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September 4, 2017

A primer on blockchain, and why compliance should watch the technology

Believe the enthusiasts and blockchain will revolutionize the industry like the internet. Listen to skeptics and it's a murky world with hidden risks that can bite firms and clients alike.

Investopedia defines blockchain as “a public ledger of all cryptocurrency transactions that have ever been executed.” It goes on to offer an analogy to conventional banking: “the blockchain is like a full history of banking transactions. Bitcoin transactions are entered chronologically in a blockchain just the way bank transactions are. Blocks, meanwhile, are like individual bank statements.”

Blockchain resembles “a shared spreadsheet where every transaction among the people who have permission to use the system” is recorded and visible, says **Ben Anderson**, a principal with **Anderson PLC** in Minneapolis.

RIAs and blockchain

Advisers are communicating with their clients about this nascent technology. The website of **Halpern Financial** (\$282M in AUM) in Ashburn, Va., displays a [graphic](#) that explains blockchain. The RIA informs clients that mainstream “companies like **IBM** and **Goldman Sachs** are investing in blockchain research. **Nasdaq** is already experimenting with a private blockchain-powered stock exchange.”

Halpern CCO **Melissa Sotudeh** says while the firm may have received some client inquiries about

(Blockchain, continued on page 2)

Your comments sought on proposal to delay fiduciary duty rule until 2019

You'll have until Sept. 14 to comment on the **Labor Department's** [new proposed rule](#) that would delay its controversial full fiduciary duty rule until July 2019.

The proposal appears in the Aug. 31 *Federal Register* after the **Office of Management and Budget** concluded its review of the proposal last week ([IA Watch](#), Aug. 17, 2017). The [39-page proposal](#) states the DOL needs more time to complete President **Trump's** ordered review of the fiduciary duty rule.

Another rationale for the delay is without putting off the rule's full implementation due in January, “compliance efforts may prove to be a waste of time and money.” The new proposal would delay the best interest contract standard and other key ERISA exemptions.

(Proposing a Delay, continued on page 2)

Subscriber-suggested story

What your peers do when it comes to monitoring staff e-mails

It's doubtful that you'd place e-mail reviews at the top of your list of favorite tasks to do but it's certainly one that must be done.

One CCO tells **IA Watch** that during a recent **SEC** visit, examiners combing through staff e-mails spotted an issue and opened a for-cause investigation against the financial advisor linked to the e-mail. Fortunately, the adviser was already aware of the e-mail and had been monitoring the staffer.

This scenario alone provides a formidable reason to scour staff e-mails.

We've reported that how you do your e-mail reviews is largely up to you ([IA Watch](#), July 25, 2011). These inspections can consume lots of your time ([IA Watch](#), Aug. 12, 2013), but know that e-mails fall under required books and records ([IA Watch](#), May 21, 2012).

Keep an archive

You should have some way of archiving your staff e-mails, recommends **Kimberly Collins**, a consultant with **Compliance Resource Partners** in Littleton, Colo.

(Eyeing E-mails, continued on page 3)

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Proposing a Delay *(Continued from page 1)* Mentioning the role of the SEC

The new proposal also notes that the SEC may be moving toward its own uniform fiduciary duty standard “for investment advisers and broker dealers” and, without a delay, advisers “would feel compelled to ready themselves for the” 2018 fiduciary duty rule provisions “despite the possibility of alternatives on the horizon.”

These alternatives include the possibility that the controversial fiduciary duty rule could end up being “revised, repealed, or replaced,” according to the new proposal.

Another possibility is that the DOL will “in the near future [propose] a new and more streamlined class exemption built in large part on recent innovations in the financial services industry,” reads the new proposal.

June provisions stick

Should this proposal, which appears to be on a fast track, be finalized and the full fiduciary duty rule delayed, this would not alter the provisions of the fiduciary duty rule that took effect in June.

This means advisers “would have to give prudent advice that is in retirement investors’ best interest, charge no more than reasonable compensation, and avoid misleading statements,” states the DOL ([IA Watch](#), June 8, 2017).

The **Financial Services Institute** praised the new proposal, encouraging the DOL to use the extra time to “coordinate with regulators, including the SEC” on a streamlined standard. The FSI also took a jab at the parts of the fiduciary duty rule that took effect in June. “It has only been a few months since the impartial conduct standards went in place, but we have already seen investor

choice limited and retirement savings advice pushed out of the reach of those who need it most,” the FSI stated.

Much of the new proposed rule recounts some of the 60,000 comments the Labor Department received since it invited new comments in June ([IA Watch](#), July 6, 2017).

Parts of this story first appeared as breaking news at www.regcompliancewatch.com on August 30.

Blockchain *(Continued from page 1)*

investing in bitcoins, the RIA posted the blog more to educate its clients about blockchain. Bitcoins are “a risky investment,” she says. “RIAs are a cautious bunch in general,” she adds.

Morling Financial Advisors (\$164M in AUM) in San Francisco [advises](#) “inquiring clients to educate themselves on cryptocurrencies and invest if they are very interested, but only in amounts that they would not mind losing.”

Big Wall Street firms see huge savings in the technology. One study predicts blockchain could cut trading settlement costs by \$16 billion a year. The technology could make financial services jobs in operations, record-keeping and custody disappear in great numbers, points out Anderson.

“Blockchain will change not only the financial services industry but a number of industries and how they do business,” believes **Kari Larsen**, counsel at **Reed Smith** in New York.

The technology will shake up banks, payment networks, stock exchanges, broker-dealers and auditors, offers **Robert Crea**, of counsel, **K&L Gates** in San Francisco.

CFTC Chairman **Christopher Giancarlo** [has](#)
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Blockchain *(Continued from page 2)*

said [Blockchain](#) “could be the biggest technological innovation in the financial services industry and financial market regulation in a generation or more.”

But build it and the bad guys may come. The SEC Aug. 28 [dispatched](#) an investor alert warning that fraudsters “often try to use the lure of new and emerging technologies to convince potential victims to invest their money in scams.”

This follows [another investor alert](#) released in July that noted “initial coin offerings” made via blockchain could be seen as securities and subject to federal law ([IA Watch](#), July 27, 2017).

The emerging technology could challenge regulators. “It’s very difficult to regulate because it’s an international, global phenomenon,” says **Richard Kastelein**, a blockchain entrepreneur based in Groningen, Netherlands.

If U.S. regulators attempt to “inhibit” the new technology, then it will simply thrive in other jurisdictions, depriving the U.S. of its benefits, Kastelein argues. He sees blockchain as “a threat” to Wall Street and banks in 10 to 15 years.

Blockchain’s reliance upon open-source software gives the little guy a chance to participate in capital formation. It also deters venture capitalists who can’t control the technology, Kastelein contends. “Our world is pseudo-anonymous,” he adds.

The technology attracts its evangelists, says Crea, but remember it “is a human invention subject to flaws and unintended consequences.”

A bit of anarchy

“Blockchain is the wild West,” states **Steve Wilson**, VP and principal analyst at **Constellation Research** in Sydney, Australia, and a critic of the technology. “If you lose your keys, you lose your wallet, you never get your money back,” he says of its risks.

That’s true, says Kastelein, which is why bitcoin

“whales” – who are the world’s heaviest investors in the cryptocurrency ([IA Watch](#), Sept. 30, 2013) – store their keys in safety deposit boxes (ironically, in banks).

Kastelein states one capital venture via blockchain raised \$1.5 billion in three months. He claims early bitcoin investors are multimillionaires. If one is skeptical about investing via blockchain, the person should “stay out of it,” he adds.

Wilson would agree with this advice. “You don’t even know if these folks are testing their software appropriately,” he says. “We need to be very careful about this.” He doubts Wall Street will ever embrace the technology given the complexity of financial services.

“It is definitely not something that is going to go away,” counters **John Viskocil**, counsel with **Locke Lord** in New York, of blockchain’s emergence. Soon clients will be asking you about it, he predicts.

Some predict trade settlement using the technology could be widespread by 2019. Others say it will be three to five years before the technology’s footprint truly makes its mark upon Wall Street.

Compliance officers should be “skeptical,” says Larsen because bitcoin exchanges have been hacked. Scrutinize disclosures. Understand the products. Confirm that exchanges have been vetted. Look for AML/KYC protections. Ask if the transactions occur in the U.S. or off shore, she continues.

Editor’s Note: Learn more about blockchain in this 2016 [World Economic Forum report](#).

Eyeing E-mails *(Continued from page 1)*

Many advisers turn to vendors, such as [Global Relay](#), [OneSecure](#), [AdviserMail](#) and [Smارش](#), she adds. There are many other firms, such as [themaillaundry](#) and [egress](#), among others.

How often you review e-mails “is contingent on how many e-mails you’re getting,” maintains Collins. Some advisers review e-mails each day, others monthly, and still others quarterly, she adds. She recommends you start with trying to review a 10% sample of your e-mails and “if it’s too much, scale it back.”

Swank Capital (\$3.7B in AUM) in Dallas, “streamlined” its e-mail monitoring, says General Counsel/CCO **Barry Greenberg**. Some staff receive an amazing 100,000 e-mails each month. Greenberg has reduced the size of his reviews so as to be able to look at more staffers’ e-mails and to target those that rouse certain search terms.

“We start with [an undisclosed] percentage and see how many e-mails that generates,” he says. If the system ([Eyeing E-mails, continued on page 4](#))

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