Compliance considerations for multiple office locations

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I. A duty to supervise

The opening of an additional office location for an investment advisory firm is an exciting event, a sign that the firm is growing. But having multiple office locations can also introduce a great deal of complexity into the advisor’s business. While many factors must be taken into account, such as finding suitable office space and understanding local employment law, this discussion will focus on an advisor’s compliance and supervisory obligations with respect to multiple office locations under the Investment Advisers Act of 1940 (the “Advisers Act”).

All investment advisors, even those not registered with the Securities Exchange Commission (“SEC”), are subject to Section 203(e)(6) of the Advisers Act, which empowers the SEC to take action against an investment advisor if the advisor or any person associated with the advisor has “failed reasonably to supervise” a person subject to their supervision who commits a violation of federal securities laws. Consequently, all advisors have a duty to supervise their employees under the Advisers Act. The repercussions of failing to do so can be severe:

• In a recent high-profile case, the SEC charged hedge fund manager Steven A. Cohen with failure to supervise for allegedly ignoring certain red flags indicating that his employees were engaging in insider trading. If the SEC wins its case, Mr. Cohen could be permanently barred from working in the securities industry.
• An advisor recently paid a $150,000 fine and agreed to hire an independent compliance consultant to settle SEC charges that the advisor failed to adopt and implement policies and procedures that were adequate to prevent an employee from making improper withdrawals of client funds.

Unfortunately, apart from its enforcement actions, the SEC has not provided much guidance on an investment advisor’s duty to supervise (although there are some areas, as described in more detail below, in which it makes sense to look at guidance from the SEC and other regulatory agencies to broker-dealers). Further, because multiple office locations come in many shapes and sizes, there is no one-size-fits-all approach to supervision. Myriad factors must be taken into account, including the office’s geographic location, the number and type of employees who work there, and the functions carried out by those employees. The following are some of the most important considerations.

II. Supervisory structure

Among the first considerations to be addressed when opening a new office location is whether oversight will be centralized or decentralized. In a centralized structure, the advisor will have a “home” office that is responsible for supervising one or more “remote” offices. The primary advantage of this structure is that, because oversight is centralized within the home office, the advisor’s policies...
and procedures will be applied consistently across the various remote offices, and there is no ambiguity about where the supervisory authority lies. (On the other hand, the home office may not have the same level of insight into the business activities taking place at a remote office as the people who actually work there, which could cause delays in the decision-making process.)

In a decentralized structure, each office location operates on more or less equal footing. Because much of the supervision takes place in the same physical location as the business activities that are being carried out there, this structure may be more beneficial from a business standpoint if it allows for more nimble decision making than a centralized structure. This could, however, lead to inconsistent interpretations of the advisor’s policies and procedures by supervisors at different office locations and confusion about who in the organization has ultimate supervisory authority.

Regardless of the supervisory structure an advisor chooses to implement, it’s crucial that the advisor’s policies and procedures clearly delineate supervisory responsibility. They should identify which person or group is responsible for oversight of a particular business activity and must be absolutely unambiguous about how and to whom to escalate any matter that requires the intervention of a supervisor.

III. Policies and procedures

Establishing clear, comprehensive written policies and procedures is probably the single most important thing an advisor can do in carrying out its supervisory duties. The SEC has stated that no person will be deemed to have failed to supervise if:

- There are policies and procedures in place that are reasonably designed to prevent and detect violations of federal securities laws
- The person reasonably discharged his or her duties under such policies and procedures

The SEC has stated that an advisor’s policies and procedures should address “conflicts and other compliance factors creating risk exposure for the firm and its clients in light of that firm’s particular operations.” In other words, effective compliance policies and procedures are customized to the advisor’s business activities. The policies and procedures of an advisor that has multiple office locations should be tailored to incorporate the specific risks applicable to those offices. The SEC has also stated that advisors should conduct an annual review of their policies and procedures, taking into account “any compliance matters that arose during the previous year, any changes in the business activities of the advisor or its affiliates, and any changes to the Advisers Act or applicable regulations that might suggest a need to revise the policies or procedures.”

Policies and procedures need to be comprehensive enough to address the firm’s key risks but not so prescriptive that they needlessly hinder the advisor’s ability to carry out its primary responsibility of providing investment advice to clients. In some cases, it’s appropriate for the policies and procedures to be very explicit and detailed; in others, it makes more sense for the policies and procedures to establish a more flexible, principles-based framework to decide the proper course of action.

Effective compliance policies and procedures are customized to the advisor’s business activities. The policies and procedures of an advisor that has multiple office locations should be tailored to incorporate the specific risks applicable to those offices.

The advisor’s policies and procedures should provide for ongoing reporting from employees of remote office locations about any potential conflicts of interest or other potential compliance concerns. This is particularly important for employees in remote offices where the employees may not be interacting with compliance personnel on a regular basis. As a best practice, upon joining the firm (and on an annual basis thereafter) employees should complete a compliance questionnaire that asks about their:

- Criminal or disciplinary history
- Outside business activities
- Relevant conflicts of interest, such as familial relationships with employees of firms with which the advisor does business

The policies and procedures should also establish a clear process for reporting any potential conflicts that may arise in the interim, including the types of issues that would need to be reported and to whom the report should be made.

A. Registration and licensing

Advisors should be sure to investigate whether there are any additional filings or licensing requirements in each jurisdiction in which the advisor opens an office. If the office is located in another state, advisors that are not registered with the SEC may be required to register in that state, and SEC-registered advisors (depending on the number of clients and/or investors the advisor has in the state) may be required to submit a notice to the state when filing Form ADV.

Certain states may also require advisory personal to be licensed as investment advisor representatives (“IARs”) in that state. If the office is located in another country, the advisor will need to determine whether registration with that country’s securities regulators is necessary, which could subject the advisor to a regulatory regime quite different from the one in place in the U.S. Advisors should
also ensure that its multiple office locations are properly disclosed in its regulatory filings. For example, Form ADV Part 1 requires an advisor to identify its primary place of business as well as any other offices at which the advisor carries out its advisory activities or where the advisor’s books and records are maintained.

B. Code of ethics

Advisors should ensure that the code of ethics reporting that employees of registered investment advisors are required to make under Rule 204A-1 of the Advisers Act are delivered to the chief compliance officer (“CCO”) or applicable compliance personnel on a timely basis, especially if employees are providing reports in hard copy. Personal securities transactions reports, for example, must be made within 30 calendar days following quarter-end, so it would be preferable for the advisor to receive duplicate statements and trade confirmations via an electronic feed or directly by mail from the employee’s brokerage firm. Otherwise, if an employee has to wait for his or her brokerage statement to be delivered and then forward a copy of the statement to the compliance department, any delay could result in a missed deadline, which is a violation of the advisor’s code of ethics.

C. Business continuity

The office’s location will dictate many aspects of an advisor’s business continuity planning. For example, if the office is in a region that is particularly susceptible to natural disasters, such as hurricanes or earthquakes, or if the office is in someone’s home as opposed to a commercial office building, those factors should be taken into account in developing a business continuity plan. Additionally, the advisor may consider whether multiple office locations can be leveraged for business continuity planning purposes.

For example, if the advisor has trading personnel located at two different offices, it may be prudent to train the traders at each location to be able to back up the traders at the other location if a significant business disruption occurs. Or if an advisor has two offices that are geographically close to each other, it may be possible for the employees of one office to work remotely from the other office if there’s a significant business disruption.

D. Books and records

Advisors should be mindful of whether an office location maintains books and records that are required under the Advisers Act or that might otherwise be critical to the advisor’s business. Whether records are maintained electronically or in hard copy, the advisor’s policies and procedures should establish a process for ensuring that the records are maintained in a way that preserves the integrity of the record and ensures that compliance and supervisory personnel have ready access to the records should a need arise, such as a regulatory examination or litigation.

For registered advisors, the policies and procedures should take into account the fact that any records required under the Advisers Act must be maintained in an “appropriate” office of the advisor and will generally need to be produced to the SEC within one to two business days upon request during an examination. Additionally, as a practical matter, offices overseas, registered advisors are required either to maintain its books and records in English or to provide for the records to be translated into English at the advisor’s expense upon request by the SEC.

E. Marketing and investor relations

Advisors should assess whether employees at the office will be interacting with current or prospective clients and investors. If personnel at the office are engaged in marketing activities, the advisor should establish a process for ensuring that all marketing materials are reviewed by compliance or an appropriate supervisor before first use, and that employees at remote offices know how to obtain and are distributing the most current approved version of any marketing materials (as well as other disclosure documents, such as Form ADV Part 2 and the advisor’s privacy notice).

The advisor should also consider any requirements specific to the jurisdiction in which the office is located. For example, certain states and municipalities may require the advisor or its personnel to register as lobbyists if the advisor is seeking to do business with a government entity. And if the advisor’s personnel are interacting with foreign nationals, the advisor will likely need to develop policies and procedures for complying with the very broad anti-bribery provisions of the Foreign Corrupt Practices Act. Additionally, the advisor’s policies and procedures should address the handling of any client or investor complaints, including the process for escalating complaints to compliance or supervisory personnel.

F. Information security and privacy

Finally, to the extent that personnel at the office may have access to sensitive information about the advisor’s business, clients, or investors, the advisor will need to ensure that its policies and procedures provide ways to protect that sensitive information.

Looking for more information on compliance or regulatory issues?

Schwab’s compliance website includes a searchable database, compliance tools, and many other resources to assist you. Visit schwabadvisorcenter.com > News & Resources > Compliance. (See “Online compliance resources” on back page for more information.)
information. For example, a home office may lack some of the physical and technological security measures available in modern commercial office buildings, so advisors would need to consider what safeguards can be used in that environment, such as requiring employees to lock sensitive documents in filing cabinets and log in to the advisor’s systems using a secure virtual private network (VPN).

Further, the advisor may have additional obligations depending on where the office is located. Each state and country has its own consumer protection and privacy laws that pertain to its residents. In the U.S., for example, Massachusetts 201 CMR 17 is currently the most onerous state consumer protection law; it requires, among other things, the encryption of personal information of Massachusetts residents when that information is being transmitted electronically or stored on laptops and other mobile devices.

Advisors should also ensure that they have policies and procedures to promptly disable an employee’s access to sensitive information when that employee resigns or is terminated from the firm, including access to the physical office and to the advisor’s systems and devices.

IV. Culture of compliance

Establishing a strong culture of compliance is vital to ensuring that employees understand the importance of compliance to the firm and that lapses will not be tolerated. This is particularly important for advisors with multiple office locations that do not necessarily have compliance personnel on-site in every office.

Perhaps the most important ingredient in establishing a good culture of compliance is a clear “tone from the top” regarding compliance responsibilities. Employees need to know that senior management takes compliance seriously, both in their words and, more critically, their actions. Senior executives must be outspoken about the necessity of compliance and must fulfill their own compliance obligations. They must also give the CCO sufficient authority and resources to discharge his or her duties. The SEC has stated that “[a]ppropriate resources must be allocated to the compliance function. ... [A] registrant must not only adopt effective procedures for supervision, but must also ‘provide effective staffing, sufficient resources and a system of follow-up and review to determine that any responsibility to supervise ... is being diligently exercised.’” A compliance function that is chronically understaffed or underfunded, or that routinely has its decisions undermined by the firm’s management, will not be effective.

In addition to the tone from the top, employees should receive frequent training on compliance matters. The advisor should:

- Provide a copy of the firm’s policies and procedures to employees promptly upon their joining the firm and following any material updates
- Obtain written acknowledgement from all employees that they have received, read, and understood the firm’s policies and procedures
- Conduct formal training sessions for all new employees and on at least an annual basis thereafter

Formal training should cover high-risk areas that are generally applicable to all employees, such as insider trading, and may also include more targeted sessions based on employees’ functional responsibilities. The advisor should maintain a copy of any training presentations and keep a sign-in sheet or other record of who was in attendance. In addition to formal training sessions, the compliance department should consider circulating periodic reminders about ongoing compliance obligations and “hot topics,” such as the SEC’s annual list of examination priorities or relevant SEC enforcement actions.

V. Monitoring and testing

Even the best policies and procedures cannot prevent all compliance issues. Mistakes will happen, and some employees may not always have the firm’s best interest in mind. Consequently, an important component of an advisor’s oversight of its multiple office locations will be the development of an effective monitoring and testing regime to ensure that employees are adhering to policies and procedures. This is particularly true in the context of multiple office locations, where compliance personnel may not have much transparency into the day-to-day activities of the office location apart from what they see in the course of their monitoring and testing.

Monitoring is a continuous process that allows the advisor to identify potential compliance issues in as close to real time as possible. Ideally, an advisor will be able to automate much of its ongoing monitoring. For example, many order management systems can be coded with pretrade compliance checks that will prevent certain violations from occurring or that will notify compliance and supervisory personnel automatically if there’s a potential violation.
Monitoring should be supplemented by periodic forensic testing to ensure that the advisor's controls are working as expected. Testing generally involves reviewing all or a meaningful sample of trades, documents, or other work product on a periodic basis to determine whether the activity is in compliance with the advisor's policies and procedures. For example, an advisor may look at commissions paid to counterparties on a monthly or quarterly basis to confirm that they were consistent with the advisor's obligation to seek best execution for clients.²

While all advisors, even those with only one office location, should endeavor to establish a robust monitoring and testing program, this is especially important when compliance and other supervisory personnel otherwise do not have a window into the activities taking place at office locations where there is no physical compliance presence. In addition to helping the advisor prevent and detect violations of its policies and procedures, the aggregate data from a well-designed monitoring and testing program will allow the advisor to identify any trends that may suggest systemic issues or patterns of wrongdoing by certain employees. The SEC has specifically endorsed this practice, noting that, “[w]here appropriate, advisers’ policies and procedures should employ, among other methods of detection, compliance tests that analyze information over time in order to identify unusual patterns.”¹¹ This allows the advisor to address the root cause of the issue (by correcting a systems glitch, providing better training, disciplining or terminating the employee responsible, etc.) and avoid future violations.

Rigorous monitoring and testing also gives compliance personnel an opportunity to remind employees that their activities are subject to continuous oversight, which serves as a key deterrent against wrongdoing. If compliance personnel are not physically located in an office, and employees at the office do not otherwise have regular interactions with compliance, employees may become lax in meeting their compliance obligations.

In the worst-case scenario, a “bad apple” who believes that compliance is not paying much attention to what he or she is doing may be emboldened to engage in activities that could expose the advisor to legal and/or regulatory risk. A call or an email from the CCO to inquire about a potential trade exception or other compliance matter serves as a powerful reminder that compliance personnel are actively supervising employees’ activities.

Electronic communications, including emails and instant messages, can be a treasure trove of information, which is why the SEC will sometimes review electronic communications even during routine examinations and will almost certainly review an advisor’s communications if any wrongdoing is suspected. Needless to say, there is a tremendous incentive for an advisor to identify any potentially troubling communications before the SEC does.

Advisors should maintain a written monitoring and testing plan or calendar to keep track of ongoing reviews. This process should start with an inventory of the advisor’s policies and procedures to determine which ones can be addressed with monitoring and testing. Policies and procedures that are determined to be higher risk should be subject to more frequent monitoring and testing. Appendix A offers an example of what a monitoring and testing plan might look like for the policies and procedures commonly found in an investment advisor’s code of ethics. Advisors should be sure to document the results of their monitoring and testing, including the resolution of any issues that were identified.

Reviewing employees’ electronic communications is a particularly effective way for compliance to gain insight into activities at remote offices. Registered investment advisors are required to retain written communications, including electronic communications such as emails and instant messages, pursuant to the books and records requirements under the Advisers Act. Electronic communications, including emails and instant messages, can be a treasure trove of information, which is why the SEC will sometimes review electronic communications even during routine examinations and will almost certainly review an advisor’s communications if any wrongdoing is suspected. Needless to say, there is a tremendous incentive for an advisor to identify any potentially troubling communications before the SEC does.

If possible, electronic communications reviews should be conducted using risk-based keywords and targeted searches rather than random sampling, although random sampling is preferable to not doing any reviews. In addition to searching for general keywords commonly associated with certain types of wrongdoing, searches should be tailored to the advisor’s business and may include, for example, the names of issuers on the advisor’s Restricted List or the names of companies with which the firm’s investment personnel recently met. Appendix B offers a list of potential keywords for use in electronic communications review.
One potential sticking point regarding electronic communications reviews is determining who at the firm should conduct them. Employees outside the compliance department and junior compliance personnel are generally not the best candidates to conduct these reviews because the communications may include sensitive information about the firm and other employees. Advisors will therefore generally have a senior compliance employee conduct the review or else delegate the review to an independent third party.

VI. On-site inspections

FINRA Rule 3010(c) requires broker-dealers to conduct regular internal inspections of branch office locations. While there is no comparable rule in place for investment advisors, advisors may consider implementing on-site inspections of multiple office locations as a best practice. Doing so will allow the advisor to assess each office's compliance with the firm's policies and procedures and will also help to prepare the employees of each office for the experience of undergoing a regulatory examination.

Advisors should avoid conducting inspections by merely checking boxes on a checklist. In a joint notice to broker-dealers, the SEC and FINRA noted that ineffective inspection programs often had a number of factors in common, including:

- Employing generic inspection procedures for all offices
- Failing to conduct the inspection
- Failing to follow the firm's policies and procedures for conducting inspections

In designing an inspection program, the advisor should perform an inventory of the activities conducted at each office location. This inventory will help an advisor determine where it should focus its efforts, especially for smaller advisors that may have limited resources to conduct on-site inspections. The scope of each inspection should also incorporate any findings from previous inspections and any trends identified by the firm's other monitoring and testing.

While an advisor should strive to have compliance or supervisory personnel visit each office location on at least an annual basis, offices with only a few employees and offices engaged in activities where the risk of noncompliance is greater (such as portfolio management, trading, and marketing) should be subject to the most frequent inspections and the most scrutiny. Advisors may also consider conducting unannounced inspections of these offices. The prospect of unannounced inspections is a powerful deterrent against wrongdoing, and surprise inspection will also increase the advisor's chances of uncovering evidence of any wrongdoing that does occur.

In certain broker-dealer enforcement actions, the SEC has expressed strong support for unannounced exams, noting, for example, that the “practice of conducting a pre-announced compliance examination only once a year was inadequate to satisfy [the broker-dealer’s] supervisory obligations.” The frequency and focus of inspections should also be revisited in light of significant findings identified during routine inspections, and it may be prudent for offices with significant deficiencies to be re-examined to ensure that corrective actions have been implemented and are working.

The scope of each on-site inspection as well as any findings should be documented in a report to the CCO and other appropriate senior management personnel. The advisor should develop a corrective action plan to remediate any deficiencies noted during the inspection, including a clear and realistic timeline for doing so. In developing the corrective action plan, the advisor should consider whether each deficiency:

- Represents a systemic issue
- Is indicative of recidivist behavior by certain employees
- Resulted in any impact on clients

These types of deficiencies should be the highest priority for the advisor to correct. In addition to addressing the immediate issue, advisors should consider what changes may need to be made to its policies and procedures, monitoring and testing, or inspection program to better prevent and detect similar deficiencies in the future. It's worth stressing an obvious point: It is imperative that the advisor follow through on its corrective action plan and actually resolve the issue. It would be a very bad thing for a regulator to examine the advisor only to discover that the advisor had identified an issue during an internal inspection and had not taken the appropriate steps to correct it.

VII. Conclusion and key takeaways

Multiple office locations introduce a number of challenges to an advisor’s compliance program. Advisors have a duty to supervise the activities that take place at each of their offices, which will be shaped by myriad factors, including the advisor’s compliance resources, the location and characteristics of each office location, and the activities that are carried out there. While regulators have not provided
a road map for how an advisor should oversee its multiple office locations, what guidance there is indicates that advisors should give careful consideration to each of the following elements:

1. **Determine supervisory structure.** An advisor should assess which type of supervisory structure will be most effective in light of the advisor’s activities (whether oversight will be centralized in a home office, shared equally among different offices, or some combination of the two).

2. **Develop policies and procedures.** Once the advisor decides on a supervisory structure, it should develop comprehensive policies and procedures that clearly delineate supervisory responsibility. The advisor must also take into account the particular risks associated with each office location and ensure that these are also addressed in its policies and procedures. Policies and procedures that are clear, thorough, and tailored to an advisor’s business are critical to establishing effective supervision, especially if they are reinforced by regular training and a clear tone from the top concerning the importance of compliance.

3. **Monitor and test.** Advisors must also test their policies and procedures on a regular basis to ensure that they are effectual and are being followed by employees. Policies and procedures that look good on paper but don’t work in practice do not constitute effective oversight. Advisors should develop a robust monitoring and testing plan that outlines the policies and procedures to be tested, the type of monitoring or testing to be done, and the frequency that the monitoring or testing will be performed. For advisors that are required or otherwise choose to retain electronic communications, the advisor’s monitoring and testing plan should include regular reviews of employee communications, which can be used to test employees’ compliance with a wide variety of the advisor’s policies and procedures. The results of any monitoring and testing should be documented, especially with regard to any exceptions that were noted and corrective action taken as a result.

4. **Office inspections.** Advisors may also consider taking a cue from their broker-dealer counterparts by implementing an inspection program for their multiple office locations. Regular on-site inspections, particularly if they are unannounced, act as a deterrent against wrongdoing and help the advisor identify any problematic activity that may be occurring at remote offices. Advisors should not take a “check the box” approach, however. On-site inspections should be tailored to the activities taking place at each office location, and the review should be meaningful and thorough. The results of each inspection should be rigorously documented, and the advisor should formulate a corrective action plan to remediate any issues identified in the course of the inspection, including a realistic timeline for doing so. It is imperative that advisors follow through on their corrective action plan; identifying an issue and then failing to correct it would be highly problematic in the eyes of regulators. To better prevent and detect any future problems, observations during inspections should also be incorporated into the advisor’s policies and procedures, monitoring and testing plan, and inspection program.

An advisor’s duty to supervise its employees is paramount and must be taken seriously. A failure to supervise can expose an advisor to regulatory and reputational risk that will harm the advisor’s ability to serve its clients. Designing an effective supervisory program may seem like a daunting task, and it certainly can be, but it’s well worth the effort.
### Appendix A:
Sample code of ethics monitoring and testing plan

<table>
<thead>
<tr>
<th>Test #</th>
<th>Policy or procedure</th>
<th>Risk level</th>
<th>Description of monitoring/testing</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Employee personal securities transactions</td>
<td>High</td>
<td>Exception report programmed into personal trade monitoring software identifies trades that did not receive prior approval from compliance.</td>
<td>Daily, T+1</td>
</tr>
<tr>
<td>2</td>
<td>Political contributions</td>
<td>Low</td>
<td>Compliance reviews public databases of political contributions (e.g., followthemoney.org and opensecrets.org) for a sample of employees to ensure that contributions were made in accordance with the firm’s policies and procedures.</td>
<td>Quarterly</td>
</tr>
<tr>
<td>3</td>
<td>Prohibition against insider trading</td>
<td>High</td>
<td>Personal trade monitoring software automatically denies any requests to trade the securities of any issuer on the Restricted List and notifies compliance.</td>
<td>Pretrade for all personal trading requests</td>
</tr>
<tr>
<td>4</td>
<td>Prohibition against insider trading</td>
<td>High</td>
<td>Exception report programmed into compliance monitoring software identifies employee trades in issuers on the Restricted List during the two business days before the issuer is added.</td>
<td>Periodically, as securities are added to the Restricted List</td>
</tr>
<tr>
<td>5</td>
<td>Prohibition against insider trading</td>
<td>High</td>
<td>Compliance reviews electronic communications containing certain keywords commonly associated with the receipt of material nonpublic information or insider-trading activities.</td>
<td>Quarterly</td>
</tr>
<tr>
<td>6</td>
<td>Gifts and entertainment</td>
<td>Medium</td>
<td>Compliance reviews employees’ G&amp;E reports to ensure that employees did not provide gifts or entertainment in excess of $250.</td>
<td>Periodically, as reports are submitted</td>
</tr>
<tr>
<td>7</td>
<td>Gifts and entertainment</td>
<td>Medium</td>
<td>Controller reconciles G&amp;E reports to employees’ business credit card statements to ensure that all gifts and entertainment given by employees were reported.</td>
<td>Monthly</td>
</tr>
<tr>
<td>8</td>
<td>Gifts and entertainment</td>
<td>Medium</td>
<td>Compliance reviews electronic communications containing certain keywords that may indicate employees are receiving gifts and entertainment that are not being reported.</td>
<td>Quarterly</td>
</tr>
</tbody>
</table>
Appendix B:
Sample list of potential keywords for electronic communications reviews

<table>
<thead>
<tr>
<th>aggressive</th>
<th>distrust</th>
<th>improper</th>
<th>nonpublic</th>
</tr>
</thead>
<tbody>
<tr>
<td>apologize</td>
<td>do the right thing</td>
<td>incentive</td>
<td>oversight</td>
</tr>
<tr>
<td>arbitration</td>
<td>do what I say</td>
<td>inexcusable</td>
<td>overstate</td>
</tr>
<tr>
<td>attorney</td>
<td>easy money</td>
<td>inside information</td>
<td>password</td>
</tr>
<tr>
<td>blame</td>
<td>embezzle</td>
<td>insured</td>
<td>proven</td>
</tr>
<tr>
<td>bulletproof</td>
<td>error</td>
<td>investigation</td>
<td>rumor</td>
</tr>
<tr>
<td>can’t go down</td>
<td>fabricate</td>
<td>jail</td>
<td>SEC</td>
</tr>
<tr>
<td>catch</td>
<td>fail</td>
<td>kickback</td>
<td>sham</td>
</tr>
<tr>
<td>can’t miss</td>
<td>fake</td>
<td>lawsuit</td>
<td>steal</td>
</tr>
<tr>
<td>cheat</td>
<td>falsify</td>
<td>lawyer</td>
<td>stolen</td>
</tr>
<tr>
<td>churning</td>
<td>fiasco</td>
<td>legal</td>
<td>subpoena</td>
</tr>
<tr>
<td>complain</td>
<td>forge</td>
<td>liar</td>
<td>sue</td>
</tr>
<tr>
<td>compliance</td>
<td>fraud</td>
<td>lie</td>
<td>suit</td>
</tr>
<tr>
<td>con artist</td>
<td>front run</td>
<td>litigation</td>
<td>sure thing</td>
</tr>
<tr>
<td>counsel</td>
<td>gift</td>
<td>loss</td>
<td>tip</td>
</tr>
<tr>
<td>did not follow</td>
<td>gigantic</td>
<td>misappropriate</td>
<td>victim</td>
</tr>
<tr>
<td>disappoint</td>
<td>guarantee</td>
<td>mistake</td>
<td>violation</td>
</tr>
<tr>
<td>disobey</td>
<td>illegal</td>
<td>monster</td>
<td></td>
</tr>
<tr>
<td>disregarded</td>
<td>illicit</td>
<td>negligence</td>
<td></td>
</tr>
</tbody>
</table>
1. While this article focuses on advisors' supervisory obligations under the Advisers Act, state-registered advisors should also be mindful of any specific state-level requirements that may affect the advisor's supervisory program. In a recent survey of examinations by state securities regulators, approximately 30% of examinations resulted in at least one deficiency related to supervision. See NASAA 2013 Coordinated Investment Adviser Examinations (Oct. 2013), http://www.nasaa.org/wp-content/uploads/2013/10/IA-Sweep-2013-Final.pdf.


4. Advisors that are dually registered as broker-dealers should note that, while registered broker-dealers have a similar duty to supervise pursuant to Section 15(b)(4)(E) of the Securities Exchange Act of 1934, there are specific rules (e.g., Financial Industry Regulatory Authority ["FINRA"] Rules 3110 and 3120) governing a broker-dealer's duty to supervise that are outside the scope of this article.

5. SEC-registered investment advisors are required to adopt written compliance policies and procedures under Rule 206(4)-7 under the Advisers Act, state-registered advisors should also be mindful of any specific state-level requirements that may affect the advisor's supervisory program. In a recent survey of examinations by state securities regulators, approximately 30% of examinations resulted in at least one deficiency related to supervision. See NASAA 2013 Coordinated Investment Adviser Examinations (Oct. 2013), http://www.nasaa.org/wp-content/uploads/2013/10/IA-Sweep-2013-Final.pdf.


7. As with the adoption of written policies and procedures, the annual review of such policies and procedures is required of SEC-registered investment advisors under Rule 206(4)-7. Again, although it is not strictly required, it would be prudent for unregistered advisors to do the same.


10. The SEC has provided examples of specific forensic testing that may be used to assess compliance in a number of risk areas that are commonly a focus of SEC examinations. See CCO Outreach National Seminar: Forensic Measures for Funds and Advisers (November 14, 2007), http://www.sec.gov/info/cco/forensictesting.pdf.

11. See note 6.

12. Advisors that are dually registered as broker-dealers will likely already have a well-developed inspection program in place and should consider whether that can be leveraged to review advisory activities as well.


About the author

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Michael Abbriano is a principal consultant with ACA Compliance Group, a regulatory consulting firm that provides compliance consulting services to investment advisors, private fund managers, investment companies, commodity trading advisors, and broker-dealers. Previously, Mr. Abbriano worked in compliance at Needham & Company, an asset management and investment banking firm, and at Smith Barney, supporting its wrap-fee advisory account programs. He earned a bachelor of arts degree with honors in music from Harvard University.
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