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Webinar: SEC Compliance Program for European Investment Advisors

13th September 2016

“We believe that great governance is at the heart of great business, helping to protect and promote your reputation”.

Brian Fahey, CEO, TerraNua

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SEC Compliance Program for European Investment Advisors

13 September 2016

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Today's Agenda

1. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.
2. Compliance Program: Required Books and Records.
3. Preparing for an SEC examination and relevant SEC enforcement actions.

Polling Question 1:

My adviser is

- 1) an investment advisory firm organized outside the U.S. which is not registered with the SEC (e.g., relying on an exemption from registration);
- 2) an investment advisory firm organized outside the U.S. which is registered with the SEC, or
- 3) an investment advisory firm organized in the U.S., or
- 4) I represent a client who manages U.S. clients assets.

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.

An **Investment Adviser** is defined as:

Any person who, for **compensation**, engages **in the business** of **advising** others, either directly or through publications or writings, as to the value of **securities** or as to the advisability of investing in, purchasing, or selling **securities**, or who, for compensation and as part of a **regular business**, issues or promulgates analyses or reports concerning securities. See *Section 202(a)(11) of the Investment Advisers Act of 1940*.

Each Element of the definition (all broadly defined):

- (i) *In the business;*
- (ii) *of advising others;*
- (iii) *concerning securities; and*
- (iv) *for Compensation.*

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.



U.S. Jurisdictional Means?

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.

U.S. Jurisdictional Means:

Section 203(a) of the U.S. Investment Advisers Act of 1940 prohibits an investment adviser from making use of *the mails or any means or instrumentality of interstate commerce* (“jurisdictional means”) in connection with its business as an investment adviser unless the adviser is registered with the U.S. Securities and Exchange Commission (“SEC” or the “Commission”) under the Advisers Act or qualifies for an exemption from registration.

***Website** viewable from “inside” the United States?

****Suggestion**: At a minimum add a disclaimer on the homepage stating that the content and information provided on this website is not intended for U.S. Persons nor is it intended as an offer or solicitation of an offer to provide advisory or broker-dealer services to any person or entity inside the United States.

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.

Regulatory Definition of U.S. Person

"U.S. Person" is defined as:

- ❖ Any natural person *resident* in the United States;
- ❖ Any partnership or corporation organized or incorporated under the laws of the *United States*;
- ❖ Any estate of which any executor or administrator is a *U.S. person*;
- ❖ Any trust of which any trustee is a *U.S. person*;
- ❖ Any agency or branch of a foreign entity *located in the United States*;
- ❖ Any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a *U.S. person*;
- ❖ Any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) *resident in the United States*; and
- ❖ Any partnership or corporation if:

A. Organized or incorporated under the laws of any foreign jurisdiction; and

B. *Formed by a U.S. person* principally for the purpose of investing in securities not registered under the Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501 (a)) who are not natural persons, estates or trusts.

See Regulation S – Rule 902(k)

Tax Definition of U.S. Person

"U.S. Person" is defined as:

- ❖ A *citizen* or *resident* of the United States,
- ❖ A partnership created or organized in the United States or under the law of the United States or of any State,
- ❖ A corporation created or organized in the United States or under the law of the United States or of any State, or
- ❖ Any estate or trust other than a foreign estate or foreign trust (see also, *Court Test* and *Control Test*).

See Internal Revenue Code Section 7701

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.

“U.S. Person” Definition under the Investment Advisers Act of 1940:

The Advisers Act does not define “U.S. person” and the SEC has not formally adopted any such definition under the Advisers Act.

Rule 203(m)-1. In 2011, to enforce the provisions under the Dodd-Frank Act (2010), the SEC adopted two new rules, Rule 203(m)-1(d)(8) and 202(a)(30)-1(c)(3), both of which define “U.S. Person” by general reference to Regulation S (making a special exception for discretionary accounts).

“U.S. Person” is also defined in the Glossary to Form ADV and in the Glossary to Form PF both by referencing Rule 203(m)-1 (adopted in June 2011).

Timing. When Adopting Rule 203(m)-1, the SEC stated: “We are adding a note to rule 203(m)-1 that clarifies that a client will not be considered a United States person if the client was not a United States person at the time of becoming a client of the adviser. This will permit a non-U.S. adviser to continue to rely on rule 203(m)-1 if a non-U.S. client that is not a private fund, such as a natural person client residing abroad, relocates to the United States or otherwise becomes a United States person. As one commenter recognized, this also will establish similar treatment in these circumstances for non- U.S. advisers relying on rule 203(m)-1 or the foreign private adviser exemption ...”

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.

SEC announces the “Conduct & Effects” Test in 1992:

SEC regulates only the activity of non-U.S. advisers where advisory conduct occurs in the U.S., even if the conduct has no effect on U.S. persons or markets, or where the activity outside the U.S. produces substantial and foreseeable effects in the U.S.

In Gim-Seong Seow (SEC Staff No-Action Letter, Nov. 30, 1987) the SEC concluded that:

A “foreign adviser to foreign clients may, without registering under the Advisers Act, use **U.S. jurisdictional means** to acquire information about securities of United States issuers, and **effect transactions** in securities of United States issuers through United States brokers or dealers, for the benefit of the adviser's clients.”

In 2011, when Adopting Rule 203(m)-1, the SEC stated:

The rule reflects our long-held view that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and that this territorial approach is in keeping with general principles of international comity.

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.



SEC Charges Major Portuguese Bank for Violating Registration Provisions of U.S. Securities Laws

Banco Espirito Santo S.A. to Pay Nearly \$7 Million to Settle Charges

"The registration provisions are core safeguards of the integrity of our securities markets and the financial institutions that act as gatekeepers of those markets," said George S. Canellos, Director of the SEC's New York Regional Office. "BES brazenly ignored those provisions over the course of many years by acting as an investment adviser and broker-dealer without registration and by offering and selling securities to members of the U.S. public without any of the disclosures required by the law."

Sanjay Wadhwa, Associate Director of the SEC's New York Regional Office, added, "Foreign entities seeking to provide financial or securities-related services in the U.S. must familiarize themselves with the statutory and regulatory framework in this arena. A failure to do so, as was the case here, can be a costly misstep."



U.S. SECURITIES AND
EXCHANGE COMMISSION

Press Release

Credit Suisse Agrees to Pay \$196 Million and Admits Wrongdoing in Providing Unregistered Services to U.S. Clients

FOR IMMEDIATE RELEASE
2014-39

Washington D.C., Feb. 21, 2014 — The Securities and Exchange Commission today announced charges against Zurich-based Credit Suisse Group AG for violating the federal securities laws by providing cross-border brokerage and investment advisory services to U.S. clients without first registering with the SEC.

Credit Suisse agreed to pay \$196 million and admit wrongdoing to settle the SEC's charges.

laws. Credit Suisse relationship managers traveled to the U.S. to solicit clients, provide investment advice, and induce securities transactions. These relationship managers were not registered to provide brokerage or advisory services, nor were they affiliated with a registered entity. The relationship managers also communicated with clients in the U.S. through overseas e-mails and phone calls.

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.



- wsroom
- Press Releases
- Public Statements
- Speeches
- Testimony
- Spotlight Topics
- Media Kit
- Events
- Broadcasts
- What's New
- Special Studies
- Podcasts
- Social Media

PRESS RELEASE

SEC Charges 32 Defendants in Scheme to Trade on Hacked News Releases

Hackers, Traders Allegedly Reaped More Than \$100 Million of Illegal Profits

**FOR IMMEDIATE RELEASE
2015-163**

Washington D.C., Aug. 11, 2015 — The Securities and Exchange Commission today announced fraud charges against 32 defendants for taking part in a scheme to profit from stolen nonpublic information about corporate earnings announcements. Those charged include two Ukrainian men who allegedly hacked into newswire services to obtain the information and 30 other defendants in and outside the U.S. who allegedly traded on it, generating more than \$100 million in illegal profits.

The SEC’s complaint unsealed today was filed under seal on August 10 in U.S. District Court in Newark, N.J., and the court entered an asset freeze and other preliminary relief that day.

“This international scheme is unprecedented in terms of the scope of the hacking, the number of traders, the number of securities traded and profits generated,” said Securities and Exchange Commission Chair Mary Jo White. “These hackers and traders are charged with reaping more than \$100 million in illicit profits by stealing nonpublic information and trading based on that information. That deception ends today as we have exposed their fraudulent scheme and frozen their assets.”

I. Definitions: Investment Adviser, U.S. Jurisdictional Means, and U.S. Person.

Non-U.S. Investment Advisers with U.S. and non-U.S. Clients:

In a long-line of SEC no-action letters issued in 1992 (commonly referred to as the “Unibanco Letters”), the SEC staff confirmed that it would not apply the Advisers Act to an SEC registered, non-U.S. adviser, with respect to the non-U.S. adviser’s non-U.S. clients, e.g., the delivery of the firm’s brochure (Form ADV Part 2) is not required to be delivered to the firm’s non-U.S. clients.

However, the SEC does impose certain “*recordkeeping*” requirements on non-U.S. advisors as they relate to their non-U.S. clients. Under exam, the SEC’s staff will review certain activities of non-US advisers in order to determine the impact of such activities on the non-U.S. advisers’ U.S. clients, e.g., *monitor the trading activities of the non-U.S. clients vs. U.S. clients to determine potential front-running. See SEC Release No. IA-3222.*

II. Compliance Program: Required Books and Records

SEC Inspection Powers:

The SEC's *power to inspect* the records of an RIA was upheld in SEC v. Olsen, 354 F.2d 166 (2d Cir. 1965).

The SEC has taken the position that its examination authority “is *unconditional* except for the requirement that the examination be reasonable”.

SEC Examination of non-U.S. advisers: In 2010, the Dodd-Frank Act confirmed that an adviser that is registered with the SEC, and has its principal office and business outside the United States, is subject to examination by the SEC. See *Section 214(b) of the Dodd-Frank Act*.

II. Compliance Program: Required Books and Records



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- Feeds ▶

PRESS RELEASE

SEC Charges Investment Adviser With Failing to Adopt Proper Cybersecurity Policies and Procedures Prior To Breach

FOR IMMEDIATE RELEASE 2015-202

Washington D.C., *Sept. 22, 2015* – The Securities and Exchange Commission today announced that a St. Louis-based investment adviser has agreed to settle charges that it failed to establish the required cybersecurity policies and procedures in advance of a breach that compromised the personally identifiable information (PII) of approximately 100,000 individuals, including thousands of the firm’s clients.

The federal securities laws require registered investment advisers to adopt written policies and procedures reasonably designed to protect customer records and information. An SEC investigation found that R.T. Jones Capital Equities Management violated this “safeguards rule” during a nearly four-year period when it failed to adopt any written policies and procedures to ensure the security and confidentiality of PII and protect it from anticipated threats or unauthorized access.

II. Compliance Program: Required Books and Records

SEC Enforcement Action on Cybersecurities (Release 2015-202, Sep. 22, 2015):

“As we see an increasing barrage of cyber attacks on financial firms, it is important to enforce the safeguards rule even in cases like this when there is *no apparent financial harm to clients*,” said Marshall S. Sprung, Co-Chief of the SEC Enforcement Division’s Asset Management Unit. “Firms must adopt written policies to protect their clients’ private information and they need to anticipate potential cybersecurity events and have *clear procedures in place* rather than waiting to react once a breach occurs.”

III. Preparing for an SEC examination and relevant SEC enforcement actions

BEING PREPARED BEFORE AN SEC EXAMINATION

- ❖ Form ADV 1 and 2 and Form PF as sources of investigative target;
- ❖ Should have a professionally written ADV 2 especially description of compliance;
- ❖ Descriptions in Form ADV may dissuade SEC from examination: assets under management; whether affiliated with other financial institutions; background of chief compliance officer; wrap fee; affiliated custodian;
- ❖ SEC examination may derive from specific focus on issue, media stories, sourced from another examination or investigation, presence in US with offices, coordination with local regulator;
- ❖ Being prepared to produce documents by reviewing standard SEC document request lists;
- ❖ Prepare opening presentation materials; and
- ❖ Inform employees on what to expect.

III. Preparing for an SEC examination and relevant SEC enforcement actions

Polling Question 2:

Have you conducted an annual compliance review that is documented in writing?

Yes

No

Conducted but not in writing

III. Preparing for an SEC examination and relevant SEC enforcement actions

HANDLING THE EXAMINATION

- ❖ Types of Examinations: Sweep, Presence, Cause, Full
- ❖ Notice of date of onsite examination
- ❖ Receipt of document request list
- ❖ Production of documents to SEC secure server
- ❖ Onsite visit
- ❖ Handling the SEC examiners: tour of office, opening presentation by most senior officers, friendly and open coordination with CCO, demonstrate culture of compliance.
- ❖ Interviews
- ❖ Additional document requests
- ❖ Closing meeting
- ❖ Deficiency Letter

III. Preparing for an SEC examination and relevant SEC enforcement actions

Polling Question 3:

Is your compliance manual developed particular for your firm or borrowed?

Particular

Borrowed

III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC EXPECTS CERTAIN COMPLIANCE POLICIES AND PROCESSES

- ❖ Compliance manual and policies and procedures prepared specifically for the adviser--
-not off the shelf
- ❖ Code of Ethics
- ❖ Risk matrix
- ❖ AML procedures
- ❖ Cyber security and procedures business continuity written procedures
- ❖ Trade blotter
- ❖ Trade allocation
- ❖ Written annual compliance review report
- ❖ Required books and records

III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC Hot Button Issues

- ❖ Culture of Compliance: CCO role in firm and involvement of senior management
- ❖ Insider Trading: Remains a continuing focus and is applicable for all US advisers and also anyone who trades in US markets.
- ❖ Wrap Fees: Does the wrap fee justify the wrap fee payment?
- ❖ Cyber Security: A priority for past few years as SEC believes that advisers need to to protect information and their on-line systems from cyber threats.
(Review the SEC September 2015 Cyber Examination Initiative document to be able to respond to the questions. <https://www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf>)
- ❖ Conflicts of Interest: Between clients and firm and principals; among clients; between clients and adviser's affiliated entities.
- ❖ Third Party Vendors: Selection and monitoring. Do you monitor clients' custodian especially if an affiliated entity?
- ❖ Marketing and Performance: Accuracy

III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC ENFORCEMENT ACTIONS AGAINST NON-US PERSONS

The SEC obtained an emergency court order on February 15, 2013 to freeze assets in a **Zürich, Switzerland**-based trading account that was used to reap more than \$1.7 million from trading in advance of the February 14, 2013 public announcement about the acquisition of H.J. Heinz Company. The SEC alleges that the unknown traders were in possession of material nonpublic information about the impending acquisition when they purchased out-of-the-money Heinz call options the day before the announcement. The timing and size of the trades were highly suspicious because the account through which the traders purchased the options had no history of trading Heinz securities in the last six months. Overall trading activity in Heinz call options several days before the announcement had been minimal. The action was brought against unknown traders.

<https://www.sec.gov/News/PressRelease/Detail/PressRelease/136517151284>
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III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC ENFORCEMENT ACTIONS AGAINST NON-US PERSONS

The SEC filed an emergency action in the United States District Court for the Southern District of New York on July 25, 2008 against one or more unknown purchasers of the call options for the common stock of DRS Technologies, Inc. and American Power Conversion Corp. ("Unknown Purchaser"). The Commission's complaint alleges that the Unknown Purchaser reaped more than \$3 million in profits by engaging in illegal insider trading, prior to announcements related to the acquisitions of DRS and APCC, through an account with UBS AG ("UBS"). The matter was subsequently settled with Gianluca Di Nardo, an **Italian** citizen, and his investment vehicle.

<https://www.sec.gov/news/press/2008/2008-149.htm>

III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC ENFORCEMENT ACTIONS AGAINST NON-US PERSONS

The SEC on August 23, 2010 obtained a final judgment the United States District Court for the Southern District of New York against the founder and former CEO of Escala Group, Inc., Gregory Manning ("Manning"), 64, who was charged, along with then-NASDAQ National Market issuer Escala Group, Inc. ("Escala"), and former CFO Larry Lee Crawford, 62, with disclosure and accounting fraud violations concerning related party transactions between Escala and its parent company, Afinsa Bienes Tangibles, S.A. ("Afinsa"). Escala, now known as Spectrum Group International, Inc., was a network of companies in the collectibles market specializing in stamps. Afinsa was a privately held **Spanish** company that sold investments in portfolios of stamps in Europe. The Commission's complaint, filed on March 23, 2009, and amended on August 28, 2009, among other things, alleged a fraudulent business scheme based upon the secret and dramatic manipulation of collectible stamp values.

<https://www.sec.gov/litigation/litreleases/2011/lr22095.htm>

III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC ENFORCEMENT ACTIONS AGAINST NON-US PERSONS

In July 2009, the SEC filed an emergency action against Gregory Bell and his firm Lancelot Investment Management, LLC that charged them with misleading investors into investing more than \$2 billion in hedge fund assets while pocketing millions of dollars in fraudulent fees at the expense of investors in the funds. The SEC obtained an asset freeze and other emergency relief against Bell and his firm and repatriated \$15 million of investors' money from **Switzerland** that Bell had misappropriated and placed in a Cook Islands Trust.

Bell, Lancelot Management, and the hedge funds they manage have never been registered with the SEC or any other regulatory agency.

In addition, as a result of a separate action by the United States Attorney, District of Minnesota, on September 30, 2010 Gregory Bell, was sentenced to 72 months in prison, with credit for the 14 months he had served since his arrest in July 2009. U.S.A. v. Bell, 09-cr-00269.

III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC ENFORCEMENT ACTIONS AGAINST NON-US PERSONS

The SEC alleged on September 26, 2013 that ChinaCast Education Corp (“ChinaCast”)’s former president for operations in **China** avoided more than \$200,000 in losses by illegally selling approximately 50,000 ChinaCast shares after participating in the ownership transfer of one of the company’s revenue-generating colleges before it was publicly disclosed by a new management team. ChinaCast had a market capitalization of more than \$200 million before these alleged frauds came to light. After the President and Chairman/CEO were terminated and their misconduct was publicly disclosed by new management.

<https://www.sec.gov/News/PressRelease/Detail/PressRelease/137053984444>

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III. Preparing for an SEC examination and relevant SEC enforcement actions

SEC ENFORCEMENT ACTIONS AGAINST NON-US PERSONS

The SEC on July 30, 2013 charged a former high-ranking official at Madrid-based Banco Santander, S.A. and a former judge in **Spain** with achieving illicit profits of \$ 1 million from insider trading based on non-public information about a proposed acquisition for which the Spanish investment bank was acting as an advisor. An executive advisor to Banco Santander's CEO learned confidentially that the investment bank had been asked by one of the world's largest mining companies to advise and help underwrite its proposed acquisition of one of the world's largest producers of fertilizer minerals. Ahead of the public announcement he and his friend purchased contracts-for-difference ("CFD"s), which were highly leveraged securities not traded in the U.S., but based on the price of U.S. exchange-listed Potash stock. not traded in the U.S., but based on the price of U.S. exchange-listed Potash stock.

<https://www.sec.gov/News/PressRelease/Detail/PressRelease/137053973746>

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RECENT SEC ENFORCEMENT ACTIONS

On July 14, 2016, the SEC found that RiverFront Investment Group, an investment adviser, disclosed to investors that client trades were typically executed through the sponsoring broker (so the wrap fee would cover the transaction costs) but in practice it executed the majority of its wrap program trading through other brokers resulting in additional costs to clients for those transactions. RiverFront's Forms ADV did not adequately address these additional costs, nor the frequency by which the additional costs occurred, and were, therefore, determined by the SEC to be insufficient and materially misleading. The SEC's order against RiverFront concluded that the firm violated Sections 207 (for making an untrue statement of a material fact) and 204 of the Investment Advisers Act of 1940 and Rule 204-1(a) (for not amending Form ADV when it becomes inaccurate). <https://www.sec.gov/news/pressrelease/2016-143.html>

On July 26, 2016, the SEC brought an enforcement action against State Street Bank and Trust Company ("State Street") for misleading its clients about its foreign currency exchange markups, telling some clients that it guaranteed the most competitive rates available on their foreign currency exchange trades, provided best execution, or charged market rates on the transactions. Instead, the SEC investigation found that State Street set prices largely driven by predetermined, uniform markups and made no effort to obtain the best possible prices for these clients. <https://www.sec.gov/news/pressrelease/2016-152.html>

III. Preparing for an SEC examination and relevant SEC enforcement actions

SUPERVISORY ARRANGEMENTS WITH THE EU AND THE EEA

Although the SEC has had cooperation arrangements with non-U.S. financial regulators for many years SEC specifically in 2013 announced supervisory arrangements with financial regulators of the member states of the European Union (EU) and the European Economic Area (EEA). The SEC's enforcement cooperation arrangements encompass partnerships with approximately 80 jurisdictions via bilateral Memorandum of Understanding ("MOU"s) and a Multilateral MOU under the auspices of the International Organization of Securities Commissions. Supervisory cooperation involves ongoing sharing of information on day-to-day operations of regulated entities, while enforcement cooperation helps the SEC collect information abroad to investigate potential violations of federal securities laws and to compensate securities fraud victims when possible.

Synchronize competing demands



Highlights

- Manage by alerts not reports
- Dashboards deliver greater ov
- Custom questionnaire builder
- Continuous updates to the so
- Enhanced control
- 100% data capture
- 24/7/365 support
- Scalable into the future



Q & A



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