IAWatch
REGULATORY NEWS & COMPLIANCE BEST PRACTICES

More regulations, a growling regulator and other big changes likely in 2009

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Let's acknowledge upfront the difficulty in forecasting the year ahead - given the spectacular surprises 2008 unleashed, ones that would have defied prediction one year ago. As you may expect, the events of the last few months weigh heavily in prognosticating 2009.

The list tops off with predictions of new regulations for the financial services industry; no surprise given recent events and an eager new administration. Hedge funds will likely be an initial target, with many envisaging mandatory registration of hedge fund advisers.

New ERISA rules and a further clampdown on shorting are also likely. "Advisers really should keep an eye on short selling activity," says **Giselle Casella**, VP and head of Global Core Advisory Compliance at **Deutsche Asset Management** in New York. "I think that's going to be a real hot button issue for 2009."

Here are more predictions - along with actions you can take to be ready:

A new attitude at the SEC. This is a given with **Mary Schapiro** likely becoming the next chairman. An agency badly burned by the alleged **Bernard Madoff** scam will likely move quickly to set a new tone. Look for more intense exams, an increase in sweeps and perhaps less assistance from the agency on how to master inspections, says **Michelle Kennedy** of **Compass Compliance Services** in Greenville, S.C.

Don't be surprised if there's a major internal shuffle, too, says **Terrance O'Malley**, partner at **Fried Frank Harris** in New York. He could foresee OCIE being disbanded, scattering IA inspectors to the Division of Investment Management and broker-dealer examiners to the Division of Trading and Markets.

Fiercer exams will translate into less attention to issues such as best execution. Instead, examiners will train on financials, O'Malley adds. "I have no doubt the SEC's going to take a hard look at" this, he says.

Congress could opt for a more radical approach: Combining the SEC with the **Commodity Futures Trading Commission**, or creating an entirely new entity. "The Bernie Madoff scenario could possibly be another chink in the armor that leads to the disintegration of the SEC," offers **Keith Marks**, partner with **Ascendant Compliance Management** in Salisbury, Conn. One possible result could be an SRO for IAs, he adds.

The Madoff fallout likely will lead the SEC - or whomever - to take a hard look at the custody rule, continues O'Malley. A panel could be appointed to search for better ways to protect investors' assets because the current rules "didn't work in the Madoff case." He also thinks the SEC this year will kill plans to revise Form ADV, Part II.

Look for more international cooperation among regulators, says **Margaret Paradis**, a partner with **Baker & McKenzie** in New York. "The current crisis is global in nature. It has shown how interconnected markets are," she adds, so regulators may respond with greater reciprocity.

Fewer hedge funds and more demanding clients. Hedge fund assets will continue to drop significantly, perhaps by 50%, drained by market losses and redemption calls, predicts Robert Leonard, a partner at **Bingham McCutchen** in New York.

He spots a ray of sunlight in the latter part of the year. "I think by the third quarter you'll see some funds starting up of decent size" because "good money always wants to find good managers."

Edgy clients will expect more transparency and new investment strategies. "They're going to be pounding the table saying 'show me'" how solid your operational platforms are and how compliant you are, believes **Tony Turner**, principal at **Financial Tracking** in Greenwich, Conn.

"The public's going to get a little scared of the old philosophy of buying and holding" securities for the long term, says **Steve Candela**, a consultant with **SEC Compliance Consultants** in Philadelphia. He fears, if this happens, the market's "volatility is just going to go through the roof and eventually it's going to have a negative impact."

Advisers should expect to do a lot more hand-holding of clients, active account managing and friendly persuasion to steer them away from the natural tendency to liquidate or move assets. "Managers are going to have to work hard to counter that dynamic," says **Matthew Eisenberg**, partner with **Finn Dixon & Herling** in Stamford, Conn.

Continued market turmoil. Of course, this is the trillion-dollar question: when will the market and the economy turn around? Bingham's Leonard is optimistic for the latter part of this year. Others peer into 2010.

"I feel we're going to see further deterioration in revenues and margins in financial advisory firms in '09," says **David Goad**, president of **Succession Planning Consultants** in Newport Beach, Calif. He believes 2010 will bring the turnaround.

The market may come back this year - it traditionally precedes the larger economy's rebound - but 2010 may produce "a pretty good recovery," predicts **Albert Kyle**, Smith Chair Professor of finance at the **University of Maryland** in College Park. That's when the housing industry will likely bottom out, he says. Kyle remains concerned that the costs of the bailout of **Fannie Mae** and **Freddie Mac** may far exceed what has been announced by the government.

Tactics for advisers in '09

? Spend time examining foreign investments. Their performance is likely to far outpace U.S. stocks because of currency exchanges favorable to the dollar, says Kyle.

? **Rethink your pre-set minimums for portfolio size**, suggests Candela. This is a trend he has been picking up on, as firms with squeezed AUMs look to expand. Be careful that your fees don't appear too large for puny portfolios as the SEC may not look kindly upon this, he warns.

? **Give yourself a grade**, recommends Turner. Assign your compliance program a pass/fail, excellent/satisfactory/unsatisfactory or some other rating. "Give yourself a basic score and see what you need to improve," he says.

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