MILNE LEGAL | ML

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Milne Legal Press Release

"Is the SEC holding Chief Compliance Officers Strictly Liable?"

I. The SEC's Trend Toward Strict Liability?

On June 18, 2015, following two recently settled SEC enforcement actions[1] against Chief Compliance Officers ("CCO") for allegedly failing to implement their firms' compliance policies and procedures under Rule 206(4)-7 of the Investment Advisers Act of 1940 ("Advisers Act"), SEC Commissioner Daniel M. Gallagher issued a public dissent which has caught the attention of the compliance community. Clearly concerned about the SEC's recent treatment toward CCOs, Commissioner Gallagher stated: "Both enforcement actions illustrate a Commission trend toward strict liability for CCOs under Rule 206(4)-7. Actions like these are undoubtedly sending a troubling message that CCOs should not take ownership of their firm's compliance policies and procedures, lest they be held accountable for conduct that, under Rule 206(4)-7, is the responsibility of the adviser itself."[2]

Admonishing the Commission not to send CCOs the wrong message, Commissioner Gallagher stated: "The Commission needs to be especially cognizant of the messages it sends to the compliance community, and in particular to CCOs of investment advisers. To put it bluntly, for the vast majority of advisers, CCOs are all we have. They are not only the first line of defense, they are the only line of defense. . . .I have long called on the Commission to

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[1] *SEC Charges BlackRock Advisors With Failing to Disclose Conflict of Interest to Clients and Fund Boards, SEC Rel. No. 2014-71 (Apr. 20, 2015), available at* http://www.sec.gov/news/pressrelease/2015-71.html; AND Investment Advisory Firm's Former President Charged With Stealing Client Funds, SEC Rel. No. 2015-120 (June 15, 2015), available at *http://www.sec.gov/news/pressrelease/2015-120.html*.

[2] *See* Commissioner Daniel M. Gallagher, *Statement on Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7*, (June 18, 2015), *available at* http://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html

tread carefully when bringing enforcement actions against compliance personnel."[3]

II. SEC Commissioner Mr. Luis A. Aguilar Offers a Rebuttal

Just eleven days later, concerned that Commissioner Gallagher's public dissent may have unnecessarily created an environment of unwarranted fear in the CCO community, SEC Commissioner, Luis A. Aguilar wrote the following:

> *"The resulting publicity [from Mr. Gallagher's public dissent], has left the impression that the SEC is taking too harsh of an enforcement stance against CCOs, and that CCOs are needlessly under siege from the SEC. I am concerned that the recent public dialogue may have unnecessarily created an environment of unwarranted fear in the CCO community. Such an environment is unhelpful, sends the wrong message, and can discourage honest and competent CCOs from doing their work.*
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> *The Commission has approached CCO cases very carefully, making sure that it strikes the right balance between encouraging CCOs to do their jobs competently, diligently, and in good faith, and bringing actions to punish and deter those that engage in egregious misconduct. In making this determination, the Commission cautiously evaluates the facts and circumstances of each case, and considers many important factors such as fairness and equity.*
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> *CCOs are vital to the protection of investors and the integrity of the capital markets. To that end, the Commission works to support CCOs who strive to do their jobs competently, diligently, and in good faith—and these CCOs should have nothing to fear from the SEC."* [4]

III. Two SEC Enforcement Actions Against Chief Compliance Officers

The two enforcement actions that compelled Commissioner Gallagher to issue his highly publicized dissent discussed in Part I above were the following: (i) In the Matter of Blackrock Advisors, LLC (April 20, 2015); and (ii) In the Matter of SFX Financial Advisory Management Enterprises, Inc. (June 15, 2015).[5]

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[3] Id.
[4] *See* Commissioner Luis A. Aguilar full statement (June 29, 2015) available at: http://www.sec.gov/news/statement/supporting-role-of-chief-compliance-officers.html.
[5] *See supra* footnote 1.

In Blackrock, the Commission charged a CCO with causing the firm's Rule 206(4)-7 violations in connection with his alleged failure to ensure that the firm had compliance policies and procedures to assess and monitor the outside activities of employees and disclose conflicts of interest to fund boards and advisory clients. In SFX, the Commission alleged that a CCO failed to implement compliance policies and procedures that, if carried out appropriately, would have detected an alleged multi-year theft of client assets by the president of the firm.[6]

IV. Rule 206(4)-7

Rule 206(4)-7 states that registered investment advisers must "[a]dopt and implement written policies and procedures reasonably designed to prevent violation[s]" of the Advisers Act and its rules.

Although the rule was adopted over eleven years ago, Commissioner Gallagher attests that "since the rule was adopted, the Commission has not issued any guidance about how to comply with the rule."[7] Mr. Gallagher concludes that although "Rule 206(4)-7 speaks directly to the responsibility of the adviser, too often the Commission interprets the rule as being directed at CCOs."[8]

Although there is a certain degree of ambiguity associated with how best to satisfy Rule 206(4)-7, the rule is clear that an advisory firm must designate a CCO to administer its compliance policies and procedures and such CCO must be knowledgeable of the requirements mandated under the Advisers Act.

V. Conclusion

Regardless of whether Commissioner Gallagher or Commissioner Aguilar is ultimately correct, ML is of the view that all CCOs must come to work each day committed to administering their firm's policies and procedures in a competent manner. When compliance matters arise within the firm, successful CCOs will look to engage in open and transparent dialogue with the firm's management team and board of directors regarding how best to resolve the issue. If any doubt remains after such discussions, CCO should encourage the firm to engage outside counsel or a compliance consultant regarding how best to implement the firm's policies and procedures and to ensure the firm's compliance under the Advisers Act.

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[6] Id.

[7] *See supra* footnote 2.

[8] Id.

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"When any alleged violation occurs within an RIA (as was the case in the Blackrock and SFX enforcement actions discussed above) and such knowledge is brought to the attention of the SEC, the SEC will most likely begin its investigation with the RIA's gatekeeper of compliance, the CCO. It is ML's hope that when that moment occurs, all CCOs can demonstrate that they acted in good faith, were diligent, and had a competent understanding of the Advisers Act when they oversaw the daily implementation of their firm's policies and procedures."

VI. Special Update at ML

We would like to take this opportunity to welcome Ms. Laetitia Mantel to Milne Legal. Ms. Mantel has joined Milne Legal as a senior compliance consultant to SEC registered investment advisers. Ms. Mantel has worked and supported SEC investment advisers and broker-dealers in Switzerland for the past decade. She has passed the Series 7 (General Securities Representative) and Series 66 (Uniform Combined State Law Examination) exams and has recently served as a CCO for a registered investment adviser with offices in the United States and in Switzerland.

She supports chief compliance officers with developing and implementing their firms' compliance policies and procedures, training programs, and annual compliance reviews.

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