

Compliance Review

Ongoing compliance updates for independent advisors

February 2018

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What has changed: New considerations for serving aging clients

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I. Introduction

As people's awareness of how to live a healthier lifestyle continues to grow and our health care improves, our older population in the United States (i.e., persons 65 years of age and older) has dramatically increased. This has profound implications for investment advisors, their clients, and the custodians, such as Schwab, who serve them.

In our July 2016 [Compliance Review](#) white paper, we provided guidance on considerations for how to service aging and vulnerable clients. Much of that white paper still applies, particularly in terms of understanding and recognizing signs of diminished capacity, assisting clients who exhibit cognitive decline, and considering regulatory statements and actions outlined therein. We refer you to that earlier white paper (found on schwabadvisorcenter.com) and will not repeat all of its contents here.

Since that time, the regulatory landscape has continued to evolve. Numerous states¹ have actively proposed or adopted senior legislation, including provisions regarding self-reporting and training, and more states are expected to follow suit in 2018. Moreover, the Securities and Exchange

Commission ("SEC") included senior investors in its 2017 examination priorities.² This focus is expected to continue into 2018.

Additionally, two new Financial Industry Regulatory Authority ("FINRA") rules that go into effect February 5, 2018, will directly impact broker-dealers and those investment advisors who transact through broker-dealer custodians, such as Schwab.

This white paper picks up where the last paper left off. Regulators' awareness and expectations have increased, and a growing number of investment advisors have incorporated new best practices to address their clients' needs. It all starts from the fact that as investment advisors, you have a fiduciary obligation to act in your clients' best interests at all times. How you do that must change as your clients age. Failure to do so could fall short of your regulatory obligations and, more importantly, lead to suboptimal outcomes or harm to your aging clients and your firm.

We will start with an overview of the new state laws that apply both to investment advisors (more specifically, to your

¹Currently, senior legislation has gone into effect in Alabama, Arkansas, Colorado, Delaware, Indiana, Louisiana, Maryland, Mississippi, Missouri, Montana, North Dakota, Oregon, Tennessee, Texas, and Vermont. Mandatory training is required in Connecticut, New Mexico, and Washington. For more information, visit ServeOurSeniors.org.

²U.S. Securities and Exchange Commission's Office of Compliance Inspections and Examinations, [Examination Priorities for 2017](#) (January 12, 2017).

investment advisor representatives [“IARs”] in those states, whether or not your firm is state-registered) and broker-dealers. We will also focus on the SEC’s recent approval of FINRA’s amendment to the Customer Account Information rule (Rule 4512), the newly created Financial Exploitation of Specified Adults rule (Rule 2165), and the impact these new rules will have on you and your clients. We will offer insight into the regulatory expectations for FINRA members, the changes being implemented by Schwab, and what to expect if you must self-report a suspected financial exploitation matter to the state. The paper ends with a review of the best practices advisors should consider adopting in addition to regulatory compliance. These include updating your investment manager agreements and understanding your obligations and how they change if your client has granted a third party a durable power of attorney in the event your client becomes incapacitated.

II. Changing regulatory expectations

State legislation

NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation (Adopted January 22, 2016)³

In January 2016, the North American Securities Administrators Association (“NASAA”) announced that its membership had voted to adopt a model act, which applies to adults age 65 or older and individuals who qualify for protection under a state Adult Protective Services statute. The model act was designed to be considered by state regulatory agencies for serving and protecting senior investors, and to give industry participants and state regulators new tools to help detect and prevent financial exploitation of vulnerable adults. The model act, which applies to state-registered investment advisors and those IARs conducting advisory services within that state, requires certain qualified individuals⁴ of investment advisors and broker-dealers who reasonably believe that financial exploitation of a vulnerable adult is being attempted to promptly notify Adult Protective Services and their state regulator. Further, it enables investment advisors and broker-dealers to delay disbursements from an account of a vulnerable adult if financial exploitation is suspected. Finally, it allows qualified employees of investment advisors and broker-dealers to provide relevant records of the financial exploitation to relevant authorities. The model act also provides immunity from administrative or civil liability for investment advisors and broker-dealers who take actions permitted under the act.

The model act is currently available to NASAA members for consideration in their jurisdictions and may be adopted as legislation during state legislative sessions or implemented by regulation. As mentioned previously, a number of states have actively proposed or adopted senior legislation, which includes provisions regarding self-reporting and training.

NASAA also released a paper titled *Guarding the Guardians: The Red Flags of Guardian Financial Abuse* on October 30, 2017,⁵ in an effort to highlight financial abuse perpetrated by financial guardians and trusted contacts. The paper highlights the red flags to look for when identifying abuse by financial guardians, including:

- Using guardianship authority to transfer property for the benefit of the guardian
- Receiving personal payments without legal permission
- Authorizing frequent withdrawals without reasonable explanation

TIP: Review [Guarding the Guardians: The Red Flags of Guardian Financial Abuse](#) for information about servicing vulnerable adults and for help identifying what to consider for this specific type of financial exploitation.

New regulatory guidance

While advisors may not be associated with a broker-dealer and therefore subject to FINRA regulations, it is nevertheless noteworthy to keep in mind this guidance, which could serve as best practices for advisors to consider when developing compliance controls. Due to new FINRA requirements, broker-dealer custodians, such as Schwab, are directly impacted and must evolve the way they service advisors and their customers. By consequence, there will be new procedures and requirements for advisors.

New FINRA Rule 2165: Financial Exploitation of Specified Adults⁶

On February 3, 2017, the SEC approved the adoption of FINRA Rule 2165 (Financial Exploitation of Specified Adults)⁷ to provide safeguards to FINRA members (“member[s]”) in the event that a member suspects financial exploitation of certain specified adults. Pursuant to this new rule, a member can place a temporary hold on the disbursement of funds or securities of a “specified adult”—particularly an adult over age 65, but also someone over 18 who has a mental or physical impairment that renders the individual

³ [NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation](#) (January 22, 2016).

⁴ The model act defines “qualified individual” as broker-dealer agents; investment advisor representatives; those who serve in a supervisory, compliance, or legal capacity for broker-dealers and investment advisors; and any independent contractors that may be fulfilling any of those roles.

⁵ Regulatory Compliance Watch, “[Guardian Financial Abuse ‘Red Flags’ Highlighted by NASAA](#),” *IA Watch* (November 9, 2017), pp. 3, 5.

⁶ Financial Industry Regulatory Authority Regulatory Notice 17-11, [Financial Exploitation of Seniors: SEC Approves Rules Relating to Financial Exploitation of Seniors](#) (March 2017), pp. 9-11.

⁷ Financial Industry Regulatory Authority Regulatory Notice 17-11, p. 1.

unable to protect his or her own interest—if the member has a reasonable belief that financial exploitation⁸ has occurred. In the event a hold is placed, the member must:

- Provide notification, including the reason for the hold, to the trusted contact and customer no later than two business days after the hold was placed;⁹
- Retain records of the notification;
- Barring certain exceptions, expire the hold within 15 business days¹⁰ after the hold was placed; and
- Adopt written supervisory procedures and a training program relating to the placement of such holds on a customer's disbursement of funds or securities.

Amendments to FINRA Rule 4512: Customer Account Information¹¹

Effective February 5, 2018, an amendment to FINRA Rule 4512 (Customer Account Information)¹² will go into effect to require protocols for making reasonable efforts to obtain the name and contact information of a “trusted contact.” Under this amendment, FINRA will now require member firms (such as Schwab) to make a reasonable effort to obtain the name and contact information for a trusted contact person upon the opening of a non-institutional customer account and whenever updating account information. Procedurally, what this means is that when opening an account, a financial advisor should obtain the name of a trusted contact who could be contacted by the member

(i.e., Schwab) and the advisor¹³ in the event that financial exploitation is suspected. In turn, the member will disclose in writing to the customer during the account opening process that the member and the advisor are authorized to contact the trusted contact and disclose information about the customer's account to:

- Address potential financial exploitation issues.
- Confirm the specifics of the customer's current contact information.
- Obtain health status.
- Acquire the identity of a legal guardian, executor, trustee, or power of attorney holder on the account.

Notably, this disclosure will be provided whether a trusted contact name is provided or not.

Schwab is making changes that may impact you and your clients

Because the new FINRA Rule 2165 and amended Rule 4512 impact broker-dealers, Schwab will be implementing changes to align with the requirements of the rules. These changes may impact your firm and your clients. For more information, please reference Schwab's Senior and Vulnerable Investor Program [FAQs](#) on schwabadvisorcenter.com.

What if the client asks the advisor to be a trusted contact? May he or she do this?

A client is not precluded from listing an individual at his or her advisory firm as a trusted contact. However, this will not help either the advisory firm or custodian in terms of offering a source of additional information in the event diminished capacity or financial exploitation is suspected. Under the NASAA model act, an investment advisor “may notify any third party” the client has designated in advance about potential concerns regarding financial exploitation. The advisor would not seem to qualify as a “third party.” Moreover, you must consider and weigh the following:

- Did you make reasonable efforts to secure “other” trusted contact names before naming yourself?
- Are you prepared to take action? As a trusted contact, you will be notified if there is a suspicion of financial exploitation. You must then actively take steps to protect the client.
- Can you identify the red flags? Most advisors do not have a medical background. You will need to become familiar with the warning signs of dementia and financial exploitation and develop standard operating procedures in this area.
- Are you comfortable with having additional responsibilities and potentially enhanced liability to potentially care for the designated client? (Discuss with counsel.)

⁸ Financial exploitation includes unauthorized taking, withholding, appropriation, or use of a specified adult's funds or securities, or an act of deception, intimidation, or undue influence over money.

⁹ An exception to this exists if the suspect in question is the trusted contact, in which case notice need not be provided to said trusted contact.

¹⁰ An exception to this exists if, as a result of a court order or internal review, the member's suspicions were supported, in which case an additional 10-business-day hold may be added by the member to help protect the customer.

¹¹ Financial Industry Regulatory Authority Regulatory Notice 17-11, pp. 12-13.

¹² Financial Industry Regulatory Authority Regulatory Notice 17-11, pp. 12-13.

¹³ Advisors are encouraged but not required to contact the trusted contact with a Schwab representative. For more information, please visit schwabadvisorcenter.com.

III. Special considerations

As the regulatory guidance outlined previously makes clear, it is imperative for firms to evaluate their business model to determine how to address working with elderly clients. While there is not a one-size-fits-all approach to this process, there are certain aspects that should be considered by any financial firm in this regard. Some of the more prevalent considerations are discussed here.

The age and life stage of the client

This seems obvious, but considering the age and life stage (whether pre-retired, semi-retired, or retired) goes to the heart of the matter when working with senior clients. Thus, how an advisor approaches working with his or her clients will change as that client ages. While the exact number will differ, firms should include as part of their policies when the firm considers a client to be “elderly.” This age typically ranges from 60 to 75 dependent upon applicable state law, but by establishing the number, the firm can clearly determine when a client is subject to the “elderly client policies” of the firm. To be clear, some clients will be subject to these policies prior to reaching the established age due to a variety of issues such as illness or injury. The firm should also develop policies that provide for regular monitoring of those clients who are approaching or exceed the pre-established elderly age. The policies should focus on recognizing signs of diminished capacity and/or elder abuse.

Regulatory focus areas

Firms should always pay special attention to those client interactions that are repeatedly focused upon by regulatory agencies. Such interactions include, but are not limited to:

Types of securities purchased for a retiree

While risk of elder financial abuse is not limited to certain kinds of financial products, the types of securities that are purchased for senior clients are still of particular importance to regulators. Firms should have policies that dictate the types, and concentration, of securities available to elderly clients. Furthermore, should elderly clients specifically request types of securities that would not normally be purchased for such clients—such as securities that involve lock-up periods or are of increased risk—the

firm should have policies that govern how it should handle such requests.

Suitability of recommendations to senior investors

Every financial firm managing or purchasing assets on behalf of clients needs to have policies concerning suitability that dictate how the firm determines whether any transaction is appropriate for a client based on the financial situation of that client. However, firms tend to overlook tailoring such policies to specifically account for a customer's age or life stage, factors that can dramatically alter a client's goals, objectives, and risk tolerance. In this regard, firms should consider establishing additional policies for elderly clients that specify, among other things, (1) the gathering of additional client information (e.g., employment status, income requirements, health care insurance status, etc.),¹⁴ (2) setting strict firm investment concentration guidelines for senior investors, and (3) developing policies firm personnel are to follow to ensure that strategies are being fully explained and understood by senior investors.

Communications and/or advertisements targeting older investors

Advertisements distributed by financial professionals are subject to an array of rules and regulations dependent upon the governing body overseeing such professionals. While such rules do not specifically delineate between advertisements geared toward senior investors and any other investors, firms should be cognizant of whom their advertisements are designed to target and whether additional disclosures may be required as a result. For instance, advertisements that focus on retirement planning, long-term care insurance, wealth preservation, and wealth transfer are dominant themes in advertisements used to attract senior investors.¹⁵ Firms should develop policies to ensure that any such communications have disclosures that are clear to the elderly individual most likely to receive and review the communication. Furthermore, such policies should provide clear instruction as to the approval process any communication must receive.

Compliance program factors

Financial firms should adopt and implement a compliance program and controls geared toward the risks and

Looking for more information on compliance or regulatory issues?

Schwab's compliance website includes a searchable database, compliance tools, and many other resources to assist you. Visit [schwabadvisorcenter.com](https://www.schwab.com/advisorcenter) > News & Resources > Compliance. (See “Online compliance resources” on last page for more information.)

¹⁴ See Financial Industry Regulatory Authority Regulatory Notice 07-43, *Senior Investors: FINRA Reminds Firms of Their Obligations Relating to Senior Investors and Highlights Industry Practices to Serve These Customers* (September 2007), for further recommendations on questions to ask senior investors.

¹⁵ The Securities and Exchange Commission's Office of Compliance Inspections and Examinations, and Financial Industry Regulatory Authority, *National Senior Investor Initiative: A Coordinated Series of Examinations* (April 15, 2015).

investment strategy of the firm. To this end, there are several additional compliance matters related to senior investors that firms should consider as best practices. Not all such practices will be applicable to all firms. However, if not already included as part of the firm's policies and procedures, the following items should be carefully considered for possible inclusion.

Train advisors regarding specific aging client issues

Training is an important tool for firms to help ensure that their personnel understand the needs of senior investors. Training should cover a wide array of topics, including the policies of the firm that relate to senior investors, such as suitability. Training should also discuss those red flags, highlighted in the July 2016 *Compliance Review*, that personnel should be looking for to identify whether a client is portraying signs of diminished capacity and/or elder abuse. Most importantly, training should cover the steps personnel should take to escalate concerns they have within the firm if they notice such red flags, and it should take into consideration applicable state requirements.

Keep in mind that training should be available to not only internal personnel but also aging clients. Firms should be proactive in educating clients on how to avoid being victims of financial fraud. Firms should also be explicit in the disclosures provided to clients regarding products and services offered to ensure that elderly clients clearly understand their financial investments.

Keep in mind that training should be available to not only internal personnel but also aging clients. Firms should be proactive in educating clients on how to avoid being victims of financial fraud.

Consider senior-specific professional designations

In keeping with the theme of receiving additional training on how to work with elderly clients, firms should consider having certain sales and management personnel attain senior-specific professional designations and certifications. Such designations vary widely, however, and firms should specify as part of their policies exactly which designations are approved by the firm. Approved designations should require formal certification programs, which include rigorous curriculum and continuing professional education. It should be noted that the SEC and FINRA, consistent with other federal agencies, state securities regulators, and self-regulatory organizations, do not grant, approve, or endorse any professional designation.¹⁶ As such, firms must

adhere to particular regulations¹⁷ that govern how they may advertise such designations to the general public.

Evaluate costs and fees associated with investment products and services

Recent initiatives (such as the SEC's Retirement-Targeted Industry Reviews and Examinations ["ReTIRE"] Initiative¹⁸) have focused on how financial professionals determine investment products and services—particularly when performing rollovers for elderly clients. The expectations portrayed in these initiatives are that the financial professionals will prepare documentation to present to clients that supports whether a rollover is appropriate for a particular client. In developing such documentation, it is recommended that certain information be included, such as (1) an explanation of the tax ramifications of performing a rollover, (2) alternative investment possibilities, (3) a detailed description of the registered firm's compensation (both direct and indirect) resulting from a rollover, and (4) a customer signature line evidencing that the client had an opportunity to review the information and ask any questions he or she may have had.

There are several tools available to both financial professionals and senior investors to help ensure that senior investors are being properly managed, including:

- Investor Complaint Center
- Aging Life Care Managers
- FINRA Securities Helpline for Seniors
- FINRA Investor Education Foundation

IV. Best practices to consider

Operational best practices

Investment advisors often serve as the first line of defense for addressing aging clients' needs. More than ever, as a client ages, advisors must engage in active dialogue to ascertain what that aging client needs. At the onset of the engagement, it is imperative for advisors to ask their clients, "If something happens to you or if I have a concern, whether it be a medical condition or financial exploitation, is there someone you trust—an emergency contact—whom I can contact on your behalf?" This information should be gathered and memorialized at the inception of the client relationship. If the client does not know how to respond, ask him or her to think about this carefully, and capture this information at the next client meeting.

¹⁶ Financial Industry Regulatory Authority Regulatory Notice 15-37, [Financial Exploitation of Seniors and Other Vulnerable Adults: FINRA Requests Comment on Rules Relating to Financial Exploitation of Seniors and Other Vulnerable Adults](#) (October 2015).

¹⁷ Such regulations include, but are not limited to, Rule 206 of The Investment Advisers Act of 1940, as amended, NASD Rules 2110 and 2210, and NYSE Rule 472.

¹⁸ For additional information, see U.S. Securities and Exchange Commission's Office of Compliance Inspections and Examinations National Exam Program Risk Alert, Volume IV, Issue 6, [Retirement-Targeted Industry Reviews and Examinations Initiative](#) (June 22, 2015).

As we have learned, working with aging clients poses many challenges. To the extent an investment advisor services retail clients, it is essential to turn to your operational procedures to create and implement a dynamic system for working with aging clients. Sample operational policies to consider implementing and providing accompanying mandatory training for all advisors include:

- Determine what and how to document atypical aging client behaviors, such as erratic financial questions and decisions, unexplained withdrawals, drastic shifts in investment style, and changes in beneficiaries and professional advisors.
- Conduct reviews of aging client files and documentation frequently to fill in any gaps. For example, if the firm maintains copies of trust documents, check for instructions for determining the grantor's incapacity.
- Inquire whether the client has a durable power of attorney ("DPOA") in place.
- If your clients do not have a DPOA in place, consider encouraging them to add one. A DPOA is authorized to act on a client's behalf if diminished capacity occurs. Ideally, the DPOA would be aware of your firm's services and would be able to work with you so that you could continue to serve the client's needs in the event of diminished capacity.
- Discuss the importance of designating a trusted contact, and obtain information for the trusted contact.
- Designate within the firm the person whom all aging client concerns should be escalated to and who will notify legal/compliance. Typically, it is best to hold all transactions and not make any portfolio changes while awaiting direction from legal/compliance.

Contact Schwab's Senior Investor Support Team

Schwab's new Senior Investor Support Team can assist if you suspect financial exploitation or other client concerns such as elder abuse or diminished capacity. Contact your service team directly for assistance.

Compliance best practices

The legal/compliance department has one of the most important responsibilities: understanding regulatory expectations and then ensuring that applicable securities rules and regulations, as well as state laws and firm policies and procedures, are being adhered to. Working with aging clients goes beyond the scope of financial industry knowledge and into the realm of medical and social work considerations.

Because this is such a complex area, training of both compliance officers and investment advisors is paramount. While there is no regulatory expectation for compliance officers to be medical experts, there is an expectation to adhere to the fiduciary standards placed on investment advisors to always act in the best interest of the client.

To help fulfill that obligation, the firm is tasked with developing policies and procedures applicable to the advisor's business model.¹⁹ To the extent that the advisor does service aging and vulnerable clients, consider implementing the following:

- Train advisors on the stages of aging, focusing on situational examples involving early, middle, and late stages of dementia; elder abuse scenarios; and other aging considerations. As necessary, bring in social workers to assist.
- Document a "response plan" on what actions the firm will take regarding aging client concerns. This may include sending account statements to both the account holder and power of attorney, contacting trusted contacts for medical concerns, and reaching out to law and regulatory authorities with concerns of elder abuse and exploitation.
- Review the terms of your standard advisory contracts and investment policy statements with counsel to clarify terms and conditions as well as applicable regulations that would permit you as the advisor to cease trading for a client's account under certain circumstances. This review should address whether the contract provides you with durable authority in the event of the client's death, disability, or incapacitation. You should consider adding language to address when you may disclose information to third parties, including regulators and law enforcement, if you suspect your client is the victim of exploitation. Lastly, you should address disbursement holds placed on client accounts if there is suspicion of exploitation. All of the language should be tailored based on the states in which you do business and your business model.
- Before acting and preventing trades in a client's portfolio, discuss with counsel to vet potential risks. For example, if an advisor and client agree to actively manage a client's account or to rebalance the account at certain set intervals, advisors may have a contractual and fiduciary obligation to do so. In other instances, the states and FINRA have either enacted or proposed certain safe harbors whereby a financial advisor may be permitted to not take such action where such action could detrimentally impact the aging client.
- Summarize regulatory guidance so that advisors can understand why aging client compliance and operational protocols are important.
- Develop suitability considerations for aging client services.

¹⁹U.S. Securities and Exchange Commission, [Final Rule: Compliance Programs of Investment Companies and Investment Advisers](#), Release Nos. IA-2204; IC-26299; File No. S7-03-03 (February 5, 2004).

TIP: Be able to capture when accounts have a power of attorney added or switched to someone else.

- Communicate investment guidelines for dealing with elderly clients.
- Enhance account opening procedures by requesting trusted contact information, powers of attorney, and applicable documents, as necessary, and capture in a central depository, such as the firm's CRM system.
- Develop protocols for documenting conversations with aging clients and capturing changes observed (both physical and cognitive).
- Implement an escalation process for what to do if you suspect a client has dementia or is a victim of elder abuse.
- Create and implement supervisory and internal controls identifying unique trends or patterns that could suggest diminished capacity and/or elder abuse (e.g., multiple withdrawals atypical for that client).

TIP: Develop a process for verifying the authenticity of the client's signature. Also, provide guidelines for duplicate account statements to be sent to the account holder and the person with power of attorney.

- Conduct education and training seminars for advisors.
- Consider under what circumstances the firm will self-report an aging client issue to Adult Protective Services, law enforcement, and/or regulatory authorities. Note: Some states have made this a mandatory requirement.

TIP: Check with counsel prior to taking action.

V. Conclusion

As clients continue to live longer and baby boomers approach retirement, regulations in this area are only expected to increase. It is essential for firms to be proactive in implementing a thoughtful, dynamic process for serving aging and vulnerable clients. Regulatory agencies, as well as state and federal lawmakers, view older investors as particularly vulnerable and in need of protection. As investment advisors, you have a fiduciary obligation to always act in your clients' best interests, which can be particularly challenging when working with aging clients and their financial needs. In many instances, you may be the first line of defense in identifying an elderly client issue. It is important to remember that at all times.

The purpose of this white paper is to provide insight into the regulatory expectations and offer helpful guidance for you to refine your internal control structure to protect your aging clients and your advisory practice. By implementing sound practices and offering consistent training, your firm will be in a good position to meet the demands of working with and serving aging clients.

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Previously, Ms. Jacko served as Of Counsel at Shustak & Partners, PC. Prior to that, she was Vice President of Compliance and Branch Manager of the Home Office Supervision team at LPL Financial Services, Corporation (Linsco/Private Ledger). Ms. Jacko has also served as Legal Counsel of Investments and Chief Compliance Officer at First American Trust, FSB and held the position of Compliance Manager at Nicholas-Applegate Capital Management. In addition, Ms. Jacko was with PIM Financial Services, Inc., and Speiser, Krause, Madole & Mendelsohn, Jackson.

Ms. Jacko regularly presents at conferences throughout the nation and is a frequent contributor to various industry journals. Ms. Jacko serves as Vice-Chair of Education and Member of the Corporations Committee for the State Bar of California's Business Law Section. She also is former Advisory Board Co-Chair and Member of the Business & Corporate Law Section of the San Diego County Bar Association and is a Member of the American Bar Association, Business Law Section. In 2013, Ms. Jacko was appointed to, and continues to serve on, the Editorial Advisory Board for the Wolters Kluwer publication *Practical Compliance and Risk Management for the Securities Industry*. She is Co-Founder and member of the Southern California Compliance Group, and she served two terms as a Board Member and is a current member of the National Society of Compliance Professionals (NSCP).

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JUT (0122-1K90) NWS100906-01 (01/22)



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