

## Legal Risk Management Tip November 2016

### **BROKER-DEALERS, IT'S TIME TO REVIEW YOUR WRITTEN SUPERVISORY PROCEDURES**

#### **Introduction**

If asked what violation is one of the most popular for FINRA to either settle or charge in a hearing, what you would guess? Could it be AML? FCPA? Or another? One of the most frequently cited violations is failure to follow the firm's Written Supervisory Procedures ("WSPs") or having deficient WSPs.

Every month, David Alsup<sup>1</sup> collates and compiles a compilation of the most notable FINRA violations. For the last rolling twelve months ending September 2016, Alsup notes that there has been 241 firms cited for WSP violations. For the same period ending September 2015, there were only two firms cited for WSP violations, and six (6) firms that were required to perform a rewrite. With this trend, it appears that FINRA is focusing its efforts on internal control systems and looking much more closely at the effectiveness of broker-dealer WSPs.

This month's legal tip will focus on the regulatory requirements for WSPs, highlight recent FINRA enforcement cases involving WSPs and provide tips on how to evaluate the effectiveness of a broker-dealer's WSPs.

#### **Regulatory Requirements**

FINRA Rule 3110 "requires a firm to establish and maintain a system to supervise the activities of its associated persons that is reasonably designed to achieve compliance with the applicable laws and regulations and FINRA rules." This includes a description of what is being supervised, when and how the subject area will be reviewed, the specific individual responsible for conducting the review, and what techniques and procedures must be followed for this surveillance (in order to comply with industry rules and regulations). Each WSP must be customized to the broker-dealer's business model and internal control system.

#### **Recent Enforcement Cases**

Here are some recent examples WSP enforcement cases focusing on WSPs:

**Respondent William H. Murphy & Co., Inc. and William H Murphy** – Respondents allegedly sold unregistered securities in violation of Section 5 of the Securities Act of 1933 and violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a

---

<sup>1</sup> David Alsup is the National Director of Business Development with The Compliance Department, Inc. and author of "Fined Times." Fined Times is a free subscription distributed via email. He can be reached at: [David@fishbowlstrategies.com](mailto:David@fishbowlstrategies.com).

supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with Section 5 of the Securities Act. For this violation, William H. Murphy & Co. was fined \$50,000 and ordered to disgorge \$78,210.91 plus interest. Murphy was fined \$50,000, suspended from associating with any FINRA member firm in all capacities for six months, and required to re-qualify by examination before he re-enters the securities industry in any capacity. Respondents are also ordered to pay the costs of this proceeding. For more information, see FINRA Disciplinary Proceeding No. 2012030731802 (Jun. 3, 2016).

**TR Capital Group, LLC dba Titus Rockefeller, LLC \ and Richard Christopher Stoyeck** – Respondents entered into a Letter of Acceptance, Waiver and Consent (AWC) in which the firm was censured and fined \$15,000 and Stoyeck was fined \$5,000 and suspended from association with any FINRA member in any principal capacity for 15 business days. Allegedly, Stoyeck knew that certain registered representatives were using personal email addresses to conduct firm business, in violation of the firm’s WSPs. Furthermore, the broker-dealer and Stoyeck failed to establish, maintain, and enforce an adequate supervisory system to ensure that business-related emails to and from these addresses were subject to retention and supervision. For more information, see FINRA Case #2015045794201 (May 2016).

Although the language in the below cases is different than the above examples, it still addresses the same regulatory issue:

**Aegis Capital Corp** - Respondent allegedly failed to enforce its WSPs, which called for the trade reporting supervisor to review trades reported to the FNTRF (the FINRA/NASDAQ Trade Reporting Facility) on a daily basis and the FINRA trade reporting report cards on a monthly basis. In addition, the firm failed to enforce its WSPs, which specified that the TRACE reporting supervisor would review transactions reported to TRACE on a daily basis and the TRACE report cards on a monthly basis. The firm was censured and fined \$145,000 and required to hire an independent consultant. For more information, see FINRA Case #2013036669201 (May 2016).

**Ascendant Capital Markets, LLC** - Respondent, among other things, allegedly did not have a supervisory system reasonably designed to achieve compliance with respect to certain applicable securities laws and regulations, and/or FINRA rules. Moreover, the firm’s WSPs failed to provide for the requirements specified in Rule 101 of Regulation M and FINRA Rule 5190. The firm was censured and fined \$12,500, and required to revised their WSPOs. For more information, see FINRA Case #2012034455101 (May 2016).

**Deutsche Bank Securities Inc.** – Respondent, among other things, allegedly failed to have sufficient WSPs requiring reviews to ensure compliance with position limits, to determine that its Large Options Positions Report (“LOPR”) submissions were accurate, to review rejects, to ensure that all reportable positions had actually been reported, and to identify and report options positions appropriately as Acting in Concert (“AIC”). The firm was censured and fined \$4,070,000. However, there were many more serious issues here other than WSPs. For more information, see FINRA Case #2011029600301 (May 2016).

## **Tips For Preparing Effective WSPs**

Although there are several areas that should be covered in your WSPs, many of them might not apply to your firm. However, you should acknowledge their existence with a simple phrase such as: The firm currently is not involved in crowdfunding. However, if the firm should begin to operate in that area, we will prepare appropriate and effective WSPs. Some of the areas that need to be covered such as BCP, AML and possibly a BIC contract should probably be in a separate document.

There are many firms that separate written procedures from written supervisory procedures. The first is more of an operational manual used by the employees. The second focuses on the supervisory structure of the firm: the who, what, when and where of supervision. How your firm does this is totally customizable, but whether it is separate or all in one, the same criteria must be met.

As mentioned earlier, FINRA has a WSP checklist on its website.<sup>2</sup> Although it is quite thorough, it is not the totality of business models and operational systems that exist in our industry. However, it is a very good start. It allows you to really think about how your firm operates from the ground up. It is really an exercise that should be done at least annually.

It is also important to keep abreast of Notices, new regulations, and new interpretations. All this new information must be reflected in your WSPs. When making changes to your WSPs, you must keep a copy of the one that is changing, as well as the dates that it was in effect.

The most important part of the WSPs is following them and evidencing that you did, in fact, follow them. As you can see in the earlier cases, not following your procedures is just as bad as not having any in first place.

## **Conclusion**

From the above cases, it is easy to recognize that merely having a set of WSPs is not enough. WSPs must be meaningful and robust enough to clearly define how the firm will comply with those regulations which govern its business practices. Broker-dealers must zealously review the adequacy of their internal control and supervisory systems, which at the forefront include your WSPs. Doing so will advance your compliance program, protect your business, provide guidance to your representatives, and help your new hires and regulatory bodies to better understand your supervisory systems.

For more information on this topic, please contact us at (619) 298-2880 or at [info@jackolg.com](mailto:info@jackolg.com).

**Author: David Sobel, FINRA Specialist; Editor: Michelle L. Jacko, Esq., Managing Partner, Jacko Law Group, PC. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds, banks and corporate clients on securities and corporate counsel matters.**

*This article is for information purposes and does not contain or convey legal advice. The information herein should not be relied upon in regard to any particular facts or circumstances without first consulting with a lawyer.*

---

<sup>2</sup> [http://www.finra.org/sites/default/files/WSPChecklist\\_Feb2013.xls](http://www.finra.org/sites/default/files/WSPChecklist_Feb2013.xls).