



Taking Care of Compliance

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July 21, 2009

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As more and more brokers and wealth managers leave large firms to start their own registered investment advisory (RIA) businesses, many have found that it takes more than creative investment ideas and attentive client service to start an advisory firm. Firms need systems and processes that will not only streamline their investment activities, but also generate the reports and filings needed to satisfy regulators and clients.



Custodians have a role to play in providing RIAs with technical and operational guidance. Some even provide technology to handle portfolio management, client relationship management and e-mail retention. When it comes to the crucial area of compliance, however, RIAs are often left to fend for themselves.

Without technology and automation, compliance will consume valuable time and resources. Even when things go relatively well, important regulatory obligations and requirements often fall through the cracks. Getting the right tools in place doesn't just simplify a firm's regulatory responsibilities; it also sends a strong message to clients that the firm is trustworthy, operationally sound and up-to-date with its fiduciary responsibilities.

Compliance is a trust issue

High- and ultra-high net worth individuals, as well as institutions, are understandably wary about financial advisors after recent scandals. The bad press that beleaguered the hedge fund industry has spread to RIAs as well. Earlier this year, for instance, scandal erupted around the Houston-based Stanford Financial Group, which has about \$50 billion in assets in its wealth management affiliate. On June 19, the firm's chief, R. Allen Stanford, was accused of operating a multibillion-dollar Ponzi scheme with the help of the bank's top lieutenants – and of the Antiguan bank regulator who was supposed to be scrutinizing Mr. Stanford's operations.

In another high-profile case, the SEC charged James Putman, who held executive positions at the National Association of Personal Finance Advisors (NAPFA), and a



colleague with taking \$1.24 million each in kickbacks related to unregistered investment pools that their firm managed.

A firm that demonstrates to clients that it conducts comprehensive compliance activities sends a message to those clients that it is a trustworthy firm and a safe place to invest assets. Yet because compliance is not an activity that directly generates revenue, even well-meaning RIAs can let their compliance tasks get away from them. That is especially true of RIAs who came out of big financial institutions, where compliance was a given. To further complicate matters, chief compliance officers (CCOs) in advisory firms often have other duties, and they may not have the resources they need to stay on top of all of their regulatory responsibilities.

Getting it done

Since most RIAs would prefer to spend more time on revenue-generating investment activities and less time on administration, automating the compliance and reporting process is a good way to achieve a streamlined program at a relatively low cost. Hands-on technology will guide a firm through the activities required for compliance – avoiding costly mistakes and missed deadlines, and effectively building the culture of compliance that is an imperative in today’s investment climate. Technology will serve as a “roadmap” for the CCO to keep compliance – even the more amorphous aspects of it – on track.

For an RIA that wants to automate, what should the criteria be for selecting a software system? From a structural perspective, compliance software should be much more than a database of information. It should contain “workflow” features to lead a firm through every step of the compliance process. This would include reporting on personal securities transactions of employees, conflicts of interests, anti-money-laundering activities, soft dollar arrangements and client eligibility – with date triggers to make sure such activities are undertaken on time. The system should be integrated with all of the firm’s other key sources of data, including order management, portfolio management, CRM and human resources platforms. This ensures the information from those systems is available for use in key reports and filings.

In addition, the software system should be programmed with periodic reminders of all compliance tasks that need to be handled during each month. Organizing compliance tasks on a month-to-month basis can ensure an advisor hits all of its marks and help prevent even the most mundane compliance tasks from slipping through the cracks. A “compliance calendar” acts as a dashboard for the CCO, to remind him or her when it’s time to update specific filings, such as Form ADV, and gather personal securities transaction reports from employees. It also alerts the CCO when certain update filings are due, such as 13F quarterly amendments and weekly Form SH submissions. Workflow triggers prompt the firm when it’s time to do annual employee compliance



training and an annual compliance review, which includes risk assessment – an important process that will further demonstrate to clients that the firm is trustworthy.

In addition to generating reminders, a compliance system should also make filing quicker and faster than gathering and collating the information by hand. For example, a system can produce personal securities transactions reports, to track and monitor the activities of employees for any wrongdoing. A system can also generate review reports and provide employees with the ability to make their own filings and get forms for pre-clearance, gifts and other relevant activities. Conflicts of interests can be tracked via an automated review – producing instant documentation of how conflicts are addressed – with quarterly reminders to do so. The key is that such a system allows a firm to report and demonstrate (to itself, clients and regulators) that it is “doing what it needs to do.”

To address anti-money-laundering regulations, an automated system should perform a review against regulatory watch lists, document that review, and provide an automated review of Financial Action Task Force (FATF) on Money Laundering jurisdictions. A compliance system can allow an advisor to do a client check prior to subscription, and upon and after as well. For firms that engage in soft-dollar activities with their brokers, compliance technology can also document a review of soft-dollar services against disclosure to clients, demonstrating a commitment to transparency and full disclosure.

Under rule 206(4)-7 of the Investment Advisers Act of 1940, RIAs are required to undertake an annual review of compliance procedures. In a busy RIA firm, making time for an annual review can be challenging. To make the review as painless as possible, technology should automate a review of major compliance areas. This can involve reviewing reporting violations for particular employees, reviewing service provider procedures, and generating updates on the CCO’s efforts to stay current with new regulatory rules.

Automated systems should also play a role in tracking and monitoring communication with clients and prospects, providing RIAs with a simple way to stay compliant with the Advisers Act record-keeping rule. E-mail retention software can provide the firm with a means for archiving, reviewing and backing up crucial communications with clients and prospective clients. During an SEC audit, examiners will almost definitely ask to review certain emails. Using email retention software allows a firm to periodically review random emails looking for the same key terms that regulators may look for (such as “guaranteed returns”).

Giving your business an edge

Automation is the only way to handle compliance comprehensively and cost-effectively. The workflow support it creates will not only remind your CCO when it’s time to address compliance requirements, it will also produce the reports and filings required, quickly and routinely.



From a human resources perspective, it makes more sense to put the heavy lifting on a computer system, allowing the CCO to concentrate on providing the leadership and planning necessary to maintain a compliant organization. For example, the CCO will have more time to think through and manage other high-level compliance risk areas of the firm, such as risk assessments, conflict of interest reviews, review of adequate and consistent disclosures and training.

Compliance is part of the cost of doing business, and doing it well gives your firm an advantage in the marketplace. Creating a streamlined system for compliance demonstrates that assets placed in your care are being handled prudently and that your business activities are managed responsibly. Today's clients are suspicious and wary. Firms that build a culture of compliance will have an edge attracting new assets.

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