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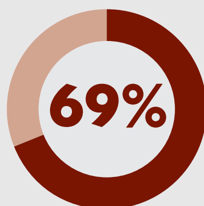
Compliance Reporter

IN THIS ISSUE

FINRA reviews comms, gifts rules **3**
Options reporting: BB&T unit fined $1m **4**
SIFMA wants research relief in swaps plan **4**
CFTC's Massad frets agency's cyber limits **5**
Muni gifts plan raises concerns **6**
SEC eyes major IA reforms **7**
Private fund LPs get BDC aid **8**
ETMF relief creates CCO responsibilities **8**
CCOs get new anti-insider trading tips **9**

ON THE CARDS?

The **Securities Industry and Financial Markets Association** commissioned **Harris Poll** to survey 1,103 U.S. investors about the **Financial Industry Regulatory Authority**'s Comprehensive Automated Risk Data System, CARDS, proposal, which the industry group opposes (Complianceintel.com, 12/4).



...opposed the plan initially after reading a "brief and balanced description" of CARDS

Source: SIFMA

CFTC, PROSECUTORS EYE OBSTRUCTION CASES

by Peter Rawlings

The **Commodity Futures Trading Commission** and federal prosecutors' offices are on the lookout for cases where firms obstruct their efforts to conduct investigations, officials have warned.

The **U.S. Attorney's Office for the Southern District of New York** is actively "looking for and bringing obstruction cases," **Katherine Goldstein**, deputy chief of the Southern District's Securities and Commodities Fraud Task Force, told attendees at a recent conference hosted by **Thomson Reuters** in New York.

Similarly, the CFTC is going to be using its new enforcement powers under the Dodd-Frank Act to go after cases of obstruction, agency enforcement director **Aitan Goelman** said on the same panel. "Where it's possible to prove false statements, you have to bring those cases," he told delegates.

The CFTC's Enforcement Division in particular plans to use new Dodd-Frank-mandated changes to the Commodity Exchange Act... ***Continued on page 15***

LOOKING TO 2015

NEW IAA HEAD WARNS CCOs OF PROXY FOCUS

by Peter Rawlings

Chief compliance officers at investment advisory firms preparing for 2015 should pay special attention to issues related to proxy voting and potential prudential-style rulemaking, according to **Karen Barr**, the new head of the **Investment Adviser Association**.***Continued on page 16***

FINRA'S SUPERVISION RULES: WHAT TO WATCH FOR

10

The **Financial Industry Regulatory Authority**'s new broker/dealer supervision rules went into effect at the start of this month. Chief compliance officers have been implementing key changes to their oversight and supervisory systems in preparation for the updated requirements. But as this week's *Compliance Clinic* explains, professionals now need to be conscious that FINRA examiners may take a particularly close look at the supervisory areas covered by the new rules during exams next year. ***See Compliance Clinic, page 10***

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Oh lawyer, where art thou?

Compliance officers need to keep their eyes on many things: what's happening at their regulators; what's happening around the industry at their peers; and, of course, what's happening within their own firms. It also helps to keep tabs on what's happening in the world of those whose services they buy – be they consultants, technology vendors or, perhaps most importantly, outside counsel.

The market for legal advice is a dynamic one, not least in terms of how, and how much, attorneys bill clients such as brokerages and asset managers. There is also a very public ebbing and flowing of the supply of lawyers, which alongside demand from clients affects their scarcity and therefore price both now and down the road. The financial crisis was tough on law firms catering to Wall Street, and created hardships for many lawyers who arrived in the market with huge student debts and suddenly evaporating prospects. So it's not surprising that law school enrollment has dropped, but the extent it has done still raises eyebrows.

The New York Times reported earlier this month that the number of first-year law students enrolling has fallen to levels not seen since the mid-1970s when there were 53 fewer law schools in the U.S. The *Times*, pointing to **American Bar Association** figures, reported that 37,924 full- and part-time students started classes this year, down 30% from just four years ago when enrollment hit a peak of 52,488.

And it's going to be hard to persuade more students to take up the profession when there are statistics such as one quoted by the *Times* that last year fewer than two-thirds of newly qualified attorneys had found jobs that required passing the bar exam.

Lawyers are in some ways subject to the same market forces as other workers – many relatively basic tasks are being automated and outsourced, often to India. "The only segment of the market that isn't affected is the elite firms, the **Wachtell Lipton**s of the world. But that represents a very tiny slice of the market," the *Times* quoted **Paul Campos**, a professor at the **University of Colorado**'s law school, as saying.

If that's all there is to it, Wall Street may not necessarily find itself having to pay a dwindling supply of attorneys even higher rates for top-end legal advice in the years to come. And surely there will always be sufficient demand for complex transactional and regulatory counsel to keep attracting thousands of bright kids to law schools. Those Dodd-Frank Act reforms are going to help many a private practice lawyer help pay off their student loans, and those of their kids, for years to come. But in the meantime it's worth keeping an eye on things to make sure the legal well doesn't run dry.

THEY SAID IT

"WHERE IT'S POSSIBLE TO PROVE FALSE STATEMENTS, YOU HAVE TO BRING THOSE CASES."

AITAN GOELMAN, DIRECTOR OF THE COMMODITY FUTURES TRADING COMMISSION'S DIVISION OF ENFORCEMENT, ON THE AGENCY'S PLANS TO BRING CASES WHERE FIRMS OBSTRUCT THEIR EFFORTS TO CONDUCT INVESTIGATIONS

(SEE STORY, PAGE 1)

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FINRA ASSESSMENTS

Gifts, comms rules get mixed reviews

The **Financial Industry Regulatory Authority** has issued two reports giving a broadly clean bill of health to its rules governing communications with the public and, separately, gifts, gratuities and non-cash compensation – while also revealing areas of industry concern.

The so-called Retrospective Rule Review Reports are designed to assess the effectiveness and efficiency of the rules. They are part of a continuing initiative launched in April 2014 to periodically look back at important groups of rules to ensure they remain relevant and appropriately designed to achieve their objectives, particularly given industry and market changes.

In each case, the self-regulatory organization's staff consulted widely with the industry. "The reports reflect widespread agreement among affected parties that the rule sets have been largely effective in meeting their intended investor protection objectives," FINRA said in a statement. "However, the rules and FINRA's administration of them may benefit from some updating and recalibration to better align the investor protection benefits and the economic impacts."

"Over the next several months, FINRA will explore a combination of guidance, proposed rule modifications and administrative measures to enhance the effectiveness and efficiency of the rules," said **Robert Colby**, the SRO's chief legal officer. FINRA will proceed through its usual rulemaking process to propose any amendments to the rules based on the assessments, officials said.

GIFTS

According to one report, most stakeholders agreed that the gifts and non-cash compensation rules (*see box*) have been effective at addressing the problems they were intended to mitigate, stating that the concerns about bribery and conflicts of interest that existed several years ago are not present today. Stakeholders noted that most firms have created written policies and procedures to implement the requirements of the rules and provide information, training and education to employees regarding the rules' requirements, officials wrote.

However, stakeholders also raised concerns that the gifts and non-cash compensation rules are "scattered throughout the FINRA rulebook causing difficulties from a reference and compliance standpoint," officials noted. "Some stakeholders also suggested that FINRA consider whether the non-cash compensation rules should be applied consistently to all securities products, rather than

"OVER THE NEXT SEVERAL MONTHS, FINRA WILL EXPLORE A COMBINATION OF GUIDANCE, PROPOSED RULE MODIFICATIONS AND ADMINISTRATIVE MEASURES TO ENHANCE THE EFFECTIVENESS AND EFFICIENCY OF THE RULES"

ROBERT COLBY, FINRA

just to investment company securities, variable insurance products, direct participation programs and public offerings of securities."

In addition, officials wrote, stakeholders requested that the SRO update the existing guidance relating to the rules and address issues not covered by previous guidance.

Among other things, the staff found:

- A consistent view expressed by stakeholders was that the $100 gift limit is too low and that raising the limit would not undermine the purposes of the gifts and non-cash compensation rules. "Several stakeholders stated that the $100 gift limit is particularly restrictive when member firms or their associated persons want to provide gifts to their clients for life events such as weddings, graduations and the birth or adoption of a child, or as a sympathy or get well gesture," officials wrote;
- Most stakeholders felt that the approach to business entertainment should be principles-based to provide firms with flexibility in setting limits on business entertainment based on the facts and circumstances, including regional cost differences as well as variations in business models. Some stakeholders asked for FINRA guidance regarding permissible versus impermissible business entertainment.

COMMUNICATIONS

According to the other report, most stakeholders agreed that the communications rules have been effective at addressing the problems they were intended to mitigate. But they also identified a number of areas where they believed the investor protection objectives and economic impacts do not align or where the rules could be made more effective or efficient, officials wrote.

Among other things, the staff reported that:

- Many stakeholders said that while the filing requirements serve to protect investors, they are overly broad in some respects relative to the investor protection they provide. They stated that the filing requirements impose significant direct and indirect costs on firms and potentially divert FINRA resources from higher risk matters. Firms also said that the high volume of materials filed with the SRO has resulted in a backlog of filings to be reviewed;
- Stakeholders asserted that the amount of required disclosure has become "disproportionate to the substance of marketing materials, diminishing their value to investors and giving the impression that the risks outweigh the benefits of the investment," officials wrote'
- Stakeholders stated that the principles-based content standards led to challenges in their application. "Some stakeholders asserted that the key content standards – eg, 'principles of fair dealing,' 'fair and balanced,' 'exaggerated' and 'unwarranted' – are too subjective and can force firms to choose between filing voluntarily to get FINRA review or assuming the risk of an examination finding or enforcement action," officials wrote.

COMPLIANCE PRIMER: RULE 3220

FINRA Rule 3220 bars any member or person associated with a member, directly or indirectly, from giving anything of value in excess of $100 per year to any person where such payment is in relation to the business of the recipient's employer. The rule also requires members to keep separate records regarding gifts and gratuities.

The rule is intended to avoid improprieties that may arise when a member firm or its associated persons give anything of value to an employee of a customer or counterparty, and to preserve an employee's duty to act in the best interests of that customer.

COMPLIANCE PRIMER: COMMUNICATIONS

The communications rules are intended to protect investors by ensuring that the communications used by broker/dealers are fair, balanced and not misleading. They impose core, principles-based content standards and spell out minimum supervision requirements designed to ensure the content standards are applied. For example, the rules require that an appropriately qualified registered principal approve some communications distributed to large groups of retail investors before use. In addition, the rules provide for reviews by FINRA to ensure rule compliance.

BB&T unit fined $1m in options reporting action

Clearview Correspondent Services, which is now known as **BB&T Securities**, has been fined $1m and censured in settling allegations regarding the reporting of options positions.

The **Financial Industry Regulatory Authority** has accepted a letter of acceptance waiver and consent from the firm, which did not admit or deny wrongdoing.

The proceeding arose from two reviews conducted by the staff of the self-regulatory organization's Department of Market Regulation regarding Clearview's compliance with the rules related to the reporting of options positions to the Large Options Position Reporting, or LOPR (*see box*).

The first review covered the period January through March 2011 and was later expanded to include the period from October 2007 through September 19, 2011. During this period, FINRA alleged, the firm failed to aggregate properly positions for roughly 1,000 accounts that were acting in concert under the common control of specific – and unnamed – registered representatives/investment advisers within Clearview.

As a result, the firm failed to report positions to the LOPR in around 1.4 million instances, constituting a violation of NASD Rule 2860(b)(5) for alleged conduct before February 17, 2009 and FINRA Rule 2360(b)(5) for conduct alleged to have occurred on or after February 17, 2009, the SRO said.

The second review covered the period October through December 2012, later expanded to include the period from May 2010 through August 2014. FINRA said that, during this time, the firm failed to aggregate properly positions for 16 accounts that were acting in concert under the common control of an unnamed unregistered third party outside of Clearview. As a result, FINRA said, the firm failed to report positions to the LOPR in 6,796 instances.

In addition, the firm failed to report in a timely fashion positions to the LOPR in four instances, according to the SRO.

FINRA also alleged that, during the first and second review periods, Clearview failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with the applicable securities laws, regulations and FINRA rules concerning the reporting of options positions to the LOPR.

According to the SRO, Clearview's supervisory system did not include sufficient written supervisory procedures, or WSPs, providing for the reporting of options positions to the LOPR. Specifically, it said, they did not include:

- The identification of the person(s) responsible for supervision with respect to the applicable rules;
- A statement of the supervisory step(s) to be taken by the identified person(s);
- A statement as to how often such person(s) should take such step(s);
- A statement as to how the completion of the step(s) included in the WSPs should be documented.

In settling the matter, FINRA took into consideration remedial steps taken by the firm, including enhancements to its supervisory systems, immediately upon being told of the SRO's investigation, and that the firm provided FINRA with a calculation of the number of impacted accounts and positions.

A BB&T spokesman said: "In the settlement, there are no findings of harm to clients or loss of funds. Upon notification of the inquiry, BB&T Securities immediately cooperated by providing required information to FINRA and making enhancements to its systems."

COMPLIANCE PRIMER: LOPR

Officials noted in a related filing that LOPR data are used extensively by SROs to identify holders of large options positions who may be trying to manipulate the market or otherwise violate securities rules and regulations. "The accuracy of LOPR data is essential for the analysis of potential violations related to, among other things, insider trading, position limits, exercise limits, front-running, capping and pegging, mini-manipulation and marking-the-close," officials wrote.

SECURITY-BASED SWAPS

SIFMA urges research relief in SBS plan

The **Securities and Exchange Commission** should expand an exemption within a proposed rule on the trading of security-based swaps (SBSs) to include research reports, according to the **Securities Industry and Financial Markets Association**.

The SEC has proposed that certain communications involving SBSs that may be purchased only by eligible contract participants (ECPs) will not be deemed, for the purposes of Section 5 of the Securities Act, to constitute offers of such SBSs or any guarantees of such SBSs that are securities (Complianceintel.com, 11/19).

Under the agency's proposed Rule 135d, the publication or distribution of price quotes relating to SBSs that may be purchased only by ECPs and are traded or processed on or through a

facility that either is registered as a national securities exchange or as a security-based swap execution facility (SBSEF), or is exempt from registration as an SBSEF, would not be deemed to constitute an offer, offer to sell or solicitation of an offer to purchase such SBSs, or any guarantees of such SBSs, that are securities for purposes of Section 5.

Section 5 prohibits the offer or sale of a security unless it is registered with the Commission or an exemption from registration is available. For example, Section 4(a)(2) of the Act provides such an exemption for transactions made by an issuer not involving a public offering.

SIFMA stated in a recent comment letter that, although the proposed rule does not provide a Section 5 exemption for SBS research, the SEC's proposing release indicated that the Commission is considering whether a broader exclusion from the Securities Act definition of "offer" than simply for SBS price quotes would be appropriate. The group said it would be appropriate for the Commission to expand Rule 135d (*see box on page 5*).

Doing so, SIFMA argued, would enable market participants to take advantage of the Section 4(a)(2) exemption from the registration requirements of Section 5 without requiring SBS dealers to limit the distribution of credit research to their existing ECP customers – a limitation it said would deprive the broader market of the potentially useful information provided by such research.

"Because not all SBS transactions will be required to be traded on a trading system or platform registered (or exempt from registration) as a national securities exchange or [swap execution facility], a Rule 135d research exemption should not be limited only to SBS that are traded on such a system or platform," the group said.

SIFMA added: "We believe that expanding the exemption in proposed Rule 135d to cover research reports discussing SBS is needed not only to avoid unnecessary disruption to beneficial market practices involving the distribution of research reports discussing SBS, but also to implement congressional intent as demonstrated in the Dodd-Frank Act, which contemplated that the SBS market would continue to operate on an unregistered basis among ECPs, and the Jumpstart Our Business Startups Act of 2012, which expressed a clear preference for relaxing the prohibition on 'general solicitation or gen-

eral advertising' in the context of transactions in which the only eligible investors are sophisticated market participants, as Congress judged ECPs to be."

SIFMA'S SUGGESTION

SIFMA said it would be appropriate for the SEC to expand proposed Rule 135d using the following language:

"For the purposes only of Section 5 of the Act (15 U.S.C. 77e), the publication or distribution of any communication described in paragraph (a) or paragraph (b) of this section shall not be deemed to constitute an offer, an offer to sell, or a solicitation of an offer to buy or purchase any [SBS] or any guarantee of such [SBS] that is a security:

(a) quotes relating to [SBSs] that may be purchased only by persons who are [ECPs] (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18))) and are traded or processed on or through a trading system or platform that either is registered as a national securities exchange under Section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)) or as [an SBSEF] under Section 3D(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–4(a)), or is exempt from registration as a security-based swap execution facility under Section 3D(a) of the Securities Exchange Act of 1934 pursuant to a rule, regulation, or order of the Commission; or

(b) research reports (as defined in Rule 139(d) (§ 230.139(d))) discussing [SBSs] that may be purchased only by persons who are eligible contract participants (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)))."

FUNDING CONCERNS

Massad: CFTC faces cyber security constraints

Commodity Futures Trading Commission chairman **Timothy Massad** has highlighted cyber security as a major area of concern, but warned that a lack of resources is hampering his agency's ability to keep tabs on the industry in an area that is gaining widespread regulatory attention.

In testimony earlier this month to the Senate Committee on Agriculture, Nutrition and Forestry, Massad called for a focus on cyber security, describing it as "perhaps the single most important new risk to financial stability." Cyber security and business continuity in general are increasingly important aspects of the CFTC's oversight of futures and swaps markets, and "the need to strengthen the security and resilience of our financial markets against cyber attacks is clear," he said.

"We will be focused on this issue in our examinations of clearinghouses and exchanges in particular to make sure they are doing all they can to address this risk," Massad told the committee. "We will also focus on business continuity and disaster recovery plans as a well-executed disaster recovery plan will aid in the recovery of a cyber security event."

He added: "There is much more we would like to do in this area. However, our capacity to carry out examinations and address cyber security more broadly is significantly constrained by our current budget. We cannot conduct examinations as frequently or in as much depth as we should. Our response to this rapidly evolving area cannot be as proactive as we would like; and the increasing number of cyber security incidents suggests a proactive approach is precisely what is needed."

COMPLIANCE REQUIREMENTS

Massad noted that, in recent years, the CFTC has modernized its core principles to address cyber and information security concerns, and the agency's regulations have been updated by adding more detailed standards addressing various aspects of cyber security.

The CFTC requires clearinghouses, swap execution facilities, designated contract markets and other market infrastructure entities to implement system safeguards, which must include four elements:

- A program of risk analysis and oversight to identify and minimize sources of cyber and operational risk;
- Automated systems that are reliable, secure and have adequate scalable capacity;
- Emergency procedures, backup facilities and a business continuity/disaster recovery plan;
- Regular, objective, independent testing to verify that the system safeguards program is sufficient to meet its regulatory responsibilities.

In addition, each entity must have a risk management program that addresses seven key elements including information security, systems development, quality assurance and governance. These entities must notify the CFTC promptly of incidents and have recovery procedures in place, Massad noted. For example, systemically important clearinghouses must have plans that enable them to recover and resume daily processing, clearing and settlement activities no later than two hours following a disruption.

"We conduct system safeguards examinations to determine compliance with these requirements. Our oversight, however, is limited," Massad told the panel. "Keep in mind that some of our major financial institutions are reportedly spending more on cyber security each year than our agency's entire budget." The CFTC does not engage in independent testing, but rather looks at whether there is evidence to support management's assertions that they are in compliance with the requirements, Massad said, outlining four key areas the agency's exams target (*see box*).

"THERE IS MUCH MORE WE WOULD LIKE TO DO IN THIS AREA. HOWEVER, OUR CAPACITY TO CARRY OUT EXAMINATIONS AND ADDRESS CYBER SECURITY MORE BROADLY IS SIGNIFICANTLY CONSTRAINED BY OUR CURRENT BUDGET"

TIMOTHY MASSAD, CFTC

CYBER EXAM TARGETS

Massad said the agency's exams focus on the following areas in regards to cyber security:

- **Governance**. Is the board paying sufficient attention to cyber security and taking appropriate steps? Does it have the expertise, and does it devote the time, to do so? Is it setting the right tone as to the importance of these issues? The same questions apply to top management
- **Resources**. Are sufficient resources and capabilities being devoted to monitor and control cyber-related risks across all levels of the organization?
- **Policies and procedures**. Are adequate plans and policies in place to address information security, physical security, system operations and other key areas? Is the entity following its plans and policies?
- **Vigilance and responsiveness**. If a weakness or deficiency is identified, does the regulated entity take prompt and thorough action to address it? Does it not only fix the immediate problem, but also examine the root causes of the deficiency?

ICAP settles business expenses case

ICAP Corporates has agreed to pay $800,000 to settle allegations that it did not have a reasonable supervisory system and procedures regarding business entertainment and did not keep complete and accurate expense records in the area.

The **Financial Industry Regulatory Authority** has accepted a letter of acceptance, waiver and consent from the Jersey City, N.J.-based inter-dealer broker. The firm did not admit or deny wrongdoing. An ICAP spokesman declined to comment.

According to the self-regulatory organization, ICAP from January 2011 through December 2013 failed to create or implement an adequate supervisory system or adopt and maintain adequate written supervisory procedures (WSPs) reasonably designed to monitor business entertainment to ensure that expenses incurred complied with regulatory requirements and to safeguard against potential or actual conflicts of interest.

During this time, FINRA said, ICAP had policies regarding business entertainment and the receipt and giving of gifts intended to ensure that business was not awarded or business commitments made based on improper personal incentives. The firm generally barred gifts to customers and its entertainment policy provided, among other things, that "customer entertainment should not be inappropriate...excessive, lavish or overly frequent," according to the SRO.

FINRA said the firm's WSPs required that expenses be submitted for supervisory review and approval and that a supervisor must not approve an expense report until receiving "adequate descriptive information of the expenditures" and "determin[ing] that the expense and activities on the report are compliant with firm policy." ICAP used expense management software to process entertainment expenses and to record supervisory approval of entertainment expenses, FINRA said.

ITEMIZED RECEIPTS

But the SRO alleged that ICAP's supervisory system and procedures were inadequate because, it said, ICAP generally did not require, and generally did not obtain, itemized receipts for entertainment reimbursement claims. Without itemized receipts, the firm was unable to verify the type and cost of the entertainment provided and to exercise adequate supervisory scrutiny over expenses incurred – and therefore was unable to evaluate whether the expenses in the entertainment expense submissions included any improper gifts to customers over the $100 per person, per year limitation imposed by FINRA Rule 3220, the SRO alleged.

Similarly, FINRA said, when ICAP employees submitted reimbursement claims for thousands of dollars in entertainment expenses incurred at different venues and establishments – including over $20,000 incurred one evening at a night club – the supervisors reviewing and approving the expense claims did not receive adequate and/or accurate descriptive information reflecting what the expenses represented and the identity of each attendee entertained at the different venues and establishments.

FINRA also said ICAP did not aggregate or compare entertainment expenses incurred over time, and as a result was unable to ensure against patterns of excessive and overly frequent entertaining of particular individuals, such as employees of prospective or existing clients, intended and/or reasonably likely to induce those persons entertained to act inconsistently with their own employer's interests.

In addition, the SRO alleged, where separate expense submissions were made in connection with expenses incurred on the same day in entertaining the same client company, and some of the same individuals – including an instance where the submissions totaled over $35,000 in restaurant and night club expenses – ICAP did not evidence that it considered the submissions together in evaluating the expenses incurred.

ICAP's expense system was not designed for, and did not permit, the identification of all persons entertained and their respective affiliations, according to FINRA. In practice, the SRO said, expense reports did not contain the names of each client employee entertained and the expense reports often contained only partial names or code names that failed to specify the attendees, but ICAP supervisors nevertheless routinely approved expense reports that omitted names of client attendees and their affiliation and contained inconsistent information regarding the number of attendees (*see box*). Without requiring that business entertainment expense submissions included the name of every person entertained and their respective employer, ICAP was not in a position to guard against potential or actual conflicts and ensure that the expenses were legitimate business expenses, FINRA said.

In addition, FINRA alleged that from at least January 2011 through at least December 2012, ICAP's expense records for business entertainment were frequently inaccurate and incomplete.

EXPENSES

FINRA alleged that the following were examples of expense reports submitted to ICAP:

- One for over $17,000, incurred in connection with a party in East Hampton, N.Y., claimed 35 individual clients attended, listed the client company name as "ICAP PLC/ALL CUSTIES," and did not list the names of any of the client attendees
- One for over $11,000 that included over $8,000 for Center Court tennis tickets at Wimbledon, claimed five clients attended Wimbledon, but listed the names of only three clients

PROBLEMS FOR DEALERS?

SIFMA raises concerns over muni gifts plan

The **Securities Industry and Financial Markets Association** has raised concerns over **Municipal Securities Rulemaking Board** plans to adapt its rule governing gifts, gratuities and non-cash compensation given or permitted to be given by brokers, dealers and municipal securities dealers.

The MSRB has proposed amending its Rule G-20 so that the rule and related recordkeeping requirements under MSRB rules G-8 and G-9 apply to municipal advisers (*see box*). In addition, as part of the self-regulatory organization's broad initiative to streamline its rule book and codify interpretive guidance into MSRB rules (Complianceintel.com, 8/7/2013), the proposed amendments would incorporate certain relevant interpretive guidance.

The changes would also add a new provision explicitly barring MSRB-regulated entities from expensing certain entertainment costs to municipal securities issuances.

The MSRB is developing a range of rules to govern municipal advisers, which have only recently had to register with the SRO. For example, the **Securities and Exchange Commission** in October approved MSRB Rule G-44, which will require municipal advisers to create systems to supervise their municipal advisory activities, and those of associated persons, in a way reasonably designed to achieve compliance with all applicable rules (Complianceintel.com, 11/12).

In a recent comment letter, SIFMA Associate

COMPLIANCE IN THE WORKS: MSRB PLANS

The draft amended Rule G-20 generally would apply the same policies that already apply to dealers and their associated persons to municipal advisers and their associated persons. These would include:

- The prohibition of gifts or gratuities in excess of $100 per person per year in relation to the municipal securities activities of the recipient's employer;
- The exclusion from the $100 limit of "normal business dealings;"
- The exclusion from the $100 limit of contracts of employment and contracts for compensation for services.

The categorical term "reminder advertising" would be deleted from the "normal business dealings" exclusion and the amendment would clarify the types of gifts in the nature of reminder advertising that would be excluded from the $100 limit, such as transaction-commemorating, de *minimis* or promotional gifts. These changes would conform draft amended paragraph (d) with existing **Financial Industry Regulatory Authority** interpretive guidance, officials said in a related filing.

The amendments would also make the $100 limit applicable to gifts given in relation to the municipal advisory activities of the employer of the recipient. At present, Rule G-20 only applies to gifts given in relation to the municipal securities activities of an employer of a recipient.

Among other things, the proposal would add the requirement that gifts not subject to the $100 limit – such as normal business dealings, de minimis or promotional gifts – must not be "so frequent or so extensive as to raise any question of propriety or to give rise to any apparent or actual material conflict of interest." The application of the component regarding questions of propriety would conform to the MSRB's and FINRA's existing treatment of normal business dealings and the same categories of gifts.

The addition of the second component regarding material conflicts of interest is consistent with the MSRB's 2007 notice that encouraged adherence to the highest ethical standards and stated that Rule G-20 was designed to "avoid conflicts of interest."

General Counsel **Leslie Norwood** *(pictured, page 6)* said the group feels the existing standards in Rule G-20 as they relate to dealers are strict enough to cover an entity with a fiduciary duty. But SIFMA has concerns about the prohibition of seeking or obtaining reimbursement for entertainment expenses from the proceeds of an issuance of municipal securities.

"SIFMA's members agree with the intent of the prohibition of seeking or obtaining reimbursement for entertainment expenses from the proceeds of an issuance of municipal securities," Norwood wrote. "However, SIFMA members have concerns about the function and interpretation of the prohibition." Until now, it has not been unlawful under the MSRB's rules for entertainment expenses, and dealers have been able to accommodate clients who would like these expenses to be paid for and reimbursed to the dealer out of the proceeds of the offering, she said.

"SIFMA generally is concerned about federal regulatory creep over state and local issuers of municipal bonds. If a municipal securities issuer would like to spend their bond proceeds in a manner that is not otherwise prohibited by state or local law, in theory we see no reason for the MSRB to prohibit such an expenditure," Norwood wrote.

"If this provision continues to be included in the draft amendments to MSRB Rule G-20, dealers would potentially have to undergo significant and costly changes to their existing compliance programs related to the reimbursement of entertainment expenses," she added.

TIME FRAMES

Another area of concern for the industry group relates to recordkeeping. Rule 15Ba1-8(b)(1) sets requirements for books and records relating to the business of municipal advisers as part of the Dodd-Frank Act-mandated municipal adviser registration regime, Norwood wrote. It requires such firms to maintain and preserve all books and records covered by the rule for not less than five years.

But the planned amendments to Rule G-9 state that dealers must preserve certain books and records for a period of not less than six years, Norwood said. "SIFMA and its members feel that there is no legitimate reason for the difference in record retention timeframes for dealers and municipal advisers," she wrote. "The different record retention rules for municipal advisers create a disparate impact on and increase the cost of compliance for dealers. These unequal rules create particular confusion and undue compliance burden when a firm acts as both dealer and municipal adviser and is thus subject to two different standards."

MANAGING RISK

SEC weighs IA reporting, portfolio, planning rules

The **Securities and Exchange Commission** is weighing an array of new investment adviser rules that would require increased reporting, liquidity and risk management programs, as well as the establishment of transition plans and regular stress testing, according to Chair **Mary Jo White**.

Beyond the SEC's recent increased monitoring of risks within the asset management industry, "a broader set of proactive initiatives is required to help ensure that our regulatory program is fully addressing the increasingly complex portfolio composition and operations of today's asset management industry," White said in a recent speech. The financial crisis has "only underscored the importance of the careful management of risk by funds and their advisers, including portfolio composition and operational risks in particular," she added.

INCREASED REPORTING

The first area in which White said she sees a need for rulemaking is in the data regulators collect from the investment advisory industry. "While funds and advisers currently report significant information about their portfolios and operations to the Commission, these reporting obligations have not, in my view, adequately kept pace with emerging products and strategies being used in the asset management industry," she said.

Among the gaps in the SEC's existing reporting regime, the agency doesn't have a standardized format for funds to convey information about the derivatives they use, White said. Likewise, the agency lacks data about fund securities lending, which according to the staff's analysis of existing documents is conducted by approximately one-fourth of all registered funds.

The SEC staff is developing recommendations that would update the rules to require such data, as well as details about the liquidity and valuation of funds' holdings and their use of separately managed accounts, White said.

The agency has recently begun developing new ways to use the existing data it has at its disposal to select exam priorities and targets for inspection (Complianceintel.com, 12/10). That has prompted warnings to chief compliance officers that subject areas that lend themselves particularly well to data analysis, such as fees and expenses, could become targets for enforcement.

PORTFOLIO CONTROLS

White also expressed concern that mutual funds and exchange-traded funds might have insufficient controls in place to manage their liquidity risks. "A fund that does not manage liquidity risk in its portfolio could have difficulty meeting redemptions if it came under stress, particularly an open-end investment company, which has to provide shareholders with redemption proceeds within seven days of any redemption request," she cautioned. Those issues could, in turn, have ripple effects, such as when a distressed fund's selling off securities at below-market rates drives down prices for other funds or investors, she said.

"BUILDING ON WHAT WE HAVE LEARNED ABOUT STRESS TESTING THROUGH MONEY MARKET REFORM, THE STAFF IS EVALUATING WHAT PROTOCOLS WOULD BE APPROPRIATE FOR INVESTMENT ADVISERS AND INVESTMENT COMPANIES"

MARY JO WHITE, SEC

The SEC is likewise concerned about funds' use of derivatives, which often lead to greater leverage and potential futures obligations that the funds may be unprepared to handle.

"At the most basic level, the staff is considering whether broad risk management programs should be required for mutual funds and ETFs to address the risks related to their liquidity and derivatives use, as well as measures to ensure the Commission's comprehensive oversight of those programs," White said. As the Commission's staff weighs various options, it has focused on three potential requirements:

- Updated liquidity standards
- Disclosures of liquidity risks
- Measures to limit leverage created by derivatives use

PLANNING, TESTING

Lastly, the SEC's staff is developing a rule that would mandate that IAs create specific plans for how they would handle potential disruptions to their business. "The process of creating such a plan in advance of an actual severe disruption in the adviser's operations could better prepare advisers and their clients to deal with a transition and its attendant risks if one were required," White said.

The Dodd-Frank Act also required the SEC to create methodologies for stress testing firms with more than $10bn in assets, and the staff is figuring out how best to implement such testing, White said. "Building on what we have learned about stress testing through money market reform, the staff is evaluating what protocols would be appropriate for investment advisers and investment companies," she said. "As with transition planning, the staff is considering how to tailor these requirements for asset management, as well as for different types of firms."

SEC GUIDANCE

Private fund LPs catch BDC break

The **Securities and Exchange Commission** has issued guidance giving the limited partners of private funds the ability to co-invest with business development companies (BDCs) with which they are remotely affiliated.

Previous SEC guidance has treated limited partners as being comparable to shareholders, and has determined that they shouldn't be considered to be affiliated persons of an investment company or BDC "solely by virtue of their status as limited partners," officials with the agency's Division of Investment Management wrote in the new guidance.

Similarly, in situations "where the limited partner is a close affiliate of the BDC solely because the private fund is organized as a limited partnership, and the limited partner is seeking to co-invest with the BDC, the staff believes that the limited partner should be treated as if it were a shareholder of the private fund for purposes of determining whether it is a close or remote affiliate of the BDC."

The issue stems from the fact that the Investment Company Act distinguishes between transactions involving remote and close affiliates, officials wrote. Certain transactions with close affiliates are prohibited under the Act, but some trades between BDCs and remote affiliates are allowed, so long as a majority of the company's directors approve them.

The SEC had been asked whether a second-tier affiliate of a BDC could be treated as a remote affiliate – and therefore allowed to make transactions with the BDC – in situations where the BDC and a private fund are under common control by a shared investment adviser. In the scenario set forth in the guidance, the private fund limited partner in question would ordinarily be considered a close affiliate of the BDC by virtue of being a partner in the private fund and owning 5% or more of the fund's outstanding voting securities.

In such a situation, the limited partner is a close affiliate of the BDC only because the fund is organized as a limited partnership, DIM officials wrote. However, "[u]nder the same facts, if the private fund were organized as a corporation, the limited partner would be a shareholder of the private fund and, as such, a remote, rather than a close, affiliate of the BDC."

THE BOTTOM LINE

New Division of Investment Management guidance will give private fund limited partners to co-invest with remotely affiliated business development companies without securing specific exemptive relief.

CCO RESPONSIBILITY

ETMF relief offers creation, redemption flexibility

New Securities and Exchange Commission relief allowing for the creation of actively managed exchange-traded funds has also opened the door to ETFs – and their chief compliance officers – having more responsibility to monitor the creation and redemption of fund shares, according to **Morgan Lewis & Bockius** Partner **Richard Morris**.

The SEC's Division of Investment Management last month said it intended to grant Eaton Vance Management exemptive relief to operate a so-called "non-transparent ETF," or exchange-traded managed fund (ETMF) (Complianceintel.com, 11/14). Unlike ETFs that are traded in the secondary market, which must disclose portfolio holdings on a daily basis, the new ETMF will have the same disclosure obligations as other mutual funds – having to disclose holdings quarterly with a 30-day lag. Also different from existing ETFs, the new offerings would trade at either a premium or discount to the fund's net asset value, which wouldn't be determined until the end of the day on which the trade is agreed to.

A "significant difference with this exemptive order is that ETMFs have more flexibility about how they structure their creation and redemption orders," Morris told *Compliance Reporter*. The ETMF order specifically stated that the board should adopt policies and procedures for creation and redemption orders, and that the CCO should monitor their implementation. "This is a potentially important development because this is one of the things that the industry has been pushing the SEC for with respect to traditional ETFs," he said.

"The language in the ETMF exemptive order represents a significant step forward, because instead of a one-size-fits-all solution for the creation and redemption process, the order said the SEC was willing to allow ETMF boards to

adopt policies, and for the CCO to monitor their implementation," Morris said.

Given that the SEC has now lessened its restrictions in this area for ETMFs, that means "if the SEC were to ever move forward with an ETF rule that could be something we might see," he said. "The industry's view is that the ability to have greater flexibility around the composition of creation and redemption orders facilitates the portfolio management of the fund, makes management more efficient and makes it easier to manage the tax efficiency within the portfolio."

In the SEC's order, the staff sets out a number conditions an ETMF would need to meet in processing the purchase and redemption of fund units. The agency said the process would have to follow policies and procedures that:

- Have been approved by the relevant ETMF's board based on a determination that such policies and procedures are in the best interests of the fund;
- Are administered in accordance with Rule 38a-1 of the Investment Company Act by the CCO that the fund has designated for that purpose.

Additionally, the SEC said, the names and quantities of basket instruments for any given day should be identical for all purchasers and redeemers of the fund's units for that day, except in exceptional circumstances (*see box*).

With respect to the adoption of ETMFs generally, "one thing that will be especially important for anybody interested in using this product to understand is the difference between the intraday fixed-price trading structure of traditional ETFs, and the [net asset value]-based trading structure of these new ETMFs," Morris said. "Where you may see a learning curve is that – like any new product – it will require portfolio managers and broker/dealers that trade in these instruments to understand and get used to NAV-based trading."

ETMF CREATION UNITS: EXCEPTIONS

The SEC said the basket of instruments should be identical for all purchasers and redeemers of creation units on a given business day except in cases where:

- Such instruments, in the case of a purchase of a creation unit, are not available in sufficient quantity;
- Such instruments are not eligible for trading by the authorized participant or the investor on whose behalf the authorized participant is acting;
- A holder of shares of an ETMF investing in foreign instruments would be subject to unfavorable income tax treatment if the holder received redemption proceeds in kind.

POLICIES AND PROCEDURES

CCOs advised on anti-insider trading tactics

Chief compliance officers looking to enhance their insider trading policies and procedures should make sure employees understand when information is considered to be public and ensure higher-ups are setting an appropriate tone, according to industry professionals.

CCOs need to make certain that their firms' employees understand whether information and data they come across is non-public, rather than public, **Weil, Gotshal & Manges** Partner **Christopher Garcia** (*pictured below*) told attendees at a recent conference hosted by **Thomson Reuters** in New York. "Public really means that is has to be distributed through traditional channels," such as through a company's website or through its **Securities and Exchange Commission** filings, he said.

"Oftentimes, hedge fund [employees] get confused when they go to a meeting with 15 other analysts" to get information about a given company, **WilmerHale** partner **Boyd Johnson** (*pictured bottom*), a former deputy U.S. attorney in the Southern District of New York, said on the same panel. Analysts often think the information they learn in such meetings is public because it is presented to the entire group of attendees, but that doesn't necessarily mean it is publicly available in the context of insider trading, he cautioned.

One of the other key ways CCOs can deter bad conduct is by working to ensure a good "tone at the top," so that lower-level employees

"WHEN DEALING WITH THE SEC YOU MAY WANT TO JUST BE VERY QUIET. OFTENTIMES MY GOAL IS TO MAKE REGULATORS LOSE INTEREST ALTOGETHER"

DANIEL GITNER, LANKLER SIFFERT & WOHL

feel comfortable reporting potential problems, Garcia said. If employees get the sense that firm executives aren't particularly concerned about insider trading, potential problems could go undetected for longer than they otherwise might, he said.

The SEC's recent focus on insider trading has led to a focus on how CCOs handle whistleblower complaints, with the regulatory scrutiny meaning compliance professionals should make sure they have up-to-date policies in the area (Complianceintel.com, 9/19).

Once a firm is under investigation for potential insider trading violations, it needs to decide how to respond to questions – with the best approach often being to keep a low profile rather than to dispute vociferously or quibble with regulators' inquiries, Johnson said in response to a question from Kasowitz, Benson, Torres & Freidman partner Daniel Fetterman.

"When dealing with the SEC you may want to just be very quiet," agreed Lankler Siffert & Wohl partner Daniel Gitner, speaking on the same panel. "Oftentimes my goal is to make regulators lose interest altogether" by trying not to attract any additional attention during the investigation.

COMPLIANCE TIP

CCOs should make sure employees have a clear understanding of which information they acquire is public, and which non-public, and work to set a strong tone at the top whereby employees feel comfortable going up the chain with questions and concerns about insider trading.

FINRA'S NEW SUPERVISION RULES: WHAT TO WATCH FOR

BY HOWARD KRAMER (L) AND ERIN GALIPEAU (R) OF WILLKIE FARR & GALLAGHER LLP

The **Financial Industry Regulatory Authority**'s new broker/dealer supervision rules went into effect on Dec. 1, 2014. The new rules, among other things, replace former **NASD** rules 3010 and 3012 with FINRA rules 3110 (Supervision) and 3120 (Supervisory Control System), and institute key changes regarding the supervisory obligations of B/Ds (Complianceintel.com, 2/6).

In response to these changes, chief compliance officers have in recent months been implementing important changes to their oversight and supervisory systems in certain areas. As a result, firms should be aware that FINRA examiners may apply heightened scrutiny to particular supervisory areas included in the new rules during their 2015 examinations.

POTENTIAL AREAS OF SCRUTINY BY FINRA EXAMINERS

Securities and investment banking business transactions: Although firms may now employ risk-based systems to review securities and investment banking business transactions when meeting the requirements of FINRA Rule 3110, the self-regulatory organization's examiners may look at firms' procedures and the use of automated systems in connection with risk-based reviews.

FINRA Rule 3110(b)(2) requires that a firm's supervisory procedures include procedures for principal review of transactions relating to a firm's securities or investment banking business. The reviews must be evidenced in writing, but a firm is not required to conduct a detailed review of each transaction if it uses a "reasonably designed risk-based review system."

However, FINRA has stated that if a firm's review procedures include the use of a technology-based review system, a principal must review the parameters of the system for selecting transactions for further assessment and document the review in writing. Moreover, the principal is still responsible when discharging any supervisory responsibilities under the rule to an automated system, aid or tool, and therefore is responsible if the system is not reasonably designed due to a deficiency in the system's criteria.

Insider trading procedures: FINRA Rule 3110(d) requires that a firm have a process in its supervisory procedures for reviewing securities transactions, and the process must be reasonably designed to identify trades that may violate securities laws prohibiting insider trading or manipulation that are effected for accounts of the firm and its associated persons and certain other so-called "covered accounts." Firms must also promptly conduct internal investigations of violative conduct.

This is not an entirely new responsibility for B/Ds, as they have been required to do this for many years under **Securities and Exchange Commission** rules and the federal securities laws. But as this requirement is included in the new supervision rules, it is likely that FINRA examiners will focus on the systems firms have in place to detect instances of potential insider trading by firm accounts.

We also note that firms "engaging in investment banking services" will be subject to reporting requirements regarding their internal investigations, which may be another focus area for FINRA examiners.

Correspondence and internal communications: Firms' required reviews of correspondence and internal communications are also addressed in the new rules. FINRA has adopted Rule 3110.06, which reflects the SRO's guidance regarding the ability of a firm to employ risk-based reviews of such communications. In addition, Rule 3110.07 codifies guidance regarding how firms should evidence reviews, and states that "merely opening a communication is not a sufficient review."

FINRA has stated that firms using lexicon-based screening tools to conduct reviews should have an understanding of the limitations of such tools or systems and consider if any additional supervisory review is necessary. It is likely that FINRA will examine whether firms can evidence an understanding of the capabilities and limitations of any tools they employ.

Supervision of supervisory personnel: FINRA requires firms to have procedures that, among other things, prohibit supervisory personnel from having their compensation or continued employment determined by, or from reporting to, person(s) whom they supervise. In addition, a firm's procedures must prohibit supervisors from supervising their own activities. FINRA allows an exception to these requirements based on the firm's size or business model.

Internal supervisory controls reports: Member firms reporting $200m or more in gross revenues during the previous year on their Financial and Operational Combined Uniform Single, or FOCUS, reports will have to include additional information in annual reports required under FINRA Rule 3120, such as compliance efforts regarding trading and market activities, investment banking activities and anti-money laundering. Examiners may also review certain members' reports to ensure that they are meeting the new reporting requirements.

Supervision of multiple OSJs: FINRA Rule 3110.03 states that the SRO's general presumption that a principal will not be the designated and on-site principal, as required by Rule 3110(a)(4), for more than one office designated as an office of supervisory jurisdiction, or OSJ.

Although a firm can overcome that presumption, it must document in its written supervisory and inspection procedures the factors used to determine why it considers its supervisory structure to be reasonable. FINRA has indicated in the rule itself that this determination will be subject to scrutiny by the SRO.

One-person OSJs: As FINRA has stated, firms should conduct focused reviews of one-person OSJs, and it will continue to monitor these offices for adequate firm supervision over areas such as potential conflicts of interest and sales practice violations.

CCO CHALLENGES

CCOs may face new challenges as they conduct analyses of their supervisory structures and procedures to ensure they are addressing any new requirements—or taking advantage of any of the flexibility—in FINRA's supervisory rules that recently went into effect. For example, CCOs may want to consider reviewing their firm's procedures relating to certain areas, such as supervision of supervisory personnel, insider trading and OSJs to determine whether the procedures cover the modifications to supervisory obligations contained in the new rules.

FINRA's supervisory rules also allow CCOs flexibility in taking a risk-based approach in certain areas, such as reviews of securities and investment banking transactions and correspondence. Some firms may want to make use of the new flexibility. But if they do, it will be important for their CCOs to demonstrate the reasonableness of risk-based approaches they employ and follow up on any indications of inadequate supervision resulting from risk-based reviews.

In addition, although automated systems, tools and aids are helpful in conducting supervisory reviews, FINRA may still find issues with deficiencies that result in a firm's system not being reasonably designed to comply with a particular supervisory rule. FINRA may also second-guess a firm's determinations regarding which transactions and correspondence should be reviewed.

Again, demonstrating that a CCO understands the capabilities and limitations of any system employed will be important to avoid deficiency findings by examiners. The new rules place a major emphasis on processes. Accordingly, CCOs should be prepared to show the reasonableness of new procedures they implement under the rules.

***Howard Kramer** is a partner and **Erin Galipeau** is an associate with **Willkie Farr & Gallagher** LLP in Washington, D.C.*

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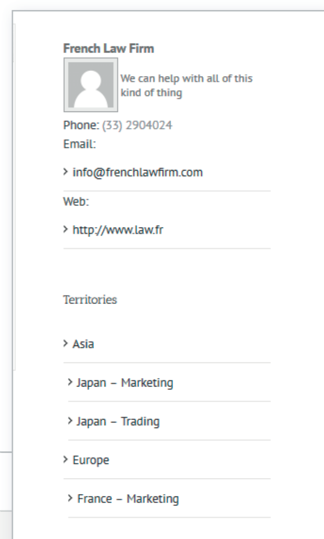

HFMWEEK
France – Trading
Summary
Short Disclosure
Long Disclosure
Recent Changes in this Area

REGULATOR GUIDANCE HUB

Compliance Intelligence presents listings of key recent no-action letters and other guidance from the regulators impacting brokerages and investment management shops. Make sure you have the latest advice and insight. You can find quick links to each of these documents by going to Complianceintel.com.

Regulator	Date	Guidance
Securities and Exchange Commission	Dec. 2014	Published audit of the Office of the Ethics Counsel's oversight of employee securities holdings.
SEC	Dec. 2014	Published management report to accompany the semi-annual report of the SEC's inspector general for the period April 1, 2014 through Sept. 30, 2014.
SEC	Nov. 2014	Issued no-action relief in response to a request from Social Finance, allowing the firm to help with "social impact bonds" offerings without registering as a broker/dealer.
SEC	Nov. 2014	Published fiscal year 2014 agency financial report.
SEC	Oct. 2014	Annouced that in the fiscal year that ended in September, the SEC filed a record 755 enforcement actions covering a wide range of misconduct and obtained orders totaling $4.16 billion in disgorgement and penalties, according to preliminary figures.
Commodity Futures Trading Commission	Dec. 2014	Approved LCH.Clearnet's amended order of registration as a derivatives clearing organization.
CFTC	Dec. 2014	The CFTC staff issued time-limited no-action relief from certain record keeping requirements under Commission Regulation 1.35(a).
CFTC	Nov. 2014	The CFTC staff provided no-action relief from the clearing requirement for swaps entered into by eligible treasury affiliates.
CFTC	Nov. 2014	Issued rule enforcement reviews of the Chicago Board of Trade, Chicago Mercantile Exchange, Commodity Exchange and New York Mercantile Exchange.
CFTC	Nov. 2014	CFTC Member Sharon Bowen sought public comment on the scope and composition of a new advisory committee.
CFTC	Nov. 2014	The CFTC staff issued an extension to a time-limited no-action letter on the applicability of transaction-level requirements in certain cross-border situations.
CFTC	Nov. 2014	The CFTC staff issued a no-action position and interpretations addressing the holding of customer funds.
Financial Industry Regulatory Authority	Dec. 2014	Reminded firms of their obligations under FINRA Rule 2265 to disclose to a customer the material risks of extended hours trading.
FINRA	Dec. 2014	Issued a new investor alert, warning investors of the risks involved with investing in physical precious metals such as silver, gold, palladium or platinum. Specifically, it warned about sellers who charge high commissions and fees but ultimately fail to purchase or deliver the physical assets as promised.
FINRA	Dec. 2014	Sent notice to members regarding the most recent FINRA board of governors meeting.
FINRA	Dec. 2014	Announced the results of elections to fill vacant seats on the Small Firm Advisory Board, National Adjudicatory Council and district committees.
Municipal Securities Rulemaking Board	Nov. 2014	Announced the effectiveness of a change to the MSRB's Electronic Municipal Market Access service to add disclosures related to municipal asset-backed securities required under Securities Exchange Act Rule 15Ga-1. The change provides for the collection and public dissemination of certain disclosures related to municipal ABS.
North American Securities Administrators Association	Dec. 2014	Announced the launch of the online Electronic Filing Depository, or EFD, designed to enhance the efficiency of the regulatory filing process for certain exempt securities offerings.
NASAA	Dec. 2014	Issued an advisory to help investors separate fiction from fact regarding the responsibilities of third-party custodians of self-directed individual retirement accounts and other qualified plans.
NASAA	Nov. 2014	Identified emerging threats investors are likely to face in 2015, including schemes involving binary options, marijuana-related businesses, stream-of-income investments and digital currency.
National Futures Association	Dec. 2014	Issued an updated guide to NFA regulatory requirements for futures commisison merchants, introducing brokers, commodity pool operator and commodity trading advisers.
Investment Industry Regulatory Organization of Canada	Dec. 2014	Published final guidance outlining common due diligence practices and suggestions for IIROC dealers involved in offering securities to the public as underwriters.
IIROC	Dec. 2014	Published academic papers from three of the four academic teams chosen to assess the impact of high frequency trading and related activity on Canadian equity markets, as part of the final phase of IIROC's comprehensive HFT study.
Canadian Securities Administrators	Dec. 2014	Members of the CSA set out their concerns with respect to the practice of routing retail equity orders to U.S. dealers.
CSA	Dec. 2014	The CSA released an oversight review report focusing on certain functional areas and key processes of IIROC.
Ontario Securities Commission	Sept. 2014	Published frequently asked questions regarding OSC Rule 91-506 Product Determination and OSC Rule 91-507 Trade Repositories and Derivatives Data Reporting.
Financial Conduct Authority (U.K.)	Dec. 2014	Set out details of how the FCA intends to meet the regulatory challenges ahead following a detailed review of its strategy, priorities and ways of working.
FCA	Nov. 2014	Published a report on the findings of its review of conflicts of interest arising from wealth management and private banking firms' use of in-house investment products in retail discretionary and advisory investment portfolios.
FCA	Nov. 2014	Announced that financial firms have collaborated with the FCA on a thematic review and, as a result, have agreed to make improvements to the way they deal with consumer complaints.
European Securities and Markets Authority	Dec. 2014	Announced the findings of a peer review of how national regulators supervise Markets in Financial Instruments Directive conduct of business rules on providing fair, clear and not misleading information to clients.
ESMA	Dec. 2014	Published a consultation paper on the Alternative Investment Fund Managers Directive asset segregation requirements.

RULE DOCKET

Compliance Intelligence presents an at-a-glance listing of key upcoming regulatory developments. The chart is designed so that you can see immediately what you need to do, and when, over the coming weeks – whether that's get your voice heard about a proposal or get your firm ready to comply.

REGULATOR	REGION	TOPIC	DETAILS	DEADLINE
Nasdaq Stock Market	**North America**	**Common ownership**	Filed with the Securities and Exchange Commission a proposal to change the definition of common ownership to extend its application.	**Comments due Dec. 30.**
Chicago Mercantile Exchange	**North America**	**Defaulting clearing member assets**	Filed with the SEC a proposal to change rules relating to the application of excess defaulting clearing member assets in crossover default scenarios, and the harmonization of defaulted base clearing member collateral definitions.	**Comments due Dec. 30.**
CME	**North America**	**Rules 818, 8G01 and 8H01**	Filed with the SEC a proposal to change CME rules 818, 8G01 and 8H01 related to derivatives clearing.	**Comments due Dec. 30.**
CME	**North America**	**Fund collateral**	Filed with the SEC a proposal to change rules to align performance bond and guaranty fund collateral acceptance with CFTC regulation 39.33 requirements.	**Comments due Dec. 30.**
BATS Exchange	**North America**	**UTP derivative securities**	Filed with the SEC a proposal to change Rule 14.11(j)(5) to remove the restriction prohibiting market makers in unlisted trading privileges (UTP) derivative securities from acting or registering as a market maker in any reference asset of that UTP derivative security or any derivative instrument based on such a reference asset.	**Comments due Dec. 31.**
BATS Exchange	**North America**	**Rule 11.1**	Filed with the SEC a proposal to change Rule 11.1 to begin accepting orders at 6:00 a.m. EST.	**Comments due Dec. 31.**
Canadian Securities Administrators	**North America**	**Women in senior management**	The CSA finalized rules regarding disclosures of women on boards and in senior management.	**Becomes effectives Dec.31.**
European Securities and Markets Authority	**Europe**	**Capital requirements regulation**	ESMA opened a public consultation regarding the capital requirements regulation.	**Comments due Dec. 31.**
Nasdaq Stock Market	**North America**	**Opening and halt cross**	Filed with the SEC a proposal to modify rules regarding the opening and halt cross of the Nasdaq Options Market.	**Comments due Dec. 31.**
Securities and Exchange Commission	**North America**	**Broker/dealer reports**	The SEC is amending requirements for broker/dealers regarding annual reporting, audits and notifications, including a requirement that B/D audits be conducted in accordance with the standards of the Public Company Accounting Oversight Board.	**Becomes effective Dec. 31.**
New York Stock Exchange	**North America**	**Supplemental liquidity providers pilot program**	Filed with the SEC to extend the operation of the supplemental liquidity pilot program. The program was set to expire July 31, 2014. The proposal would make the pilot permanent Dec. 31, 2014.	**Becomes effective Dec. 31.**
Municipal Securities Rulemaking Board	**North America**	**Continuing education**	The SEC approved rules to require dealers to provide annual municipal securities training for registered persons who are regularly engaged in or supervise municipal securities activities.	**Becomes effective Jan. 1.**
SEC	**North America**	**Credit rating agencies**	The SEC is adopting amendments to existing rules and proposing new rules governing credit rating agencies. The Commission is also adopting a new rule and a form that will apply to providers of third-party due diligence services for asset-backed securities, and is adopting requirements that issuers and underwriters of ABS make publicly available the findings of any third-party due diligence reports the issuers or underwriters obtain.	**Annual report due Jan. 1.**
SEC	**North America**	**Nationally recognized statistical rating organizations**	The SEC is adopting amendments to 240.17g-3(a)(7) and (b)(2) and Form NRSRO that apply to credit rating agencies registered with the Commission as nationally recognized statistical rating organizations.	**Becomes effective Jan. 1.**
CME	**North America**	**Rule 814, Rule 901**	Filed with the SEC a proposal to clarify CME Rule 814 and Rule 901.	**Comments due Jan. 2.**
NYSE Arca	**North America**	**Penny pilot program**	Filed a proposal to amend commentary to exchange Rule 6.72 to extend the penny pilot in options classes in certain issues through June 30, 2015.	**Comments due Jan. 2.**

REGULATOR	REGION	TOPIC	DETAILS	DEADLINE
NYSE	**North America**	**Annual report filing**	Filed with the SEC a proposal to amend its continued listing requirements in relation to the late filing of a company's annual report as set forth in Section 802.01E of the exchange's listed company manual.	**Comments due Jan. 7.**
NYSE Arca	**North America**	**Rule 6.2a**	Filed an amendment and order granting accelerated approval of a proposal to amend Rule 6.2A to authorize the exchange to share any user-designated risk settings in exchange systems with the clearing member that clears transactions on behalf of the user.	**Comments due Jan. 7.**
NYSE Arca	**North America**	**Rule 6.62(k)**	Filed with the SEC a proposal to amend Rule 6.62(k) to disallow market orders from being eligible for designation as an immediate-or-cancel order.	**Comments due Jan. 8.**
Financial Industry Regulatory Authority	**North America**	**OTC equity volume**	FINRA is seeking comment on a proposal to expand its alternative trading system transparency initiative to publish the remaining equity volume executed over-the-counter, including non-ATS electronic trading systems and internalized trades.	**Comments due Jan. 9.**
FINRA	**North America**	**Business clock synchronization**	FINRA is seeking comment on a proposal to reduce the synchronization tolerance for computer clocks.	**Comments due Jan. 9.**
FINRA	**North America**	**OTC equity trade identification**	FINRA is seeking comment on a proposal to identify over-the-counter trades in national market system stocks reported more than two seconds following trade execution as “out of sequence” and not last sale eligible, for public dissemination purposes.	**Comments due Jan. 9.**
CME	**North America**	**CDS risk model**	Filed with the SEC a proposal to change rules related to enhancements to the risk model for credit default swaps.	**Comments due Jan. 12.**
Commodity Futures Trading Commisison	**North America**	**Residual interest decline**	The CFTC is proposing to remove the Dec. 31, 2018 termination date for the phased-in compliance schedule for futures commission merchants and provide assurance that the residual interest deadline would only be revised through a separate Commission rulemaking.	**Comments due Jan. 13.**
CFTC	**North America**	**Records of commodity interest and related cash or forward transactions**	The CFTC is proposing to amend Rule 1.35(a) to require that records maintained under the rule must be searchable and meet other standards.	**Comments due Jan. 13.**
FINRA	**North America**	**Audit Trail System**	FINRA is seeking comment on a proposal to amend Order Audit Trail System rules to require member firms to report additional information.	**Comments due Jan. 13.**
NYSE Arca	**North America**	**Quote migration**	Filed with the SEC a notice designating a longer period for action on a proposal to remove the exchange's quote mitigation plan.	**Action period extended until Jan. 19.**
FINRA	**North America**	**Fixed income pricing**	The CFTC and SEC have issued proposed interpretation on a rule regarding contracts with embedded volumetric optionality.	**Comments due Jan. 20.**
FINRA	**North America**	**Pricing disclosures**	FINRA is seeking comment on a proposal that would require firms to disclose additional information on customer confirmations for transactions in fixed income securities.	**Comments due Jan. 20.**
MSRB	**North America**	**Pricing information on retail customer confirmations**	The MSRB is requesting comment on a proposal to require dealers to give pricing reference information on retail customer confirmations.	**Comments due Jan. 20.**
MSRB	**North America**	**Fixed income pricing**	FINRA and the MSRB have released companion proposals to require the disclosure of pricing reference information on customer confirmations for transactions in fixed income securities.	**Comments due Jan. 20.**
CFTC	**North America**	**Position limits**	Filed a proposal to establish speculative position limits for 28 exempt agricultural commodity futures and option contracts and the physical commodity swaps that are economically equivalent to such contracts.	**Comments due Jan. 22.**
ESMA	**Europe**	**Asset segregation requirements**	ESMA published a consultation paper on the Alternative Investment Fund Managers Directive asset segregation requirements.	**Comments due Jan. 30.**
FINRA	**North America**	**Supplemental Inventory Schedule**	The SEC approved the Supplemental Inventory Schedule that must be filed by a firm that is required to file FOCUS Report Part II, FOCUS Report Part IIA or FOGS Report Part I, and has inventory positions as of the end of the FOCUS or FOGS reporting period, unless the firm has a minimum dollar net capital or liquid capital requirement of less than $100,000 or inventory positions consisting only of money market mutual funds.	**Becomes effective Jan. 30.**
CSA	**North America**	**Clearing requirements**	The CSA is proposing National Instrument 24-102 Clearing Agency Requirements, which would adopt international standards for Canadian financial market infrastructures.	**Comments due Feb. 10.**

(CONTINUED FROM PAGE 1)

CFTC, prosecutors eye obstruction cases

...outlawing false statements made to the agency, Goelman noted. Where Section 6(c) of the Act used to prohibit firms from providing false information in their registration applications or in reports to the Commission, Dodd-Frank broadened the rule to include false statements made to CFTC officials in other contexts *(see box)*.

"I wouldn't be surprised to see an uptick in these sorts of cases. This is a very aggressive enforcement environment right now from both the **U.S. Department of Justice** and financial regulators," **Schulte Roth & Zabel** Special Counsel **Seetha Ramachandran**, a former DoJ official, told *Compliance Reporter* later. In light of that, it's particularly important for firms not to provide incomplete information to investigators or to provide a selection of "information that could be construed as misleading, even if you're providing it voluntarily," she said.

"Firms should recognize that false statements charges and obstruction charges are especially serious because they can extend the statute of limitations for conduct that was not prosecuted earlier," Ramachandran said. "If you have bad facts it's better to just confront them. You can only make the situation worse by withholding information or misleading investigators."

The same principle applies to document preservation and collection, she said, adding: "If you receive a subpoena or other request for information it's important to make sure that information is being preserved, and that if you don't feel you can provide the information being sought that you engage with government and get a clear understanding of what they want and what you can give them."

STEPS TO TAKE

Sending around a document preservation notice instructing employees to preserve relevant documents is one of the first steps firms should take in response to a government investigation, Schulte Roth partner **Gary Stein**, a former chief appellate attorney with the SDNY, told *Compliance Reporter*. "There are certain steps the government will expect you to take in almost every case, and if you don't do them you may get off on the wrong foot."

As a second step, "and this is not easy sometimes, you need to let the relevant employees know that the matter is now the subject of a government investigation, and that they shouldn't be talking about it between or among themselves," Stein said. "The government often has a jaundiced view of conversations that take place between witnesses after the investigation has commenced. They will often view that as people getting together to come up with a consistent story."

Failure to follow those steps can be a "double whammy" to firms, Stein cautioned. "First of all, it could lead to some sort of investigation or charge for obstruction. But it can also color significantly the way the government views the underlying conduct that they're investigating [with] the theory that if you're not preserving documents or if you're all talking together, you must have something to hide."

In sending out the initial notice to employees to preserve documents, firms should be careful to "fairly reflect what the subpoena is asking for," Ramachandran cautioned. "Even if you think you will later be able to narrow the government's request, your instructions to the company should reflect what the government is asking you for."

2015 TARGETS

Enforcers' focus on bringing cases where firms obstruct their investigations is one of several target areas for 2015. Goldstein cautioned attendees that prosecutors in the Southern District also plan to focus on the following four areas:

- Insider trading;
- Accounting fraud, particularly the misevaluation and mismarking of esoteric securities;
- Investing-related fraud, such as investment advisers that make misleading representations;
- Market manipulation

The CFTC's Enforcement Division will also focus heavily on manipulation in 2015, with benchmark-related issues in particular being "a big focus of our enforcement program," Goelman said. "There is little as damaging to the integrity of our markets, or the perception of the integrity of our markets, as benchmark manipulation."

The agency has recently conducted high-profile investigations into alleged manipulation of both the London interbank offered rate and other foreign exchange benchmarks. Firms have settled related actions without admitting or denying wrongdoing. Given the issues the CFTC uncovered in those investigations, "there is no reason to be sanguine or confident that there aren't a host of other benchmarks that haven't been corrupted," Goelman said.

> "FIRMS SHOULD RECOGNIZE THAT FALSE STATEMENTS CHARGES AND OBSTRUCTION CHARGES ARE ESPECIALLY SERIOUS BECAUSE THEY CAN EXTEND THE STATUTE OF LIMITATIONS FOR CONDUCT THAT WAS NOT PROSECUTED EARLIER"
> SEETHA RAMACHANDRAN

COMPLIANCE PRIMER: FALSE STATEMENTS

Following Dodd-Frank Act rules changes, Section 6(c)(2) of the Commodity Exchange Act states:

"It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, including in any registration application or any report filed with the Commission under this chapter, or any other information relating to a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to omit to state in any such statement any material fact that is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, or reasonably should have known, the statement to be false or misleading."

ONE YEAR AGO

Andrea Seidt, then-president of the **North American Securities Administrators Association** and still-Ohio Securities Commissioner, warned chief compliance officers at state-registered investment advisers to keep a close eye on their firms' use of private offerings, as regulators were increasingly scrutinizing such transactions. [Seidt's successor for the one-year term as NASAA president is Washington Securities Director **William Beatty.** He told *Compliance Reporter* recently that authorities are planning to expand their inspections of state-registered firms to include targeted questions about cyber security policies and procedures (Complianceintel.com, 12/10).]

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New IAA head warns CCOs of proxy focus

"The [**Securities and Exchange Commission**] in the past year spent a lot of time focused on the use of [both] proxy advisory firms and the proxy voting process by IAs," Barr *(pictured right)* told *Compliance Reporter* in a recent interview. "CCOs should expect that the SEC will look at their policies and procedures with respect to proxy voting, and the due diligence that firms do on proxy advisory firms, in future examinations."

Barr took over as president and CEO of IAA last month. She replaced **David Tittsworth**, who resigned from the industry group after 18 years to explore other opportunities, according to a spokesman.

The SEC's Division of Investment Management and Division of Corporation Finance in June issued guidance in which they cautioned the industry about the hidden conflicts of interest that proxy advisory firms may have (Complianceintel.com, 7/7). The guidance warned fund advisers that they have a fiduciary duty to guard against such conflicts and to enhance efforts to spot incorrect statements by third-party advisory firms they use.

IA CCOs need to be reviewing that guidance because the agency's Office of Compliance Inspections and Examinations is likely to be reviewing practices in the area in the year ahead, Barr cautioned. CCOs should ensure they have due diligence policies in place to address the potential conflicts the staff identified, she said *(see box)*.

The SEC is also "looking at the process by which advisers consider recommendations of how to vote on various proxy issues. That's an area that firms should be considering—how they form their recommendations, what information they use," Barr said. "This is certainly an area where CCOs should take a fresh look at their proxy voting policies and procedures, including not just the actual process of voting proxies, but the process that advisers have in place to decide how to vote proxies."

Commission Member **Daniel Gallagher** in August said the SEC

may need to release additional guidelines related to IAs' proxy voting (Complianceintel.com, 8/11). Gallagher said Commission-level guidance could clarify that IAs need to assume responsibility for the manner in which their votes are cast and cannot simply depend by "rote" on the recommendations of proxy firms to absolve them of that obligation.

PRUDENTIAL REGULATION

Meanwhile, both the SEC and the **Financial Stability Oversight Council** have been scrutinizing systemic risks posed by asset managers with an eye toward potential new rules and supervision. FSOC's Office of Financial Research has been studying advisers and the IAA, along with other industry groups, has taken pains to point out certain flaws in its approach, Barr said.

FSOC now recognizes that, instead of looking at specific asset management firms, it should look at activities that may pose systemic risk, and instead of focusing on any one particular entity or size of entity, instead look at the underlying activities, Barr said. IAs should keep an eye on the Council's activities to see what, if any, new compliance burdens may come their way, she added.

The industry also expects "increased activity from the SEC with respect to gathering data about both registered funds and separately managed accounts to try to gather more information with respect to various aspects of portfolios and risks, derivatives and liquidity, and in other areas," Barr said. The SEC is scoping potential rules that would require advisers to conduct stress tests and to put in place transition plans for funds, she cautioned.

The Commission's potential transition planning rule, in particular, is a very new idea, Barr said. "We would certainly look at the information the SEC is proposing [to collect] and try to, among other things, analyze the feasibility of providing the information; what use the SEC might make of the information; and whether the information should be in a public form like Form ADV or whether the nature of what might be requested is of a confidential or proprietary nature."

"CCOs SHOULD EXPECT THAT THE SEC WILL LOOK AT THEIR POLICIES AND PROCEDURES WITH RESPECT TO PROXY VOTING"
KAREN BARR,
INVESTMENT ADVISER ASSOCIATION

PROXY VOTING: DEMONSTRATING COMPLIANCE

The SEC's June bulletin set forth a number of steps IAs could take to demonstrate that proxy votes are being cast in the best interest of clients and in compliance with proxy voting procedures:

- Periodic sampling of proxy votes to review for compliance with the IA's policies and procedures
- Specific sampling of proxy votes related to proposals requiring in-depth analysis
- At least annual reviews of the adequacy of proxy voting policies and procedures to ensure effective implementation, including whether they are reasonably designed to ensure proxies are voted in clients' best interests

FIVE YEARS AGO

Looking ahead to 2010, attorneys and compliance officials expected to be kept on their toes by regulators looking at issues such as combating bribery and harmonizing broker/dealer and adviser exams, as well as custody controls and valuation. [A senior official with the **Securities and Exchange Commission**'s national exam program recently warned chief compliance officers at investment advisory firms to keep close tabs on when they have custody of client assets because many related deficiencies occur due to firms not realizing they have become subject to the custody rule (Complianceintel.com, 10/27).]