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New York Customer Summit

MEETING THE SUPERVISORY CHALLENGE

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- This panel will cover the following three topics:
 - Supervision and supervisory controls: rules and regulatory focus
 - Establishing and maintaining a supervisory system
 - Regulatory pronouncements and enforcement actions



- SEC and SRO supervision rules utilize a “reasonableness” standard.
 - Section 15(b)(4)(E) of the 1934 Act
 - NYSE Rule 342
 - NASD Rule 3010



- NASD Rule 3012 requires a firm to:
 - Test and verify that supervisory procedures are reasonably designed to achieve compliance.
 - Change procedures where the need is identified by such testing and verification.
 - Designate principals who establish, maintain, and enforce the supervisory control system.
 - Submit an annual report to senior management.
- NASD Rule 3013 requires a firm's CEO to execute an annual certification stating that the company has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable requirements.



3012 Review

- Leading the Charge – Business, Compliance and Others
- Assessment: Top Down and Bottoms Up Methods
 - Per business line
 - Other approaches
 - Memorializing the system components
- Elements of Supervisory Environments to Assess
 - Policy, procedure, written supervisory procedures, supervisory resources and tools, training and communications, monitor/surveillance/audit/branch reviews, examination results



The Supervisory and Internal Control Models (cont'd)

- The Testing and Verification Requirement
 - Leveraging existing work
 - Filling the gaps
- Making the Most of the Review
 - Integration with other processes
 - Separation of results

3013 Certification

- To subcertify or not to subcertify? That's the CEO's question.



In April 2003, Mary Schapiro, then the NASD's President of Regulatory Policy and Oversight, outlined five key measures that, in her view, must be taken by senior executives of broker-dealers to restore investor faith:

- Management, not just compliance officers, must seek to create a culture that takes the obligation to observe high standards of commercial honor and just and equitable principles of trade seriously.
- There must be a high level of interaction between senior business executives and compliance and legal officers.
- Senior executives must be prepared to confront and take action against misconduct.
- Management cannot rationalize improper conduct.
- Even in down markets, management must resist the temptation to cut compliance programs to enhance financial results.



Distinction Between Compliance and Supervisory Personnel

- Compliance officers provide advice, guidance and recommendations.
- Business line management has the ultimate responsibility to take appropriate action to achieve compliance by hiring, firing, and otherwise affecting the conduct of brokers and others performing securities activities.



The July 2005 Securities Industry Association Compliance and Legal Division White Paper on the Role of Compliance

1. Advisory
2. Policies and procedures
3. Education and training
4. Monitoring and surveillance
5. Business unit compliance reviews
6. Centralized compliance functions
7. Licensing, registration, and employment-related functions
8. Internal inquiries and investigations
9. Regulatory examinations, reporting, and investigation
10. Fostering regulatory relationships
11. Promoting a culture of compliance
12. Assessment of existing business activities and emerging trends
13. Chaperoning



- The NASD has identified four keys to creating written supervisory procedures:
 - identification of responsible individuals;
 - a description of the supervisory tasks;
 - a statement of the frequency of the reviews to be conducted; and
 - documentation of the completion of the required actions.



Implementation of Written Supervisory Procedures

- Be involved in the process of developing – and changing – the procedures so that when finalized they are practical, useful and appropriately tailored for your business.
- Can the procedures be reasonably accomplished?
- Are the necessary tools available to perform the review?
- Are there other things that should be reviewed?
- Understand exactly what is expected in carrying out the duties and responsibilities.



Implementation of Written Supervisory Procedures

- How are reviews supposed to be documented?
- How long are documents to be saved?
- What steps should be taken where a potential problem is noticed?
- If duties are delegated, it must be done properly.
- Continually think about how the procedures should be changed in light of new business, changed practices or regulatory issues.



- *Raymond James Financial Services, Inc.*
(NASD - Feb. 21, 2007)
 - Between 2000 and 2004, RJFS allegedly permitted approximately 1,100 branch managers to serve as the primary supervisors of their own business activities. Among other steps, the branch managers approved their own transactions, opened and accepted new accounts, and reviewed their own correspondence.
 - RJFS consented to a \$2.75 million fine.



- *Robert L. Cram*
NYSE Regulation HPD 05-94
 - In this case, NYSE Regulation censored and imposed a supervisory suspension upon a Director of Compliance and General Counsel for allegedly failing to reasonably supervise variable annuity sales.
 - The HPD notes that Cram “was not disciplined simply because he held the title of Compliance Director or General Counsel. Holding such a title does not automatically make one a supervisor under Exchange Rule 342. Rather he was named and properly disciplined because he had lapses of personal responsibility.”



- The HPD continues:
 - “Whether a Compliance Director or General Counsel is or becomes a supervisor is a fact based on analysis. Here Enforcement and the Hearing Panel are convinced that the Respondent undertook certain specific responsibilities concerning BOM and failed to perform them. He also was personally and specifically put on notice by IM of problems for which he had undertaken an oversight relationship. He is therefore before the Hearing Board because he had become, as to specific problems, a failed supervisor.”



- Yuet Kwan Wong
NYSE Hearing Board Decision 07-110 (July 20, 2007)
 - Wong was the Firm's President, Chief Compliance Officer and Anti-Money Laundering Compliance Officer
 - Decision notes failure of Firm to conduct the required independent audit of the Firm's anti-money laundering program, which was the Chief Financial Officer's responsibility, and holds Wong responsible, in her capacity "as the Firm's anti-money laundering compliance officer" for the failure to "reasonably supervise and control" the AML activities.
 - This supervisory failure was one of a number of allegations against Wong but the only one that related to her responsibilities as a compliance officer.

