

## Abundant CCO lessons found in \$40 million enforcement settlement

By now you've heard about the **Evergreen Investment Management** case and the SEC's settlement with the Boston-based firm for more than \$40 million. But perhaps some of the lessons from the case haven't been brought to the fore.

**IA Watch** featured breaking news on this biggest case yet to snare an RIA for lapses tied to mortgage-backed securities on June 8, and you can read a more comprehensive article on it at [www.iawatch.com](http://www.iawatch.com). We've weaved the compliance lessons among some of the facts from the case here (see story, page 5).

At its heart, the case is about flawed valuation, as well as misleading some investors and giving others preferential treatment.

"What stands out about this case is the number of securities that were overvalued and the length of time they were overvalued," **David Bergers**, regional director of the SEC's Boston office tells **IA Week**.

Evergreen managed a mutual fund, the Ultra Fund, which was heavily invested in mortgage-backed securities. For nearly 1½ years, until the fund was liquidated in June 2008, the adviser and its affiliated broker overstated the fund's value by as much as 17%, the **SEC** states.

Evergreen, which boasts \$122 billion in AUM and was owned by **Wachovia**, declined to comment on the case to **IA Week**. **Wells Fargo** now owns Evergreen.

According to the SEC, the Evergreen Valuation  
*(Evergreen, continued on page 4)*

### IA Week Exclusive

## Stanford hid SEC exam even from its compliance department

When SEC examiners descended upon the **Stanford Group Company** in January, they kept alluding to their 2006 visit, which drew blank stares from the compliance staff. They hadn't known the SEC had staged an exam at the firm three years earlier.

"They started referring to this mystery audit," a source close to Stanford tells **IA Week**. SEC examiners assumed the compliance department would know about the prior visit. "Compliance was unaware of it."

The general counsel of the colossal Stanford companies, **P. Mauricio Alvarado**, shepherded the 2006 exam. "We were very controlled in a lot of ways regarding information flow," the source continues.

The long-time general counsel resigned his position with Stanford just before the **FBI** raided the Houston-based company in February, collapsing the international empire of **Robert Allen Stanford** amid charges of an \$8 billion Ponzi scheme (**IA Week**, Feb. 23, 2009).

*(Stanford Exam, continued on page 2)*

## 9 hot topics OCIE examiners are scrutinizing at firms

That controversial tactic by SEC examiners to reach out to clients during exams and ask them about the safety of their assets may have staying power (**IA Week**, May 25, 2009). **John Walsh**, chief counsel in the SEC's Office of Compliance Inspections and Examinations, told a conference in Washington last week that the tactic will be a vital part of examinations going forward.

**Richard Choi**, a partner with **Jorden Burt** in Washington, hosted a panel featuring Walsh at the NAVA Government & Regulatory Affairs Conference. He jotted down the hot exam topics affecting advisory firms that Walsh ticked off:

1. **Custody.** This issue has sizzled since Madoff got slapped with handcuffs. Examiners grow most concerned when assets aren't segregated or a key principal dominates the firm.

*(9 Hot Exam Topics, continued on page 4)*

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## Stanford Exam (Continued from page 1)

IA Week reached Alvarado by phone but he declined to comment.



An attorney close to the case, who requested anonymity, says the various Stanford entities didn't communicate well with each other, and warned that those compliance staff "who were in the know" may face trouble. "I suspect there are some serious legal consequences down the road for the legal and compliance folks" who knew what was going on, he added.

Some reports indicate the SEC may have been looking at Stanford's books and records as early as 1999, and ala **Bernard Madoff**, that a whistleblower warned FINRA and the SEC in 2003 that the knighted billionaire's firm really served as a veiled Ponzi scheme. Stanford has denied any wrongdoing and is fighting civil charges ([IA Week](#) , April 6, 2009). His attorneys declined to comment.

To date, the FBI has filed criminal charges only against former Stanford CIO **Laura Pendergest-Holt** for allegedly lying to the SEC, a charge she denies.

### 'Fraud was the furthest thing from our minds'

Only days after authorities arrested Bernie Madoff last December the Stanford companies received correspondence from the SEC signaling a pending exam. Compliance found out because the letter went to multiple Stanford companies, rendering the exam impossible to conceal. (In 2006, the SEC's letter must have gone to only one of the firms, our source believes.)

A few days later, a more complete document request letter arrived. IA Week has obtained a copy of this [request letter](#) , which you can read at [iawatch.com](http://iawatch.com) . The timing forced the compliance staff to labor throughout the holiday season to prepare.

SEC examiners marched into the firm on Jan. 12. Their sheer numbers sent a chilling message. The posse featured 10 examiners, including the boss of the SEC's Fort Worth regional office and a special counsel.

Minutes later news filtered in that FINRA investigators were raiding six Stanford offices in distant locales like Dallas, Memphis, Tenn., and Tupelo, Miss. The simultaneous visits surprised compliance staff. "The word 'raided' was used because ... they were not wanting to wait," a source tells us. For example, FINRA examiners insisted on immediately copying hard drives.

Sources recall a very thorough SEC exam that lasted four solid weeks. The request letter contains many of the usual suspects, e.g., asking for annual reviews, a compliance issues log, and the business continuity plan, among other items.

But it also holds some signs the SEC knew what it was looking for. For example, examiners requested a "List of all compensation paid to employees for the sale of CDs for the past two years, by employee, by quarter. Include gross sales, percentage paid and employees' name."

The civil case alleges fraud built on the sale of certificates of deposit.

The letter also seeks the names of any officers/directors who resigned and employees who were disciplined or terminated within the past five years. It also includes extensive questions regarding anti-money laundering and seeks a "list of customers" that are offshore banks or hedge funds as well as all "Suspicious Activity Reports that have been filed since January 1, 2007."

### The exam changes in a flash

SEC examiners were not on-site Feb. 17, the day the FBI raided the Houston headquarters, a source tells us.

*(Stanford Exam, continued on page 3)*

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## Stanford Exam (Continued from page 2)

“Everything with the SEC exam changed ... the tone definitely changed,” the source says. Now the firm would insist an attorney sit in on every interview authorities did with employees.

“Fraud was the furthest thing from our mind,” the source continues. Staff had no idea the FBI was even involved until agents swung through the doors. ■

## New SEC panel likely to be shaped by experiences of RIA reps

One has run the largest pension funds in the U.S. and England. Another invests exclusively in socially responsible companies. A third proudly waves the flag of retail investors.

They share in common working at registered investment advisory firms and being newly minted members of the SEC’s first investor advisory committee ([IA Week](#) , June 8, 2009). The fourth RIA representative on the 15-member panel, **Dennis Johnson**, managing director of **Shamrock Capital Advisors** in Burbank, Calif., aims to “help the SEC protect the interests of shareholders,” a goal

that fits well with the SEC’s intent for the panel.


**Jeff Brown**, senior vice president of Legislative and Regulatory Affairs at **Charles Schwab & Co.**, looks forward to representing retail investors and “the customers of our RIA clients.” He imagines reacting to issues and regulatory ideas the SEC brings before the committee, as well as raising topics dear to Schwab, such as short selling and the return of the uptick rule.

Helping the Commission understand “some of the issues that RIAs faced last year” will be among the goals of **Mark Anson**, president and executive director of Investment Services at **Nuveen Investments** in Chicago. Anson says he brings a diverse resume, including having run **CalPERS**, the country’s largest pension fund.

Issues he could envision putting before the committee include proxy access, FAS 157 (Congress should delegate this to the SEC, he contends) and the regulation of hedge funds and private equity managers. “I firmly believe that all asset managers should be regulated,” he says. “Anyone who takes in client money and invests that money on behalf of clients should be registered as an investment adviser.”

*(RIA Reps, continued on page 6)*

### Numbers of RIAs that would shift to state registration if AUM threshold is raised to \$100 million

As the Obama administration prepares to release its plan for regulatory reform of the financial services industry this week, some have suggested one modification should be raising the threshold for IA SEC registration from \$25 million in AUM to \$100 million ([IA Week](#) , May 4, 2009). **IA Week**’s exclusive analysis reveals 4,191 firms (37% of the current 11,300 SEC-registered firms) would shift to state registration if the threshold were increased to \$100 million in AUM. A state-by-state tabulation follows below.

The SEC has the authority to hike the AUM level but it appears the agency has no appetite to do so at this time.


State	New RIAs to state	State	New RIAs to state
California	612	South Carolina	49
New York	377	Alabama	39
Texas	286	New Hampshire	35
Florida	240	Oklahoma	35
Massachusetts	175	Nebraska	32
Illinois	173	Nevada	30
Ohio	145	Iowa	26
Pennsylvania	142	Louisiana	22
Connecticut	135	Arkansas	19
Virginia	132	Maine	19
Colorado	126	Rhode Island	19
New Jersey	126	New Mexico	17
Michigan	112	Idaho	16
Washington	102	Kentucky	15
Maryland	96	Delaware	14
Georgia	92	Hawaii	14
North Carolina	91	Washington, D.C.	13
Minnesota	77	Vermont	12
Missouri	71	Montana	9
Arizona	70	Mississippi	8
Oregon	70	West Virginia	6
Tennessee	61	Wyoming	5
Wisconsin	59	North Dakota	4
Utah	52	South Dakota	4
Indiana	51	Alaska	3
Kansas	50	Puerto Rico	3

Source: **IA Week** analysis of RIA data, using the RIA’s main address and firms that reported AUM data on their Form ADV. ■

## 9 Hot Exam Topics (Continued from page 1)

**2. Controls over valuation.** Examiners will be impressed by signs of independence, checks and balances and transparency.

**3. Marketing.** Claims about performance join a new concern: firms that exaggerate that they can keep investors safe in a shaky market.

**4. Supervision and compliance.** Again, this one is shaped by the economy, and the worry firms with shrinking budgets will slash staff, including compliance personnel, and place a “disproportionate burden” on those who remain. This issue arose in another session on new compliance challenges. Make sure your compliance department is treated fairly when it comes to staff cuts, advised **Amy Lynch**, president of **Frontline Compliance** in Alexandria, Va. Compliance shouldn’t bear the brunt. Raise your concerns with upper management, chimed in **Dan Wright**, vice president and CCO at **Jackson National Life Insurance Co.** in Denver. “You cannot assume management knows what the issues are,” he said. You may even mention the SEC’s view that compliance shouldn’t pay a disproportionate toll in these lean times ([IA Week](#) , Dec. 8, 2008).





**5. Ownership changes.** This is similar to #4, in that examiners want to make sure that compliance and risk management don’t suffer when firms merge or are sold.

**6. Trading.** This reflects continuing trepidation about false and manipulative rumors designed to affect securities’ prices. Walsh said the SEC hopes to soon publish examples of best practices in this area.

**7. Controls over material, non-public information.** Insider trading remains a perennial concern.

**8. Revenue sharing.** Examiners are on the lookout for cheaters, pressed by this economy, who push for under-the-table payments, kickbacks and other questionable arrangements.

**9. Hedge funds.** The hot items include undisclosed side deals and giving some investors preferential treatment on redemptions.

**Editor’s note:** Come hear the SEC’s [John Walsh](#)  talk about exam hot topics at [IA Week’s 9th Annual IA Compliance Fall Conference 2009](#)  in Philadelphia Sept. 21. Check out the entire agenda and register at <http://www.iawatch.com/conferences/fall09/>  .


## Evergreen (Continued from page 1)

Committee used a three-tier system to help establish fair valuation:

1. Used prices provided by a third-party pricing vendor. This was the committee’s preferred method.
2. Selected values given by one or more third-party broker-dealers. The SEC found the adviser relied too heavily on one Florida broker-dealer, and had done little due diligence into the methods the broker-dealer used.
3. Went with prices recommended by the Fund’s portfolio management team, the firm’s least preferred method.

One lesson for CCOs is the need to ensure there is adequate due diligence of the sources that provide information used in valuating portfolios. The case also speaks to the need for proper retention of text and instant messages by broker-dealers.

Another lesson is to watch for too many overrides of valuation procedures and the reliance on one broker who consistently lands on prices higher than other sources, says attorney **Todd Cipperman** of **Cipperman & Company** in King of Prussia, Pa. “That should have raised at least a due diligence inquiry,” he says.

The need to build relationships with portfolio managers screams throughout the case. For example, as Evergreen approached the liquidation, staff prepared “talking points” to raise with some of the 500 financial advisers who sold clients on the Ultra fund. But the talking points weren’t run by the compliance department until the CCO started receiving phone calls and inquired about them, according to an [exhaustive chronology](#)  by Massachusetts state regulators, who assisted the SEC.

“A chief compliance officer ... requested to be copied on ‘similar communications to the troops in the future,’” according to the Massachusetts complaint. “Significantly, the [CCO’s] email expresses no surprise at the talking points, no indication of any problems with the content, and no suggestion that they be modified or their use discontinued .... neither senior management of [the Evergreen broker-dealer] nor the CCO saw any problems with the content of the communications.”

This is germane because Evergreen played favorites in who it first contacted, drawing authorities’ charges that the firm shared material, non-public information about the true state of the securities with certain investors, giving them an unfair advantage when it came to seeking redemptions.

The case found the adviser either didn’t maintain adequate policies and procedures to prevent this or didn’t enforce them.

Another aspect of the case concerns a portfolio *(Evergreen, continued on page 5)*

## Evergreen (Continued from page 4)

manager not being forthcoming with the valuation committee. But compliance may find it difficult to overcome this. “If a guy lies, the guy lies,” says Cipperman. “I don’t know what you do about that.”

A final lesson is to stay current with the news. The SEC faulted Evergreen for not adjusting downward the valuation of its Ultra Fund despite widespread news media reports beginning as early as February 2007 that the bottom was dropping out of the residential mortgage-backed securities market.

Besides the huge payment, Evergreen has agreed to hire an SEC-approved compliance consultant to review its program and compensate harmed investors. ■

There's more to this story at [www.iawatch.com](http://www.iawatch.com), which first appeared as breaking news at [www.iawatch.com](http://www.iawatch.com) on June 8.

## Understand pricing services' methods puts a down payment on compliance

Satisfying the SEC when it comes to valuation begins with having policies and procedures that are consistent and take into account contingencies, but the job doesn't end unless your firm has a good idea of the methodologies employed by pricing services it relies upon.

These are among the best practices that poured from IA Week's webinar last week, [Answers for Valuation & Best Execution's Most Vexing Compliance Challenges](#). Its timing proved propitious, being broadcast within one day of the SEC's **Evergreen Investment Management** enforcement settlement (see story, page 1).

That case came to the SEC's attention after Evergreen's Ultra Fund liquidated in June 2008, said **Doug Scheidt**, associate director and chief counsel at the SEC's Division of Investment Management in Washington.

“There have been temptations by advisory personnel to look too much on the bright side” of prices in the last year or so, he continued, insinuating the mistakes of Evergreen may have been repeated by other firms.

A compliance department shouldn't feel it alone carries the weight of adequate valuation. In the Evergreen case, the mutual fund board played loose with its responsibilities, too. But the CCO should ensure there are policies and procedures that are specific enough to identify who is responsible for what function. This way, if new pricing information becomes available, everyone knows “who is responsible for passing that information along” to the valuation committee, noted Scheidt.

“Firms should take a consistent approach,” said Scheidt, but not a rigid one. Always have a Plan B, he suggested, in case a source of pricing information is no longer available. “It's probably best to specify upfront” what pricing source your firm will turn to if the primary source isn't available.

Another lesson from Evergreen was relying upon a Florida broker who painted too rosy of a pricing picture, and the firm doing little to double-check his numbers. “If you don't know what's behind the price, then you don't really have a good reason to rely on that price,” said Scheidt. You should be able to explain to the fund board how a broker arrived at a certain price, as well as understand “the methodologies being used by the pricing service.”

## Portfolio managers

Watch for the influence of portfolio managers on the process, warned **J. Christopher Jackson**, director and head of U.S. Retail Legal for **Deutsche Asset Management** – Legal Division in New York, in recognizing one of the lessons of Evergreen.

“I'm very interested in their input and their suggestions but at the end of the day, I would be hesitant to say I would let any portfolio manager or any trader have carte blanche to price any portfolio,” responded **Todd Spillane**, CCO at **Invesco** in Houston.

Jackson recounted a sweep exam the SEC conducted last year. Examiners focused on valuation policies and procedures, forensic testing and how firms responded to the results of the testing.

Deutsche turns to monthly, weekly and even daily tests for valuation. Jackson gave examples of these tests, including a daily NAV impact report that compares today's prices with yesterday's and is programmed to flag wide price gaps “so that we can take a further look at those.”

“We'll do a comparison of prices between our primary and our secondary vendor,” he added, in parroting a best practice recommended by Scheidt.

Spillane spoke of a “breaking news report” test that searches for any positive or negative news on a company reported after the market closes and that might sway the valuation of a security.

## Best execution

Testing for best execution doesn't “have to be cosmic,” noted Jackson. “They can be relatively simple tests.” For example, make sure negotiated commission rates aren't being violated. Spillane pushed use of computerized  
*(Valuation, continued on page 6)*

## Valuation (Continued from page 5)

standard trading cost analysis presentations.

Whatever happened to the SEC's long-awaited guidance on valuation? Scheidt said it remains in the pipeline but more pressing matters – such as the agency's recent proposed custody rule change – have squeezed in front of it.

**Editor's note:** Secure your copy of the webinar's working materials and audio CD at <http://www.iawatch.com/Conferences/A1819/home.html>  ■

## RIA Reps (Continued from page 3)


Socially responsible investing tops the subjects **Adam Kanzer**, managing director and general counsel at New York-based RIA **Domini Social Investments**, brings to the panel. Others include focusing on long-term thinking (Kanzer blames short-term investing in part for last year's financial meltdown), continuing to give investors the ability to file shareholder resolutions on social and environment issues and urging the SEC to consider mandatory disclosure of corporate social and environmental performance.

Kanzer would welcome feedback from RIAs. "I'm open if somebody wants to give me their views, to give me a call," he says.

Although details need to be finalized, the committee will remain in place for at least two years and hold perhaps four meetings a year in Washington. ■

## Criminal charges to be filed against CCO in fraud case

A former CCO who co-founded an investment advisory firm 16 years ago has settled a civil case with the SEC but awaits criminal charges in a case that involved the theft of \$6 million from clients – including \$430,000 stolen from a terminally ill man and, after his death, another \$85,000 swiped from his grieving widow.

**Matthew Weitzman** served as CCO at **AFW Wealth Advisors** (\$200 million AUM) in Purchase, N.Y., until March. The SEC [complaint](#)  states Weitzman forged client signatures to transfer their assets into his bank account. The firm's clients had given him a limited power-of-attorney to control their assets.



The firm served 300 clients and Weitzman made some

100 transfers from at least 20 client accounts.

"He used this client money ... as his personal piggy-bank to furnish a lavish lifestyle, which included a multi-million dollar home, an interest in a horse, cars, and other expensive luxury items," the SEC states. The agency also says New York authorities were going to file criminal charges against Weitzman related to the thefts. ■

Read more from this story at [www.iaweek.com](http://www.iaweek.com) .

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Sign up today for **IA Week's** upcoming webinar, **[Understanding How the SEC's Proposed Custody Rule Changes Will Affect Your Firm](http://www.iawatch.com/conferences/A1828/home.html)** , Tuesday, June 16 from 2-3:30 p.m. ET. Register at <http://www.iawatch.com/conferences/A1828/home.html> .

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