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What the SEC Really Wants to Find in Your Firm's Compliance Manual

BY MICHELLE L. JACKO, ESQ. ON 12.14.2020



It's that time of year again for many investment advisory firms when Compliance departments often spend the end of the calendar year reviewing their policies and procedures to meet the annual

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requirements set forth in Rule 206(4)-7, better known as the “Compliance Rule” under the Investment Advisers Act of 1940.

There’s a strong likelihood that your compliance manual will need to undergo greater internal scrutiny than usual in this topsy-turvy year. The COVID-19 pandemic has changed how and where many of us work, and there’s no indication the "Zoom-from-home" movement will end anytime soon. In fact, many investment advisory firms have already adopted telecommuting as the new norm to enhance employee morale and reduce office expense.

At the very least, your firm’s Business Continuity plan must be updated with any changes to policies and procedures that have been made during these pandemic-plagued times.

In a pre-COVID environment, you could've easily walked down the hall to request Compliance to review the newest marketing materials for an upcoming important meeting. But that’s not the way of the world anymore. We now must re-think our supervisory controls and whether they are customized for the needs in a COVID-19 world.

With All That's Changed, We Can't Rely on Off the Shelf Solutions

Among the most helpful communications vehicles the U.S. Securities and Exchange Commission produces are their frequent *Risk Alerts*. They can be a significant tool to help you to analyze your existing internal controls and advance compliance in your firm.

Risk Alerts tend to focus on examination findings and industry best (and problematic) practices, rule changes and other items of timely interest that keep compliance departments informed.

Resultingly, this may help investment advisory firms fortify their role as fiduciaries to help protect investors.

The latest SEC *Risk Alert* was issued on November 19, 2020, which provided an overview of the Compliance Program Rule and some of the more common compliance deficiencies recently identified by the Office of Compliance Inspections and Examinations ("OCIE") in connection with the Compliance Rule.

The Compliance Rule requires SEC investment adviser registrants to, among other things, name a CCO, develop policies and procedures that are reasonably designed to prevent violations of federal securities laws, and test, no less than annually, the effectiveness of those policies and procedures. Notably, potential challenges CCOs may face include inadequate compliance resources, insufficient authority of the CCO, and shortcomings in their firm's annual review. All CCOs should pause to consider whether these areas need to be addressed at their own organization.

Yes, those things are important. But what I believe to be some of the most important information is found in a footnote.

Consider the importance found on page 4 of this *Risk Alert's* footnote 6:

⁶ *Id.* (“We expect that an adviser's policies and procedures, at a minimum, should address the following issues to the extent that they are relevant to that adviser: Portfolio management processes, including allocation of investment opportunities among clients and consistency of portfolios with clients' investment objectives, disclosures by the adviser, and applicable regulatory restrictions; Trading practices, including procedures by which the adviser satisfies its best execution obligation, uses client brokerage to obtain research and other services (“soft dollar arrangements”), and allocates aggregated trades among clients; The accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements; Safeguarding of client assets from conversion or inappropriate use by advisory personnel; The accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction; Marketing advisory services, including the use of solicitors; Processes to value client holdings and assess fees based on those valuations; Safeguards for the privacy, protection of client records and information; Business continuity plans.”) [Emphasis added]

It's a 169-word sentence the SEC uses to say:

1. we want to remind you that this list is not exhaustive;

2. your firm's policies and procedures manual must be customized, based on relevancy to the adviser; and
3. your manual must include specific protocols and standards of care customized to your organization's overall compliance program.

A critical consideration when it comes to reviewing and updating your firm's compliance manual is to give careful thought to the many specifics of how your business is conducted and how your business is dictating the content of your compliance policies and procedures.

For example, let's consider the SEC's Advertising Rule. Summarily, the Advertising Rule states that there cannot be anything fraudulent, deceptive, misleading, or considered to be a material omission when communicating with an investor. To comply with that rule, the firm must develop and follow specific procedures to review the advertising material for adequacy of disclosures and content prior to dissemination.

- When developing a policy and procedure to encompass this, it is important to first formulate and then articulate: how is the firm going to comply with the rule;
- what are you going to do, who is going to do it and what is required from others;
- who will maintain documents; and
- who is responsible for supervision.

Keep in mind that the role of Compliance is to oversee the Compliance Program and not necessarily to supervise others; this concept should be reflected and customized throughout your policy and procedures manual.

Charting the Way Forward

Not since Jacko Law Group first opened its doors in 2007 has there been a more challenging year for investment advisory firms forced to persevere during a pandemic

But change brings opportunity. We specialize in helping investment advisers and financial industry firms understand and fulfill their regulatory obligations, grow their companies and transition to new opportunities when the time is right. Our attorneys and professional staff provide sophisticated insight to help our clients achieve their goals.

When it comes to reviewing compliance policies and procedures, we will work closely with your team to identify areas you may not have considered that should be included in the manual. We also make certain the procedures in your manual are effectively descriptive, so your employees know what to do - and when.

To schedule a strategy session, please call 619.648.2283 or contact us online. We welcome the opportunity to serve you during these turbulent times.

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Michelle L. Jacko, Esq. is the
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Jacko Law Group, PC, which offers corporate and securities legal services to broker-dealers, investment advisers, investment companies, hedge/private funds and ...
