JACKO LAW GROUP, PC

Legal Risk Management Tip
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COMMUNICATING REGULATORY COMPLIANCE MATTERS WITH YOUR CEO

Being a CCO is one of the most difficult positions within an organization. Not only do you need to have knowledge of every area of the firm, but you must be a leader. It is your responsibility to interface with senior management on a continuous basis. For many, you serve as a primary adviser to the C-Level executives. You may consult with them not only on regulatory compliance subject matters, but also, to a large extent, on new regulatory initiatives that may impact the business and its advisors. At other times, when new products and services are proposed, the CCO serves as a business consultant – providing both pros and cons to various initiatives.

Effective communications in any organization is essential; but effective communications to your CEO is an art and a skillset that must be developed over time. In this legal tip, we will provide guidance on the general characteristics of most CEOs, foundational matters that the CEO should be made aware of and how to effectively communicate those matters to reduce liability and formulate a strategic partnership with the CEO.

General Characteristics of a CEO

If you have ever taken a Myers Briggs personality test, you will learn that only a certain segment of the population fits the mindset of a CEO. Most CEOs have climbed their way to the top through hard work, competition and dedication. They excel at having a vision and rely upon their teams to execute that vision. Tirelessly, they work long hours, travel and always have their eye out on the next opportunity. It is the goal of every CEO to increase the bottom line through innovative thinking and providing a value-added proposition to consumers. They are entrepreneurs through and through and have taken great risks to be where they are at.

It is for that reason that sometimes compliance may clash with the CEO. Generally speaking, compliance is designed to be risk-adverse, which is contrary to the very mindset of the CEO, who may wish to take certain business risks to achieve a particular objective. At times the advisement that a CCO may provide can prevent certain initiatives from occurring, which may not be viewed favorably by other members of senior management.

Consequently, it is important for the CCO to know how to "manage up" to the CEO by keeping in mind that most CEOs desire:

- Tangible improvements (in the form of productivity, efficiency and profitability)
- Good ideas
- Organization and orchestration
- Coordination and teamwork
- Follow through and problem solving

Keeping this in mind, the CCO can approach compliance conversations by being logical, direct and offering solutions. During the conversation, discuss why, for example, purchasing technology to review potential insider trading abuses can improve efficiencies by allowing compliance staff to be more productive, accurate and thorough in their reviews. Explain that by implementing internal controls, such as a pre-trading compliance system, the firm can yield greater profitability by reducing errors, mitigating regulatory risks and meeting the increasing needs of its clients and consultant base.

Additionally, it is crucial for the CCO to build a strong relationship with the CEO early on. It is essential to be viewed as a reliable adviser to the business, rather than a cop on the beat. Establishing that relationship, however, takes time and persistence. You will need to communicate effectively and clearly, in a style that is personal to them.

Most CEOs are results-driven. They want to know if their investment in compliance is paying-off. Describe to them how their return on investment within compliance is reaping dividends – in the form of reduced customer complaints, lower compliance infractions and an overall impact in the culture of compliance within the organization.

Foundational Matters Your CEO Should Be Made Aware Of

The CEO is responsible not only for overseeing all aspects of the business, but for rainmaking and ensuring profitability of the enterprise. To that end, many CEOs may be on the road and not involved in day-to-day meetings regarding development and implementation of controls. For that reason, the CCO may wish to proactively establish periodic meetings with the CEO to inform him or her of material compliance initiatives, risk management concerns and resource needs for the maintenance and enhancement of the firm's compliance program.

For example, suppose that your organization is in discussions of lifting out a new portfolio management team in order for the firm to diversify its service offerings. In that scenario, the compliance initiatives may be:

- Considerations of what the firm must evaluate prior to the lift-out, such as non-compete and non-solicitation concerns
- Reviewing firm communications relating to this change with existing and prospective clients
- Contemplating portability issues related to the portfolio management team's performance track record
- Compliance review of proposed marketing materials related to the new portfolio offerings, including brand new disclosures and composite descriptions (as applicable)
- Authoring new client disclosures within Forms ADV
- Registration (as required) and background checks on the new portfolio management personnel
- Surveillance and other technology needs to conduct compliance reviews of the new strategies
- Compliance training for new personnel

The CEO should be aware of these initiatives, which help to set an expectation of how much time, effort and resources, both in the form of economic and human capital, compliance and other areas may need to facilitate the transition and rollout of a new product to its clients.

Another area to consider communicating to the CEO is material compliance infractions and violations that have occurred, with recommendations for the CEO to consider for potential disciplinary or other measures. For example, consider if while performing email surveillance, you detect that the head sales person has been creating last minute presentations and not submitting them to compliance for review prior to first use. Particularly if the head of sales reports directly to the CEO, you will want to inform the CEO of your findings, including any internal investigations you may be pursuing, with recommendations on how to best address the compliance infraction. Dependent upon whether this is a recidivist or one-time event, your recommendations may differ.

Effective Communications to Reduce Liability and Formulate a Strategic Partnership with the CEO

Being the leader of any organization means that the CEO is faced with direct liability issues. If the CEO has knowledge of a compliance infraction and either turns a "blind eye" or fails to take action, he or she can be cited with either causing or aiding and abetting the firm's violations and with failure to supervise. However, if the CEO does not have knowledge of infractions, it is impossible for him or her to fulfill fiduciary and regulatory obligations. As a result, there are several things that CCOs should keep in mind to effectively communicate with their CEO, which may in term help to formulate a trusted, strategic partnership over the long-term.

1. Set expectations with the CEO that compliance is everyone's responsibility and encourage him or her to be consistent when enforcing policies and procedures.
2. Be clear on how critical it is to the firm's success to have a culture of compliance.
3. Communicate regularly (at least monthly, and if possible, weekly) with the CEO regarding compliance topics.
4. Take time to develop a good understanding of the firm and its internal controls prior to proposing new alternatives.
5. When an issue arises, conduct your own internal review to ensure that there really is a problem before bringing it to the CEO's attention.
6. Learn the regulatory rules that govern your organization and be able to communicate their applicability in "plain English."
7. Come to meetings prepared with backup documentation for any compliance recommendation that you make.
8. Encourage the CEO to be involved in compliance trainings; that will show that the leader of the organization takes compliance and his or her duty to supervise seriously.

Conclusion

It is the wish of every CCO to be a strategic partner of the business and to do what he or she can to help shield the CEO (and the firm) from liability. To achieve this, encourage your CEO to:

1. Listen and take time to understand proposed compliance initiatives and the regulatory considerations behind the proposal;
2. Understand what supervisory responsibilities he or she has within the organization;
3. Take time to read and analyze the Annual Review report to better understand potential gaps within the firm's internal controls and compliance's prioritization areas; and
4. Have the CCO participate in new firm initiatives to provide guidance on how to implement new strategies in conformance with regulatory requirements.

For more information including other strategic ideas and considerations, please contact us at info@jackolg.com, or (619) 298-2880. Also, please visit our website at www.jackolg.com.

Author: Michelle L. Jacko, Esq., Managing Partner, JLG. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds, banks and corporate clients on securities and corporate counsel matters.