The Evolving Role of the CCO

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What is a CCO?

Rule 206(4)-7 requires each adviser registered with the SEC to designate a **Chief Compliance Officer** to administer its compliance policies and procedures. An adviser's **Chief Compliance Officer** should be competent and knowledgeable regarding the Advisers Act and should be empowered with full responsibility and authority to develop and enforce appropriate policies and procedures for the firm. Thus, the compliance officer should have a position of sufficient seniority and authority within the organization to compel others to adhere to the compliance policies and procedures .

-Investment Advisers Act of 1940 (as amended February 2004):

Sidebar on Policies

- Intertwined with CCO Concept and Role
- Reasonably Designed
- Three W's
  - Who
  - What
  - When

What is a CCO?

- Practical Definition:
  - A compliance program director who oversees others in the firm from a compliance prospective and is responsible for the design, implementation, administration and testing of an adviser's policies and procedures.
  - Not a direct supervisor of individuals within the business units but an overall supervisor of compliance firm wide.
  - Key player in the identification, assessment, and mitigation of risks to the adviser at varying levels throughout the organization.
  - A resource which can be utilized by the various business units as a partner in the decision making process.

Positive Traits of a CCO

- Professional.
  - A CCO must be able to “walk the walk” and “talk the talk”. This is a profession, a “practice”, not a “job”. You are practicing compliance, just as an attorney practices law or a doctor practices medicine.
- Knowledgeable & Resourceful.
  - Possess the knowledge necessary to practice compliance by providing expert opinions to the business units to ensure decision making which includes compliance considerations. Know the business inside and out. Know the rules and how they apply to your business.
- Pragmatic.
  - Possess the ability to find the “middle ground” while ensuring compliance with regulatory requirements and facilitating needs of the various business units. Knows which battles are worth fighting and therefore gains credibility and respect.

Positive Traits of a CCO

- Intuitive/ Has a Curious Mind.
  - Always prepared to think outside the box to investigate hunches and explore gut feelings. Creates innovative tactics to investigate and gains involvement and recognition.
- Be a Problem Solver.
  - Identifies issues and always has a plan or multiple plans to solve an issue. There is usually more than one solution to every problem.
- Visible.
  - Makes a point to interface with all areas of the firm. Maintains constant interaction and communication with CEO.

Some Negative Traits of a CCO

- The “Rule Reciter”.
  - Meets every question with a response containing various rule numbers and legalese which is incomprehensible to many of the business units therefore causing the business units to dread speaking to the CCO. Further causing isolation and lack of understanding of the business by the CCO as they have been excluded from all conversations relating to risks.
- The “NO Man/Woman”.
  - Takes the approach that when there is any doubt just say NO. Can be known as a bully. Avoids the responsibility associated with investigating issues and problem solving. Does not propose alternative solutions, only provides a dead end. Results in decisions being made at the business level without compliance involvement or consultation. Inhibits the ability of Compliance to be proactive and creates a reactionary culture.

Some Negative Traits of a CCO

- The “YES Man/Woman”.
  - In fear of being disliked and/or proven wrong, takes the approach that it is not his/her place to say NO and goes along with all ideas presented. The CCO has become a pushover and now endorses anything that crosses their desk. He/She is quite popular with everyone in the firm but has created enormous liability for both him/herself and the firm.
- “Ignorance is Bliss”.
  - Chooses to look the other way, ignores gut instincts and pretends that if they do not know about an issue it is not theirs to solve. Sometimes avoids conversations with business people for fear of becoming aware of potential issues/risks. Results in the CCO ignoring his responsibilities.
- The “Chatterbox”.
  - Continually reveals confidential information in conversations with employees at varying levels within the firm. Does not understand the vital elements of confidentiality and trust inherent to the CCO position.
- The “Complainer”.
  - Complains to anyone who will listen about the trials and tribulations of being the CCO. Sometimes coupled with the “Chatterbox” and other times resulting in unnecessary confrontations and posturing.

The “Ideal CCO”

- The ideal CCO is more an “ideal situation” created by both the CCO him/herself and the firm.
- Every firm has specific needs and a unique culture.
- It is the CCO’s responsibility to demonstrate their value within the firm. This will foster a culture of compliance and the CCO will gain the “buy-in” from the CEO and others at the top. This will get the CCO a seat at the table when business decisions are being made.
- It is the firm’s responsibility to ensure that the CCO position is of sufficient authority and receives sufficient respect to effectively create a culture of compliance.

The "Ideal CCO"

- Acts as a Resource
- Understands the firm's business inside and out.
- Knows how to choose battles.
- Can isolate the "Grey Area" and function in uncharted territory while ensuring regulatory compliance.
- Can identify, prioritize and mitigate risks firm wide and industry wide.
- Can demonstrate the theoretical return to the firm/investors from compliance.

- Again, there is no Panacea, No “Ideal CCO” or “Ideal Firm.” There are varying levels of both.
- A culture of compliance must be created and maintained through a partnership between senior management of the firm and the CCO.
- A strong culture of compliance will foster cooperation from employees.

Question: How can you be an effective CCO and protect yourself from liability?

Recent SEC Actions against CCOs

- In the Matter of Prime Capital Services, Inc., et al., Admin. Proc. No. 3-13532 (Mar. 16, 2010)
- In the Matter of Pinnacle Capital Markets LLC and Michael A. Paciorek, Admin. Proc. File No. 3-14026 (Sep. 1, 2010)
- In the Matter of Theodore W. Urban, Admin Proc. No. 3-13655 (Sep. 8, 2010)
- In the Matter of The Buckingham Research Group, Inc., Buckingham Capital Management, Inc. and Lloyd R. Karp, Admin. Proc. File No. 3-14125 (Nov. 17, 2010)

Recent FINRA Actions against CCOs

- Westpark Capital, Inc. (May 6, 2010)
- Trillium Brokerage Services, LLC (Sep. 13, 2010)

Supervisory “Creep” & Liability

- Test is whether CCO has sufficient “responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue”
- Urban Facts
  - Legal and compliance opinions viewed as “authoritative”
  - Recommendations “were generally followed by people” in the business units
  - Member of the firm credit and risk committees that reviewed compliance concerns

Aiding and Abetting Liability

- Elements & Substantial Assistance
- Dodd-Frank Act amended Exchange Act and Advisers Act to provide for aiding and abetting liability for recklessness
- Examples
  - Failure to carry out representations in SEC exam reply
  - Failure to ensure that a firm corrected compliance problems even though aware of them
  - ADV inaccuracies

Whistleblower Complications

- The Dodd-Frank Act includes new whistleblower provisions
  - Designed to motivate those with inside knowledge
  - To come forward voluntarily and
  - Assist the SEC in identifying and prosecuting potential violations of federal securities laws
- Dodd-Frank Act requires the SEC to pay whistleblowers who voluntarily provide original information between 10% - 30% of monetary sanctions exceeding $1 million from a successful judicial or administrative action
- SEC proposed implementing rules in November 2010, which are still pending
- Dodd-Frank required the SEC to create a Whistleblower Office
  - In February 2011, the SEC appointed the head of the new office

Recent Examples

- Insider trading
- Quant Models
- Others

What to Do?

- Make sure WSPs or other documents
  - Designate a supervisor for each employee
  - Specify that compliance personnel
    - Offer recommendations
    - But do not have the responsibility, ability or authority to affect conduct of personnel outside their department
  - Specify the “Three Ws”, including “Who” is responsible for carrying out required functions
    - Any vacuum may flow back up to the CCO

What to Do?

- If compliance personnel have concerns about conduct
  - Escalate those concerns to appropriate supervisory personnel in the business
  - If misconduct is identified, identify which business line supervisor is responsible for handling the issue
  - Seriously consider self-reporting and other options
- Follow through on undertakings to regulators

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