

Running the Risk: Wisdom Gathered from our Compliance and Risk Verifications

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a MarketCounsel *du jour* Presentation




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MarketCounsel *du jour*

- ❑ Examination Update
- ❑ Organizational Risk Management
- ❑ Wisdom Gathered
- ❑ Managing the Examination

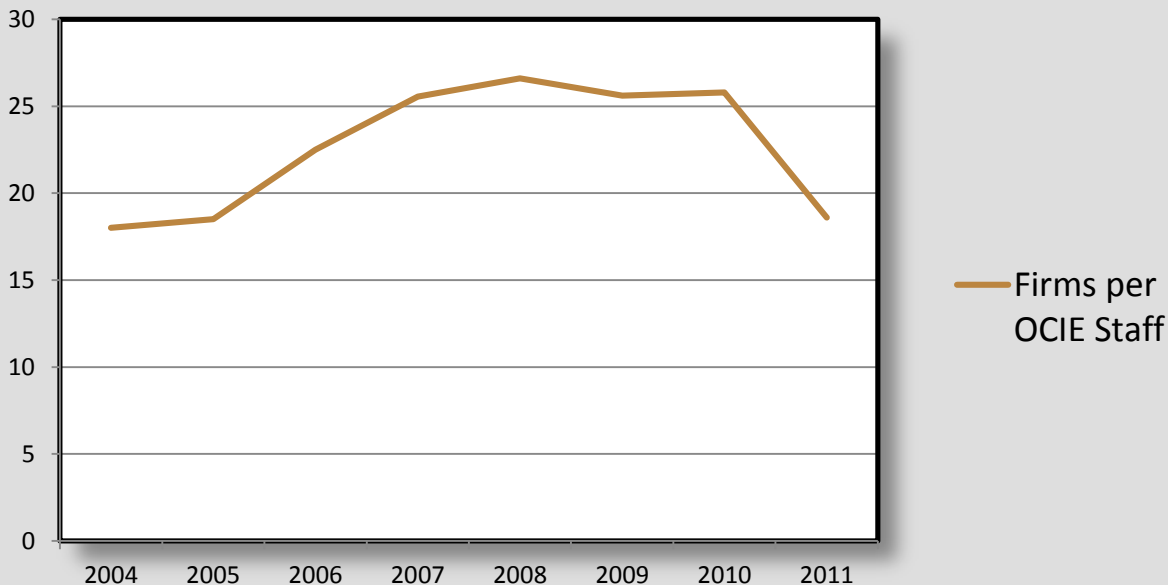


Examination Update



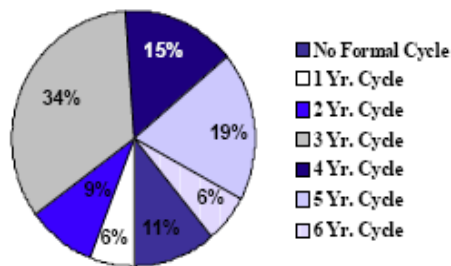
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*2011 data based on Staff estimates as of July 21, 2011

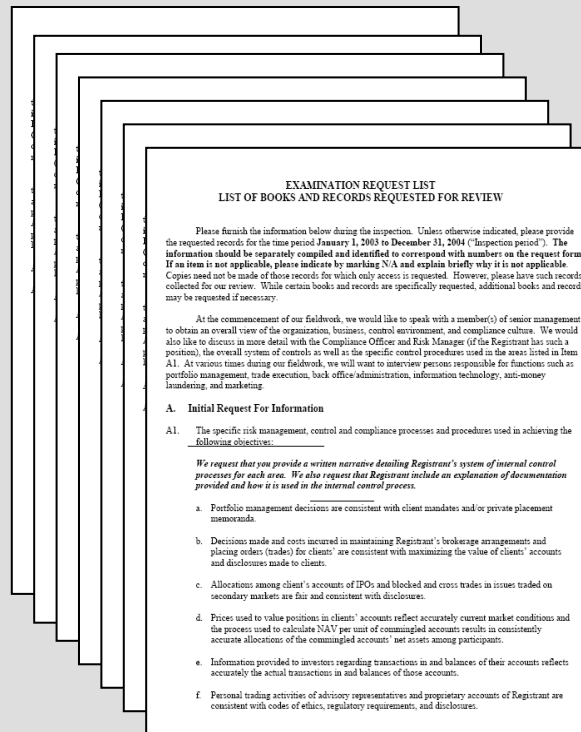
Table 2 - Frequency of State Investment Adviser Examinations



“Virtually all states (94%) conduct Investment Adviser examinations on-site at the Investment Adviser’s principal place of business on a “routine” or non-cause basis. These examinations are often initiated within the first two years of a firm’s registration.”

Source: NASAA Report, 2011

- ❑ SEC Examinations
 - ▣ Limited Scope
 - ▣ Full Scope
 - ▣ For Cause
 - ▣ Sweeps
- ❑ State examinations vary by state
- ❑ Uptick in risk-based examinations



EXAMINATION REQUEST LIST
LIST OF BOOKS AND RECORDS REQUESTED FOR REVIEW

Please furnish the information below during the inspection. Unless otherwise indicated, please provide the requested records for the time period **January 1, 2003 to December 31, 2004** ("inspection period"). The information should be separately compiled and identified to correspond with numbers on the request form. If an item is not applicable, please indicate by marking "N/A" and explain briefly why it is not applicable. Copies need not be made of those records for which only access is requested. However, please have such records collected for our review. While certain books and records are specifically requested, additional books and records may be requested if necessary.

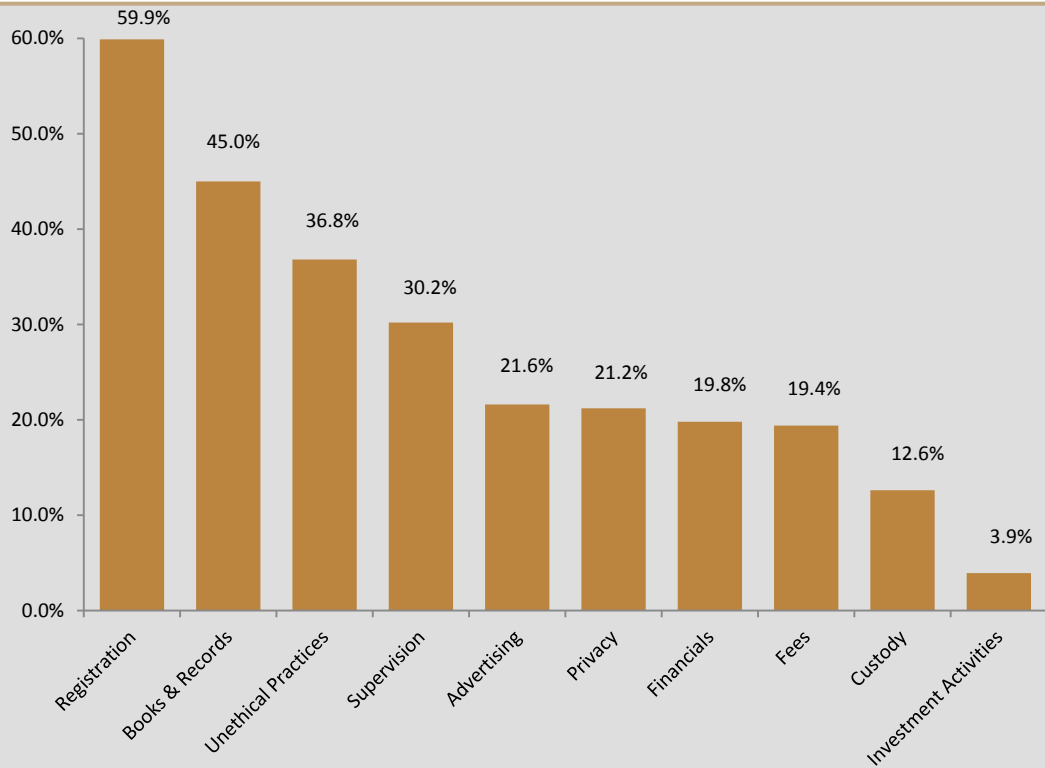
At the commencement of our fieldwork, we would like to speak with a member(s) of senior management to obtain an overall view of the organization, business, control environment, and compliance culture. We would also like to discuss in more detail with the Compliance Officer and Risk Manager (if the Registrant has such a position), the overall system of controls as well as the specific control procedures used in the areas listed in Item A1. At various times during our fieldwork, we will want to interview persons responsible for functions such as portfolio management, trade execution, back office/administration, information technology, anti-money laundering, and marketing.

A. Initial Request For Information

A1. The specific risk management, control and compliance processes and procedures used in achieving the following objectives:

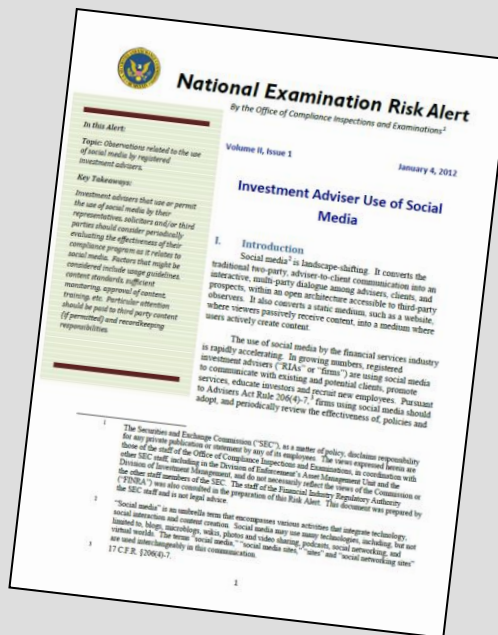
We request that you provide a written narrative detailing Registrant's system of internal control processes for each area. We also request that Registrant include an explanation of documentation provided and how it is used in the internal control process.

- a. Portfolio management decisions are consistent with client mandates and/or private placement memoranda.
- b. Decisions made and costs incurred in maintaining Registrant's brokerage arrangements and placing orders (trades) for clients' are consistent with maximizing the value of clients' accounts and disclosures made to clients.
- c. Allocations among client's accounts of IPOs and blocked and cross trades in issues traded on secondary markets are fair and consistent with disclosures.
- d. Prices used to value positions in clients' accounts reflect accurately current market conditions and the process used to calculate NAV per unit of commingled accounts results in consistently accurate allocations of the commingled accounts' net assets among participants.
- e. Information provided to investors regarding transactions in and balances of their accounts reflects accurately the actual transactions in and balances of these accounts.
- f. Personal trading activities of advisory representatives and proprietary accounts of Registrant are consistent with code of ethics, regulatory requirements, and disclosures.



- ❑ **Social media**
- ❑ **Insider trading**
- ❑ **Hedge funds**
- ❑ **Valuation**
- ❑ **Conflicts of interest**
- ❑ **Portfolio management**
- ❑ **Performance and advertising issues**
- ❑ **Asset verification**
- ❑ **Risk governance**
- ❑ **Business continuity/disaster recovery**

- ❑ SEC National Examination Risk Alert
 - ▣ Adopt policies and procedures related to the use of social media.
 - ▣ Testimonials
 - ▣ Recordkeeping
- ❑ Massachusetts Letter
- ❑ FINRA Guidance



- **Permission**
- **Monitoring**
- **Retention**



Sample Electronic Media Policy and Procedures

Electronic Media Policy

Personnel of <<COMPANY NAME>> (the "Firm") are prohibited from establishing, maintaining, contributing to or communicating through any website, blog, chat room or other social media resource (including but not limited to Facebook, Twitter, LinkedIn and YouTube) (together "Electronic Media") that includes content relating to the Firm's business without prior approval from the Chief Compliance Officer.

In determining whether to allow firm personnel to use Electronic Media, the Chief Compliance Officer will first determine whether the Electronic Media can be properly monitored for supervision purposes and that the communications can be properly retained. This includes communications sent and received through Electronic Media.

When reviewing Electronic Media communications by personnel, the Chief Compliance Officer should determine whether the Electronic Media will be characterized as an advertisement under the Rules. Where the Chief Compliance Officer determines that the Electronic Media is advertising, corresponding materials should be reviewed pursuant to the Firm's procedures regarding advertising found in the compliance manual.

In addition to determining whether the Firm can properly monitor and retain communications through Electronic Media, the Chief Compliance Officer will determine whether permission should be given to the particular personnel making the request. The Chief Compliance Officer will consider the particular risks of the Electronic Media requested, as well as each personnel's experience and past history with regard to complying with communication policies.

Electronic Media Procedures

The Firm has implemented these procedures with regard to determining if and how personnel can engage in the use of Electronic Media.

Permission: All personnel must receive prior permission regarding the use of a particular Electronic Media site for business purposes. The request must include at least the following:

- A brief description of the site to be used (not required for Facebook, LinkedIn, Twitter or YouTube) as well as the URL of the site.
- A detailed description of the features the personnel intends to use for business purposes.
- A description of why the personnel believes that permission should be granted. This should include a description of the personnel's experience with communications and advertising compliance as well as why the Electronic Media will be beneficial to the Firm.

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Sample Electronic Media Policy and Procedures

Monitoring: The Firm will monitor all communications (sent, received, or otherwise posted) by personnel through the Electronic Media site.

The Firm has engaged MailBanc, a division of MarketCounsel, to monitor Electronic Media communications. MailBanc provides enterprise-class compliance solutions to capture, retain and monitor electronic communications. MailBanc receives social media activity feeds from Facebook, LinkedIn and Twitter via the API (application programming interface). This allows personnel to use any method or medium to publish to those sites, while ensuring that the Firm will still archive and monitor the activity. MailBanc's archiving solution enables the Firm to capture the following Electronic Media content:

- Facebook profiles and Fan pages, including wall posts, photos, notes, and groups, as well as private messaging;
- LinkedIn profiles, status updates, network updates (including private RSS feeds), connections, and recommendations;
- Twitter status updates, mentions, tweets retweeted, and direct messages; and RSS integration for blogs, blog comments, social and web searches, YouTube and more.

MailBanc stores all of those communications within the same electronic archive as the Firm's email communications. Upon archiving the communications, MailBanc automatically enforces a proprietary filter of keywords and phrases, customized for the Firm (as needed).

To enable archiving of Electronic Media content, personnel must authenticate their social media accounts through a secure web portal. Recognizing the privacy issues associated with sharing of account passwords, passwords shared through this web portal are stored in a secure method and never shared with any individuals or used for any other purpose.


Retention: The Firm must retain any communications sent, received or otherwise posted through Electronic Media. As discussed above, the Firm utilizes MailBanc which stores all Electronic Media content within the same archival system as the Firm's email. All data is retained in SAS 70 compliant facilities for a minimum of six years, in the same manner that the Firm retains emails.

Learn more about MailBanc by visiting www.mailbanc.com, emailing sales@mailbanc.com or calling (877) 7GO-BANC.

DISCLAIMER: This policy and procedures is a sample and offered for informational purposes only. It is not intended as legal or regulatory compliance advice. Any person or organization seeking to use this information may do so only after confirming the extent of its applicability with their legal counsel and/or regulatory compliance consultant and tailoring it to their own specific circumstances and situation. MarketCounsel assumes no responsibility for damages arising from its use.

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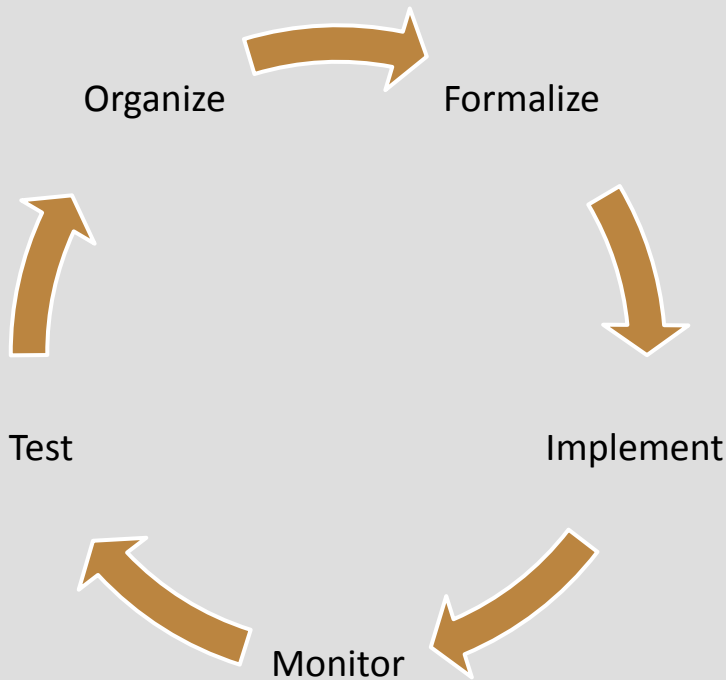
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Avoiding the Stress



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- ❑ **Assess areas of risk**
- ❑ **Develop policies and procedures**
- ❑ **Determine clear lines of responsibility and reporting**
- ❑ **Review and revise**

- ❑ **Distribution**
 - ❑ New policies
 - ❑ Changes to existing policies
- ❑ **Acknowledgement**
- ❑ **New employees**
- ❑ **Ongoing training**

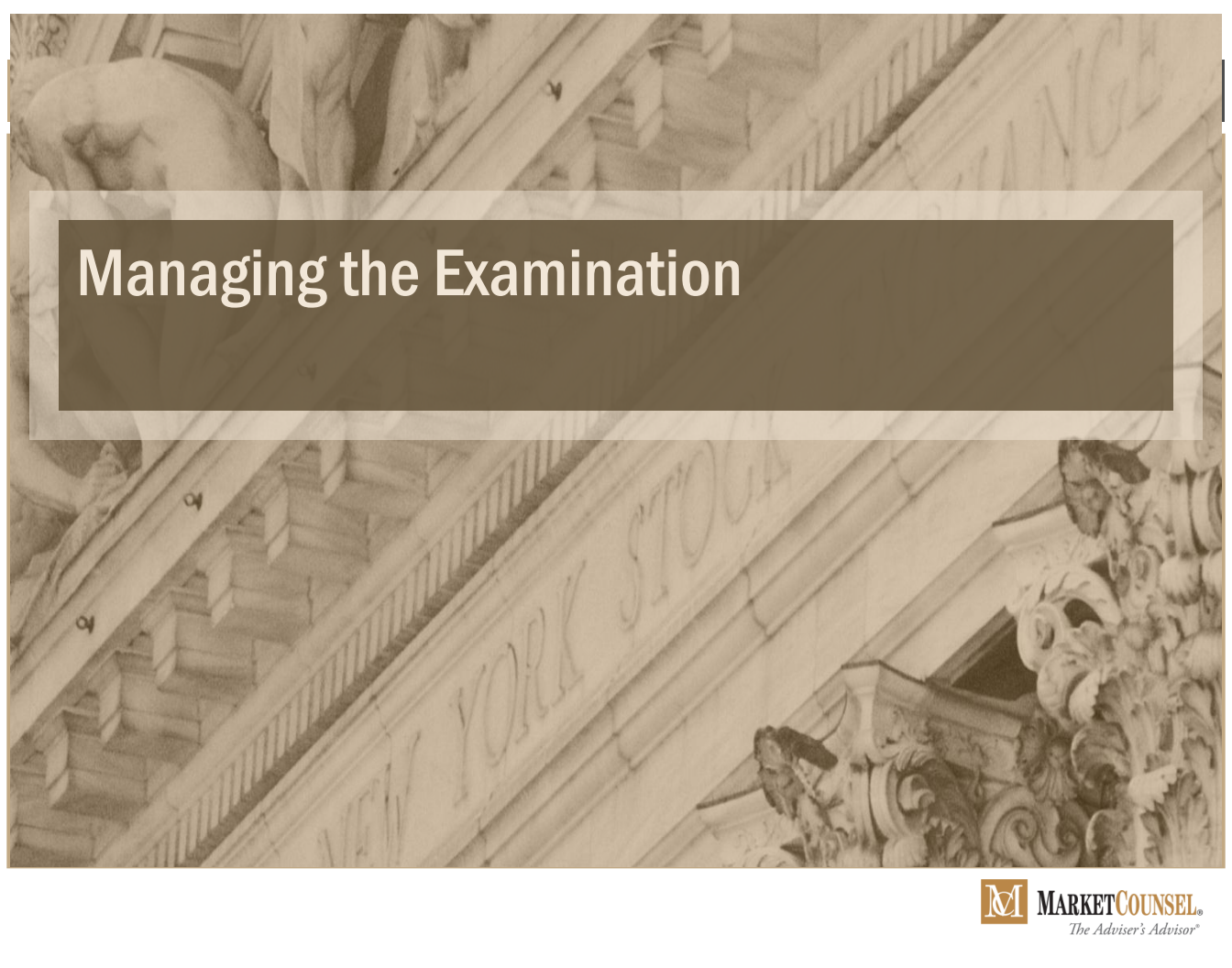


- ❑ **Proactive risk assessment testing**
- ❑ **Focused Testing**
- ❑ **Annual Review**
- ❑ **Documentation**

- ☐ Scope of policies
- ☐ Consistency of policies
- ☐ Fee accuracy
- ☐ Billing
- ☐ Risk profiles
- ☐ Best Execution
- ☐ Trade allocation
- ☐ Trade error review
- ☐ Email
- ☐ Social media
- ☐ Business continuity
- ☐ Data security
- ☐ Code of ethics
- ☐ Regulatory filings

- ❑ Lack of process
- ❑ Lack of training
- ❑ Failures to follow policies and procedures
- ❑ Lack of documentation
- ❑ Typical deficiencies





Managing the Examination



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Regulatory Exam "Fire" Drill

Procedures for Members to Implement Immediately Upon Notification of a Regulatory Exam



Upon Notification



Sound the Alarm

1. Notify your firm's principals.
2. Call (201) 705-1200. Follow the prompts for "Member Services" and notify us of the pending regulatory examination.
3. Fax all documents received to (201) 705-1201.
4. Appoint an examination liaison. Please consult with us in the selection.
5. Prepare and deliver any documents requested by examiners in advance of their visit and, if time allows, prepare an initial set of documents for the examiners' review upon arrival.
6. End start of upcoming visit and expected behavior.

Upon Arrival



Greet the Examiners

1. Request permission to ask business cards in your ongoing effort to safeguard your client's information.
2. Direct them to a quiet room; preferably away from the firm's activities and files.
3. Offer them water or coffee (only).
4. Collect any additional document request.
5. Explain that you would like to assemble your management team and you will return shortly.
6. Assemble the firm's principals and examination liaison.

Initial Meeting



Call the Opening Meeting

1. Gather all principals of the firm and the firm's liaison to meet with the examiners.
2. Introduce all of your firm's representatives in attendance.
3. Lay out the Ground Rules (see below).
4. Ascertain an individual on the length of their stay. Let them know that as long as they are there, you will need to reallocate firm resources.
5. Provide a brief explanation of your firm.
6. Furnish initial list of documents requested.
7. If you were given advance notice of the examination these 4, 5 and 6 may be done prior to the Opening Meeting.

During the Exam



There When You Need Us Most

1. The liaison is intended as a buffer. If you are unsure how to respond to any request, contact us immediately outside the presence of the examiners.
2. Continuously attempt to narrow the examiner's requests by asking for more specific information. Avoid supplying unrequested but not volunteered information.
3. Make photocopies only when copies are specifically requested. Do not make copies for future reference.
4. We are committed to ensuring a successful examination with around-the-clock support and priority service.

Fire Marshall's Duties

MarketCounsel's Role Throughout the Examination Process

1. Review scope of upcoming examination.
2. Support in preparation for the examination.
3. Conference calls with start to discuss outstanding issues.
4. Around-the-clock support throughout the examination.
5. Preliminary assessment of examination outcome.
6. Direct steps towards management in anticipation of potential deficiencies.
7. Review regulator's deficiency letter and consult with you.
8. Review response strategy with firm's counsel.
9. Report firm's counsel in drafting response to deficiency letter.
10. Assist in the implementation of remediation measures.

The Ground Rules To Be Described to the Examiners

1. Our firm takes compliance issues very seriously and we have instilled our compliance culture in everything we do.
2. Please direct all requests to our firm's liaison who will arrange for the firm's timely response.
3. Our liaison would be pleased to give you a tour of our facility upon request. Please do not roam about freely.
4. We would be pleased to make photocopies of any documents you need. Please ask our liaison to make copies for you.
5. We would appreciate if you would arrange an exit interview with us in advance of your departure.

Always remember, the examiners...

... have a job to do. Let them do it but do not volunteer information that is not specifically requested.
 ... may be very nice and engaging. Nevertheless, please limit your social interactions.
 ... are on your turf. Don't be intimidated to let the ground rules.
 ... are your guests, please be hospitable. The cold dark room with one hanging light bulb is a sure way to prolong an examination.

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- ❑ Review scope of request letter
- ❑ Appoint an examination liaison
- ❑ Develop a strategy
- ❑ Prepare initial document request



- ❑ **Conduct the opening meeting**
- ❑ **Maintain a log**
- ❑ **Request closing meeting**
- ❑ **Begin remediation**

Gary D. Davis Jr. serves as Vice President, Practice Management for MarketCounsel. He is responsible for assisting clients with raising the bar of their operations, including compliance, through the implementation of industry best practices. Mr. Davis brings a solid track-record of assisting investment firms with the operational aspects of growth.

Prior to joining MarketCounsel, Mr. Davis was the Founder and President of Beneficial Concepts Group, a practice management consulting firm for registered investment advisers. Previously, he managed the operations, compliance and investment departments at two financial planning and investment advisory firms. He has also managed operations for a broker/dealer and has served as a financial planning analyst.

Mr. Davis received a Masters in Accounting and Financial Management from the Keller Graduate School of Management, and holds a Bachelor of Science in Financial Planning from Purdue University. He has also passed the Series 65 exam.

Gary lives with his daughters KayLynn and Ella in central New Jersey.





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