

Compliance Review

Ongoing Compliance Updates for Investment Advisors

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New Year's Compliance Resolutions for Registered Investment Advisors

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Has your firm made its compliance resolutions for 2008? There are a number of annual regulatory requirements that must be completed by a registered investment advisory firm, and the start of the calendar year provides an excellent opportunity for your firm to reaffirm its commitment to meeting these compliance obligations.

Your firm should ensure that it resolves to address the following requirements during 2008:

Renewals—Although the registration renewal season is over, your firm should confirm that the registrations of the firm and its investment adviser representatives were properly renewed for 2008. Every year, there are a handful of firms that fail to submit renewal fees through the IARD system in a timely fashion. Therefore, even if it's your belief that the renewal payment was sent in time, your firm should retrieve the 2008 Final Renewal Statement and confirm that the firm and its investment adviser representatives are renewed for 2008 in all applicable states. In the event your firm did fail to renew, you should contact the state regulatory authorities to determine the next course of action. Almost all states will automatically terminate a firm and its investment adviser representatives for failing to renew.

Annual Offer of Form ADV—A registered investment adviser is required to offer a copy of its Form ADV Part II and Schedule F or a copy of its disclosure brochure (containing the same information as Form ADV Part II and Schedule F) to all clients on an annual basis. The annual offer does not need to be at the end of year; however, it should be made at approximately the same time each year for consistency. Documenting that the firm has fulfilled this requirement is essential. Some investment advisers elect to keep a copy of each client's annual offer letter in the client's file. Other investment advisers elect to keep a sample, dated copy of the annual offer letter, along with a list of all clients the offer was sent to and a list of all clients who requested a copy of the Form ADV Part II and Schedule F or similar disclosure brochure. Keep in mind, if a client requests a copy of the Form ADV Part II and Schedule F or similar disclosure brochure, the SEC requires that delivery be made within seven days. Most states also require delivery to be made within a seven-day time frame.

Customer Privacy Policy Statement—Similarly, registered investment advisers must deliver their customer privacy policy statements annually. Securities regulators require investment advisers to

provide a copy of their privacy statement to all clients when they enter into a contract and also to provide a complete copy of the privacy statement to clients on a yearly basis. Many investment advisers have begun to incorporate the customer privacy policy statement with the annual Form ADV offer. Again, the key here is to document the delivery by keeping a log that lists each client who receives the statement and the date when the statement was sent, and to retain a copy of the statement.

IARD Administrative Functions—The start of the year provides an excellent opportunity to make sure your firm’s IARD administrator and user accounts are up-to-date. Maybe an account administrator left your firm recently, or maybe someone who is listed as an IARD user no longer needs to have access to the account. This is a good time to make sure that only those within the firm who need access to the IARD system have access. If a former employee still has an account, make sure the account has been disabled and terminated. Likewise, make sure that all current administrators and users know their user names. While the IARD system requires all administrators and users to update their passwords once every 120 days, this is a good time to make sure everyone has an updated password for security reasons.

Financial Statements—If your firm is registered with one or more states, you may be required to submit certain financial statements to the state regulators on an annual basis. Many states have certain net worth or net capital requirements. Some states also have surety bond requirements. Most states that have these provisions require investment advisers to substantiate that they are in compliance with net worth and/or net capital rules by submitting financial statements. In some states the financial statements must be submitted at the end of the firm’s fiscal year, and in some states the financial records must be submitted at the end of the calendar year.

In addition to submitting any required forms directly to securities regulators, it is essential the firm has updated all of its financial records under the regulatory books and records requirements. This is true for state- and SEC-registered adviser firms. In particular, the SEC has stated in a no-action letter

that an investment adviser registered with the SEC is required to maintain financial statements on at least a quarterly (every three months) basis. These required financial records include the journals showing cash receipts, disbursements and supporting records; the general ledger reflecting asset, liability, reserve, capital, income and expense accounts; the checkbook register; cancelled checks; bank statements; and financial statements.

Form ADV Annual Amendment—The SEC and almost all states require an investment adviser to amend its Form ADV on at least an annual basis in the form of an Annual Amendment. The Annual Amendment must be completed within 90 days after an investment adviser’s fiscal year-end. Since the majority of investment advisers coordinate their fiscal year-end with the end of the calendar year, the Annual Amendment has become a requirement that must be completed at the beginning of each year for most firms. The main item that must be updated on the Annual Amendment is the firm’s assets under management. Other items such as (but not limited to) the number of accounts, clients, employees and adviser representatives should also be updated. The Annual Amendment can also be used to disclose any material changes. Keep in mind, however, that material changes need to be reflected promptly (generally within 30 days), no matter when they take place. Material changes include items such as, but not limited to, reportable disciplinary and financial disclosures, changes in advisory programs, changes in fee arrangements and changes in billing practices.

Form 13F—Even if your firm has not been required to submit Form 13F reports in the past, it should review whether it reached the discretion threshold of \$100,000,000 of Section 13(f) securities during calendar year 2007. Section 13(f) securities generally include exchange-traded or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies, exchange-traded funds and certain convertible debt securities. Section 13(f) excludes open-end investment company mutual funds. On the SEC’s website, there’s an official list of Section 13(f) securities (see www.sec.gov/divisions/investment/13flists.htm). If your firm met the threshold during calendar

year 2007, it will need to file its first Form 13F within 45 days of the end of 2007, reflecting Section 13(f) securities holdings as of December 31, 2007.

Outside Business Activities and Other Form U4 Amendments—The start of the new year is a great time to remind all employees and investment adviser representatives to officially disclose their outside business activities to the firm. The disclosure of outside business activities must be done for three important reasons: (1) to assure that the individual's Form U4 is current and up-to-date; (2) to assure that the investment adviser's Form ADV does not need to be amended due to an individual's business activities; and (3) to help the firm determine if an individual's outside activities are in conflict with the firm's policies or with a client's best interests. In addition to disclosing outside business activities, the firm must also update other items on the Form U4 when those items are materially inaccurate. Deadlines to update the Form U4 vary by state. As a general best practice, updates to the Form U4 need to be made in a prompt manner, generally within 30 days.

Solicitors—If your firm pays a referral fee to third-party solicitors in a state that requires such individuals or entities acting as solicitors to be registered as investment advisers, your firm should verify and document that the solicitor is properly registered with the applicable securities regulator.

Annual Review—If your firm is registered with the SEC and it has not done a review and analysis of its compliance program within the last 12 months, it needs to complete such a review as soon as possible. While we recommend that an investment adviser continuously review its compliance program and implement updates whenever needed, SEC-registered firms are required to review the adequacy of their compliance programs and to assess the effectiveness of their procedures at least annually. The key is to document these reviews and maintain

them as part of the investment adviser's master books and records. Previous versions of the firm's written policies and procedures must also be maintained according to the books and records rules. Issues identified during the review must be documented, and a plan to take corrective action must be formulated.

When a firm makes changes to its code of ethics, to a compliance policy and/or to a procedure, representatives and employees should be made aware of the changes and required to sign off on their understanding and acknowledgment of the policies. Even if no changes are made, we suggest that all employees agree to their understanding and acknowledgment of your firm's code of ethics, policies and procedures in writing each year.

Personal Securities Transactions—All SEC-registered investment advisers must collect or prepare updated personal securities holdings reports from all access persons. The information on the report must be current as of a date no more than 45 days before the report is submitted. The annual report does not need to be done at the end of the calendar year necessarily; however, the timing of the report must be consistent from year to year. The holdings report is in addition to the review of fourth-quarter transaction reports. As part of the code of ethics rule, all SEC-registered investment advisers are required to review the activity of their access persons' securities holdings. Quarterly transaction reports must be submitted no later than 30 days after the end of each calendar quarter.

Compliance Training for Representatives and Employees—We recommend that your firm consider holding compliance training at the beginning of the new year, because many firms implement new policies or advisory programs that are set to take effect at the beginning of the year. Anytime a new rule or program is implemented, it is imperative that proper training be provided so all employees and representatives are aware of the changes. In today's

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regulatory environment, a formal compliance training program is essential for an investment adviser's representatives and employees.

An investment adviser faces numerous other compliance obligations that are not listed above but are worthy of your New Year's compliance resolutions. As with all other New Year's resolutions, your firm can improve its likelihood of success by

documenting its compliance obligations and goals in writing—just as it's critical to carefully document when your firm completes its supervisory tasks and annual requirements. Hopefully, your firm will achieve greater success with its compliance resolutions than many of us accomplish with our personal resolutions.

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