

COMPLIANCE REQUIREMENTS FOR  
SEC REGISTERED  
ADVISERS

**August 28, 2000**

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# Cash Solicitation Fees

An adviser may pay cash solicitation fees only if:

- “Bad boy” exclusion: the solicitor has not engaged in any disqualifying conduct
- The cash fee is covered by a written agreement retained by the adviser

# Cash Solicitation Fees

Agreements with an unaffiliated solicitor must:

- Describe the solicitation activities of and compensation to the solicitor
- Require the solicitor to perform his duties in a manner consistent with the adviser's instructions and the Investment Advisers Act of 1940
- Require the solicitor to deliver the disclosure described in the next slide

# Cash Solicitation Fees

- A solicitor who is not an affiliate must:
  - ❖ Provide the prospect a separate written disclosure document and the adviser's Form ADV Part II *and*
  - ❖ Obtain a signed acknowledgement from the prospect before the prospect enters into a contract with the adviser

# Cash Solicitation Fees

- A solicitor who is an affiliate of the adviser must disclose this to the client at the time of the solicitation

# SEC Anti-Fraud Rules

- An SEC registered adviser must comply with the SEC anti-fraud rules requiring disclosure about the adviser's financial and disciplinary problems, including:
  - Any SEC order finding violations of the Investment Advisers Act of 1940 or other federal securities laws or regulations
  - Any order issued by a state securities regulator imposing remedial sanctions

# Form ADV Amendments

*Form ADV must be amended and filed promptly to reflect all changes in:*

- PART I
  - Item 1: name of adviser
  - Item 2: principal place of business and hours
  - Item 3: location of books and records
  - Item 4: contact person
  - Item 5: consent to notice

# Form ADV Amendments

*Form ADV must be amended and filed promptly to reflect all changes in:*

- PART I
  - Item 8: corporate form of adviser
  - Item 11: disciplinary questions
  - Item 13: adviser custody of funds or securities
  - Item 14: custody by affiliates of adviser



# Form ADV Amendments

*Form ADV must be amended and filed promptly to reflect material changes in:*

- PART I
  - Item 9: transfer or acquisition of an investment advisory business
  - Item 10: control persons of or persons providing financing to adviser

# Form ADV Amendments

*Form ADV must be amended and filed promptly to reflect material changes in:*

- PART II
  - Item 1: advisory services and fees
  - Item 2: types of clients
  - Item 3: types of investments
  - Item 4: methods of analysis, sources of information and investment strategies

# Form ADV Amendments

*Form ADV must be amended and filed promptly to reflect material changes in:*

- PART II
  - Item 5: education and business standards
  - Item 6: education and business background
  - Item 7: other business activities
  - Item 8: other financial industry activities or affiliations

# Form ADV Amendments

*Form ADV must be amended and filed promptly to reflect material changes in:*

- PART II
  - Item 9: participation or interest in client transactions
  - Item 10: conditions for managing accounts
  - Item 11: review of accounts
  - Item 12: investment or brokerage discretion
  - Item 13: additional compensation

# Form ADV Amendments

- An adviser must file, within 90 days of the adviser's fiscal year end, a Form ADV amendment reflecting any changes in other Form ADV items

# Top Compliance Mistakes

Buying investments that violate client investment guidelines

- ❖ This is more likely with parallel management of multiple portfolios
- ❖ This is one of the most expensive mistakes
- ❖ As fiduciaries, advisers may have to reimburse clients for losses on prohibited investments

# Top Compliance Mistakes

## Mishandling trade errors

- ❖ Trade errors don't improve with age
  - ❖ Don't wait for market action to reduce losses
- ❖ This is how some rogue traders get started

# Top Compliance Mistakes

## Mishandling trade errors

- ❖ An adviser can't correct errors by
  - ❖ Buying securities directly from client account
  - ❖ Unfairly reallocating trades to other clients
  - ❖ Using soft dollars to compensate brokers for breaking trades



# Top Compliance Mistakes

## Improperly allocating client trades

- ❖ SEC has prosecuted advisers that allocated profitable trades to favored accounts and unprofitable trades to disfavored accounts

# Top Compliance Mistakes

## Improperly allocating client trades

- ❖ Risk of actual or perceived misallocation and enforcement action is increased by
  - ❖ Delays in allocating trades
  - ❖ Failure to document reasons for disproportionate or changed allocations
  - ❖ Not having written allocation procedures

# Top Compliance Mistakes

## Mishandling sensitive information

- ❖ Talking publicly about recommended portfolio companies may limit a portfolio manager's freedom to sell it in the near future
- ❖ Receiving non-public inside information about a company could prevent an adviser from trading that company's securities for any client

# Top Compliance Mistakes

## Transactions involving conflicts of interest

- ❖ Don't trade directly with clients without advance individual consent for each transaction
- ❖ Don't act as the client's broker without complying with the agency cross trade rule
- ❖ Use client brokerage or other assets to benefit the adviser only if allowed by the section 28(e) safe harbor for research

# Top Compliance Mistakes

## Violating personal trading procedures

- ❖ Don't tolerate persistent non-filing or late filing of personal securities trading reports
  - ❖ A common item in SEC inspection deficiency letters
- ❖ Employees sometimes have trouble obtaining information about or remembering to report trades by related accounts that employee is technically deemed to own

# Top Compliance Mistakes

## Ignoring client complaints

- ❖ Unresolved client complaints can lead to:
  - ❖ Enforcement action
  - ❖ Private client litigation against adviser
  - ❖ Public embarrassment and loss of business
  - ❖ Missed opportunities to correct problems before they get worse
- ❖ Adopt written procedures for responding to complaints and keep a complaint file

# Top Compliance Mistakes

## Out-of-control marketing

- ❖ Avoid misleading statements and omissions in all communications to clients and the public
- ❖ Compensate solicitors only in accordance with the solicitation fee rule
- ❖ Check for compliance with state filing requirements before accepting new clients
- ❖ Don't forget to hand out Part II of Form ADV and avoid discrepancies in substitute brochures

# Top Compliance Mistakes

## Inadequate record keeping

- ❖ Most SEC enforcement actions and inspection deficiency letters cite record keeping violations
- ❖ A thorough documentation process may discourage questionable or thoughtless conduct
- ❖ Effective controls depend on the availability of documents for review
- ❖ Regulators don't give credit for disclosure and compliance measures that aren't documented