

RISK IDENTIFICATION QUESTIONNAIRE*

Below is a list of questions that a risk assessment committee, or other appropriate person(s), may want to contemplate in order to identify potential risks to a firm and its clients' interests. A risk assessment committee or other appropriate person(s) should seek out any information from firm employees and management that would assist in answering adequately any question below. This is not an exhaustive list and the questions posed may not apply to all firms due to variations in firm size and nature.

Firm Affiliations

- What are the firm's business affiliations?
- What explicit/implicit arrangements does the firm have with these entities? Does the firm use services or products of affiliates? Have arrangements, if any, been disclosed? Should the arrangements be discontinued? Could the firm have received the same or better services from an alternative firm at a better rate or fee?
- Review any related party transactions (*e.g.*, loans). Any conflicts and/or risks to client?

Business Lines

- What are the firm's business lines (*e.g.*, mutual funds, hedge funds, ERISA accounts, pooled funds, private accounts) and any associated conflicts (*e.g.*, side by side management of hedge fund and mutual fund)?
- What are the major sources of revenue and savings for the firm? Are there any conflicts or risks associated with these arrangements (pay to play, kickbacks, favoritism, fraud, *etc.*)? Any special incentives or payments for use or sale of products or services?

Business Continuity

- Does the firm have a business continuity plan?
- Has the plan been tested? Does the plan have any weaknesses?
- Are systems and technology functioning adequately to meet business needs? Are systems and technology tested?

* The Investment Adviser Association does not intend for this document to be a (i) comprehensive treatment of each issue that an adviser may need to address in its risk assessment process, or (ii) substitute for legal advice. Each advisory firm must tailor its risk assessment process to the firm's own operations and business. The Investment Adviser Association undertakes no responsibility to update this document.

- Have there been any systems outages?
- Is there adequate systems backup?
- Is there sufficient processing capability for transaction volume?

Firm Viability and Personnel

- Does the firm have adequate cash flow to meet debt obligations?
- If key personnel were incapacitated, could the firm continue to operate properly? Is there back-up for key positions and adequate cross training provided to other individuals?
- Do employees have enough resources?
- Is the firm adequately staffed?
- Does the firm conduct background checks on employees?
- Has the firm experienced significant turnover?
- Does the firm treat any employee with more freedom/leniency than other employees, whereby the employee would have less difficulty circumventing firm policies, procedures and operations in furtherance of his or her own interest or gain?
- Does the firm employ a portfolio manager(s) with stellar performance or reputation? Would assets under management decrease if this portfolio manager left the firm? If so, does the firm grant this portfolio manager special treatment or monitor the manager infrequently?

Corporate Governance

- Is the firm's board structure (if any) appropriate?
- Are the firm's reporting relationships appropriate?
- Is the process for making material decisions regarding firm operations appropriate?
- Is information flow adequate (*e.g.*, if an employee used a creative accounting scheme, would senior management discover it)?

Strategic Direction

- If the firm is changing strategic direction, are the firm's resources, employees and skills adequate to implement the strategy?
- Have there been frequent changes to strategic direction?

Investment Products

- Identify the types of products about which the firm provides advice. Any conflicts of interest or risks associated with these types of products that should be disclosed and/or eliminated?

Service Providers

- Are all service providers necessary and appropriate (*e.g.*, is the firm using an affiliated custodian when it could use a more appropriate custodian)?
- How are service provider activities monitored? Are services provided in accordance with the contract? Are there any inspections of the service providers' facilities, operations and compliance programs?
- Is the firm being compensated for using a specific service provider?

Third Party Payments

- Any compensation from third parties? Any related conflicts?

Gifts/Entertainment

- Does the firm have a gift and entertainment policy?
- Does the firm require reporting/monitoring of gifts and entertainment?
- How large and frequent are the gifts? Are the gifts so large/generous that they create the appearance that the gifts are swaying the decision making of employees (*e.g.*, portfolio manager and trading desk)?
- Does the receipt of gifts or entertainment indicate that the firm is favoring a certain service provider?

Political Contributions

- Does the firm or individual employees make political contributions?

- Is there a firm policy regarding political contributions by the firm and individual employees?
- Are decision makers being pressured to make political contributions in order to “pay to play?”
- Is the firm receiving business from entities controlled by persons who have received contributions from the firm?

Privacy

- How does the firm protect customer information (physical, technical safeguards)?
- Does the firm have a privacy policy?
- Is the policy disclosed to clients?
- Is there a strong emphasis on data integrity and security including client account record keeping, passwords used, passwords changed frequently, virus software used, virus software updated at time of new releases, and firewalls in place if data is accessed through the Internet?
- What is the protocol when customer information is procured without permission from the firm or inadvertently disclosed against firm policy?
- Is consumer report information being disposed of properly?

Trading

- Are trading accounts monitored? If so, are there any corresponding conflicts (*e.g.*, a person with authority to trade on behalf of the accounts is also the person reviewing the overall account activity)?
- Is best execution periodically and systematically monitored?
- Is fair value pricing of illiquid securities employed?
- Any trading with affiliates?
- Is cross trading and principal/agent trading monitored?
- Any soft dollar arrangements? Are they in compliance with the Section 28(e) safe harbor and adequately disclosed to clients?

- Does the firm use client brokerage to obtain anything that benefits the firm, whether or not it may also benefit clients and whether or not the benefit to the adviser fits within the soft dollar safe harbor?
- Does the firm play multiple roles in a transaction?
- Are trade error correction policies and procedures clear?
- Evaluate trade error rate, do errors seem to be occurring frequently or with the same personnel?
- Are clients who are referred to the firm from a brokerage firm informed of corresponding conflicts (*e.g.*, execution of client trades through referring broker or possible higher commission rate)?
- Are all clients that direct brokerage informed of the associated risks?
- Are IPOs and other limited securities allocated equitably among clients?
- Are trade executions placed equitably?

Portfolio Management

- Is there an investment committee in place? Should there be?
- Is there a process for vetting new instruments before placement into a client account (*e.g.*, credit swaps, collateralized debt obligations)?
- Any *quid pro quo* arrangements for assets?
- Any preferential treatment of clients? Does the investment process favor some clients over others?
- Are clients' portfolios consistent with clients' guidelines, mandates, investment objectives, disclosures and regulatory restrictions? Any style drift?
- Is there accounting, booking, or reporting to achieve other interests?
- Any waivers of transfer limits, redemption fees or trading windows?

Hedge Funds

- Does the firm provide credit to a hedge fund or take an equity position in it, or provide execution or prime brokerage services while recommending that hedge fund to their customers?

Pricing/Valuation

- Are the firm's valuation policies/methodologies adequate?
- How are thinly traded securities or private placements valued?
- Does the firm perform price variance analyses?
- Is there a process to monitor the valuation of investments?
- Is performance valued accurately?

Fees

- Are client holdings valued appropriately and back tested?
- Are client fees computed accurately? Could they be based on inaccurate computation of client assets?
- Do different fee structures for different clients pose any conflicts of interest?

Custody

- Does the firm have custody of client funds and/or securities, or could it gain access to client assets? How does the firm ensure that clients' account activity is accurately reported to the client?

Marketing

- How is advertising/marketing information approved?
- Is there coordination between the marketing staff and legal and compliance departments? How does the firm ensure that marketing and selling practices are in accordance with regulatory requirements?
- How are assets under management calculated? Does this coincide with marketing representations and Form ADV?
- How are performance numbers and composites calculated? How are they used in marketing materials and what disclosure accompanies the numbers? GIPS compliant?

- Does the firm enlist a solicitor(s)? If so, is the arrangement formalized with a contract? Is the arrangement disclosed? If applicable, is the solicitor providing Form ADV and the solicitor's written disclosure document? Does the firm review the solicitor's separate written disclosure document for completeness and accuracy? Does the firm have a process for ensuring that the solicitor's written disclosure document is current?

Proxy Voting

- Any conflicts regarding proxy voting? If the firm had any such conflict, was it disclosed to clients prior to voting proxies?

Pension Consultants

- Are firm managers compensating the pension consultant for its referral to the adviser of a pension fund account? Is this arrangement disclosed?
- Does the firm have a process for seeking to review any disclosures made by a pension consultant to a pension fund account regarding the adviser?
- Are firm managers directing pension fund brokerage to a certain broker-dealer with which the pension consultant (who referred the pension fund account to the firm) has an arrangement or relationship?

Form ADV

- Are all material conflicts of interest disclosed?
- Are there any material inadequacies/omissions in the disclosure?
- Is the disclosure easily understood by clients?
- Is Form ADV disclosure consistent with marketing representations, client contracts, and offering materials?

Regulatory Environment/Best Practices

- Who or what department is responsible for keeping abreast of changes in the regulatory environment and how does the firm respond to these changes?
- Who or what department is responsible for monitoring industry best practices and how does the firm respond to these practices?

Unethical Behavior/Fraud

- Are there ways for senior management and other firm employees to commit fraud or engage in unethical behavior (*e.g.*, front running, self-dealing, asset misappropriation, money laundering, unfair investment allocation, incorrect management fee calculation, market manipulation, *etc.*)?
- How frequently is staff trained on compliance/ethics?

Insider Trading

- Are the firm's policies and procedures adequate to detect and prevent insider trading?
- Do the firm's employees understand the meaning of "insider trading" and the firm's related policies and procedures?
- Is any one employee (*e.g.*, star portfolio manager) treated with more freedom/leniency, whereby detection of insider trading by the firm would be made difficult?

Client Complaints

- Any complaints from customers or potential customers?

Record-Keeping

- Does the firm keep records in compliance with the Advisers Act?
- Does the firm have a system for ensuring record retention?
- What is the firm's e-mail retention policy?
- Does the firm review emails on a periodic basis to determine if employees (including senior employees and officers) are acting legally and ethically?

Anti-Money Laundering

- Does the firm have an anti-money laundering policy?
- Does the firm review the anti-money laundering policy of its service providers?