

Establishing Your Compliance Program

By Polly Cordle

Whether it is your first day at a new firm or you have spent your entire career at one firm, taking a ground-up look at your Compliance program can be a valuable exercise. In this article we look at how the new Chief Compliance Officer can get the firm's compliance program going, but the lessons could be the same for any Chief Compliance Officer. Programs can become stale after years of Band-Aids and slight changes, so it makes sense to take a step back and give the program a detailed review, not because you are required to annually, but because you want your compliance program to be the best it can possibly be. Knowing that responsibility for the firm's compliance program lies with you can be daunting. You do share the responsibility with the Chief Executive Officer, but ultimately it is you who must put together a strong system of supervisory processes and controls to ensure the firm is covered both from a regulatory standpoint and from a solid business practices standpoint. So, where do you begin?

While there is clearly no way to cover everything a person needs to know to create and facilitate any firm's compliance program, in this article we will attempt to establish some first steps for the process. These include establishing your culture of compliance, your written manuals to provide to regulators, your branch examination process, your routine for ensuring you know all new rules and regulations as they are published and how you will document the work you do day-to-day to ensure compliance with those rules and regulations.

Establish Your Culture

First, take a look at where you are and determine what kind of culture has existed before you. If this is a brand new firm, great: you get to set the tone from day one. If not, well, you may have some work to do.

Every year FINRA mentions the importance of compliance culture in its Examination Priorities letter. Knowing that you need a culture of compliance and knowing how to establish one, however, are two very different things. Starting from scratch at a new firm can be challenging but no more so than restarting at an existing firm. First you

Polly Cordle is a Senior Consultant with Oyster Consulting LLC. She has a wide variety of experience in the brokerage industry, including Compliance Supervisor, Brokerage Operations, Training and Branch Operations. A versatile asset to Oyster's clients, Polly develops and provides custom compliance training, regulatory and communication, and rule implementation services. Her intimate knowledge of the many facets of the brokerage industry enables her to provide expertise and support for various projects.



©2016, Polly Cordle

must establish a level of trust between Compliance and all other areas of the firm.

For many years, the term “Compliance” had a negative connotation. Firms felt that Compliance and the regulators always got in the way of doing business and making money. Some Compliance departments still live in an “us versus them” environment. But, the idea of Compliance as a business deterrent or negative can be damaging to the program you are trying to build. You must first make sure

Ultimately it is you who must put together a strong system of supervisory processes and controls to ensure the firm is covered both from a regulatory standpoint and from a solid business practices standpoint.

that all areas understand you are there to protect the firm, the people, and the clients, not necessarily in that order. You shouldn’t be there to deter business or keep the firm from making money. It can sometimes seem like “no” is the only word that Compliance knows. You have to change that perception. Your answer needs to be “let’s see what we can come up with,” instead of just “no.” There are going to be times when you simply can’t avoid the word “no.” There are regulations in place that don’t leave room for certain activities. Most of the time, though, the answer doesn’t have to be “no” but could be a combination of finding a way to say “yes” while protecting clients and the firm. Teach your firm the expectations of the regulators and always remind them of the expectations of the public. Following the rules will not pay off if something hits a headline that damages the reputation of the firm. You will need to be a creative problem solver. You need to be willing to help find solutions while making sure everyone understands the risks being assumed.

You will still, however, be required to address compliance violations as they occur. This is where things can get a little tricky. You have to maintain a balance. You need to be seen as an authority figure and you need to be taken seriously if you recommend the firm take action against an employee, if necessary. However, a solid Compliance program comes from

people trusting you and being willing to tell you everything. You do not want employees hiding things from you because they are afraid they will get in trouble. You need to know all the “skeletons” so you can address them and reduce risk to the firm.

In those situations where disciplinary action is required, you have to be willing to make it count. Consider your action as educational. Sometimes tough lessons need to be learned the hard way, so you may have to issue warnings or even put someone on heightened supervision. But this does not need

to be the end of the trusting relationship between that person and Compliance. Approach such actions as educational opportunities for the employee. Having Compliance take a detailed look at a registered representative’s day-to-day actions and his or her overall book of business does not have to be a negative. Compliance should be able to provide an overview of the business from the regulators’ perspective. Identifying areas that

seem to imply risk to clients can be viewed, if done in the right tone, as a learning experience. This can give the registered representative the opportunity to address the risk and tighten up processes before a regulator identifies the same concerns.

Establish Written Supervisory Procedures

While you are working to convince your firm that you are part of the team and not to be feared, you need to make sure your policies and procedures are in good order. Your Written Supervisory Procedures (“WSPs”) are the playbook of your department and your firm. They are the basis for all other policies and procedures.

If your firm has existing WSPs, get to know them, inside and out. Depending on what you find, you may want to rewrite them. This sounds exhausting, but is actually a great way to get to know the WSPs. It can also be an effective way to acquaint yourself with the other team members of the firm. Form a group and review section by section to make sure that the requirements of the WSPs are actually ones that can be accomplished. It is surprising how often a firm has a policy and procedure in place that they are not even capable of completing.

Your WSPs need to be clear and concise. Filling them with background information, rule quotations, and additional guidance not only will create a headache to keep them up to date

but can also result in a huge document that no one has the time to read or understand. If you can get across the basics for each procedure (i.e. the policy, the process, and the responsible parties), you don't need the other pieces. Regulators are not impressed by page count; they are impressed by substance.

Go through each and every procedure and make a list of who is responsible for each. Some WSPs can become so large and cumbersome that many of the people who are responsible for the procedures don't even know they exist. You need to remedy this. Create a "cheat sheet" for each person or role listed in your WSPs and publish that list. Let those affected know what they are responsible for and where to find more information.

If your firm has no WSPs, you will have to start from scratch. When a new firm is created, FINRA has a checklist it uses to verify WSPs. It is a huge spreadsheet that tells you what should be included and what rules apply to each section. But be careful, the spreadsheet isn't always up to date and even FINRA will tell you not to rely solely on this list. You may want to engage a third party, someone with expertise in setting up WSPs from the ground up. There are plenty of consulting firms who would welcome your business. Just be sure you give them guidance on what you want. Give them detailed instructions on how much detail you want included and how much input you want to give during the drafting process. Don't buy an off-the-shelf, one-size-fits-all manual. Especially when it comes to WSPs, one size most certainly does not fit all. Your manual needs to speak specifically to your firm or there isn't much purpose in having it.

Establish Other Manuals

Once you establish the WSPs, you have a jumping off point for all other manuals. Depending on the business model of your firm, you may have the need for many additional manuals. You will need to decide which ones suit your firm's model and make the most sense. Some options include:

- Anti-Money Laundering Guide (all firms need to have an AML program; whether you carry accounts or not will decide how thorough this needs to be);
- Qualified Supervisor/Branch Manager Guide (if your firm serves traditional retail clients, you will want to ensure that your branch offices understand the details of their day-to-day compliance responsibilities);
- Investment Advisory Guide (if your firm is also a registered investment adviser, you will need a solid program for it as well);
- Associates/Employee Guide (you may want to separate out employee responsibilities from supervisor responsibilities to keep policies clean and pertinent to the reader);
- Investment Banking Guide (if you have an investment banking channel in addition to a retail channel, it may make sense to separate the manuals); and
- Any other manual that makes sense in view of your business model.

Keeping many manuals instead of just one may not make sense, depending on your firm, but for firms that have multiple business channels running simultaneously, it may make your challenge of getting employees to know the policies that pertain to them easier. Giving employees a manual of 500 pages and expecting them to know all the parts that pertain to them, can be nearly impossible. But if you give the same employees an 80-page manual that only talks about the things that apply to them, you reduce the exhaustion factor of reading 500 pages and have a chance that they may actually read the document.

You will be tempted in some cases to use a template provided by some resource. FINRA provides a small firm AML guide that may prove helpful. Be careful, though, for FINRA also points out that you should not use their template just as is. Review this template or any template and make it your own and make it your firm's. Just moving a couple of paragraphs around won't do the job. Be detailed, particularly in your AML guide, but in others as well. Don't overdo it, however. This is another situation where you have to maintain balance. You want to state what and how your firm will accomplish its responsibilities, but if you state that something will be written in blue ink, you have to ensure that it is written in blue ink, and having many such obligations can be overwhelming. You will often be tested as to your policies and procedures manuals, so make sure they are true, accurate and make sense for your firm.

Establish Your Priorities and Calendar

As a CCO, you will quickly become aware that there are multiple deadlines to track and meet. You are going to want to get your calendar reminders set so you don't lose track.

The following are some of the items that you should include on your calendar:

3120/3130 Testing and Certification - Annually you are required to engage in Rule 3120¹ testing. This testing includes a look at certain controls in your firm to ensure they are working. The result of this testing is a 3120 Report. The

While you are working to convince your firm that you are part of the team and not to be feared, you need to make sure your policies and procedures are in good order.

requirements of this report are spelled out by FINRA in the rule, but basically the testing and report should review each area of the firm's business. For example, if the firm engages in investment banking, an overview of those activities for the year should be included. The report and its supplemental documentation must be reviewed with the Chief Executive Officer. The intent is to identify any areas where the firm could strengthen its compliance efforts. Once the review with the CEO is complete, the CEO must certify to his or her review of the report and its findings and ultimately to the strength of the firm's compliance program. This report is required to be done annually, by the anniversary date of the previous report.

AML Program Review - As previously mentioned, all firms are required to have an AML program. This program must address how the firm will engage to prevent the intentional or unintentional funding of terrorism or laundering of illicit funds. The program is required to be reviewed annually by an independent third party. In some cases this may be a department within the firm or its parent company. It is required, however, that the department be separated enough from the process it is reviewing that the firm could not influence the reviewer. Not only will you need to ensure the testing is done, but you will have to find a third party to complete the testing. Remember that vendor relationships require due diligence and that diligence should be documented so you can easily show why you chose a particular vendor and how you know they are doing a good job for your firm. This testing is required to be completed within 12 months of the prior testing and must occur every year.

AML Information Sharing Filings - As part of your AML program you may share information with other firms, such as your clearing firm or other firms with which you engage. The information sharing filing basically says that when researching suspicious activity, firms on the list of filers may share information to ensure that the best investigation possible is completed. These filings expire annually and, while it should be part of any third-party AML review to ask if the filing has been done, it is a good idea to set reminders for yourself.

Complaint Filings - While you will hope that your firm gets no complaints, it is simply not practical to think you will not, at some point, have to deal with complaint filings. When you are made aware of a complaint, you will first need to decide what type of filing needs to be completed. Before you can make that determination, you will need to investigate the merits of the complaint and the activity that caused the complaint. If no damages were alleged, you would need to determine what the likely accusation would be if the client did name an amount for damages. Once you have this information, you can review the Form U4 questions asked regarding client complaints. Generally speaking any complaint that accuses an individual of a sales practice violation, has named damages or possible named damages more than \$5000 and is in writing needs to be disclosed on the individual's Form U4. If these conditions are not met, the complaint should still be filed at the firm level. Form U4 updates are required within 30 days of the complaint. Firm level complaint reporting is required quarterly and the due dates are tracked in the FINRA Firm Gateway system.

Form U4/U5, BD Updates and Filings - Compliance is usually responsible for all Form filings through the Firm Gateway. Updates are most often required within 30 days of the change requiring the update. For example, if a registered representative is arrested while driving intoxicated, the disclosure of the event on the U4 is required within 30 days of the arrest date. Failure to file within the required time period is cause for a \$1575 fee from FINRA. Remembering what events require disclosure can be difficult. Take the time periodically to review the Form BD and Form U4 disclosure questions so you are knowledgeable when questions arise.

Form ADV and Brochure Filings and Updates - If your firm engages in advisory activity either through a dual registration or through a separate entity, you need to mark your calendar for 90 days after the end of your fiscal year. Firms are required to file an annual amendment to their Form ADV by this date. As part of this amendment, firms must upload their most recent firm brochures, so they will need to be up to date in order to complete the filing. Depending on the number of programs offered or platforms on which a firm operates there may be more than one brochure that needs updating and since brochures can range from 20 to 50 or more pages, this project will take some time.

Annual Attestation - You will want to establish an attestation process for your employees. These attestations cover a number of required disclosures, such as employee accounts, outside activities and certain activities such as the use of social media and those that lead to Form U4 disclosures. The development of an attestation that applies to your firm is key to its success. You want employees to disclose all pertinent facts at this time and to attest to their understanding of the firm's policies, procedures, and the Employee Handbook. It can take time to get these issued to and returned by employees. Once you have all of these returned, you have an excellent opportunity to take an overall look at your registered employees' activities. This gives you a chance to do a regular review of all outside activities and inventory those that could be or could appear to be a conflict for employees and clients. It also allows you to identify associates whose conduct could violate your firm policies and any needed Form U4 disclosures that were missed during the rest of the year.

Needs Analysis and Annual Training - As part of your role in Compliance, you must provide training to your registered representatives on an annual basis. This training is required, by regulation, to be pertinent to your business model and your employees. You will need to provide AML training, an Annual Compliance Meeting, and Firm Element training, at a minimum. You will also need to document the reasons you chose certain topics and not others by completing a Needs Analysis for your firm on an annual basis. Any of these trainings can usually be purchased off the shelf, but you want to be careful that the course(s) you purchase and provide to your employees are actually applicable to them or you run the risk of a wasted effort. Compliance training has a reputation for being dry and mundane, but there are consulting firms who

will work with you to provide interesting training that you help to mold so you are not subjecting your employees to 20 pages of rule and regulation regurgitation.

Registration Renewal Process - Sometime in November, FINRA will begin providing information about registration renewals. There are several things you should consider when looking at renewals, and not all of these require waiting for FINRA's reports:

- Each registration costs money, so consider how much business is generated in a particular state before you opt for its renewal.
- Have representatives consider if they are registered in the proper states. No one knows the clients better than the representative does. So trust them to tell you what they need, but verify those answers. Particularly for Investment Banking firms, you will need to rely on the representative's knowledge of pending deals and clients.
- If a state is dropped, ensure that no clients or business dealings are still conducted by any representative in the state. This may mean moving accounts to other reps who are properly registered.

Establish the Branch Examinations Process

Just as your Rule 3120 testing should identify areas where the firm can improve its processes or policies, your branch reviews are the opportunity to point out similar weaknesses in your branch structure. For years the typical branch exam consisted of a long checklist of files to review and questions to ask. All of these files were reviewed on site at each location and the branch visit lasted for at least a full day, sometimes more.

Today, so much is available digitally that compliance officers can do a great deal of the review before they arrive onsite, thus making the actual onsite examination much less disruptive to the branch. Reviewing documents and supervisory activities on a regular basis rather than annually also provides a means of identifying issues within a much shorter time than would happen with the traditional annual review. Your branch exams should include:

- Any items your WSPs say will be tested on a regular basis;
- A review of the types of business conducted in the branch to ensure areas of risk are identified and addressed in some manner during the exam;

- A review of documentation to ensure proper books and records are being maintained and that evidence of reviews, where needed, are in good order; and
- A brief interview or questionnaire with each registered representative to understand the particular risks for that rep's book of business.

Establish a Reading Routine

Now that you are a CCO, you have tons of time to read. Well, okay, you have no time to read. But, you need to make the time. FINRA will send you a monthly newsletter and it will help you sort out which of their regulatory notices require your attention, but there are many other places you should visit and publications you should read.

If you are a new firm or if your WSPs have not been updated for some time, you may want to review past regulatory notices. Sometimes the most recent notice regarding a particular rule or guidance may be two to three years old or even older. Take a look through all available notices for the last five years. FINRA will provide a brief overview of each notice so you can quickly determine which apply to your firm and which do not.

Take time at least quarterly to skim the disciplinary actions reported by FINRA. A review of these actions can give you an idea on what issues the regulators are focused and what areas of concern can move you, in their eyes, from a recommended action to an enforcement action.

Review the most recent FINRA Exam Priorities Letter and, if you have time, the previous letter. These letters, provided by FINRA annually, will guide you to look at certain areas of your business. If you are due for an exam, the letter gives you an idea where FINRA may focus its efforts. Do the same for the Securities Exchange Commission ("SEC") Exam Priorities Letter, which also is published annually. Don't lose site of the fact that FINRA is not your only regulator. You will also want to know the SEC's areas of interest for the coming year.

Review the North American Securities Administrators Association ("NASAA") website. This group provides guidance, among other things, on continuing education. Remember, you are required to do a Needs Analysis annually. This group provides excellent tools for helping to get your training program on track.

Check the SEC site for recent rule releases and review those as well. These can be daunting since they can sometimes run to hundreds of pages. Try to find analyses of the rule that focus on the rule itself and what it means for your firm.

Sign up for every newsletter you can find that touches on rules and regulation and the activities of the regulators. If you have specific regulators that apply to your business such as the Commodities Futures Trading Commission, be sure to include them in your search for newsletters. You won't want to take the time to read all of these topics, but there are blogs and resources out there, through consulting firms and other organizations, that can focus your efforts. Consider making an appointment with yourself each week for your reading.

Establish your Documentation

It will sometimes seem redundant to make a decision and then write a memorandum about why you made it, but in a year, two years or even more, you may have trouble remembering the details of a situation. Every investigation you conduct, every formula you calculate, should be documented in some way. The "memo to file" is a mighty tool.

In a world where regulations are changing every week and where you have so many balls in the air, you want the comfort of knowing that whatever you have done or will do has some basis. The regulators will often ask about specific situations; being able to pull out a memorandum that explains the actions of the firm and your reasoning behind a decision may not alone justify your decision, but it shows the regulators that you gave the decision educated thought.

If there is no documentation to show what happened, very often the regulators will assume that compliance did nothing. You must ensure that your department, as well as all supervisors maintain complete records of the work they do. Having a branch manager review a trade blotter means nothing if there is no record of the timeframe in which the review was done and who completed the review.

Documentation used to be maintained in "ink on paper" format. In today's technology-driven world, this is often not necessary. Many programs are available that allow you to notate review directly on a document and timestamp that review. Explore the many software solutions available and find one that makes sense for your firm.

Finally

It will take some time to get all of this in place. Don't rush yourself. Moving at a calculated pace will generally mean that you do not miss the little things that can end up becoming large. Lists can be a life-saver. In every meeting, on every call, take notes and identify actions you need to take. The single biggest requirement for your firm is a Culture of Compliance. You will need your firm and ALL of its employees to recognize the importance of compliance day to day and the role it must play in all aspects of the firm's business. Establishing trust and respect with Senior Management and being seen as a resource and not an adversary by employees can create the culture you need. If you can establish that, the other pieces will fall into place.

Your manuals will fall in line if you earn the respect and trust necessary to build that culture. If you prioritize and keep organized through reminders and calendar tasks, you will not miss a deadline. You won't be able to read everything, but you can put in place a process where you are able to review as much as possible and not miss the "big hits." Just remember to document, document, document. It will make all the difference to you and to the regulators.

Don't be overwhelmed by all of this. There are many resources out there that will help you get your program established or clean up your program. Countless consulting firms are willing and able to assist you. Just be sure you pick one that you trust and with which you feel comfortable. Don't let a firm or consultant intimidate you. Remember that you are paying for their services and you need to work together as a team; you should not just be told what to do. Consultants should listen as much as talk, and should be asking how you want things done so as to customize their approach to you and your firm. Buying a copy of what every other firm has won't accomplish your ultimate goal. That goal should be to have the strongest and most respected Compliance Program you can build. You can do it, with or without help. You just have to be willing to work at it, particularly in the beginning. Once the Program is established, it gets much easier. But don't forget to reread this article every couple of years and give your program a thorough review.

ENDNOTE

¹ FINRA Rule 3120 Supervisory Control System

This article is reprinted with permission from *Practical Compliance and Risk Management for the Securities Industry*, a professional journal published by Wolters Kluwer Financial Services, Inc. This article may not be further re-published without permission from Wolters Kluwer Financial Services, Inc. For more information on this journal or to order a subscription to *Practical Compliance and Risk Management for the Securities Industry*, go to pcrmj.com or call 866-220-0297