



COMPLIANCE RISKS & CONSIDERATIONS DURING COVID-19

SEC GUIDANCE FOR INVESTMENT ADVISERS AND BROKER/DEALERS

PHYSICAL AND CYBER SECURITY
SUPERVISION
BUSINESS CONTINUITY

SEPTEMBER 25, 2020 | PRESENTED BY: VALERIE DAHIYA, PARTNER
GWENDOLYN WILLIAMSON, PARTNER
THOMAS AHMADIFAR, ASSOCIATE

COVID-19 Compliance Considerations & Risks for IAs and BDs

- The SEC's Office of Compliance Inspections and Examinations (OCIE) issued a **risk alert** on August 12, 2020, highlighting **COVID-19 pandemic-related risks and considerations** for broker-dealers and investment advisers
 - Extended remote operations have resulted in an **increase in fraudulent activity** due to heightened market volatility.
 - These conditions create **new stresses** on investment advisers' and broker-dealers' compliance obligations and efforts.

COVID-19 Compliance Considerations & Risks for IAs and BDs

OCIE identified **six compliance areas** that require more nuanced focus in these conditions

1. Protection of investors' assets
2. Supervision of personnel
3. Fee, expense, and financial transaction practices
4. Investment fraud
5. Business continuity
6. Protection of investor and other sensitive information

1. Protection of Investors' Assets

REQUIREMENTS AND OCIE OBSERVATIONS

- The federal securities laws require investment advisers and broker-dealers and to
 - ensure the **safety** of investor assets
 - **guard against** theft, loss, and misappropriation (fraud)
- OCIE has observed
 - changes in adviser and broker-dealer practices and procedures for **collecting and processing client checks and transfer requests** sent via the U.S. Postal Service
 - **retirement account withdrawals** will likely increase

1. Protection of Investors' Assets

OCIE RECOMMENDATIONS

- Firms should
 - **review** their practices, policies, and procedures and conduct tailored **employee trainings** around check handling
 - have in place a **process to authenticate and verify** client identities and fund disbursement instructions

2. Supervision of Personnel

REQUIREMENTS AND OCIE OBSERVATIONS

- Investment advisers and broker-dealers must
 - **proactively supervise** their personnel,
 - including by overseeing their investment and trading activities
 - have **tailored policies and procedures** reflecting firm's current activities and operations
- OCIE has observed
 - widespread if not universal **remote working**
 - myriad issues associated with **ongoing market volatility**

2. Supervision of Personnel

OCIE RECOMMENDATIONS

- Firms should **modify** their practices **to address these “WFH” challenges:**
 - **Remote Supervision**
 - lack of physical and proximity oversight/interaction
 - **Securities Recommendations**
 - some market sectors have experienced greater volatility or have a heightened risk of fraud
 - **Limited On-Site Diligence Reviews**
 - on-site due diligence reviews of third-party managers, investments, and portfolio holding companies are limited and resource-constrained
 - **Off-System Communications**
 - communications or transactions may occur on personal devices outside of firms’ surveilled and monitored information technology systems
 - **Remote Oversight of Trading**
 - may be difficult to achieve timely reviews of affiliated, cross, and aberrational trading, particularly in high volume investments

3. Fees, Expenses, and Financial Transactions

REQUIREMENTS AND OCIE OBSERVATIONS

- Investment advisers and broker-dealers have **disclosure obligations**
 - **fees** charged
 - **conflicts** of interest
- OCIE has observed
 - **increased opportunities** for potential **misconduct**
 - **financial conflicts** of interest
 - **adherence to** risk, fee, and expense **disclosure** obligations
 - exacerbated by volatile market conditions

3. Fees, Expenses, and Financial Transactions

OCIE RECOMMENDATIONS

- Firms should consider enhancing their compliance monitoring and policies and procedures
 - **Validation**: ensure consistent accurate and timely validation
 - disclosures
 - expense calculations
 - **High Fee or Expense Investor Transactions**
 - identify, track, and review the appropriateness
 - **Loans**
 - evaluate **risks of borrowing** from investors, clients, and others that create **conflicts of interest**

4. Investment Fraud

OCIE OBSERVATIONS

- OCIE and SEC Enforcement staff have alleged **investment fraud**
- SEC has **halted trading** and/or taken **enforcement action**
 - orders address information disseminated by the issuers through verbal public statements, press releases, social media posts, and podcast interviews

4. Investment Fraud

OCIE RECOMMENDATIONS

- Firms should
 - **be aware** of these risks
 - **affirmatively report** any potential fraud to the SEC
 - be mindful of their **suspicious activity reporting** (SAR) obligations
 - ensure that all conduct is being flagged and timely reports are being submitted

5. Business Continuity

REQUIREMENTS AND OCIE OBSERVATIONS

- **Business continuity and disaster recovery** should be a **primary focus** for investment advisers and broker-dealers
- OCIE expects firms to
 - be mindful of compliance and operational **risks and potential impacts** to operations
 - take **steps to mitigate** such risks

5. Business Continuity

OCIE RECOMMENDATIONS

- Firms should
 - Consider, particularly with respect to physical and cybersecurity, whether
 - **additional resources** and/or measures for **securing servers/systems** are needed
 - the integrity and security of **vacant facilities** is maintained
 - relocation **infrastructure and support** for remote personnel is necessary
 - **remote location data** is protected
 - Be prepared to
 - provide **disclosures** to clients if operations are materially affected
 - actively coordinate with **third party service providers** to ensure capacity, security, and continuity

6. Protection of Sensitive Information

REQUIREMENTS AND OCIE OBSERVATIONS

- Investment advisers and broker-dealers are obligated to protect investors' **personally identifiable information (PII)**
- OCIE has observed **the increase in videoconferencing and other electronic communications** may
 - compromise PII and other sensitive information
 - create increased opportunities for bad actors

6. Protection of Sensitive Information

OCIE RECOMMENDATIONS

- Firms should **review** their policies and procedures **and consider**
 - **enhancing identity protection** practices
 - providing **trainings** on cyberattacks (rise in ransomware)
 - using **heightened measures** such as multifactor authentication for access rights and other encryption protections for data

Key Take Aways

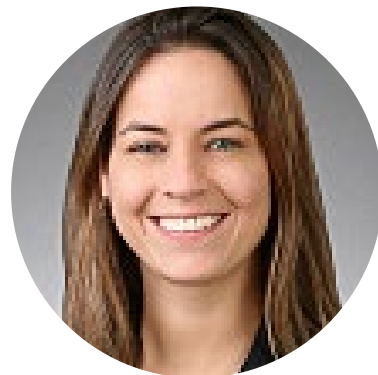
- During COVID-19, the SEC together with FINRA and the CFTC, is monitoring for increased risks to
 - investors
 - capital formation
 - financial markets
- Firms should
 - **proactively identify, monitor, assess, and mitigate risks** to their clients and operations
 - actively **coordinate with regulators and third-party service providers**, where applicable, in their efforts to identify and ameliorate issues
 - consult with counsel as appropriate

Thank you for joining us!



VALERIE DAHIYA

PARTNER
INVESTMENT MANAGEMENT



**GWENDOLYN
WILLIAMSON**

PARTNER
INVESTMENT MANAGEMENT



THOMAS AHMADIFAR

ASSOCIATE
INVESTMENT MANAGEMENT