

On July 27th, members of Washington, D.C. Compliance Roundtable participated in the SEC/FINRA National Compliance Outreach Program for Broker Dealers in Washington, D.C.

Written by:



Marina Baranovsky,
Scitus Consulting LLC,
mbaranovsky@scitusconsulting.com



Kenneth W. Pegher, CSCP®
Branch Operations Manager
Chief Compliance Officer
Synergy Financial Group
kpegher@sfgmd.com



Michelle Glicklin
Principal Vice President, Compliance Officer
McLaughlin Ryder Investments Inc.
mglicklin@mclaughlinryder.com

The Outreach was opened by Peter Driscoll's introduction of Jay Clayton; Chairman of the SEC. July 27th was the 85th day in the office for the Chairman.



Chairman Clayton's opening remarks emphasized the following points:

- Strong effort for coordination between the SEC and FINRA with a particular focus on examinations by both organizations.
- Focus on the information sharing with each other by both SEC and FINRA.
- SEC will continue to support the industry especially in developing and implementing more effective compliance programs.

Full transcript of Chairman Clayton's remarks can be found at the link provided below:

<https://www.sec.gov/news/public-statement/clayton-statement-cco-program-broker-dealers>

Chairman Clayton's opening remarks followed by Robert Cook, President and CEO of FINRA welcoming commentary:

- Robert Cook and Jay Clayton met on June 9th, 2017 to reaffirm the SEC and FINRA's commitment to collaborative relationships.

- FINRA is committed to ensuring that there are no gaps in FINRA and SEC regulation
- There is a new focus on understanding adverse cost effects of certain aspects of compliance programs and regulatory oversight.
- FINRA is working to understand certain overlaps in the regulatory environment between SEC and FINRA to see whether they can be evaluated better for efficiency and effectiveness.
- FINRA provides extensive investor education initiatives, which are tailored to help the industry to comply with the Rules and Regulations. These initiatives include:
 - Compliance Calendar
 - Compliance Vendor directory (please note that FINRA doesn't engage in any sort of verification, or an approval process related to the vendors listed on the website, it is the responsibility of each firm to conduct its own due diligence in selecting the right vendor).
 - Senior investor hotline celebrated its 2nd year.
 - Report cards including cross marker surveillance are continued to be developed by FINRA.
 - Some additional Rules and Standards are being considered for the Brokers including heightened supervision
 - FINRA has reinvigorated its focus on the bad actors
 - There is an increased attention to Cybersecurity

All of the above is designed to prevent and reduce problematic proceedings such as enforcement actions and other regulatory issues.

Panel 1: Insights from SEC and FINRA Leadership – Robert Cook, President and CEO of FINRA and Chairman of the FINRA Investor Education Foundation; **Michael Piwowar**, Commissioner, SEC; **Peter Driscoll**, Acting Director, National Examination Program, Office of Compliance Inspections and Examinations, SEC (Moderator).



Commissioner Piwowar’s remarks included emphasizing the partnership model with FINRA and the industry where people can reach out to the SEC.

Robert Cook commented that currently there are only about 4,000 registered Broker Dealers (BD). By comparison there were 4600 registered BDs last year. According to FINRA’s analysis, the reduction in number of the registered BDs doesn’t indicate the reduction of Registered Representatives (RR). The number of RRs is in line with the previous years prior to decline in number of BDs. Additionally the new registrations for BDs are consistently seen by FINRA. These facts may be indicative of the industry consolidation, but not reduction.

Other insights included the following points.

1. High Risk Areas:

- a. Senior investors continues to be one of the top area of concern for both SEC and FINRA;
- b. Bad actors and how to effectively handle the issues of related disclosure;
- c. Cybersecurity;
- d. Best Execution practices
- e. FINRA developed a high risk list of firms and RRs. This list is not publicly available. It is taken into account by the SEC when conducting a Risk Assessment described below.

2. How is High Risk BD defined by the SEC?

The high risk BDs are defined based on risk analysis by the regulators, which includes the following factors:

- Regulatory History. Results of prior exams or enforcement actions, including regulatory actions by other regulatory agencies and SROs such as CFTC, FINRA, NFA etc.,
- Size of the BD. Please note that large size does not equal high risk, and similarly small size does not equal low risk.
- Number of RR, where large number does not equal high risk and vice versa.
- All of the above is then combined with the separate “big data” analysis conducted by DERA. How is a particular BD compared to the industry peers – a process of looking for unusual patterns, aka an outlier testing.

3. DOL Fiduciary Rule commentary by Commissioner Piwowar:

Commissioner Piwowar continued to criticize the Rule referring to it as “Terrible, Horrible, No good, Very bad Rule”.

More specifically, the Rule failed to distinguish between advice vs. selling activity; the Rule discounts the current fiduciary standards in existence today; Because it focuses on retirement accounts, it affects the entirety of brokerage accounts, both qualified and non-qualified, among other things.

SEC is looking forward to working together with the Department of Labor on making changes to the Rule.

4. Impact of FinTech:

This area is considered to be “tricky” by both regulators. This type of innovation is a complex task, which makes the regulators think about capital formation mandate and other difficult considerations.

5. Looking Ahead:

- The regulators will continue to work on more coordination between the agencies including banking regulators.
- SEC OCIE started developing new priorities based on “High Risk” areas reported by the examiners on the field.
- Consolidated Audit Trail (CAT) - FINRA is focusing on automation to enhance electronic reporting.
- SEC Record-Keeping requirement is now a priority for the agency related to its modernization and automation. The delay was caused by the focus on the Dodd-Frank Rule making.
- FINRA will continue to coordinate with the SEC including in the areas of Exams priorities. Please refer to the most recent letter issued this year (2017) [Regulatory and Examination Priorities Letter](#)
- Both SEC and FINRA are looking into cost of regulation with FINRA’s specific focus on figuring out ways to help smaller BDs with their regulatory requirements without compromising the investor protection.
- FINRA is in the process of combining the Enforcement department into one unit. Historically it was split in two: Market Regulation’s surveillance and other regulatory oversight divisions including Member Regulation, Corporate Financing, the Office of Fraud Detection and Market Intelligence, and Advertising Regulation. Please refer to the press release at the following link:

<http://www.finra.org/newsroom/2017/finra-promotes-susan-schroeder-head-enforcement-announces-plan-consolidate-existing>

6. Other updates:

- a. Last year the SEC launched “FISIO” - FINRA and Securities Industry Oversight. This unit consolidates the SEC’s oversight of FINRA into one group.
- b. FINRA created a new category of a BD – Capital Acquisition Broker (CABs) and the Rule book. For more information on CABs please refer to the following link: <http://www.finra.org/industry/capital-acquisition-brokers>

- c. FINRA is undergoing a retrospective Rule review, which is up for public comments.
- d. Both agencies will also be focusing on avoiding duplicate efforts.

For additional information, please refer to the [SEC/FINRA resources list](#)

Panel 2: Regulatory Hot Topics – Kristen Snyder Associate Regional Director, San Francisco Regional Office, SEC; **Georgia Bullitt**, Partner, Willkie Farr& Gallagher LLP; **Susan Axelrod** Executive Vice President, Regulatory Operations, FINRA; **Michael Rufino**, Executive Vice President Head of Member Regulation – Sales Practice, FINRA



Regulatory Hot Topics Panel discussed SEC and FINRA examination priorities as well as current trends related to **Anti Money Laundering (AML)** issues; gave an overview of **Conflicts of Interest, Recidivist and High Risk brokers** and concluded its discussion with issues related to **Dual Registrants**.

AML:

- Training is an important component on AML

- SAR's are also very important
- Independent testing which includes common exceptions; It is important to continually review/adjust data parameters, as well as reviewing the system of Red Flags at the firm. FINRA, SEC and FinCen have established collaborative relationships in the AML space.
- Firms can delegate duties related to AML independent testing however, the responsibility for the quality and effectiveness of AML testing still resides with the firm. When hiring an independent tester look for the following characteristics:
 1. Prior experience of the AML tester
 2. Industry reputation of the tester
 3. Whether or not the tester is planning to perform a sampling of the given population
 4. Whether the tester intends to perform a follow up review to ensure the continuation of the AML reviews.

The regulators are not permitted to endorse vendors. The firms are responsible for selecting a high quality service provider and conducting the due diligence analysis of vendors.

Conflicts of Interest:

The firms should try to eliminate the conflict of interest if possible, and consider the following list of suggestions:

- Keep a list of Conflicts of Interest – determine methods of mitigation and management
- Have a Conflicts of Interest Committee
- Review your compensation conflicts

For more information, please review FINRA report from 4 years ago located at the following link:

<http://www.finra.org/industry/2013-report-conflicts-interest>

Recidivist and High Risk brokers:

The panelists suggested the following tools in handling High Risk Brokers and shared some statistics from the recent examinations results.

1. Conducting a thorough due diligence on people firms are hiring should established as the base threshold.
2. FINRA currently Risk Ranks all RR's (over 600k) – the list is kept confidential as Robert Cook mentioned earlier.
3. FINRA follows high risk RR's to various firms and scrutinizes both the firm and RRs
4. 454 RRs were barred from the industry recently.
5. FINRA also has gotten out of the industry about 42% of the firms, due to severe violations.
6. The regulators view is that continued recidivism will result in problems for the firm, RRs, as well as supervisors

Dual Registrants:

At the center of this discussion was a topic of a reasonable liability standard, not a strict liability standard. Other discussion points included the following.

- Reverse churning – choosing an advisory account vs. a BD account.
- SEC has launched a wrap fee initiative, including looking at large cash balances and lack of trading in advisory accounts to generate fees instead of commissions; analyzing whether the fee charged makes sense.
- Firms are reminded that they must have the clients' best interest in mind.
- Some of the best industry practices include having robust conversations with clients on products and account types. Also keeping detailed notes of the relationship and decision making process is highly encouraged by the regulators.

Panel 3: Senior Investors - Linde Murphy, Chief Operating Officer and Chief Compliance Officer M.E. Allison and Co., Inc.; **Susan Hechtlinger**, Senior Vice President and Chief Compliance Officer SunTrust Investment Services Inc.; **Susan Axelrod** Executive Vice President, Regulatory Operations, FINRA; **Lori Schock**, Director, Office of Investor Education and Advocacy, SEC.



Senior Investors panelists discussed issues related to senior investors and retirement accounts as well as shared some insights and the best industry practices related to this topic.

- Know your clients
- Document the relationship
- Know the Red Flags and train your RR's
- Bring in compliance and your principal when issues arise
- RR designations should have continuing education requirements; review the curriculum
- Review business cards to ensure that there are no designations that are not approved. FINRA is including the business cards reviews in some of their inquiries.
- Have a full picture of the investor from the inception of the relationship and know the clients' trusted persons.
- As the client gets older, meet more frequently and bring others to the meeting (whether client relationship person or a fellow advisors) and document each meeting with dates and times.

- Use larger fonts for correspondence so it is easier for the client to read and understand.
- Tools to protect against Elder Abuse include:
 - a. Be conscious of diminished capacity.
 - b. FINRA Senior Helpline 844.57.HELPS (844.574.3577)
 - c. Extortion or removal of monies immediately or in a short timeframe – follow the procedures if your firm has them. It is highly encouraged to develop such procedures and train your people to properly respond.
 - d. Look for situations where you can no longer get in touch with the client or a drastic change in investment strategy
 - e. Please consider reviewing FINRA’s resources such as Suitability Rule as well as FINRA materials [from Suitability Considerations and Sales Practices for Senior Investors conference of October 2016](#).

For additional information, please refer to the [SEC/FINRA resources list](#).

Panel 4: Cybersecurity – **David Kelley**, Surveillance Director, FINRA; **Chad M. Pinson**, Managing Director, Stroz Friedberg; **Richard J. “Jay” Johnson**, Attorney, Jones Day; **Shamoil Shipchandler**, Regional Director, Fort Worth Regional Office, SEC (Moderator).



Panelists addressed current **cybersecurity threats** impacting BD firms and the securities markets including mitigation approaches. Panelists also discussed the **legal landscape** and shared **effective industry practices**.

Top cybersecurity issues identified by the panelists were:

- [Phishing](#) is the largest issue
- Insider threats from disgruntled IT personnel or others (non IT disgruntled employees).
- Data breaches are now evolved into the following cybersecurity issues:
 - a. Ransomware
 - b. Loss of the use of systems (for any reason)
 - c. Monetary theft through use of IT

Top cybersecurity regulatory weaknesses:

- Data Protection Laws represent the smallest regulation, which generally requires “reasonable” measures to protect data.

- Data Loss Laws are much more extensive and vary by state. These regulations are driven by a premise of what must be done if a data breach occurs.
- FINRA has no specific Rule in this space, and relies on Reg. SP.
- SEC started to conduct limited scope exams

Effective cybersecurity mitigation approaches and best industry practices:

- Develop and implement a Risk Assessment Program, which includes a walk through the cybersecurity issues.
- Test and validate the quality of the systems.
- Companies should consider developing either a Cybersecurity Officer function or a Cybersecurity Committee. The Committee should be comprised of various departments including Legal and Compliance. The Committee or the Cybersecurity Officer should be responsible for initiating and continuing discussions related to company's security of the assets, keeping minutes of meetings and to ensure continuance.
- Creating an Incident Response Team.
- Develop an incident response flyer. The messages must be very short and clear. The flyer must be easily accessible by the necessary personnel.
- The incident response protocol must be practiced.
- Proactively establish relationships with vendors including an outside legal counsel who can assist you during a breach (not after the fact).
- Cybersecurity is not just a compliance problem; it affects all areas of operations.
- Be aware of the preservation of evidence issues. Preservation of evidence can be handled by a Data Forensic vendor
- Utilize available resources such as FINRA's Small Firm Checklist

To find more information about the infiltration please refer to FINRA Cybersecurity Report <https://www.finra.org/industry/cybersecurity>

For additional information, please refer to the [SEC/FINRA Resources List](#).