

## Using Compliance Training to Establish Compliance DNA—A Practical Approach

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For nearly twenty years, I served as general counsel of several public and private companies, including, most recently, a near six-year term as general counsel and chief compliance officer of an investment adviser with assets under management during my tenure ranging from \$6 billion to \$20+ billion. Having recently returned to private practice, I've had some time to ponder the role of Chief Compliance Officer (CCO) as I stand on *this* side of the relationship advising CCOs rather than *being* one. In this article, I discuss how the CCO of a registered investment adviser can use compliance training to evangelize and propagate the "culture of compliance" throughout the enterprise.

### *The Current Environment and 'Compliance DNA'*

Events of recent weeks including the Goldman Sachs hearings and the ongoing debate inside of Congress regarding meaningful financial reform demonstrate the extraordinarily intense and demanding environment in which financial services firms, including investment advisers and broker-dealers, currently operate. In response to well publicized industry scandals and frauds (both admitted and alleged), as well as financial markets crises, the SEC has also re-staffed, restructured and reassessed the way it pursues examinations and enforcement actions. Additionally, the white-hot spotlight of the media continues to hone in on financial services firms for any hints of impropriety or ill-gotten gains (real or apparent). Finally, investors and the plaintiffs' bar have also sharpened their focus on compliance and the manner in which investment advisers and broker-dealers operate their business. In this environment, the pressure on CCOs to develop and maintain robust compliance programs is greater than ever. For these reasons, and the increasing recognition that compliance failures translate into a deterioration of reputation and enterprise value (irrespective of investor losses), the role of CCO must evolve (if it hasn't already) from that of a lightly regarded (and necessary evil) bureaucrat, to that of a highly valued member of senior management with the concomitant expansion of authority and visibility throughout the enterprise.

In remarks made to investment adviser CCOs at the National CCO Outreach program in January 2010, Carlo V. di Flori, Director of Compliance Inspections and Examinations at the SEC, made the following remarks regarding compliance and ethics programs maintained by investment advisers: "I believe [such programs] need to be ingrained in the DNA of the organization and the decision-making framework of the

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organization.<sup>1</sup> They need to be imbedded in the business process and at the table when strategic decisions are being made and new products are being developed.... And, they need to be part of the way business is done." By developing compliance training that is well-designed, effectively presented and systematically reinforced, the CCO can play an important role in institutionalizing the "culture of compliance," and foster the *enterprise DNA* in which business operations and compliance policies and procedures are seamlessly integrated.

### *Compliance Training and The CCO as Evangelist*

In order to cultivate a workplace that appropriately values, and can effectively demonstrate its commitment to compliance, the CCO cannot function as a "check the box" bureaucrat hidden away in an obscure office. Instead, the CCO must *walk the beat* and evangelize compliance on a daily basis, performing his or her role as a business leader who is actively engaged with staff in all functional departments at all levels within the enterprise. This active engagement by the compliance function generally, and the CCO in particular, begins at the inception of the employment relationship. The compliance function should be introduced to new employees as they literally *walk through the door*. Thereafter, compliance must maintain a continuing dialogue, formal and informal, as the business evolves, as employees' roles change, as new employees join and others depart, and as policies and procedures are adopted or modified in response to new laws, rules, regulations and other developments.

### *New Employee Introduction to Compliance—The Initial Compliance Package*

The CCO's role as *evangelist* begins when new employees are introduced to the firm as part of a formal or informal orientation process. New employees draw many inferences from the way the orientation program is conducted, and specifically the way the compliance program is presented. New employees must be presented with a package of materials that is comprehensive, comprehensible, pleasing in appearance and design, and that reflects the level of priority that compliance occupies at the firm. For registered investment advisers, these materials will generally include (1) the compliance manual and code of ethics, (2) the initial holding report and other conflicts disclosure form(s), (3) the Form ADV, Part I, Item 11 disclosure questionnaire (covering disciplinary history), and (4) the compliance manual acknowledgement. A representative of human resources or compliance should present these materials with a brief explanatory memorandum or slide presentation summarizing key compliance issues and the manner in which the materials must be reviewed, acknowledged, returned and/or retained. It is the CCO's responsibility to ensure that the initial compliance package is properly assembled and presented, that questions can be promptly and clearly answered and that a process is in place to document the manner in which the compliance orientation process is conducted and the requisite compliance forms are completed and returned.

### *New Employee Training*

Promptly after an employee's start date, the CCO (or an appropriately senior compliance representative) should conduct formal new employee compliance training. Whenever possible, the CCO should have a representative of senior management participate in these training sessions to reinforce the importance of

compliance within the organization. As always, senior management sets the tone, so participation by the CCO (or other senior compliance representative) and a member of senior management reinforces the notion that the investment adviser appropriately prioritizes and values compliance.

New employee training should focus (with appropriate degrees of granularity) on compliance concepts that are applicable to the general employee population irrespective of each employee's particular job responsibilities, primarily those policies and procedures contained in the investment adviser's code of ethics. Training should emphasize the investment adviser's commitment to compliance, discuss in detail the concept of fiduciary duty and how that duty manifests itself in the firm's business operations, and summarize the regulatory framework governing the activities of the investment adviser<sup>2</sup> and the infrastructure that has been established to address compliance matters. Compliance should lead new employees in a practical exchange of ideas concerning conflicts of interest (personal and institutional), as it may not always be evident where duties are owed and what course of conduct is appropriate in any one particular fact pattern. In all cases, the goal is to ensure that all employees are sufficiently knowledgeable to identify conflicts of interest, and vigilant to raise them with the CCO to ensure that the conflicts are addressed in a deliberate and responsible way. Additionally, new employee training should include practical information and guidance regarding subjects including (1) insider trading (personal securities trading and reporting, outside activities, access to and use of material, non-public information), (2) political contributions and gifts/entertainment restrictions, (3) electronic communications, (4) investor privacy, (5) anti-money laundering and (6) business continuity and disaster recovery.

The process by which new employee training materials are prepared and presented is not as daunting as it may first appear. Professional advisers such as attorneys and compliance consultants can often provide templates addressing generally recurring issues faced by investment advisers. With a modest amount of work and consultation with advisers and/or business unit representatives, these templates can be customized to reflect the particular operations and policy choices made by the investment adviser. Alternatively, or in addition to these templates, the CCO may also choose simply to "cut and paste" sections of the compliance manual into bullet points so that the most important policies and procedures can be presented in digestible portions that incoming employees at all levels of sophistication can readily comprehend.

The process of preparing compliance training materials is an iterative one. These materials will improve significantly over time as changes are made based on feedback received at the training sessions and as a result of ongoing review in connection with the introduction of new investment products, changing market conditions and/or legal or regulatory developments. While the preparation of a comprehensive, high quality new employee training program may entail a meaningful investment of time and/or money up front, these templates can be continually refined for use in other applications including more targeted investment staff training, and thereafter for increasingly narrow audiences such as investor relations/marketing staff, operations staff, as well as finance and accounting staff. Additionally, these materials can be repurposed for other applications, including investor due diligence or SEC examinations as further discussed below.

*Investment Staff Training*

As part of a dynamic and effective compliance program, the CCO should develop training presentations customized for investment staff<sup>3</sup> focused on the policies and procedures that govern the manner in which they carry out their particular roles and responsibilities. In addition to an expansion of the subjects covered in new employee training, investment staff training should cover pertinent operating procedures such as the investment approval process, insider trading prohibitions, valuation guidelines, preparation and retention of marketing materials, and delegation of authority inside the business unit and throughout the enterprise. In my experience, the new employee training template served as a good starting point for the more focused investment staff compliance training with additional materials culled from the compliance manual, as well as recent cases and/or enforcement actions, or news stories. As with new employee training materials, a properly constructed investment staff compliance template can be used for several years and revised and refined periodically as business and regulatory changes dictate.<sup>4</sup>

The CCO should view compliance training as an opportunity to present information that helps *connect the dots* between the *theory* of compliance as reflected in the written policies and procedures and the *reality* associated with (actual or alleged) improper conduct. The kind of information that most resonates with investment staff includes recent news articles and actual complaints filed in high-profile cases, all of which can be presented in slides or as exhibits to the compliance training presentation.<sup>5</sup> For example:

- When presenting policies governing insider trading in violation of personal securities trading policies, I presented a case in which regulators accused a married couple of working together to execute trades using insider information and using personal emails to exchange material, non-public information and effect trades.
- When presenting policies and procedures governing insider trading and misappropriation of material, non-public information in client fund trades, I presented enforcement actions brought against investment advisers who traded on material non-public information gained through participation on steering committees or portfolio company boards or through information received as a result of payments made to corporate insiders.
- When discussing policies and procedures relating to electronic communications, I presented various actions brought against investment advisers, portfolio managers and investment banks where emails are featured prominently in the complaint.

Presentation of these cases helps to crystallize the risk of violating compliance policies and procedures in the minds of participants and encourages frank discussion regarding the issues raised in the cases and the safeguards adopted by the investment adviser to address them. These discussions help to socialize compliance policies and procedures and serve to embed the importance of compliance in the *hearts and minds* of the participants in the meeting. In that way, training not only plays an important role in evangelizing the compliance program, but also positions the CCO as a trusted advisor who enables the investment adviser and its staff to avoid bad outcomes in connection with the conduct of its investment activities.

### *Additional Training*

In order to extend the compliance function deeper into the organization, CCOs should continue to refine the compliance training templates to emphasize areas of particular concern to increasingly narrow constituencies including investor relations, operations, and finance and accounting staff. For instance, training of investor relations staff should focus on issues such as (1) Rule 206(4)-1 anti-fraud provisions and the investment adviser's internal review of marketing materials including Clover no-action guidance,<sup>6</sup> (2) Regulation D and the rules against marketing in a manner that could jeopardize the registration exemption of an investment fund including general solicitation; and (3) maintenance of books and records under Rule 204-2(a), including retention requirements in respect of investor communications and the determination and presentation of investment performance.

### *Other Applications—Investor Due Diligence and SEC Examinations*

Over the last several years, investors have continued to sharpen their focus on compliance and the manner in which investment advisers operate their business. In my experience, I found it helpful to show investors excerpts of the firm's training materials so that they could *touch and feel* the compliance program and gain comfort that the investment adviser was appropriately committed to compliance. Presumably, the training materials would send a similar message to examiners in the context of an SEC examination. By producing a coherent package of well-designed and well-conceived training materials (including documentation of the dates upon which training was conducted and the employees who participated), the CCO demonstrates to regulators and investors alike the seriousness of the investment adviser's compliance efforts.

### *Continuing Socialization, Reminders and a Compliance Intranet*

In addition to ongoing compliance training, the CCO can reinforce policies and procedures in a systematic way by preparing and distributing recurring compliance reminders and establishing a compliance intranet. The CCO should itemize the most significant ten to twenty compliance policies pertinent to the adviser's business and determine the frequency with which reminders should be distributed throughout the firm. The reminders should consist of (1) a subject line stating the name of the policy, (2) a bullet point short-hand description of the policy and (3) a copy of the full policy as it appears in the compliance manual. The CCO's challenge in using automated reminders to evangelize the compliance program is balancing the desire to circulate enough reminders with sufficient frequency to socialize the program, but not so many reminders with so much frequency that the reminders are disregarded. CCOs should consider distributing the most important reminders quarterly while circulating lower priority reminders semi-annually or annually. In certain cases, the CCO may determine that a formal response to the notice or inquiry is required and should therefore construct the reminder with a demand that the recipient provide a one word response (*i.e.* "Yes," "No" or "Confirmed"). Additionally, the CCO should work with information technology staff to establish a compliance intranet where important compliance materials (compliance manual, reporting forms, training materials, links to applicable law, etc.) are easily accessible at all times.

*Back to the DNA*

While administering a dynamic and effective compliance program is a challenging proposition for a CCO, the task can be made easier by developing a training and evangelism program designed to ingrain compliance into the DNA of the organization. The CCO accomplishes this by greeting new employees upon their arrival at the firm and by inculcating them into a *program* where compliance is communicated, reinforced and socialized on a systematic and continuous basis. Effective compliance training and the ongoing refinement of the platform by which compliance policies and procedures are socialized allows the CCO to foster an environment where the awareness and appreciation for compliance is reflected in the way that employees carry out their day-to-day responsibilities. Effective training instituted by financial services firms will serve to strengthen compliance DNA at these firms and help stem the tide of recent abuses, improve protection for investors and preserve or restore the integrity of the capital markets.

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<sup>1</sup> Speech by SEC Staff: Remarks at the CCO Outreach National Seminar by Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations (Jan. 26, 2010)

<sup>2</sup> The regulatory framework governing registered investment advisers includes the Investment Advisers Act of 1940, the Securities Act of 1933 and the Securities Exchange Act of 1934 and the rules and regulations promulgated pursuant thereto.

<sup>3</sup> At larger advisers which pursue multiple strategies, training for investment staff may involve customized training for each strategy. Presumably, the core training materials will be the same for each strategy with nuances or particular policies and procedures which are unique to the pertinent strategy.

<sup>4</sup> Compliance training must be reinforced systematically. Depending on the size of the firm, compliance training should be updated and conducted no less than annually or semi-annually, if possible, or otherwise based on changes in the market, the regulatory environment or in the products and services offered by the investment adviser.

<sup>5</sup> CCOs are likely to find that a picture truly is worth a thousand words and that images of the complaints filed in high profile cases, and pictures of notorious *perp walks* conducted in connection therewith, helps to focus and direct the presentation.

<sup>6</sup> Rule 206(4)-1 of the Advisers Act defines what constitutes a fraudulent, deceptive, or manipulative advertisement. Clover Capital Management (October 28, 1986) is the seminal no-action letter in which the SEC provided guidance on the use actual and model performance in advertisements.