Summertime is Here! Compliance Can Keep You Cool!

As the summer heat kicks in, there is little indication that the Regulatory heat will subside any time soon, but the typical slowdown in business over the summer months provide a good opportunity to review certain aspects of your firm's compliance program. Focusing on selected aspects of your compliance program may also reveal ways to cut costs associated with compliance in the long run. The secret to an efficient review is to focus on the regulatory target areas and not try to do too much.

The Regulatory Focus

The regulatory focus continues in all matters that are sales practice related, and the SEC and FINRA have added focused operational reviews and targeted product reviews – the return of the Sweep! For dually registered entities FINRA is also digging deeply into RIA activities of its members as well as the supervisory procedures for firms that permit their RRs to have an independent RIA. The modified examination scopes have caught many firms off guard as they try to respond to questions concerning areas of their business operations that have never been examined. Adding to the typical sales practice examinations, FINRA and the SEC have increased their focus on operational issues, including vendor arrangements and outsourced functions. The prime focus areas are due diligence of third party vendors and the process to monitor the vendors on an ongoing basis.

Identifying the Areas to Review

With the above in mind, the review of your firm's operations should focus on those areas most relevant to your business. First assess your products and services from the financial perspective identifying products and services that generate the most revenue. The compliance review should focus on those areas of your firm's operations that generate the most business, i.e. revenue. Also, consider looking at the policies and procedures for supervising branch offices and remote locations. Additionally, if there is a product or service that you have not reviewed in some time, or that is new to your firm, the policies and procedures related to those areas should be included. For example, if you're selling more mutual funds, look at the supervisory and operational procedures for that product. If you recently added exchange traded notes, look at those procedures.

Second, consider any areas where you rely on third parties to provide a significant support function. The most common for broker-dealers is the clearing function, while RIAs may rely heavily on the custodian or a portfolio valuation service. Create a list of vendors that includes the services they provide, the contact people for the vendor, and the contract date. Larger firms should also add the person internally who owns the relationship, such as the FINOP for accounting software, the Chief Operations Officer for Clearing relationships, etc. Consider all services provided by third parties or affiliates (services provided by affiliates are typically considered outsourced). In addition to the clearing and custody relationships noted above, many firms use third party vendors to support internet access and email, storage of books and records, payroll processing, and accounting functions. Some other common areas that are often overlooked are the phone systems, technology support, and consultants.

Conducting the Review

For the areas you've selected to review, determine how the business is processed from start to finish. It may be helpful to create a flow diagram of the process that identifies "touch points" where a supervisory procedure or control would exist. A good example would be where the representative forwards completed paperwork for a variable annuity transaction to a principal for review. These points could include the representative assembling the paperwork, delivering it to a sales assistant, and the sales assistant forwarding it to the principal or a centralized operations department for review and approval. Your procedures should address a control or supervisory process for each time the paperwork changes hands. Perhaps the sales assistant does a check to ensure all the proper paperwork is included, and in a predetermined order, before forwarding to the principal. This simple control will reduce delays in processing paperwork and the time that the principal has to spend reviewing, and supervising, the transaction, thereby saving time and money. When reviewing processes, policies and procedures for new lines of business, be careful not to try to fit a square peg in a round hole. That is, don't assume that the procedure for supervising an equity security transaction will fit the exchange traded note. You must consider the unique aspects of the product, related disclosures, and the customer's objectives.

If your firm relies on third party vendors and does not have a due diligence process for assessing them, you should develop one. Start with the vendor contract to determine if the regulatory requirements are met. For example, if the vendor is deemed a "Service Bureau" for the purposes of the SEC's Books and Records Rules, the vendor must agree to make the records available to the Regulators. Similarly consider any AML, business continuity and privacy issues that may arise from the relationship. These arrangements may also have to be disclosed to FINRA before implementing. Depending on the nature of the vendor relationship, your due diligence process should include reviews of the vendor's SAS 70 or similar internal control examination results, business continuity plans, information and technology security, and insurance coverage such as E&O, theft, and professional liability. Ongoing vendor monitoring is critical. While most services can be monitored on an ongoing basis – that is, if the service fails you know it and correct it – it's a good practice to schedule a formal meeting at least annually with the vendors' representatives to review the services and reassess the areas covered in the due diligence process.

Correction and Documentation

As you complete each review, create a short written summary of the review performed, including the corrective steps to be taken, if any. For material deficiencies, consider reviewing with counsel to determine the potential regulatory impact. In addition to amending written policies and procedures, corrective actions should include training employees to ensure that proper procedures are implemented and the new procedures are adequately communicated.

Conclusion

A compliance review provides a great opportunity to reassess your business operations, not only for compliance purposes, but to identify areas of cost savings. This type of review can be incorporated into your annual FINRA' required review of your compliance program and supervisory controls testing. Your review should be reasonable and you should not try to do too much. Once you start digging, you may find that one issue will take longer than you anticipated completing. It's better to do a portion at a time and complete a full review of an area, than to take on too much and leave items undone. So what are your plans this Summer? Awaiting the regulatory heat? Or sitting back and enjoying the compliance reliance?

By: Louis Dempsey, CRCP, CSCP

Louis Dempsey is the Founder and President of Renaissance Regulatory Services, Inc., a full service compliance consulting firm based in Boca Raton Florida. He has over 20 years of broker-dealer and investment adviser regulatory and compliance experience, including 12 years as a regulator. Mr. Dempsey can be reached in our main office.

Renaissance Regulatory Services, Inc.
Compliance Consultants
To Broker-Dealers and Investment Advisers
(561) 368–2245
350 Camino Gardens Blvd.
Suite 105
Boca Raton, FL 33432
www.RRSCompliance.com

Offices in:
Atlanta – Washington - Pittsburgh