

NASAA Annual Meeting Reveals Partnerships and Progress

The North American Securities Administrators Association (NASAA) 2016 Annual Conference (September 11-13, 2016, Providence Rhode Island), titled *“Diversity in Today’s Financial Markets,”* provided unique insight into the state regulatory activities affecting both broker-dealers and investment advisers. This annual event brings together NASAA representatives (regulators and law enforcement) from the 50 states, US territories, and Canadian Provinces, as well as staff from the Securities and Exchange Commission, and FINRA to discuss the results of their examinations, enforcement actions, studies, collaborative efforts, and rule developments.

Among other areas, the topics focused on Senior Investors and Vulnerable Adults, Cybersecurity, Business Continuity Planning, and Enforcement Activities. With diversity being the overlying theme, one panelist drove home an important point, that fraud, exploitation, and investor protection are “color blind.” Fraudsters and their victims exist in virtually every race, ethnic group, and religious background – and often work within their so called “affinity groups.” Diversity is not only important to the health of the business, but to compliance as well. What was also notable at NASAA’s annual meeting this year, was the collaboration among regulators and the industry to address significant issues that pose a threat to the security of our most vulnerable investors, the financial system, and the industry itself.

Exploitation of Senior Citizens and Vulnerable Adults

State regulatory examinations relating to seniors and vulnerable investors revealed that firm’s utilizing “trusted contact forms” and providing senior training to their representatives, and presumably operational employees, were more vigilant to responding to potential exploitation of seniors and vulnerable adults. While the regulators appeared disappointed that their examinations revealed a relatively small number of firms that obtained contact information for a trusted third party from customers, the

panel members recognized that there may be operational impediments and encouraged the industry to continue to assess the practicality of adopting the practice. The collection of this information – with the customer’s authorization - may enhance the ability for a firm to protect its most vulnerable customers, while at the same time avoiding potentially costly litigation, by involving a trusted third party such as a relative, attorney, accountant, or other confidant, when the firm believes that a customer is being exploited by a third party.

In addition to firm’s establishing comprehensive compliance policies and supervisory procedures that address this important class of investors, the NASAA panel members identified training as a critical aspect to heighten the awareness of the staff within firms that enables the identification of potential exploitation of vulnerable adults. Registered representatives and operations staff are often among the first line of protection and it is important that they are fully aware of the firm’s policies in this area. Training these employees to identify potential exploitation may help prevent the loss of funds by clients. Unfortunately, it is often those who are entrusted to care for a senior or vulnerable adult who are the most likely to be the agent of exploitation. Firms should educate their employees to identify signs of exploitation, while being sensitive to privacy concerns. Indicators include unusual requests for transfers of assets - especially to third parties - and new or increased influence by “friends and family.” Examples include the new “significant other,” long lost relatives reentering the client’s life, siblings or children who “suddenly appear” to take care of the customer. Think of some of the high profile cases where relatives or other third parties have attempted to gain access to a vulnerable individual’s assets; when money is involved anyone can be suspect. NASAA provides resources to assist firms with training in this very sensitive but important area that all firms should consider. The support is as close as your local state regulator’s office or through the NASAA website at www.NASAA.org or www.ServeOurSeniors.org.

For firms who permit their representatives to utilize “senior” or “retirement planning” designations, state

Research Services

regulators stressed their view that some firms are not doing enough to assess either the designations used or their efforts to supervise the appropriate use of such designations. They reminded firms that it is important to review the source and accuracy of the designation, and to ensure that marketing materials accurately reflect the nature of the designation. It is important to note that state regulators have worked closely with the industry to deal with these issues and are providing valuable resources to the industry to support compliance efforts. We must remember, that while seniors are the focus, exploitation can occur to any adult as a result of some form of early stage diminished capacity, or even financial illiteracy.

One of the areas where state regulatory activity is most notable is in NASAA's efforts to develop a model rule to protect seniors and vulnerable adults. The states worked closely with major financial services firms to develop a model regulation designed to enhance investor protections while also providing a safe harbor to the industry that should help to prevent the loss of funds by investors who may be exploited by unscrupulous third parties. At this point, five states have adopted senior protection statutes in some form and additional protections are anticipated at the federal level with the Senior Safe Act. These developments also correspond to FINRA's proposed amendments to rule 4512 as set forth in Regulatory Notice 15-37, "Financial Exploitation of Seniors and Other Vulnerable Adults" last year.

Cybersecurity

While the protection of seniors and vulnerable adults is at the forefront for regulators and the industry, cybersecurity bears equal significance. The NASAA working group had been actively looking at the cybersecurity plans for both broker-dealers and investment advisors. Their examinations will focus on the content of the plans, mitigation of threats, testing practices, response, and reporting. NASAA representatives stressed the importance of training for all staff. To this end, training programs should not only focus on effective security safeguards, but also stress the importance of identification of potential

infiltration to customer records by hackers or access to the customer's account when the customer's login has been compromised. Examples include unusual activity in the customer's brokerage account, or email requests for transactions or transfers of assets to third parties – all such requests should always be confirmed verbally with the customer. All of the regulators recognized the significant risks and challenges that cyber-threats pose to consumer, the industry and their own operations. Therefore, continued collaboration in this area is critical.

Business Continuity and Succession Planning

State regulators also expressed concerns about the apparent lack of adequate business continuity plans for investment advisors. While these plans have been a long standing requirement for broker-dealers, the advisor community has been slow to adopt such plans. Some of the findings raised by the NASAA panel, based on their observations at smaller firms, may provide insight to larger firms with widely dispersed advisory practices. Of particular note by regulators, was the apparent lack of adequate planning surrounding advisory practices that rely on a key advisor or team. State regulators expressed concern that there were significant gaps in plans to deal with situations where an advisor becomes unable to manage their client base. This could result from illness, communication breaks, or even death of an advisor or key employee. Firm's should ensure that where a particular book of business relies on a key individual, that adequate contingency plans are in place to route customer inquiries to the appropriate personnel within the firm. Similarly, firms should assess their continuity plans for branch offices, including independent contractors or platform providers, to ensure that the plans provide the appropriate means of communications so that customers can access their account information and conduct transactions in the event of a loss of a key individual, location, or third party provider. Firm's should also ensure that original records, which in some cases may be maintained at a local branch office, are adequately reproduced and stored remotely to ensure continuity and compliance with record retention rules.

NASAA Enforcement Efforts

The enforcement panels at the NASAA conference are always provocative, and for some firms embarrassing. NASAA members are not shy about naming names. To be fair, this is also true of the SEC and FINRA at their public conferences, where the press may be attending. For our purposes, naming names is not as important as reporting the significant impact the states have on the industry and on understanding the conduct that resulted in their enforcement actions. For the past year, state regulatory agencies reported that their actions resulted in \$530 million in restitution to the public. That's an astounding number, and represents money returned to investors and not simply levied in fines that are paid to government agencies and in many cases are ultimately comingled with general revenues. State regulatory activities focus on returning money to investors.

NASAA member states collectively conducted five thousand investigations, initiated two thousand enforcement actions, and three thousand license sanctions. State regulatory actions also resulted in over 1,200 years of incarceration for bad actors. The top five schemes that NASAA members identified were Ponzi schemes, real estate investments, oil and gas schemes, internet scams, and affinity fraud. Although many of these actions were based on the actions of unregistered perpetrators, all firms must be vigilant to the potential that their representatives become entangled by unscrupulous crooks, who will try to infiltrate a firm with a solid reputation to take advantage of that reputation in order to wreak havoc on its clientele. Firms should be vigilant to the potential that these schemes permeate their advisors and sales force. This is a particular issue with low producers, remote advisors, or individuals new to the industry who do not have the experience or training necessary to identify fraud, or are sucked in to fraudulent schemes.

Why This Matters

State regulators have long held that they are at the forefront. They are on the ground when responding to

customer complaints. Historically, many broad industry issues have been identified in their early stages at the state level. Despite their limited resources, the state regulators have shown an impressive ability to work collectively to identify issues impacting the investing public. They serve an important role in the regulatory framework, investor protection, and ensuring that markets are fair and equitable for all participants. States work closely with the SEC, FINRA and law enforcement agencies to protect investors, and support the public trust in our industry. In recent years, state regulators have also shown a strong desire to work with the industry on the most significant issues facing the industry, including senior and vulnerable adult exploitation, cybersecurity, and business continuity. For firms, engaging with their home state regulators may yield valuable results.

By: Louis Dempsey, CRCP, CSCP, CAMS

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 25 years of broker-dealer and investment adviser regulatory and compliance experience, including fifteen 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

1515 South Federal Highway

Suite 306

Boca Raton, FL 33432

www.RRSCompliance.com

Offices in:

New York - Washington - Miami