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summaries

SIGMA INVESTMENT COUNSELORS

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Compliance – Serious Business

New rules and regulations seem to be the bane of existence for many people associated with the investment profession. The US Securities and Exchange Commission (SEC), Department of Labor and Congress, have all issued laws within the past few years that have left many advisors frustrated. The cost of complying with these policies and procedures can become almost prohibitive and may cause some firms to leave the industry. So why would these burdens be placed on registered investment advisors and registered advisory firms alike? One does not have to go very far to figure out the answer. Individuals like Bernard Madoff, and years before him, Charles Ponzi (the namesake of the "Ponzi" scheme), have tainted the industry.

Congress created the Investment Advisers Act of 1940 (the Act) to try to eliminate the various abuses that had taken place in the profession during the 1920s and 30s. By regulating the securities industry and the employees thereof, it was assumed that these individuals would not only abide by the law but that it would leave little room for them to refuse to comply. One of the basic tenets of the Act is that an investment adviser, as a fiduciary, may not engage in any activity that is fraudulent, deceptive or manipulative. The adviser must place the client's interest above his/her own. Any investments selected for the client must meet strict criteria. All conflicts of interest (if any) must be disclosed to the client. The adviser must seek "best execution" in all client transactions. In a nutshell, the adviser/advisory firm must act in an honest and ethical manner.

Unfortunately, over the years, the Act has had to be amended because of blatant disregard, differing interpretations, and loopholes, among other things. For example, in the 1963 case, "SEC v. Capital Gains Research," individuals that produced and published "A Capital Gains Report", a subscribed-to service, bought stock in companies that they subsequently recommended to readers of the report. After the report was issued and the market price of the stock rose, which happened every time within a few days after the distribution of the report, the individuals that produced the report would then sell their shares at a profit. By not disclosing this practice to their subscribers, it was determined by the SEC that these individuals were engaging in a fraudulent and deceitful manner, which is illegal under the Investment Advisers Act of 1940. The respondents argued that "Congress could have made, but did not make, failure to disclose material facts unlawful in the Investment Advisers Act of 1940" and that "their advice was honest in the sense that they believed it was sound." Hmmmm…

I regularly consult the website, www.sec.gov , which is the official website of the SEC, and receive updates from the agency on a daily basis. Some recent examples of cases brought include: "SEC Charges Ponzi Scheme

Promoter Targeting Primarily African-American Churchgoers", "SEC Charges South Florida Man in Investment Fraud Scheme" and "SEC Charges Four Brokers with Defrauding Customers in $18.7 Million Scheme." In fact, since 2010 alone, there have been more than 100 enforcement actions brought by the SEC for misconduct as it relates to investor scams. After reading case after case of individuals charged with lying, cheating and stealing, it reasonably makes one wonder why there aren't even more regulations!

The Investment Advisors Act was amended twice in 2004 when the SEC adopted new rules that required registered advisers to adopt and implement policies and procedures "reasonably designed" to prevent violations of the Act and a code of ethics that required an adviser "to set forth standards of conduct and require compliance with federal securities laws." Strangely, this seems just a given. Why would new rules have to be created to tell one to be honest, to do what is right, and to follow the previous law? Did the aforementioned Act not state that advisers were not to engage in manipulative, deceitful, or fraudulent activities? Advisers needed another reminder? Yes, guidelines are appropriate; a manual that tells one what the rules of engagement are. But, another manual to tell one to follow the first manual is not necessary.

We take our compliance effort very seriously. Not only do we want to stay in good standing with the SEC, we want our clients to know that their assets are protected, that personal information remains confidential, that our clients' interests come before our own, and that we are following the law. We reinforce these standards through internal educational meetings, case studies and a system of checks and balances to gauge our success.

For more information regarding our compliance efforts, feel free to contact us and we will be pleased to address any questions you may have.

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