



## Freedom Through Independence: Compliance

by Karla Paxton

*This is the sixth installment in our series of transitioning to an RIA. [Part 1](#) discussed selecting a custodian, [Part 2](#) discussed selecting in-house software for your operations, [Part 3](#) discussed outsourcing your operations, [Part 4](#) discussed going paperless, and [Part 5](#) discussed outsourcing your investment research.*

Compliance for the new RIA can be a daunting task. The guidelines regulating small independent advisors are similar to those regulating the largest mutual fund companies. Until the SEC recognizes that wealth advisors do not provide the same service (or product) as the large mutual fund companies the rules will be the same.



Advisors register by filing a form ADV through the SEC's [Investment Adviser Registration Depository](#) (IARD) system. This system is administered by the National Association of Securities Dealers (NASD).

The advisor with less than \$25 million in assets under management can file with their state. However the filing requirements are almost the same for SEC filing. So, if you plan on reaching more than \$25 million within the first year or two, it makes sense to file with the SEC from the start. The biggest difference is the filing fees.

For example, Massachusetts requires a \$300 registration fee, and each registered representative must file a U-4, which is \$50 each. If you file with the SEC then, in addition to the state fees, you must pay a registration fee of \$150 to \$1100 depending in your assets under management. The SEC has approved a waiver of the initial filing and the annual renewal fee until October 31, 2008. In Massachusetts, you still have to file as a "notice filer" even if you are an SEC registered advisor. The [SEC](#) provides more information on their filing fees.

Advisors are required to file an ADV Part I on the IARD website, and manually fill out ADV Part II, which is available on the website to download. Currently there is no way to submit Part II electronically. You are required to give Part II to all clients prior to signing an engagement letter. You can write your own disclosure brochure, but you must include all the information from the ADV Part II.

For a general overview and a summary of the requirements for registering with the SEC, click [here](#). Each state has its own requirements. For Massachusetts, click [here](#).



The requirements for the independent advisor have expanded greatly in the last three years. It is more difficult for the small office to manage the recordkeeping, the written policies and procedures, disclosure statement, code of ethics, best execution, and other requirements the SEC imposes. Attending the SEC's outreach seminars is a great way to stay up to date on what areas are priorities. It gives the advisor a chance to interact with the examiners outside of an audit environment and to openly discuss compliance issues. Both the SEC and the advisor benefit from the exchange of effective compliance practices. You can go to the SEC [website](#) for more information on their outreach efforts, and you can e-mail questions anonymously.

Your custodian can provide services and help with compliance requirements. Custodians typically publish their own newsletter with relevant compliance topics. You can speak to your Relationship Manager or log onto the [Schwab](#) and [Fidelity](#) web sites.

Many law firms and specialized consulting firms address compliance issues. Some are listed below, and your custodian is also a good source for recommendations:

[Stark and Stark](#) - This is a law firm that has a practice in Securities law and has earned a reputation for knowing the securities regulations for the investment advisor specifically.

[ComplianceMax](#) – A subsidiary of National Regulatory Services, they provide an on-line framework that gives the advisor the ability to create their own compliance program.

The firms below provide full service compliance consulting. Many of the consultants for these firms were examiners or auditors for the SEC or a state.

[ACA Compliance Group](#)

[Regulatory Compliance](#)

[RIA Compliance Consultants](#)

[National Regulatory Services \(NRS\)](#)

The SEC recognizes the need for outsourcing in the small advisory firm, but likes to see one person in-house who is responsible for making sure the policies and procedures are followed, and who is responsible for the relationship with the consultant. That person should also be familiar with the requirements and report



any changes to the consultant. The SEC prefers that the Chief Compliance Officer (CCO) is not the CEO. This way the CCO can monitor the CEO.

When it comes to compliance, the most important thing is to create a culture of compliance and disclose what you do, how you do it, and who does it. If you put in your policies and procedures that you do something, make sure it is done that way. Make sure everyone in the firm is familiar with the policies and procedures and everyone follows them, from the CEO to the newest staff person. If your procedures are not done as stated, suspicion is raised.

Disclose, disclose, disclose! You cannot disclose too much in your disclosure to clients. Whether you use the ADV Part II or create a brochure, disclose anything you think will be pertinent to the client. There are many areas that ADV Part I and II address. These should be elaborated on in Schedule F, so there is no question on how you run your practice.

Currently, one of the hotspots is communicating the biggest risks to clients and the firm from an operational and compliance perspective, especially in the areas mentioned in Rule 206 (4)-7. These areas are expanded upon at this [link](#) and are listed below:

- *Portfolio management*
- *Accuracy of disclosures*
- *Proprietary trading*
- *Safeguarding of client assets*
- *Required records*
- *Privacy protection*
- *Trading practices*
- *Marketing*
- *Valuation of client holdings and the assessment fees*
- *Business continuity*

There are many areas the SEC expects the advisor to monitor. Utilizing some of the resources mentioned here will help get you going in the right direction. Two more areas to take into consideration are Errors and Omissions insurance and Investment Policy Statements. These are not required by the SEC but are a good idea for the protection of your firm and your clients.

If you are a new firm, use an outsourcing solution. The cost may seem high, but they have the experience to get you up and running efficiently. The cost of having someone in house will be even higher. There is no need to recreate the wheel, so use the expertise of someone who has experience and knows what areas to prioritize.



If you are an established firm, don't assume that once you have all the requirements in place you are done. Rules change, your practice changes, your clients change and your employees change. Your policies and procedures should be updated regularly so they do not become outdated. Make sure you change your ADV to reflect changes in staff and services. And remember the SEC is on the same side you are: to do what is best for the client!

*Karla Paxton is an independent consultant with a practice that helps investment advisors with their transition to an independent RIA model. She can be reached at [karlapaxton@yahoo.com](mailto:karlapaxton@yahoo.com).*

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