



Risk Management Update December 2011

COMPLIANCE END-OF-THE-YEAR CHECKLIST

With the passing of the Dodd-Frank Act and heightened regulations governing investment advisers, now more than ever compliance is a critical component of any successful financial practice. For smaller advisers, compliance can be challenging given limited time and resources. To that end, we are providing the following Compliance End-of-the-Year Checklist to help our clients ensure that all necessary requirements are satisfied by the New Year.

Key Considerations

On November 9, 2011, the Securities & Exchange Commission (“SEC” or the “Commission”) issued a press release announcing that the Commission filed a total of 735 enforcement actions in its fiscal year ending September 30, the most ever in a single year in SEC history. More than \$2.8 billion in penalties and disgorgement were ordered as result of the enforcement actions. The SEC views the increase in the overall number of enforcement actions as evidence that it is fulfilling its’ mission of protecting investors and maintaining market efficiency, and credits the increase to the recent reorganization of the Division of Enforcement, the most significant since its’ establishment in the 1970s. In addition to the increase in the total number of enforcement actions, the number of enforcement actions related to investment advisers and broker-dealers also increased substantially. A single-year record of 146 enforcement actions pertaining to investment advisers and investment companies were filed, up 30 % from 2010.

At the state level, the number of deficiencies noted for adviser examinations also continue to increase. The North American Securities Administrators Association (“NASAA”) recently released that in 2011, 3,543 deficiencies were noted from 825 exams compared to 1,887 deficiencies from 458 exams in 2009. The top five categories with the greatest number of deficiencies involved registration, books and records, unethical business practices, supervision, and advertising. In fact, the examination findings revealed that a whopping 59.9% of state-registered investments were deficient in some aspect of their registration obligations.

Based on these factors, the following checklist may serve as a useful tool to help ensure that potential “gap areas” are addressed in the short-term:

- Review your Form ADV Parts 1 and 2 to ensure it reflects current and accurate information. Be sure that information is consistent between the documents.
- Review, and if necessary, update contracts. Ensure they contain required provisions and consider whether you should add electronic delivery language.
- Consider how you are maintaining and safeguarding required records, including client, corporate and financial records.

- Test your business continuity plan and ensure that you have adequate controls for backing-up electronic data.
- Check your client files to ensure that client profiles are complete and updated, as necessary.
- Consider whether your policies and procedures manual requires updating based on new regulations, such as pay-to-play protocols, social media practices and /or custody controls.
- Be sure that you have delivered your annual privacy notice to all clients and review the effectiveness of your safeguarding controls to protect confidential, non-public client information.
- Renew E&O policies and maintain a surety and/or ERISA bond, if required.
- Ensure that your website and marketing materials are updated, particularly if you are providing performance information, with requisite disclosures.
- Review your solicitor arrangements, and make certain that all necessary disclosures and agreements are up to date.
- Perform and document your due diligence review of service providers, third-party managers and investment products as applicable.
- Consider whether you have provided employees with training on compliance requirements, including the adviser's Code of Ethics or personal trading policies, and reviewed all quarterly outside brokerage statements, as applicable, against client transactions.
- Be sure that all outside business activities and annual compliance certification forms have been completed and filed for each applicable associated person.
- Consider whether you have performed necessary compliance reviews, which may include email surveillance, custody safeguards, calculation of assets under management, best execution analysis and anti-money laundering ("AML") checks.
- For SEC registered investment advisers, consider whether you have performed your "Annual Review" and tested your policies and procedures for their effectiveness in preventing violations of federal securities laws.

For state registered advisers, conducting an annual review generally is not required, but is considered a "best practice."

Looking Ahead

In 2012, regulatory changes continue to evolve. Here are some of the most notable.

Form ADV Part 1

The SEC recently amended Form ADV Part 1A to incorporate numerous changes to the registration, reporting, and recordkeeping requirements imposed by the Dodd-Frank Act. The [IARD system](#) has now been updated to reflect the Form ADV Part 1A revisions and as a result, firms filing new applications for registration or amendments to existing applications will be required to provide significant additional information required by the

new Form. The [Form ADV Instructions and Glossary of Terms](#) has also been revised to reflect the new requirements and definitions used throughout Form ADV.

As amended, [Form ADV](#) (now officially named the “Uniform Application for Investment Adviser Registration and Report by Exempt Reporting Advisers”) requires firms to provide more detailed information about private funds they advise, information about the number and types of clients of the adviser, whether the firm holds itself out as specializing in certain types of investments, and more specific information about the number of employees of the firm that are investment adviser representatives, licensed insurance agents, registered representatives of a broker-dealer, or perform advisory functions. In addition, firms must provide more details pertaining to the adviser’s other business activities and financial industry affiliations. The SEC has provided a [redlined version](#) of Form ADV Part 1A showing the substantive changes made from the prior version, which can be found at www.sec.gov.

Transitioning from SEC to State Registration

SEC-registered investment advisers with assets under management between \$25 million and \$100 million will generally be required to transition to state registration under the Dodd-Frank Act. Due to the large number of firms that are expected to transition, states are encouraging advisory firms to file the application as soon as possible, since the application must be approved (not just filed) by June 28, 2012, or the firm’s registration will lapse.

In addition, advisers currently registered with the SEC must file an annual updating amendment to Form ADV no later than March 30, 2012, whether or not a state application has been submitted. For some states, applications that are submitted and approved by the end of 2011, firms can elect to either have the registration take effect in 2011 or request that the Department grant registration effective as of January 1, 2012, which would permit the adviser to avoid having to pay duplicate IARD renewal fees. To assist firms in the transition process, states such as California are providing [step-by-step instructions](#) detailing what needs to be done to complete the transition, including amendments to Form ADV Parts 1 and 2, additional specific forms required for state-registered advisers and instructions for filing Form ADV-W to withdraw from SEC registration.

Notably, mid-sized advisers registered with the Commission as of July 21, 2011 must remain registered with the Commission until January 1, 2012. After July 21, 2011, all mid-sized advisers became prohibited from registering with the Commission and now must register with the appropriate state securities authorities. For more information, including exemptions, visit www.sec.gov.

Form 13H – Large Trader Reporting

As of December 1, 2011, all “larger traders” are to register with the SEC by filing [Form 13H through EDGAR](#). A larger trader is defined as any person that, directly or indirectly

has investment discretion over accounts and effects transactions in exchange-listed securities through registered broker-dealers in an aggregate amount equal to or greater than 2 million shares or \$20 million market value during any calendar day, or 20 million shares or \$200 million market value during any calendar month. The larger trader will need to report, on an ongoing basis, its SEC assigned larger trader identification number to all broker-dealers it uses to effect transactions, and the accounts to which this identification applies. After the initial filing, large traders will be required to file annual amendments to the Form within 45-days after the calendar year-end, as well as quarterly - should the information on the Form become inaccurate.

Conclusion

A quality compliance program must have discipline. Take the time now to review the checklist. Consider what resources and tools may assist you in this process, and develop a compliance budget for 2012. To assist, you may want to develop your own compliance calendar checklist and consider technology and outsourcing solutions. Finally, your CRM system could provide a wonderful resource to help keep track of compliance requirements and deadlines so that you don't fall behind the curve.

For more ideas on considerations for your compliance program, please visit www.corecls.com.

For more information, or to learn about how CCLS may be of assistance, please do not hesitate to contact us at (619) 278-0020.

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