

# COMPLIANCE REQUIREMENTS FOR REGISTERED INVESTMENT ADVISERS

The following outlines the compliance requirements generally imposed on Registered Investment Advisers (“RIAs”) by the Investment Advisers Act of 1940 (the “Advisers Act”) and the rules and regulations promulgated thereunder. Please note that the compliance requirements applicable to a particular RIA will depend on the facts and circumstances of such RIA and may include additional compliance requirements (see e.g. “Additional Requirements” below).

Pursuant to Rule 206(4)-7 of the Advisers Act, an RIA must:

- Adopt written policies and procedures reasonably designed to prevent violations of the securities laws;
- Annually review the policies and procedures; and
- Designate a Chief Compliance Officer (a “CCO”).

Although Rule 206(4)-7 does not require any specific compliance element, the SEC has indicated that an RIA’s policies and procedures should address the following matters:

- Portfolio management processes, including allocation of investment opportunities;
- Trading practices including best execution and use of soft dollars;
- Proprietary and personal trading;
- Accuracy of disclosure to clients and regulators;
- Safeguarding of client assets;
- Recordkeeping;
- Marketing activities;
- Valuation of client holdings and fee assessment;
- Client privacy; and
- Business continuity plans.

The annual review under Rule 206(4)-7 must determine the adequacy and the effectiveness of the implementation of the policies and procedures. Such

review should consider any compliance matters that have arisen, changes in business activity, and changes in laws and regulations. An RIA should maintain written evidence of this review.

Under Rule 206(4)-7, an RIA must appoint a CCO to administer the policies and procedures. The CCO must be knowledgeable and competent with respect to the securities laws. The CCO must have sufficient seniority and authority within the organization to develop and enforce the policies and procedures.

In addition to the compliance program required by Rule 206(4)-7, an RIA must also observe several other provisions of, and rules under, the Advisers Act:

## REGISTRATION AND DISCLOSURE

An RIA with more than \$100 Million in assets under management must complete and file a Form ADV with the SEC. An RIA must also file an updated Form ADV each year and an amended Form ADV upon the occurrence of certain material events. An RIA must deliver Part 2 of Form ADV (or an equivalent brochure) to each client. An RIA has an obligation to disclose all material facts to the SEC and to its clients. An RIA should also periodically review state blue-sky filings to ensure that all registrations remain current and all filing fees are paid.

## FIDUCIARY RESPONSIBILITY AND SUITABILITY

An RIA is a fiduciary with respect to its clients. In this role, the RIA owes its clients a duty to provide only suitable investment advice, taking into account the client’s financial situation, investment experience, and investment objectives. An RIA must also disclose all material information including any conflicts of interest.

## RECORDKEEPING

An RIA must maintain all paper and electronic records related to its investment advisory business including journals, ledgers, purchased securities, checks and bank statements, billing, trial balances and financial statements, written communications

and communications regarding recommendations, discretionary accounts and authority, written agreements, securities ownership, disclosure documents, advertising, and insider trading. The RIA must maintain such records in its principal office for at least 2 years and for another 3 years in an easily accessible place. An RIA must also retain records relating to personal securities transactions under its Code of Ethics.

## **SOLICITORS**

In the event an RIA pays a referring agent or solicitor to solicit clients, the RIA and the solicitor must enter into an agreement containing certain provisions required by the Advisers Act including the requirement to provide the solicited client with a disclosure statement describing the fee paid to the solicitor. The Adviser Act also limits political contributions and payments to solicitors with respect to public plans.

## **ADVERTISING**

An advertisement (i.e. any written communication directed to more than one person regardless of distribution medium) may not be fraudulent or deceptive. Specific prohibitions include client testimonials, selective past specific recommendations, over-stating the effectiveness of a chart/graph/formula for investment selection, and misleading performance data.

## **PRIVACY**

An RIA must adopt policies and procedures to protect private client information and prevent disclosure of such information to third parties. The RIA must distribute its privacy policy to its clients each year.

## **ADVISORY CONTRACTS**

Contracts with clients should be in writing, prohibit assignment without a client's consent, and avoid language waiving a client's rights under applicable law. Additional provisions of the Advisers Act apply in the event the RIA charges a performance fee.

## **FEES**

An RIA must adequately disclose its fees and not charge a penalty for termination of an advisory contract. An RIA can only charge performance fees to clients that have at least \$1,000,000 in assets under

management or have \$2.0 Million in net worth. An RIA can also charge a fulcrum fee to entities with assets of at least \$1 Million.

## **CUSTODY**

In the event that an RIA maintains custody of client assets, the RIA must maintain the assets at a qualified custodian and satisfy certain notice requirements. A fund managed by an RIA must annually deliver audited financial statements to investors in the fund in order to avoid having to provide periodic account statements and fund holdings.

## **TRADING**

The Advisers Act generally prohibits agency cross and principal transactions involving an RIA's clients. An RIA should also adopt policies and procedures to ensure appropriate trade allocation. An RIA must also seek best execution for client trades and disclose directed brokerage or soft dollar practices.

## **INSIDER TRADING**

An RIA must establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the misuse of material nonpublic information by the RIA or any associated persons.

## **SUPERVISION AND LICENSING**

An RIA has a duty to supervise the activities of any person acting on its behalf. An RIA can satisfy this duty by establishing reasonable compliance procedures. In general, each associated person of an RIA that provides investment advisory services must become an Investment Advisory Representative by passing the Series 65 examination.

## **CODE OF ETHICS**

An RIA must adopt a Code of Ethics that addresses (a) standards of business conduct reflecting the RIA's fiduciary responsibilities, (b) compliance with the securities laws, (c) reporting, review and pre-approval of personal securities transactions by certain designated access persons, (d) safeguarding of information about client transactions, (e) reporting of Code of Ethics violations, and (e) enforcement and administration by the CCO.

## **PROXY VOTING**

In the event that a client appoints the RIA to vote proxies, the RIA must adopt policies and procedures designed to ensure that it casts votes in the client's best interests. The RIA must adequately address conflicts of interest, disclose its proxy voting policies and procedures to its clients, and provide information as to how a client may obtain the RIA's proxy voting record. An RIA must also comply with certain recordkeeping requirements with respect to proxy voting.

## **ANTI-MONEY LAUNDERING**

Although RIAs are not yet subject to the Anti-Money Laundering provisions of the USA PATRIOT Act, the Financial Crimes Enforcement Network has issued a proposal that, if adopted, would require an RIA to adopt policies and procedures designed to ensure that the RIA would not be used to launder money, including periodic testing, designation of an anti-money laundering compliance officer, and on-going training. FinCEN has also considered whether to subject RIAs to the USA PATRIOT Act, which would require customer identification and suspicious activity reporting.

## **INSPECTIONS AND ENFORCEMENT:**

An RIA is subject to regular and surprise SEC inspections, sweep inspections, and just-cause inspections. Violations of the Advisers Act could subject an RIA or its personnel to civil sanctions, fines, and imprisonment (for willful violations).

## **ADDITIONAL REQUIREMENTS:**

An RIA must also consider other applicable laws and regulations depending on the nature of its business. For example, an RIA that recommends investments in "new issues" as defined by the FINRA should obtain certain eligibility representations from clients in order to make required representations to FINRA members. All NFA members (Commodity Trading Advisors and Commodity Pool Operators) must complete and retain a self-examination questionnaire. Registered CPOs that manage non-exempt pools and certain exempt pools must deliver annual financial statements to the NFA. Additionally, an RIA that holds more than 5% of any registered equity security must file either Form 13D or Form 13G. An institutional investment manager with more than \$100 Million in discretionary assets must file Form 13F.

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