

2016

Investment Management Compliance Testing Survey



Cybersecurity Continues to Top Compliance Concerns

Survey Also Finds Majority of Investment Advisers Rate their AML Risk as “Low”

The Investment Adviser Association is pleased to present this Executive Summary of the results of the 2016 *Investment Management Compliance Testing Survey*, a joint project of the **Investment Adviser Association**, IAA Member Firm **OMAM**, and IAA Associate Member **ACA Compliance Group**. Now in its 11th year, the *Survey* is the most comprehensive resource available for identifying the top concerns of investment management compliance professionals, as well as the types of compliance testing practices and strategies investment adviser firms are using to address core compliance topics such as conducting annual reviews, identifying and

disclosing conflicts of interest, overseeing service providers, cybersecurity, social media, and more.

SEC-registered investment advisers operate in a rapidly changing, ever-evolving regulatory environment. The *Survey* is designed to be a useful resource for compliance professionals to:

- **Benchmark** their compliance testing practices against those of other firms;
- **Collect ideas** for new testing techniques that can be used by firms in future testing efforts;

EXECUTIVE SUMMARY PRESENTED BY



- **Assess compliance testing trends** over time within a variety of specific areas;
- **Identify practices** that appear to have become (or may become) prevalent industry practices; and
- **Assess the impact** of current and potential regulatory requirements and market developments on advisers' businesses.

This year's survey addressed compliance testing in the areas of **anti-money laundering, anti-bribery and corruption, fees and expenses, political contributions, gifts and entertainment policies**, and the utilization of **quantitative trading strategies**. The *Survey* also addressed the ever-increasing **cost of regulatory compliance** and the use of **environmental, social, and governance factors** in investing. In addition, the *Survey* provided trend updates regarding **cybersecurity, oversight of third parties, alternative investment products, social media**, and other compliance hot topics.

About the Survey Respondents

Compliance professionals at **a record 730** investment adviser firms participated in the *Survey*. Established firms made up the vast majority of the respondents. Firms with six to 25 years in business constituted 58 percent of the respondents. Another 28 percent were firms with more than 25 years in business.

And all firm sizes were represented – with 34 percent of respondents managing less than \$1 billion in assets, 43 percent managing between \$1 billion and \$10 billion, and 23 percent of respondents

managing more than \$10 billion. Two-thirds (66 percent) reported having 50 or fewer employees.

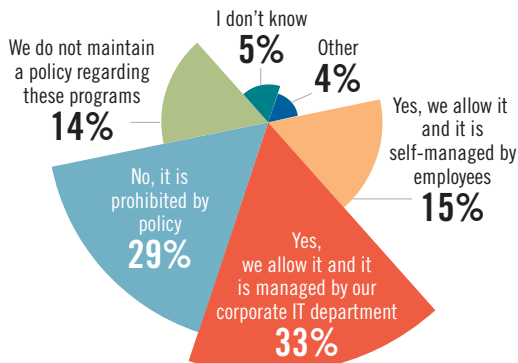
Services provided by responding firms spanned the full range, including advising private funds (55 percent), high net worth individuals (46 percent), ERISA assets/pension consultants (34 percent), individuals (23 percent), and family offices (11 percent).

Hot Topics

Cybersecurity: CCOs' Top Concern

There were several interesting takeaways from this year's survey. Not surprisingly, first and foremost is the continued heightened focus by advisers on addressing cybersecurity risks – an area identified by regulators as a top priority as well. Survey participants reported that safeguarding critical information continues to top their list of compliance concerns – with 88 percent (up from 75 percent a year ago) identifying **“cybersecurity/privacy/identity theft” as the “hottest” compliance topic for 2016**. Nearly three quarters – 72 percent – reported

Does your firm allow the use of Cloud-based file sharing programs
(i.e., Dropbox, Box.com, Sharefile, etc.)?



having a formal, written, standalone cybersecurity program, up significantly from 43 percent last year. Another 21 percent reported having cybersecurity policies and procedures that are incorporated into broader programs. Eighteen percent reported a known cybersecurity breach in the past 18 months. Another seven percent said they did not know whether their systems had been breached. And more firms have purchased specific cyber insurance (33 percent) or are considering doing so (15 percent) to address this paramount compliance concern.

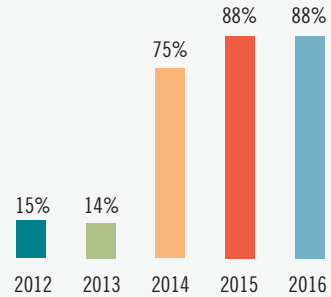
Anti-Money Laundering (AML)

While data and information security topped the list for the third year in a row, **anti-money laundering** is taking on greater importance with compliance officers in light of recently proposed regulations by the Treasury Department. These rules, if adopted, would require advisers to have dedicated policies to address AML issues. AML, combined with anti-bribery and corruption, was the **second hottest topic**, cited by 24 percent of respondents – triple last year’s eight percent – despite the fact that 88 percent of respondents believe their firms’ AML risk is low. Nevertheless, 76 percent have already adopted AML policies and procedures, and 40 percent believe their policies and procedures will satisfy the proposed AML requirement for advisers. Two-thirds of respondents (66 percent) reported that they periodically review their AML policies, and 56 percent said staff responsible for AML matters at their firms have sufficient seniority and experience. Nearly half – 49 percent – said they train all employees on their firms’ AML policies on at least an annual basis.

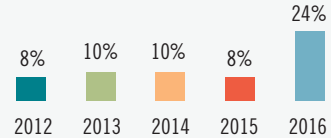
Trend Update:

Hot Compliance Topics

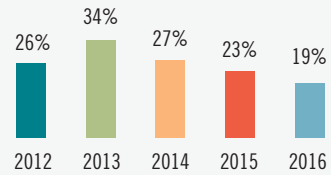
Cybersecurity/ Privacy/Identity/Theft



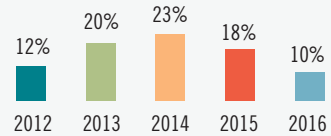
AML/FCPA/Anti-Bribery



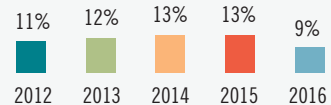
Advertising/Marketing



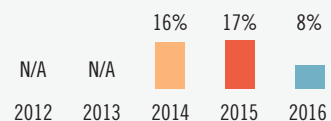
Custody



Fraud Prevention



Disaster Recovery



Compliance Testing and Reviews

Firms are also putting **greater focus on compliance reviews**, including by conducting SEC-type mock examinations – either through internal staff or engaging an independent third party. Most firms reported increasing the amount of compliance testing they do in a broad range of key areas, including:

Cybersecurity/Privacy/Identity Theft
74%

Advertising/Marketing
40%

Personal Trading/Code of Ethics
34%

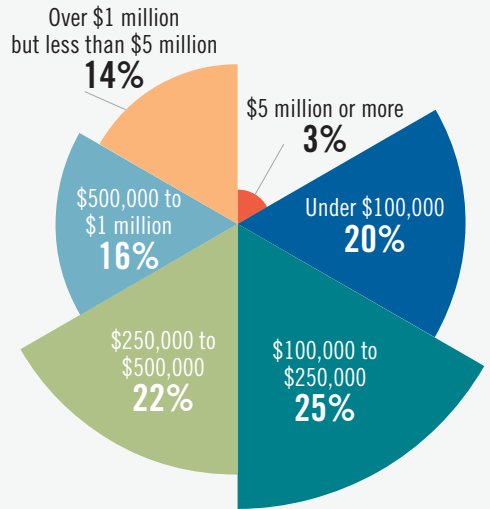
Disaster Recovery Planning
32%

Best Execution
30%

Perhaps the most telling statistic is this: nearly four in five respondents – 77 percent – indicated they have not *decreased* testing in any compliance area.

Cost of Compliance

How much did your firm incur in total compliance-related costs in 2015?



Rising Costs of Compliance

The Survey findings also highlight the potential for rapidly increasing **regulatory compliance costs**. Nearly half of respondents – 48 percent – said their firms spend between \$100,000 and \$500,000 annually on compliance-related costs. Twenty percent put their compliance costs at under \$100,000; 25 percent reported compliance costs of \$100,000 to \$250,000; 22 percent said their compliance costs are between \$250,000 and \$500,000; 16 percent reported compliance costs between \$500,000 and \$1 million; 14 percent reported compliance costs over \$1 million but less than \$5 million; and three percent put their compliance costs at \$5 million or more. Not surprisingly, the findings showed that the larger the firm's AUM, the larger the compliance costs tended to be.

The **costs of paying compliance professionals** typically represented more than 20 percent of an adviser's budget and included hiring internal personnel (88 percent), outside legal counsel (35 percent), or third-party consultants. In fact, 40 percent of firms reported employing between two to five legal and/or compliance professionals and 18 percent reported that they employed more than six. And 33 percent of respondents reported that another major compliance expenditure included the costs of technology, such as personal trading software, email retention, and surveillance systems.

The **role of the CCO** continues to increase at firms: 68 percent wear more than one hat, 69 percent are considered senior executives, and 67 percent have a direct reporting line to the CEO or president.

Fully 59 percent of respondents reported paying a **third party to conduct compliance reviews** of their firms, and 40 percent of those reviews were mock SEC-type examinations. Regulatory compliance consultants were the most frequently engaged (88 percent). Most respondents (38 percent) paid third parties between \$10,000 and \$30,000 while 33 percent paid between \$20,000 and \$50,000.

Social Media

The **use of social media** is on the rise despite unique compliance challenges. The vast majority of respondents – 90 percent – said their firms have adopted formal written policies and procedures to govern the use of social media by employees. Nearly four in 10 – 37 percent – prohibit the use of social networking sites for business purposes, down from 47 percent in 2015. The top five types of social media used were LinkedIn for employees (55%) and the firm (36%), Twitter for the firm (18%) and employees (14%), and Facebook for employees (15%). Less than 10 percent reported using blogs.

Anti-Bribery and Corruption (ABC)

While 88 percent of respondents believe that their ABC risk level is low, 78 percent reported having adopted general policies to address the ABC risks associated with their business; 63 percent periodically review the policy to ensure that it appropriately addresses ABC risks; 59 percent restrict gifts or corporate hospitality to comply with their policy and relevant local regulatory requirements; and 49 percent train all employees on at least an annual basis on the ABC policies.

Trend Update: Social Media



90%

of firms have adopted formal written policies and procedures to govern the use of social media by employees.



37%

prohibit the use of personal social networking websites for business purposes, compared to **47%** in 2015.



29%

do not test compliance with the firm's social media policy.



32%

do social media testing annually.

About the IAA – and its Compliance Resources

The Investment Adviser Association is the leading trade association representing the interests of SEC-registered investment adviser firms. The IAA's more than 600 member firms collectively manage nearly \$20 trillion in assets for a wide variety of institutional and individual investors. In addition to serving as the voice of the advisory profession on Capitol Hill and before the SEC, DOL, CFTC and other U.S. and international regulators, the IAA provides extensive compliance, educational, and business resources to its membership. For more information, visit www.investmentadviser.org.

The IAA's Members-Only Legal, Regulatory and Compliance Library

The IAA's online resource library receives thousands of visits from members seeking information on a wide range of issues. It also features a series of issue-specific Compliance Guides with practical information for building a successful compliance program and preparing for SEC exams.

For more information about the IAA Compliance Conference and Workshops, visit www.investmentadviser.org and click on **Events**.

Get the Complete Survey Results

Full results of this year's *Survey* – and all previous years – are available at www.investmentadviser.org (*Publications*>>*Investment Management Compliance Testing Survey*) and at www.acacompliancegroup.com.

The IAA Investment Adviser Compliance Conference

Each spring, the IAA holds what has become the industry's premier compliance conference, a two-day program that provides legal and compliance officers with the most current information available on the changing regulatory landscape. Participants return to their firms with practical insights and knowledge of best practices to help them maintain a successful compliance program. In addition to meetings and interacting with peers, attendees hear from a distinguished roster of speakers that includes SEC staff, investment adviser industry professionals, and legal experts.

The IAA Fall Compliance Workshop Series

Every fall, the IAA's legal team leads one-day Compliance Workshops in cities across the country. IAA attorneys, representatives from nationally recognized law firms, and SEC staff address new compliance challenges, along with current regulatory and examination priorities.

For questions regarding the *Survey* or ideas for topics on future surveys, please contact:

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