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INSIDE...

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RIA CCO charged with misleading investors, diverting cash

Investors were told their funds would be placed in safe vehicles, like **Burger King** restaurant franchises and real estate. The **SEC** claims the president/CCO of **Sentinel Investment Management** ($59M in AUM) in New York actually mismanaged and commingled their funds, took improper withdrawals and spent at least $1.4 million on luxuries like an apartment on Fifth Avenue, a home in the Hamptons and fancy cars.

As the alleged scheme crashed, President/CCO **William Landberg** sent a desperate e-mail to his co-defendant **Kevin Kramer**, president/COO of an affiliated firm **West End**. The e-mail noted the firm needed $1.7 million fast or "we are dead meat."

Meantime, the SEC alleges, Kramer appeared on *Fox Business News* and "trumpeted the safety" of the investments when he knew the fund was collapsing. Landberg may have lured 94 investors to fork over $66.7 million, the agency claims. The phone number to Sentinel was temporarily out of order. At least six other defendants are also charged in the case.

More on self-reported case

The SEC recently announced a settlement with two former portfolio managers, **Kimball Young** and **Thomas Albright** for improperly charging assessments to municipal bond issuers disguised as credit monitoring fees. Young tells **IA Watch** prior management were aware of and had approved his receiving the charges. Young admits the previous manager denies this. Young reported

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SEC study on RIA exams gives Congress three options, including an SRO

Congress can improve examinations of investment advisers by either permitting the **SEC** to impose user fees on advisers, allowing for the creation of one or more SROs or giving **FINRA** the right to examine dually registered firms under the Advisers Act.

These are the three options outlined in the 40-page *Study on Enhancing Investment Adviser Examinations* released by the agency Jan. 19. It's described as the work of SEC staff and not the Commission. Commissioner **Elisse Walter**, a former FINRA executive and a strong supporter of the SRO approach, took the unusual step of issuing a statement critical of the staff's study. "I am quite disappointed with the result," she writes. "Unfortunately, the study's description and weighing of the alternatives is far from balanced or objective …. The study does not lay out the variety of viewpoints regarding

(SRO Study, continued on page 2)

New GIPS changes take effect; April compliance deadline looms for many

This is a big year for your firm if it claims compliance with GIPS standards. Every five years the **CFA Institute** updates its voluntary Global Investment Performance Standards to reflect industry changes and its latest version, GIPS 2010, went into effect this month (**IA Watch**, Feb. 22, 2010).

Many of the changes will have you recalling what the **SEC** did after the financial crisis – focus on asset verification, encourage valuation of hard-to-value assets and mandate additional disclosures. The new GIPS standards heed many of the lessons afforded by the crisis.

The new standards "shouldn't scare anybody," says **Karyn Vincent**, founder of **Vincent Performance Services** in Portland, Ore. "It really should not be that overwhelming."

They're "more of an evolution and not a revolution," describes **Neil Riddles**, principal of **Riddles Investment Consulting** in Pompano Beach, Fla. Click here for a red-lined version of the standards, which graphically show what's new and revised.

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SRO Story (Continued from page 1)

the SRO option" (see the story on the next page).

The study chronicles years of explosive growth in the numbers of RIAs – they even grew every year of the great recession – while OCIE shrunk. It concludes "the number of OCIE staff is unlikely to keep pace with the growth" of RIAs.

Although the movement of a newly estimated 3,350 RIAs from SEC registration – currently more than 11,000 – to the states later this year "could enable more frequent" exams of RIAs the study concluded that "in the near term" it won't be enough.

Even if Congress provided more money to the SEC, the cash would continue to be insufficient given the agency's many new regulatory responsibilities under Dodd-Frank and the expanding the numbers of RIAs. The new duties include additional oversight of municipal advisers, swap entities, clearing firms and credit rating agencies. "OCIE already has begun to re-assign staff to new program areas" because of these new duties, the study notes.

Long-time observers will recognize two of the options discussed in the study. For instance, RIA user fees were first proposed in 1992 (**IA Watch**, Oct. 19, 2009). The idea of an SRO for advisers dates back more than 45 years. SEC staff shared the pros and cons of each option.

1. Impose RIA user fees

"User fees also would shift the cost of regulation to the advisers themselves. Registered investment advisers currently bear little of the cost of their regulatory oversight as compared to other groups of participants in the financial services markets," according to the study. User fees also "may be a less expensive option than an SRO" and would continue to harness the experience and expertise of OCIE staff.

2. Approve one or more SROs

SEC staff recognize the "strong opposition" in some quarters to this idea and "tensions about the prospect of FINRA" being the SRO, not to mention the costs. It also warns this option may lead to "industry capture," referring to bias created by the industry funding the SRO and also dominating its governance. Establishing multiple SROs could cause advisers to shop for a regulator or weaken the SROs as they compete to attract members. For an SRO to work, membership must be mandatory, the study observes.

3. Appoint FINRA to examine dual registrants

The pro here being the simplicity for a dually registered firm; it need report to only one regulator. The option also steers clear of the inherent controversy in extending FINRA oversight to all advisers. About 5% of advisers are also brokers, the study notes.

Walter hailed the SRO model as having "benefitted regulation … for more than seven decades." She doesn't call on FINRA to be the SRO for advisers but lays out statistics demonstrating that it examines far more firms annually than the SEC does.

"We need to address this issue now. It must not be relegated to another day – as has happened in the past. For far too long, in the investment advisory area, the Commission has been unable to perform its responsibilities adequately to fulfill its mission as the investor's advocate, and investment advisory clients have not been adequately protected. This must change," Walter writes. The issue now gets handed to a divided Congress to decide. ■

This story first appeared as breaking news at www.iawatch.com on Jan. 19. ■

Groups offer varying reactions to SEC's IA exam study

The **SEC**'s study giving Congress three options to enhance RIA exams contains a little bit for everybody (see story, p. 1). It also gives industry groups an excuse to repeat their oft-expressed positions for or against an SRO.

Investment Adviser Association Executive Director **David Tittsworth** critiques the study as "interesting and balanced." IAA opposes an SRO for advisers. Tittsworth found that the "report appears to find the greatest number of advantages, and the least number of disadvantages, with regard to user fees."

It would have been preferable had the SEC "more strongly endorsed" the user fees option, offers **Diahann Lassus**, the past chair of the **National Association of Personal Financial Advisors**, speaking on behalf of the **Financial Planning Coalition**.

"The only option that addresses the serious regulatory gap that exists today is the authorization of an SRO to examine all SEC-registered investment advisers," states **Dale Brown**, president/CEO of the **Financial Services Institute**. The FSI endorses **FINRA** as the SRO for advisers. "The SRO option will close the regulatory gap." Brown also praised SEC Commissioner **Elisse Walter**'s comments about the study (see story, p. 1).

FINRA issued a statement that agrees "with the SEC that an SRO can augment government oversight programs through more frequent examinations …. Investors deserve the same level of protection regardless of whether they are dealing with a broker or investment adviser."

SIFMA expressed disappointment with the study. "It avoids addressing the fact that the SEC cannot currently fulfill its exam mandate for advisers, and that an SRO would greatly augment SEC oversight of advisers to retail investors. As the SEC looks to write a uniform fiduciary standard for brokers and advisers, it should ensure that standard includes comparable examination and oversight by an SRO," according to GC **Ira Hammerman**.

The study surprised **Blaine Aikin**, president and chief executive of **Fiduciary 360** in Bridgeville, Pa. He had braced for a report that would recommend an SRO as the only solution. "The SEC simply needs more cops on the beat to enforce it," he wrote on his blog.

"We share the SEC staff's concerns about the disadvantages inherent in allowing industry to regulate itself," said **NASAA**'s President and North Carolina Deputy Securities Administrator **David Massey**. "Now is not the time for Congress to consider outsourcing the SEC's regulatory authority."

The study pleased **Knut Rostad**, deputy CCO at **Rembert Pendleton Jackson** in Falls Church, Va. and a leader of **The Committee for the Fiduciary Standard** because it focused "on the need for additional funding and does not recommend outright an SRO."

No one wanted to predict what Congress would do beyond that lawmakers will hold hearings this year on the issue. ■

Mixed reviews greet GAO on regulation of financial planners

Last week, in a Dodd-Frank study on financial planners, the **GAO** recommended educational efforts, confirmed that consumers are confused about the role of financial planners, itemized how responsibility for planners is dispersed across regulators and reasoned that new regulation specifically for them isn't necessary.

Congress punted the issue to GAO in its Dodd-Frank debates last year (**IA Watch**, March 29, 2010). The new report, *Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain*, pleases some and angers others.

"This is a clear victory for investors," says **Financial Services Institute** President **Dale Brown**. "FSI agrees with the GAO that a separate regulator for financial planners wouldn't be sufficiently distinct from other regulated activities to justify itself."

"I'll never understand" how GAO reached its conclusion given consumer confusion, the current patchwork of regulation and the clear differences between financial planners and investment advisers, says **Nancy Hradsky**, special projects manager at the **National Association of Personal Financial Advisors** in Arlington Heights, Ill. "I think they listened too much to the naysayers."

Investment adviser issues examined

The GAO report addressed the issues of the day for advisers. Many financial planners are considered investment advisers by the **SEC** and 29 states. The SEC examines low-risk advisers "on average, every 12 to 15 years," GAO writes, in bringing up talk of an SRO for advisers. It also mentions much of the public mistakenly believe planners operate under a fiduciary duty standard.

"An investment adviser is different from a financial planner," implores Hradsky. "It's the difference between going to a doctor and going to a car dealer."

(Financial Planners, continued on page 4)

Financial Planners (Continued from page 3)

The GAO study finds "no specific, direct regulation" of financial planners but a mishmash including the SEC (via RIA registration), **FINRA** (planners who provide brokerage services) and state insurance regulators (for planners licensed to sell insurance). Insurance industry reps told GAO "a better alternative" to new regulation would be "increased enforcement of existing law."

GAO mentions four possible solutions: (1) create a board to oversee financial planners (2) increase oversight of investment advisers through the creation of an SRO (3) extend a fiduciary duty standard to financial planners and (4) clarify the standards and professional credentials of planners.

In the end it simply recommends that the **National Association of Insurance Commissioners** study the public's understanding of the standards of care for those selling insurance products and that the SEC include in its financial literacy campaign information about financial planners. ■

GIPS Changes (Continued from page 1)

Valuation

Valuation changes will be among the most challenging, although firms that have followed SEC advice to apply consistently their policies and procedures to value difficult securities will be fine. GIPS now wants these assets assessed at fair value, no easy task when prices are not readily available. That's when the firm's written P&Ps for valuation must kick in.

Also, firms may have excluded difficult-to-value assets from composites. The new standards insist they be added in if the portfolios that hold the assets are an actual account (not a model), include a management fee and are discretionary, says Vincent.

Firms that specialize in private equity and real estate will find numerous changes for them, notes Riddles. For instance, firms will have to calculate real estate portfolio returns quarterly.

The standards offer a hierarchy for valuation and **Coleman McKinstry**, manager of **ACA Deacon Verification** in Morristown, N.J., reminds that firms should adhere to its structure.

Performance advertising

Also new is the reporting of a three-year standard deviation in performance advertising, says **Harry Chaffee**, director at **Renaissance Regulatory Services**, Boca Raton, Fla. An exception applies if the data don't extend 36 months.

"There are lots of minor differences in the types of disclosures firms must make in their compliance presentations," adds Vincent. This presents an opportunity for CCOs to look at their firm's disclosures "with a fresh eye ... which I think a firm should do periodically anyway."

You're likely to find the task eased because the new version lumps all the disclosures into one area (Section 4: Disclosure), which acts like a handy checklist for CCOs, says Vincent.

Firms needn't comply with the new changes until after they've added 2011 data into their compliance presentations. Many will do so after the first quarter ends, essentially making April the quasi deadline. Riddles recommends you start early to avoid anxiety and running the risk of slowing your firm's marketing.

Compliance verified

Another change requires a firm that claims to be GIPS verified to be verified. You must secure the verification by year's end, says **Richard Levan**, attorney with **Wiggin Dana** in Philadelphia. Not surprisingly, you'd have to share your GIPS P&Ps with the verifier.

One source who declined to be identified tells **IA Watch** the global standards are losing their allure in some countries. Several are upset that the **CFA Institute** has copyrighted and sells the standards and that they're dominated by U.S. issues. An expansion of this sentiment could threaten the reputation of the standards.

Special considerations for hedge funds

Presenting performance data by hedge funds can be especially challenging because there can be multiple feeder funds, share classes and fee structures. McKinstry authored a white paper 💻 on the issue, and another one 💻 on the new GIPS standards. He submitted three options for fund advisers. The most common may be to identify "the original, full fee paying investor or share class and using that as a proxy for funds' performance," he says. "Your goal is to identify and present the return stream that is most representative of what a prospective investor would have achieved."

McKinstry points out two new disclosures likely to affect most hedge funds: (1) if returns are net of any performance-based fees, and (2) the presence, use, and extent of short positions. ■

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Have and use a system to oversee your firm's marketing efforts

The **SEC** expects your policies and procedures to include a look at the "accuracy of disclosures made" in advertisements but it doesn't lay out a concrete system for firms. How you do this is up to you.

Smaller firms may rely on tools like a log that tracks marketing pieces and compliance's oversight. Larger firms, like **ING Investment Management** ($2.4B in AUM) in New York, even build their own proprietary system to monitor their extensive marketing. ING calls its home-grown system the "marketing compliance portal," says **David Chung**, senior compliance officer of sales and marketing.

Marketers must use the system when completing a piece. Its sends to compliance information about the ad, which also arrives as an attachment. The portal records the approval process and serves as a library for the pieces.

Compliance staff also meet monthly with the marketers "to discuss any changes in the regulatory landscape," says Chung. "It also gives us an opportunity to ask our marketing colleagues [about] 'what's coming down the pike, what are you guys doing?'"

Tools-you-can-use at IAWatch.com

If smaller firms can't afford a software approach, paper makes for a good back up. An example of a marketing log and a marketing review form, both courtesy of **Michelle Kennedy**, consultant with **Compass Compliance Services** in Greenwood, S.C., can be found at **IAWatch.com**.

Kennedy recommends a method similar to Chung's. Use the review form and staple the marketing piece to it. Better still, because "electronic storage is so easy" these days, create a folder on your computer to store the PowerPoints and other marketing files. They'll be easier to find. "This goes a long way whenever you have an exam," she says.

She also recommends maintaining a marketing committee consisting of the CCO, a principal, research analyst and a compliance assistant. It should meet quarterly, keep minutes and review marketing materials and performance presentations as well as discuss future marketing.

Keep a log of all marketing efforts. The CCO should approve all standard marketing materials. Non-standard materials – which Kennedy defines as anything that varies from standard slides – would go through the marketing committee. The CCO should periodically review the log to confirm the process is working, she adds. ■

Former Goldman Sachs RIA executive named to head SEC IM Division

The **SEC**'s Division of Investment Management will have new leadership next month when **Eileen Rominger** takes over as director. She worked during the past 11 years as an executive with the RIA **Goldman Sachs Asset Management** ($575B in AUM) in New York, according to the SEC.

Rominger comes with an investment as opposed to legal background. She possesses an MBA, not a JD. Before Goldman, she worked 18 years at **Oppenheimer Capital** as a portfolio manager, managing director and a member of the executive committee, states the SEC.

"Eileen brings the agency a lifetime of experience in the asset management industry and a record of strong leadership," said SEC Chairman **Mary Schapiro**. "She understands the importance of the nation's investment management industry to the well-being of investors everywhere."

"I'm honored to have the opportunity to lead the Investment Management Division and its talented staff as they drive their critical agenda of transparency and integrity in the industry," Rominger said in an SEC release.

At the RIA, Rominger was CIO over PM teams in eight countries plumbing strategies such as fixed income, fundamental equity and quantitative investment.

She replaces former IM director **Andrew "Buddy" Donohue**, who left the SEC in November (**IA Watch**, Aug. 17, 2010). ■

This story first appeared as breaking news at www.iawatch.com on January 18. ■

Correction: indexed annuities scrubbed from regulatory calendar

We erred in one of the entries to our regulatory calendar earlier this month (**IA Watch**, Jan. 10, 2011). We stated the **SEC** would define equity-indexed annuities as securities beginning this month (**IA Watch**, Jan. 5, 2009). That definition was part of a larger rule that the SEC pulled last fall after losing a court case. We regret the error. ■

Close to 40% of FINRA firms are dually registered

Of the nearly 5,000 brokerage firms registered by **FINRA**, 1,734 firms – or 37% – have an affiliate engaged

(FINRA Numbers, continued on page 6)

FINRA Numbers (Continued from page 5)

in investment advisory activities. The statistics appear in a letter FINRA sent in response to an **SEC** request, apparently related to its Dodd-Frank mandated fiduciary duty study. Here are some more interesting data from the letter:

√ Of the 4,648 firms with an "approved" FINRA status as of Sept. 30, 2010, 53% (or 2,483), had fewer than 10 registered persons. Twenty-nine percent of the firms had 11-50 and almost one out of 10 had 51-150.

√ There were a total of 636,529 registered persons, including any person associated with a firm engaged in the securities business of the firm such as partners, officers, directors, branch managers, department supervisors and salespersons. ■

Overcooked (Continued from page 1)

the fees when new management asked staff to report outside income.

He then flew to New York from Utah to meet with the compliance officer at **Aquila Investment Management** ($4.3B in AUM). Young saw the compliance officer as "an information gatherer" who didn't display a bias. The firm had no further contact with him, except to suspend him for two months before terminating him. Aquila never told him it was going to the SEC. Young contends no shareholders were harmed. The SEC says Young and Albright split $520,000 in credit monitoring fees over a six-year period.

Hedge fund cries foul

"We've done nothing wrong," says CCO **Michael Fontenot** of **SJK Investment Management** ($77M in AUM) in Greensboro, N.C. "We believe we'll be cleared of the charges once we have our day in court." Fontenot responds to recent SEC charges that his boss, **Stanley Kowalewski**, secretly diverted investors' funds, including to purchase a $2.8 million home and a $3.9 million "vacation home."

Watch out for overnight shorting

The SEC also recently hit **Fontana Capital** ($3.9M in AUM) in Winchester, Mass., with charges of violating Rule 105 of Regulation M, which bars taking a short position within five days of a secondary offering. The firm's attorney, **Lisa Wood**, a partner with **Foley Hoag** in Boston, says the three technical violations stem from overnight positions. "In an overnight offering, you're not going to be able to [close the position in time] because you're not even going to know about the [public] offering until after it's too late to close out your short position." ■

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