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Compliance projects

By Jennifer Zordani

Historically equity markets are quieter during the U.S. summer season, so it is a good time to improve golf games and compliance programs.

Regulators regularly admonish that compliance needs to be a top priority. For the majority of firms, however, there is little time, energy or funding to regularly schedule a compliance project. At this time of year, with lower volatility and clients on vacation, business and supervisory personnel might have more availability for a compliance project.

The never-ending rules and rule changes provide a disheartening number of potential compliance projects, but if viewed from the business perspective, certain projects will make better sense because they increase efficiencies or provide another benefit to the firm or its clients. Regardless, if the only reason remains regulatory, i.e., improving the compliance tone at the top, it is better to choose one or two projects than to avoid all of them.

Summarized below are steps that help assess the type of compliance project a firm should undertake.

Make a General Evaluation of the Firm's Compliance Program

A relatively limited number of firms may have compliance programs that do not meet basic requirements. Perhaps, a firm has used "off the shelf" procedures and failed to tailor them to the firm's business. Regulators will suspect that this type of firm has spent money, but has not yet dedicated time and personnel to the compliance effort. Worse yet, a firm's procedures might have blanks in them or refer to another firm. In these situations, regulators will be hard pressed to be-

lieve the firm has made much effort on the compliance front because it will appear that not even management has reviewed the procedures.

At some point, firms with incomplete or ill-fitting procedures will have to commit time and resources to developing procedures and documentation that reflect the firm's business and its compliance program. This is more likely to be necessary for firms that are not regularly examined, such as state registered investment advisers. Making the assessment now and crafting a plan to update procedures before year end will help the firm make substantial progress before revenue generating activities intensify, before substantive rule violations occur and before an examiner questions the effectiveness of the existing procedures.

The majority of regulated firms are unlikely to need large scale attention to their entire compliance program. Yet there will continue to be significant aspects of their compliance programs that deserve attention. The following types of assessments will help them determine where they can best enhance their compliance program.

Review Prior Issues

Examinations result in findings. Some findings might not be meaningful, but most findings are valid and reveal areas that need improvement. Summer is a good time to return to prior issues that required follow up and confirm all required actions have been completed. Compliance and supervisory personnel should confirm that personnel continue to follow revised procedures and that they have not reverted to old methods that gave rise to an examiner's findings. Of

course, failing to complete or maintain corrective actions increases the risk of subsequent violations and higher penalties.

Review Rule Changes

Every firm should have a program in place to review rule changes and regulatory developments and incorporate them into the firm's compliance program as appropriate. Even with such a program in place, a mid-year assessment is likely to reveal topics that need updating.

Choose A Hot Topic To Review

Closely related to reviewing rule changes is reviewing hot topics. The Securities and Exchange Commission currently is focused on four "initiatives" that are common to all SEC registrants:

- fraud detection and prevention;
- corporate governance and enterprise risk management;
- conflicts of interest; and
- technology controls.

These are broad categories with numerous sub-categories, many of which are relevant to any regulated firm.

Additionally, within each segment of the industry, there are "hot topics" that are drawing regulators' interest. For example, advisory firms' **custody and safekeeping of client property** are a renewed focus among SEC and state examiners because of recent findings among registered advisers. For retail broker-dealers, sales practices for **complex products** remain a focus, including because of numerous customer complaints about leveraged ETFs. For proprietary firms, trading practices remain in the spotlight particularly because of algorithmic or high frequency

trading, but more recently, the focus has shifted from manipulation to **“unethical” or “disruptive” trading**. For private funds, the **use of finders** is once again on the SEC’s radar.

Firms that have implemented a compliance risk assessment program might review hot topics when they are completing a compliance risk matrix. Whether the firm has a formal or informal approach to assessing compliance risk, hot topics factor into the assessment and are excellent subjects for compliance projects.

Review Controls and Testing

And of course, controls and testing are

difficult topics that regularly receive scant attention. There is a great deal of subjectivity as to what constitutes effective controls and testing of procedures. As a result, reviews and testing of controls are most often done as part of the rush to prepare annual reports, if required by regulators. This should not detract from the benefits of controls and testing. Assigning a team to review controls and conduct testing on particular topics provides an opportunity to catch gaps. If during the project someone has an “ah-ha” moment, that is precisely what helps the firm to update its procedures and other aspects of its compliance program before a problem oc-

curs.

The foregoing steps provide ways of identifying compliance projects. The projects themselves will vary in length and complexity. Even if projects proceed at a slower pace, summer provides an opportunity to assess the current state of the firm’s compliance program and to take proactive steps to improve it. ■

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