

## Compliance and Supervisory Solutions for Investment Advisory Firms

### Adviser's Compliance Program – Twelve Significant Elements

Many Advisers manage their own RIA or are considering going independent. While there are many benefits to being independent, there are also offsetting obligations that must be considered when determining the overall benefit of independence. One significant obligation that must be addressed is the regulatory requirements placed upon RIAs by the Investment Advisers Act of 1940. While historically, regulatory scrutiny of small retail based RIAs has been limited, the regulatory climate has changed. Both the SEC and State regulators have increased the oversight of smaller RIAs and increased the number of onsite inspections they conduct. Many RIAs have come to the realization that the resources historically devoted to compliance are not be sufficient going forward.

Now is a good time for RIA's to review their compliance program and ask whether the current compliance program is sufficient given the changing regulatory environment. Typically, when a regulator examines the policies and procedures of a registered investment adviser, there are certain basic compliance elements they expect to find. If your current compliance program does not include procedures to address each of these basic elements, you should consider bolstering your program. It is better to be prepared than to find yourself on the wrong side of a regulatory action.

The compliance requirements for an RIA are established in SEC Rule 206(4)-7 under the Investment Advisers Act of 1940 (Investment Advisers Act). While not intended as an all-inclusive list, below are twelve significant elements that should be included in your Adviser's compliance program.

#### **1. Written Compliance and Supervisory Policies and Procedures**

Each RIA is required to establish policies and procedures reasonably designed to prevent violation of the Advisers Act. These policies must be written and must encompass everything relevant to the specific operations engaged in by the adviser. Advisers must identify conflicts and any potential compliance risk factors that are specific to the firm and ensure these areas are addressed in the firm's policies and procedures. How confident are you that your policies and procedures are current and being followed?

#### **2. Annual Review of Policies and Procedures**

Rule 206(4)-7 also requires that RIAs conduct an annual review of their policies and procedures to determine if they are still adequate and being followed. The review should consider any compliance issues that arose during the year, any changes in business activities, and any changes in regulations that might necessitate a revision of the policies or procedures. The review process, findings, and corrective actions taken must be documented each year. Can your Investment Adviser demonstrate that you have conducted a thorough annual review this year?

## Compliance and Supervisory Solutions for Investment Advisory Firms

---

### **3. Appoint a Qualified CCO**

RIAs must appoint an individual to serve as the Chief Compliance Officer (CCO). The CCO must be an individual who is competent and knowledgeable and should be empowered with full responsibility and authority to develop and enforce policies and procedures, and have a sufficient position of seniority and authority to compel others to adhere to the firm's policies and procedures. Many Advisers have delegated the compliance responsibilities to a partner or administrative person whose compliance knowledge is limited. Does your CCO have the necessary experience and authority to effectively execute your RIA's compliance program? If not, you should strongly consider an on-going relationship with a compliance consulting firm to augment and/or mentor your CCO.

### **4. Maintain Form ADV Parts I and 2**

The Form ADV is the primary vehicle for an investment advisor to disclose information to clients and securities regulators. This is where clients learn about the Firm's principals, the investment advisory services your adviser provides and the fees and costs associated with such investment advisory services. RIAs are required to file an annual amendment to their Form ADV via the IARD system within 90 days of the close of their fiscal year. Additionally, the Form ADV must be updated within 30 days of any material changes. How confident are you that those necessary changes and filings are being made to your Form ADV and that all of your disclosures are current?

### **5. Code of Ethics**

The SEC and many state securities regulators require RIAs to create and implement a written code of ethics that outlines the standards of business conduct of the firm's supervised persons and reflects the fiduciary duties of the RIA. This needs to be reviewed annually and each supervised person needs to acknowledge their receipt and understanding of the policy. Is your Code of Ethics current and can your RIA evidence receipt of it by your supervised persons?

### **6. Maintain Books and Records (SEC Rule 204-2)**

Your RIA is required to make and keep true, accurate and current certain books and records relating to its investment advisory business. Your RIA policies must address the manner in which records need to be maintained, and where and for how long they must be maintained. Are your RIA's records being properly maintained? Are you prepared to provide required records to regulators upon request?

### **7. Register and Maintain License Filings (Federal and State)**

All persons functioning in the capacity of an IAR must be properly licensed and registered. It is the responsibility of the RIA to determine which supervised persons of your firm need to be licensed as investment advisor representatives, which licenses they are required to maintain and which jurisdictions they must be registered in.

## Compliance and Supervisory Solutions for Investment Advisory Firms

All registrations must be kept current and the U-4 must contain accurate information. How confident are you that all of your supervised persons are properly registered and that their U-4's are correct and current?

### **8. Monitor Personal Securities Trading of IAR's and Access Persons**

Do you know who at your firm is classified as an access person? Does your RIA maintain a list of all access persons? Your RIA is required to monitor the securities holdings and personal securities transactions of all IARs and Access Persons. Access persons must submit to the RIA a report of their personal securities holdings no later than 10 days after the person becomes an access person and update their holdings report at least once each 12-months. Your adviser is also required to monitor and review the personal trading of IAR's on a quarterly basis. Does your firm have procedures in place to identify all IARs and access persons, maintain records of their securities holdings and monitor their personal securities transactions as required?

### **9. Review and Approval of Marketing Material Rule 206(4)-1**

The term "advertisement" includes any written or electronic communication addressed to more than one person or any notice or announcement in any publication, by radio or television which offers any analysis, report, publication and device for making securities decisions or any other investment advisory services regarding securities. Advertisements cannot be fraudulent, deceptive, or manipulative and testimonials are prohibited. It is also important for your firm's policies to address the use of social media sites. Firms must provide guidance to IAR's regarding the use of such sites and policies must address their use and supervision. Additionally, while Email communication may not be "advertising", your RIA must have procedures to supervise and retain these communications. Are you comfortable that your firm has adequate procedures to approve and monitor and archive advertising and marketing materials, direct the use of social media and properly supervise the use of email?

### **10. Privacy Policy and RIA Handling of Customer Information.**

Section 504 of the Gramm-Leach-Bliley Act establishes regulation S-P which requires that your RIA establish policies that detail what your RIA is permitted to do with the confidential personal information of your clients. The regulations require your RIA to adopt and distribute written policies and notify your clients annually. Do you have the appropriate written policies regarding confidentiality of client information? Do they require your RIA to notify your clients annually in regards to your policy?

### **11. Solicitor Agreements**

Many RIA firms receive client referrals from outside professional sources such as CPAs, attorneys, and insurance agents. If your firm shares advisory fees with these referral sources, it is essential that you have appropriate policies in place to govern this activity. For each solicitation arrangement, a written solicitor referral arrangement

## Compliance and Supervisory Solutions for Investment Advisory Firms

---

between the investment adviser and third-party (non-employee) solicitor must be in place. It may also be necessary for the solicitor to become registered as an investment advisor representative of your adviser. Has your investment adviser established policies and procedures designed to properly monitor this activity and to supervise licensed solicitors?

### **12. Outside Business Activities (OBA)**

Your adviser should have written policies and procedures designed to monitor and approve the outside business activities of supervised persons (i.e. officers, directors, partners, investment advisor representatives, and employees).

Policies regarding the supervision and disclosure of outside business activities help ensure all Forms U4s are current and up to date, the firm's Form ADV is current and also helps determine if the OBA represents a potential conflict of interest. How confident are you that your adviser has the appropriate policies and procedures in place to ensure all disclosures are current and that changes are made within 30 days of the event?

### **Now is a good time to review your adviser's compliance program**

The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act created significant changes to the regulatory framework for Investment Advisers. When is the last time your RIA conducted a thorough review of your written policies and procedures? If your compliance program does not address these basic elements, you should consider amending your policies immediately. While addressing these issues does not guarantee a smooth examination, it is best not to wait until a regulator shows up at your front door to start asking these questions. If you need assistance evaluating your policies and procedures, consider bringing in compliance experts to help. Red Oak Compliance Solutions can provide an economic RIA Checkup that reviews your firm's policies, in all of the areas above, and recommends cost efficient solutions when necessary. Taking action now will help keep your business compliant and reduce your firm's regulatory risk.

If you would like to inquire about Red Oak Compliance Solutions RIA Checkup or receive more in depth information on any of these topics, please contact us by calling 888.302.4594 or emailing us at [info@redoakcompliance.com](mailto:info@redoakcompliance.com).