



Risk Management Update November 2012

COMPLIANCE END-OF-THE-YEAR CHECKLIST UPDATE

The regulatory landscape for the financial industry has changed dramatically since the passing of the Dodd-Frank Act in July 2010, demanding even greater collaboration between management and compliance professionals to help ensure that a firm's compliance program is effectively designed to prevent violation of federal and state securities laws. With the advent of the SEC's risk-based examination program, district office examiners are turning their attention on firms that have higher risk profiles as measured by their registration filings, reporting documents and prior examination deficiencies in order to focus attention on potential transgressions. Importantly, a firm's culture of compliance and particularly its "tone at the top," must be supported by senior management, whose commitment is critical to the long-term success of the enterprise. Today, compliance efforts must not only reside with designated compliance officers but with every member throughout the organization.

This month's risk management update focuses on those "hot topic" areas that should be reviewed by compliance professionals and senior management, based upon those subject matters most frequently examined by the SEC in 2012.¹ As part of this process, it is essential to focus on the evaluation of compliance internal controls in order to detect any gaps that may exist within the compliance program, which should be addressed as soon as practical. To assist, we have provided the following tips to help with your assessment.

To begin the process:

- Review your Form ADV Parts 1 and 2 to ensure it reflects current and accurate information, including disclosures pertaining to your management of or investments in private funds.
- Review, and if necessary, update client contracts, paying special attention to conflicts of interest. Ensure they contain provisions regarding the roles and responsibilities of the parties and consider whether you should add electronic delivery language.
- Consider whether your policies and procedures manual requires updating based on recent regulations, such as ERISA Section 408(b)(2) disclosure requirements, custody controls, social media protocols, and valuation practices.
- Consider how you are creating, maintaining and safeguarding required books and records, including client, corporate and financial records.
- Test your business continuity plan and ensure you have adequate controls for backing-up and restoring electronic data. Be sure to document findings and updates.
- Check your client files to ensure that client profiles, investment policy statements or similar documents containing investment guidelines are complete and updated, as necessary.
- Be sure 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.
- Ensure that your website, pitchbooks and other marketing materials are updated, and have requisite disclaimers, particularly if you are providing performance information.
- Review your solicitor arrangements, and make certain that all necessary disclosures and agreements are up-to-date, with client acknowledgments on file.

¹ Such information was gathered from various news sources, industry conferences and webinars (deemed to be reliable) as participated in CCLS personnel from August 1, 2012 – November 2, 2012.

- Review surveillance, exception reports and checklists for detection of violations to ensure corrective actions were taken, as required.
- Perform and document your due diligence review of service providers, third-party managers and investment products, as applicable.
- Evaluate whether clear lines of responsibility and authority are in place for compliance and supervisory personnel.
- Consider whether you have provided employees with appropriate training on compliance requirements, including the adviser's Code of Ethics and insider trading policies, and reviewed all quarterly outside brokerage statements, as applicable, against client transactions for potential abuses.
- Be sure that all outside business activities and annual compliance certification forms have been completed and filed for each associated person.
- Confirm with registered personnel that their Form U-4 contains current and accurate information.
- Consider whether you have performed all necessary reviews set forth in your policies and procedures manual, which may include conflict inventories; enterprise risk management assessment; annual reviews; and other forms of surveillance (e.g. electronic communications and the use of social media).
- Review what tests vendors have performed, and the results of such tests, especially those related to custody, performance verification, privacy safeguards, best execution analysis and anti-money laundering ("AML") checks.
- Ensure that applicable required federal and/or state regulatory filings have been made, such as Form 13-F, Schedule 13-D/G, Form 13H, Form PF, and net capital state filings.
- For private funds, check that an annual audit of the fund's financial statement is scheduled and internal controls are in place to ensure mailing of the audited financial reports to investors.
- For private funds, make sure all Form D and Blue Sky filings have been made.
- For private funds, review Form PF to ensure that relevant data points have been verified and accurately calculated, and reconcile to information reported on Form ADV Part 1.
- For Commodity Pool Operators ("CPOs") and Commodity Trading Advisers ("CTAs"), confirm that required quarterly and annual reporting to the CFTC is completed.

Looking Ahead

Form PF

Certain private fund advisers that were not affected by the June 15, 2012 compliance date of filing Form PF may be required to file. Effective December 15, 2012, smaller private fund advisers, (defined as having aggregate private fund assets greater than \$150 million, but less than \$1 billion) are required to file Part 1 of Form PF no later than 120 days after the adviser's fiscal year end. To assist private fund advisers with questions they may have on requirements of filing Form PF, the SEC posted an FAQ regarding Form PF, which can be found [here](#). Please review carefully.

The Jumpstart Our Business Startups (JOBS) Act of 2012

The JOBS Act was enacted on April 5, 2012, which among other things requires the SEC to implement amendments to Rule 506 of Regulation D to permit general advertising and general solicitation of offerings to accredited investors. Importantly, issuers will need to establish reasonable controls to verify that purchasers of the securities are accredited investors. The JOBS Act also requires the SEC to amend Rule 144A(d)(1) under the Securities Act of 1934 to permit offers of securities pursuant to Rule 144A to persons other than qualified institutional buyers ("QIBs"), under certain circumstances.

On August 29, 2012, the SEC issued proposed amendments to Rule 506 and 144A(d)(1) for public comment (<http://www.sec.gov/rules/proposed/2012/33-9354.pdf>). In addition, the SEC has devoted a

section of their website to provide information regarding the JOBS Act and proposed amendments, including a series of FAQs (<http://www.sec.gov/spotlight/jobs-act.shtml>). However, until such time as the proposed amendments become final, any offers or sales of securities purporting to rely on the new exemptions would be considered unlawful under the federal securities laws.

Conclusion

As compliance professionals are looking ahead to 2013, it is necessary to take the time now to review the above checklist and consider how new regulations could impact your business. Assess what resources and tools may help you with your compliance program and enterprise risks. Determine what kind of internal controls you may need to advance your compliance program, including technology, resources and training, and provide estimated costs to senior management for preparing next year's budget. By taking these steps, you should be able to readily identify potential gaps that exist, which then can be promptly addressed to stay ahead of the curve!

For more ideas on considerations for your compliance program and for additional assistance, please visit www.corecls.com or contact us at (619) 278-0020.

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