



Insights: Alerts

Investment Management Regulation: Year in Review

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As we prepare for a new year of regulatory initiatives and actions, we believe it is important to take inventory of the most significant regulatory events from the past year. True to its word, the SEC focused on reducing unnecessary regulatory burdens and increasing its efforts to protect unsophisticated investors. We believe the SEC will remain dedicated to its stated priorities and continue the initiatives it began in 2018. As preparation for the year ahead, we invite you to review a summary of regulatory initiatives and actions from the past year.

SEC Enforcement Results and 2019 Priorities

On November 2, 2018, the SEC announced the results of its enforcement actions for fiscal year 2018 and stated its enforcement priorities for fiscal year 2019. The past year's enforcement actions focused on both new concerns (e.g., Initial Coin Offerings) and traditional focuses (e.g., investment adviser fee calculations) of the SEC. For the current fiscal year, the SEC will continue to be guided by five core principles: (1) a focus on Main Street (i.e., unsophisticated) investors; (2) a focus on individual (as opposed to organizational) accountability; (3) keeping pace with technological changes; (4) imposing sanctions that most effectively further enforcement goals; and (5) assessing the allocation of resources.

You can learn more about the SEC's enforcement actions and priorities by reading our [previously published article](#).

SEC Scrutiny of Share Class Selection Practices Continues

Last February, the Division of Enforcement of the SEC launched the Share Class Selection Disclosure Initiative. The initiative enabled registered investment advisers to self-report their failure to disclose certain mutual fund share class selection practices on their Form ADVs in return for a settlement with the SEC that, among other things, would not include civil penalties. The initiative ended on June 12, 2018, but the Division of Enforcement has stated that it will continue to make mutual fund share class selection practices a priority.

You can learn more about the SEC's scrutiny of share class selection practices by reading our [previously published article](#).

Opportunity Zones

Last year's Tax Cuts and Jobs Act created an incredible opportunity for private fund managers: the "Opportunity Zone Program." Congress enacted the Opportunity Zone Program to encourage long-term investments in low-income communities designated as "opportunity zones" by state governments. Essentially, the program allows

investors to (1) defer paying taxes on capital gains by re-investing the gains in qualified opportunity funds, and (2) exclude from the calculation of taxable gross income any gains recognized from investments in qualified opportunity funds that are held for more than ten years. Qualified opportunity funds present an exciting opportunity for private fund managers.

You can learn more about the Opportunity Zone Program by reading our [previously published white paper, article](#), and [list of Opportunity Zone key features](#).

Clarifying the Single Issuer Exemption for Broker-Dealers

On September 20th, the SEC released a proposed rule amending Rule 17a-5 of the Securities Exchange Act of 1934. Under Rule 17a-5(d)(1)(i)(C) of the Exchange Act, broker-dealers registered with the SEC generally must file an annual report that includes financial reports audited by an independent public accountant registered with the Public Company Accounting Oversight Board. Under the proposed rule, the audit requirement would not apply where a broker-dealer's business is "limited to acting as broker (agent) for a single issuer in soliciting subscriptions for securities of that issuer..." The proposed rule could be particularly helpful to private funds and their investment advisers, some of which have created broker-dealers for the express purpose of selling fund shares.

You can learn more about the single issuer exemption by reading our [previously published article](#).

OCIE Risk Alert Highlights Adviser Best Execution Deficiencies

On July 11th, the SEC's Office of Compliance Inspections and Examinations released a Risk Alert highlighting the most frequent compliance issues with respect to the duty to seek best execution. The Risk Alert identified the following issues as the most-observed deficiencies among over 1,500 adviser examinations:

- Advisers did not perform best execution reviews or could not demonstrate through documentation they performed such review.
- Advisers did not consider materially relevant factors during best execution reviews.
- Advisers used a single broker-dealer without comparison to other broker-dealers.
- Advisers did not provide full disclosure of their best execution practices and did not review trades to ensure the prices obtained fell within a reasonable range.
- Advisers did not provide full and fair disclosures of their soft dollar arrangements.
- Advisers did not make a reasonable allocation of the cost of mixed use products or services.
- Advisers had inadequate compliance policies and procedures with respect to best execution.
- Advisers were not following their own best execution policies and procedures.

You can learn more about the Risk Alert by reading our [previously published article](#).

Georgia Court Rules that the Terms of Employment Agreements Trump the Broker Protocol

On June 27th, the Court of Appeals of the State of Georgia issued an opinion in *HA&W Capital Partners LLC et al v. Bhandari et al* that will have significant implications of Georgia-based investment advisers and potentially for advisers outside the state as well. At issue in the case was whether four investment advisers leaving their employer, which was a signatory to the Protocol for Broker Recruiting (the "Broker Protocol"), were required to provide notice of their departure pursuant to terms in their respective employment agreements or whether the terms of the Broker Protocol rendered those notice terms invalid. The court held that "the protocol does not

categorically invalidate notice provisions in employment agreements.” Ultimately, the opinion may lead to additional deterioration of the Broker Protocol and return to the primacy of individual contracts in regulating adviser migration between firms.

You can learn more about the employment agreements and the Broker Protocol by reading our [previously published article](#).

Amendments to the Liquidity Rule

On June 28, 2018, the SEC finalized an amendment to the Liquidity Rule replacing the so-called “bucket approach”. Instead, funds were required to discuss the operation and effectiveness of its liquidity risk management program in its annual report. The SEC replaced the bucket approach because classifying assets is inherently subjective and the bucket approach did not provide investors the necessary context to understand how the classification relates to the fund's liquidity and risk management. The SEC believes a narrative description in the fund's annual report will “better inform investors of how the fund's liquidity risk and liquidity risk management practices affect their investment.”

You can learn more about the amendments to the Liquidity Rule by reading our [previously published article](#).

SEC Launches Howey Coins Website

The SEC has consistently demonstrated concern over the marketing of cryptocurrency trading and investments in initial coin offerings (“ICOs”), which SEC Chairman Jay Clayton has called “fertile ground for bad actors to take advantage of our Main Street investors.” On May 18th, to illustrate the ways in which “bad actors” operate, the SEC's Office of Investor Education and Advocacy created a website promoting fictional Howey Coins. The website included red flags commonly seen in ICO promotions: guaranteed returns, special entry rates, claims of special (albeit secret) partnerships, and celebrity endorsements.

You can learn more about the Howey Coins website and the SEC's views towards ICOs by reading our [previously published article](#).

SEC Proposes Regulation Best Interest

On May 9, 2018, the SEC released its much-anticipated proposed rule (“Regulation Best Interest”), which is intended to set the standard of conduct for broker-dealers and displace the Department of Labor's so-called “Fiduciary Rule”. As anticipated, the SEC did not hold broker-dealers and their associated persons to a fiduciary standard. Instead, Regulation Best Interest would require the broker-dealer “to act in the best interest of the retail customer at the time the recommendation is made without placing the financial interest of the broker-dealer or natural person that is an associated person making the recommendation ahead of the interest of the retail customer.”

You can learn more about Regulation Best Interest by reading our [previously published article](#).

SEC Proposed Rules to Help Distinguish Between Advisers and BDs

On April 18, 2018, the SEC issued proposed rules which would require investment advisers and broker-dealers to provide summary disclosure documents to new retail investors. The documents would inform investors of, among other items: (i) the relationship and services the firm offers to retail investors, (ii) the standard of conduct and the fees associated with those services, (iii) conflicts of interest, and (iv) comparisons of brokerage and investment advisory services (for standalone investment advisers and broker-dealers). The proposed rules

would also prohibit broker-dealers from using certain confusing terms to describe themselves and their representatives, like “adviser” or “advisor” as part of a name or title.

You can learn more about the proposed rule by reading our [previously published article](#).

OCIE Issues Adviser Fees and Expenses Risk Alert

On April 18, 2018, the SEC's Office of Compliance Inspections and Examinations released a Risk Alert on the most frequent compliance issues relating to advisory fees and expenses. The Risk Alert identified the following six compliance issues as the most observed deficiencies related to fees and expenses:

- Advisers using a metric or process to value a client's account that was different from the metric or process stated in the advisory agreement;
- Advisers billing fees in advance or with improper frequency;
- Advisers applying an incorrect fee rate when calculating advisory fees for certain clients;
- Advisers failing to apply discounts or rebates in the manner described in the advisory agreement;
- Advisers using Form ADV Part 2 disclosures that were inconsistent with the adviser's actual practice; and
- Private and registered fund advisers misallocating expenses to clients in contravention of advisory agreements, operating agreements and disclosure documentation

You can learn more about the Risk Alert by reading our [previously published article](#).

SEC Issues Cybersecurity Guidance

On February 21, 2018, the SEC released an interpretative guidance on public company cybersecurity disclosures (the “2018 Guidance”) that reinforced and expanded guidance issued in 2011. The 2018 Guidance reminds companies that current SEC disclosure requirements include the obligation to disclose cybersecurity risks and incidents. The 2018 Guidance also describes certain factors companies should consider when determining whether a cybersecurity risk or incident is material. These factors include the importance of the compromised information, impact on company operations, and range of harm an incident may cause. The 2018 Guidance states that companies should provide useful information to investors while cautioning that companies must avoid both overly detailed disclosures that could compromise their cybersecurity efforts and disclosures that are too generic. The obligations and considerations detailed in the 2018 Guidance are envisioned to fit within a comprehensive compliance program. To that end, companies should have “comprehensive policies and procedures related to cybersecurity” and “assess their compliance regularly.”

You can learn more about the 2018 Guidance by reading our [previously published article](#).

FINRA Proposed Rules Friendly to RIAs

In February, FINRA proposed a rule addressing FINRA-registered broker-dealer's responsibilities to supervise the outside business activities of their registered representatives. According to FINRA, the proposed rule is “intended to reduce unnecessary burdens while strengthening investor protections relating to outside activities.” The proposed rule eliminates broker-dealer's ongoing supervision requirements with respect to their registered representative's investment advisory activities, including serving as investment adviser representatives of registered investment advisers. The proposed rule also eliminates various supervisory requirements of broker-dealers over such registered representatives.

You can learn more about the proposed rule by reading our [previously published article](#).

As always, please feel free to contact a member of the [Investment Management Team](#) if you have any questions about the topics we have introduced or investment management and broker-dealer regulation more generally.

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