
Financial Services Regulatory Practice

How we can help asset managers

2014/2015

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Introduction

Asset management firms face unprecedented regulatory and compliance challenges. They must grapple with the regulatory framework and demands of the landmark Dodd Frank Financial Reform and Consumer Protection Act (Dodd-Frank Act), as well as rules governing many aspects of their business – from the advice they provide, the way they trade securities, how they market themselves and the disclosures they provide, to their employees' personal trading and political contributions. Keeping up with the new regulations and ensuring effective implementation is daunting.

At the same time, the expectations of asset management firms have never been higher. Key stakeholders including investors, clients and prospective clients are demanding greater transparency and more assurance that the manager has strong compliance and internal controls. Recent frauds and compliance failures have only heightened their concerns and expectations. Senior managers and boards of directors need confidence that their firm has no unintended and undiscovered compliance problems. Existing legacy compliance programs may not be adequate to meet these expectations.

Heightened regulatory expectations place additional pressure on asset management firms. Regulators expect a comprehensive, tailored, state-of-art compliance program with full testing, use of technological tools, and expertise. The consequences of non-compliance are regularly front-page news, and a compliance failure can be fatal to a firm's business.

PwC can help asset management firms of all types address regulatory compliance issues and manage regulatory risk effectively. From an initial risk assessment to a soup-to-nuts compliance review, our asset management regulatory team can help firms have confidence that their compliance program meets regulatory, investor, client and management expectations. Our experienced professionals have diverse backgrounds in the asset management industry, and bring up-to-the minute perspective and a strong knowledge of current industry leading practices.

Our team includes:

- Former commissioner at the SEC;
- Former assistant director of the SEC's Division of Enforcement in the Asset Management Unit;
- Former SEC and SRO examiners, branch chiefs and enforcement personnel;
- Former chief compliance officers, traders, operations specialists and industry professionals;
- Asset management audit and internal control expertise
- Forensics and investigations specialists, and data and systems specialists.

This brochure outlines the issues as we see them and how we can help asset management firms address those issues.

Expectations are greater, risks are heightened

Regulatory and compliance challenges for asset management firms



Top compliance risk areas for asset managers

Top compliance risks

Compliance program	<ul style="list-style-type: none">• Assessing business model and operations risks• Designing policies and procedures tailored to the investment adviser's business and having adequate controls and reviews in place to prevent, detect and promptly correct compliance problems• Addressing the areas that regulators currently focus on
Safeguarding investor assets	<ul style="list-style-type: none">• Protecting investor assets from theft, loss, and abuse• Controlling and monitoring fee and expense calculations and allocations to prevent abuse
Valuation	<ul style="list-style-type: none">• Pricing and valuing client securities appropriately, particularly illiquid or difficult-to-price securities, in all market conditions• Reviewing the overall pricing process and testing the effectiveness and implications of such process, e.g., conduct acid testing – comparing the actual sale price against the last valuation
Institutional conflicts	<ul style="list-style-type: none">• Identifying and addressing potential conflicts arising from the selection of service providers, the manner in which securities and opportunities are allocated among clients, in brokerage execution and affiliated dealings• Having appropriate policies and procedures to address applicable conflicts which may include but are not limited to: allocating scarce investment opportunities equitably amongst all the firm's clients and trading practices relating to best execution, soft dollars, short selling, market manipulation• Providing adequate disclosure
Personal conflicts	<ul style="list-style-type: none">• Maintaining a Code of Ethics and surveillance procedures that adequately address employee trading and investments, gifts and entertainment, political contributions, proper email usage and other potential personal employee conflicts of interest
Insider trading	<ul style="list-style-type: none">• Identifying the sources of material non-public information ("MNPI") the firm receives or maintains• Instituting adequate controls to prevent and detect possible insider trading at the personal or portfolio level including but not limited to: information barriers, restricted lists and watch lists.• Establishing whether and to what extent employees have ties to other financial firms either personally or financially• Providing training so that all employees are fully trained to know "where the lines are" regarding MNPI

Top compliance risk areas for asset managers

Top compliance risks

Investment guidelines and restrictions

- Following an investment strategy and process that is consistent with representations and disclosures made to clients and prospective clients in advisory agreements, offering documents, marketing materials, and written materials provided at investor meetings
- Ensuring and verifying that all trading, investments and holdings are in accordance with client guidelines and restrictions and regulatory requirements

Marketing practices

- Complying fully with all internal and regulatory requirements relating to the firm's marketing, performance advertising, and sales efforts requirements
- Maintaining all required supporting documentation for historical performance information
- Vetting all conflicts and following all the regulatory rules associated with the use of third party solicitors/marketers or placement agents
- Maintaining strong adequate "pay-to-play" policies and procedures around soliciting state/municipal investors that meet the SEC's rules in this area

Regulatory reporting

- Filing all required regulatory reports (ADV, PF, PQR, 13F, 13D, 13G, 13F, SH, Forms 3, 4 and 5, portfolio company filings, blue-sky filings, etc.) on an accurate and timely basis
- Ensuring consistency of reported information across all filings
- Monitoring of filing thresholds as applicable and necessary

Risk disclosures

- Making full and accurate disclosures to all relevant investors and clients concerning liquidity, counterparty, investment, and other risks
- Ensuring consistency of risk disclosures across all relevant documents

Additional key challenges and compliance risks specific to private equity advisers

Top compliance risks

Safeguarding of investor assets

- Maintaining privately held securities in accordance with the SEC's revised rules
- Focus on expense allocations, including expenses related to dead deals or use of consultants such as operating partners.

Valuation

- Documenting the rationale and process concerning valuation decisions, including the ability to demonstrate that internally modelled illiquid securities are valued appropriately
- Utilizing a third party valuation agent to value illiquid positions and having controls in place for monitoring or overseeing the third party valuation agent's process

Institutional conflicts

- Disclosing the receipt and benefit of any deal-related fees (break-up fees, consulting fees, exit fees, director fees, portfolio company management fees, etc.)
- Having proper controls in place and providing appropriate disclosures relating to the following (not meant to be exhaustive): participation in and offerings of co-investment in PE deals; conflicts between funds or accounts that own different parts of the capital structure of the same issuer; the extent of any deals between portfolio companies; conflicts between the funds and other portfolio company investors – for example increasing portfolio company debt in order to pay a special dividend to the PE fund and other equity holders
- Maintaining appropriate policies and procedures relating to the Foreign Corrupt Practices Act if the investment adviser or portfolio companies have dealings in foreign jurisdictions
- Addressing any conflicts regarding the selection of underwriters to take portfolio companies public

Personal conflicts

- Ensuring the written Code of Ethics that addresses nepotism and other personal compliance risks
- Having proper disclosures and controls in place to the extent any principals or employees: have direct ownership in the investments owned by any of the fund accounts or clients; make investment recommendations and co-invest alongside any fund accounts or clients; receive any management or consulting fees; personally invest in fund-of-funds that invest in, or co-invest with, the adviser's fund; or invest in PE deals that are considered but ultimately not purchased by the adviser's funds or accounts

Insider trading

- Further understanding additional sources of MNPI, e.g., customers and vendors of portfolio companies, investment adviser's personnel acting as officers or directors of portfolio companies

Additional key challenges and compliance risks specific to real estate advisers

Top compliance risks

Safeguarding of investor assets

- Maintaining privately held securities in accordance with the SEC's revised rules
- Focus on expense allocations, including expenses related to dead deals or use of consultants such as operating partners

Valuation

- Documenting the rationale and process around valuation decisions including the ability to demonstrate that internally modelled illiquid securities are valued appropriately
- Utilizing a third party valuation agent to value illiquid positions and the controls in place for monitoring or overseeing the third party valuation agent's process

Institutional conflicts

- Having proper controls in place and providing appropriate disclosures relating to participations in and offerings of co-investments on real estate deal
- Policing use of affiliated and unaffiliated property management, appraisers, or other service providers
- Addressing any conflicts regarding joint venture operating partners

Personal conflicts

- Having a written Code of Ethics that addresses nepotism and other personal compliance risks
- Having proper disclosures and controls in place to the extent any principals or employees: have direct ownership in the investments owned by any of the fund accounts or clients; make investment recommendations and co-invest alongside any fund accounts or clients; receive any management or consulting fees; personally invest in fund-of funds that invest in, or co-invest with, the adviser's fund; or invest in PE deals that are considered but ultimately not purchased by the adviser's funds or accounts

Additional key challenges and compliance risks specific to mutual funds and their advisers

Top compliance risks

Money market fund reform	<ul style="list-style-type: none"> Transforming policies, accounting, governance, operating and disclosure systems related to registered money market funds Instituting required stress testing for money market funds
Distribution expenses	<ul style="list-style-type: none"> Overseeing policies, disclosures and controls to ensure that payments to fund service providers, including omnibus holders and sub-transfer agents, are not indirect payments for distribution
Liquid alternative funds	<ul style="list-style-type: none"> Managing risk and compliance challenges associated with mutual funds using hedge-like investing strategies and alternative investment products Driving board reporting and monitoring of unique risks associated with liquid alternative funds, including leverage, liquidity, valuation and risk reporting
Use of derivatives	<ul style="list-style-type: none"> Considering risk and compliance issues associated with fund investments in derivative instruments Addressing SEC concerns and pronouncements regarding the impact of derivatives on fund leverage, diversification, exposure to certain financial issuers and valuation
Multi-manager platforms	<ul style="list-style-type: none"> Demonstrating fiduciary-level reviews and controls over the hiring, firing and monitoring of third-party sub-advisers
Regulatory reporting	<ul style="list-style-type: none"> Coordinating between fund advisers, custodians, administrators, counsel and other fund service providers to generate and file timely and accurate regulatory reports specific to registered funds Enhancing systems and procedures to respond to anticipated increased SEC data demands regarding registered funds
Valuation	<ul style="list-style-type: none"> Determining whether the fund's NAV is susceptible to market timing and, if so, establishing additional controls to address that risk Confirming that the fund board is fulfilling its statutory obligations regarding pricing
Governance and compliance program	<ul style="list-style-type: none"> Coordinating and consolidating between fund and adviser compliance programs Managing an effective relationship between the board and fund/adviser CCO and producing effective board reports sufficient for the board to properly oversee fund operations and potential conflicts

Even the most well-intentioned firms are likely to have significant interaction with regulators in the coming years
Good compliance truly is good business, and an imperative in today's environment

The new regulatory and compliance reality

New regulatory obligations and accelerated rulemaking

- The Dodd-Frank Act
- New rules for adviser registration, money market funds, pay-to-play, Form ADV, large trader reporting, registration with the CFTC (for investment advisers to commodity pools)
- Changes to the general solicitation and advertising activities of issuers in the offering and selling of securities in order to implement Section 201(a) of the JOBS Act including disqualification of felons and other “bad actors” from Rule 506 offerings
- More to come: target date funds, distribution expenses (i.e. 12b-1 plans), incentive-based compensation rules for large advisers
- New regulatory reporting: systemic risk reporting (Forms PF, CPO-PQR), Treasury Form SLT
- Firms designated as “systemically important” will face new scrutiny
- Foreign jurisdiction laws and rules: AIFMD

Increased client/prospective client demands

- Due diligence by prospective clients and RFPs include questions concerning the adequacy of compliance programs and breaches
- Clients request information about examination results and any contacts from enforcement investigators, including copies of deficiency letters
- Sub-advisers see more vigorous due diligence and ongoing monitoring and reporting requests from primary advisers; diligence is moving beyond certification process

Increased regulatory expectations

- Examiners expect a comprehensive program: no gaps
- Examiners look for senior management support and knowledge of the compliance program – you may be interviewed about it during an exam
- Examiners expect robust testing that identifies potential problems, annual reporting and use of available technological tools
- Examiners expect a demonstrable governance process that assures reporting up and timely action to resolve problems and address their root cause
- Firms designated as “systemically important” will face heightened scrutiny

Even the most well-intentioned firms are likely to have significant interaction with regulators in the coming years
Good compliance truly is good business, and an imperative in today's environment

The new regulatory and compliance reality

More and multi-phased examinations

- Risk-driven examinations, surprise exams, cause exams, sweeps including the SEC's recently announced Cybersecurity Sweep Initiative
- Presence exams: SEC examines a "significant number" of newly-registered advisers

Consequences of non-compliance

- Lengthy, costly examinations and deficiency remediation efforts
- Increased reputational risk
- Increased likelihood of enforcement investigation – the SEC is targeting asset managers with a special unit of investigators focused solely on the asset management industry
- Joint insider trading and other investigations by the SEC and the Department of Justice
- Cooperation among SEC, CFTC, FinCEN, IRS, FBI, Department of Labor, state AGs/securities divisions
- More cooperation agreements between SEC and foreign counterparts

Investigative techniques have changed

- Whistleblower program with bounties encourages tipsters
 - Wiretaps
 - Use of data analytics to detect misconduct
 - Ability to analyze millions of electronic trading records to identify groups of traders who repeatedly make similar well-timed bets
 - More frequent use of subpoenas for registered firms that fail to produce records to examiners in a timely way
 - Cooperation and non-prosecution agreements between SEC and witnesses
 - Trained, experienced investigators and examiners (industry experience, Chartered Alternative Investment Analysts, Certified Fraud Examiners)
-

PwC's team provides a range of services to help you gain confidence that your compliance program is effective, meeting industry best practices and regulatory expectations

Services we provide

Assistance with compliance programs

- We provide a high-level assessment of the structure, breadth, reporting and resources of the compliance program
- Assists management and boards of directors in having confidence that the funds' compliance program is reasonably designed relative to peers and regulatory expectations
- Focus on key components of compliance programs including formal policies, risk identification and mitigation, oversight committees, monitoring, testing and reporting
- Conduct targeted reviews of a specific area of risk or concern to identify practices and make recommendations for improvement based on regulatory requirements and/or industry practices

Compliance and forensic testing

- We provide assistance to CCOs in performing the annual compliance review
- Analyze complete information sets over time in order to identify unusual patterns that routine compliance spot-checking may not find. Forensic tests attempt to answer skeptical questions such as "what if" or "how do we know"
- Forensic tests performed could include, e.g., trade execution quality, comparative account performance, email reviews, etc.
- Other forensic tests based on the particular risk issues identified by the fund/adviser

Training

- We assist firms in developing targeted and tailored training on regulatory requirements

Regulatory reporting

- We assist firms preparing for regulatory filings, including the SEC's Forms ADV and PF, and the CFTC's Form CPO-PQR
- Assist the adviser in analyzing how the regulatory reporting requirement applies, understanding the requirements, performing a gap analysis around the data required, and drafting policies and procedures and assumptions

Mock SEC exam

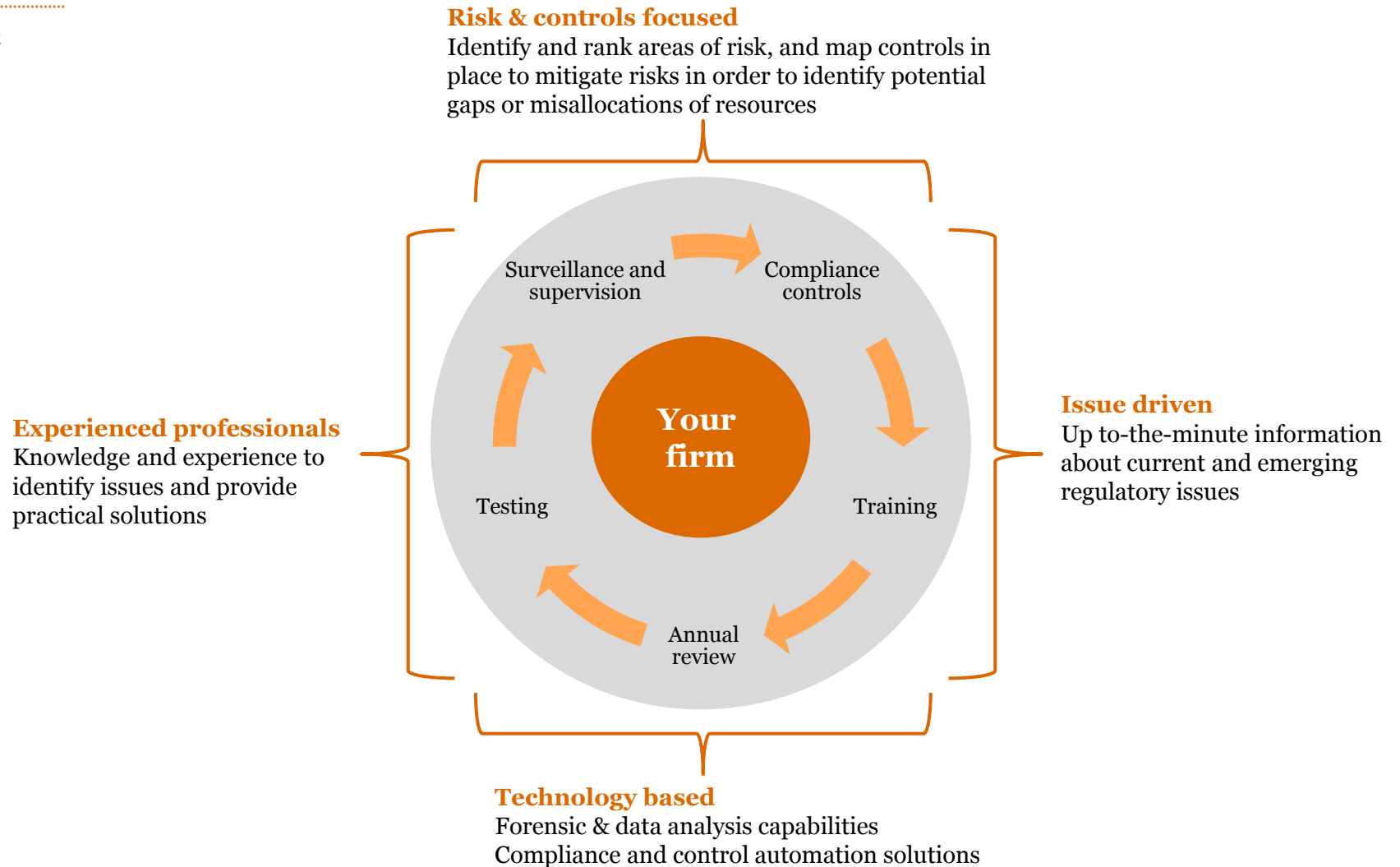
- Simulates full-scope SEC compliance examination
- We provide a realistic test of what to expect in an examination, and allows the firm to identify and address gaps or weaknesses in the compliance program, interview skills, and its ability to respond quickly to numerous document requests
- Includes testing in specific areas, such as adherence to prospectus guidelines and Investment Company Act rules, trade execution, and personal trading to validate compliance program's effectiveness
- Includes interviews of key personnel likely to be interviewed in an exam

Assistance with SEC interactions

- SEC Registration – We provide support for firms establishing new SEC registration, including assistance with creating and implementing tailored policies and procedures, controls, training, surveillance and testing
- SEC Examination – We provide support for firms undergoing an SEC examination
- SEC Remediation – We provide guidance and assistance on how to correct a problem noted by the SEC and institute controls to prevent reoccurrence

Experienced professionals identify gaps and weaknesses – and bring up-to-the-minute solutions

Our approach

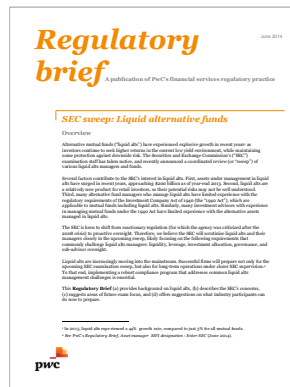


PwC's regulatory professionals take great pride in being recognized as "thought leaders" in the industry

Some of our recent, noteworthy regulatory publications include:

Our thought leadership

SEC sweep: Liquid alternative funds



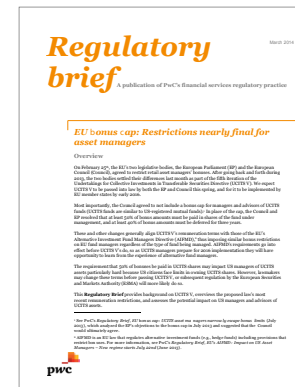
This Regulatory Brief (a) provides background on liquid alternative funds, (b) describes the SEC's concerns, (c) suggests areas of future exam focus, and (d) offers suggestions on what industry participants can do now to prepare.

Asset manager SIFI designation: Enter SEC



This Regulatory Brief provides our view that (a) asset manager SIFI designations will not occur this year, (b) the SEC's upcoming money market reform rule will play an important role in the debate, (c) the Council is facing increased political scrutiny as a result of the designation process, but (d) nevertheless we continue to believe two to four large asset managers will ultimately be proposed for designation as we have indicated in our prior briefs.

EU bonus cap: Restrictions nearly final for asset managers



This Regulatory Brief provides background on UCITS V, overviews the proposed law's most recent remuneration restrictions, and assesses the potential impact on US managers and advisors of UCITS assets.

www.pwc regulatory.com

Our team includes staff members with deep industry knowledge and a wide range of invaluable experience

Our team

The combination of experience and broad ranging skill-sets helps us provide unique insights and services to our clients.

We bring a timely perspective and a strong baseline knowledge of current industry leading practices.

***Former
commissioner
at the SEC***

***Former
assistant
director of the
SEC Division of
Enforcement's
Asset
Management
Unit***

***Former SEC
and SRO
examiners and
enforcement
staff***

***Former chief
compliance
officers,
compliance
professionals,
traders and
operations staff***

***Asset
management
audit and
internal
control
expertise***

***Forensics,
investigations,
data, systems
and
operations
specialists***

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Introducing...

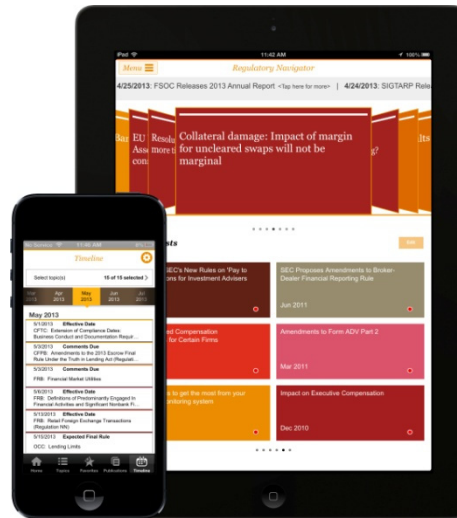
PwC's Regulatory Navigator App Version 2.0



We are pleased to announce that **Version 2.0** of PwC's new **Regulatory Navigator App** is here and ready for you to install on your iPad or iPhone!

The **Regulatory Navigator App**, an innovation from PwC's Financial Services Regulatory practice, delivers the first single-source resource to help guide you through the constantly changing, complex, and often opaque financial reform regulatory environment.

If you do not have an iPad or iPhone, you can access PwC's financial services regulatory points of view on www.pwcregulatory.com.



**Download PwC's
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Key features of PwC's Regulatory Navigator include:

- **Dynamic timeline** that you can scroll and sort by key regulatory dates and deadlines (which includes links to the source documentation, comment period deadlines and final rule effective dates)
- **Financial Services Regulatory practice publications library** featuring thought leadership and videos that is sortable by topic, most viewed and most liked
- **Weekly regulatory ticker** of the latest regulatory developments
- **Customization** by topic or industry
- **Notifications about new content** available on the app as frequently as you want

For more information, please contact your local PwC representative or Alison Gilmore at alison.gilmore@us.pwc.com.

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