

The Effect of New and Proposed Regulations on Investment Advisers

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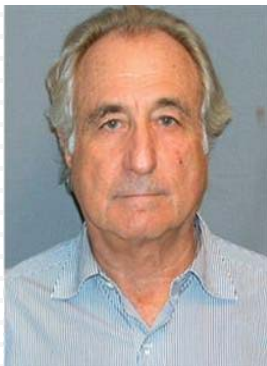
Profiles in Fraud



\$15 million (in 1920s dollars)



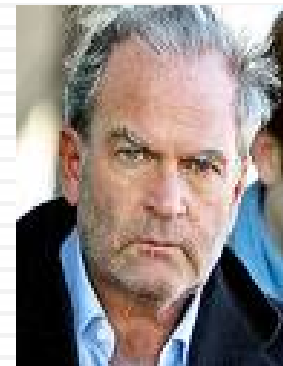
\$400 million



\$50 billion



\$7 billion

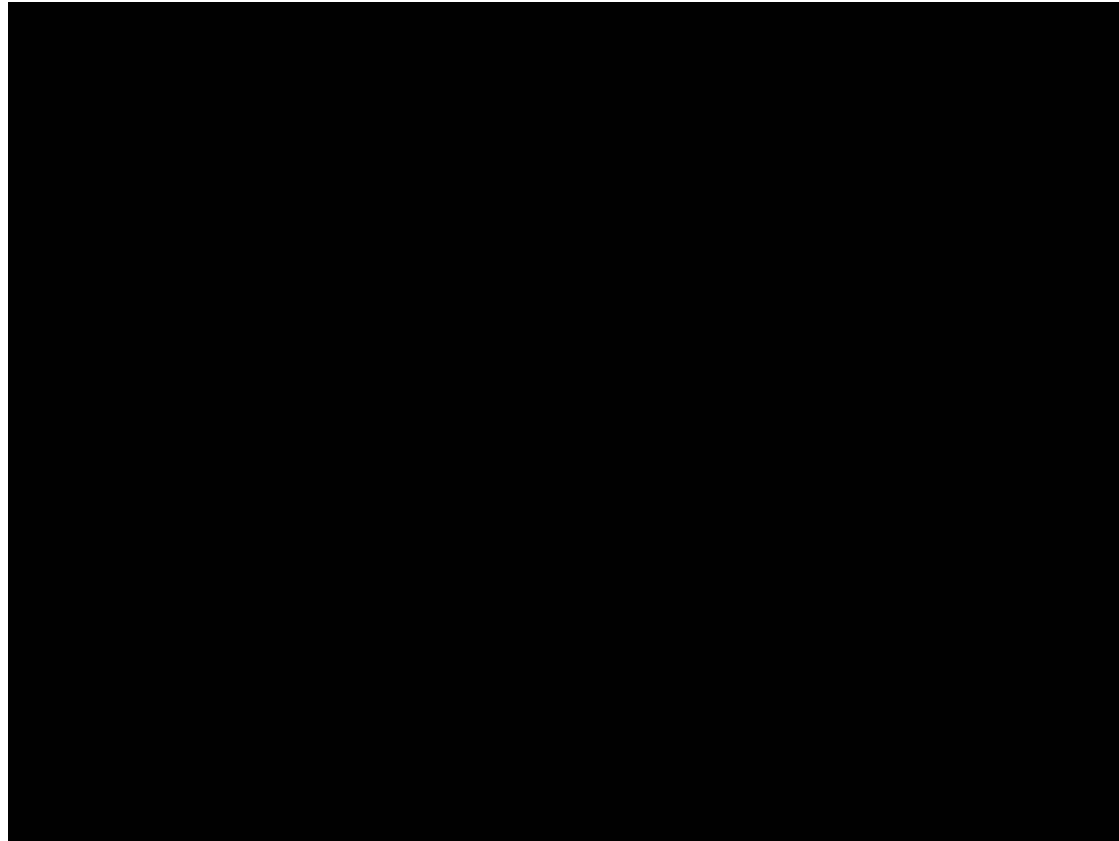


\$1.2 billion

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Profiles in Fraud

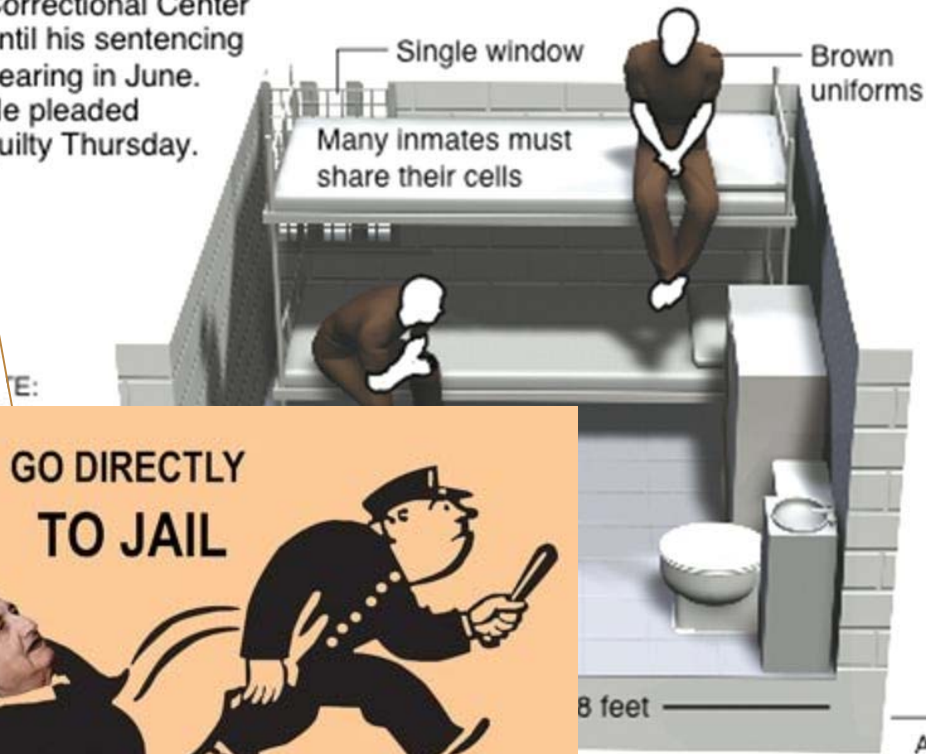


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Madoff's new Manhattan studio

Bernard Madoff will be in a jail cell at Manhattan's Metropolitan Correctional Center until his sentencing hearing in June. He pleaded guilty Thursday.



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*“Only when the tide goes out
do you discover who’s been
swimming naked.”*

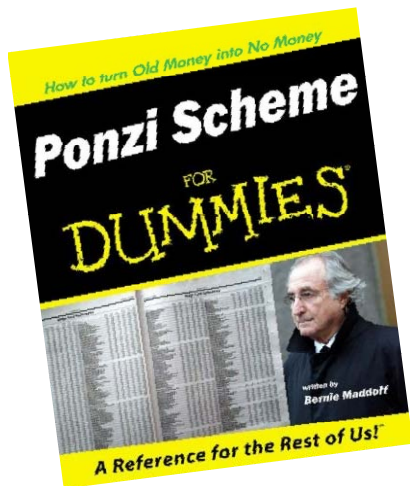
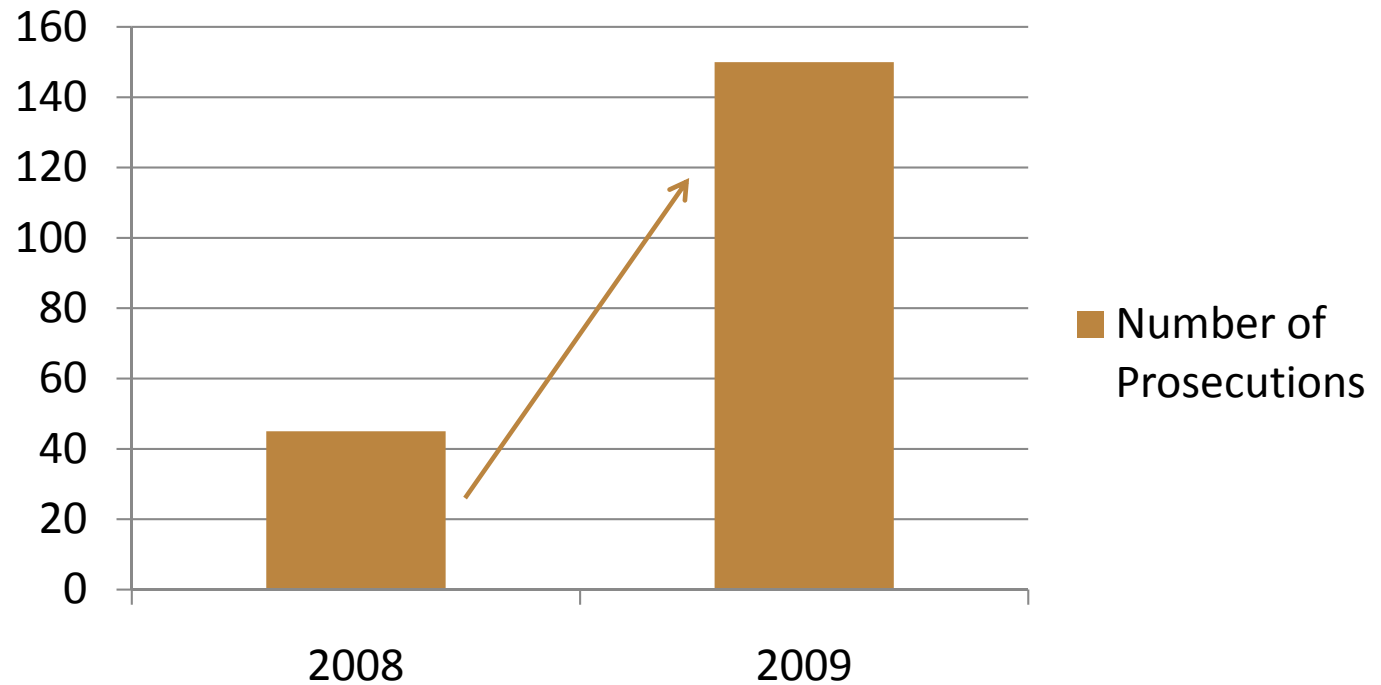
Warren Buffet

Profiles in Fraud



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Surge in Ponzi-Related Prosecutions



Profiles in Fraud



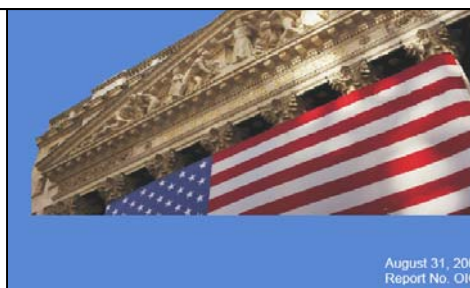
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SEC Porn Problem: Officials Surfing Sites During Financial Crisis, Report Finds

SEC Employees Exposed Downloading, Uploading Pornography at Work

More than 24 SEC workers investigated for porn surfing during work



August 31, 2009
Report No. OIG-09-018



GOVERNMENT STIMULUS?



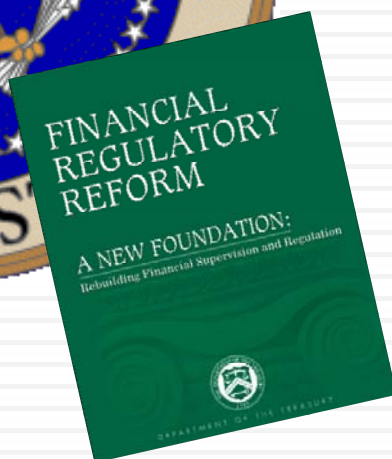
Senior SEC staffers spent hours at work looking at porn websites

Inquiries of 33 employees find one who was blocked more than 16,000 times in a month from visiting certain sites. He eventually found a way around the agency's filter.



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PROPOSED LAW	STATUS
Wall Street Reform and Consumer Protection Act	Passed the House; awaiting reconciliation with Restoring American Financial Stability Act
Restoring American Financial Stability Act of 2010	Introduced to Senate banking committee in March 2010; pending full Senate debate
Private Fund Investment Advisers Registration Act of 2009	Incorporated into the Wall Street Reform and Consumer Protection Act
The Arbitration Fairness Act of 2009	Pending committee approval in both the House and Senate
The Pension Security Act of 2009	Pending committee approval in the House
Federal Insurance Office Act	Passed by the House Financial Services Committee
Hedge Fund Study Act	Passed the House in 2006 (Senate vote never occurred). Reintroduced in 2009 and currently pending committee approval in the House.

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WALL STREET REFORM AND CONSUMER PROTECTION ACT

- ❑ Creation of the Consumer Financial Protection Agency (CFPA).
- ❑ Doubles the SEC's authorized budget over five years.
- ❑ Creation of a whistleblower bounty program.
- ❑ Registration of most advisers to hedge funds.
- ❑ Change to AUM threshold for SEC registration, depending on whether a state raises its AUM allowance under its own rules.
- ❑ Inflation adjustment for the "qualified client" standard.



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RESTORING AMERICAN FINANCIAL STABILITY ACT OF 2010

- ❑ SEC would become self-funded rather than limited to the current budget appropriations process.
- ❑ Increase in AUM threshold for investment adviser registration.
- ❑ Certain hedge funds would be required to register.
- ❑ Study on the impact of applying the fiduciary standard to broker-dealers; no recommendation.



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	Restoring American Financial Stability Act of 2010	Wall Street Reform and Consumer Protection Act
Threshold for SEC Registration	\$100 million	\$100 million but subject to state adoption
Fiduciary Standard	Requests a study to determine the impact on applying a fiduciary standard to broker-dealers	Imposes a fiduciary duty towards customers on every financial intermediary who provides advice
SEC's Source of Funding	Self-funded	User fees to be paid by RIAs, but still subject to appropriations process

Status

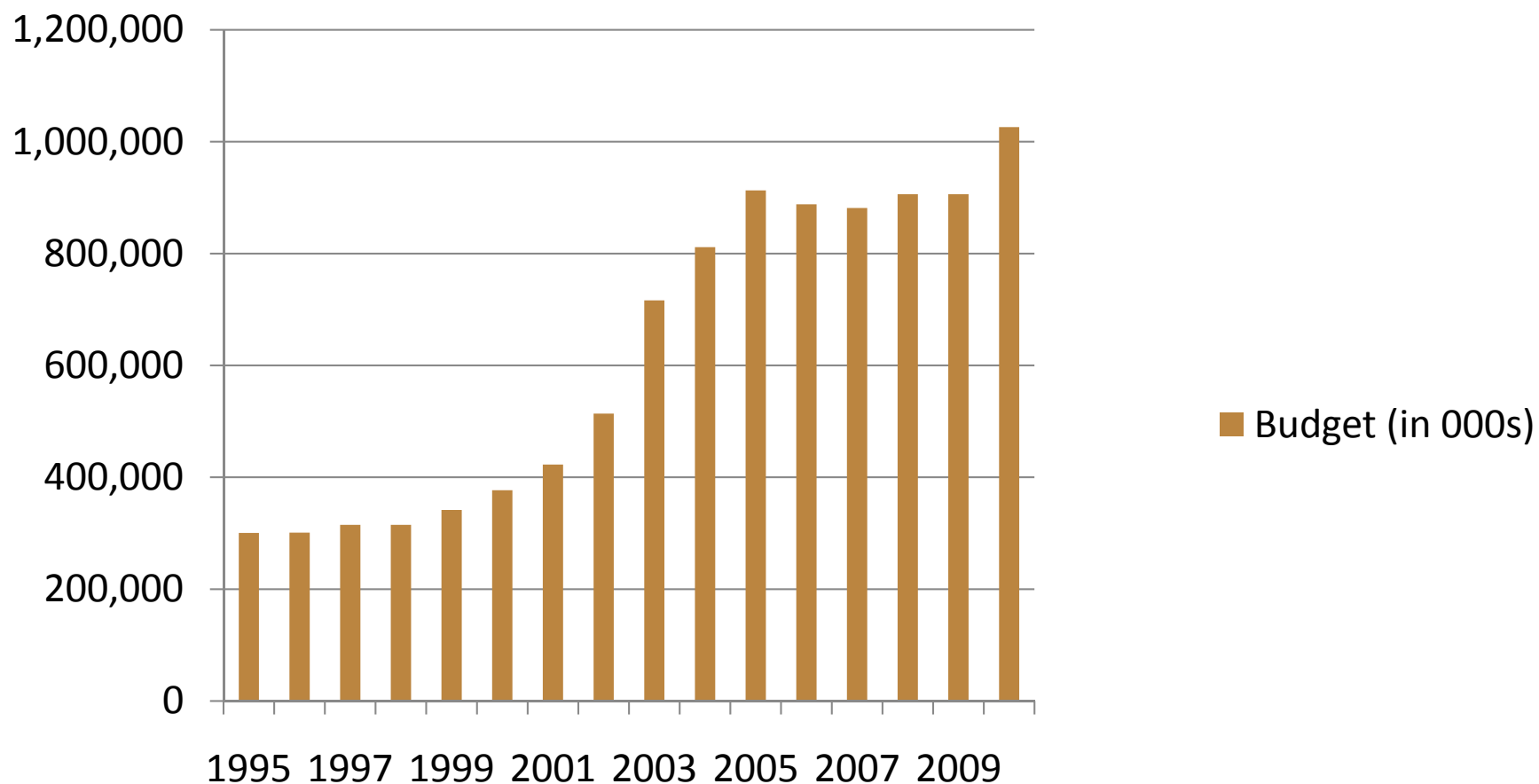
Pending debate by the full Senate

Passed by the House

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PRIVATE FUND INVESTMENT ADVISERS REGISTRATION ACT OF 2009

- ❑ Mandate the registration of hedge fund advisers.
- ❑ One year window to comply with registration requirements.
- ❑ Fiduciary duty owed only to the fund and not each individual investor with the fund.
- ❑ Managers of venture capital funds excluded from registration.



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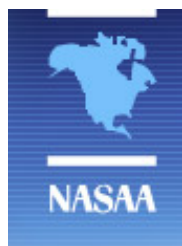


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“States have both the will and the ability to regulate. The state system of investment adviser regulation has worked well with the \$25 million threshold since it was mandated in 1996. The states have developed an effective regulatory structure and enhanced technology to oversee investment advisers. Increasing the threshold to \$100 million would reduce the SEC’s examination burden and allow the agency to focus on larger firms and other market issues.”

“Government never has enough resources to do everything, but it’s clear that states have done a much better job at deploying their limited resources. States are ready to accept this increased responsibility.”

*NASAA Statement on Investment Adviser Regulation
by Denise Voigt Crawford, NASAA President
October 28, 2009*



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- Commissioner Walter: *universal fiduciary standard for all financial professionals*
 - “For the most part, broker-dealers and investment advisers are regulated under different statutes and at times by different regulatory bodies. Yet, they often provide practically indistinguishable services to retail investors and direct them to the same products.”
 - “I believe that the Commission should ... pursue a harmonization approach. Specifically, using current statutory authority, I believe the Commission should try to harmonize, among other things, the registration process, disclosure obligations, supervisory responsibilities, and recordkeeping requirements of broker-dealers and investment advisers. The Commission should also consider imposing a uniform standard of conduct on all broker-dealers and investment advisers, which is something I will discuss more fully in just a moment. Although such rulemaking may not be the complete solution to the problem, it would be a good start.”
- SIFMA: *develop a standard between fiduciary and suitability*
- Financial Planning Coalition: *establish a universal fiduciary standard*
- Richard Ketchum, Chairman and Chief Executive of FINRA: *suitability standard is already higher than the fiduciary standard*

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ARBITRATION FAIRNESS ACT OF 2009

- ❑ Makes any pre-dispute, mandatory arbitration agreement unenforceable if it requires arbitration of employment, consumer, franchise, or civil rights disputes

THE PENSION SECURITY ACT OF 2009

- ❑ Amends ERISA to require in the annual report of each defined benefit pension plan disclosure of plan investments in hedge funds

FEDERAL INSURANCE OFFICE ACT

- ❑ Provides for the creation of a Federal Insurance Office which will provide a unified voice on insurance matters for the United States in global deliberations.

HEDGE FUND STUDY ACT

- ❑ Requires the President's Working Group on Financial Markets to conduct a study on the hedge fund industry.

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PROPOSED RULE	AGENCY	STATUS
Red Flags Rule	FTC	Effective June 1, 2010
Revisions to Form ADV Part 2	SEC	Comment period closed May 16, 2008
Revisions to Custody Rule	SEC	Effective March 12, 2010
Revisions to Pay to Play Rules	SEC	Comment period closed October 6, 2009
Revisions to Regulation S-P	SEC	Comment period closed May 12, 2008
Proxy Disclosure and Solicitation Enhancements	SEC	Effective February 28, 2010
Revisions to Advertising Rules	SEC	Pending rule proposal
Revisions to Books & Records	SEC	Pending rule proposal



FINANCIAL PLANNING

New Privacy Regulations are Going to Change the Way you Handle Client Data

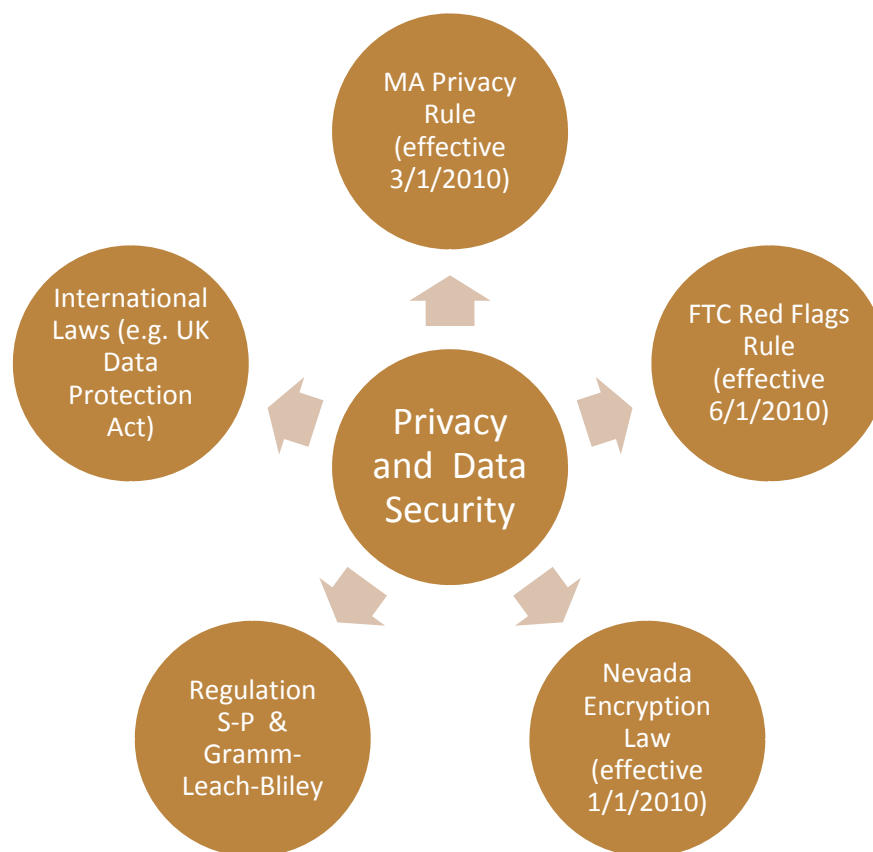
Protecting client privacy is one of the most important responsibilities of any financial advisor. And it's about to become one of the most time-consuming and highly regulated aspects of the business as well. The challenge for small, independent firms is especially acute, and it speaks to an even larger industry problem: regulatory compliance in this area is about to reach a whole new level of crazy.

Advisors unaware of all the changes taking place in this realm have their work cut out for them. These new mandates may require an assessment of technology capabilities, a new awareness on the part of advisor personnel, and some real changes in an advisor's practices.

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FTC RED FLAGS RULE

- Response to a concern regarding the increasing number of cases regarding identity theft and data breach incidents.

STANDARDS FOR THE PROTECTION OF PERSONAL INFORMATION OF RESIDENTS OF THE COMMONWEALTH

- Protect the personal information about residents of the Commonwealth of Massachusetts from unauthorized access or use.

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□ Revisions to the Custody Rule

- maintains the broad definition of custody which includes those that have control over client assets;
- exempts from the examination requirement advisers that merely have custody due to withdrawing fees;
- provides that advisers that maintain *physical* custody, or place assets with an affiliated custodian will be required to file a SAS-70 report prepared by a Public Company Accounting Oversight Board (PCAOB)-registered public accountant; and
- exempts hedge funds and their managers from the surprise examination requirement because the funds are subject to an annual audit. The annual audit, however, must be conducted by a PCAOB-registered public accountant.





FINANCIAL PLANNING

Surprise! SEC Hands Advisors the Tab for Madoff Fraud

As sure as day follows night, summer follows spring, and kids follow an ice cream truck's shrill, new securities regulations follow financial scandals. It would seem inevitable that in the wake of recent epic advisor frauds the securities watchdogs would begin to find ways to make those schemes more difficult for financial advisors to perpetrate, had these regulations been in place to begin with. The byproduct of that regulatory response means that regulatory compliance becomes more complicated and expensive for everyone else, those advisors that are actually interested in doing business within the confines of the law. For those would-be perpetrators of fraud, well, they can just ignore the new regulations too.

Well, regulators have risen to the recent challenge. Most recently, the U.S. Securities and Exchange Commission ("SEC") adopted amendments to the custody rule, Rule 206(4)-2 under the Investment Advisers Act of 1940, at the end of last year. The existing custody obligations for most advisors require little more than placing the assets with an independent custodian, furnishing disclosure to clients about where their money is being held and ensuring that the custodian is sending account statements to clients. Some advisors are also required to have an independent verification of certain client assets. The new rule, which takes effect on March 12, is a game changer for affected advisors.

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- Fostering Cooperation
 - ▣ Cooperation Agreements
 - ▣ Deferred Prosecution Agreements
 - ▣ Non-Prosecution Agreements
- Streamlined process for submitting witness immunity requests
- New Evaluation Criteria
 - ▣ Assistance provided by the cooperating individual
 - ▣ Importance of the underlying matter
 - ▣ Societal interest
 - ▣ Appropriateness of cooperation credit





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Compliance Measures

Compliance Measures



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ACTIVITIES DEEMED CUSTODY

- You or a related person hold, directly or indirectly, client funds or securities, or have authority to obtain possession of them. Custody includes:
 - ▣ Possession of client funds or securities.
 - ▣ Any arrangement under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian. Examples include:
 - ▣ Any capacity that gives you or your supervised person legal ownership of or access to client funds or securities.

Compliance Measures



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CUSTODY COMPLIANCE (CIRCA 2005)

- Independent Third Party
 - ▣ Qualified Custodian
 - ▣ Notification
 - ▣ Quarterly Statement

- Other Custody
 - ▣ Surprise audit



Compliance Measures



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2009 REVISIONS

- ❑ Statements from Custodian
- ❑ Disclosures on Adviser-Generated Statements
- ❑ Form ADV
- ❑ Compliance Manual

Compliance Measures



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2009 REVISIONS

- Surprise Examinations
 - ▣ Exceptions
- Internal Control Reports
- Examinations by PCAOB-Registered Firm

Compliance Measures



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COMPLIANCE DATES

- ❑ Legends for supplemental statements
- ❑ Surprise examination
- ❑ Internal control report
- ❑ Audits of pooled investment vehicles
- ❑ Form ADV

Compliance Measures



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FTC RED FLAGS RULE

- ❑ Identify relevant patterns, practices, and specific forms of activity that are “red flags” signaling possible identity theft
- ❑ Incorporate red flags, along with means for detection, into a written program
- ❑ Prevent and mitigate identify theft by responding appropriately to any red flags detected
- ❑ Update the program periodically to reflect changes in risks from identity theft



Compliance Measures



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STANDARD FOR THE PROTECTION OF PERSONAL INFORMATION OF RESIDENTS OF THE COMMONWEALTH

- ❑ Adopt and implement a written privacy program
- ❑ Designate one or more employees to maintain the program
- ❑ Identify and assess reasonably foreseeable internal and external risks to the security, confidentiality or integrity of any electronic, paper or other records containing personal information
- ❑ Develop security policies for employees relating to the storage, access and transport of records containing personal information outside of business premises
- ❑ Take reasonable steps to select and retain third-party service providers capable of maintaining appropriate security measures to protect such personal information
- ❑ Implement reasonable restrictions on physical access to records containing personal information



Compliance Measures



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DEVELOP AN INFORMATION SECURITY POLICY

- ❑ Security of hard copy documents
- ❑ Security of electronic documents
- ❑ Transmission or receipt of nonpublic information
- ❑ Protection of portable resources
- ❑ User authentication requirements
- ❑ Computer/network security

Compliance Measures



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ACTION ITEMS

- Custody
 - ▣ Review which portions of the rule the firm is subject to and ensure compliance with those necessary
- FTC Red Flags Rule
 - ▣ Adopt and implement a program by June 1, 2010
- Standards for the Protection of Personal Information of Residents of the Commonwealth
 - ▣ Adopt and implement a program; if already adopted, ensure program is adequate to comply with the regulation



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