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Alternative Investment Industry Outlook for 2015

by Elana Margulies

Despite hedge funds underperforming the S&P 500 Index last year and the California Public Employees' Retirement System, the biggest U.S. pension, deciding to divest from the asset class, the alternative investment industry is poised for a stellar 2015. Investors are expected to increase their allocations to both hedge funds and private equity, managers are anticipated to outperform, the industry will see more new fund launches, and finally, there will be continued growth in the liquid alternatives space.

INVESTOR OUTLOOK

Both institutional investors, led by public pension funds, and family offices/high-net-worth individuals, are expected to boost their allocations to alternative investments.

Don Steinbrugge, managing member of Agecroft Partners, a Richmond, Virginia-based third-party marketing firm, specified that public pensions are expected to be the most active group of institutional investors that will increase their hedge fund allocations, redeeming money from both their long-only fixed-income and long-only equity buckets and redeploying it to hedge funds, arguing the returns are likely to be higher.

"Pensions will be coming out of the fixed-income component part of their portfolio because this long-only fixed income component is expected to generate a 2.5-3% return while hedge funds are expected to generate a 4-7% return," he said. "Also, some money may come out of equities into hedge funds as a means for a diversification hedging strategy to reduce downside volatility."

Some allocators will prefer managers with a longer track record and greater amount of AUM while others will favor smaller and/or emerging managers.

MSF Capital Advisors, a New York-based global multi-family office, which invests opportunistically, is one investor that will continue to eye smaller managers on the premise they perform better than the bigger funds. "Like most studies have found, the smaller managers have gotten better alpha and we certainly believe in that," said Michael Felman, president.

Last year, MSF Capital Advisors seeded two private equity funds.

PERFORMANCE

Both hedge funds and private equity managers are expected to generate solid returns this year. Hedge funds will benefit from the increase in volatility in the marketplace while leveraged buyout managers will profit from more attractive valuations.

Matt DenBleyker, director of research at Larry Thompson & Associates, a Dallas-based independent investment management consulting firm, said that the multi-strategy hedge funds and sub-strategies that underperformed last year are poised to benefit this year due to the increase in volatility.

"The unwinding of the Fed stimulus will prompt volatility to pick up and help hedge fund performance," he said.

He specified that equity long/short, credit long/short and event-driven strategies are amongst some groups slated to benefit from the spike in volatility.

Meanwhile, on the private equity side, he added middle market offerings will be one of the best performers as a result of more attractive valuations.

LAUNCH ACTIVITY

As a result of the positive performance, the alternative investment industry is expected to see more launches. Boris Onefater, CEO of Constellation Investment

Consulting Corporation in New York, said that the industry will witness more launches in the first quarter since a number of them were postponed from the fourth quarter last year due to overall underperformance.

"We will see a lot of peer-to-peer lending launches, long/short equity launches, long-biased global, credit and real estate-supported products," he said.

According to the most recent data from Hedge Fund Research, an industry research firm, the pace of launches slowed throughout last year. There were only 240 new fund launches in the third quarter last year compared to 285 during the second quarter.

LIQUID ALTERNATIVES

Liquid alternatives are on target for continued growth this year, both in the total amount of AUM and in the number of new product launches.

Rafay H. Farooqui, co-founder and president of CAIS, a New York-based financial product platform for registered investment advisors and broker-dealers, said the space will see new multi-manager and single-manager fund launches, along with more wealth advisors using liquid alternatives as a key component of their asset allocation process.

"Liquid alternatives appear to be at the beginning of a 10-15 year growth period and one that could result in a similar success to that of the ETF market," he said. "2015 should be no different than 2012, 2013 and 2014 in that there should be continued double-digit growth in the number of funds and the AUM they attract."

CONCLUSION

If these predictions hold true, between increased investor interest, outperformance, more new launches and the robust growth in liquid alternatives, 2015 should be a great year for the alternative investment industry. As a result, AUM will reach new levels. ■

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AIFMD — Looking Back, but Moving Forward

By Wendy Piergolam, Vice President-International Desk, Orangefield Group

On November 11, 2010, following the event in which the Economic and Financial Affairs Council reached consensus in respect of the Alternative Investment Fund Managers Directive ("AIFMD" or the "Directive"), the European parliament voted in favor of adapting this new legislation.

The Directive aims to regulate the management and marketing of collective investment undertakings that are not subject to the UCITS regime. The legislation was drafted following the Madoff case with the goal of preventing such fraud and protecting investors from investing into a fund which has no title to the assets it claims, or uses the funds collected from investors for different purposes than communicated.

AIFMD applies to all Alternative Investment Funds ("AIFs") which are not in scope of the UCITS regime with very little exemptions. In general, unleveraged funds with 500 million EUR in AUM or leveraged funds with 100 million EUR in AUM are obligated to comply. This includes all alternative investment funds regardless of whether a hedge fund, private equity fund, real estate fund, or fund of hedge fund. Given the extremely broad scope and far-stretching consequences of failure to comply, the Directive has managed to keep the European regulators, fund managers, banks, lawyers, and nearly all active members in the financial services industry occupied for the past few years leading up to its recent implementation.

Last year on July 22, the legislation finally came into full effect throughout the European Union upon the elapse of the one-year grace period.

The Directive also affects managers and funds outside of Europe when:

AIFMD — Looking Back, but Moving Forward *(continued)*

a. A fund outside of Europe is managed by a European fund manager

b. A manager outside of Europe is managing a European fund

c. A manager outside of Europe is managing a non-European fund that markets to European investors.

Simply said, fund managers either fall under the full or partial scope of the legislation depending on the local laws of the European member state involved.

For those who are unfamiliar with the regulation, a manager who is under full scope of AIFMD qualifies as an Alternative Investment Fund Manager ("AIFM") and is obligated to uphold the following rules, which are imposed by the Directive:

- Apply for authorization from the regulator of the country in which the AIFM is based.
- Comply with the minimum capital requirements.
- Comply with conduct of business rules (such as managing conflicts of interests and fair treatment of investors) and implementation of risk and liquidity management measures.
- Comply with specific remuneration practices (including requirements for deferred payment of variable remuneration and for share or unit based payments).
- Segregate internal risk functions and portfolio management.
- Appoint external depositories to safeguard fund assets and monitor cash flows (and requirements regarding depositories' liabilities for safeguarding such assets).
- Delegate the AIFM's functions according to strict rules.
- Submit to limits on and disclosure of the use of leverage.
- Disclose information to the regulator and to investors.

Whilst European AIFMs, their advisors, service providers, and bankers have been fully occupied ensuring that all AIFMs met the extensive list of requirements, non-European managers have been on the sidelines, struggling to understand what their obligations were per country.

Each non-European manager who intends to market to investors of any European member state is obligated to comply with the National Private Placement Regime ("NPPR") of that member state. In a situation where, for example, a U.S. manager with a non-European fund is marketing to European-based investors in the United Kingdom, Luxembourg, France and the Netherlands, the manager will need to follow the NPPR of all four European countries.

Thus, despite AIFMD being a European regulation, it has been implemented into the local laws of each member state, leaving non-European managers forced to comply with different local regimes varying from full exemptions in certain countries, to light regimes imposed on them in others, to very strict rules in some countries such as Germany.

Although the regulation is still perceived as challenging, nearly half a year later, the regulators have provided much more clarity and there are now certain jurisdictions with the European Union that have strongly positioned themselves as "AIFMD-friendly."

With the progression of time, we continue to see attention shifting to different facets of the Directive. From becoming AIFMD compliant and obtaining a license, to finding a depository and complying with many other aspects which have swiftly become business as usual, the focus has shifted to complying with the stringent data-reporting obligations known as the AIFMD Annex IV transparency reporting. The latter has also stirred up all parties outside Europe who need to register and submit their first local reporting.

There are two Annex IV reports:

a. The AIFM report provides details of the manager and a consolidated view of the assets managed.

b. The AIF report must be completed for each fund and contain details of the assets held by the fund, the risks to which it is exposed, the types of investor holding shares or interests in the fund, and much more.

The exact filing dates are different within in each member state. Adding further complexity, the frequency of the Annex IV reporting is based upon the AUM, resulting in a variance of reporting dates for managers – quarterly, bi-annually or simply annually (for those who are lucky).

Producing an Annex IV report requires more than merely gathering data. Aggregating information from several sources and managing different types of data — varying from static data, accounting data and risk measurements—are involved, creating a substantial amount of work and tremendous time demands on a manager. The report has some similarities to Form PF, which is a reporting due to the Securities and Exchange Commission in the U.S.

With the elapse of each new AIFMD phase comes a new challenge: 2015 brings the EU Passport and resolution on whether this will become available for non-European managers.

For those who are not familiar with the EU passport regime under AIFMD — this will in fact allow AIFMs to market their AIFs to professional investors across Europe and to manage an AIF that is domiciled in another member state. The regime will become effective in the course of 2015.

On November 7, 2014, the European Securities and Markets Authority ("ESMA") published a call for evidence on the EU passport under the AIFMD and third country AIFMs; the deadline for responses to the call for evidence was January 8, 2015. ESMA will consider the feedback it received in the first quarter of 2015 and is required to deliver the opinion and the advice to the Commission by July 22, 2015.

This means that it is possible that non-EU AIFMs may be able to apply for authorization to market AIFs under the passport system, depending on the outcome of ESMA and its advice to the Commission.

Although the regulation has caused necessary concerns amongst those who need to comply with it, I believe that it all stands or falls with guidance; having the right local support to rely upon makes a difference. As challenging as the regulation might seem, AIFMD is here to stay. ■

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Accounting Considerations in the Valuation of Restricted Securities

By Ari Samuel, CPA and Patterson Chiweshe

Improving expectations on economic conditions have opened the spigot on public offerings by private equity-backed portfolio companies in the public capital markets. Ordinarily, one would expect that the availability of a public market price on a security would simplify the arithmetic in the estimation of fair value for financial reporting purposes. However, financial officers and auditors should give careful considerations to the applicable securities laws when determining the valuation of portfolio securities held in companies that have recently undertaken a public offering of either debt or equity securities.

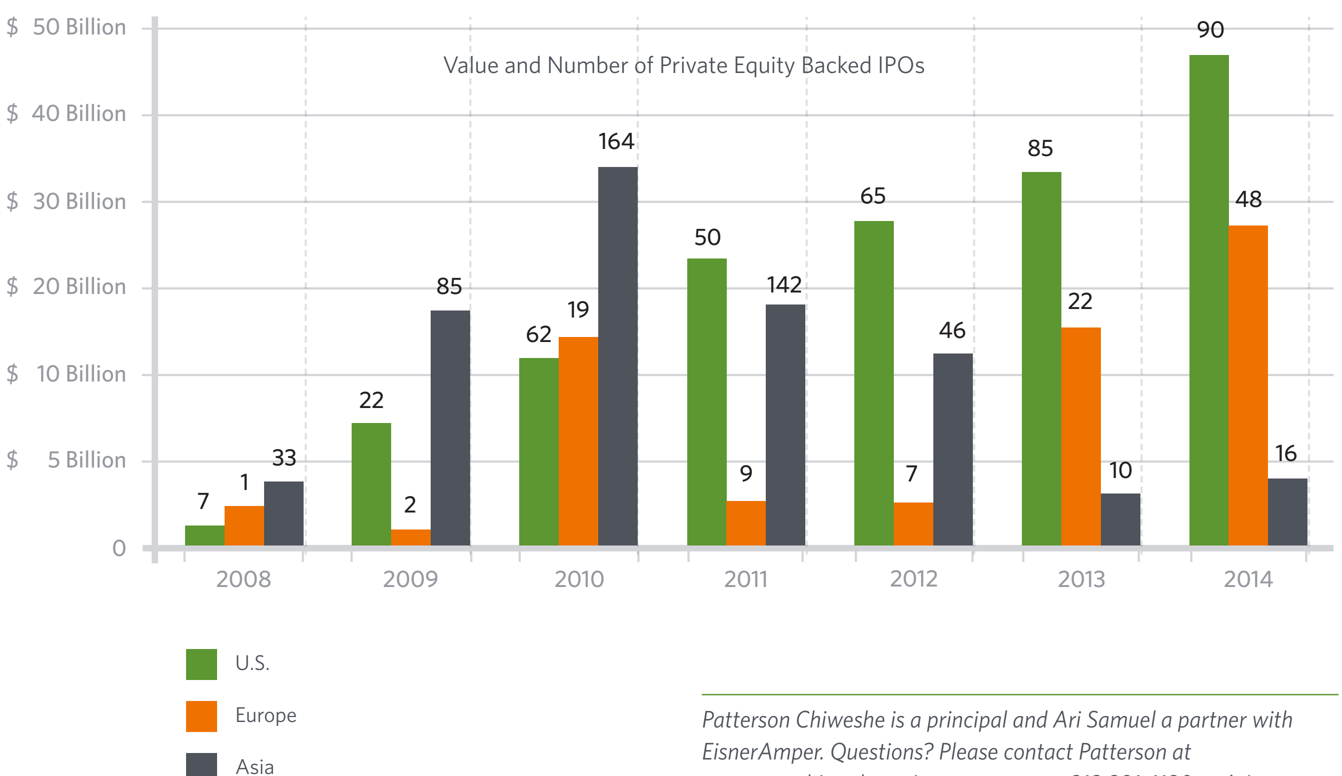
The guidance in ASC 820 states clearly that the effect of resale restrictions on securities (legal or contractual) that are a characteristic or attribute of the security should be considered in the determination of that security's fair value.

Accounting Considerations in the Valuation of Restricted Securities *(continued)*

In the United States, securities that are the subject of an effective registration statement (under either forms S-1, S-3 or S-8) can be freely traded in a public securities market. Where an investment company holds registered securities in its portfolio, valuation using PxQ methodology is appropriate.

However, financial officers and auditors should be aware that not all portfolio equity securities held by a financial sponsor may be registered. Securities that are not registered are restricted under federal securities laws, and accordingly cannot be freely traded on a public securities market. Restricted securities, for example, securities acquired pursuant to one of the transactions specified in Rule 144(a)(3) of the Securities Act of 1933, include all securities acquired from an issuer in a transaction not involving any public offering. Furthermore, financial officers and auditors should be aware that in valuing these restricted securities, the guidance of ASC 820 requires that they consider and evaluate the effect of the attribute restriction in determining the value of the security. Financial officers should carefully consider the effect of these attribute restrictions of securities laws in the valuation policies adopted by the funds they administer, and should be cognizant of the fact that securities laws differ, sometimes in material respects across jurisdictions. In the European Union, for instance, it is a condition of obtaining admission of securities to a regulated exchange, such as the London Stock Exchange or the Frankfurt Stock Exchange (Börse Frankfurt) that (i) the application for admission relates to the whole class of securities, and (ii) the securities be freely transferable (subject to very limited exceptions). Accordingly, adopting and applying a singular valuation policy to all geographic markets where the funds may trade may not be appropriate. ■

MARKET DATA



Source: Bloomberg

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FATCA's Major Impact on Domestic and Foreign Funds

By Gerard O'Beirne, CPA and Harold Adrion, JD

The Foreign Account Tax Compliance Act ("FATCA") is a U.S. law aimed at foreign financial institutions ("FFIs") and other financial intermediaries to prevent tax evasion by U.S. citizens and residents through the use of offshore accounts. The FATCA provisions were included in the Hiring Incentives to Restore Employment ("HIRE") Act, which was signed into U.S. law on March 18, 2010.

The impact of FATCA on U.S. and offshore funds is extraordinary. Almost every asset management fund will have to comply with FATCA and will either be considered a U.S. withholding agent or an FFI.

The U.S. has entered into Model 1 intergovernmental agreements ("IGAs") (agreement between a foreign jurisdiction and the IRS) with several jurisdictions, including the Cayman Islands. Under a Model 1 IGA, investment funds must register with the IRS but will not be required to enter into an FFI Agreement. Instead, they will be obligated to comply with the local rules issued by the IGA partner country for the implementation of FATCA. Under a Model 2 IGA, an FFI Agreement is necessary and reporting is done in the U.S.

FATCA will apply in different ways to domestic and foreign funds.

Fund requirements under FATCA can be broken down into four categories: account documentation; due diligence; withholding; and registration and reporting. To the extent funds are established in the Cayman Islands, the Cayman Islands-U.S. IGA and the Guidance Notes the Cayman Islands have issued will govern the above obligations of funds.

DOMESTIC FUNDS (INCLUDING DOMESTIC FEEDERS)

To comply with FATCA, domestic funds must:

1. Confirm that foreign funds and other investment entities in which a fund invests are taking steps to become FATCA-compliant.

2. Identify U.S. withholding agents to which the fund and investors will need to provide new FATCA documentation and confirm that documentation has been provided where requested by the U.S. withholding agent. Generally, this will be the prime broker for hedge funds and portfolio companies for private equity funds.

3. Confirm that the fund has received affirmative confirmation that the agent will withhold in accordance with the fund's expectations.

4. Confirm the fund has valid Form W-9s and W-8s for all its investors. (See discussion of forms below.)

U.S. funds are generally not required to register with the IRS. However, if a U.S. fund chooses to be a lead FFI or a sponsoring entity, or if it seeks to maintain "qualified intermediary" status with respect to its foreign branch(es) or if it has a foreign branch in a Model 1 IGA jurisdiction, it is required to register.

FOREIGN FUNDS (INCLUDING FOREIGN FEEDER FUNDS AND MASTER FUNDS)

Similarly, foreign funds need to be concerned with FATCA.

1. Foreign funds should have registered by now on the IRS website and have obtained a Global Intermediary Identification Number ("GIIN"). They will also have to review accounts and obtain appropriate documentation from investors. If the foreign fund has not yet registered as an FFI, it should take the necessary steps to register now.[1]

FATCA's Major Impact on Domestic and Foreign Funds *(continued)*

2. Confirm who is responsible for due diligence procedures for new and pre-existing accounts. For hedge funds it will generally be the administrator or other third-party service provider. For private equity funds it may be the administrator or in-house personnel depending on the size and complexity of the fund. (See discussion on due diligence below.)

3. Review the rules governing the FFI depending on where it is organized (IGA or non-IGA country).

4. For Cayman Islands funds they will in general be governed by Cayman Island Guidance Notes. (See below.)

COMPLIANCE UNDER THE CAYMAN ISLANDS GUIDANCE NOTES

The Cayman Islands Tax Information Authority ("TIA") issued Guidance Notes on Cayman Islands FATCA in July 2014. The TIA issued a second version on December 15, 2014 which replaces the previous version and provides additional guidance on a number of issues.

Investment managers, general partners and investment funds located in the Cayman Islands need to have arrangements in place to allow them and the funds that they operate or sponsor to comply with Cayman Islands FATCA.

Filings with the TIA begin on May 31, 2015 with respect to U.S. Reportable Accounts.[2] If an FFI establishes that it has no U.S. Reportable Accounts, then it must still make a nil filing with the TIA as noted above. This will be through an online portal which is yet to be released. We expect that the TIA portal will be online in the early part of the first quarter of 2015.

However, if a fund concludes that it is a reporting FFI, notification to that effect together with name classification and any GIIN must be given to the TIA by March 31 of the year in which the first report is due.

The above is a high-level summary of the actions which U.S. and foreign funds must take to become compliant with FATCA. We used the Cayman Islands as an example because of the number of funds established in the Cayman Islands and the fact that the Cayman Islands has developed guidance notes, unlike some of the other jurisdictions in which funds are located.

The above discussion is limited to FATCA compliance by funds; other U.S. tax withholding and reporting rules continue to apply.

DUE DILIGENCE

Due diligence is required for holders of pre-existing accounts and new accounts. The time frame for applying due diligence procedures is generally upon opening for new accounts and as follows for preexisting accounts.

1. December 31, 2014 for accounts held by "prima facie" FFIs,

2. June 30, 2015 for "high value" accounts, and

3. June 30, 2016 for all other accounts.

Preexisting accounts are:

- Individual accounts opened and existing as of June 30, 2014.

- Entity accounts opened and existing as of December 31, 2014.

New accounts are:

- Individual accounts opened on or after July 1, 2014.

- Entity accounts opened on or after January 1, 2015.

REPORTING

FATCA requires reporting of U.S. account information to the relevant tax authorities.

1. A fund located in a Model 1 IGA jurisdiction will have to report the information required by the IGA to the governmental authorities in that jurisdiction rather than to the IRS. Those governmental authorities will in turn report that information to the IRS.

2. A fund located in a Model 2 IGA jurisdiction or in a jurisdiction where there is no IGA will be required to annually report the U.S. account information directly to the IRS (Form 8866).

Note that Cayman funds subject to reporting must report by May 31 of each year starting in 2015.

FORMS

1. Confirm that all Form W-9s for domestic partners are valid. Note a Form W-9 does not expire but a new Form W-9 was released by the IRS in August 2013. The new Form W-9 has two new exemption codes to:

  a. claim exemption from backup withholding if you are a U.S. exempt payee.

  b. certify that you are exempt from FATCA reporting.

2. Confirm that Form W-8s for foreign partners are valid and have not expired. Generally the Form W-8 will expire 3 years after it is submitted to a withholding agent. However, the IRS has extended the term of the 2010 Form W-8s that would otherwise have expired in 2013 through December 31, 2014. If the Form W-8 has expired or is about to expire, the new Form W-8BEN for individuals and the new Form W-8BEN-E for entities should be collected by the fund.

3. Form W-8IMY was revised in April 2014 and is the current version of the form for use by foreign intermediaries, such as foreign partnerships and trusts. The old version (dated February 2006) can only be used through December 31, 2014. Generally Form W-8IMY is valid until the status of the person whose name is on the certificate is changed in a way relevant to the certificate or if there is a change in circumstances that makes the certificate no longer correct. The Form W-8IMY must be updated as often as necessary to enable the withholding agent to withhold at the appropriate amount. ■

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[1] Under transitional relief, certain non-U.S. investment funds, including Cayman Islands funds that qualify as FFIs, have been permitted to certify their status under FATCA without registering with the IRS to obtain a GIIN. As of January 1, 2015, this relief no longer applies, and, going forward, all FFIs should expect FATCA withholding agents to require withholding tax forms that include a GIIN.

[2] The term "U.S. Reportable Account" means a financial account maintained by a reporting financial institution and held by one or more specified U.S. persons or by a non-U.S. entity with one or more controlling persons that is a specified U.S. person.

Cyber Security: A Brave New World

By Gary Swiman, CPA, CFF

In today's advanced technological society, commercial organizations are increasingly under attack. The growing reliance on technology, globalization and the inter-connectivity of large financial services firms around the world make them an attractive target for those with the skills to gain access to the systems they use to manage their day-to-day operations.

Financial institutions, such as banks, investment advisory firms, and security broker-dealers around the world, have been susceptible to cyber attacks. Even large retail chains, such as TJ.Maxx, as well as the U.S. federal government and other sovereign countries have been victims of cyber espionage. No one connected to the internet is exempt from an attack. Financial firms are by-and-large the most attractive targets due to the nature of their business. Cyber criminals seek access to personal credit card data and corporate secrets, and to steal corporate data, engage in money laundering activities and intimidate internet-dependent businesses. As technology becomes more sophisticated, so too will the tools and techniques used to gain access to systems.

Let's examine financial investment advisors who manage client portfolios, whether in the form of a separate account or in a commingled investment pool such as a private fund or mutual fund. Financial firms are under increasing pressure to more effectively communicate with their clients due to the explosion of mobile capabilities, social media and cloud computing. Therefore, firms who are taking advantage of technology, such as those financial services industry seeking to become more transparent and available to their investors, have become more susceptible to cyber crime.

WHAT CAN BE DONE TO FEND OFF ATTACKERS?

While there is no universal solution that will guarantee the security of clients' personal data, there are some common-sense solutions that will enhance the security of systems used to maintain client information. The good news is that the United States Securities and Exchange Commission ("SEC") has taken note of these attacks and taken action by proposing new regulations and providing guidance on what financial services firms (primarily investment advisors) can do to address this threat.

On November 19, 2014, the SEC adopted Regulation Systems Compliance and Integrity ("SCI") under the Securities Exchange Act of 1934. Regulation SCI applies to certain self-regulatory organizations (including registered clearing agencies), alternative trading systems, plan processors, and exempt clearing agencies that require these entities to have in place robust technology controls and promptly take corrective action when problems arise. These types of technology controls encompass a wide range of activities related to mobile devices, email, social media, and client website access, where cyber attacks can occur.

In addition to the adoption of new rules, the SEC has also provided guidance to financial services firms, performed a cyber-sweep inquiry and enhanced their examination program to include a closer look at SEC registered entities' information security programs ("ISPs").

GUIDANCE

The SEC, in an investment advisor conference sponsored by industry newsletter *IAWatch*, stated that advisory firms should adopt the National Institute of Standards and Technology controls outlined in its February 12, 2014 whitepaper, "Framework for Improving Critical Infrastructure Cybersecurity"(the "Framework"). This paper is the outgrowth of Presidential Executive Order 13636, enacted on February 12, 2013, which established a U.S. Government policy "to enhance the security and resilience of the Nation's critical infrastructure and maintain a cyber environment that encourages efficiency, innovation, and economic prosperity, while promoting safety, security, business confidentiality, privacy, and civil liberties."

The Framework focuses on using business drivers to guide cyber security activities and consider cyber security risks as a component of the organization's risk management process. It consists of three parts:

1. The Core Framework: A set of cyber security activities, outcomes, and informative references which are common across critical infrastructure sectors, providing the detailed guidance for developing individual organizational profiles.

2. The Framework Profile: The Framework, used in conjunction with specific profiles, aligns the firm's cyber security activities with its business requirements, risk tolerances, and resources.

3. The Framework implementation tiers: A mechanism for organizations to view and understand the characteristics of their approach to managing cyber security risk.

The Framework is not a one-size-fits-all approach to managing cybersecurity risk for critical infrastructure. Financial service firms have unique risks – different threats, vulnerabilities, and risk tolerances – and how they implement the Framework will vary. Ultimately, it is aimed at reducing and better managing cyber security risks. The Framework is a living, breathing document that will be updated as industry provides feedback on implementation.

SWEEP INQUIRY

In April 2014, the SEC announced an initiative to assess cyber security preparedness in the securities industry and to obtain information about the industry's recent experiences with certain types of cyber threats. As part of this initiative, the SEC's Office of Compliance Inspections and Examinations ("OCIE") conducted sweep examinations of registered broker-dealers and registered investment advisors focused on cyber security governance, identification and assessment of cyber security risks; protection of networks and information; risks associated with remote customer access and funds transfer requests; risks associated with vendors and other third parties; detection of unauthorized activity; and experiences with certain cyber security threats.

The results of these sweep examinations will help the OCIE formulate a similar program to incorporate into their routine examination of investment advisors and broker-dealers.

COMMON SENSE SOLUTIONS

While you are working on implementing the Framework, there are some common sense industry best-practice quick fixes to enhance and maintain information security of critical client and proprietary data at your firm without breaking the bank. These common practices include:

- Eliminate unnecessary data and keep tabs on what is left.
- Ensure essential controls are met and regularly audited to ensure consistent implementation.
- Change default credentials.
- Avoid shared credentials.
- Implement a firewall or access control list ("ACL") on remote access/administration services.
- Utilize IP blacklisting.
- Update anti-virus and other software consistently.
- Audit user accounts.
- Restrict and monitor privileged users.
- Monitor and filter outbound network traffic.
- Test applications and review codes.
- Monitor and mine event logs.
- Change the approach to event monitoring and log analysis.
- Define 'suspicious' and 'anomalous' (then search and monitor whatever activities you define as such).
- Increase awareness of social engineering.

Cyber Security: A Brave New World
(continued)

- Implement cyber security employee training and customer alerts to look for signs of tampering and fraud.
- Create an incident response plan.
- Engage in mock incident testing.
- Secure business partner connections.

In addition to the above, here are some common sense, everyday operating principles to implement:

- Perform due diligence on third-party vendors with information security and privacy as part of the agenda:
  - Develop an ongoing Vendor Management Program ("VMP") that subjects those vendors that obtain access to critical client information to the same criteria that the SEC requires of you.
  - Your VMP should consider second-tier vendors (when vendors you select in turn outsource your client data to a vendor that they select without your knowledge, e.g., disaster data back-up recovery sites, systems security, etc.) .
- Examine FTP sites in use. Third parties you work with may use their FTP sites for long-term storage:
  - FTP sites should be used only to transfer current information. When old files are not removed, it invites cyber chicanery.
- "Risk rank" your firm's data with client and proprietary confidential and non-public mission-critical data, respectively, ranked as high:
  - You may want to segregate this data to a non-widely accessed in-house server and limit access to the data through application entitlement.
- Be aware of digital debris, or files that won't go away when deleted.
- Do not use a cloud-based data retention service for mission-critical data.
- Engage an independent vendor to perform a risk assessment of your ISP and ongoing surprise penetration testing of your network.

There are a lot of cyber security experts who believe that the next major war between nations will not be fought with bombs, missiles and ground troops entirely but through cyberattacks to blind countries early warning and defense systems. Yes, it is a Brave New World that is moving quickly to a more computer and software-driven society with a reduction human capital dependency. The real question is: Are you prepared? ■

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