

IBDC

FINRA & SEC “HOT TOPICS”



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CULTURE OF COMPLIANCE

FINRA Is Formalizing Process for Assessing “Firm Culture”

- Defined as “the set of explicit and implicit norms, practices, and expected behaviors that influence how firm executives, supervisors, and employees make and implement decisions.”
- Regulatory “Sweeps”: seeking general information on firm culture, with a particular focus on how management communicates firm culture and measures compliance with cultural values.
- Low Tolerance for Breaches of Procedures
- Adequate Resources Devoted to Compliance

INDICATORS OF FIRM CULTURE

- Whether control functions are valued within the organization;
- Whether policy or control breaches are tolerated;
- Whether the organization proactively seeks to identify risk and compliance events;
- Whether supervisors are effective role models of firm culture; and
- Whether sub-cultures (e.g., at a branch office, trading desk or an investment banking department) that may not conform to overall corporate culture are identified and addressed.

HIRING PRACTICES AND TRANSITION ISSUES

- Enhanced Background Checks
 - FINRA Rule 3110(e) & Regulatory Notice 15-05 (eff. July 2015)
 - Must Adopt Written Procedures to Verify the Accuracy of RRs U4 Information
 - Must Conduct Search of “Reasonably Available Public Records”; Must Include Criminal History, Civil Litigation, and Business Records
 - Background Checks Must be Completed Within 30 Days of U4 Being Filed With FINRA
- Special Focus on “Cockroaching” and Recidivist Brokers: Data Analytics

HIRING PRACTICES AND TRANSITION ISSUES

- Best Practices
 - Don't Just Collect Documents, Review Them; Do the Documents Support the Decision to Hire?
 - Maintain Well-Organized Files on Each Hire.
 - Perform Due Diligence and Monitoring of Third Party Background Check Providers.
- Regulatory and Litigation Implications
 - Supports Defense in "Failure to Supervise" Cases

ANTI-MONEY LAUNDERING AND SUSPICIOUS ACTIVITY

- FINRA Rule 3310 and SEC Rule 17a-8
 - Increased focus by the government and industry on AML risks and Firms' role in combating financial crimes, especially microcap stock fraud
 - Renewed enforcement interest in cases involving failure to file SARs (money movements, share movements and trading activity)
 - A broker/dealer must implement policies reasonably designed to achieve compliance with the BSA, perform independent compliance testing of its AML policies, and “detect and cause the reporting” of transactions within the scope of federal law, such as the filing of CTRs and SARs.
 - Firm must designate a qualified AML Compliance Officer, and provide ongoing AML-related training for appropriate personnel.

ALTERNATIVE & NON-TRADITIONAL PRODUCTS

- Firms and Brokers must consider the suitability of the security recommended and must carefully review and understand the product
 - Reliance on Prospectuses and Disclosure Documents is Not Sufficient
 - Due Diligence Must Be Done By People With “Appropriate Training And Skill”
 - “Track Records” of Issuers Can Be Considered, But Due Diligence Must Be Performed for Each Offering
- Factors to Be Considered: Liquidity/Secondary Market, Duration, Credit Worthiness of Issuer, Quality of Underlying Collateral, Use of Leverage
- Concentration Issues

DATA PRIVACY AND (CYBER)SECURITY

- Regulation S-P
 - Requires Firms to have policies and procedures addressing protection of customer information
 - Must address “anticipated” threats to the security/integrity of customer records
- Technology
 - Are the firm’s technology systems sufficient to support its risk management policies and practices?
 - Chief Technology Officers should expect to have a seat at the “grown-ups” table.
- Cybersecurity
 - FINRA will review cybersecurity risk management, considering a firm’s business and risk profile.
 - Focus on risk assessment, technical controls, incident response, vendor management, data loss prevention, and staff training.
 - Noted deficiencies include (i) a lack of written procedures and evidence of supervision, (ii) insufficient segregation of duties, and (iii) insufficient training and quality assurance.

OUTSIDE BUSINESS ACTIVITIES AND CONFLICTS

- FINRA Rule 3270: Firms must determine whether the proposed activities might interfere with or compromise the registered person's responsibilities to the firm or the firm's customers, or be viewed by customers or the public as part of the firm's business.
- Focus on Firms' procedures to review outside business activities.
- The "Rubber Stamp" Problem: Failure to adequately assess representatives' written notifications of proposed OBAs is one of the most common examination findings.
- Private Securities Transactions Considerations (FINRA Rule 3280)

PRIVATE PLACEMENTS AND CROWDFUNDING

- Focus on suitability, disclosure and due diligence.
- Give ‘Em Enough Rope: Consideration of recent regulatory developments, including the ability to conduct general solicitations under SEC Rule 506(c) of Regulation D.
- Fair and Balanced: Communications must address significant risks of loss of principal and lack of liquidity; where a communication addresses a specific investment benefit associated with a private placement offering, the key risks associated with such benefit must be disclosed.
- Crowdfunding Considerations
 - Eliminates Accreditation Requirements and Permits “General Solicitation”
 - Requires an SEC-Registered Intermediary (Broker-Dealer or Crowdfunding Portal)
 - Intermediaries must take reasonable steps to prevent fraud and ensure that issuers and investors comply with Regulation CF.

NAVIGATING THE LANDSCAPE

- What Can We Expect:
 - Ganging Up & Piling On: Greater Regulatory Cooperation
 - Cases Based on Metrics, Easily Sortable/Trackable Conduct and Products
 - Sanction Inflation
- What Can We Do:
 - Partnership With Compliance and Risk Managers
 - Early Intervention in Suspect Conduct; Mobilization of Resources
 - Document and Retain Due Diligence and Related Materials

QUESTIONS AND ANSWERS

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