



INVESTMENT ADVISER NEWS UPDATES

CREATING AN EFFICIENT CULTURE OF COMPLIANCE

For many managers, navigating through the regulatory compliance landscape depends on finding the right balance between implementing an exhaustive compliance program and containing compliance costs. However, by understanding regulators' priorities and tailoring firm practices to fit these focuses, firms can limit their compliance costs and still implement a robust compliance program.

It is important to note that regulators typically focus on two areas when it comes to evaluating compliance programs:

- 1. Evidence of Firm Compliance Policies:** Regulators are looking to see that firms have an operable customized compliance framework in place. A firm's compliance program should identify risks, set forth methods to prioritize company action, and have dependable procedures to follow when compliance risks arise.
- 2. Firm Character of Compliance:** A firm's compliance program is not simply a collection of rubberstamped processes. Regulators want to see a culture of compliance that begins at the top—a culture that is enforced by senior staff and followed by employees. Firms should have a dedicated budget for compliance costs, a designated staff, clearly defined duties with regards to compliance obligations, and an open line of communication between compliance and management.

Firms should tailor their compliance programs to fit the regulators' focus. This means that firms should avoid a one-size fits all approach to compliance and, instead, examine how their policies serve to protect against common compliance pitfalls. Some suggestions include:

Determine Internal Expertise

The Securities Exchange Commission (SEC), Financial Industry Regulatory Authority (FINRA), and the Commodities Futures Trading Commission (CFTC) each have their own unique regulatory obligations. Considering the breadth and complexity of each agency, it is unlikely that one person at your firm would possess all the knowledge needed to navigate each regulatory body. Evaluate what your firm's

strengths are in dealing with these regulatory bodies and identify external resources to cover any gaps in knowledge.

Outsource Quality Control

Firms should consider what compliance tasks are best addressed in-house and which tasks can be outsourced to third-party compliance professionals. The greatest value of an outside compliance expert is as a quality control measure—auditing firm records, conducting mock exams and risk assessments, and monitoring the overall efficiency of a firm's compliance program.

Be Proactive

It is best to proactively address compliance issues as they arise or have effective controls in place to prevent them in the first place. Regulators are looking for consistency in carrying out your firm's established compliance policies. Being proactive can help your firm identify major compliance risks while assessing which policies are essential to your operations. Proactive firms excel by conducting periodic compliance reviews, creating compliance calendars, and immediately documenting compliance issues as they arise. Staying diligent about your compliance program will allow you to retain the services your firm needs while cutting costs on the services that are not applicable.

Leverage Professional Networks

While there are distinct costs associated with a compliance program, firms often overlook the free resources at their disposal. Your firm should take advantage of networking events, industry roundtables, expert panels, and free webinars. These are opportunities for you to connect with other compliance professionals and learn about how they construct their compliance framework. Such knowledge will be invaluable as you continue to refine your compliance program without increasing your cost.

UPCOMING Q2 2015 COMPLIANCE DEADLINES

As a reminder, there are two important Q2 deadlines on the horizon:

Form PF

Investment advisers registered with the SEC, managing private funds, and with at least \$150 million in regulatory assets under management attributable to "private fund assets" must file a Form PF annually, within 120 days of the end of their fiscal year, or by **April 30, 2015** for advisers with a December 31 fiscal year end. The Form PF filing should be submitted through the IARD website.

FATCA

As part of the ongoing compliance roll out for the Foreign Account Tax Compliance Act (FATCA), managers with Cayman Island funds should take notice of the **April 30, 2015** deadline for registration through the Automatic Exchange of Information Portal ("AEIP"). The Cayman Islands created the AEIP to help centralize the FATCA reporting obligations of Cayman Islands Financial Institutions. The Cayman Islands Tax Information Authority recently published a User's Guide to assist with the registration process.^[1]

[1] See [Cayman Islands Automatic Exchange of Information Portal User Guide](#)

BROKER-DEALER NEWS UPDATES

SEC NYLIFE “No Action” Letter Grants Relief for Introducing Broker-Dealers

On March 12, 2015 the SEC issued a “no action letter”^[1] to NYLIFE Securities LLC (NYLIFE) focusing on the practices of “introducing” broker-dealers. The no action letter rendered new guidance with respect to Securities Exchange Act Rule 15c3-3, which governs how broker-dealers account for, handle, and treat customer funds and securities.

Rule 15c3-3(k) permits introducing broker-dealers to accept customer funds and securities for specified times and purposes. Generally, broker-dealers operating under Rule 15c3-3(k) do not hold customer funds and securities as a service to their customers—they forward these funds to a clearing or carrying broker-dealer. The SEC requires that broker-dealers operating under Rule 15c3-3(k) forward all customer funds and securities to a third party by “noon of the next business day” after receipt. Though simple in construction, this time constraint for delivering funds to a clearing broker became practically difficult in light of other regulatory requirements—such as FINRA suitability and supervision rules.

The SEC’s March 12, 2015 no action letter recognized the compliance issues arising out of the “noon of the next day” deadline, and would not recommend enforcement action against NYLIFE “or any other broker-dealer in similar circumstances [that] holds customers’ checks payable to issuers if the purpose for holding the customers’ checks is to complete principal suitability reviews of each sale of a recommended subscription-way security and:

1. Establishes policies and procedures reasonably designed to ensure that each check is safeguarded and that a registered representative of the member who recommends a sale of a security on a subscription-way basis promptly prepares and forwards a complete and correct application package to an OSJ of the member regarding such security;
2. Causes a registered principal to perform a suitability review in accordance with FINRA Rule 2111 and determines whether he or she approves of each recommended subscription-way of sale within seven business days after an OSJ of the member receives a complete and correct application package;
3. Transmits the check no later than noon of the business day following the date of the registered principal reviews and determines whether he or she approves the transaction;
4. Maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the issuer if approved or was returned to the customer if rejected; and
5. Discloses to customers its process for handling customer checks payable to issuers for subscription-way securities transaction in advance of each

transaction.”

The SEC’s no action letter should provide ample relief for introducing broker-dealers that operate under Rule 15c3-3(k).

[1] See [Cayman Islands Automatic Exchange of Information Portal User Guide](#); See [SEC NYLIFE No-Action Letter](#)

ALSO IN THE NEWS

FINRA Cybersecurity Report

On February 3, 2015, FINRA published their Report on Cybersecurity^[3], highlighting effective practices that firms should consider to strengthen their cybersecurity programs. The report highlighted that firms with the most robust cybersecurity policies were those that conducted periodic risk assessments, had clear response plans in the event of cyber breaches, and well-trained staff with regards to the firm’s hardware and software.

As we stated in our previous newsletter, cybersecurity remains a big area of focus for FINRA, the SEC, and other regulators in 2015. Please contact your Gordian consultant with any questions regarding your firm’s cybersecurity policies and procedures.

SEC Guidance: Acceptance of Gifts by Fund Advisory Personnel

On February 20, 2015, the SEC Division of Investment Management issued guidance in *IM Guidance Update No. 2015-01* examining the conflict of interests that arise when fund advisory personnel accept gifts, favors, or other forms of consideration.^[4] The SEC issued this guidance to remind mutual fund participants that the receipt of such items gifts may trigger a violation of Section 17(e)(1) of the Investment Company Act of 1940, which prohibits an affiliated person of a registered investment company from accepting compensation for the purchase or sale of property from or to the investment company, except in the ordinary course of acting as an underwriter or broker. While an investment adviser typically addresses this conflict of interest within a firm’s Code of Ethics, the SEC explicitly stated that firm policies should include a preapproval process for gifts, and other consideration, to minimize potential Section 17(e)(1) violations.

The prohibition in section 17(e)(1) generally applies whenever fund advisory personnel, acting as *agent* rather than broker, accept from any source any compensation (other than regular salary or wages from the fund) for the purchase or sale of any property to or for the fund.^[5] Thus, if a fund’s portfolio manager accepts any gifts or entertainment from a broker-dealer for the purchase or sale of the fund’s portfolio securities, the portfolio manager has violated section 17(e)(1).^[6]

Pursuant to sections 2(a)(3)(E) and (D) of the 1940 Act, a fund’s investment adviser and the investment adviser’s officers, directors and employees, among others, are

affiliated persons of the investment adviser and are second-tier affiliates of the fund. Thus, 17(e) applies to all such persons.

Compliance Policies and Procedures

The receipt of gifts or entertainment by fund advisory personnel, among others, should be addressed by compliance policies and procedures under rule 38a-1 under the 1940 Act. Rule 38a-1 requires a fund board of directors to approve, and each fund to adopt and implement, written policies and procedures reasonably designed to prevent the fund and its service providers from violating the federal securities laws. Rule 38a-1 also requires a fund board to approve the policies and procedures of fund service providers, including investment advisers, and requires the fund's compliance policies and procedures to include provisions for fund compliance oversight of its service providers.

The exact policies and procedures would depend on the nature of the adviser's business and other considerations but might include "a blanket prohibition on the receipt of gifts or entertainment by fund advisory personnel" or "a pre-clearance mechanism for acceptances of gifts or entertainment to assess whether they would be for the purchase or sale of any property to or for the fund and therefore prohibited under section 17(e)(1)." [7]

[3] See [FINRA Report on Cybersecurity](#)

[4] See [IM Guidance Update No. 2015-01](#)

[5] Id.

[6] Id; Section 17(e)(1) of the 1940 Act states that "[i]t shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person . . . acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker."

[7] Id.



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