Shaken Not Stirred: SEC and FINRA Disciplinary Actions Against Compliance Officers (January-June 2015)*

By Brian L. Rubin and Irene A. Firippis

Introduction

Bond. James Bond. There is no mission insurmountable for 007. James Bond has faced it all—he played in a high-stakes poker game against a weapons dealer,¹ traveled to the Bahamas to recover stolen nuclear warheads in an international extortion scheme,² and uncovered a plot to contaminate the Fort Knox gold reserve³—while still remaining dashingly handsome in a tuxedo. With martini in hand, gadgets from Q, the advice of M, and witty comments from Ms. Moneypenny, James Bond is always ready for the next international adventure or femme fatale.

Being a Chief Compliance Officer (CCO) for broker-dealers (BDs) or investment advisers (IAs) is (usually) not as exciting (or dangerous) as being a British Secret Service agent. Yet, CCOs and in-house counsel have the difficult task of advising their colleagues and helping to ensure that their firms comply with securities laws and regulations, without having the authority to enforce their decisions or advice (and without having Bond’s trusted Beretta or Aston Martin).

While the U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) are not equipped with lipstick bombs,⁴ dragon tanks,⁵ or Oddjob’s sharpened steel-rimmed bowler,⁶ the regulators do carefully monitor and scrutinize the conduct of CCOs.

CCOs not only face liability solely for their compliance-related activities, but for other conduct as well. Over the last several years, only a few SEC cases have targeted CCOs solely for their compliance-related conduct, and the number of enforcement actions fluctuates each year. For example, according to SEC Commissioner Luis Aguilar, in 2013, roughly 20% of the cases brought against IAs and investment companies involved CCOs; in 2014, that number dropped to 6%.⁷ The majority of these cases involved CCOs who wear “more than one hat,” meaning many of their job duties were outside the traditional work of CCOs (such as acting as chief financial officers,

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chief investment officers, directors, etc.). Additionally, from January through June 2015, FINRA brought approximately a dozen cases involving CCOs who allegedly failed to fulfill compliance-related responsibilities.

These cases raise a fundamental policy question of whether enforcement actions against compliance officers will “motivate them to greater vigilance or risk a demoralizing belief that even exercising their best judgment will not protect them from the risk of a career ending enforcement action, with the result that many of the best compliance officers will choose to leave the profession rather than face the risks.” Recently, SEC enforcement decisions have applied a simple negligence liability standard where the compliance officer is alleged to have “caused” the primary violation committed by another. While CCOs do not face the danger encountered in the world of international espionage, they are consistent targets of SEC and FINRA disciplinary proceedings, as this article and our prior articles demonstrate. Some of the cases brought against CCOs by the SEC and FINRA during January through June 2015 (and a more recent case brought by the SEC) are discussed below and can provide insight on conduct that is likely to attract the attention of the regulators.

**Recent Issues**

**Supervisory Systems and Written Supervisory Procedures**

_Natalya Simonova [Bond Girl]: Do you destroy every vehicle you get into?_ 

_James Bond: Standard operating procedure . . . .11_

While James Bond apparently has at least one standard operating procedure (or “SOP” as we in the legal, compliance and spy fields call it), in general, with his “license to kill”12 (which is much different from a Series 7), he is not bound by any rules when fighting Dr. Julius No13 or Mr. Big.14 However, that is not the case for BDs and IAs. They are subject to FINRA and SEC regulations. Specifically, FINRA requires BDs to establish and maintain supervisory systems “reasonably designed to achieve compliance” with applicable laws, regulations and rules, including written supervisory procedures (WSPs) designed to supervise the business activity of firms.15 FINRA also requires that the supervisory system “is tailored specifically to the member’s business.”16 Similarly, IAs must adopt and implement written policies and procedures reasonably designed to prevent violations of applicable laws, regulations and rules.17 Occasionally, CCOs are responsible for these procedures and supervisory systems and, therefore, may be subject to disciplinary actions when the procedures or systems are inadequate.

In an April 2015 settlement, the SEC disciplined an IA’s CCO for failing to adopt and implement written compliance procedures concerning the outside activities of its employees.18 The IA failed to disclose a conflict of interest involving the outside business activity of one of its portfolio managers. After joining the IA to manage energy-focused registered funds, the portfolio manager later formed an oil and natural gas production company. Thereafter, the portfolio manager’s production company formed a joint venture with a publicly traded coal company held in the IA’s funds and accounts managed by the portfolio manager. A year later, the coal company’s stock was the largest holding in the portfolio managed by the portfolio manager. The IA knew of the portfolio manager’s involvement in his production company and the joint venture, but failed to disclose the portfolio manager’s conflict of interest to the IA’s board of directors or to advisory clients.

The CCO was sanctioned for not implementing procedures specifically addressing how to monitor and assess employees for conflicts of interest, how to monitor employees who participated in firm-approved outside activities, and how to determine when an employee’s outside activity should be disclosed to the firm’s board of directors or to the firm’s advisory clients. The firm did not have any written policies or procedures regarding the outside activities of its employees. The firm only required preapproval for an employee to serve on a board of directors and had a broad conflicts of interest provision in its business conduct and ethics code. The SEC found that as the IA’s CCO, he was responsible for the design and implementation of the IA’s written policies and procedures. In addition, the CCO knew and approved of numerous outside activities engaged in by the portfolio manager and other employees, but did not recommend written policies and procedures to assess and monitor those outside activities and to disclose conflicts of interest.

Accordingly, the SEC found that the CCO caused the IA’s violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. The CCO was fined $60,000.
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spondence, failed to memorialize the steps to be taken, failed to specify the frequency of the review, and failed to specify how the reviews were to be documented. FINRA found the firm’s and the CCO’s failures violated NASD Rules 3010(a) and 3010(d)(1) and FINRA Rule 2010. FINRA fined the CCO $5,000 (and also fined the firm $5,000) but did not impose a suspension.

Takeaways: Regulators may sanction CCOs for their firms’ failure to have and maintain procedures relating to, and appropriately tailored to, the business in which their firms are engaged. Sometimes firms also need to have clear policies relating to non-business functions, such as outside business activities, and when those policies are deficient, regulators may sanction the CCOs.

Supervision of Individuals

M [Head of the Secret Intelligence Service, also known as MI6]: If you could avoid killing every possible lead, it would be deeply appreciated.

James Bond: I’ll do my best.

M: I’ve heard that before.

While M may be considered James Bond’s supervisor, M could only do so much to affect his conduct and—as far as we know—she has never faced a failure to supervise charge for Bond’s antics. In the regulatory world, CCOs may be considered supervisors and may face potential liability if they have been delegated specific supervisory responsibility over another person, or have adequate “responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue.”

The SEC has explained one standard of conduct expected of supervisors, describing “[t]he duty of supervision [to include] the responsibility of investigating ‘red flags’ that suggest that misconduct may be occurring and to act upon the results of such investigation. Once indications of irregularity arise, supervisors must respond appropriately.” The Securities Exchange Act of 1934 (Exchange Act) similarly provides a safe harbor from supervisory liability for broker-dealers where there are “established procedures and a system for applying such procedures, which would reasonably be expected to prevent and detect” violations. Section 203(e)(6) of the Advisers Act contains the same language. Compliance officers generally do not supervise anyone outside of their direct-line employees. Supervisory authority generally includes hiring, firing, failing to promote, reassigning with significantly different responsibilities, and making a decision causing a significant change in benefits. Cf. Division of Trading and Markets, “Frequently Asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act” (Sept. 30, 2013) at n. 8, available at http://www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm.

and ordered to cease and desist from committing or causing any violations and future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

Through a February 2015 Letter of Acceptance, Waiver and Consent (AWC), FINRA disciplined a CCO (who was also the firm’s president and financial and operations principal or FINOP) for his firm’s failure to establish and enforce a supervisory system and supervisory controls for reviewing registered representatives’ correspondence. During the review period, the firm used an outside email vendor to capture and maintain emails. One of the vendor’s email message review reports revealed that 122,442 emails were captured but only 18 were actually reviewed by the CCO. Additionally, the firm did not have a supervisory system and WSPs for reviewing and documenting the CCO’s review of emails to and from the firm’s registered representatives. The firm’s WSPs regarding review failed to specifically identify who was responsible for the supervision and review of corre-
For example, in a May 2015 litigated decision, a FINRA Hearing Panel disciplined a CCO for failing to reasonably supervise the activities of the firm’s registered representatives in violation of NASD Rules 3010(a) and 3010(b) and FINRA Rule 2010. The Panel found that the CCO’s supervisory violations were two-fold. First, the CCO failed to respond appropriately to red flags. Specifically, during the review period, customers rejected more than 18% of the initial trades in new accounts that the firm submitted to its clearing firm. The CCO acknowledged that customer “reneges” as high as 30% were not uncommon for some representatives. The Hearing Panel found that these rates of rejection were red flags that required inquiry. The CCO did not track customer reneges nor did he have an adequate process for investigating the reneges. Further, the CCO did not exercise any special care when addressing registered representatives who had large amounts of customer reneges nor was he concerned with potential excessive trading activity. Second, the CCO failed to implement heightened supervision, as required by the firm’s WSPs. The WSPs required the CCO to consider placing representatives who met certain criteria on heightened supervision. During the review period, 13 brokers met these criteria for heightened supervision, some of whom substantially exceeded the threshold criteria. For example, one representative was the subject of seven complaints for sales practice abuses within only one year; another representative was the subject of seven complaints for sales profiting. The Hearing Panel found that the CCO’s failure to report numerous customer complaints in violation of NASD Rules 3070 and 2110, and FINRA Rule 2010. During the review period, the firm received 53 written customer complaints involving excessive trading, unauthorized trading, or poor performance. The Hearing Panel found that the CCO’s failure to report more than half of the written customer complaints was, at a minimum, reckless conduct, if not knowing. The Hearing Panel also noted the firm “lacked a good compliance culture. The problem started at the top.” The CCO “evidenced little concern about potential unauthorized account opening, unauthorized training, or excessive trading.”25

The Hearing Panel found that in light of the CCO’s supervisory violations and disciplinary history, it did not believe the CCO was capable of meeting applicable regulatory requirements. Therefore, to protect the investing public and deter the CCO and others from engaging in similar misconduct, the Hearing Panel barred the CCO from associating in any capacity with any FINRA member firm. In light of the bar, the CCO was not fined.

In January 2015, through an AWC, FINRA disciplined a CCO for failing to reasonably supervise a registered representative and for failing to establish and maintain a supervisory system reasonably designed to supervise the registered representative’s activities. During the review period, a registered representative operated three unregistered BDs for the sole purpose of purchasing securities, primarily initial public offerings of corporate bonds, for an unregistered proprietary trading firm. The registered representative purchased the securities through delivery-versus-payment brokerage accounts that he instructed the CCO to open. After the unregistered BDs purchased the securities for the unregistered proprietary trading firm, the proprietary trading firm sold the securities within days of the purchase. The unregistered BDs received trading profits and other compensation.

The CCO was responsible for establishing and maintaining a supervisory system reasonably designed to supervise the registered representative’s activities. Moreover, as the registered representative’s direct supervisor, the CCO knew that the representative was purchasing securities through his outside business and was being compensated for those securities transactions. FINRA found that the CCO should have recognized, but failed to recognize, that the representative’s outside businesses were functioning as BDs that required registration under Section 15(a)(1) of the Exchange Act. By failing to reasonably supervise the representative’s activities, FINRA found that the CCO violated NASD Rules 3010 and 2110 and FINRA Rule 2010 (in addition to other misconduct including making misleading or inaccurate statements to corporate bond dealers). FINRA suspended the CCO for six months from associating with any FINRA member in a principal capacity and for three months from associating with any FINRA member in any capacity, with the suspensions running concurrently. The CCO was also fined $50,000.

CCOs not only face liability solely for their compliance-related activities, but for other conduct as well.
**Takeaways:** CCOs should generally not supervise registered representatives, if the firm’s structure makes this at all possible. If they do (or if they supervise anyone), regulators may sanction them if they fail to respond adequately to red flags or follow their firms’ procedures.

**Approval of Advertising Material**

*Waiter (after handcrafting James Bond’s cocktail): One medium dry vodka martini mixed like you said, sir, but not stirred.*

When one prepares 007’s favorite cocktail, James Bond’s approval is essential. CCOs, on the other hand, may be responsible for approving advertising material (and occasionally enjoying drinks … although hopefully not at the same time). FINRA Rule 2210(b)(1), which replaced NASD Conduct Rule 2210, provides that “an appropriately registered principal of the member must approve each retail communication before the earlier of its use or filing with FINRA’s Advertising Regulation Department.”

In May 2015, through an AWC, FINRA disciplined a CCO for failing to demonstrate appropriate principal approval of certain advertising materials, including communications on the firm’s websites and social media accounts. The firm’s WSPs stated that the CCO was responsible for preapproving advertising materials including sales literature, websites, and social media. Additionally, the WSPs required the CCO to preapprove online webinars. Despite these requirements, the CCO failed to review and preapprove the content on the firm’s two websites. The CCO also failed to review and approve postings on the firm’s Facebook, YouTube, and Twitter pages. Further, the CCO could not demonstrate that certain posts on the firm’s social media accounts relating to options trading were approved in advance by him or any other registered operations principal at the firm. Lastly, several registered representatives at the firm’s branch locations conducted webinars advertising various online trading strategies, which were not reviewed or preapproved by the CCO, as required. For this misconduct, FINRA found the CCO violated NASD Rule 2210(b), and FINRA Rules 2210(b), 2220(b), and 2010. Accordingly, the CCO was fined $10,000 and suspended for three months from association with a FINRA member in a principal capacity.

**Takeaways:** Regulators may sanction CCOs if they fail to adhere to WSPs that require them to perform certain monitoring tasks, such as preapproving advertising materials including sales literature, websites, and social media.

**Anti-Money Laundering Procedures**

*James Bond: You break into the Bank of England via computer, and transfer the money electronically. Just minutes before you set off the GoldenEye, which erases any trace of the transactions. Ingenious.*

In the real world, despite there being no GoldenEye “app” to assist with money laundering (as far as we know), firms have certain anti-money laundering (AML) obligations. For example, FINRA Rule 3310 (formerly NASD Conduct Rule 3011) requires FINRA member firms to develop and implement AML compliance programs reasonably designed to achieve and monitor the member’s compliance with the requirements of the Bank Secrecy Act, 31 U.S.C. § 5311 et seq. In general, BDs are required to have specific procedures and systems to enable them to detect and respond to suspicious movements of money. In Notice to Members 02-47, FINRA reminded members of their obligation to look for red flags and report suspicious activity by filing a Form SAR (Suspicious Activity Report). Additionally, federal law requires AML procedures to be appropriately tailored to the firm’s business. AML procedures should reflect the firm’s business model and customer base. Additionally, Rule 17a-8 of the Exchange Act requires BDs to comply with reporting obligations under the Bank Secrecy Act.

In January 2015, through an AWC, FINRA disciplined a CCO, who was also the anti-money laundering compliance officer (AMLCO), for failing, among other things, to establish, maintain, and enforce the firm’s AML compliance program. The AMLCO failed to establish and implement a supervisory system, including written procedures, tailored to the firm’s primary business line of extending direct market access (DMA) to domestic and foreign active traders. During the review period, the firm’s monitoring of trade activity in customer accounts solely consisted of the following: (i) a weekly review of trades of $50,000 or greater and certain penny stock trades of 500,000 shares or greater, and (ii) manual real-time reviews by a principal of the firm of all order and trade activity in customer accounts. FINRA found that neither of
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these practices was reasonably designed to identify suspicious or potentially manipulative trading activity. FINRA found especially unreasonable the firm’s reliance on a manual real-time review by a principal to detect suspicious or potentially manipulative activity, given the number and frequency of DMA-customer orders processed daily. Additionally, FINRA found that the AMLCO failed to implement and enforce a risk-based due-diligence program for correspondent accounts maintained by foreign financial institutions. Accordingly, FINRA found that the AMLCO violated FINRA Rules 3310(a), 3310(b), and 2010. The AMLCO was suspended from association with any FINRA member in a principal capacity for three months and fined $20,000.

In a late 2014 default decision, FINRA disciplined a CCO, who was also the firm’s AMLCO, for failing to establish and implement reasonable AML policies and procedures. The AMLCO was responsible for ensuring that all accounts were monitored for suspicious activity, but FINRA found that the firm’s AML policies and procedures were not reasonably designed to achieve compliance with the requirements of the Bank Secrecy Act. The AML policies and procedures were not reasonably designed to detect, and cause the reporting of, suspicious transactions. During the review period, FINRA identified more than 6,300 instances of suspicious trading activity involving potentially manipulative wash sales, layering, and pre-arranged trading in a particular account. As a result, FINRA sent the firm 11 inquiries requesting documents and information on more than 5,000 of the 6,300 instances. FINRA found that its inquiries and the 5,000 instances should have served as red flags to the AMLCO, alerting him to potentially manipulative and/or suspicious trading activity. The AMLCO ignored these red flags. Even worse, despite these red flags, the AMLCO never identified any manipulative activity. He failed to ensure that the firm had controls, such as electronic surveillance or exception reports, to monitor transactions for suspicious activity.

FINRA found that the firm’s AML policies and procedures were deficient for various reasons and the CCO never created any monitoring parameters nor contributed to the monitoring parameters established by the clearing firms for their trade surveillance reports. For this misconduct, FINRA concluded that the CCO violated FINRA Rules 3310(a) and 2010. For his “egregious” violations, the CCO was fined $20,000 and suspended for one year in all principal capacities.

Takeaway: Regulators may sanction AMLCOs if red flags are not addressed adequately or if AML policies and procedures are not tailored to ensure that the proper systems are in place to detect and report suspicious trading activity.

Books and Records

Dryden [corrupt MI6 section chief; Bond’s second kill]: Your file shows no kills, but to become a double-0, it takes...

Bond: Two.

Book, records, and files serve many purposes, including (sometimes) foreshadowing the future. Creating documents containing false information, however, is never a good idea. CCOs (and others) can make life (and examinations) a whole lot simpler by not producing false books and records. BDs and IAs are required to maintain certain books and records under Securities Exchange Act Rules 17a-3 and 17a-4, Investment Advisers Act Rule 204-2, and related FINRA Rules, including NASD Rule 3110. If BDs and IAs fall short in maintaining truthful books and records, or tamper with them in some fashion, CCOs may face liability if they played some role in the violation.

In June 2015, through an AWC, FINRA disciplined a CCO for failing to enforce the firm’s WSPs related to financial controls and financial books and records. The CCO (also the firm’s FINOP for a brief period) was responsible for maintaining the accuracy of the firm’s books and records, including the general ledger, the trial balance, and the balance sheet. Additionally, the CCO was responsible for reconciling the clearing firm statements. The CCO’s failure to enforce the firm’s WSPs related to financial controls and financial books and records resulted in several inaccuracies in the firm’s books and records, including the general ledger, the trial balance, the balance sheet, net capital computations, and the Financial and Operational Combined Uniform Single Reports (FOCUS).

As a result, during the review period, the CCO permitted the firm to operate a securities business while it was net capital deficient. For example, the CCO failed to notify the firm that its net capital fell below 6 2/3% of its aggregate indebtedness. The CCO did not ensure that the firm’s general ledger, trial balance and balance sheet accurately
reflected the firm’s liabilities. In addition, the CCO failed to provide the firm’s FINOP with supporting documents required to accurately compute the firm’s net capital and to file accurate FOCUS reports. Lastly, the CCO did not notify the firm’s FINOP that the firm agreed to pay a $25,000 fine to FINRA, which should have been accrued as a liability. FINRA found that the CCO violated NASD Conduct Rule 3010(b) and FINRA Rules 4110, 4511, and 2010. Accordingly, the CCO was suspended for one month from associating with any FINRA member firm and was ordered to requalify as a FINOP through requisite examination prior to either acting in that capacity or registering with any FINRA member firm. FINRA did not impose monetary sanctions because the CCO demonstrated an inability to pay.

**Takeaway:** Regulators may sanction CCOs if they do not ensure that their firms’ books and records contain accurate information. Additionally, regulators may sanction CCOs if they produce books and records containing false information.

### False Responses to Rule 8210 Requests for Information

*Literary devices can be important.*

Lying to regulators is never a good idea. FINRA Rule 8210 “provides a means, in the absence of subpoena power, for [FINRA] to obtain from its members information necessary to conduct investigations.” Rule 8210(a) states, in pertinent part, that for the purpose of an investigation or examination authorized by FINRA’s By-Laws or rules, FINRA Staff has the authority to “require a member, person associated with a member, or any other person subject to FINRA’s jurisdiction to provide information . . . in writing . . . or electronically . . . with respect to any matter involved in the investigation . . . [or] examination . . . .” The rule further authorizes FINRA Staff to “inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation . . . examination, or proceeding.” Rule 8210 is considered “the heart of the self-regulatory system for the securities industry.” Providing misleading and false information to FINRA in response to a Rule 8210 request “mislead[s] [FINRA] and can conceal wrongdoing,” impeding FINRA’s “ability to perform its regulatory function and protect the public interest.”

In March 2015, an extended FINRA Hearing Panel disciplined a CCO for providing false documents to FINRA. The firm engaged in penny stock trading and followed a particular protocol for the receipt of penny stocks. When customers sought to deposit shares of penny stock into their accounts, the firm required its registered representatives to have the customers complete a Deposit Securities Request (DSR) form. The DSR’s purpose was to provide the firm with sufficient information that the shares of penny stock were legally qualified for resale. During a seven-month period, one of the firm’s registered representatives falsified approximately 37 DSR forms by photocopying the CCO’s signature, which was required for supervisory approval, and altering the dates on the forms to conform to the dates the customers deposited securities into their accounts. Thereafter, the CCO learned of the falsified DSR forms and met with the registered representative. The CCO did not document the meeting or conduct an investigation to determine the scope of the registered representative’s misconduct. Additionally, the CCO never reported the misconduct to FINRA.

Further, in response to four FINRA Rule 8210 requests for information, the firm provided 37 falsified DSR forms to FINRA. The CCO was responsible for the information provided to FINRA, and the CCO never notified FINRA that the Rule 8210 responses contained falsified information. In his defense, the CCO asserted that he did not know of the falsified forms until after the first three Rule 8210 requests. But, upon learning of the falsified forms, the CCO did not review the firm’s prior productions to FINRA to determine if the firm had provided other falsified documents. The Hearing Panel noted that “regardless of when [the CCO] learned of the falsified documents, whether he knew the true extent of the misconduct, scienter is not an element of a Rule 8210 violation.” Finding the CCO’s conduct a “serious violation of Rule 8210” and Rule 2010, FINRA fined the CCO $25,000 and suspended him from all principal capacities for 12 months.

**Takeaway:** Regulators may sanction CCOs if they provide misleading and false information to any regulator (and if they lie to secret agents, well, you don’t want to know . . .).
Monitoring Insider Trading

James Bond: I help people with problems.
Franz Sanchez [South American Drug Lord]: Problem solver.
James Bond: More of a problem eliminator.48

Like James Bond, CCOs are tasked with eliminating problems, such as ensuring firms have adequate procedures to detect suspicious trading activity and insider trading. Recently,49 an SEC Administrative Law Judge (ALJ) declined to sanction a former compliance officer (CO) for tampering with documents relating to her review of questionable trades of securities, despite Exchange Act, Rule 17(a)-4(j), and Section 204(a) of the Advisers Act.50 In her capacity, the CO was the primary employee responsible for conducting the firm’s insider trading reviews. To initiate her review, the CO relied primarily on news stories. The CO also maintained a log to track her reviews, and to record the companies and stocks she reviewed. The log also documented her findings and whether the review was escalated.

On September 2, 2010, an acquisition of a public company was publicly announced. That same day, the CO began her review of pre-acquisition announcement trading in that security by a particular registered representative and three of his customers. In her review, the CO determined: (a) the registered representative and his customers comprised the top four positions in that security firm-wide; (b) the registered representative and his customers bought those securities within 10 days prior to the announcement, including on the same days; (c) the profits by the registered representative and his customers each exceeded the $5,000 threshold specified in the firm’s policies (the policies called for a review of the account owner and trading history if profits or avoided losses were greater than $5,000); (d) both the registered representative and the headquarters for the company being acquired were located in the city; and (e) the registered representative, one or more of his customers, and the company making the acquisition were all from the same South American country. The CO conducted an “enhanced review,” which included determining if any of the registered representative’s clients were board members or officers of the company being acquired. The CO determined there were no “red flags” requiring follow-up and that none of the trading was suspicious. The CO’s insider trading review file contained a webpage printed on September 2, 2010, showing the company’s stock price movement and headlines regarding the acquisition. The CO did not follow up with the registered representative or his branch manager about the registered representative’s trading; contact the branch; and did not escalate the review to her manager or take any further steps. The CO then stored the insider trading reviews she had conducted. The 2010 file was later sent to an off-site storage facility.

In 2012, the SEC initiated an investigation into the registered representative’s insider trading. As part of that investigation, the SEC requested, pursuant to Exchange Act Sections 17(a) and (b), that the firm, among other things, produce “[a] ll documents concerning any inquiry made by any representative of [the firm], including but not limited to the compliance department, relating to trades in [the acquired company] securities made by [the registered representative] and his response to any such inquiry.” The SEC made a second request that the firm produce, among other things, all “compliance files including but not limited to reviews, inquiries, or complaints” relating to the registered representative. In response to both requests, the firm produced documents, but neither production contained any documents relating to the CO’s September 2010 insider trading review. The firm certified its production as complete in early September 2012, even though the production did not contain any of the CO’s files.

In mid-September 2012, the CO became aware of the SEC’s investigation regarding the registered representative’s potential insider trading and that the firm was providing trading information to the Commission. After discussing the investigation with her supervisor, the CO created a separate 2012 file to store documents compiled in 2012, in an effort to avoid creating the appearance of backfilling documents. A few days later, with her supervisor’s permission, the CO had her 2010 review file retrieved from the off-site facility. The CO kept the 2010 file at her desk. The CO later testified that she printed several articles about the acquisition in September 2012 and that she could not recall whether she printed those articles in 2010 because the firm was “trying to be green.” Two months later, the SEC announced that it had settled a case with one of the registered representative’s customers. As a result, the CO’s supervisor requested the 2010 file containing the CO’s review. In December 2012, the SEC initiated an investiga-
tion into the sufficiency of the firm’s policies. Pursuant to that investigation, the SEC requested all internal reviews or investigations regarding the review of pre-acquisition announcement trading in the security. Before turning over her review file, the CO added two sentences to the notes section of her log; she also created a cover page. Thereafter, the review file was produced to the SEC, without any mention that it contained alterations.

The ALJ found that the CO aided and abetted and caused the firm’s violations of the Exchange Act and the Advisers Act. Despite these violations, the ALJ declined to impose sanctions on the CO, basing the decision on the following factors: the CO’s alteration of the log was an isolated event; her violation was limited to the addition of two sentences to the log and was neither a recurrent nor widespread offense; and the CO credibly testified that she has no desire to work in the securities industry again. Additionally, no documents were destroyed, and the CO timely produced documents when asked to do so. The ALJ explained that, taken in isolation, these factors weighed in favor of at least some sanction. Yet, the ALJ found that the factors were “decisively outweighed” by the remaining public interest factors: egregiousness, degree of harm, and deterrence. While the ALJ stated that he did not condone the CO’s misconduct, he concluded that the CO’s misconduct caused no proven harm to the marketplace or investors. In dismissing the action, the ALJ stated: “it is clear that sanctioning [the CO] would be overkill.”

**Takeaways:** Regulators may sanction CCOs if they fail to comply with their firms’ policies and procedures regarding insider trading. In addition, regardless of the type of review being performed, regulators may sanction CCOs if they fail to contemporaneously document their reviews.

**Conclusion**

*Ernst Stavro Blofeld [Super villain]: James Bond, Allow me to introduce myself. I am Ernst Stavro Blofeld. They told me you were assassinated in Hong Kong.*

*James Bond: Yes, this is my second life.*

*Blofeld: You only live twice, Mr. Bond.*

Unlike James Bond, CCOs are not immortal; a single enforcement action (and sometimes a single investigation that is ultimately closed) can kill a CCO’s career. One way for compliance officers to dodge the bullet, so to speak, may be for them to study applicable securities laws and regulations, review cases concerning other CCOs who have faced disciplinary actions, and read articles such as this one. By taking these measures (and avoiding getting poisoned), compliance officers may feel only shaken, but not too stirred up, the next time they hear about a compliance officer being sanctioned by the SEC or FINRA.

**ENDNOTES**

1. The authors recommend their audience listen to the “James Bond Theme” while reading this article. Readers can access Monty Norman’s classic at: [https://www.youtube.com/watch?v=li1tc493bZM](https://www.youtube.com/watch?v=li1tc493bZM).


10. *See, e.g., Brian L. Rubin and Irene A. Firiippis, Compliance Wars: SEC and FINRA Disciplinary Actions Against Chief Compliance Officers and In-House Counsel in a Galaxy Not Too Far Away (June-December 2014), Practical Compliance and Risk Management, May-June 2015 at 25; Brian L. Rubin and Katherine L. Kelly, Catching Fire During Regulatory Hunger Games: SEC and FINRA Disciplinary Actions Against Chief Compliance Officers and In-House Counsel (January-June 2014), Practical Compliance and Risk Management, November-December 2014 at 13 n.1 (citing prior articles published in the same journal).* 


set forth substantially similar requirements for supervisory systems and written procedures.

30 FINRA Rule 3310(a) requires that members “[e]stablish and implement policies and procedures that can reasonably be expected to detect and cause the reporting of transactions required under 31 U.S.C. § 5318(g) and the implementing regulations thereunder.”


33 NASD Notice to Members 02-21, 2002 NASD LEXIS 24, at *17 (Apr. 2002).


37 FINRA also disciplined the CCO for failing to establish and maintain an adequate supervisory system and written supervisory procedures. The CCO violated NASD Conduct Rule 3010 and FINRA Rule 2010.

38 This case is outside of the January through June 2015 time frame but the authors decided to include this case due to the seriousness of the conduct and the Administrative Law Judge’s analysis and decision to not impose sanctions.


40 FINRA Rule 4110 enables FINRA to prescribe greater net capital requirements for carrying and clearing members, or require any such member to restore or increase its net capital or net worth, when deemed necessary for the protection of investors or in the public interest.

41 FINRA Rule 4511 requires members to preserve for a period of at least six years FINRA books and records for which there is no specified period under the FINRA rules or applicable Exchange Act rules.


47 Id. at 9 (citing Berger 2008 SEC LEXIS at *39).


49 Id. at *20.


52 Id. at *20.


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