (490 vs. 446 in 2017), with increased civil monetary penalties and decreased disgorgement attributed to 5% of the enforcement actions brought in 2018
  - Expected new leadership of Asset Management Unit as co-head leaves
- The Whistleblower Office continues to provide significant awards ($320M+)
- Drawbacks to formal order delegation have changed investigations and informal requests should be treated seriously
- Commissioner Peirce opined that enforcement should be limited
- Actions against advisers remain active (22% of all actions in 2018)
  - No "Showstoppers" but cooperation and remediation remain central

SEC ENFORCEMENT

ADVISER ENFORCEMENT OVERVIEW

- Share Class Selection Disclosure Initiative and related cases
- Conflicts of interest
- Testimonial Rule
- Valuation
- Insider trading
- CCO liability
- Cybersecurity

SELECTED ENFORCEMENT ACTIONS
SHARE CLASS SELECTION DISCLOSURE INITIATIVE

- SEC has brought over 15 enforcement actions since 2013 against investment advisers for recommending 12b-1 fee-paying fund share classes when lower cost share classes were available
- Each case takes nearly 2 years to investigate and bring
- 2018 Share Class Selection Disclosure Initiative
  - Designed to promote self-reporting to SEC to conserve enforcement resources, and voluntary disclosures of conflicts and disgorgement of fees to fund investors
  - Enforcement Division will recommend negligence-based securities fraud action against reporting firms with no civil monetary penalty
  - Rebates to investors are a key element of the Initiative
- No cases brought as yet from the Initiative but coming soon
- Actions brought in 2018 were already in enforcement pipeline

SELECTED ENFORCEMENT ACTIONS
CONFLICTS OF INTEREST

12b-1 Fee-Paying Share Classes

Capital Analysts, LLC, Advisers Act Rel. No. 5009 (Sept. 14, 2018)

- The adviser settled claims that it invested clients in share classes that paid 12b-1 fees when lower-cost share classes were available without disclosing that an affiliated broker-dealer was receiving these 12b-1 fees.
- The adviser also found to have failed to disclose that it had an agreement with a third-party clearing broker to share the shareholder service fee paid to the clearing broker when the adviser invested its clients into certain no-transaction fee mutual funds.
- Relief included remediation under which new clients were invested in the lowest share class, and existing clients were converted to the lowest share class. Disgorgement of $936,000 was ordered for the 12b-1 violation. Disgorgement of $691,000 was ordered for the clearing broker violation. A penalty of $300,000 was ordered.

SELECTED ENFORCEMENT ACTIONS
CONFLICTS OF INTEREST

Undisclosed Benefits to Affiliates

Devere USA, Inc., Advisers Act Rel. No. 4933 (June 4, 2018)

- RIA to defined benefit and contributions pension plan settled action for Adviser Act §§ 206(1) and 206(2) violations for recommending use by clients of trustee or custodial services provided by third parties without disclosing or making misleading statements about compensation arrangements between RIA's overseas affiliate and the third parties amounting to 7 percent of transfer amount. Issues noted in prior OCIE deficiency letter.
- $8 million civil monetary penalty paid into a Fair Fund for distribution to investors; undertaking to retain independent compliance consultant, strengthen compliance procedures and training. Pending litigation against CEO and manager of adviser for fraud.

SELECTED ENFORCEMENT ACTIONS
CONFLICTS OF INTEREST

Undisclosed Benefits to Affiliates

Advisers Act Rel. No. 4868 (March 8, 2018)

- RIA to insurance-dedicated mutual fund fined over $3.6 million and ordered to disgorge over $3 million for violating Advisers Act § 206(2) by failing to disclose its practice of recalling portfolio securities it had loaned in advance of dividend record dates which allowed affiliate insurance company to take a tax deduction while investors lost securities lending income.

Lending Club Asset Management, Advisers Act Rel. No. 5054 (Sept. 28, 2018)

- Private fund RIA fined $4 million and subject to 3 year collateral bar for Advisers Act § 206(2) violations for causing funds to buy affiliate's interest in loans at risk of expiring. SEC noted RIA's self-reporting and remediation of reimbursing investors, constituting new majority independent board, and engaging third-party compliance consultant.

SELECTED ENFORCEMENT ACTIONS
CONFLICTS OF INTEREST

Undisclosed Business Considerations

Merrill Lynch, Pierce, Fenner & Smith, Inc.,
Advisers Act Rel. No. 4989 (August 20, 2018)

- RIA ordered to disgorge over $4 million to advisory clients and fined $4 million for violating Advisers Act §§ 206(2), 206(4) and Rule 206(4)-7 when departing from disclosed due diligence process for selecting products it recommended to its clients on its investment advisory platforms.
- RIA rejected Due Diligence Unit's recommendation to terminate a product managed by third party, elevating its own business interests, after product manager directly approached RIA's senior management to request that it be retained in light of broader business relationship between the parties.
- Direct contacts with senior management not disclosed to advisory clients or to RIA's Governance Committee.

SELECTED ENFORCEMENT ACTIONS
CONFLICTS OF INTEREST

Undisclosed Compensation for Recommendations

Lyxor Asset Management, Advisers Act Rel. No. 4932 (June 4, 2018)

- RIA censured and fined $500,000 for failing to disclose agreement with outside asset managers who compensated adviser based on how many of its clients used the asset manager’s services.
- RIA also sanctioned for inadequate policies and procedures and books and records violations.
- Consideration given to adviser remediating its internal review process for its agreements, notifying and providing rebates to its clients.

SELECTED ENFORCEMENT ACTIONS
TESTIMONIAL RULE

William M. Greenfield, Advisers Act Rel. No. 4961; Brian S. Eyster, Advisers Act Rel. No. 4962; HBA Advisors, LLC and Jaime Enrique Biel, Advisers Act Rel. No. 4963; Leonard S. Schwartz, Advisers Act Release No. 4964; Romano Brothers & Co., Advisers Act Rel. No. 4965 (July 10, 2018)

- On July 10, 2018, the SEC brought five enforcement actions against RIAs, their investment adviser representatives ("IAR"), and a marketing consultant for violations of Advisers Act § 206(4) and Rule 206(4)-1(a)(1) (the "Testimonial Rule") with civil monetary penalties ranging from $10,000 to $35,000.
- Testimonial Rule applied to publication of client testimonials on social media and other websites by the RIA, its IARs, and/or marketing consultants they hired. Testimonial videos were published on RIAs' websites, YouTube.com, Yelp and other social media sites, proclaiming that RIAs provided clients with unique investment opportunities, income, security and peace, helped generate investment returns, and protected client investments from risk.
- Actions follow September 2017 OCIE Risk Alert on Advertising Rule 206-4(1) and 2016 Touting Initiative and sweep involving 70 examinations.

SELECTED ENFORCEMENT ACTIONS
VALUATION AND INSIDER TRADING

Visium Asset Management, LP, Advisers Act Rel. No. 4909 (May 8, 2018)

- RIA to private fund settled to findings of fraud under Exchange Act §10(b), Securities Act §17(a), and Advisers Act §§ 206(1), 206(2) and 206(4), for artificially inflating fund's performance and NAV based on sham quotes for value of bonds from "friendly" third party brokers instructed to "U-turn" the portfolio managers' inflated quotes to make these quotes appear to have been provided by the outside brokers.
- Adviser departed from valuation methodology and procedures disclosed to fund investors, which resulted in inflated monthly NAV statements sent to investors and payments of over $3 million in management and performance fees to adviser.
- Portfolio managers also caused funds to engage in insider trading on the basis of material non-public information about pharmaceutical and home health care companies which was obtained from a former FDA official and trade association officer and a political consultant who were retained as consultants by the fund.
- Adviser de-registered and agreed to pay over $4.7 million each in civil monetary penalties and disgorgement. SEC litigating against adviser's COO and managers.

SELECTED ENFORCEMENT ACTIONS
VALUATION

SEC v. Yorkville Advisors, LLC, C.A., 12 Civ. 7728 (S.D.N.Y. Mar. 29, 2018)

- District Court granted summary judgment ***against*** SEC in prominent valuation case against hedge fund investment adviser and its executives, which had been brought in 2011 as part of SEC's Aberrational Performance Inquiry initiative.
- SEC failed to establish evidence of material fraud or deceit or scienter by adviser relating to valuations of illiquid securities in fund's portfolio. Court credited evidence of adviser's Valuation Committee considering outside valuation reports for the distressed securities and employing valuation models in an effort to arrive at fair market value of the distressed securities.
- Fund's outside auditor considered valuation methodology and issued clean audit opinions that financial statements of the fund conformed with GAAP. After SEC launched its enforcement investigation, auditor reviewed its opinions pursuant to GAAS and considered additional information shared by the SEC but concluded that it was not required to withdraw or change its audit opinions.
- SEC voluntarily dismissed remaining claims.

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SELECTED ENFORCEMENT ACTIONS
CHIEF COMPLIANCE OFFICER LIABILITY

Dawn Roberts, Advisers Act Rel. No. 5044 (Sept. 25, 2018)

- Controller and CCO allegedly helped adviser fraudulently circumvent the impact of a fund's high-water-mark fee structure by tracking losses or gains for the month and informing the adviser as to the amount of realized losses, knowing it would then execute a trade to make up for the losses in order to obtain a performance fee.
- Follow-on 12-month suspension

Arlington Capital Management, Inc. et al.,
Advisers Act Rel. No. 4885 (Sept. 14, 2018)

- Adviser settled claims that it advertised results using back-tested hypotheticals of its computer model, including times where the model would be adjusted and the performance was reported as if the new version had previously been in effect.
- Principal and CCO fined $75,000 for failure to adopt and implement policies and procedures reasonably designed to prevent advertising violations.

SELECTED ENFORCEMENT ACTIONS CYBERSECURITY

- Altaba Inc., f/d/b/a Yahoo! Inc.,
  Securities Act Rel. No. 10485 (Apr. 24, 2018)
  - Settled order for failure to disclose data breach to investors and an acquirer
  - Framed as a disclosure controls failure; $35 million penalty
  - Preceded by SEC's Statement and Guidance on Public Company Cybersecurity Disclosures, Exchange Act Rel. No. 82756 (Feb. 21, 2018)
- Voya Financial Advisors, Inc., Advisers Act Rel. No. 5048 (Sept. 26, 2018)
  - Settled order finding failures to adopt policies and procedures reasonably designed to protect customer records and information (Regulation S-P), and to detect identity theft (Regulation S-ID)
  - Despite noting remediation, SEC imposed a $1 million penalty

FINRA ENFORCEMENT

FINRA ENFORCEMENT TRENDS TO DATE

- AML – increased focus on penny stocks, SARs and systemic compliance failures
- Suitability – short-term trading of long-term products (UITs and Class A-share mutual funds)
- Variable annuities – multi-share class VAs, VA exchanges, and restitution

SELECTED AML ENFORCEMENT CASE

FINRA AWC No. 2015045550801 (May 16, 2018)

- Industrial and Commercial Bank of China Financial Services LLC (ICBCFS) agreed to pay $5.3 million and retain an independent consultant for systemic AML compliance failures, including its failure to have a reasonable AML program in place to monitor and detect suspicious transactions, as well as other financial, recordkeeping, and operational violations.
- In late 2012, ICBCFS began clearing and settling equity transactions and, within a few months, took on thousands of new customers, many of whom began purchasing and selling millions of dollars' worth of penny stocks. Ultimately, ICBCFS cleared and settled the liquidation of more than 33 billion shares of penny stocks, which generated approximately $210 million for ICBCFS's customers.
- Prior to June 2014, FINRA found that ICBCFS had no surveillance reports that monitored potentially suspicious penny stock liquidations; didn't require its employees to document their review of the surveillance reports it did have in place; and lacked systems and procedures to monitor whether certain business activities were unusual for any given customer, despite the firm's written AML procedures specifically identifying such items as red flags requiring monitoring.
- ICBCFS also settled with the SEC and agreed to pay an $860,000 penalty in a separate action involving AML and other violations by the firm.

SELECTED SUITABILITY ENFORCEMENT CASE

FINRA AWC No. 2016051750001 (Sept. 5, 2018)

- A General Securities Representative and Principal (“representative”) agreed to a suspension of eight months in any capacity and $10,000 fine for making unsuitable recommendations to a senior customer in short-term switches between UITs and Class A-share mutual funds over a 14-month time period.
- The representative created a script for the customer to use if contacted by the firm about the transactions which contained false statements, including that the customer understood costs associated with short-term trading of long-term products.
- Due to the long-term nature of the products and upfront costs (bond UITs mark-ups cost between 3.5-3.8%, and Class A-share sales charges cost between 2.7-3.0%, suitability concerns were raised.
- In violation of FINRA Rules 2111 and 2010, FINRA found that the representative’s recommendations were unsuitable due to the frequency and cost of the transactions.

SELECTED VARIABLE ANNUITIES ENFORCEMENT CASES

- On July 24, 2018, FINRA entered into two separate settlements with eight firms (AWC Nos. 2015047177001 & 2016047636601) alleging that each firm failed to establish, maintain and enforce adequate supervisory systems and procedures and training for the sale and supervision of multi-class VAs.
- Both settlements noted above emphasized that the firms' procedures didn't address suitability concerns raised by the sale of an L-share contract when combined with a long-term income rider or to a customer with a long-term investment horizon. One settlement imposed a total of $1.69 million in fines against four affiliated firms and required the payment of at least $6 million in restitution to affected customers, and the other settlement imposed a total of $1 million in fines against four affiliated firms.
- On May 8, 2018, FINRA fined a firm $4 million for recommending VA exchanges without a reasonable basis that the exchanges were suitable (AWC No. 2013035051401). In addition to supervisory failures related to training and surveillance procedures, FINRA found that the firm's representatives didn't consider or compare information about VA exchanges and misstated the costs and benefits of VA exchanges to customers. The firm was also ordered to pay $2 million in restitution to affected customers.

DOJ, CFTC and NFA Enforcement
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DOJ / CFTC – DISRUPTIVE TRADING CASES

- In 2015 a federal jury convicted Michael Coscia of criminal fraud and the disruptive trading practice called "spoofing."
- He was sentenced to three years' imprisonment.
- CME Globex is the world's leading electronic futures trading platform, and its servers are located in suburban Chicago – the former U.S. Attorney said jurisdiction over all such trading can be found here.
- Chicago has become the "Epicenter" of criminal and civil spoofing prosecutions, bringing defendants from Asia, Europe, and other states to the federal courthouse in Chicago.

DOJ / CFTC – DISRUPTIVE TRADING CASES

- There have been dozens of criminal prosecutions for disruptive trading in the past four years.
- The defendants are not just individual traders, but proprietary trading firms and also the world's largest banks who have paid millions of dollars in fines for their employees' disruptive trading.
- DOJ prosecutions are almost always accompanied by CFTC parallel civil actions.
- … and sometimes by class action lawsuits.
- The CFTC has a "Spoofing Task Force" and promises future prosecutions.

CFTC INSIDER TRADING AND INFORMATION PROTECTION TASK FORCE

- Remember Arya Motazedi and Jon Ruggles?
- September 28 - CFTC announced the creation of an Insider Trading and Information Protection Task Force.
- Simultaneously announced an enforcement action against an Introducing Broker and one of its traders.
- According to the CFTC, the trader had access to the IB's customers' material nonpublic information, such as:
  - Trading histories, patterns
  - Trading preferences, tendencies
  - Prices at which they bought or sold, or wanted to buy or sell, and their positions

CFTC INSIDER TRADING AND INFORMATION PROTECTION TASK FORCE

- According to the CFTC the IB was required to establish and enforce procedures to ensure that its traders do not use their knowledge of customer orders to trade ahead of or against the interests of such customers for their own benefit, or for the benefit of preferred customers.
- According to the CFTC the IB did not do so, and therefore failed to supervise its trader.
- The CFTC brought enforcement actions against a CPO that was the victim of a cyber scam (Tillage) and against an FCM that was the victim of a cyber breach (AMP).
- Is a CFTC enforcement action now another risk if your traders steal trade secrets or engage in insider trading?

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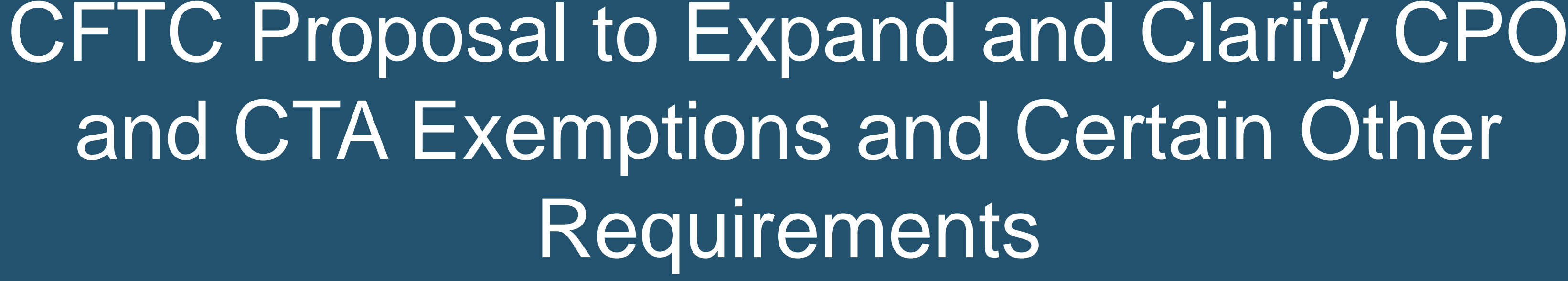
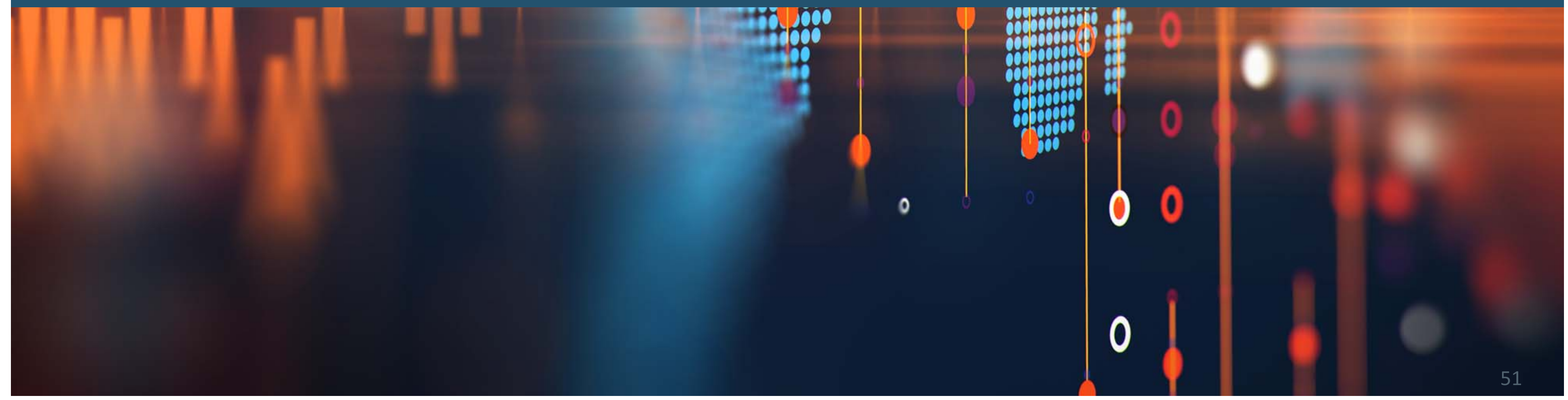
CFTC – FAILURE TO SUPERVISE

- 17 C.F.R. § 166.3 states: Each Commission registrant … must diligently supervise the handling by its partners, officers, employees and agents … of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents … relating to its business as a Commission registrant.
- For a registrant to fulfill its duties under 166.3, it must both design an adequate program of supervision and diligently ensure that the program is followed.
- A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary.

NFA ENFORCEMENT – CPO / CTA / SD

- February 1 – permanently barred Managed Capital Advisory Group for failing to adequately supervise the firm's operations.
- May 3 – permanently barred The Stock Mentor for failing to issue a disclosure document, and for issuing a materially false and misleading disclosure document.
- June 22 – took emergency action against Golden Point Capital Management for refusing to cooperate with an NFA examination.
- October 30 – fined swap dealer Mizuho Capital Markets for failing to diligently supervise of its swaps business, including risk assessment and margin modeling.


CFTC Proposal to Expand and Clarify CPO
and CTA Exemptions and Certain Other
Requirements



CFTC PROPOSAL TO EXPAND AND CLARIFY CPO AND CTA EXEMPTIONS AND CERTAIN OTHER REQUIREMENTS – NEW CPO EXEMPTION

- New Proposed Exemption – Regulation 4.13(a)(4)
  - Codifies Advisory 18-96
  - Conditions:
    - Non-US pool
    - No meetings or administration in the United States
    - No shareholder/participant in the pool is or will be within the United States
    - The pool will not receive, hold or invest any capital directly or indirectly contributed from sources within the United States
    - No marketing in the United States
    - Notice within 30 days of registering or claiming exemption

CFTC PROPOSAL TO EXPAND AND CLARIFY CPO AND CTA EXEMPTIONS AND CERTAIN OTHER REQUIREMENTS – NEW CPO EXEMPTION (CONT'D)

- Can combine CPO exemptions in Regulations 4.13(a)(3) and (4)
- Registered CPO can rely on exemption in Regulation 4.13(a)(4) for some pools
- Raises issue as to whether Regulation 4.13(a)(3) and 3.10(c)(3) exemptions can be combined

CFTC PROPOSAL TO EXPAND AND CLARIFY CPO AND CTA EXEMPTIONS AND CERTAIN OTHER REQUIREMENTS – OTHER ITEMS

- All CPO exemptions in Regulation 4.13(a) would require no statutory disqualifications under Commodity Exchange Act Sections 8a(2) and 8a(3)
- Non-U.S. persons added to list of Regulation 4.13(a)(3) pool investors
- Requires communication of conditions of relief to pool participants

CFTC PROPOSAL TO EXPAND AND CLARIFY CPO AND CTA EXEMPTIONS AND CERTAIN OTHER REQUIREMENTS – OTHER ITEMS (CONT'D)

- Jobs Act relief codified
- Codification of family office relief in Regulations 4.13(a)(7) and 4.14(a)(11)
- BDCs added to Regulation 4.5 with *de minimis* and marketing restrictions
- Codification of investment adviser as CPO for registered funds and BDCs but not for private funds

CFTC PROPOSAL TO EXPAND AND CLARIFY CPO AND CTA EXEMPTIONS AND CERTAIN OTHER REQUIREMENTS – OTHER ITEMS (CONT'D)

- Recordkeeping relief for CPOs to allow records to be held other than at CPO's main business office – still requires filing from third-party recordkeeper
- No Form CPO-PQR and CTA-PR reporting for CPOs with only exempt pools and CTAs with only exempt accounts and non-directed accounts

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