

Compliance Programs, Assessments and Surviving SEC Examinations

For the 26th National Risk Management Training Conference



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SEC and FINRA Oversight



- Every investment adviser, investment company, broker-dealer
- Third party service providers
- Purpose:
 - Prevent fraud
 - Improve compliance
 - Monitor risk, and
 - Inform Regulatory Policy



Basic Compliance Elements

- Written program
 - Policies and Procedures outlined in writing
 - Chief compliance officer
 - Annual review and assessment
- Required books and records
- Fiduciary mindset
 - Including organizational culture

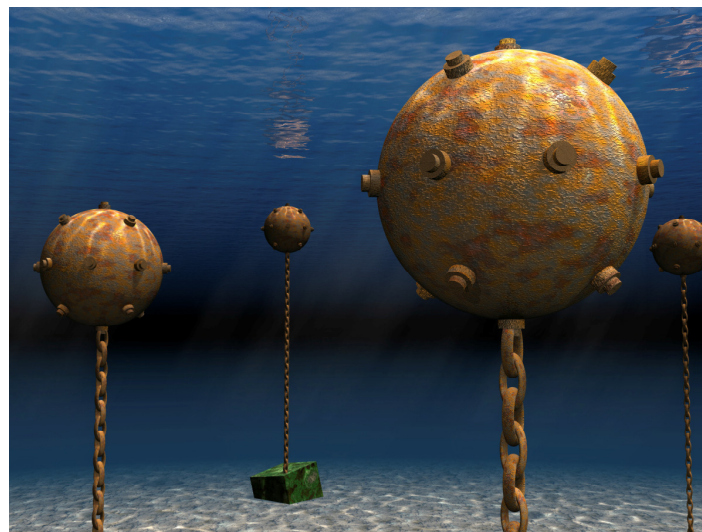


Being The Fiduciary

- Obligation to act in the client's best interests
- Duty of undivided loyalty and upmost good faith to clients
- Application of reasonable care to avoid misleading clients
- Provide full and fair disclosure of all material facts to clients
- Eliminate, or at a minimum disclose, all conflicts of interest

Types of Risk and Responses

- Financial
- Regulatory
- Compliance
- Market
- Credit
- Operational
- Reputational
- Litigation
- Counterparty
- Terminate it
- Reduce or mitigate it
- Transfer it
- Accept and plan for it





Policies and Procedures

- Portfolio management processes (investment allocation and investment objective review)
- Accuracy of disclosures, for example, in account statements and marketing materials
- Proprietary trading
- Safeguarding of client assets
- Required records and their maintenance and protection
- Privacy protections
- Trading practices like best execution, soft-dollar arrangements, and trade allocation
- Marketing issues including solicitors and finders



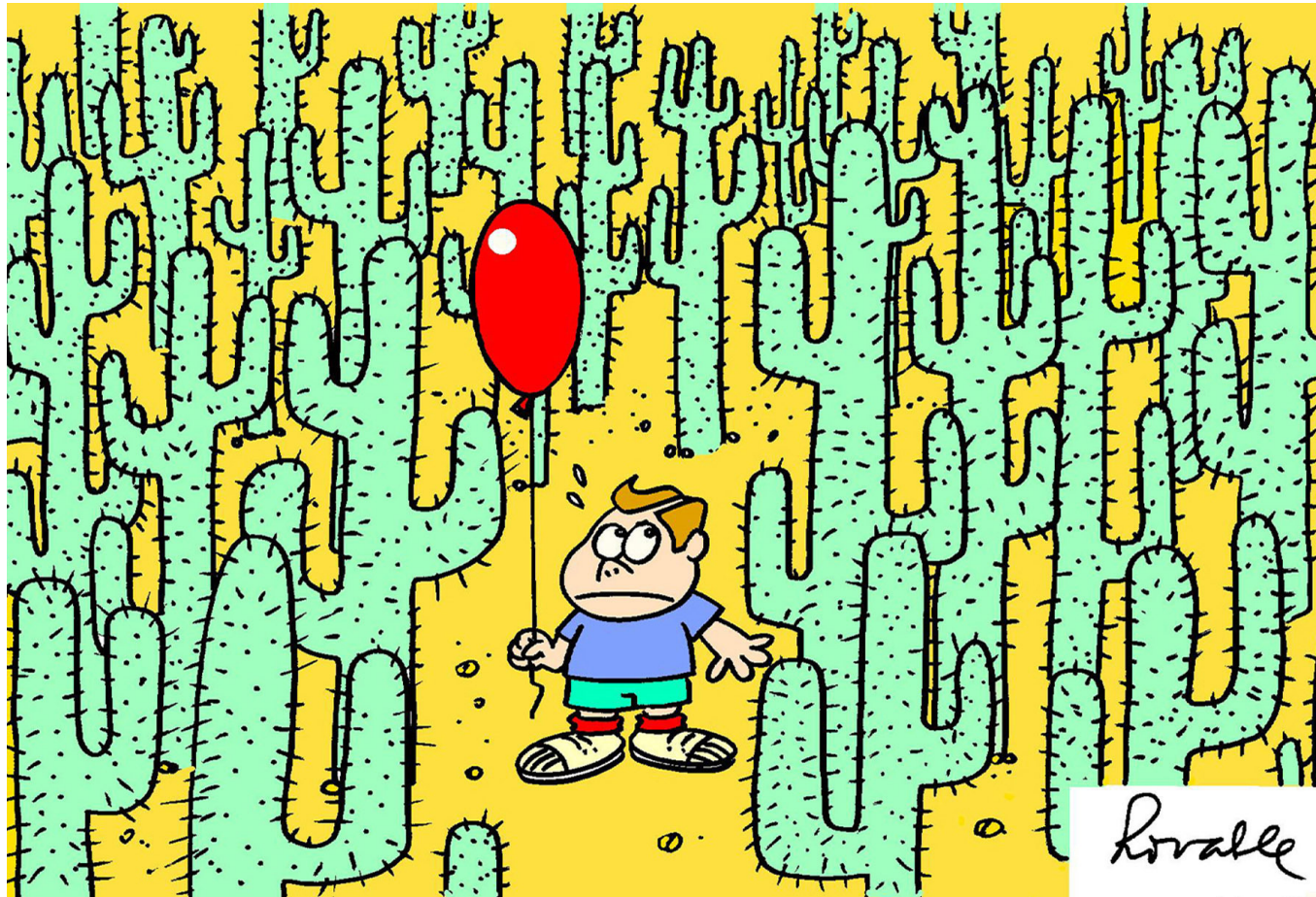
More Policies and Procedures

- Personal trading
- Research reports and their preparation
- Gifts and entertainment
- Regulatory filings and registration
- Regulatory reporting
- Continuing education and job requirements
- AML, SARs, CTRs, OFAC checks
- Short selling
- Outside business activities
- Business continuity

Deficiency letter or enforcement?

- New manager failed to take steps in the first year to ascertain whether firm had written P&P that were adequate to prevent trading violations
- Compliance director purchase of off-the-shelf manual and failed for more than a year to tailor it to the firm's risks
- Compliance officer failed to perform compliance procedures outlined in P&P
- CCO knew of late and incomplete custody audits and failed to get Code of Ethics acknowledgements from employees

Testing and Evaluating



Annual Review Testing

- Risk driven priorities
- Methods of testing
 - Transactional
 - Periodic
 - Forensic
 - “People”
- Year-long or one time
- Review prior year’s report





Prove Your Testing

- Document the process
 - Steps taken when and by whom
 - What period covered and documents reviewed
- Create written report and summary
 - What was found and what was the follow up
- Revise P&Ps as needed



SEC Examination Landscape

- Building National Exam Program
- Specialized working groups
 - 1) new and structured products; 2) valuation; 3) equity market structure and trading practices; 4) fixed income, including municipal, securities; 5) microcap fraud and trading; and 6) marketing and sales practices
- Streamlining processes – efficient, effective and consistent
- Risk based approach

Types of Exams

- Due diligence examinations
- For Cause examinations
- Risk-based examinations
- Sweep examinations
- Large firm examinations





Exam Preparation

- Before any request letter is received
- When you receive the request letter
 - Exam information brochure
 - Form 1661
 - Information request list
- Ready for arrival
 - Space and personnel issues

Set the Agenda and Implement



- Initial meeting with Management and CCO
- Presentation
- Records control
- Interviews of firm employees
- Ongoing remediation
- Exit interview requests



Concluding the Exam

- Follow up requests from exam staff
- Dodd-Frank's requirement – 180 days; OCIE goal of 120 days
- Letter from the Exam staff
 - No further action
 - Deficiency
 - Serious problems identified may signal enforcement referral

Is there any Lemonade?





Company Responses

- Small portion of exams result in enforcement referral and contact
- Respond to deficiency letter
- Correct and/or explain
- Reporting to management, board and audit committee as required
- Resources and tools
- At the end, reflect

Congratulations are in Order



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