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Risk Management Update
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CONSEQUENCES OF NON-COMPLIANCE

Since the 2008 financial crisis that dramatically changed the regulatory framework for the financial industry, the SEC has brought numerous enforcement actions and levied approximately $2 billion in fines against a variety of financial companies for non-compliance with federal securities regulations. The agency has also been very busy proposing and adopting a deluge of new and revised regulations mandated by the Dodd-Frank Act, with more calendared to come.

Compliance professionals have their hands full with the implementation of policies, procedures and internal controls with respect to new regulations that are applicable to their firms. For example, over the last three and half years the SEC has adopted a total of eight new/revised regulations under the Investment Advisers Act of 1940 (the "Advisers Act"). While that may not seem like a high number, these finalized regulations contain a plethora of administrative and reporting requirements that registered investment advisers must follow to remain in compliance. This, of course, requires firms to allocate a considerable amount of additional time and resources to their compliance efforts.

This Risk Management Update outlines some of the consequences faced by investment advisory firms and their senior officers for non-compliance with regulations under the Advisers Act and provides straightforward, practical steps to help reduce the costs and administrative burdens of compliance.

Recent SEC Enforcement Cases

Outlined below is a small sampling of cases that illustrate the ramifications of non-compliance.

In the Matter of Asset Advisors, LLC (IA Release No. 3324/November 28, 2011)
http://www.sec.gov/litigation/admin/2011/ia-3324.pdf

Summary: Asset Advisors, LLC failed to adopt required written compliance policies and procedures that were reasonably designed to prevent violations of the Advisers Act, only took minimum steps to adhere to their compliance obligations, failed to properly administer a compliance program and train employees, and failed to collect reports from employees required under the firm's Code of Ethics.

Penalties: Asset Advisors, LLC was required to: (i) cease operations; (ii) transfer (subject to client consent) all existing clients to an SEC registered investment adviser that had a fully developed and implemented compliance program and a designated CCO; (iii) provide each client with a copy of the SEC Order, along with a cover letter acceptable to the SEC; (iv) certify in writing, compliance with the undertakings outlined in the Order

and provide evidence of such compliance; and (v) pay a penalty in the amount of $20,000.

In the Matter of JSK Associates, Inc., Jerome S. Keenan, and Paul Dos Santos (IA Release No. 3175/March 14, 2011) *http://www.sec.gov/litigation/admin/2011/ia-3175.pdf*

Summary: JSK Associates, Inc., failed to make certain required disclosures to clients, engaged in principal transactions without first obtaining client consent, failed to adopt written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act, and failed to establish, maintain and enforce a written Code of Ethics, including the collection of certain records required under the firm's Code. Both Mr. Keenan and Mr. Dos Santos were found to have aided and abetted and caused JSK Associates, Inc. violations due to their conduct and senior roles in the firm.

Penalties: JSK Associates, Inc. was required to: (i) cease and desist committing or causing any future violations of certain Adviser Act regulations; and (ii) pay a penalty in the amount of $60,000. Mr. Keenan and Mr. Dos Santos also had to cease and desist committing or causing any future violations of Adviser Act regulations and pay a penalty of $10,000 each. In addition, all three Respondents, on a joint and several basis, were ordered to pay disgorgement of over $64,000.

In the Matter of Thrasher Capital Management, LLC and James Perkins (IA Release No. 3108/November 16, 2010) *http://www.sec.gov/litigation/admin/2010/ia-3108.pdf*

Summary: Thrasher Capital Management, LLC and James Perkins, acting as Chief Executive Officer, failed to provide the SEC with copies of required books and records requested numerous times by the exam staff, and also having untrue statements in the firm's Form ADV.

Penalties: Thrasher Capital Management, LLC's registration was revoked and Mr. Perkins was suspended from association with any investment adviser for nine months. Neither were required to pay a monetary penalty due to affidavits submitted, which reflected that the firm and Mr. Perkins had no assets to pay any monetary penalty.

Compliance Solutions

To comply, or not to comply? All three cases above reflect that non-compliance carries a hefty price, and for two of those firms, that price was termination of their SEC registration.

There are a number of sanctions that the SEC may invoke in an enforcement action, including requiring the firm to hire a third party consultant to perform audits and provide the SEC with periodic reports, and/or conduct yearly compliance reviews, which can be very costly. Firms that are allowed to stay in business after an enforcement proceeding is finalized are required to include disclosure of the enforcement action in their Form ADV for at least ten years. Additionally, they may also be required to add such disclosure to their firm's website.

In this new regulatory environment, staying in compliance with all the federal securities laws that are applicable to investment advisory firms is an extremely daunting and expensive task. Following the steps outlined below, however, may help lessen the economic burden and simultaneously assist with avoiding unnecessary violations.

1. Implement a compliance calendar into Microsoft Outlook or a similar program, to provide electronic reminders of filings and other compliance deadlines.
2. Set up electronic "new account" checklists to help ensure receipt of required new account documentation (*e.g.*, executed client agreement and investment objectives information) and the performance of anti-money laundering (OFAC) checks.
3. Use technology to the extent possible, as a compliance tool to monitor adherence to client restrictions and investment objectives, perform trade execution reviews and comparisons, and provide exception reports.
4. Use "friendly" email reminders to help ensure employees remember important compliance requirements, especially Code of Ethics reporting.
5. Create an internal "intranet" site accessible to all employees, which contains copies of the current Policies and Procedures Manual, Code of Ethics and other compliance documents and reporting forms.
6. Utilize periodic compliance checklists to help confirm processes match procedures.
7. Sign up for email alerts on the SEC website and well known securities law firms to keep abreast of changes to regulations and recent enforcement actions.
8. Obtain client written consent to deliver required documents (*i.e.*, Form ADV, Privacy Notice, etc.) electronically.
9. Complete and maintain a books and records matrix that outlines required documentation, internal responsibility and location of such records.

Lastly, when administering compliance keep in mind that policies, procedures and internal controls only need to be "reasonably" designed to prevent violations of federal securities laws.

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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