

2024 Investment Adviser Compliance Conference

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EFFECTIVE STRATEGIES & BEST PRACTICES

Compliance 101

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**2024 Investment Adviser
Compliance Conference**

**EFFECTIVE STRATEGIES
& BEST PRACTICES**

Agenda

- Introduction of Panelists
- How to Design an Effective Compliance Program
- Tone at the Top – The Key to Making Internal Controls Work
- Deploying Risk Management
 - ❖ Assessing Risks and Conflicts of Interest
 - ❖ Mitigating Risks
 - ❖ Remediation Tips
- Q&A

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How to Design an Effective Compliance Program

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Background

Anti-Fraud Provisions

- Section 206 sets forth the fiduciary duty an SEC Registered Investment Advisers owes to clients:
 - ❖ Good faith
 - ❖ Full and fair disclosure of all material facts
 - ❖ Reasonable care to avoid misleading clients
- Compliance programs help protect investors with clear policies and training to uphold fiduciary obligations

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Background

February 5, 2004: IA Compliance Program Rule Becomes Effective

- Rule 206(4)-7 requires SEC Registered Investment Advisers to:
 - ❖ Adopt and implement written policies & procedures;
 - ❖ Designate a competent Chief Compliance Officer; and
 - ❖ Conduct an annual review to test the effectiveness of the adviser's policies & procedures

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Written Policies and Procedures

- Must be reasonably designed to prevent violations by the adviser and its supervised persons of the Advisers Act and the rules thereunder
- “Supervised Person”
 - ❖ Any partner, officer, director, employee of the adviser, or other person who provides investment advice on behalf of the adviser AND
 - ❖ The adviser supervises and controls that person

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Written Policies and Procedures

- Rules do not mandate specific policies or procedures, but must be customized to the business and at a minimum, address the following:
 - ❖ Portfolio management processes
 - ❖ Trading activities – including execution, allocation and soft dollars
 - ❖ Safeguarding of client assets and privacy protection of client information
 - ❖ Accurate Recordkeeping
 - ❖ Marketing of advisory services and referral arrangements
 - ❖ Valuing assets and assessing fees
 - ❖ Business continuity
 - ❖ Recordkeeping
 - ❖ Accuracy of disclosures
 - ❖ Proprietary / personal trading

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Written Policies and Procedures

- Do Your Homework – Policies must be tailored to your organization
- Each policy should have an owner
- Your procedures should document your controls
- Be mindful of recordkeeping requirements (maintain version control)
- Not a once and done project
 - ❖ Remember: reasonably designed to prevent, detect, correct

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The Chief Compliance Officer

- Qualification of CCOs
 - ❖ Competent and knowledgeable
 - ❖ Have full responsibility and authority to enforce compliance policies
 - ❖ Have sufficient seniority and authority to compel others to adhere to policies
 - ❖ Be aggressive in pursuit of violations

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The Chief Compliance Officer

- Duties
 - ❖ Administer the Compliance Program
 - Administer does not mean “supervise” business processes
 - ❖ Advise senior management
 - ❖ Maintain exception records and program documentation
 - ❖ Identify new compliance risks and address failures
 - ❖ Direct and document annual review

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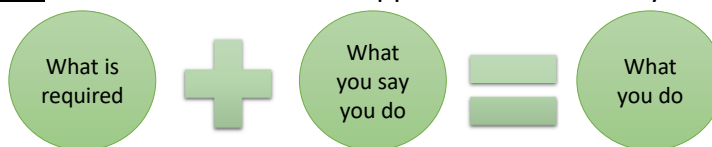


Primary Elements of a Compliance Program

Develop an Internal Control System to Address Regulatory Requirements

This is Achieved Through:

- Disclosures: Focus on material information and conflicts of interest as a fiduciary to your clients
- Policies and Procedures: Must be reasonably designed to prevent violations of securities laws
- Documentation: Maintain records that support the above and your business operations



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The Annual Review

- Purpose
 - ❖ To assess the “adequacy” of policies and procedures and the “effectiveness” of their implementation
 - Must be a formal documented process
 - Today, technically requires a written report
 - ❖ Should address:
 - Compliance matters that arose during the prior year
 - Changes in the business
 - Changes in laws and regulation

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The Annual Review

- SEC Guidance
 - ❖ Inventory legal obligations
 - ❖ Identify areas of conflicts of interest
 - ❖ Tie compliance policies to obligations, addressing gaps
 - ❖ Assess effectiveness of compliance function generally within the organization
 - ❖ Identify which procedures are missing, inaccurate or not working to its intended purpose
 - ❖ Test all procedures (transactionally, periodically and forensically)

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Testing Examples

Transactional

- Reviewing activity against policy and procedures
- Assessing risks and confirming controls
- Snapshot in time

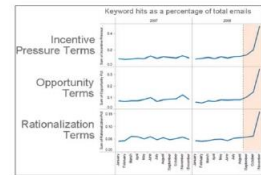
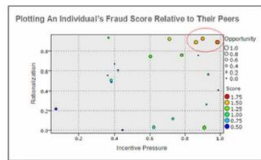
Periodic

- Comparing activity with procedures and experience
- Assessing risks and confirming controls
- Experience over a time period

Forensic

- Analyzing activity against procedures and experience
- Diagnosing risks and evaluating controls
- Trends and occurrences over time

Individual	F-Score	R-Score	O-Score	Total Score
Ann	0.90	0.93	0.92	0.92
Ben	0.86	0.88	0.87	0.88
Carl	0.91	0.93	0.91	0.92
Dale	0.76	0.78	0.78	0.78
Eve	0.91	0.93	0.93	0.93
Frank	0.88	0.90	0.89	0.89
Grace	0.88	0.90	0.87	0.88
Heidi	0.93	0.93	0.93	0.93
Ivan	0.92	0.93	0.92	0.92
Jane	0.92	0.93	0.92	0.92
John	0.92	0.93	0.92	0.92
Karen	0.92	0.93	0.92	0.92
Laura	0.92	0.93	0.92	0.92
Mark	0.92	0.93	0.92	0.92
Nancy	0.92	0.93	0.92	0.92
Oliver	0.92	0.93	0.92	0.92
Peter	0.92	0.93	0.92	0.92
Quinn	0.92	0.93	0.92	0.92
Rachel	0.92	0.93	0.92	0.92
Samuel	0.92	0.93	0.92	0.92
Tina	0.92	0.93	0.92	0.92
Uma	0.92	0.93	0.92	0.92
Victor	0.92	0.93	0.92	0.92
Wendy	0.92	0.93	0.92	0.92
Xavier	0.92	0.93	0.92	0.92
Yara	0.92	0.93	0.92	0.92
Zoe	0.92	0.93	0.92	0.92



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The Annual Review

- Considerations
 - ❖ Map policies to Form ADV and other client disclosures
 - ❖ Don't over rely on certifications
 - ❖ Focus on higher risk areas
 - ❖ Address red flags and findings
 - ❖ Assume no attorney-client privilege
 - ❖ Wording counts; be mindful of the contents of the report

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Tone at the Top – The Key to Making Internal Controls Work

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The Importance of Compliance Culture



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Compliance Program Building Blocks

- Culture
- Governance
- Risk Assessments
- Policy and Procedures
- Communication and Training
- Ongoing Process Improvement
- Monitoring and Reporting
- Testing
- Issues Management
- Investigations and Enforcement

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How to Build a Compliance Culture

Executive Support of Compliance Shapes the “Tone at the Top”

- Leadership
 - ❖ Supporting the efforts of compliance by example helps to get firm-wide buy in
- Supervision
 - ❖ Senior managers within the business embracing supervisory responsibilities to ensure compliance with firm requirements
- Compliance is everyone’s business
 - ❖ Having all personnel aware of compliance and the importance it has for the business is accomplished through robust training programs

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Compliance Training

- Focuses on risks, requirements, and results
- Collaboration
- Committees or Groups
- Common themes
- Creative distribution

**Create dialogue with all employees.*



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Compliance Training

- Takes place periodically (not just annually)
- Establishes expectations
- Provides controls
- Delegates responsibility
- Incorporates assessment
- Evolves – not static



**Training helps shift risk and responsibility to where it can be mitigated.*

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Compliance Training

Example: Policies & Procedures - Everyone Leaves a Footprint on Activities

- Employees Performing the Activity
 - ❖ Own the activity and meet the internal control requirements
 - ❖ Provide feedback on the performance of activity
- Management (“C” Suite, Managers, Supervisors)
 - ❖ Oversee the activity and determine desired outcomes and acceptable risks
 - ❖ Establish and evaluate performance controls
- Compliance & Legal
 - ❖ Assess the activity and the requirements, outcomes and risks
 - ❖ Establish and evaluate internal controls

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Deploying Risk Management

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What is a Risk?

- The likelihood of any occurrence that prevents the achievement of objectives
- Types of Risks
 - ❖ People – due to a misunderstanding or failure to complete tasks
 - ❖ Process – due to improper execution (e.g., data capture, documentation, etc.)
 - ❖ Technology – due to error in coding, software, systems or cyber event resulting in a data breach
 - ❖ External Events – actions outside of the firm, such as regulatory changes, vendor failures, credit risk and force majeure, such as a pandemic

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What is a Conflict of Interest?

- Under Reg BI and the IA fiduciary standard, a conflict of interest is an interest that might incline a BD or IA – consciously or unconsciously – to make a recommendation or render advice that is not disinterested
- A conflict of interest may also occur when employees act in their own interest rather than in the best interest of the firm's clients or the firm
- Some conflicts are unavoidable while others can be mitigated or eliminated
- Obvious and possible conflicts of interest must be disclosed
 - ❖ **Challenge:** Compliance may not always be on the front line or know of possible changes in the business, product expansion, investment process change, or hear of supervised employee outside activities

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Assessing Risks and Conflicts of Interest

- Three Part Analysis
 - ❖ Step 1: Identify the Risk
 - ❖ Step 2: Evaluate the Risk
 - ❖ Step 3: Mitigate the Risk

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Identifying Risks and Conflicts of Interest

- Begin by Identifying Your Objective
 - ❖ *E.g.*, Compliance with Cybersecurity Rules
- Objectives must be tailored to your firm and cover regulatory obligations
- Objectives should include how you will assess the risk
- Objectives should be tied to how the firm's policies and procedures mitigate the risk associated with failure to meet the objective

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Evaluating Risks and Conflicts of Interest

Consider:

- What activities in our business model create regulatory risk?
- What activities in our business model present conflicts of interest between our firm and our clients?
- What activities of our employees' present conflicts of interest between them and our clients?
- Are there any new risks to our business in the past year?
- Are there any new conflicts of interest being contemplated that may need to be disclosed or reported?

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Performing the Risk Assessment

- Assessing Risks: foundation of an effective compliance program
- SEC staff expect that firms will conduct an inventory of regulatory obligations, conflicts of interests and other risks which arise as part of the firm's practice and develop written policies and procedures to address each
- These efforts should be documented and revisited as changes develop
- Each risk area identified should be ranked according to its potential impact should a violation occur
 - ❖ Medium to high-risk areas should be subject to ongoing testing and monitoring

Example of Common Matrix Approach:

Risk Area	Risk Issues	Ranking (H; M; L)	Procedures; Disclosures; Other Controls	Testing

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Mitigating Risks

- Controls are activities, processes and procedures put in place to mitigate risks
 - ❖ Examples include compliance surveillance systems, policies and procedures manuals, access controls, quality reviews, and training
 - ❖ It also includes ongoing evaluation and forensic testing
- The type of control you use is dependent upon:
 - ❖ Level of exposure faced by the firm
 - ❖ Risk tolerance of the organization
 - ❖ Likelihood of risk occurring
 - ❖ Cost/benefit analysis

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Remediation Tips

- If a Risk is Identified, Classify as High, Medium or Low Risk
 - ❖ If a *high risk*, escalate to senior management and provide a compliance recommendation on how to remediate the risk
 - This may be through disclosures, a new policy or procedure, issuance of guidelines, training and communications to others (clients, vendors, counter-parties)
- Consider Formal Exception and Escalation Procedures
 - ❖ Consider formulating an exceptions committee
 - ❖ Determine who needs to be apprised of exceptions and how long they can exist
 - ❖ Documentation

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Remediation Tips

- Reputation is a Critical Factor
 - ❖ Senior management must articulate, adhere to and require others to adhere to clear ethical standards and create a risk conscious culture
 - ❖ Risk exposures must be measured, managed and understood
 - ❖ Determine who to report to internally, and when necessary, externally (pursuant to regulations and contractual obligations)

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Remediation Tips

- Regulatory Risk Mitigation Steps
 - ❖ Be sure to document risks in a Risk Assessment Report
 - Map to controls and consider market, compliance, operations, financial, and investment risks
 - Follow-up frequently to ensure that risk mitigation steps were carried out, and document when
 - Frequently test higher risk areas to ensure that the mitigation control deployed is effectively working
 - ❖ Seek legal counsel for higher risk areas, particularly for self-reporting

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Conclusion / Q&A

Questions? Let us know how we can help!



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