



REGULATORY UPDATES

November 1, 2017

Provided by Hardin Compliance Consulting LLC

- [SEC Addresses Impact of MiFID II with Three No-Action Letters](#): *The SEC has issued three no-action letters to help market participants comply with the European Union’s Markets in Financial Instruments Directive II (MiFID II) in advance of the January 3, 2018 implementation date. The temporary relief is granted for 30 months from MiFID II’s implementation date in January 2018.*

The first is relief for broker-dealers receiving payments for research from investment managers subject to MiFID II. In a [no-action letter to Securities Industry and Financial Markets Association \(SIFMA\)](#), the SEC has agreed not to take enforcement action against broker dealers that provide research services that constitute [investment advice under the Investment Advisers Act of 1940](#). Essentially this allows broker-dealers to receive payments in hard dollars or through MiFID-governed research payments accounts from clients subject to MiFID’s requirements.

The [second no-action letter was addressed to the Investment Company Institute](#), and allows investment advisers to continue to aggregate client orders for purchases and sales of securities, even where some clients pay different amounts for research as required by MiFID II, as long as all clients continue to receive the same average price for the security and execution costs. This letter refers to the [SMC Capital no-action letter](#), that allowed advisers to aggregate orders for advisory clients, including collective investment vehicles in which the adviser or its affiliates have an interest, without violating [Section 17\(d\) of the Investment Company Act of 1940](#), [Rule 17d-1](#), or [Section 206 of the Advisers Act](#), as long as clients received the same average price for the security and shared the execution costs pro rata.

The [third no-action letter](#) provides relief to money managers under Section 28(e) of the Exchange Act, the “soft dollar” safe harbor which allows advisers to use client commissions to purchase brokerage and research services without breaching their fiduciary duty. The letter is addressed to SIFMA’s Asset Management Group. In a typical soft dollar arrangement in the U.S., an investment adviser may pay a single bundled commission for brokerage and research service that is separated after execution (by the broker-dealer) to pay for order execution and research. Money managers subject to MiFID II are allowed to pay for research using a research payment account (RPA) that complies with the requirements of MiFID II. No-action relief is granted to allow advisers to continue to rely on the Section 28(e) safe harbor as long as the money manager pays for research to the executing broker-dealer at the same time it pays for execution through the RPA. Additionally, the broker-dealer must be legally obligated to pay for the research. Contributed by Jaqueline M. Hummel, Partner and Managing Director

- [SEC Backing Off from “Broken Windows” approach?](#) *In a recent speech, SEC Commissioner Michael S. Piowar announced that the SEC is proceeding down a new path, calling the past six years of pursuing the “broken windows” approach a “misguided effort”. The “SEC 180” will be focused on facilitating capital formation, and using the SEC’s scarce enforcement resources to focus on emerging threats such as cyber security and protection of retail investors. Of course, this also means creating two new enforcement units, creatively named the Cyber Unit and the Retail Strategy Task Force. Contributed by Jaqueline M. Hummel, Partner and Managing Director*

- [FINRA’s Consolidated Registration Rules will bring significant changes come October 1, 2018: FINRA Notice 17-30](#) *is a must-read. Consolidated FINRA Rules 1210 – 1240 address registration requirements, registration classifications, exemptions from registration, and continuing education, respectively. Significant changes include:*
 - *the implementation of the Securities Industry Essentials (“SIE”) Exam and streamlining representative examinations to address the material required to perform the activities covered by the specific registration category;*
 - *the introduction of the Financial Services Affiliate Waiver Program that allows individuals who terminate their registrations in order to work for a financial services industry affiliate of a member firm to return to the securities industry, under specific conditions, without having to retake the examinations;*
 - *the expansion of Permissible Registrations;*
 - *the requirement to designate a Principal Financial Officer and a Principal Operations Officer, each of which must possess the Series 27 or 28 examination, as appropriate based on the firm’s business model;*
 - *the addition of three new Principal registration categories including “Compliance Officer,” “Investment Banking Principal,” and “Private Securities Offerings Principal;”*
 - *the amendment of the Research Analyst, Research Principal and Supervisory Analyst registrations qualifications;*
 - *the expansion of the period in which a registered representative may serve as a registered principal before passing the requisite exam, from 90 days to 120 days; and*
 - *the restriction of non-registered persons from accepting customer orders under any circumstances.*

Contributed by Rochelle Truzzi, Senior Compliance Consultant

- [NASAA Releases Regulatory Exam Summary:](#) *The North American Securities Administrators Association (NASAA) released its [2017 Enforcement Report](#) on 2016 Data in late September, which makes for scary reading. Overall, state regulators received more than 9,300 complaints, conducted more than 4,300 investigations and launched more than 2,000 enforcement actions. State regulators levied fines and penalties of approximately \$682 million, ordered about \$231 million to be returned to investors, and required reimbursement of \$5 million in costs and expenses to the states. In addition to criminal sanctions, state regulators also “revoked, barred, suspended, or prohibited the licenses/registrations of more than 250 individuals and firms, and denied or conditioned the licenses/registrations of more than 400 others.” Contributed by Jaqueline M. Hummel, Partner and Managing Director*

- [NASAA Provides Cybersecurity Checklist for Investment Advisers and list of Best Practices:](#) *The North American Securities Administrators Association (NASAA) has developed a resource for state-registered investment advisers to gauge their cybersecurity preparedness. [NASAA announced](#) that*

state securities examiners in 37 jurisdictions examined more than 1,200 exams of state registered advisers in 2017, and found about 700 deficiencies involving cybersecurity. In addition to cybersecurity, NASAA release includes a list of 10 best practices for investment advisers. Check it out before you perform your annual review of the compliance program. Contributed by Jaqueline M. Hummel, Partner and Managing Director

- [Form ADV Updates](#), and [funding your IARD account for annual renewals](#). Investment advisers should start getting ready for the Form ADV amendments. Remember, Form ADV has been updated and will require more information about an investment adviser's separate accounts by the time the next annual amendment rolls around. So, for the time being, the SEC will allow advisers that have to file an "other-than-annual" amendment to Form ADV to use a placeholder value of "0" when responding to new Schedule D, Section 5.K.(2), which asks for the amount of regulatory assets under management and borrowings in separately managed accounts. And get out your checkbook -- investment advisers should prepare to fund their [IARD renewal accounts](#) to pay state fees for renewal of state registration, state investment advisers representative registrations and state notice filings. Contributed by Jaqueline M. Hummel, Partner and Managing Director
- [Broker Dealer 2018 Renewal Program is underway](#): Broker-dealers can access their Preliminary Statements through E-Bill beginning November 13, 2017. FINRA's Deadline for receipt of Preliminary Statement payments is **December 18, 2017**. Click here for more information regarding the [Web CRD Renewal Program](#), including the Calendar and payment options. Click here for more information about the [Web IARD Renewal Program, including the Calendar](#) and payment options. Hardin recommends reviewing your firm and branch rosters to verify registrations are complete and accurate. Be sure to monitor the balance of your Flex-Funding Account to ensure it remains sufficient to cover your assessment. Contributed by Rochelle Truzzi, Senior Compliance Consultant

Lessons Learned from Recent SEC, FINRA and Massachusetts Cases:

[Adviser Nailed for Charging Performance Fee to Unqualified Clients](#): Massachusetts Securities Division cracked down on state-registered fund manager for fraud and breach of fiduciary duty. The state regulators allege that Moser Capital Management, and its principal, Nicklaus Moser, lied to clients about the firm's investment experience and assets under management, improperly assessed performance fees on a senior citizen who did not have sufficient net worth to meet the definition of "qualified client", and falsified signature pages for new capital contributions for private funds. Nicklaus Moser also lied about his role as a sales representative of two of the portfolio companies that the private funds invested in. The takeaways from this case are that state authorities are getting tougher. Additionally, in Massachusetts, it is considered "dishonest or unethical conduct" to receive a performance fee, unless it is received in compliance with Rule 205-3 of the Investment Advisers Act of 1940. *Contributed by Jaqueline M. Hummel, Partner and Managing Director*

[The Dark Side of Custody](#): If you ever wonder why regulators get so hot and bothered about "custody", just check out this case. Tarek ("Terry") D. Bahgat, a state-registered investment adviser in Williamsville, New York, and his operations manager, Lauramarie Colangelo, are being charged with fraud in the U.S. District Court for the Western District of New York. The SEC alleges that Bahgat stole funds from the accounts of seven different clients (many of whom were elderly) by getting access to their brokerage accounts and transferring funds to his account or to WealthCFO, a payroll and accounting firm Bahgat

owned. Bahgat, with the help of Colangelo, impersonated his clients to get user names and passwords for their brokerage accounts, and ultimately transferred more than \$378,000 from his clients to accounts he controlled. Mr. Bahgat moved to Egypt in September 2016. *Contributed by Jaqueline M. Hummel, Partner and Managing Director*

Worth Reading:

[Don't write off client complaints -- unhappy clients often talk to regulators.](#) Kenneth Corbin confirms what we already know -- unhappy clients will often complain to regulators, and regulators will knock on your door.

[Simple Ethics Lesson of Tom Price:](#) Great article from Matt Kelly -- good ethical judgment is cheaper than lots of controls.

Filing Deadlines and To Do List for November

FOR INVESTMENT MANAGERS

- [Form 13F](#): Form 13F quarterly filing for Q3 2017 is due for advisers within 45 days after the end of the calendar quarter. Due date is November 14, 2017.
- [Annual Renewal Program for IARD System](#): The IARD Renewal Program facilitates the annual renewal of investment adviser (IA) firms and their IA representatives' (IARs) registrations with jurisdictions/states. Preliminary renewal statements for the IARD system will be available **November 13, 2017**, and will be accessible only through the E-Bill System. Renewal statements reflect the registration renewal fees and annual system processing fees for all IARs and state-registered IA firms. Deadline for the receipt of preliminary statement payment is **December 18, 2017**. Questions? Check out [the FAQs](#).

FOR BROKER DEALERS

- [Form OBS for the quarter ending September 30, 2017](#): Unless subject to the *de minimis* exception, the Form OBS must be filed by (1) all FINRA member firms that self-clear their proprietary transactions or clear transactions for others or carry customer accounts; and (2) all other FINRA member firms that have, pursuant to SEA Rule 15c3-1, a minimum dollar net capital requirement equal to or greater than \$100,000 and at least \$10 million in reportable items pursuant to the Form OBS. **Filing is due November 1, 2017.**
- [Annual Audit Reports for the period ending September 30, 2017](#). FINRA members are required to submit their annual audit reports in electronic form. In addition, firms that are members of Securities Investor Protection Corporation (SIPC) must file the annual audit report with SIPC. **Filings are due by November 29, 2017.**

- [Monthly and Fifth FOCUS Part II/IIA Filings](#): FINRA members are required to submit their FOCUS reports through the eFOCUS System for the period ending October 31, 2017 **by November 27, 2017**.

Hardin Compliance Consulting provides links to other publicly-available legal and compliance websites for your convenience. These links have been selected because we believe they provide valuable information and guidance. The information in this e-newsletter is for general guidance only. It does not constitute the provision of legal advice, tax advice, accounting services, or professional consulting of any kind.