



INVESTMENT ADVISER
ASSOCIATION



2011 Investment Management Compliance Benchmarking Survey Results Presentation

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Survey Focus Areas

- ❖ Overall Compliance Program
- ❖ Pay-to-Play
- ❖ The New Form ADV Part 2
- ❖ Insider Trading
- ❖ Whistle Blowing
- ❖ Anti-Bribery and Financial Crime
- ❖ Social Media/Networking
- ❖ TREND UPDATE – Foreign Advisory Activities
- ❖ TREND UPDATE - “Hot” Compliance Topics

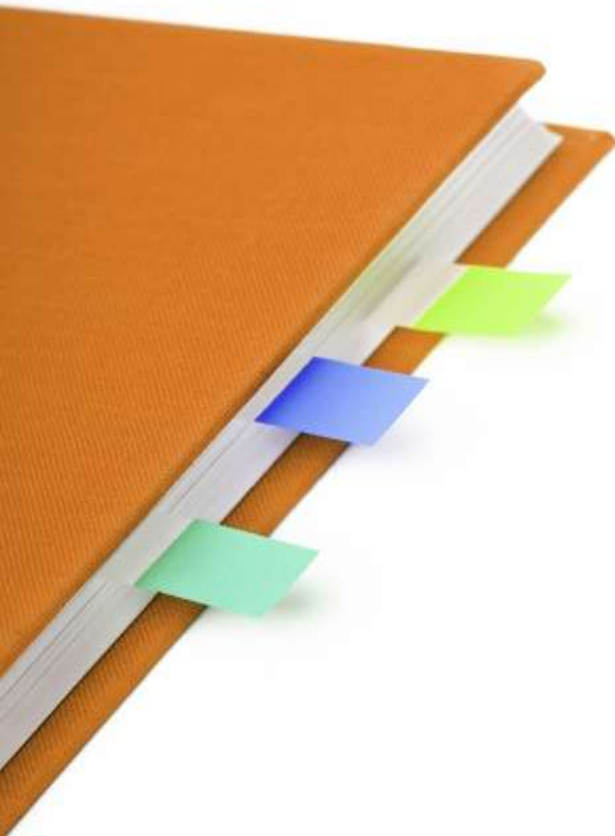


Survey Demographics



- The largest contingency responding were mid-size firms with **44%** of respondents with between **\$1 billion and \$10 billion** in assets under management and **88%** of respondents reporting **less than 251 employees**.
- Both small and large firms were well represented with **32%** of respondents managing **<\$1 billion** and **24%** of respondents managing **>\$10 billion**.
- **Established firms** (5-25 years in business) constituted **61%** with **Long-timers** (more than 25 years) making up **27%** of respondents.
- The **services** provided by our respondents span the full range:
 - **53%** advise high net worth individuals (>\$1mm).
 - **50%** advise a private fund
 - **41%** advise ERISA assets/Pension Consultant.
 - **35%** advise a registered investment company.
 - **25%** advise retail individuals (<\$1mm).
 - **11%** advise a Family Office.

Notable Findings

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- ❖ **37%** of the firms responding have only one person in a full time legal/compliance role.
 - ❖ **24%** of firms with <\$500mm in assets do not have a full-time legal/compliance role.
 - ❖ **7.5%** of firms reported detecting material compliance issues – of those **65%** were detected at firms with more than 10 full-time legal and compliance professionals.
 - ❖ **66%** of CCOs are wearing two or more hats.
 - ❖ **63%** of firms do not engage third-party solicitors/placement agents.
 - ❖ **60%** of firms plan to deliver Form ADV Part 2 electronically.
 - ❖ **83%** of firms are preparing a Form ADV Part 2B.
 - ❖ **64%** of firms have adopted formal written policies surrounding social networking.
 - ❖ **54%** of firms are “registered” with at least one foreign securities regulator.

Compliance Program

- **92.5%** of CCOs at firms **with an AUM of \$1bb or less** are wearing **two or more hats**. The number drops to **64%** at firms with **AUM of \$1bb-\$10bb**, to **49%** for **\$10bb-\$20bb firms**, and to **22%** at firms with an **AUM of greater than \$20bb**.

- **92%** of the firms responding have at least one employee dedicated full-time to the legal/compliance role. **24%** of firms with **<\$500mm** in assets do not have a full-time legal/compliance role.

- It appears that there are common threads **in best practices** regardless of the characteristics of the firm:
 - **93%** of firms provide a copy of the annual compliance review to senior management.
 - **81%** of firms conduct at least annual employee compliance training.
 - **78%** of CCOs attend committee and other management meetings (e.g. valuation, best execution, investment/portfolio management, etc.)
 - **76%** of CCOs are mandated to immediately inform the CEO/President of any material compliance issues.
 - **74%** of CCOs meet periodically with the CEO/President of the firm to discuss compliance issues and initiatives.

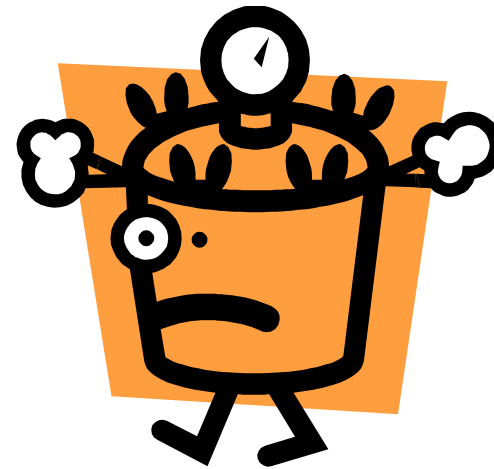
Compliance Program

In total, 70% of respondents indicated that they had detected compliance issues over the previous year, none of which were deemed to be material. 7.5% reported detecting material issues, and 22% reported detecting no issues.

Over the previous year, has your compliance testing detected any issues?			
No. of Compliance Personnel	No, we did not detect any compliance issues.	Yes, we detected compliance issues, none of which we deemed to be material.	Yes, we detected material compliance issues.
0	43.75%	56.25%	0.00%
1	26.80%	67.32%	5.88%
2 to 5	20.98%	71.33%	7.69%
6 to 10	5.71%	88.57%	5.71%
11 to 20	19.05%	66.67%	14.29%
Grand Total	22.09%	70.39%	7.52%

Compliance Program

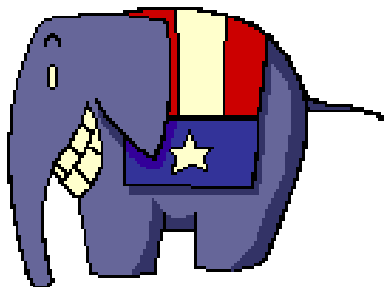
- Firms reported **increasing the amount of testing** in the following areas:
 - Advertising and Marketing (**42%**)
 - Data Security (**42%**)
 - Custody (**41%**)
 - Personal Trading (**39%**)
- When asked about areas of **decreased testing**, **42%** of firms indicated that they **have not decreased testing** in any area.
- One participant summed up the majority sentiment received quite nicely:



“you're kidding, right?”

Pay-to-Play

- **20%** of firms report that the rule is **not applicable** to them. Of those firms reporting the rule is not applicable to them, **51%** have **AUM of less than \$500mm**.
- **38%** of firms reported that they have adopted policies to address the rule as **part of other compliance policies**.
- **32%** of firms have adopted a **stand alone policy** to address the rule.



- **68%** of firms apply their policy to **all employees**.
- **46%** report applying their policy to **Covered Associates** as defined under the Rule.
- **18%** of firms apply their policy to the **spouses and dependent children of Covered Associates**.
- **17%** of firms apply their policy to the **spouses and dependent children of other employees** covered by the policy.

- **9%** of firms **prohibit political contributions**.
- **24%** of firms **prohibit contributions above a de minimis amount**, which ranged from \$100 to \$350 and was defined by additional controls such as:
 - the eligibility of the employee to vote for the candidate
 - whether it was a state or federal election
 - whether the firm has a client relationship which is potentially affiliated with the candidate.
- **53%** of firms responding **require pre-clearance** of political contributions by those who are covered by the firm's policy.
- Approximately **50%** of firms **have not adopted specific gifts and entertainment policies** regarding candidates or government officials.
- **63%** of firms **require periodic certifications** by employees to compliance with the policy.
- **37%** of firms **request a list of all contributions** as part of the employee hiring process.

Form ADV, Part 2

- Although the Form ADV Part 2 disclosure format has changed, the most common response (**40%**) was that the firm **has not changed** policies and procedures relating to the preparation of the form.
- **34%** of those responding indicated, however, that they are **in the process** of making such changes.
- The most commonly cited reason for making changes to policies and procedures for preparation of the form (16%) is to **assure consistency among the new form and other documents**, such as client agreements, marketing materials, and Form ADV Part 1.
- **37%** of respondents are **in the process of making changes** to their policies and procedures relating to the **delivery** of Part 2.
- **60%** indicated that they will be **delivering Part 2 electronically**.
- **37%** stated that they will **email a copy of the brochure and/or supplement** to all clients individually. Individual comments indicate that some firms are planning on posting the brochure to their websites.

“We will post to our website for accessibility, but will not rely on this as our method of delivery.”

Form ADV, Part 2

- The CCO was the most commonly cited participant in preparing the Form ADV, Part 2 (**90%**), followed by firm management, outside attorneys, in-house attorneys, outside consultants, marketing professionals, and client relations professionals.

“For efficiency/simplicity – it is easier to have one brochure supplement with everyone than trying to figure out for each client/prospect which advisor(s) to include.”

- **58%** of respondents intend to include the brochure supplement (Part 2B) as part of the brochure (Part 2A), and **58%** intend to prepare brochure supplements for all of their supervised persons together in one group.
- Less than half of those responding (**47%**) intend to use the “team” approach in their brochure supplements.
- **71%** of those using the team approach use *function* as a factor in identifying the 5 team members and **45%** consider *seniority* as a factor..

Form ADV, Part 2

- Firms will obtain information required in the brochure supplement (education, business experience, and disciplinary information) concerning the supervised person by asking the individual to complete a questionnaire (**48%**), requiring certification (**43%**), and/or providing for supervisory review of the information (**37%**).
- **12%** will perform a background check on each supervised person.
- Required updates to the brochure supplement will be identified through employee questionnaire (**29%**), employee certification (**28%**), and/or the employee's supervisor (**14%**).
- **28%** of the firms responding will conduct employee training to ensure that employees bring updated information to the attention of the firm.



Insider Trading



- Surprisingly given the media coverage of the issue in recent times, only small percentage of respondents reported using Expert Network Firms (**15.7%**)
- Interestingly **3%** of respondents reported halting the use of such services due to increased regulatory focus; and **16%** reduced their use based on the perceived risk exposure.
- The overwhelming percentage of respondents (**80%**) did not previously use Expert Network Firms, nor plan to in the future.
- Only **3%** of respondents indicated that they use alpha capture programs, which is interesting as this has been another well publicized focus area for the SEC recently.
- Approximately one-third of respondents reported that they do not engage in activities which they believe heighten their risk of receiving MNPI.

Insider Trading

The most popular compliance controls reported to prevent the misuse of MNPI:

- Require employees to certify to not receiving MNPI **(43%)**
- Favoring compensation structures rewarding long-term performance **(22%)**
- Requiring employees to complete periodic conflict questionnaires **(14%)**

Common tests used for the detection of insider trading:

- Review trading patterns around news stories for client trading **(31%)**
- Review news stories around personal trading **(40%)**
- Review for unusually profitable trades in client accounts and personal accounts **(27%)**
- Review most profitable trades in client accounts **(22%)**



Insider Trading

“We specifically look at trades involving companies that our employees or clients have affiliations with.”

“All partners are involved in (3rd party research) calls (not on an individual basis) so there is self-monitoring in place.”

“We test for trading patterns and new stories after meetings with expert consultants and management.”

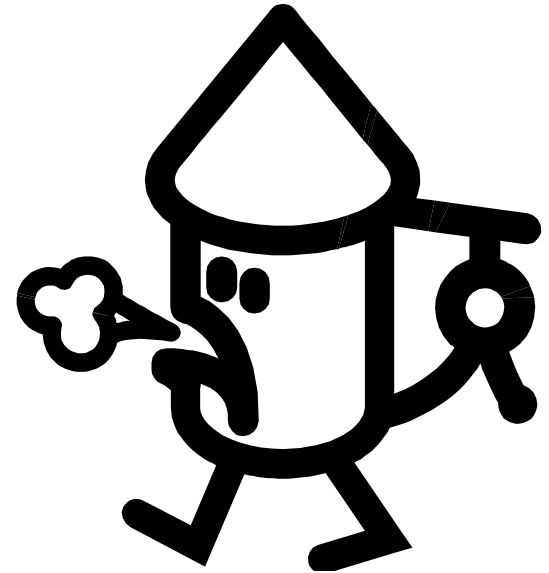
“(We) review compliance procedures of expert networks used.”

Whistle Blowing

- As expected, the majority of respondents have some form of whistleblowing policy (**63%**)
- Surprisingly, given the pending rule requirements, **31%** of respondents indicated that they don't have and are not considering adoption of a whistleblowing policy
- **90%** indicated that no changes are planned to their compliance programs in this area post proposal.
- **17%** reported implementing a hotline for anonymous reporting
- A large majority of respondents indicated that they promote an open door policy (**77%**)

“Employees can report issues directly to our Audit Committee Chairman”

“Employees may also contact Fund Counsel.”



Anti-Bribery and Financial Crime

- Almost half of the firms reporting indicated that they do not have a policy in place to address bribery and/or corruption.
- Just over half have no standalone financial crime/fraud policy and less than one-third reported that they have implemented procedures to escalate and report allegations of bribery and corruption.
- Perhaps surprisingly in the wake of the recent Pay-to-Play legislation, less than one-third of respondents reported that their firm's political contribution activity is restricted.



Common controls adopted to prevent financial crimes include:

- **61%** implemented an appropriate segregation of duties.
- Just under **60%** of respondents indicated that they perform background checks on employees
- Slightly less than **60%** reported requiring periodic reporting of gifts *received* and almost **50%** indicated that they require reporting of gifts/entertainment *provided*
- Over **60%** of respondents indicated that they review employee emails to detect fraud/financial crime.
- Close to **50%** of firms have adopted AML programs, but not beyond what is required under the BSA.

- **64%** of firms have adopted **formal written policies and procedures** to govern the use of social networking by the firm and/or employees.
- **54%** of firms allow employees' personal use of social networking websites **subject to appropriate restrictions**.
- **16%** impose **no restrictions** on the use of social networks.
- **29%** **prohibit** the use of personal social networking websites for **business purposes**.
- **83%** of firms **do not maintain** a corporate social networking website.
- **65%** do not maintain postings by employees.



Social Media and Networking

“We have provided pre-approved standard firm information for employees to post on LinkedIn. Any other posting for business purposes must be pre-approved by compliance.”

“Compliance personnel monitor certain websites on a periodic basis.”

“We have a firm that monitors any mention of our name on websites.”

“We monitor the websites accessed by employees on corporate computers.”

“We block access on office computers.”

TREND UPDATE: Foreign Advisory Activities

- **61%** of respondents invest in non-U.S. securities; **45%** are investing in foreign exchanges and **16%** trade foreign-domiciled issuers on U.S. exchanges only.
- **48%** of firms investigate foreign regulatory requirements prior to investing in a foreign region; **30%** engage U.S. outside counsel and **32%** engage local counsel to assist with regulatory requirements for investing abroad.
- About **12%** institute a maximum investment threshold to avoid foreign shareholder filing requirements while **29%** of firms undertake regulatory filings abroad.
- Only **23%** of firms doing business abroad have adopted a full FCPA policy.
- The majority of advisers providing advisory services abroad provide services to clients located in Europe (**78%**), Canada (**48%**), Asia (**44%**), and Japan (**28%**).



- **35%** of firms report prospecting clients and providing advisory services outside of the U.S., with **30%** of those respondents maintaining a tracking system for monitoring and **45%** consulting with outside counsel prior to beginning prospecting activities. Only **9%** of respondents use a database for assistance with foreign requirements.

TREND UPDATE: Hot Compliance Topics

Topics	2009	2010	2011
Custody	26%	56%	35%
Data Security/Privacy	22%	41%	33%
Advertising/Marketing	27%	27%	29%
Valuation	33%	20%	27%
Fraud Prevention	22%	20%	20%
Regulatory reporting	X	X	44%
Insider Trading	X	X	42%

Some new additions to the list:

“Pay-to-Play”

“Risk Management”

“Social Networking”

Speaker Contact Information



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