

## REGULATORY ADMINISTRATION DIGEST

### TOPICS IN THIS ISSUE:

OCIE Releases 2015 Examination Priorities: [read more](#)

OCIE Releases Results from its Cybersecurity Initiative: [read more](#)

Adviser of Alternative Mutual Funds Settles SEC Allegations of Improper Handling of Fund Assets: [read more](#)

SEC Announces Leadership Change for the Division of Investment Management: [read more](#)

*This Regulatory Administration Digest is provided for informational and educational purposes only and is not accounting, legal or tax advice, opinion or a substitute for the advice of your legal counsel or other professional advisors. Information contained herein should not be relied upon in regard to any particular facts or circumstances without first consulting a lawyer.*

The following is a summary of select developments in investment management regulation during the first quarter of 2015.

### OCIE Releases 2015 Examination Priorities

The Office of Compliance Inspections and Examinations (the “OCIE”) of the Securities and Exchange Commission (the “SEC”) has released its [Examination Priorities for 2015](#). The priorities include issues that impact a range of financial institutions and that were selected by the OCIE in consultation with the SEC’s policy divisions, regional offices and enforcement division, and the SEC’s Investor Advocate, and other regulators. This year the priorities focus on investment advisers, broker-dealers and transfer agents.

The OCIE has organized the priorities into three categories: (i) “protecting retail investors, especially those saving for or in retirement;” (ii) “assessing market-wide risks;” and (iv) “using data analytics to identify signs of potential illegal activity.” The OCIE’s release includes a summary of its enforcement initiatives in in each category:

- **Retail Investors.** To determine the impact of recent trends involving the offering of alternative investment options and investment service products to retail investors and investors saving for retirement, the OCIE will examine matters of importance to those investors, including whether the information, advice, products, and services being offered is consistent with applicable laws, rules, and regulations.
- **Market-wide Risks.** To assess market-wide risk, the OCIE will “examine for structural risks and trends that involve multiple firms or entire industries, and may: (i) monitor large broker-dealers and asset managers in coordination with the SEC’s policy divisions; (ii) conduct annual examinations of clearing agencies; (iii) assess cybersecurity controls across a range of industry participants, and (iv) examine broker-dealers’ compliance with best execution duties in routing equity order flow.”
- **Data Analytics.** Using the SEC’s data analytics capabilities, the OCIE will seek to “identify and examine registrants that may be engaged in illegal activity, such as excessive trading and penny stock pump-and-dump schemes.”

[northerntrust.com](http://northerntrust.com)



#### TOPICS IN THIS ISSUE:

OCIE Releases 2015 Examination Priorities: [read more](#)

OCIE Releases Results from its Cybersecurity Initiative: [read more](#)

Adviser of Alternative Mutual Funds Settles SEC Allegations of Improper Handling of Fund Assets: [read more](#)

SEC Announces Leadership Change for the Division of Investment Management: [read more](#)

The OCIE also outlined three specific examination initiatives focused on “alternative” and fixed income mutual funds and mutual funds not previously examined by OCIE. When examining alternative mutual funds, the OCIE stated that it would “assess funds offering alternative investments and using alternative investment strategies, with a particular focus on: (i) leverage, liquidity, and valuation policies and practices; (ii) factors relevant to the adequacy of the funds’ internal controls, including staffing, funding, and empowerment of boards, compliance personnel, and back-offices; and (iii) the manner in which such funds are marketed to investors.” The OCIE stated that its examination of fixed income mutual funds will include reviewing whether the funds “have implemented compliance policies and procedures and investment and trading controls sufficient to ensure that their [ ] disclosures are not misleading and that their investments and liquidity profiles are consistent with those disclosures.” Finally, the OCIE stated that it will allocate examination resources to “conduct focused, risk-based examinations of selected registered investment company complexes that we have not yet examined.”

### OCIE Releases Results from its Cybersecurity Initiative

On February 3, 2015, the OCIE recently published a [Risk Alert](#) that offers insight into how a cross-section of broker-dealers and investment advisers are addressing cybersecurity issues. The Risk Alert, captioned “Cybersecurity Examination Sweep Summary,” includes the OCIE’s summary observations based on information gathered during examinations performed under the [OCIE Cybersecurity Initiative](#) (the “Initiative”). The Initiative was undertaken to improve the OCIE’s understanding of “how broker-dealers and advisers address the legal, regulatory, and compliance issues associated with cybersecurity” and included the examination of 57 registered broker-dealers and 49 registered investment advisers.

The Risk Alert includes the following OCIE observations:

- The vast majority of examined broker-dealers (93%) and advisers (83%) have adopted written information security policies.
- The vast majority of examined firms conduct periodic risk assessments, on a firm-wide basis, to identify cybersecurity threats, vulnerabilities, and potential business.
- Most of the examined firms reported that they have been the subject of a cyber-related.



#### TOPICS IN THIS ISSUE:

OCIE Releases 2015 Examination Priorities: [read more](#)

OCIE Releases Results from its Cybersecurity Initiative: [read more](#)

Adviser of Alternative Mutual Funds Settles SEC Allegations of Improper Handling of Fund Assets: [read more](#)

SEC Announces Leadership Change for the Division of Investment Management: [read more](#)

- Many examined firms identify best practices through information-sharing networks.
- The vast majority of examined firms report conducting firm-wide inventorying, cataloguing, or mapping of their technology resources.
- The examined firms' cybersecurity risk policies relating to vendors and business partners revealed varying findings.
- Almost all the examined broker-dealers (98%) and advisers (91%) make use of encryption in some form.
- The designation of a Chief Information Security Officer varied by the examined firms' business model.
- Use of cybersecurity insurance revealed varying findings among the examined firms.

According to the Risk Alert, the OCIE will continue to focus on cybersecurity using risk-based examinations. In the SEC's companion [press release](#) announcing the Risk Alert's publication, SEC Chair Mary Jo White, stated: "[c]ybersecurity threats know no boundaries. That's why assessing the readiness of market participants and providing investors with information on how to better protect their online investment accounts from cyber threats has been and will continue to be an important focus of the SEC."

### **Adviser of Alternative Mutual Funds Settles SEC Allegations of Improper Handling of Fund Assets**

The Securities and Exchange Commission ("SEC") has [announced](#) the settlement of an administrative proceeding instituted against Water Island Capital LLC, a New York-based registered investment adviser. According to the SEC's [order](#) in the proceeding (the "Order"), WIC served as the investment adviser to several alternative mutual funds (the "Funds") and employed specialized trading strategies that required WIC to trade equities and derivatives, including swaps.

In its Order, the SEC alleged that WIC failed to ensure that approximately \$247 million of the Funds' assets were maintained in the custody of the Funds' qualified bank. The SEC found that, instead, the Funds' broker-dealer counterparties held certain of the Funds' assets in cash collateral.



The SEC determined that WIC's actions violated the custody requirements of Section 17(f)(5) of the Investment Company Act of 1940 (the "1940 Act") and that WIC violated Section 12 and Rule 12b-1(h) of the 1940 Act by failing to implement the Funds' directed brokerage policies and procedures. The SEC further determined that WIC caused the Funds' to violate Rule 38a-1 under the 1940 Act.

To settle the matter, WIC agreed to pay a \$50,000 penalty and consented to the SEC's cease-and-desist order, without admitting or denying the findings.

## SEC Announces Leadership Change for the Division of Investment Management

In a February 3, 2015 [press release](#), the SEC announced the appointment of David Grim as Acting Director of the SEC's Division of Investment Management (the "Division"). According to the press release, Mr. Grim has been the Deputy Director of the Division for the past two years and has been responsible for overseeing the Division's disclosure review, rulemaking, guidance, and risk monitoring functions. Chair White, stated that "[t]he [SEC and investors will benefit tremendously from his extensive legal knowledge, deep roots in the work of the [D]ivision, and his managerial expertise." Mr. Grim stated that "[i]t is a privilege to work with Chair White, the other Commissioners, and the staff as we continue to carry out our important mission." The Division's mission includes protecting investors, promoting informed investment decisions, and facilitating innovation in investment products and services through oversight and regulation of the asset management industry.

In a January 21, 2015 [press release](#), the SEC announced that the Division's former director, Norm Champ, planned to leave the SEC at the end of January after five years with the agency. According to that press release, Mr. Champ is credited with: (i) creating the Division's Risk and Examination Office, which uses data collected from the asset management industry to monitor risks in the industry, firms, and products using the results to inform policy at the SEC; (ii) creating the Senior Level Engagement Program under which senior leadership of the Division meets with senior management and Boards of Directors of strategically important asset management firms to improve the Commission's awareness of emerging issues in the industry and to engage in direct dialogue about market developments; and (iii) instituting regular "IM Guidance Updates" to make staff views on investment management issues transparent to stakeholders in the investing public, industry and the regulatory community. Chair White said that "[t]he Commission has benefited

### TOPICS IN THIS ISSUE:

OCIE Releases 2015 Examination Priorities: [read more](#)

OCIE Releases Results from its Cybersecurity Initiative: [read more](#)

Adviser of Alternative Mutual Funds Settles SEC Allegations of Improper Handling of Fund Assets: [read more](#)

SEC Announces Leadership Change for the Division of Investment Management: [read more](#)



greatly from Norm’s expertise and sound judgment and we have been very fortunate to have had him work on behalf of U.S. investors and our markets.”

## Northern Trust

Northern Trust is a best-in-class provider of middle and back office fund services to investment managers worldwide. Our unique expertise extends across products, fund vehicles and domiciles, delivering the flexibility associated with a boutique administrator but with all the advantages of being one of the world's leading financial institutions.

For further information, contact: Owen Meacham, Esq. at [otm1@ntrs.com](mailto:otm1@ntrs.com) or 312.557.3948 or visit [northerntrust.com/fundservices](http://northerntrust.com/fundservices).

**Regulatory Administration Digest is compiled by our Regulatory Administration Group.  
© Northern Trust Corporation. All rights reserved.**

*This Regulatory Administration Digest Newsletter is provided for informational and educational purposes only and is not accounting, legal or tax advice, opinion or a substitute for the advice of your legal counsel or other professional advisors. Information contained herein should not be relied upon in regard to any particular facts or circumstances without first consulting a lawyer.*

### TOPICS IN THIS ISSUE:

OCIE Releases 2015 Examination Priorities: **read more**

OCIE Releases Results from its Cybersecurity Initiative: **read more**

Adviser of Alternative Mutual Funds Settles SEC Allegations of Improper Handling of Fund Assets: **read more**

SEC Announces Leadership Change for the Division of Investment Management: **read more**