Quarterly Newsletter – Q3 2021

Dear clients

Welcome to our regular quarterly newsletter covering a few of the more important updates and news coming from the SEC as relating to Switzerland.

On Tuesday, 21. September 2021 we gave a presentation to the Swiss Registered Investment Advisor Association (SRIAA) at the Baur au Lac. It was great to finally be able to actually get together again. The presentation, designed to be a reference piece compares and contrasts the U.S. SEC and new Swiss regulatory & compliance framework and is available here.

General updates

1. Hot topics according to the Investment Advisors Association 2021

According to the recently released 2021 Investment Management Compliance Testing Survey, available here for the brave, the survey of 350 RIA compliance officers found the following in order of what keeps them awake at night:

1. Advertising and Marketing at number one;

Followed closely by;

1. Cybersecurity

Then in no particular order:

2. Climate change and ESG
3. Business Continuity Planning
4. Digital Assets

Which makes sense, since the new advertising rule is being implemented and RIAs are looking closely at the information they are disseminating and how.

2. Cybersecurity deficiency cases brought for the first time

In the last newsletter we took a deep dive into digital assets, cryptocurrency and cryptoassets. This time we can report the SEC is actually starting enforcement in cybersecurity at an entry level. Up to this summer, the SEC hadn't actually done much noteworthy enforcement-wise. In August this changed with three separate enforcement cases involving eight firms in total.

The eight firms, covering RIAs, broker-dealers and dual registrants were found to have deficient cybersecurity policies & procedures (P&Ps) and were charged with Reg S-P violations. Two of the firms were found to have violated Advisers Act rule 206(4)-7, relating to their duty to notify clients of a breach.

The reasoning behind charging the firms with the violations was the firms failure to adopt and implement cybersecurity P&Ps "reasonably designed" to protect customer information. The firms in question were the subjects of a successful cyberattack compromising firm employees Email accounts resulting in the exposure of personal information of thousands of clients at each firm. The Head of the SEC Enforcement Divisions Cyber Unit, Kristina Littman stated: "It is not enough to write a policy requiring enhanced security measures if those requirements are not implemented or are only partially implemented, especially in the face of known attacks". Saying essentially, it was a problem of implementation in that the information was not protected in a manner consistent with the firms policies. Or, if the firms had done what they said they would do in the P&Ps, the breaches would likely not have happened.

The lesson coming out is:

1. Implement what is in the P&Ps
2. Respond quickly when a breach is detected

Both of which the firms apparently did not. There were delays in both responding and notifying clients, compounding the problem.

3. Focus on Cybersecurity by Division of Examinations

Carrying on with the cybersecurity theme, the DOE 2021 Examination Priorities stated explicitly that the DOE would be looking at whether firms had taken appropriate measures to:

- Protect customer accounts
- Prevent account intrusions
- Address malicious Email activities
- Respond to incidents

To this end, the DOE has started the process. The DOEs 5. August, 2021 cybersecurity sweep exam document request letter lists 33 items they want to see.

A few highlight requests from the sweep exam letter:

1. Policies and procedures relating to data classification
2. Policies and procedures relating to encryption of data in motion both internally and externally and data at rest on all systems and servers
3. List of systems, utilities, and tools used to prevent, detect, and monitor data loss, including documentation that describes their functions and whether the systems are proprietary or managed by a third party or commercial off-the-shelf products
4. Policies and procedures that address the following
   - On unauthorized persons do not access network resources and devices
   - Restricting users
   - Updating access rights

- Obtaining manager approval of changes
- Ongoing reviews to ensure access rightsaccurately assigned
- List of logs and reports used to review failed in log attempts, access logouts, dormant user accounts and unauthorized login attempts
- List of third party vendors with access to network, systems or data

5. With respect to Regulation S-ID

- Risk assessment regarding covered accounts
- Policies and procedures for compliance with regulation S-ID
- Annual report with respect to regulation S-ID
- Training provided to employees and contractors
- Changes implemented to identity theft program

6. Copy of written plan addressing mitigation of the effects of a cyber security incident and or recovery, if such a plan exists

7. List of all cybersecurity incidences or breaches

Overall, remarkably extensive and strong evidence that the SEC are taking cybersecurity increasingly seriously in practice.

4. The Moratorium on new registrations in Switzerland

At the end of June we were informed that the moratorium was lifted. A week later we were informed that the moratorium had in fact not been lifted.

As we all know by now, the Swiss Federal Data Protection and Information Commissioner (FDPIC) sent a 16 page memorandum to the SEC on the 25. June

outlining their position and giving the go-ahead for information to be passed to the SEC.

The SEC responsed in late August saying:

> *"We do consider the FDPIC memorandum, which addresses the Swiss data protection law, a positive step. It is our understanding that other Swiss laws likely need to be addressed to confirm that applicants located in Switzerland will be able to provide the Commission with prompt direct access to their books and records and to submit to onsite inspection and examination once registered."*

The FDPIC has to our knowledge not formally responded. However, in response to an enquiry, they said informally that having taken a final position on the matter, they have exhausted their scope of competence and cannot grant a permit nor issue a formal confirmation. They went on to say that should the SEC come with further questions about data protection, they will of course be happy to help, but otherwise they consider the matter closed.

Bottom line: so far as we know, we are waiting for the SEC to come back. We will continue to inform when we receive any updates and have something meaningful to say.

5. Whistleblower Awards

This is appears not very relevant for Switzerland, but we think worth putting in anyway as one of those things "we just normally don't think of". We find it interesting and informative to gain some insight in how things are progressing and evolving in the US at the moment.

The whistleblowing business is booming in the U.S.

On 15. September, the SEC announced two awards, one of ca. $110 million to one whistleblower and $4 million to another for information and assistance lea-

ding to successful SEC and related actions. This brings the total in awards to over $1 Billion to date to 207 whistleblowers. $500 Million of this was paid in 2021 alone in an indication of how much this program is picking up steam. The highest single award to an individual was in October 2020 of $114 Million.

Given statements from both the SEC Chair Gary Gensler

> *"The whistleblower program has been instrumental to the success of numerous enforcement actions since it was instituted a decade ago"*

and

> *"The assistance that whistleblowers provide is crucial to the SEC's ability to enforce the rules of the road for our capital markets", plus the statement from SEC Director of Division of Enforcement Gurbir S. Grewal, "The whistleblower program has been instrumental to the success of numerous enforcement actions since it was instituted a decade ago",*

this is highly likely to continue.

The SEC has an actual "Office of the Whistleblower" with its own head responsible for overseeing the program.

Whistleblower awards can range from 10-30% of the money collected when monetary sanctions exceed $1 Million.

6. Compliance Company Market

This is one we just had to put in. Yes, there is a used market for compliance companies. You can't buy one on eBay yet, but it appears to be an emerging market. According to Grandview research, the global market for outsourced compliance was around $6.3 Billion total revenue in 2020, with growth set to reach $97.3 Billion in total revenue by 2028, a CAGR of 13.7%. The report summary is available here.

Seeing the opportunity, private equity firms and private fund advisors have started buying stakes in compliance companies. There has apparently now been at least one deal valued at over $1 Billion with several deals in the $10 - $50 Million range.

This appears to be being driven by regulatory pressure and the resultant growth in the industry. The SEC appears to be viewing the outsourcing firms quite fa-

vourably, especially for small and medium sized RIAs because the SEC views it as a sign the RIA is taking compliance seriously, mandating an external provider to fill the gaps. Being an optional expense on the part of the RIA, it shows extra care being taken.

Impressum

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