

## How Mutual Fund Boards Should Take CARE of their CCOs

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The role of a mutual fund's Chief Compliance Officer was partially devised to assist the board in the execution of their duties. Principle among them is to ensure that the Fund complies with the Securities Laws. In many ways the CCO is the eyes and ears of the fund directors. And in return, the fund board has an obligation to guide, monitor and support their CCO.

The purpose of this article is to describe the ways in which the mutual fund directors can accomplish this. Like any good manual their responsibilities can be summarized with an acronym. For this subject matter it is, "CARE."

- **C for CLEAR** responsibilities. These should be stated in the CCO's annual plan or somewhere similar. These duties are often summarized at the highest level as simply "to detect, prevent and correct" violations of the Securities Laws. This description is so general that it is not particularly helpful in providing a guideline for daily operations. The CCO must translate this stated responsibility to effective procedures – and the fund board must help and guide this all-important effort.

One of the most efficient and comprehensive methods to define CCO responsibilities and identify possible areas of risk is to develop a process map that starts at the solicitation of potential customers and then follows the shareholders' money from investment to redemption. Superimposed on this map are areas where risk is apparent, usually grading varying levels of risk exposure.

From this risk map the CCO can sensibly prepare his or her Annual Compliance Plan, emphasizing the areas of greatest exposure. The map can also be used to refine the scope of the annual audit. Procedures can be put in place that allow for check and balance oversight for the CCO, and at the conclusion of the plan the risk should be modified to show "residual risk," which then provides the fund board with a guide for best allocating their time.

- **A for AUTHORITY.** The board should empower their CCO with their authority so that he or she can establish needed procedures and gain access to necessary information. The responsibilities of the CCO require diligent monitoring and active cooperation within the advisor organization. A CCO cannot succeed unless he or she can build on a culture of compliance set from the very top of the advisor organization, and motivate others to cooperate with agreed compliance procedures.

Investment management firms often either have a wholly centralized compliance function or a system of decentralized compliance scattered throughout the organization. The more common compliance philosophy is "decentralized compliance: centrally monitored" where the CCO represents the central monitoring authority. However the compliance function is structured, without the active support of the fund board, the CCO may not be able to be effective.

- **R for RESOURCES.** There is a common interest with the management company to “detect, prevent and correct” violations of the Securities Laws, however the fund board needs to ensure that the CCO has the necessary staff and organization to accomplish this task. In addition the board must ensure that the CCO is sufficiently well paid and respected and that he or she is motivated and retained in the position.

Because of the recently changing role, and increasing responsibilities, a CCO may be paid more than his or her pay grade would indicate. This also may be because the CCO does not receive a bonus, or equity participation, or even the same promotion potential. Because fund management companies make efforts to keep expenses low and not disturb the implementation of human resource policies throughout the firm, there may be situations when the fund director has to intervene on the CCO’s behalf.

In addition to ensuring that the CCO has the appropriate support staff, the board has the initial task of selecting the appropriate individual to fill the CCO position. The board does a disservice not only to the funds and themselves, but to the CCO as well, if the needed skills and qualifications for the specific role are not identified and fulfilled. As the role of the CCO has taken on greater responsibilities since 2004, the personal and professional characteristics that are needed to be successful at the position have also changed, and the board has to identify these traits and hire accordingly. In addition to having extensive knowledge of the Securities Laws, it is often imperative to have distinctive personal characteristics, including independence of thought, strong interpersonal skills and conflict resolution capabilities.

- **E for EXPECTATIONS** and deliverables. The board should ensure that the CCO knows what daily activities, weekly events, and periodic and annual reports are expected. These responsibilities and procedures must be agreed upon and communicated with management to create an environment that allows for a cohesive process. The fund board should participate in the decision-making about which committees the CCO should sit on. In particular the board (in conjunction with counsel) should also delineate the reports and summaries that are required to support the periodic board meetings.

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The CCO is an important asset for the fund board and its members should take CARE that their CCO has clearly defined duties, has the authority required to do the job, receives the necessary resources and shares reasonable expectations of the deliverables required.

*Management Practice Inc. is a boutique consulting firm in Stamford, CT which provides fact based analysis, trends and comparisons for mutual fund directors and their supporting infrastructure.*