

Best practices offered for hammering out an impressive annual review

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Conducting an annual review of your compliance program forms a pillar of the **SEC's** expectations for RIA CCOs. How you do it depends largely on your creativity, time and energy. Your effort should revolve around three questions: (1) What's changed at your firm in the last year? (2) Did a significant compliance problem pop up in that time? (3) Were there legal or regulatory changes affecting your firm?

For instance, your 2011 annual review should examine your firm's compliance with the new pay-to-play rule, if applicable to your business, because this represents a new regulatory change, points out **Karen Huey**, president of **Professional Compliance Assistance** in Canton, Ga. She spoke during **IA Watch's** March 1 webinar, [*Tested Best Practices for Achieving a Rock-Solid Annual Review*](#).

Getting started can be half the battle. **Lori Renzulli**, CCO/GC with **Harding Loevner** (\$6.6B in AUM) in Somerville, N.J., begins with the policies and procedures she brought up in the prior year's review. Her risk assessment guides her compliance testing. She consults industry publications and the SEC's website for new topics to probe and sets up tests for new business practices.

For example, given the recent news regarding use of expert networks ([IA Watch](#), Jan. 10, 2011), if your firm deploys these consultants, you may wish to conduct a test that correlates firm trading in the topics discussed to the dates firm staff spoke with the experts, said Renzulli.

The end result should be to revise firm policies and procedures accordingly. Say your firm purchased new trading software in the last year. This should prompt a change in your compliance manual around trading because the procedures have shifted, said **Michelle Kennedy**, president of **Compass Compliance Services** in Greenville, S.C.

5 items for an annual review

Kennedy recommends your annual review each year include revisiting your compliance manuals, Form ADV, any deficiency letter from your firm's last SEC exam, a re-reading of last year's review and your business continuity plan. "All of these things should be reviewed each year," said Kennedy.

She also shared some examples of compliance testing to fold into your review:

- **BCP:** If your firm stayed open despite a recent blizzard or other extreme weather event, document the response as a test of your BCP.
- **Valuation:** Each quarter randomly select a few accounts and check your firm's market value of the securities versus your custodian's.
- **Portfolio management:** Each month bring a new item to your investment committee meeting. One time it could be sharing the firm's top 10 and bottom 10 trading outliers, a list of the best and worst performing securities for the period or samples of client investment profiles.

Stephanie Brown, the CCO at **Merriman** (\$1.3B in AUM) in Seattle, told of her approach, which builds on weekly and monthly compliance tasks. She tracks her progress on each task throughout the year using an [audit grid](#) and other tools.

A risk assessment plays a crucial role in deciding the topics to investigate, although techniques differ on whether to create the assessment first to guide your inquiry or refresh the assessment at the end of the review. Renzulli provided an example of one topic within her risk assessment (see the box below). Brown passed on an example of a [risk matrix](#) that serves to document her entire effort.

Be sure to interview department heads for their opinions of what poses the greatest compliance risks to your firm, stressed Brown.

Although the SEC doesn't require investment advisers to produce a formal report of their annual review (exception: mutual fund advisers must present such a report to the fund board yearly), it's clearly a best practice. A poll of webinar attendees indicated most do assemble a report. Forty-five percent answered the report usually runs fewer than six pages. Another 36% replied their report stretches between seven and 20 pages. Most conduct their annual review throughout the year and finish up in December.

Brown also provided an [example](#) of the format of her annual review report.

Editor's Note: The webinar included more than a dozen electronic tools to assist CCOs in conducting their annual review, including a [new account checklist](#). To order your copy of the webinar - including electronic tools and the audio CD - click [here](#).

Description of Risk Area	Type of Risk and Rating	Operational Area Responsible	Applicable Policies and Procedures	Description of Potential Risks and Mitigating Factors
Retention of Electronic Mail	Type: (e.g., Low, Medium, High) Probability: Impact:	IT	E-mail Retention and Supervision	Third-party interception based e-mail system that captures and retrieves all incoming, outgoing, interoffice and Bloomberg messages is in place and regularly reviewed.