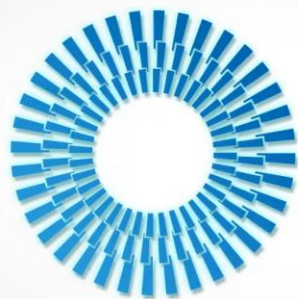


Welcome to our Compliance Current Affairs webinar in conjunction with our panel of experienced professionals from Sutherland Asbill & Brennan LLP

Powering Your Compliance Program



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Brian Fahey, CEO, TerraNua

[advance@mycomplianceoffice.com](mailto:advance@mycomplianceoffice.com)



Brian L. Rubin  
Michael B. Koffler  
Andrew M. McCormick  
December 9, 2015

# Regulatory Hot Topics for Broker-Dealers and Investment Advisers



SUTHERLAND

**“You sit on a throne of lies!”**

**(We hope FINRA never says that to you.)**



# **2015 FINRA ACTIONS: The Statistics**

# 2015 FINRA ACTIONS

- Projected number of 2015 cases filed: 1,443\*
  - This would be a projected increase of 3% from the 1,397 cases filed in 2014.
  - This would be the first increase in the number of FINRA cases filed since 2012.

	2008	2009	2010	2011	2012	2013	2014
<b>Number of Cases</b>	1,073	1,158	1,310	1,488	1,541	1,535	1,397
<b>Change From Prior Year</b>	-	8%	13%	14%	4%	-0.40%	-9%

- 34% increase in the number of cases since 2008

\* Projections based on results through September 2015

# 2015 FINRA ACTIONS

- Projected amount of 2015 FINRA fines: \$80 million
  - This would be a projected decrease of 41% from the \$135 million in fines imposed by FINRA in 2014.
  - Despite that significant decrease, \$80M in fines would still be the second-highest amount of fines since the financial crisis.

	2008	2009	2010	2011	2012	2013	2014
<b>Fines Assessed</b>	\$28M	\$50M	\$42M	\$72M	\$69M	\$60M	\$135M
<b>Change From Prior Year</b>	-	79%	-16%	71%	-4%	-13%	125%

- 186% increase in the amount of fines since 2008

# 2015 FINRA ACTIONS

- Projected amount of 2015 restitution: \$90 million
  - This would be a projected increase of 73% from the \$52 million in restitution ordered by FINRA in 2014.
  - The \$52 million in restitution ordered by FINRA in 2014 was a FINRA record.

	2009	2010	2011	2012	2013	2014
<b>Restitution</b>	\$8M	\$6M	\$19M	\$34M	\$13M	\$52M
<b>Change From Prior Year</b>	-	-25%	217%	79%	-61%	300%

- 1025% increase in restitution since 2009



## Supersized Fines of \$1M+

- 2013: 12 supersized fines, \$31M in total fines
- 2014: 25 supersized fines, \$100M in total fines
  - 10 cases resulted in fines of at least \$5M
- 2015 (through November): 12 supersized fines, \$29M in total fines
  - 2 cases resulted in a fine of at least \$5M

**“I’ve gained 45 pounds  
in a week!”**



# 2015 FINRA ACTIONS: The Key Cases

# 2015 FINRA ACTIONS (and 2016 New Year's Resolutions)

## Treat Everyone Equally, Unless You're Not Supposed To:

- Focus on firms that did not provide required sales discounts for mutual fund and/or UIT purchases by charities and retirement plans.
- FINRA announced 20 such cases in three 2015 News Releases
  - \$52M in restitution and \$2.6M in fines
- FINRA alleged the firms relied on their brokers to provide the sales discounts, but did not properly train these representatives.

## Lose Some Weight, But Not Some Documents:

- Firm fined \$2.6M for failing to preserve documents in WORM format. Firm did not have a central retention process, but each department was responsible for maintaining its own documents.
- Firm also failed to retain 168 million outgoing emails in a WORM format. These were automated emails, such as password and address change emails.

# 2015 FINRA ACTIONS (and 2016 New Year's Resolutions)

## Clean Up, Well, Everything

- Firm fined \$10M for broad supervisory failures in many key areas
  - Supervision of complex products, training of brokers, account monitoring, fee disclosures, AML, confirmation delivery, trade reporting
  - Largest fine of 2015 (so far); firm also ordered to pay \$1.7M in restitution
- FINRA said that “supervisory breakdowns resulted from a sustained failure to devote sufficient resources to compliance programs...”

## Buy a Timeshare in Puerto Rico (But Be Careful of the Bonds and CEFs)

- Two firms were fined a combined \$9.5M and required to pay \$15.4M in restitution for the sales of Puerto Rican municipal bonds and closed-end funds (CEFs).
- FINRA alleged that the firms did not properly supervise the suitability of investments in customer accounts.
- FINRA noted that supervisory systems should be tailored to specific business needs, especially if a firm is working in a unique market such as Puerto Rico.



# 2015 FINRA ACTIONS (and 2016 New Year's Resolutions)

## Keep Your Friends Close and Your Suspicious Friends Closer:

- Firm ordered to pay a fine of \$2.5M and restitution of \$1.25M for failing to supervise a broker.
- FINRA alleged that the broker had excessively traded in customer accounts and had stolen nearly \$3M from customers.
- FINRA said that the firm ignored repeated red flags, including:
  - 12 reportable events before the broker was hired;
  - criminal charges;
  - a lawsuit alleging that the broker had defrauded his business partners out of millions of dollars; and
  - correspondence indicating that the broker was wiring money from customer accounts to entities he owned or controlled.
- Firm also had to pay \$6M in customer arbitrations.

# FINRA ENFORCEMENT POLLING QUESTION

SUTHERLAND

Has your firm been or do you expect your firm will be the subject of a FINRA enforcement action in 2015?



**“I’ve got a sneaky feeling that you’ll find that [hackers] actually [are] all around.”**





# CYBERSECURITY

## Examined 57 BDs and 49 RIAs for general cybersecurity practices

- 74% of RIAs and 88% of BDs had a cyberattack either directly or through a vendor
- 54% of BDs and 43% of RIAs received fraudulent email funds transfer requests
- 85% of firms have a formal IT risk assessment program
- 50% of firms have cyber insurance
- The number of “successful” attacks and financial losses were low. The types of “successful” attacks included: (1) malware infections; (2) phishing; (3) theft of devices; (4) DDOS; and (5) taking over customer accounts.

## RIAs have some catching up to do in certain areas:

- 93% of BDs have written information security policies; 83% of RIAs do
- 89% of BDS conduct periodic audits “to determine compliance” with these policies; 57% of RIAs do
- 84% of BDs perform risk assessments of vendors with access to firm networks; 32% of RIAs do

## Some near universally-accepted practices:

- Use of encryption (98% of BDs and 91% of RIAs)
- Inventorying physical devices (96% of BDs and 92% of RIAs)
- Inventorying software platforms and applications (91% of BDs and 92% of RIAs)

FINRA examined BDs, noting:

- “A sound governance framework with strong leadership is essential”
- Risk assessments are “foundational tools” for understanding cyber risk and developing a cybersecurity program
- Technical controls should be a “central component” of a firm’s cybersecurity program but are also “highly contingent on firms’ individual situations”
- Firms are expected to have incident response plans.
- Should include elements for “containment and mitigation, eradication and recovery, investigation, notification and making customers whole”
- Vendor risk should be evaluated before and throughout a vendor relationship
- A firm’s staff can be a major source of cybersecurity risk
- Firms should “take advantage of intelligence-sharing opportunities to protect themselves from cyber threats.”

- Stand-alone, part of routine exam, or because of breach/incident
- Covering
  - Governance
  - Risk Assessment
  - Access Rights and Controls
  - Data Loss Prevention
  - Vendor Management
  - Training
  - Incident Response

# Recent SEC Enforcement Action: Rulemaking by Enforcement?

SUTHERLAND

- The Breach
- The Response (by the Victim)
- The Reply (by the SEC)
- Lessons (for Future Victims)



# CYBERSECURITY POLLING QUESTION

SUTHERLAND

Have you been breached between 2014 and the present?

“Well, what else could we be forgetting?”





# Rule 3a-4

- Reason for the rule
- Safe harbor
- Philosophy of the rule

A discretionary program with the following is not an investment co.

- Each client's account is managed on the basis of client's financial situation and investment objectives and in accordance with any reasonable restrictions imposed by client
- At account opening, sponsor/designee obtains information regarding client's financial situation and investment objectives, and gives opportunity to impose reasonable restrictions
- At least annually, sponsor/designee contacts the client to determine whether any changes in client's financial situation or investment objectives, and whether the client wishes to impose or modify reasonable restrictions

- At least quarterly, the sponsor/designee notifies client in writing to contact sponsor/designee if there have been any changes in client's financial situation or investment objectives, or if client wishes to impose or modify any reasonable restrictions, and provides client with means to make such contact
- The sponsor and personnel of the manager of the client's account who are knowledgeable about the account and its management are reasonably available to the client for consultation
- Each client has the ability to impose reasonable restrictions (including the designation of particular securities or types of securities that should not be purchased for the account or that should be sold if held)

- Sponsor/designee provides each client with a statement, at least quarterly, containing a description of all activity in the client's account during the preceding period, including all transactions, contributions and withdrawals, all fees and expenses charged, and the value of the account at the beginning and end of the period
- Each client retains, with respect to all securities and funds in the account, the right to:
  - Withdraw securities or cash;
  - Vote securities (or delegate the authority to vote securities);
  - Be provided with written confirmations of each securities transaction, and all other documents required to be provided to security holders; and
  - Proceed directly as a security holder against the issuer of any security in the client's account

- Meaning of (annual) contact and how it differs from (quarterly) notification
- What is a reasonable restriction?
- How the rule is operationalized in the context of a wrap or other program?

- The elements firms find challenging
- What firms should be doing
- Why the SEC staff is again focusing on the rule now
- Implications for the industry

# RULE 3a-4 POLLING QUESTION

SUTHERLAND

Within the last six months, have you reviewed your policies and procedures to confirm you are within the safe harbor?





# “Isn’t it wonderful? I’m going to jail!”



**CIRCULAR 230 DISCLOSURE:** To comply with the requirements of Circular 230, you that, unless otherwise expressly indicated, any tax advice contained in this advisory (including any attachments) is intended to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or any other applicable tax law, or (ii) promoting, marketing or recommending to another party any transaction, arrangement, or other matter.



# AML for RIAs

**CIRCULAR 230 DISCLOSURE:** To comply with Treasury Department regulations, we inform you that, unless otherwise expressly indicated, any tax advice contained in this communication (including any attachments) is intended for your personal use only and is not intended to be used, and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the Internal Revenue Code or any other applicable tax law, or (ii) promoting, marketing or recommending to another party any transaction, arrangement, or other matter.



# The AML Proposal

- Background
- Scope of the Proposal
- Why did FinCEN act now?

The Proposal encompasses three components:

- (i) Amending BSA to include RIAs in the definition of “financial institution” (thereby making RIAs subject to various rules applicable to financial institutions);
- (ii) Requiring RIAs to establish AML programs; and
- (iii) Requiring RIAs to report suspicious activity

- Each RIA must develop and implement a written AML program approved in writing by board of directors (or similar body)
- The program must establish and implement policies and procedures reasonably designed to prevent the adviser from being used for money laundering and to comply with applicable provisions of the BSA and implementing regulations
- The program also must provide for the designation of:
  - A compliance officer,
  - Independent testing of the program for compliance, and
  - Ongoing training for appropriate persons

# Reporting Requirements

- RIAs would be required to file currency transaction reports (rather than the Form 8300 they are currently required to file) to report receipt of more than \$10,000 in cash and negotiable instruments
- RIAs would also become subject to the requirements of the “Recordkeeping and Travel Rules” and related recordkeeping requirements that apply to transmittals of funds in amounts that equal or exceed \$3,000
- RIAs would be required to file suspicious activity reports

- Risk-Based Approach
- Enterprise-Wide AML Programs
- Delegation of AML-Related Duties
- What does this mean for RIAs
- Practical Tips for Compliance
- FinCEN examples of red flags

# AML POLLING QUESTION FOR THE IAs

SUTHERLAND

Have you either adopted or are you in the process of adopting policies and procedure regarding AML?





# Questions?

SUTHERLAND

Email [advance@mycomplianceoffice.com](mailto:advance@mycomplianceoffice.com) now  
to have your questions answered live on the webinar.

Brian L. Rubin

brian.rubin@sutherland.com

202.383.0124

Michael B. Koffler

michael.koffler@sutherland.com

212.389.5014

Andrew M. McCormick

andrew.mccormick@sutherland.com

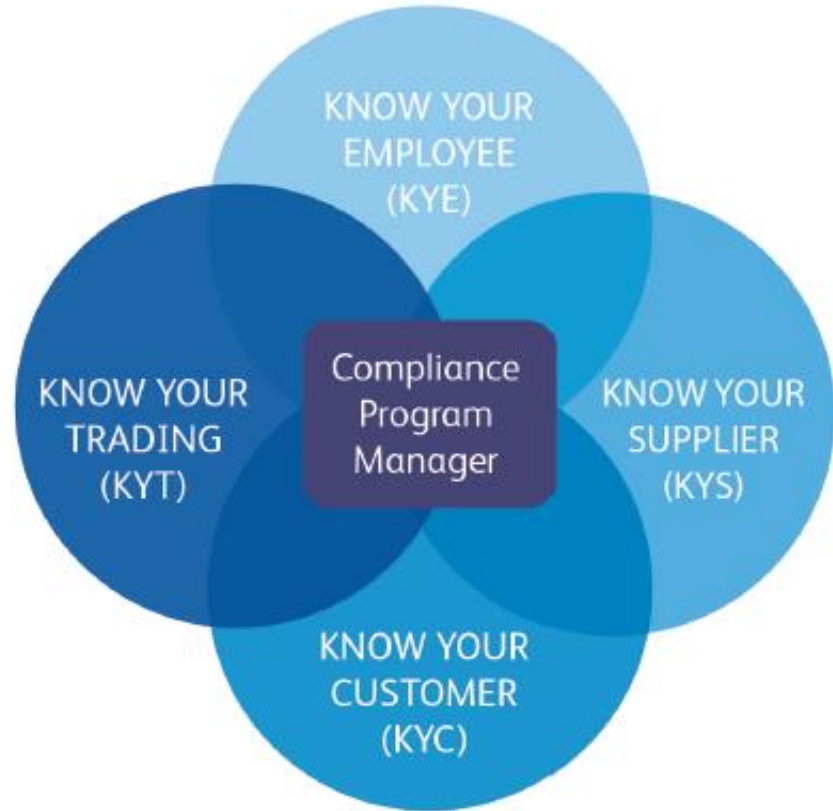
202.383.0867

# Synchronize competing demands



# Highlights

- Manage by alerts not reports
- Dashboards deliver greater oversight
- Custom questionnaire builder
- Continuous updates to the software
- Enhanced control
- 100% data capture
- 24/7/365 support
- Scalable into the future



Q&A with the panel

Thank you