

NASAA Finds Many Investment Advisers Have Deficient Compliance Programs; Proposes "Best Practices"

Summary

Hundreds of investment advisers throughout the U.S. have compliance program deficiencies, according to the North American Securities Administrators Association's ("NASAA") recent nationwide series of coordinated examinations.¹ In conjunction with the release of these results, NASAA also issued an updated series of "best practices" to assist advisers in developing their compliance practices and procedures and reduce their potential for regulatory violations.

Coordinated Examinations

The examinations took place between January 1, 2007, and May 31, 2007. They were conducted by 43 state and provincial securities examiners working alongside the NASAA's Investment Adviser Operations Project Group. The operation was fairly comprehensive, covering 418 investment advisers and finding 2,135 deficiencies in 13 compliance areas.² The greatest number of deficiencies involved registration, unethical business practices, books and records, supervisory/compliance, and privacy.

Among the findings:

- 71% of advisers had deficiencies related to registration, an increase of 12% from 2005. The top deficiencies in this area were inconsistencies between parts I and II of Form ADV, failing to amend Form ADV in a timely manner, and failing to provide or offer to provide disclosure documents annually;
- 47% of advisers had unethical business practices, including contract deficiencies, excessive fees, and recommendations made in violation of the adviser's duties to its clients;
- 46% of advisers had books and records violations, an increase of 19% since 2005. The most common books and records issues were not maintaining suitability data and financial statements;
- 36% of advisers had supervisory deficiencies, up 25% since 2003. The majority of the deficiencies resulted from having no procedures or inadequate procedures in place; and
- 28% of advisers had issues relating to client financial privacy, the majority of which stemmed from having no privacy policy or no annual delivery of the adviser's privacy notice.

¹ See, http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/7273.cfm.

² The examinations covered Books and Records, Financials, Registration, Fees, Advertising, Privacy, Supervisory and Compliance procedures, Investment Activities, Performance Reporting, Custody, Solicitors, Pooled Investment Vehicles (Hedge Fund) and Unethical Business Practices.

Best Practices

In addition to the examination results, the NASAA released an updated series of best practices for advisers to consider when developing their compliance programs. According to NASAA President and North Dakota Securities Commissioner Karen Tyler, the best practices were developed “to help regulators and advisers better understand and meet compliance challenges.”³ The NASAA endorsed the following best practices:

- Review and revise Form ADV and disclosure brochure annually to reflect current and accurate information.
- Review and update all contracts.
- Prepare and maintain all required records, including financial records.
- Prepare and maintain client profiles.
- Prepare a written compliance and supervisory procedures manual relevant to the type of business.
- Prepare and distribute a privacy policy initially and annually.
- Keep accurate financials. File timely with the jurisdiction. Maintain surety bond if required.
- Calculate and document fees correctly in accordance with contracts and ADV.
- Review all advertisements, including web site and performance advertising, for accuracy.
- Implement appropriate custody safeguards, if applicable.
- Review solicitor agreements, disclosure, and delivery procedures.

³ Press Release, North American Securities Administrators Association, Coordinated Examinations Identify Investment Adviser Deficiencies (Oct. 15, 2007), available at http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/7273.cfm.

Conclusion

The NASAA examinations demonstrate that many advisers do not have fully effective compliance programs. The NASAA best practices, noted above, outline steps that advisers can take to strengthen their compliance programs and minimize the potential for regulatory violations. In addition to these best practices, more specific guidance on advisers' compliance can be found in the 2007 Investment Management Compliance Testing Survey (Sept. 4, 2007).⁴ This survey is the result of a joint effort of ACA Compliance Group, the Investment Adviser Association, IM Insight, and Old Mutual Asset Management. It has specific approaches taken by advisers to address compliance issues similar to those uncovered by the NASAA examinations.

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⁴ See http://www.investmentadviser.org/public/compliancetestingsurvey_report-2007.pdf.

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