

IS YOUR COMPLIANCE MANUAL SUSTAINABLE?



SUSTAINABLE COMPLIANCE STRATEGIES, LLC



**Pitfalls to Recognize to Mitigate
Your Regulatory and Reputation Risk**

Is Your Compliance Manual Sustainable? ©

**Pitfalls to Recognize to
Mitigate your Regulatory
and Reputation Risk ©**

**By Ellen McCarthy, CEO & Founder,
Sustainable Compliance Strategies, LLC ™**

Are you a bank, broker-dealer, investment adviser, transfer agent, fund, or trust company? I welcome the opportunity to consult with you and provide individualized strategies to keep your financial services company safe and sound!

Ellen McCarthy, CEO of Sustainable Compliance Strategies, LLC™ (the Company), is an accomplished attorney with over 25 years of experience in regulatory, risk management, and compliance leadership. Ms. McCarthy founded the Company to leverage her strong and consistent record of transforming organizations, to offer tailored, sustainable solutions that provide regulatory safety and soundness to the financial services industry. Previously, Ms. McCarthy served as Executive Vice President and Chief Risk and Compliance Officer of the American Stock Transfer & Trust Company (AST) where she directed all corporate compliance and risk functions throughout the U.S and Canada for the company and its affiliated operating entities, including CST Trust Company and DF King. An active member of an industry-wide Risk and Compliance Committee as well as the company's Trust Indenture, New Business Acceptance, and New Initiative Approval Process Committees, Ms. McCarthy provided leadership and subject matter expertise to clients and the Board, and led a senior executive team composed of CCOs, CROs, AML officers, and privacy officers in the U.S. and Canada.

Prior to joining AST, Ms. McCarthy advanced through increasingly responsible Senior Counsel roles with the New York Stock Exchange (NYSE) and the Financial Industry Regulatory Authority (FINRA), holding key positions on several committees that focused on driving continuous improvements through cross-functional collaborations with internal and external stakeholders, and advanced the organization's diversity, inclusion, and educational initiatives. During her tenure with NYSE and FINRA, she planned and executed high impact regulatory investigations, including know your customer (KYC) and suitability, anti-money laundering (AML), cyber security/protection of sensitive customer data, complex structured products, alternative investments, initial public offerings (IPOs), conflicts of interest, and private placements.

Ms. McCarthy earned her Bachelor of Arts in History and Business Management from Saint Joseph's College, where she graduated Summa Cum Laude and was class Valedictorian, and a Juris Doctor from Saint John's University School of Law. She is a Bar Member of the State of New York and is currently on the faculty of the Practicing Law Institute. She received Working Mother Magazine's "Working Mother of the Year Award" in 2013.

Learn more at www.strategiccompliance.com.

What is a Sustainable Compliance Manual?

A **compliance manual** is a set of written policies and procedures that document the internal controls a financial services company has implemented to ensure compliance with applicable rules and regulations.

The purpose of a compliance manual is to mitigate your regulatory and reputation risk.

It is NOT a one-size-fits-all solution. A **sustainable compliance manual** has the following characteristics:

- a. It is specifically tailored to the nature, size, and complexity of your particular firm, and to the rules that govern your business.
- b. As with every effective written document, it clearly addresses the Who, What, Where, When, Why, and How.
- c. It is updated regularly. Your approach to the manual should be flexible and nimble, allowing you to keep up with regulatory developments and with any changes in the way you do business.

There is no requirement that all compliance policies and procedures be consolidated into a single document, although some companies may prefer to maintain their compliance manual in that manner for the sake of convenience.

Why do you need a compliance manual?

Most financial institutions are subject to regulatory requirements that mandate having a compliance manual. For example, the Financial Industry Regulatory Authority (FINRA) has promulgated FINRA Rule 3110, which requires **broker-dealers** to establish, maintain, and enforce written procedures to supervise the types of business in which the broker-dealer engages, and the activities of the broker-dealer's associated persons, that are reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable FINRA rules.

Similarly, the Securities and Exchange Commission (SEC) requires **investment advisers** and **investment companies** (including mutual funds, closed-end funds, and unit investment trusts) registered with the SEC to adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws, and to **review those policies and procedures annually for their adequacy and the effectiveness** of their implementation. These requirements are set forth in Rule 38a-1 under the Investment Company Act of 1940 and Rule 206(4)-7 under the Investment Advisers Act of 1940. (FINRA also requires that broker-dealers test the effectiveness of their compliance manual on a periodic basis.)

State regulators also have such requirements. For example, when the examination staff of the New York State Department of Financial Services (NYDFS) conduct a safety and soundness audit of the **banking industry**, one of the first items they request to review is a company's written policies and procedures.

Unless they operate as a bank or trust company subject to the jurisdiction of a federal or state banking regulatory authority that requires written compliance policies and procedures, most **transfer agents** are not currently required to have a compliance manual. However, on December 22, 2015, the SEC issued an Advance Notice of Proposed Rulemaking (ANPR) and Concept Release (Concept Release) concerning Transfer Agent Regulations. In the ANPR, the SEC stated its intent to propose a new rule requiring each registered transfer agent to adopt policies and procedures reasonably designed to achieve compliance with applicable securities laws and applicable rules and regulations thereunder.

It appears, then, that sometime in the future the SEC will treat transfer agents the same as broker-dealers, investment companies, and investment advisers, mandating that they have compliance manuals. In the interim, certain clients already impose this requirement on transfer agents. Most of the operations of investment companies (funds) are carried out by service providers, including transfer agents. Because Rule 38a-1 under the Investment Company Act of 1940 requires funds to oversee compliance by their service providers, funds conduct periodic due diligence compliance visits during which they inspect their transfer agents' compliance manuals.

In short, your compliance manual documents which rules apply to your business and sets forth your individualized action plan to ensure that your company is following those rules. You need it to keep your company safe and sound, and to provide assurance to both your regulators and your clients.

Risk Assessment

Your compliance manual **mitigates your regulatory and reputation risk.**

The SEC has noted that as financial institutions design their compliance policies and procedures, they should begin by identifying any compliance factors that create risk exposure to the company and its clients, including all applicable rules and regulations. This analysis should be done from the perspective of the company's specific business operations. Appropriate policies and procedures should be implemented and documented to effectively manage the risks that have been assessed. (SEC Release Nos. IA-2204; IC-26299; File No. S7-03-03)

"Reputational risk is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions.

- The biggest threat to reputation is seen to be a failure to comply with regulatory or legal obligations." (from a presentation by Russell Damitz, NYDFS Foreign & Wholesale Banks Division, 11/4/14)

Once you have identified which rules apply to your business (risks), you can design and implement an individualized action plan (controls) to ensure compliance.

Example: Transfer Agents are subject to the following regulations:

A. Federal Transfer Agent Rules

- a. Registration and Annual Reporting Requirements
- b. Processing, Reporting, Recordkeeping, and Exemptions: SEC Rules 17Ad-1 through 17Ad-7 and Rules 17f-1 and 17f-2
- c. Recordkeeping and Safeguarding Rules: SEC Rules 17Ad-8 through 17Ad-13
- d. Issue-Specific Rules: Rules 17Ad-14 through 17Ad-21T

B. Bank and Internal Revenue Service (IRS) Regulations

C. Self-Regulatory Organization (SRO) Rules and Requirements Applicable to Transfer Agents

- a. New York Stock Exchange (NYSE) Requirements
- b. Depository Trust Company (DTC) Requirements

D. Regulation of Transfer Agents Under State Law

If you are a transfer agent, your compliance manual must adequately address all of these regulatory requirements.

Compliance Matrix

The bricks and mortar of a sustainable compliance manual are anchored with a regulatory **compliance matrix**. This is a spreadsheet containing the relevant regulations applicable to your business and who is responsible for complying with them. You can then use the matrix as a sort of checklist, to ensure that the responsible parties have implemented specific policies and procedures in order to comply with the regulations.

In the transfer agent example above, the compliance matrix would begin with a listing of the specific requisites of the Federal Registration and Annual Reporting Requirements. That is, it would cover such items as:

1. SEC Rule 17Ac2-1, which requires transfer agents to apply for registration with the SEC by submitting what is known as a Form TA-1; and
2. SEC Rule 17Ac2-2, which requires all registered transfer agents to file an annual report, called a Form TA-2, with the SEC. The transfer agent's Chief Compliance Officer, with input from various operational business units, is usually responsible for filing these reports.

Done properly, i.e. with an appropriate degree of specificity, the compliance matrix can form the basis of your compliance manual's table of contents - a centralized inventory of your compliance policies and procedures.

SAMPLE COMPLIANCE MATRIX

The transfer agent compliance matrix might look something like this:

Regulation	Requirement(s)	Responsible Party(ies)
A. Federal Registration and Annual Reporting Requirements		
SEC Rule 17Ac2-1	<p>1. Apply for registration with SEC via Form TA-1, disclosing: a) general identification information, b) identity of direct and indirect owners and other control persons, and c) whether applicant or any of its control affiliates have been subject to investment-related criminal prosecutions, regulatory actions, or civil actions.</p> <p>2. Amend as necessary, i.e. within 60 days following the date on which information reported in the Form TA-1 becomes inaccurate, incomplete, or misleading. [NOTE: If the transfer agent's appropriate regulatory agency (ARA) is the SEC, the Form TA-1 must be filed electronically on the SEC's EDGAR system, with each answer formatted as an XML data tag. Transfer agents applying for registration with other ARAs, i.e. the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation, are not required to use EDGAR.]</p>	Compliance, with input from Operations and Legal
SEC Rule 17Ac2-2	<p>File an annual report with the SEC via Form TA-2, covering the calendar year January 1 to December 31. The Form TA-2 must be filed by March 31 of the year following the end of the reporting period. Regardless of the transfer agent's ARA, the Form TA-2 must be filed electronically on the SEC's EDGAR system, with answers formatted as XML data tags.</p> <p>Required TA-2 reporting elements:</p> <ul style="list-style-type: none"> a) Identification and reporting on use of service companies, or other transfer agents, in connection with the filing transfer agent's activities; b) Submission of annual data regarding compliance with turnaround rules; c) Submission of updated information about the transfer agent's business activities, including accounts administered, items received, turnaround performance, total amounts of funds distributed, and lost securityholder accounts. 	Compliance, with input from Operations
B. Federal Processing, Reporting, Recordkeeping, and Exemptions		
SEC Rules 17Ad-1, 17Ad-2, 17Ad-3, and 17Ad-4	<p>SEC Rule 17Ad-1 defines the relevant terms used throughout the federal transfer agent regulations, including "item," "transfer," "turnaround," "routine item," and "non-routine item."</p> <p>SEC Rule 17Ad-2 sets the basic performance standards for transfer agents. Among these are the requirement that transfer agents who are not acting as a registrar must turnaround within three business days of receipt at least 90% of all routine items received by the transfer agent during any month. If a transfer agent fails to meet the performance standards for turnaround set forth in Rule 17Ad-2 with respect to any month, it must notify the SEC (and the transfer agent's ARA if other than the SEC) within certain timeframes, provide certain data, explain the reasons for the failure, and identify the steps that have been taken to prevent future failures. Similar performance and</p>	Operations

	<p>notification requirements apply to transfer agents acting as a registrar. <i>[NOTE: While this matrix does not spell out all the requirements of SEC Rule 17Ad-2, the transfer agent's policies and procedures must be detailed enough to cover each of the specific requirements of SEC Rule 17Ad-2, and exactly how the transfer agent ensures compliance with all of those requirements. This NOTE is applicable to all regulations to which the transfer agent is subject.]</i></p> <p>SEC Rule 17Ad-3 provides limitations on the expansion of transfer agent activities if a transfer agent is unable to meet the minimum performance standards established by Rule 17Ad-2.</p> <p>SEC Rule 17Ad-4 provides certain exemptions from the turnaround, processing, and recordkeeping rules.</p>	
SEC Rule 17Ad-5	Generally requires transfer agents to respond within prescribed timeframes to certain types of written inquiries.	Operations
SEC Rule 17Ad-6 and 17Ad-7	<p>SEC Rule 17Ad-6 generally details what records every transfer agent shall make and keep.</p> <p>SEC Rule 17Ad-7 specifies the particular lengths of time for which the records described in SEC Rule 17Ad-6 shall be maintained.</p>	Operations, Legal, Compliance
SEC Rule 17f-1	SEC Rule 17f-1 requires transfer agents to report missing, lost, counterfeit, or stolen securities to the SEC or the SEC's designee. The Dodd-Frank Act of 2010 expanded SEC Rule 17f-1's reporting requirements to include securities certificates that are cancelled.	Operations
SEC Rule 17f-2	SEC Rule 17f-2 requires that transfer agents fingerprint, with certain exemptions, all partners, directors, officers, and employees.	HR, Legal, Compliance
C. Federal Recordkeeping and Safeguarding Rules		
SEC Rules 17Ad-8 through 17Ad-13	<p>SEC Rule 17Ad-8 requires clearing agencies, upon request, to provide securities position listings to issuers or transfer agents acting on behalf of issuers.</p> <p>SEC Rules 17Ad-9 through 17Ad-13 set forth various requirements and exemptions designed to ensure that transfer agents maintain appropriate internal controls, meet adequate levels of service and performance, and avoid adverse operational and financial problems that could harm investors, issuers, or other securities industry participants. The requirements include minimum standards for recordkeeping and minimum requirements for the safeguarding of funds and securities.</p>	Operations, Compliance
<p>NOTE: This transfer agent compliance matrix would continue in a similar manner, covering the Federal Issue-Specific Rules, Bank and IRS Regulations, SRO Rules and Requirements Applicable to Transfer Agents, and Regulation of Transfer Agents Under State Law.</p>		

Pitfalls to Sustainability

In designing your compliance manual, you need to **recognize** these **pitfalls**:

- Don't just copy the regulation, without documenting exactly what you are doing to comply with it. Make sure you include the who, what, where, when, and how. The applicable rules are the "why."
 - The "who" is not just the Chief Compliance Officer and the Compliance Department. Operational business units bear responsibility for performing the actual tasks necessary to comply with many regulations.
 - Many regulations have deadlines, and establishing a centralized **compliance calendar** is a helpful tool for dealing with the "when" of your compliance obligations. Pictured below is the beginning of a sample compliance calendar for a registered investment adviser:

MONTH	DATE	REQUIRED ACTIVITY
January	1/10/17	Quarterly Form 13H Large Trader filing
	1/15/17	Quarterly Form PF Large Liquidity Fund Adviser filing
February	2/14/17	a) Quarterly Form 13F Institutional Manager filing
		b) Annual Form 13H Large Trader filing
		c) Annual Form 13D amendment
		d) Annual Form 13G amendment
		e) NFA Form PR for year ended December 31
March	3/1/17	a) Quarterly Form PF Large Hedge Fund Adviser filing
		b) Initial Form PF filing (Large Hedge Fund Advisers with > \$1.5 billion in regulatory AUM as of December 31)
		c) Re-affirmation of CPO and CTA exemptions
		d) CFTC CPO-PQR Large Commodity Pool Operator Form filing
		e) IARD fees payment

- Be specific. A compliance manual is not one-size-fits-all. Yours must be specifically tailored to the size, nature, and complexity of **your** business.
- Don't just write the manual and put it up on a shelf, never to be seen again. A compliance manual needs to be **updated regularly**.

If you avoid these pitfalls, your compliance manual will be sustainable, and you will mitigate your regulatory and reputation risk.

A sustainable compliance manual makes good business sense!

CONTACT US

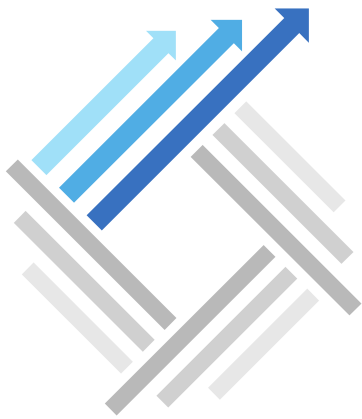
- PHONE**
- EMAIL**
- WEBSITE**

**Ellen McCarthy
CEO & Founder
Sustainable Compliance Strategies, LLC TM**

Website: www.strategiccompliance.com

Email: emccarthy@strategiccompliance.com

Phone: 917-608-8020



**SUSTAINABLE
COMPLIANCE
STRATEGIES, LLC**