



Risk Management Update October 2013

COMPLIANCE END-OF-THE-YEAR CHECKLIST UPDATE

In 2013, the financial industry has continued to shift under the force of perpetual change created in the wake of the 2010 Dodd-Frank Act. The tightening of compliance programs by financial firms has become more critical as regulatory demands within organizations increase, and as federal and state securities laws continually alter under new and revised legislation. The role of senior management and the policies and procedures enacted internally are critical to the long-term success of an enterprise. Increasingly, the responsibility of maintaining and carrying compliance initiatives forward lies with each individual in the firm, and the cooperation of senior management with compliance officers and their initiatives is paramount and constitutes an essential financial business practice.

In a recent speech delivered to attendees at the Securities Enforcement Forum, SEC Chairman Mary Jo White stated the following:

“...minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines. And so, I believe it is important to pursue even the smallest infractions. Retail investors, in particular, need to be protected from unscrupulous advisers and brokers, whatever their size and the size of the violation that victimizes the investor.”

White has been very vocal since her confirmation as SEC Chairman about the fact that she plans to take a strict and unyielding approach to the enforcement of federal securities laws.

To assist investment advisory firms in ensuring adherence to mandated requirements of the Investment Advisers Act of 1940 and other applicable federal securities laws, this month's Risk Management Update (RMU) provides a checklist of action steps that compliance personnel should perform by year-end. This list is not all inclusive and can be incorporated into a firm's annual review process.

- Review Form ADV Parts 1 and 2 to ensure they reflect current and accurate information and contain all required disclosures. (*Helpful hint: Look at Form ADV Instructions and compare requirements to current ADV disclosures to determine if any information is missing.*)
- Review standard client agreement(s) to confirm their adherence to Section 205 of the Investment Advisers Act of 1940, as well as clearly outline the roles and responsibilities of the parties. (*Helpful hint: It's important to have legal counsel review all standard agreements to help protect the firm from unnecessary liabilities, particularly as the business model evolves.*)
- Determine whether your compliance policies and procedures manual needs to be updated, particularly due to changes in business practices and/or regulatory framework. (*Helpful hint: Document your findings as part of the firm's annual review.*)
- Analyze maintenance and safeguarding controls for required books and records, including client, corporate and financial records. (*Helpful hint: Utilize a spreadsheet or*

software to identify and document required records, controls already in place, and those persons responsible for maintenance.)

- ❑ Test the firm’s business continuity plan to ensure adequate controls are in place for backing-up and restoring electronic data. *(Helpful hint: Consider the new Joint Release by the SEC, FINRA and CFTC and be sure to document all testing, findings, and any updates made to the plan.)*
- ❑ Check client files to ensure that investment guidelines have been documented and appear current. *(Helpful hint: Set up electronic “new account” checklists to help ensure receipt of required new account documentation.)*
- ❑ Confirm annual delivery of the firm’s privacy notice to all clients, and review the effectiveness of safeguarding protocols to protect confidential, non-public client information. *(Helpful hint: Consider the applicability of Regulation S-ID and enlist the assistance of IT personnel to test the strength of firewalls and passwords.)*
- ❑ Ensure that your website, pitchbooks, and other marketing materials are up-to-date and contain all necessary disclosures. *(Helpful hint: Confirm all backup data is being maintained, and that valuation procedures and processes are adequate – especially when marketing performance returns.)*
- ❑ Determine that all social media sites being used for business purposes have been reported and contain only approved content. *(Helpful hint: Perform online searches, send reminder emails to employees regarding your social media policy and conduct training on appropriate business uses.)*
- ❑ Review solicitor arrangements to verify that agreements are up-to-date and in compliance with Rule 206(4)-3 of the Advisers Act, while also confirming that all required disclosures are made in Form ADV and offering documents. *(Helpful hint: Send annual certifications to solicitors to confirm, among other things, that they continue to meet the requirements of Rule 206(4)-3(a)(1)(ii) and remain properly licensed in appropriate states and carefully review current disclosures on compensation arrangements.)*
- ❑ Review surveillance, exception reports, and checklists, for detection of violations and to ensure corrective actions were taken, as required. *(Helpful hint: Use technology to the extent possible to perform reviews and testing and ensure that the captured data is meaningful.)*
- ❑ Perform and document due diligence review of service providers, third-party managers, and investment products, as applicable. *(Helpful hint: Send annual questionnaires and obtain and review documents such as financial statements, Business Continuity Plans, regulatory filings, privacy safeguards, SSAE 16 reports, etc.)*
- ❑ Evaluate whether clear lines of responsibility and authority are in place and have been communicated to compliance and supervisory personnel. *(Helpful hint: Have organizational chart(s) outlining the supervisory control system and periodically meet with supervisors to verify their understanding of such roles and responsibilities.)*
- ❑ Consider the training provided to firm personnel on compliance requirements and newly implemented policies and procedures, and conduct additional training, as needed. *(Helpful hint: Send email reminders throughout the year, and hold “learn and lunch” compliance training sessions whenever possible.)*
- ❑ Ensure that all compliance reports have been received from personnel, including forms for outside business activities, political contributions, gifts and entertainment, and personal trading, in addition to annual compliance certifications; then, consider whether

additional disclosures may be required in Form ADV and other client documents. *(Helpful hint: 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 Form U-4 contains current and accurate information. *(Helpful hint: Distribute current copy of Form U-4 for review, and require written response for documentation purposes.)*
- Consider whether all necessary compliance reviews and steps set forth in the firm's policies and procedures manual have been performed, which may include items such as periodic risk assessments, annual reviews, regulatory filings, branch office audits, and other forms of surveillance (e.g., best execution reports and soft dollar analysis). *(Helpful hint: Implement an electronic compliance calendar to provide scheduled reminders of filings and other compliance deadlines to the firm's members.)*
- Ensure that applicable required federal and/or state filings have been made, including Form 13-F, Schedule 13-D/G, Form 13H, Form PF and net capital state filings, as applicable. *(Helpful hint: Due to the formatting requirements for some of these filings, seek software solutions or consider using a third party outsourcing solution 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 mailing of the audited financial statements to investors within the required time period. *(Helpful hint: Coordinate with the Fund Administrator and employees to allow sufficient time to prepare and facilitate the audit.)*
- For private funds, make sure that all required Form D and Blue Sky (state) filings and amendments have been made. *(Helpful hint: Always check with legal counsel to ensure the filings are accurate and made in a timely manner to avoid possible retroactive filings with associated fees.)*
- For advisers to private funds, review Form PF to ensure that relevant data points have been verified and accurately calculated, and reconcile with information reported on Form ADV Part 1. *(Helpful hint: Review Form PF instructions to confirm all required sections have been completed.)*
- For Commodity Pool Operators ("CPOs") and Commodity Trading Advisers ("CTAs"), confirm that all required quarterly and annual reporting has been completed. *(Helpful hint: Be sure to use the electronic filing system on the National Futures Association website at www.nfa.futures.org.)*
- Remain aware of changes to regulations and recent enforcement actions. *(Helpful hint: Sign up to receive email alerts from the SEC and applicable state(s), and subscribe to receive newsletters and blogs from securities law firms and compliance consulting firms.)*

Looking Ahead

Reg S-ID – Identity Theft and Red Flag Rule

On May 20, 2013, the SEC and the Commodities Futures Trading Commission ("CFTC") finalized a rule that had been proposed in 2012, which requires entities registered with the SEC and those registered with the CFTC to implement an identity theft red flags program. Known as Regulation S-ID ("Reg S-ID"), the rule mandates that affected firms adopt such programs by

November 20, 2013. Considerations should therefore be taken promptly to determine whether your firm falls under the purview of this new rule, starting with an internal review of business practices to evaluate the applicability of your firm to this regulation. If your firm is currently not subject to Reg S-ID, internal controls should be implemented to ensure the performance of an annual assessment for determining future pertinence of the regulation to the firm.

New technology services to assist with implementation of your compliance program – while often overlooked – is critical due to the complexity of today’s regulatory requirements. In 2014, CCLS will be providing its clients with new technology solutions that may assist in meeting this objective. More information will be unveiled in the first quarter.

Preliminary Renewal Statements from the IARD system outlining the IARD and state fees owed by investment advisory firms will be ready on November 11, 2013 for downloading. The full amount must be paid no later than December 13, 2013. Payment instructions can be found at http://www.iard.com/ren_payment.asp.

Finally, CCO’s should update their compliance calendars for 2014, ensuring that any new deadlines are included, along with updates to current ongoing requirements.

Conclusion

Since the implementation of Rule 206(4)-7 of the Investment Advisers Act of 1940, investment advisory firms have been required to conduct “annual reviews.” Importantly though, in the release of the rule the SEC outlined when they expect firms to perform such reviews, specifically stating: “Although the rule requires only annual reviews, advisers should consider the need for interim reviews in response to significant compliance events, changes in business arrangements, and regulatory developments.”

Taking action now can assist with identifying any issues that may exist and allows corrections and enhancements to be made promptly, thereby giving a firm the ability to work effectively toward a promising and prosperous New Year!

For more ideas on considerations for your compliance program, and for additional assistance, including performing an independent annual review for your firm, please contact us at info@corecls.com, at (619) 278-0020 or visit us at www.corecls.com for more information.

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