

The Top 10 Current Compliance Issues For Investment Advisers



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ABOUT YOUR SPEAKER AND HOST

Christopher J. Moyen, Esq.

- SNSFE associate attorney
- Practice concentrated in securities regulatory and compliance matters for broker-dealers, registered representatives and investment advisers before the SEC, NASD, NYSE, and state securities regulators
- Experience in complex commercial and class action litigation, securities arbitration and litigation, and proceedings before the SEC, NASD, NYSE and other regulatory agencies

SNSFE

- Established in 1960
- Full service business law firm
- Representing closely-held businesses, entrepreneurs and individuals
- From start-up to succession planning
- "A-V" Peer-Review Rated*

* Martindale-Hubbell is the facilitator of a peer-review process that rates lawyers. An "A-V" rating is the highest rating for "Legal Ability" and "General Ethical Standards."

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The Top 10 Current Compliance Issues For Investment Advisers

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**Codes of Ethics & Compliance Manuals
Policies and Procedures**

Example Deficiencies Include:

- Adopting "One size fits all" Codes of Ethics, Policies and Procedures
 - Some standardized forms are a very good start
 - They are only a start and must be customized for your business
- Failing to follow adopted Policies and Procedures
- Compliance Manuals that do not address a firm's risks

**Codes of Ethics & Compliance Manuals
Policies and Procedures**

Overall, are Codes of Ethics and Policies and Procedures updated and relevant?

Marketing/Performance Advertising

Example Deficiencies Include:

- Inaccurate performance calculations
- Overstated performance
- Omitting relevant disclosures, which would prevent advertisements from being misleading
- Unsubstantiated claims
- Misrepresentation of services offered

Marketing/Performance Advertising

Specific Restrictions.

An advertisement may not:

- Use or refer to testimonials of current or former clients including any statement of a client's experience with, or endorsement of, an adviser

Marketing/Performance Advertising

Specific Restrictions.

An advertisement may not contd.:

- Refer to past specific recommendations made by the adviser, unless the advertisement sets out a list of all recommendations made by the adviser within the immediately preceding year

Marketing/Performance Advertising

Specific Restrictions.

An advertisement may not contd.:

- Represent that any graph, chart, formula, etc. can in and of itself be used to determine which securities to buy or sell or when to buy or sell them

Marketing/Performance Advertising

Specific Restrictions.

An advertisement may not contd.:

- State that any report, analysis, or service will be furnished for free, unless it really is entirely free

Marketing/Performance Advertising

Make sure your marketing materials (including brochures, websites, advertisements, etc.) are reviewed by someone with knowledge of the applicable securities laws and regulations

Form ADV/Disclosures

Example Deficiencies Include:

- Failure to provide Form ADV or untimely delivery to clients
- Inaccurate, omitted, or unclear disclosures

Form ADV/Disclosures

Example Deficiencies Include contd.:

- Out of date disclosures
 - In addition to the annual updating amendment, Form ADV must be amended by promptly filing additional amendments if:
 - ✓ Information provided in response to Items 1, 3, 9, or 11 of Part 1A becomes inaccurate in any way
 - ✓ Information provided in response to Items 4, 8, or 10 of Part 1A becomes materially inaccurate

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Form ADV/Disclosures

Example Deficiencies Include contd.:

- Misrepresentation of services offered
- *Failure to disclose potential conflicts of interest*
- Inaccurate account statements
- Overstating account values

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Disaster Recovery/Business Continuity Plans

The SEC has stated that the following provisions in Disaster Recovery Plans have appeared to be effective in helping advisers provide uninterrupted advisory services to clients in a compliant manner after a disaster included:

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Disaster Recovery/Business Continuity Plans

Provisions include:

- A pre-arranged remote location for short-term and possible long-term use
- Alternate communication protocols to contact staff and clients, such as cell phones, text messaging, web-based email accounts, or an Internet website

Disaster Recovery/Business Continuity Plans

Provisions include contd.:

- Remote access to business records and client data through appropriately secured means that ensure ongoing compliance with Regulation S-P and other confidentiality requirements
- Temporary lodging for key staff where necessary as a result of a relocation of the firm

Disaster Recovery/Business Continuity Plans

Provisions include contd.:

- Maintaining accurate and up-to-date contact information for all third-party service providers, including custodians, broker-dealers, transfer agents, pricing services, and research firms
- ***Familiarity with the business continuity plans of such third-party service providers***

Disaster Recovery/Business Continuity Plans

Provisions include contd.:

- Contingency arrangements for loss of key personnel, such as the president or primary portfolio manager, either temporarily or permanently
- Effective training of staff on how to fulfill essential duties in the event of a disaster, including compliance matters

Disaster Recovery/Business Continuity Plans

Provisions include contd.:

- Periodic testing, evaluation, and revision of disaster preparedness plan
- Maintaining sufficient insurance and financial liquidity to prevent any interruption to the performance of compliant advisory services

Personal Trading

Example Deficiencies Include:

- Trading in securities for personal accounts, or for accounts of family members or affiliates, shortly before trading the same securities for clients (*i.e.*, front-running), and thereby receiving better prices

Personal Trading

Example Deficiencies Include contd.:

- Directing clients to trade in securities in which the adviser has an undisclosed interest, causing the value of those securities to increase to the adviser's benefit

Personal Trading

Example Deficiencies Include contd.:

- Codes of Ethics that are deficient or not implemented
 - Effective codes of ethics should be designed to prevent inappropriate trading in personal accounts (*e.g.*, front-running, insider trading, and market timing)
 - Those policies need to be adequately disclosed
 - Actual practice must comport with the policies and disclosures

Personal Trading

Example Deficiencies Include contd.:

- Employees' trading is not reported or not reviewed

Personal Trading

An investment adviser and its advisory representatives must maintain adequate records of personal securities transactions.

Personal Trading

- These records must include:
- A description and amount of the security transaction
 - The date and nature of the transaction
 - The price at which it was effected
 - The name of the broker, dealer, or bank that effected the transaction

Personal Trading

Personal securities transactions must be reported to the advisory firm not more than 10 days after the end of the calendar quarter in which the transaction was effected

Client Privacy Issues

Example Deficiencies Include:

- Ineffective policies and procedures for capturing, compiling, maintaining and reporting information to regulators and customers
- Clients' personal financial information is not effectively protected from unauthorized access and untimely destruction

Client Privacy Issues

Regulation S-P procedures

- Adopt Policies and Procedures for the safekeeping of nonpublic personal information
 - Personally identifiable financial information
 - Any list, description, or other grouping of consumers that is derived using personally identifiable financial information

Client Privacy Issues

Regulation S-P procedures contd.

- Provide customers with a clear and conspicuous notice that accurately reflects your privacy policies and practices
 - Not later than when the client relationship is established
 - Not less than annually during the continuation of the client relationship

Client Privacy Issues

Regulation S-P procedures contd.

- Opt-out Notice
 - Prior to disclosing nonpublic personal information about a consumer, an opt-out notice must be provided to the individual
 - There must be a reasonable means for customers to opt out
 - ✓ *E.g.*, mailing a form or calling a toll-free number
 - ✓ Requiring the individual to write his or her own letter is not a reasonable means

Client Privacy Issues

State Registered Investment Advisers fall under FTC jurisdiction

- The FTC has acknowledged that an investment adviser's compliance with the sample clauses in the SEC rules will equate to compliance with the FTC rules

Soft Dollars

Example Deficiencies Include:

- Research and/or sources of research outside safe harbor
- Inadequate due diligence on research products
- Broker does not pay research source directly
- Research obtained is not current
- Using soft dollars inconsistent with disclosures

Best Execution and Brokerage

Example Deficiencies Include:

- Brokerage arrangements that are not consistent with disclosures
- Failing to seek to obtain best execution
- Favoring brokers based on research or referrals received
- Failing to identify and resolve errors and corrections in the client's best interest

Best Execution and Brokerage

Example Deficiencies Include contd.:

- Failing to periodically and systematically evaluate the costs and benefits of brokerage arrangements and the execution performance of broker-dealers executing their transactions

Best Execution and Brokerage

In evaluating the full range and quality of a broker's services in placing brokerage, consider:

- Value of research provided
- Execution capability
- Commission rate
- Financial responsibility
- Responsiveness to the adviser

Portfolio Management

Example Deficiencies Include:

- Failure to have controls to ensure that investments for clients are consistent with their investment objectives and restrictions
- Inconsistency of securities recommendations and investments with the adviser's disclosures and the client's risk tolerance and goals
- Failure to maintain required records

Portfolio Management

Required records for each client include documents showing:

- Securities purchased and sold and the date, amount, and price for each such purchase or sale
- The identity of each client holding a position in a security in which any client receiving portfolio management services holds a position

Portfolio Management

"True, accurate and current" records are required to be kept "to the extent that the information is reasonably available to or obtainable by the investment adviser"

Safety of Clients' Assets

Example Deficiencies Include:

- Ineffective policies and procedures for safeguarding client assets from theft, loss and misuse
- Failure to follow established policies and procedures

Safety of Clients' Assets

Examples of effective policies and procedures include:

- Reviewing the firm's custodian arrangements
- Having an independent custodian send account statements to clients
- Establishing a process for regularly reconciling client and fund balances of securities owned with those shown by custodians

Some Thoughts on Annual Reviews:

- Make sure that annual reviews are performed with a critical eye in an attempt to identify risks that have not previously been recognized
- Create policies and procedures to address these risks
- Document your annual review and your findings.

Some Thoughts on Annual Reviews contd.:

- Note that SEC Rules require that annual reviews occur *no less frequently than annually*
- Compliance is an ongoing responsibility, and policies and procedures should be reviewed more than just once every year

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Questions?

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