

## **Risk Management Update October 2016**

### **COMPLIANCE YEAR-END PREPARATION CHECKLIST**

The end of 2016 is fast approaching and the financial services industry has been hit this year with some very important and complicated new regulations, such as the Department of Labor's Conflicts of Interest Rule ("DOL Rule") and the Securities and Exchange Commission's ("SEC") amendments to Form ADV. While both of these new rules have compliance dates in 2017, due to the extensiveness of each it is imperative that firms get prepared now.

Additionally, the SEC has provided some insight into what their examination focuses will be for investment advisers in 2017, which include some new areas and a continuation of certain 2016 high priority areas. These are:

- ReTIRE (The SEC's Retirement-Targeted Industry Reviews and Examinations Initiative)
- Branch Office Reviews
- Robo-Advisers
- Cybersecurity
- Advisers with Public Pension Clients
- Wrap Fee Programs
- Fee Selection
- Exchange-Traded Funds
- Reverse Churning

Notably, the above is not complete since the SEC does not officially release their full exam priorities list until January. To help firms prepare for what's to come, this month's Risk Management Update provides an end-of-year compliance checklist. While this checklist is not all inclusive, it will assist Chief Compliance Officers in determining what is needed, while at the same time ensuring their firm's compliance program remains robust and dynamic.

#### **Compliance Checklist:**

- Schedule IARD annual filing fees payment to ensure they are paid within the required deadline. (*Risk Management Tip:* This year's deadline is December 16, 2016. The link to the IARD renewal and method of payment is found at <https://www.iard.com/renewals>.)
- Examine the firm's annual review process performed over the last couple of years and make enhancements to help ensure it remains sufficient in determining the "adequacy" of firm policies, procedures and controls in preventing violations of applicable securities regulations. (*Risk Management Tip:* Consider using a third party service provider to periodically perform annual reviews. Having an "independent" review often brings to light areas that were unintentionally missed.)

- Determine fiduciary status under new DOL Rule, which can be complex depending on facts and circumstances. (*Risk Management Tip:* Use this CCLS flow chart<sup>1</sup> to assist with the determination. For more information, review the two CCLS Risk Management Updates on the DOL Rule<sup>2</sup> for information on preparation steps to consider.)
- Ensure all necessary compliance steps outlined in your firm’s policies and procedures have been performed (or will be by end of the year), including testing and surveillance processes, compliance risk assessment and conflict inventory, regulatory filings, branch office audits and supervisory reviews. (*Risk Management Tip:* Utilize compliance software that prioritizes, tracks and documents reviews and updates.)
- Confirm annual delivery of the firm’s privacy notice to all clients (if required), and review the effectiveness of the firm’s safeguarding protocols that are in place to protect confidential, non-public client information. (*Risk Management Tip:* Send friendly reminder emails to employees as part of the firm’s ongoing training process.)
- Ensure that all annual compliance reporting has been completed by supervised persons, including, but not limited to, reports covering annual securities holdings, outside business activities, political contributions, gifts and entertainment. (*Risk Management Tip:* Consider using third-party compliance software to facilitate the reporting and annual certification process and evaluate responses for new conflicts that require disclosures to clients and investors.)
- Confirm with registered personnel that their currently filed Form U-4 contains update and accurate information. (*Risk Management Tip:* Distribute a current copy of the filed Form U-4 to each registered supervised person for review.)
- Ensure that applicable required federal and/or state filings have been made, including state net capital filings, state registrations, state notice filings, Form 13-F, Schedule 13D/G, Form 13H, Form PF, Form D (private funds), and state blue sky filings. (*Risk Management Tip:* To maximize efficiencies, consider software and third-party outsourcing solutions to assist with these filings.)
- For private funds, verify that the annual audit of the fund’s financials is scheduled, and that internal controls are in place to ensure timely mailing of the audited financial statements to investors within the required period. (*Risk Management Tip:* Coordinate with the Fund’s third- party service providers and employees to allow sufficient time to prepare and facilitate the audit.)
- Review current registration documents and client disclosure documents (such as Form BD, Form N1-A, Form ADV Parts 1, 2A and 2B, client agreements, prospectus and statement of additional information, and private placement memorandums) to ensure they reflect current information and contain required disclosures. (*Risk Management Tip:* Read the SEC issued instructions for the applicable document to ensure you are including all required information. Also, consider recent SEC enforcement actions available at [www.sec.gov](http://www.sec.gov) to better understand the types of disclosures the SEC requires.)

---

<sup>1</sup> See <http://www.corecls.com/wp-content/uploads/2016/04/00113873.pdf>.

<sup>2</sup> See <http://www.corecls.com/wp-content/uploads/2016/04/CCLS-RMU-April-2016-The-DOL-Conflicts-of-Interest-Rule-and-How-it-May-Affect-You-Part-1.pdf> and <http://www.corecls.com/wp-content/uploads/2016/06/CCLS-RMU-June-2016-The-DOL-Conflicts-of-Interest-Rule-and-How-it-May-Affect-You-Part-2.pdf>.

- Review the SEC final rule release on the amendments to Form ADV<sup>3</sup> to determine the specific impacts the amendments will have current reporting and record-keeping processes. (*Risk Management Tip: Meet with senior management sooner rather than later to discuss additional resources that may be needed for gathering data.*)
- Confirm all branch offices have received adequate reviews by compliance personnel. (*Risk Management Tip: Perform onsite visits in conformance with your policies and procedures and consider the strength of internal controls for surveying offsite activities.*)
- Have legal counsel review standard client agreement(s) for necessary provisions and focus on the clarity of the services and fees associated with the servicing mandates. (*Risk Management Tip: Have the agreement(s) reviewed by experienced legal counsel well versed in federal and state securities laws.*)
- Ensure that business websites, social media sites, presentations, commentaries, and other marketing materials are up-to-date, contain all necessary disclosures, have been reviewed by compliance, and copies are retained as part of the firm's required books and records. (*Risk Management Tip: Perform testing to confirm that the firm is only using currently approved marketing and promotional materials.*)
- Analyze maintenance and safeguarding controls for required books and records, including client, corporate and financial records. (*Risk Management Tip: Ensure employees understand the requirements on what to maintain – and how.*)
- Review and test the firm's business continuity plan and ensure training to employees is provided. (*Risk Management Tip: Consider performing various tests relating to different components of the business continuity plan at defined intervals throughout each year.*)
- Perform a risk assessment of your cybersecurity policies, procedures and protocols, to ensure adequate controls are in place. (*Risk Management Tip: Provide user awareness training to supervised persons, including information on current cyber-crimes and how to handle cases of identified cyber threats.*)
- Sample test client files to confirm that investment objectives have been documented and appear current and in-line with portfolio investments. (*Risk Management Tip: Consider automating the "new account" intake process to help ensure timely receipt of required new account documentation.*)
- Audit the billing process to ensure fees are being invoiced properly and clients are not being overbilled. (*Risk Management Tip: Interview employees that perform billing to confirm their knowledge of firm's applicable billing policies and procedures and related safeguards to help ensure accuracy.*)
- Review solicitor arrangements to verify that agreements are up-to-date and in compliance with Rule 206(4)-3 of the Advisers Act, and that solicited clients received a copy of the solicitor's disclosure statement. (*Risk Management Tip: Obtain annual written certifications from each solicitor that they are still in good standing and are adhering to requirements under agreement.*)
- Review surveillance reports, exception reports, and checklists for detection of trends and patterns indicating systemic risk areas and take appropriate actions as needed. (*Risk*

---

<sup>3</sup> See <https://www.sec.gov/rules/final/2016/ia-4509.pdf>.

- Management Tip:* Use technology to the extent possible to perform trend analysis reviews and document all results.)
- Confirm that due diligence reviews of service providers have been performed and documented. (*Risk Management Tip:* Set up a system to maintain due diligence questionnaire responses and implement a monitoring system and due diligence calendar.)
  - Confirm written policies and procedures have been implemented covering the following areas, as applicable: (i) dealing with senior investors, (ii) identifying and handling conflicts of interest, (iii) succession and transition planning, (iv) participating in or sponsoring wrap fee programs, (v) inactive accounts, (vi) handling courtesy accounts, and (vii) branch office reviews and supervisory oversight. (*Risk Management Tip:* When drafting procedures, be sure to involve the employees that will be responsible for these areas so practices match written protocols.)
  - Ensure compliance training has been provided to firm personnel, particularly as it relates to new and revised policies and procedures, risks and conflict areas. (*Risk Management Tip:* Utilize webinars, lunch and learn compliance presentations, symposiums and conferences, and periodic compliance e-news bulletins to assist in educating personnel.)

## **Conclusion**

Keeping up with compliance requirements is an administrative feat that keeps getting more complex with each passing year. While technology may seem costly, it can be very cost efficient in terms of preventing compliance violations and should be used to the extent possible, especially for testing and surveillance. In 2016 alone, the SEC won judgments and entered into settlement orders against financial service firms totaling more than \$4 billion in fines and disgorgements.

To find out about technology solutions offered by CCLS and how we can further assist with year-end compliance planning and beyond, please contact us at [info@corecls.com](mailto:info@corecls.com), at (619) 278-0020 or visit us at [www.corecls.com](http://www.corecls.com) for more information.

**Author: Tina Mitchell, Lead Sr. Compliance Consultant; Editor: Michelle Jacko, CEO, Core Compliance & Legal Services, Inc. (“CCLS”). CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds, private equity firms and banks on regulatory compliance issues.**

*This article is for information purposes and does not contain or convey legal or tax advice. The information herein should not be relied upon in regard to any particular facts or circumstances without first consulting with a lawyer and/or tax professional.*