NSCP *Currents*

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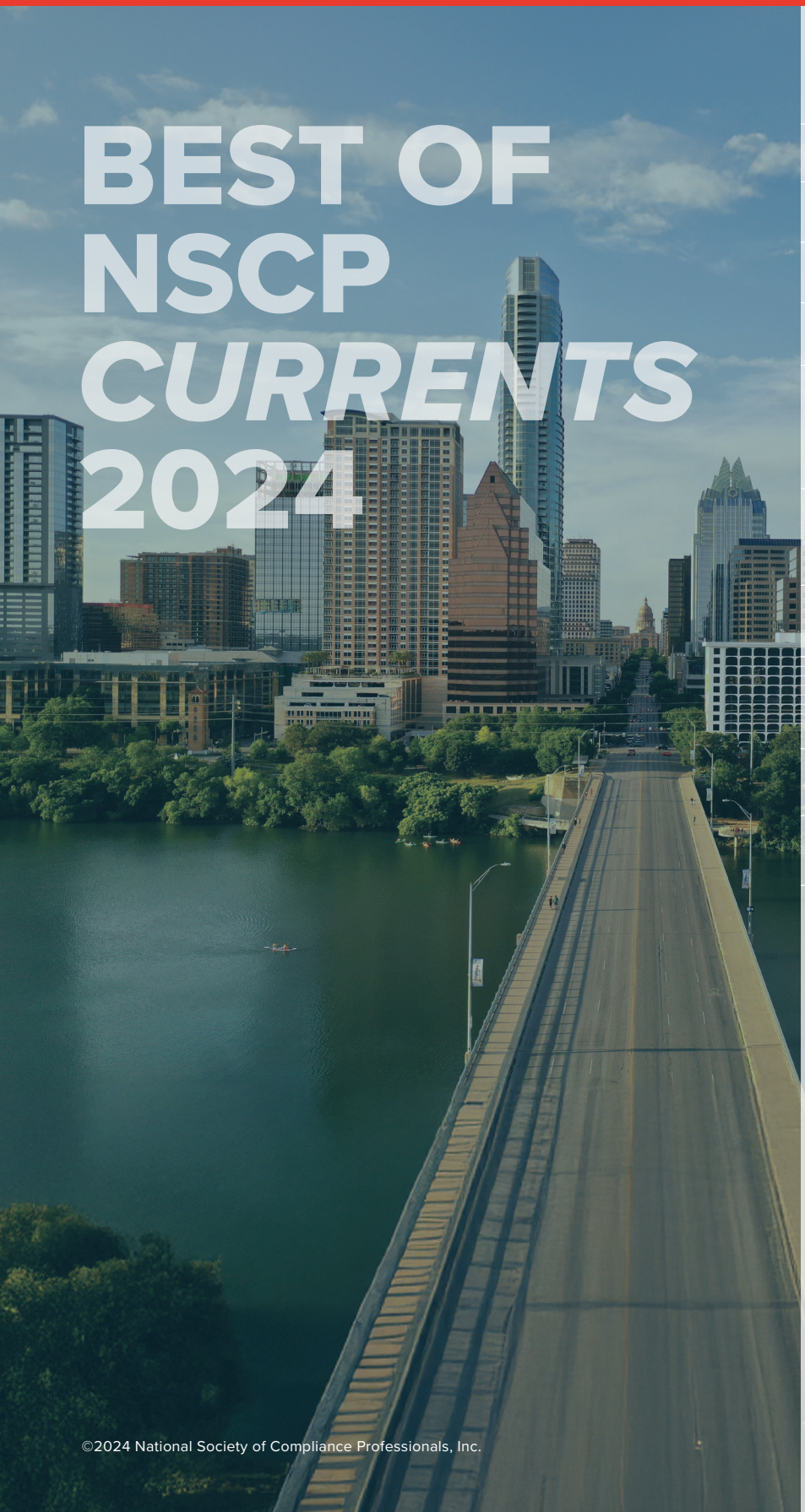

BEST OF NSCP *CURRENTS* 2024

In this Issue:

NSCP
NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS

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NSCP | REGULATORY INTERCHANGES

NSCP Regulatory Interchange Webinars

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Tuesday, March 4, 2025 – Regulatory Interchange Webinar Featuring FINRA
Tuesday, March 18, 2025 – Regulatory Interchange Webinar Featuring the SEC
Registration to open in January 2025.

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Registration to open in January 2025.

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NSCP National Conference

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Two and a half days of educational sessions, keynotes, networking events, exhibit hall, and much more! Exhibit and sponsor opportunities available.
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The NSCP Publications Committee has published yet another year of high-level articles and practical resources!

Thank you to all of our dedicated committee members!

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2024 Author of the Year

NSCP *Currents* seeks to embody the broader NSCP mission "to educate, connect, and empower a community of diverse financial services compliance professionals" and to further NSCP's core values by producing a "best in class resource that includes opportunities for professional development, promotes the exchange of knowledge, and advocates for the compliance profession." For over 35 years, NSCP *Currents* has been delivering invaluable content, becoming the go-to resource for over 2,500 industry professionals and the premier compliance publication of the financial services industry. During that time, NSCP Currents has featured articles written by legal and compliance experts, thought leaders, colleagues, and professionals of all types tackling financial service compliance challenges for its readers.

In this December 2024 "Best of" edition, we again honor all of the amazing authors from years past, while providing particular distinction by formally recognizing the NSCP *Currents* Author of the Year! In determining the recipient of this honor, the NSCP Publications Committee selects an author whose contributions went above and beyond and whose content elevates the industry, our members, and the National Society of Compliance Professionals.

We are so very pleased to announce that the NSCP *Currents* 2024 Author of the Year Award goes to author Melissa Starr of Corundum Group.

Melissa's comprehensive articles not only provide invaluable guidance to help readers make sense of new and existing regulations, but they also provide valuable insights into the compliance profession itself. You will find one such piece in this "Best of" issue, with links below to additional articles as well. Congratulations, Melissa! We are so grateful for your contributions, and we celebrate and appreciate you!!

Once again, by handing out this year's award, the race for the top NSCP *Currents* author of 2025 has begun again. Will it be you? We certainly hope so! Check out the Writing Opportunities page on the NSCP website or contact Publications@nscp.org for more information.

All articles written by Melissa in 2024:

- Explaining What We Do in Compliance by Melissa Starr, Jane Riley, Craig Watanabe and Miriam Lefkowitz
- Proposed AML Rule for Advisers by Melissa Starr and Craig Watanabe
- Proposed Customer Identification Program Rule for Advisers by Melissa Starr and Craig Watanabe
- Developmental Coaching of Junior Compliance Officers by Ted McCutcheon, Shawn Bostic and Melissa Starr

Risk-Based IA Compliance Testing

By Janice Powell and Craig Watanabe

About the Authors:

Janice Powell is the Chief Compliance Officer at DFPG Investments. She can be reached at jpowell@dfpg.com.

Craig Watanabe is the Director of IA Compliance at DFPG Investments. He can be reached at cwatanabe@dfpg.com.

A Comprehensive Risk-Based IA Testing Program

What is the biggest hurdle to your compliance program? How do you incorporate changes to the program? In short, a common response is finding time to revamp the old and create a new, more efficient risk-based testing program. While not obvious, we should be in the mode of constant and never-ending improvement. This is our goal – work smarter, not harder, as the saying goes. The authors have a well-developed IA testing program developed over ten years ago. Some lessons have been learned and improvements made, but with the ever-changing regulatory landscape, we decided to completely overhaul our IA testing program. We will share our thoughts behind the new risk-based testing program as well as the new modules, in the hope you will have some takeaways that will be helpful in improving your IA testing program.

Rationale Behind the Overhaul

The old program broke down testing into 24 modules which were calendared two per month. In addition, we performed an annual comprehensive risk assessment (scope limited to regulatory and compliance risks). Our testing and risk assessment have a lot of overlap. Moreover, risk assessment is a big task performed all at once. We never thought to break down risk assessments into modules as we did with the testing program, and this is partly because the tools we use are not broken down. To eliminate redundancy, we decided to merge the testing program with the risk assessment. Included with this article are 11 IA testing modules in Excel format:

1. Client Relationships and Sales Practices
2. Code of Ethics
3. Compliance Program
4. Culture of Compliance
5. Disclosures and Agreements
6. Fees and Expenses
7. Marketing
8. Portfolio Management
9. Private Fund Advisers
10. Safeguarding Assets and Information
11. Trading

We believe fully integrating risk management into testing results in a better and more efficient process to monitor a compliance program. With the new risk-based IA testing program, we will complete one module per month, and the twelfth month will be left open to complete the 206(4)-7 annual review.

Testing

The authors published "BD Compliance Testing" in March 2023 edition of "NSCP *Currents*." This article addresses gap analysis, mapping to policies and procedures, and sampling, as well as other basics of testing. Even though the article is for BDs, the fundamentals of testing are the same for IAs, and we refer you to this prior article.

Risk Management

The risk management industry is much older and more established than the compliance industry. Risk management dates to the 1920s, and there are well-established standards and frameworks

such as ISO 3100[1] and COSO.[2] Compliance is frequently assessing risks to the firm and developing controls to mitigate the risks using these frameworks.

At a glance, the updated modules resemble the risk assessment matrix more than the testing modules. The important contributions from the testing modules are references to the firm's policies and procedures as well as sampling and testing. Next, we will explore some of the features in the 11 modules by looking at the column headings.

Column Headings in the Modules

- *Testing Item* – The items are broken down into sub-categories and are posed in the form of a question.
- *Response* – Drop-down box (Yes, No, N/A or Follow Up).
- *Rule or Guidance* – Maps the items to rules or guidance.
- *Reference to Documents* – You should map the item to your policies and procedures manual.
- *Risk* – Describe the risks to your compliance program posed by the item in question.
- *Risk Category* – Drop-down box (Compliance, Operational, Financial, Portfolio, Credit, Reputational).
- *Risk Appetite* – Drop-down box (Averse, Minimal, Cautious, Open, Hungry).
- *Metrics* – Whenever possible, it is helpful to create objective metrics to measure compliance with various policies and procedures.
- *Risk Rating* – Drop-down box (High, Moderate, Low).
- *Responsible Party* – Identify who is responsible for this item.
- *Risk Response* - Drop-down box (Acceptance, Avoidance, Mitigation, Transfer).
- *Policies and Procedures* – This section is intended to allow comments on the efficacy of existing policies and procedures in addressing the item in question.
- *Comments* – This section allows one to elaborate on the item, in particular any findings and remediation.

Conclusion

Personal preferences are evident in testing and risk management. Not everyone will want to merge the two, but for the authors, it made sense. The risk-based testing modules eliminate a lot of redundancy in our program and focus on the best of what a testing program and risk management program offer. A common theme across most compliance officers is having adequate resources to do what is needed to demonstrate compliance with regulation. Whether you are a one-person shop, or a vast team of compliance professionals, learning to identify where your risks are and testing them still takes practice and constant evaluation. As with most compliance tools, it is important to customize the tool for your needs and preferences. ■

1. *See* "ISO 3100 – Risk Management", The International Organization for Standardization (2009), available at: https://www.iso.org/iso-31000-risk-management.html.
2. *See* "COSO Enterprise Risk Management Framework", Committee of Sponsoring Organizations of the Treadway Commission (2017), available at: Enterprise Risk Management | COSO.

NSCP *Resources*

Included below are examples of two of the IA Testing Modules included with this article. NSCP members can download all eleven IA Testing Modules in the original Excel format from the NSCP Resource Library.

DOWNLOAD

IA Testing Module: Client Relationships and Sales Practices

<Adviser Name>

Testing Item	Response	Rule or Guidance	Reference to Documents	Risk	Risk Category	Risk Appetite	Metrics	Risk Rating	Resp Party	Risk Response	Policies and Procedures	Comments
Client Relationships / Sales Practices												
Complaints												
Review the firms policies and procedure regarding customer complaints. Are they adequate?		[Reference your documents such as your procedure manual, brochure, advisory agreement, prospectus, private placement memorandum etc.]	[Describe the risk as it relates to your firm and use the drop-down box in the next column to assess the risk.]	[Some firms may find it helpful to categorize risks. Common risk classifications are compliance, operations, financial, portfolio, credit, and reputational]						*[Describe how you manage and mitigate risks through policies, procedures and internal controls.]*	[Use this space to add comments. Be advised this document is discoverable and will be reviewed by regulators so be judicious in your comments.]	
How are complaints addressed?												
Are all complaints reported to compliance?												
Does the adviser have a complaint log in place?												
Have all customer complaints been properly reported and/or disclosed on Form U-4/U-5 and Form ADV?												
New Client Policy / Qualification of Investors												
Does the firm use checklists to ensure all required documents are in place, all disclosures have been made, and all procedures followed?												
Client Reporting												
Do the reports have adequate disclosures?												
Does the firm have steps to ensure reports sent to clients are accurate and complete?												
Closing Account/Lost Client Policy												
If a client requests to terminate his account, how quickly is the account terminated?												
How are prepaid fees refunded?												
Vulnerable Investors												
Does the firm have written policies to protect vulnerable investors such as diminished capacity, elder abuse, client exploitation, and marketing to seniors?												
Has the firm conducted training on recognizing signs of diminished capacity and elder abuse?												
Products												
Product Due Diligence												
Does the firm employ a robust process to perform adequate due diligence on products?		SEC Risk Alert - January 27, 2022	SEC Risk Alert - January 27, 2022									
Is product due diligence adequately documented?		SEC Risk Alert - January 27, 2022	SEC Risk Alert - January 27, 2022									
Wrap Fee Programs/Separately Management Accounts												
What steps has the firm taken to avoid Investment Company classification?												
Does the firm's wrap fee brochure provide adequate disclosure?		204-3(f)	204-3(f)									
Has the firm evaluated the Wrap fee program in light of custodians eliminating commissions?		204-3(f)	204-3(f)									
Investing in Externally Managed Private Funds		Rule 206(4)-8, SEC Risk Alert "Investment Adviser Due Diligence Processes for Selecting Alternative Investments and Their Managers" (January 28, 2014)	Rule 206(4)-8, SEC Risk Alert "Investment Adviser Due Diligence Processes for Selecting Alternative Investments and Their Managers" (January 28, 2014)									
If the firm recommends externally managed private funds has adequate due diligence been performed and documented?												
Does the firm have side pocket arrangements and if so have these been adequately disclosed to all investors?												

IA Testing Module: Trading

<Adviser Name>

Testing Item	Response	Rule or Guidance	Reference to Documents	Risk	Risk Category	Risk Appetite	Metrics	Risk Rating	Resp Party	Risk Response	Policies and Procedures	Comments
Trading												
Brokerage Practices												
Does the firm have an affiliated broker-dealer or is the firm dually registered?												
Does the firm engage in more trading at the end of a client's reporting period (window dressing)? If so why?												
How are portfolio managers compensated?												
Insider Trading		Rule 204A										
Does the firm receive non-public information?												
Does the size of the firm's assets under management create nonpublic material information?												
Principal Transactions		Rule 206(3)-2										
Does the firm engage in principal transactions?												
Has the firm disclosed its practices and obtained client consent?												
Agency Cross Transactions		Rule 206(3)-2										
Does the firm engage in agency cross transactions?												
Has the firm disclosed its practices, obtained client consent, and delivered required notices?												
How is the price determined?												
Trade Errors												
How are trade errors handled?												
Who pays for losses?												
Who receives gains?												
How are trade errors documented?												
Does the firm have a trade error log in place?												
Best Execution/Broker Selection		SEC Interpretive Release 34-23170,										
How are brokers selected?												
Do brokers refer clients to the firm?												
Does the firm direct brokerage to the referring broker?												
How does the firm determine the commission rate to be paid to referring brokers and non-referring brokers?												
How is the firm determining and documenting its obligation to obtain best execution?												
Directed Brokerage		Investment Company Act of 1940, Section 12b-1										
If the firm directs brokerage is this adequately disclosed in the Form ADV Part 2A, Item 12 as well as the advisory agreement?												
Soft Dollars		Securities Exchange Act of 1934, Section 28(e)										
Does the firm use soft dollars to pay for research or brokerage services?		Section 28(e) Safe Harbor										
Does the firm use clients' commissions to pay for anything other than research or brokerage services?												
How is the firm ensuring that soft dollars paid are reasonable?												
Are the soft dollar arrangements fully disclosed?												

The New Age of Branch Office Inspections

By Andrew T. Mount and Erin Preston

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The COVID-19 pandemic changed how broker-dealers serve customers and supervise associated persons, and pushed regulators to consider how to adapt regulatory requirements to fit an environment where many, if not most, firms have embraced some form of remote work. On November 17, 2023, after two years of prolonged rulemaking, the SEC approved changes to FINRA Rule 3110 that introduced a three- year Remote Inspections Pilot Program[1] and a new Residential Supervisory Location (RSL) office designation[2] (referred to together as the "Remote Office Rules"). The Remote Office Rules, which garnered strong support from the industry, but faced substantial pushback from state securities regulators, were, according to FINRA, driven by a combination of "advances in compliance technology" and the industry's "shift to hybrid work environments."[3]

Beyond the new rules themselves, the focus on remote, residential offices and hybrid work arrangements has caused firms to re-examine and question how they classify certain office locations, with wide-ranging impacts to Form U4, Form BR, internal inspections, and FINRA Membership Agreements. In light of the upcoming effective dates of the Remote Office Rules – **June 1, 2024** for the RSL office designation and **July 1, 2024** for the Remote Inspections Pilot Program[4] – this article focuses on the Remote Office Rules. We first review the primary requirements of each rule and analyze several key impacts of the rule changes on broker-dealers' office inspection programs. After reviewing the Remote Office Rules, we touch on several compliance practices that can apply to both remote and in-person office inspections.

The Residential Supervisory Location Office Designation

The newly adopted RSL office designation is defined as an associated person's private residence where supervisory activities are conducted. An RSL, which traditionally would have been classified as a supervisory branch office or OSJ, will be treated as a "non-branch location" under FINRA Rule 3110. The reclassification of certain residential office OSJs and supervisory branch offices as RSLs will impact firms' internal inspection programs. Under FINRA Rule 3110(c), firms are required to inspect all offices and locations on a specified schedule. More specifically, a firm is required to conduct:

- *An annual* inspection of Offices of Supervisory Jurisdiction ("OSJs") and supervisory branch offices;
- An inspection *every three years* of non-supervisory branch offices; and
- An inspection *on a regular periodic schedule (presumed to be at least every three years* of "non-branch locations."

Because RSLs will be treated as "non-branch locations," they will be subject to inspections on a "regular periodic schedule" – presumed to be at least every three years – rather than the annual inspection requirement imposed on OSJs and other supervisory branch offices. Prior to designating an office as an RSL, firms will be required to, among other things: (1) conduct and document a risk assessment of each proposed RSL, including evaluating the disciplinary history of the individual at the location; (2) determine that the firm's surveillance and technology tools are appropriate to supervise its RSLs; and (3) provide FINRA with a list of RSLs on a quarterly basis.

1. *See* SEC Order Approving a Proposed Rule Change to Adopt SupplementaryMaterial .18 (Remote Inspection Pilot Program) under FINRA Rule 3110 (Supervision), Release No. 34-98982; File No. SR-FINRA-2023-007 (Nov. 17, 2023) (the "Remote Inspections Approval Order"), available at https://www.sec.gov/files/rules/sro/finra/2023/34-98982.pdf.
2. *See* SEC Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, to Adopt SupplementaryMaterial .19 (Residential Supervisory Location) under FINRA Rule 3110 (Supervision), Release No. 34-98980; File No. SR-FINRA-2023-006 (Nov. 17, 2023), available at https://www.sec.gov/files/rules/sro/finra/2023/34-98980.pdf.
3. *See* the Remote Inspections Approval Order.
4. The effective dates for the Remote Office Rules was announced by FINRA in Regulatory Notice 24-02 available here.

The Remote Inspections Pilot Program

The second new rule is the introduction of a Remote Inspections Pilot Program. At the onset of the pandemic, FINRA provided temporary relief to allow broker-dealers to fulfill their inspection obligations remotely.[5] FINRA's "temporary" remote inspection relief has been extended several times over the past few years, and is currently set to expire on June 30, 2024.

The newly adopted Remote Inspections Pilot Program will allow FINRA member firms to continue to fulfill their inspection obligations under FINRA Rule 3110(c) by conducting some or all inspections of OSJs, branch offices, and non-branch locations remotely without on-site visits to such offices or locations. The "Pilot Program" is exactly that – a three-year "Pilot Program" – and firms' participation is voluntary. If a broker-dealer "opts-in" in the Pilot Program, it will be required to comply with several controls and safeguards that, according to FINRA, are intended to "achieve a responsible balance preserving the investor protection objectives of the rule."

a. Development of a "Reasonable, Risk-Based Approach" to Using Remote Inspections

A broker-dealer opting into the Pilot Program will be required to develop and document a risk-based approach for each office location that it intends to remotely inspect. The risk assessment would require the firm to consider specific enumerated factors, such as the volume and nature of customer complaints at the location, the volume and nature of outside business activities ("OBAs") at the location, the complexity of products offered, the nature of the firm's customer base, and past failures of the associated person(s) at the location to comply with the firm's written supervisory procedures.

Along with the factors firms are required to consider, FINRA suggests several other factors that firms *may consider* as part of their risk assessment, including the number of registered persons at the location, feedback from supervision regarding the location and its registered persons, how often the location and its representatives appear on surveillance reports, and the number of disclosures on representatives' Form U4. This list is non-exhaustive, meaning that in developing a risk assessment, FINRA suggests that firms consider the factors, specific to their business, that would make a location higher-risk, and therefore inappropriate for remote inspections.

The development of a "risk-based" approach to using remote inspections will undoubtedly pose some difficult challenges. Each firm's risk appetite is different and each firm's approach to this analysis will differ based on myriad factors. These factors may include:

- The size and composition of the firm, including the number of registered representatives, locations of registered representatives, change in number of registered representatives over the inspection period, and acquisition or divestitures;
- The composition of the firm's client base (*i.e.*, retail vs. institutional), the types of products offered (*i.e.*, complex products, insurance products, managed assets vs. brokerage, etc.), and the types of services offered (i.e., asset management, financial planning, investment banking, research, sales, and trading);
- Compliance concerns related to the office, including the frequency and subject matter of enforcement cases during a particular look-back period, examination findings, and compliance testing results;
- The technology available to the firm to provide services to customers and to supervise/surveil registered representative activities.[6]

5. *See* FINRA Regulatory Notice 20-08, available here.
6. *See* Supplementary Material .12 to FINRA Rule 3110; See also the Remote Inspections Approval Order at p. 6-7.

b. Policies and Procedures and Surveillance and Technology Tools

Firms opting-in to the Pilot Program will be required to establish, maintain, and enforce written supervisory procedures that address the methodology they use to conduct remote inspections, including the technology used and the factors considered in the firm's risk assessment of each office or location. Some firms may have adopted policies and procedures that comply with the temporary remote inspection relief granted by FINRA in 2020 in response to the pandemic. While these firms have a "leg up" in developing the policies and procedures required by the Pilot Program, there are several new elements they will be required to implement. By way of example, firms "opting-in" to the Remote Inspections Pilot Program will be required to identify in their policies and procedures the technology that they plan to use to conduct remote inspections – a requirement not found in the temporary relief.

Speaking of technology, participating firms will be required to determine that their surveillance and technology tools are "appropriate" to supervise the type of risks posed by each remotely supervised location. FINRA sets forth a non-exhaustive list of tools that a firm may use in conducting remote inspections, including firm-wide tools, such as electronic recordkeeping systems, electronic surveillance of email and correspondence, electronic trade blotters, regular activity-based sampling reviews, and "tools for visual inspections." FINRA does not provide any guidance around what "tools for visual inspection" (*i.e.*, Zoom, Microsoft Teams, etc.) it expects firms to use, or whether the tools that firms use must have certain features or be used in a certain way. Firms will likely be left to make these determinations based on their business models and the risk profiles of the offices they plan to inspect.

c. Reporting Requirement

One of the most consequential elements of the Remote Inspections Pilot Program is the requirement that participating firms collect, maintain, and provide FINRA with certain data and information on a quarterly basis. More specifically, participating firms will be required to collect and produce data to FINRA, broken down by office type (*i.e.*, OSJs, branch offices, non-branch locations), of: (1) the total number of inspections – on-site or remote – completed during each calendar quarter; (2) the number of offices or locations in each calendar quarter that were subject to an on-site inspection because of a "finding"; (3) the number of offices or locations in which an inspection (broken down by on-site and remote) was conducted that identified a "finding," the number of "findings," and a list of the most significant "findings." FINRA noted during the rulemaking that the quarterly reporting requirement is intended to "help FINRA… study trends in the data and information… promptly… [to] identify any regulatory oversight concerns…."

To prepare for this data reporting requirement, participating firms may consider reviewing, analyzing, and determining what will qualify as a "significant finding" that will need to be reported to FINRA. According to FINRA, a "significant finding" is "one that should prompt the member firm to take further action that could include escalation to the appropriate channels at the firm for further review…."[7] FINRA has noted several examples of "significant findings," which include the use of unapproved communication mediums, customer complaints, or undisclosed outside business activities or private securities transactions.[8] We note that this list is not exhaustive, and firms will be required to evaluate what constitutes a "significant finding" based on their own risk profile. To that end, after the firm determines what a "significant finding" is, compliance professionals may consider meeting with their lines of business to prepare them for this change, and assisting them in understanding how significant findings will be determined and reported.

7. *See* Remote Inspections Approval Order at FN 82.
8. *Id.*

d. Joining the Remote Inspections Pilot Program

Broker-dealers that participate in the Remote Inspections Pilot Program will be required to provide FINRA with an opt-in notice at least five calendar days before the beginning of the "Pilot Year" in a manner and format to be determined by FINRA. For the first "Pilot Year," which begins on July 1, 2024 and ends on December 31, 2024, the opt-in period will run from June 1, 2024 through June 26, 2024. FINRA is developing a way for firms to opt-in to the Pilot Program through FINRA Gateway and has noted that further guidance is forthcoming.

It is important to note that when a participating member firm provides the notice to FINRA, the participating member firm agrees to participate in the pilot for the pilot year, to comply with the requirements of FINRA Rule 3110, and is automatically deemed to have elected to participate in subsequent pilot years until the pilot expires. To opt-out, the participating member firm is required to provide FINRA with an opt-out notice at least five calendar days before the end of the pilot year.

Remote Examination Practices and Considerations

The new reality is that most broker-dealers have adopted some form of hybrid work arrangement – with employees working some part of the week/month from the office and some part from their home. A firm operating in a hybrid work environment that wants to utilize remote inspections to inspect residential locations will be required to "opt-in" to the Pilot Program. If the firm does not "opt-in," it will be required to: (1) conduct in-person inspections of all remote office locations, including people's homes and/or (2) modify remote work policies to mandate that associated persons work from the firm office full-time.

That said, now is a good time for firms to review their branch and non-branch office inspection programs. Firms opting into the Pilot Program will have to ensure that their inspection programs and policies and procedures meet the requirements of the Pilot Program (a portion of which are referenced above). Firms that do not opt-in to the Pilot Program would still be well served to review their office inspection programs in light of the industry's shift to remote and hybrid work. Set forth below are several practices and considerations that firms may consider as they review their inspection programs. These practical tips apply to both remote inspections and in-person inspections.

i. Preparing for the Branch Inspection Process

As noted above, firms will be required to conduct a risk-based review of each office location they want to remotely inspect. As part of this process, firms may consider evaluating their compliance testing and the material exceptions that appear on their regulatory examination reports. The results of compliance testing are important components of preparing for the branch office inspection process and, among other things, firms may consider:

- Does a particular location regularly appear on compliance testing reports?
- Does a particular location appear to need additional training on compliance policies?
- Does a particular location have unresolved compliance testing findings?

Firms may determine that particular locations make regular appearances on compliance testing reports that may necessitate an on-site examination. Firms may also notice certain themes that regularly appear that raise the risk profile of certain locations such that the firm may need to

undergo a further review of those locations before implementing remote inspections or choose to conduct in-person inspections of those locations. Similarly, a firm may determine from a review of regulatory examination reports that it should perform an on-site examination of a particular location. For example, in the process of their review, firms could ask:

- Has a particular location, its activities, and lack of compliance with regulations or policy contributed to a material finding on a regulatory examination?

- Has a particular location failed to address items that were cited on prior regulatory examinations?

Beyond a risk-based review of specific office locations, prior to conducting remote inspections under the Pilot Program, Firms may consider conducting a holistic review of their surveillance systems. Whether the firm uses an in-house produced set of surveillance/exception reports or a third-party provider, firms should consider regularly reviewing the types and frequency of alerts generated for each location. In the process of this review, firms could ask:

- Does any particular location generate more alerts/exceptions?

- Does any particular type of alert generate the most for the location? For example, a particular location has x number of alerts/exceptions related to the recommendation of complex products.

- Do locations with the same supervisor appear more frequently on exception reports/alerts?

This is yet another area where firms may determine, at the conclusion of their review, that an on-site inspection is appropriate for one or more locations.

ii. Performing Office Inspections

1. Branch Office Questionnaires

Questionnaires can play a helpful role in the branch office inspection process. An effective branch office questionnaire could focus on eliciting answers that provide information related to the location's activities, the associated persons at the location, and the level/thoroughness of supervision conducted at the location. The below are items for consideration for a branch office location questionnaire:

- Confirmation of the location as an OSJ/non-OSJ;

- Confirmation of the Branch Office Manager/Person-in-Charge;

- Confirmation as to whether this location supervises other locations;

- Confirmation of the types of activities conducted at the location (Investment advisory, trading/market making, brokerage (retail), brokerage (institutional), research, investment banking, back office/operational, or other);

- Confirmation as to whether the location is a shared office space;

- Confirmation as to whether the location is personal residence or commercial location;

- Whether the location meets with clients, advisers, or other employees at the location;

- Whether correspondence is received or sent from this location;
- Supervisory considerations: (i) does the Branch Office Manager/FINRA supervisor regularly hold meetings/trainings for staff relevant to the business activities of the associated persons assigned to the location; (ii) confirmation of any supervisory tasks assigned to the Branch Office Manager/FINRA supervisor per policies or other documentation; (iii) whether any supervisory tasks are delegated to another individual; (iv) confirmation of registered representatives on heightened supervision;
- Communications with the public considerations: (i) does the office have business cards; (ii) if the location is not an OSJ, confirmation that the OSJ is listed on business cards; (iii) use of social media accounts for business; (iv) use of standard email signature lines; (iv) use of websites for this location; and (v) production of marketing materials or advertising at this location; (vi) participation in presentations, or public appearances;
- Activities: (i) confirmation of products sold/offered at this location; (ii) client profile and account breakdown (retail vs. institutional, investment advisory vs. brokerage, retirement vs. non-retirement, etc.); (iii) participation in referral business, or solicitation agreements; (iv) receipt/processing of customer funds, checks, etc.; (v) account opening; (vi) processing of securities transactions/orders; (vii) trading of securities;

2. Non-Branch Office Location Questionnaire

In addition to branch office questionnaires, firms may consider sending non-branch locations a questionnaire annually. These questionnaires could ensure that the activities and number of persons assigned to the location still allow the firm to classify the location as a non-branch location. The below are items for consideration for a non-branch office location questionnaire:

- Whether individuals at the non-branch locations have a Doing-Business-As ("DBA"), and details about the DBA;
- Confirmation of the types of activities and products/services offered at this location;
- Breakdown of client profile and types of accounts handled from this location;
- Confirmation of receipt of correspondence, checks, securities or funds;
- Whether the location employs multiple individuals;
- Whether the location is a personal residence or commercial location;
- Confirmation as to whether this non-branch location is meeting with clients or other employees at this location;
- Details about signage: (i) whether the location is held out to the public; (ii) SIPC signage;
- Details about business cards, stationary, and the use of advertising, social media, and websites;
- Information about supervisory practices: (i) confirmation of the supervisor; (ii) whether training meetings are held at this location and the frequency of such;
- Confirmation of accuracy of all outside brokerage accounts, outside business activities, political contributions, private securities transactions, and gifts and entertainment given or received as recorded with the firm;

3. Documentation Requests

Based on the results of the questionnaires for registered branch locations, a firm may want to make a tailored document request to each branch and/or non-branch location to facilitate a productive interview as part of the inspection process. The below are several documents that a firm may want to request:[9]

- List of all associated persons assigned to a location;
- List of all disciplinary actions involving any associated persons at the location during the inspection period;
- List of all accounts or websites used at the location;
- Evidence of training held at the location during the inspection period;
- List of all social media accounts or websites used at the location;
- Documentation of recorded outside accounts, gifts and entertainment given/received, political contributions, OBAs, and private securities transactions for associated persons at the location.

4. Conducting the Interview

After reviewing the responses to the document requests and other documentation supplied by the branch office location or non-branch location, a firm may want to interview as part of the inspection the branch office manager or appropriately licensed supervisor to clarify certain items or review preliminary findings.

5. Branch/Non-Branch Reports

A firm may want to create branch office inspection and non-branch office inspection reports to memorialize findings, recommendations, and items for remediation. For example, this could include a branch office report with risk ratings based on the firm's risk appetite and policy requirements, and a checklist of items considered/documents reviewed as well as action items for remediation. These reports may be delivered to the branch office manager/FINRA supervisor for review and signature. With respect to non-branch locations, a firm may wish to produce a summary of the inspection process and findings to share with the appropriate supervisors of the locations.

6. Remediation Tracking

After identifying areas of non-compliance or areas for improvement, firms may consider escalating and tracking the remediation of these items. This tracking can be accomplished internally through tools such as Excel or Sharepoint, or externally through third-party compliance tools. When a firm participating in remote inspections has identified red flags, it may be good practice to conduct an on-site examination. The firm's written policies may outline the red flags that the firm considers to be cause for an on-site examination.

Conclusion

The compliance dates for FINRA's Remote Offices Rules is fast approaching. Broker-dealers should consider the new rules in light of their business and analyze how the rules will impact their office inspection programs. ■

9. This list is non-exhaustive, and firms should tailor requests to their business.

Explaining What We Do in Compliance

By Melissa Starr, Jane Riley, Craig Watanabe and Miriam Lefkowitz

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Explaining What We Do

Have you ever had to explain what we do as Compliance Officers to someone who knows little to nothing about compliance? Or have you trained a new Compliance Staff member who has no experience in compliance? These are common occurrences, and in this article, four experienced Compliance Officers explain what they do and what training resources they provide. Even experienced Compliance Officers will likely pick up some helpful tips to help make future orientations more effective and consistent.

Melissa Starr, Chief Compliance and Operations Officer, Corundum Group

When asked to define what compliance is or what precisely I do, I prefer to use the simple simile of an umbrella rather than dive into regulations or complex definitions, regardless of whether I am speaking to a new staff member, adviser, or even an individual unaffiliated with the securities industry. I have found this approach is easy to understand and relatable. I will even bring in a physical umbrella to get the point across when necessary. In my years, I have learned that if people understand the purpose of compliance and my intent, they are more likely to get on board with the program and recognize that I am not the "antibusiness department."

Picture an umbrella. This umbrella is our compliance program. Every umbrella comprises a cap, canopy, ribs, shaft, and handle. Each piece of the umbrella is integral to your program.

Canopy

The canopy is the central part of the umbrella. This represents your compliance manual (or Written Supervisory Procedures for broker-dealers). Each gore of the canopy symbolizes one of your individual policies (i.e., Off-Channel Communication Policy or Advertising Policy). A hole in one of the gores would symbolize an out-of-date policy. Let's say you have not updated your policy to reflect the new Marketing Rule, for example. A tear in your canopy would be more akin to an ineffective policy, such as permitting text messaging for communication but lacking the technology to archive those messages.

Ribs

In case you are unfamiliar, the ribs are the complex parts of the umbrella that support the canopy and connect to the shaft. These represent your procedures, which you do every day to bring life to and support your policies. We have all opened an umbrella before to have it misshapen or refuse to stay open due to a broken rib. This would be the equivalent of a broken procedure. Let's imagine that, as a firm, you tell a regulator that you do not take custody; therefore, the firm is not required to undergo an annual surprise examination. However, you discover that clients regularly have checks mailed to the office rather than the custodian, and you have no procedure to handle that situation. This would be a broken rib.

Shaft

The umbrella shaft is the rod that connects to the ribs, canopy, and handle. This is intended to represent your compliance team, which works daily to audit, review, develop, support, and carry forward the procedures and compliance policies. Who hasn't seen a movie where someone leans a little too hard on their umbrella, as though it is a walking stick, and snaps the shaft? Our compliance staff is our bloodline, and we have to watch out for them and ensure that their workload is not too burdensome, their mental load is healthy, and that they are respected and seen.

Handle

The handle is part of the shaft and integral to the overall umbrella. In our story, the handle represents the CCO, who ultimately holds up the compliance program and defends the firm, employees, and clients. The SEC requires that all firms designate a CCO. The SEC did not impose specific educational requirements for being a CCO (FINRA requires a Series 24), and within the industry, there is much debate about what qualifications an individual should possess to assume the role. One thing is for sure: I, as the CCO, will protect my firm, my employees, and my clients.

Cap

I did not forget about the cap. Although the cap is at the top of the umbrella and ties everything together, I intentionally save this for last. The cap represents the CEO or board of directors. This is our tone from the top—your culture of compliance. The cap's job on an umbrella is to divert rain from the canopy. Similarly, the leadership's job is to divert anger from the compliance department and instead support the compliance program from the top down. A broken cap will not keep an umbrella from functioning, but you will feel it whenever it opens and closes. Tone from the top is vital for the program to work.

So, how does this all come together? I explain that employees of the firm have a choice. They can choose to either stand under the umbrella of protection or stand outside of it. By choosing to stand under it, they are opting to follow the policies and procedures put into place. In return, the umbrella will protect them from inclement weather. What inclement weather, they might ask? Regulatory inquiries, client complaints, lawsuits, and so forth. However, if they choose to stand outside the umbrella, they will face these on their own. The caveat is that no compliance program can guarantee it is foolproof. After all, the system is reasonably designed to prevent, detect, and correct securities violations. But they stand a much better chance with the firm's umbrella between them and the SEC than dancing in the rain.

An early mentor first shared this idea with me, and I have since expanded upon it. Feel free to adapt it and make it your own.

Jane Riley, Chief Compliance Officer, The Leaders Group

Navigating the Compliance Landscape: My Daily Mission

When I'm met with perplexed expressions upon revealing my position as Chief Compliance Officer for an Investment Firm, the real challenge begins. Breaking down the role to those outside the industry involves simplifying my mission: ensuring that our registered representatives know and follow all the state, federal, and self-regulatory laws and rules, ultimately safeguarding regular investors. It's an experience I often humorously liken to herding cats or babysitting kindergartners on a sugar rush.

However, my narrative takes on a more strategic outlook when addressing the board of directors. My role is to protect the firm by safeguarding our investors and representatives. This encompasses managing inherent conflicts of interest, educating stakeholders on rules and policies, overseeing our compliance program, and highlighting the pivotal role compliance plays in our firm's success.

Training the Guardians of Compliance: My Approach

When it comes to training new compliance associates, I emphasize positioning compliance as the glue holding our company together. We establish policies based on rules, creating a

supervisory system designed to prevent, detect, and correct securities violations. Compliance isn't just advisory; it requires personnel who possess a comprehensive knowledge base covering operations, products, marketing strategies, and the overall business model.

Inspiring a culture of compliance is the linchpin for our success. Beyond rules and regulations, it's about instilling integrity, honesty, and transparency into our organizational ethos. I often refer to Lori Richards, a luminary in the compliance realm, and her speeches in the SEC archives, particularly the one from October 28, 2004, NSCP National Meeting (https://www.sec.gov/news/speech/spch102804lr.htm), as a cornerstone for understanding the cultural nuances of compliance.

A Perfect World: My View for Compliance

In an ideal scenario, compliance doesn't just play a role; it has a seat at the executive table and a direct line into the Board. Consultation with compliance should be a routine step in most business decisions, assessing their impact and alignment with regulatory frameworks. The goal is to integrate compliance seamlessly into the decision-making process, ensuring a symbiotic relationship between business objectives and regulatory adherence.

Craig Watanabe, Director of IA Compliance at Diversify Advisory Services (Formerly DFPG Investments)

The definition of compliance is: "*To create a supervisory system reasonably designed to prevent, detect, and correct securities violations.*"

There are three components to this definition.

"Supervisory system": The securities regulatory regime in the U.S. is built on a compliance chassis. A firm's supervisory system is a collection of policies and procedures which are codified in the Policies and Procedures Manual (aka Written Supervisory Procedures Manual for broker-dealers, Policies and Procedures Manual for investment advisers, or simply The Compliance Manual). The Compliance Manual is the heart of the Supervisory System and needs to be not only read but ingrained in business workflows and should serve as a constant reference.

"Reasonably designed": Just as law enforcement can never prevent all crime, Supervisory Systems are not expected to be perfect but instead are held to a "reasonable" standard. What is reasonable is subjective but is informed by regulatory guidance and enforcement precedence.

"Prevent, detect and correct securities violations": There are three levels of securities violations. At the top, we have laws which are enacted by Congress or State Legislatures. Examples are the Securities Act of 1933 or the Investment Advisers Act of 1940. The next level is rules and regulations enacted by Regulators, such as the U.S. Securities and Exchange Commission ("SEC.") Rules and regulations are enacted to achieve compliance with laws; for example, the Gramm, Leach Bliley Act of 1999 spawned the SEC's Regulation S-P to govern safeguarding and privacy. Finally, firms create policies and procedures to comply with applicable laws and regulations. The firm's policies and procedures must be designed to protect, detect, and correct securities violations of laws, regulations, or firm policies.

Policies versus Procedures

Policies are broad guidelines for expected practices, and procedures offer specifics on how to comply with policies. Most procedures are written in the who, what, when, and how format. An example of a policy is "We do not accept cash deposits." The procedures would specify:

Who: any staff member presented with a cash deposit
What: the cash deposit must be refused or returned
When: anytime a cash is presented for deposit
How: refuse the deposit and memorialize the refusal on the firm's Check Deposit Log.

The Four-Step Compliance Process

1. Design and Create Policies and Procedures
2. Implementation
3. Execution
4. Monitoring (Surveillance and Testing)

It is essential to internalize this four-step process and understand that violations can occur at any of the four steps. Policies and procedures will inevitably have "gaps" or situations where the application of the policies and procedures is silent or unclear. Many times, violations occur because the policies and procedures were not properly implemented, which entails training. Probably the most common step where violations occur is in execution, where a procedure was not properly followed. Finally, nearly all regulatory regimes require monitoring, and failure to monitor can cause an otherwise solid approach to compliance to not be "reasonably designed."

Reviewing the Compliance Manual

There is no way around having to read the Compliance Manual; however, without assistance, this often will not be productive. Very early on, when training a new hire in compliance, I review the manual's table of contents with them and describe the chapter headings as "pieces of the puzzle." Depending on how the new hire learns best, I may ask them to read a chapter and discuss it with me, or we may go over each chapter together.

Compliance Calendar and the Testing Program

After reviewing the table-of-contents to identify the pieces of the puzzle, next is to put the pieces together, which takes us to implementation, execution, and monitoring. Every firm should have a program to test its policies and procedures to see how they are working and make any changes as necessary. Most firms conduct testing periodically, and many other compliance tasks are inherently episodic, which lend themselves well to a Compliance Calendar. The "pieces" identified in the Compliance Manual come together with the aid of the Compliance Calendar and Testing Program.

Core Belief

If I had a magic compliance wand that granted me one wish, I would wish every staff member shared the core belief that good compliance is good business. If everyone shared this core belief, the job of compliance would be much easier because staff conduct activities in a compliant manner because it is the right thing to do and not out of fear of reprisal or punishment. Academic studies have shown that good compliance is good business, and especially for a Compliance Officer, this is an essential core belief.

Advisor Friendly and Great Service

Compliance has a significant human element, and our motto is "advisor friendly." Think of our Compliance Department as if we were in the hospitality industry. We need to be kind and cordial and provide not just good service but great service. Good service is accurate and timely. Great service goes over and above by being helpful. You will have many individual responsibilities, and

service is high, if not number one, on the priority list. We expect all requests from the field to be accommodated within 24 hours, if not immediately.

Parenting Analogy

Influence is a critical aspect of compliance since we want staff to act in a compliant manner. There is an analogy to parenting styles. Developmental psychologists believe that a nurturing style is more effective than an overbearing, authoritative style. In the nurturing style of parenting, children are empowered to make choices, knowing the consequences of their actions. I am not suggesting we treat our staff as children, but a nurturing style of compliance will likely lead to better outcomes than an overbearing authoritarian style.

Deontological versus Utilitarian

I have discovered there are two broad philosophies of compliance: deontological and utilitarian. One is not better than the other; they are just different. Deon is Greek and means duty. Deontological people take a strict interpretation of compliance and do things "by the book." Utilitarian means "greater good," and utilitarians see compliance as a means to an end and don't relate well to bureaucracy.

Most people will be either deontological, utilitarian, or somewhere in between. What I have found is since their core values differ, there can be miscommunications when deontologists speak with utilitarians. However, being aware of this difference can be very helpful. I am a utilitarian and generally have no issues conversing with other utilitarians. However, when speaking with deontologists, there can be issues. For example, I may not get too excited when faced with a technical violation in a marketing piece; however, it may be a big deal to a deontologist.

Consider whether you are more deontological or utilitarian, and then assess your co-workers. This can aid in avoiding miscommunications when you understand your core values as well as theirs.

Finally, I experienced a moment of enlightenment many years ago. I am utilitarian, but the definition of compliance, "to create a supervisory system reasonably designed to prevent, detect and correct securities violations," is deontological. This definition never resonated with me, so I came up with a utilitarian version which has had a significant impact on my career in compliance.

"To create a supervisory system reasonably designed to protect clients, protect advisers, and protect the firm."

"Protect, protect, protect" is my rallying cry, and I use it often in staff meetings. Neither definition is better than the other, but this definition is better for me. You need to determine which is better for you, but at least when you hear me say "protect, protect, protect," you know where I am coming from.

Miriam Lefkowitz, Compliance & Regulatory Expert Witness/Consultant/ Attorney (and former general counsel/CCO to dual registrants)

Depending on the context, I have different answers to explain the role of compliance. When talking to firm management about establishing a robust compliance program, I often start with this simple framework for good compliance programs. At a high level, senior management should be committed to the following:

1. knowing the firm's business
2. knowing the rules
3. assessing the firm's strengths as an organization
4. identifying areas of relative weakness
5. refreshing

It is easy to get buy-in at this level, although the devil is in the details, as they say. Once I have firm commitment that this is a valid framework, I flesh out the details. The following is how I explain to new compliance, supervisory and operations staff, and senior management what that looks like in practice. I find it is important to give examples of the granularity of business activity that is impacted because many will assume that the business activities of a retail-focused broker dealer ("BD") or registered investment adviser ("RIA") would be to

(1) open accounts and
(2) recommend investments to (BDs), or advise on investments for (RIAs), retail investor assets in accordance with the client's financial profiles and objectives.

As compliance professionals, we need to point out that there are many sub-activities that likely require specific guidance. For example, buried within "opening accounts," there is likely to be marketing, deciding which account type to recommend, gathering client information, assessing the appropriateness of rolling over retirement assets, considering the liquidity of the current portfolio to assess the timing to reallocate, disclosing conflicts of interests, delivery of various disclosure documents, and supervising the new account opening, among other discrete topics. Ideally, the firm would implement a program that addresses the following elements for each distinct business activity.

1. Written policies and procedures (which may include compliance, operations, supervisory, job aides, checklists, worksheets, and forms, as applicable)

2. Training, as warranted, on the topic and tools

3. Supervisory oversight

    a. guidance on what the supervisors should be looking for
    b. how supervisors should document their reviews
    c. what resources/tools are available to improve the quality of the reviews
    d. escalation and follow up, as appropriate

4. Compliance testing – two components

    a. testing whether the procedures are being followed by the RRs/IARs and the supervisors
    b. design effectiveness testing - whether the procedures are actually effective at preventing conduct that should be prevented (e.g., RRs/IARs do not recommend/advise that clients with high needs for cash invest in illiquid assets) and/or compelling the conduct that should be compelled (e.g., RRs/IARs have a reasonable understanding of the investments/strategies before recommending/advising clients buy them)

5. Recordkeeping – which may be at the RR/IAR, Supervisor, Operations, and Compliance levels, as warranted

6. Conflicts identification and mitigation

7. Disclosures, if applicable

8. Risk assessment

    a. Start with conflicts, then layer on other risks such as vendor management, data security, affiliate considerations, I.
    b. Consider trends that indicate systemic weaknesses.

9. Governance

    a. The results of the compliance testing and risk assessment should be reported to a sufficiently senior or independent committee to consider trends.
    b. Appropriateness of resource allocation to the overall compliance program should be considered in light of the results of the testing, assessment, and changes to the business.

This is a lot; not every narrow business activity will require every step, and often, multiple activities can be combined in a single approach. But I think it is important for people who are responsible for executing or overseeing the compliance and supervision programs to understand conceptually what the program would look like if time and resources were infinite.

Necessarily, firms will need to prioritize and will not have this level of attention for every topic. It is realistic, however, for firms to be able to identify each of these steps for at least the most important or highest risk activities by the firm.

When I talk to RRs/IARs, I use a different approach. I have worked in-house at a number of dual registrants and advised many more. In my experience, RRs/IARs try to do what is in their clients' best interest and uniformly believe they are. They see themselves as honest and honorable, with strong moral compasses. With a few notable exceptions over the years, I agree with their self assessments. But I explain that these qualities, while an essential component to being compliant in the securities industry, are insufficient. This is because many of the securities rules are simply not intuitive. While some of the regulations are obvious (i.e., do not commit fraud), most are not. Being trustworthy and ethical does not help RRs know that FINRA's supervision requirements for static vs. interactive content on social media are different. Or help IARs understand the nuances of reporting performance.

I remind RRs/IARs that their jobs are to understand their clients and the investments available to them. Mine is to understand the regulatory requirements, risks, and expectations, and put structure to them. This division of labor is recognized by the regulators. If the RRs/IARs follow the firm procedures – the regulators will be very unlikely to find they violated the regulations even if the procedures are not actually sufficient. In that event, I could be liable as the CCO for failing to develop a reasonable compliance program, or the firm could be on the hook, but the regulators will not fault RRs/IARs who followed the firm's procedures. I sometimes get a little dramatic here, pausing for affect, as I present the alternative scenario. I mime, raising my right hand and getting sworn in to give testimony as I explain that I was an SEC enforcement attorney earlier in my career. I present a picture of RRs/IARs sitting in a small conference room, across from an enforcement attorney with a court reporter on their side, watching the pile of procedures and attestations they signed year after year grow taller while their own postures shrink. Defense counsel cannot help them when they repeatedly signed statements that they would read and follow procedures but then failed to take steps to do so. Those are the two scenarios – and I urge the RRs/IARs to let me take the risk with the regulators that the procedures are insufficient rather than have them face discipline because they did not follow them.

I often hear the objection that the RRs/IARs cannot make any money if they spend so much time filling out forms and making disclosures. I am sympathetic, but only so far. One analogy I often use in response involves the speed limit. Imagine that a widget salesperson can be very profitable, selling 1 widget every 10 minutes and scheduling sales appointments every hour on the hour. The appointments are 60 miles apart, and the speed limit is 55 miles/hour. The salesperson has to drive 60 miles in 50 minutes for an average speed of 72 MPH. (Trust me on this – I checked with a current algebra student😉!) When the salesperson gets pulled over for speeding – will the officer care that the business model depends on the salesperson traveling this speed? Will the judge care?

I remind RRs/IARs that they are in a very heavily regulated industry. If they were selling shoes, they could sell anything they wanted – soccer cleats to basketball players or high heels to people with bad ankles. No one would stop them. But in the financial services arena, that simply is not so.

And to people I meet at the rare parties I attend – I explain that I help asset managers by interpreting and applying guidance to protect their clients *and also* to protect the firms from their clients and regulators. The second clause often invites inquiry, but it is often as true as the former. People are generally surprised at how animated I am when I talk about our field – but I really believe that a strong compliance program is not about business prevention but a problem prevention. ■

Documentation Under Reg BI – Requirements, Expectations and Reasonable Practices

By Christopher J. Kelly and Miriam Lefkowitz

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Compliance professionals frequently incorporate interpretive guidance issued by SEC and FINRA Staff as they develop and maintain their compliance programs. Such guidance also helps firms prepare for the inevitable regulatory examinations, as the guidance often lays out expectations about how firms can demonstrate their implementation of applicable rules. Concerningly, however, guidance issued by the staff of regulators also can have the effect of undermining delicate and deliberate balances that that Commission itself has adopted. This consequence seems to be implicated with respect to Regulation Best Interest (Reg BI) where there is an increasingly wide gap between the records that broker dealers (BDs) must create in order to be in compliance with the rule, and the records that examiners expect firms produce to demonstrate compliance with the rule.

Background—Reg BI

Essentially, Reg BI requires BDs to act in the best interest of their retail investors (referred to as "customers" in this article) at the time they recommend any securities transactions or investment strategies involving securities.[1]

Reg BI is comprised of four component obligations and an express recordkeeping requirement. Those five duties are the following:

- *Disclosure Obligation*: At the time of a recommendation, BDs and registered representatives (RRs) must make full and fair written disclosure of all material facts relating to the scope and terms of the relationship with the customer and all material facts relating to any conflicts of interest that are associated with the recommendation.

- *Care Obligation*: In making recommendations to customers, BDs must exercise reasonable diligence, care, and skill to understand the potential risks, rewards, and costs associated with the recommendation. They must also consider the risks, rewards, and costs in light of the customer's investment profile and have a reasonable basis to believe that the recommendation is in that particular customer's best interest and does not place the broker's interest ahead of the customer's interest.

- *Conflict of Interest Obligation*: BDs must establish, maintain, and enforce written policies and procedures reasonably designed to identify, disclose, mitigate, and/or eliminate conflicts of interest relating to recommendations.

- *Compliance Obligation*: BDs must establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI.

- *Record Creation and Retention*: BDs are obligated to make and keep current (i) the customer profile collected from and provided to the retail customer pursuant to Reg BI, and (ii) the identity of any RR responsible for the account, if any, and they must retain such records for 6 years.[2]

Documentation Requirements Under Regulation Best Interest

Four of the five duties of Reg BI have express documentation requirements; the Care Obligation does not, as it is a real-time duty to understand the investment, the customer, and the strategy.[3] The Commission did not forget to include a documentation requirement in the Care Obligation—

1. Exchange Act Rule 15l-1. As this article focuses on the documentation requirements of Reg BI, its summary of the aspects of the rule are provided at a very high level. Since Reg BI only applies to recommendations to retail investors, as Reg BI defines that term, this article addresses only recommendations made to such persons.
2. Exchange Act Rules 17a-3(a)(35) and 17a-4(e)(5)
3. The Disclosure Obligation requires firms to provide written disclosures to customers, and the Compliance and Conflict of Interest Obligations mandate the maintenance of written policies and procedures, all of which are subject to the recordkeeping requirements under Exchange Act Rule 17a-4.

rather, it recognized the excessive burden that such a duty would create and decided against imposing one. The Commission explained:

> [T]he Commission does not intend this to require, in practice, the creation of extensive new and potentially duplicative records for each and every recommendation to a retail customer. Instead, broker-dealers should be able to explain in broad terms the process by which the firm determines what recommendations are in its customers' best interests, and similarly to explain how that process was applied to any particular recommendation to a retail customer. However, we are not mandating that broker-dealers create and maintain a record of each such determination. Nonetheless, as noted above we are providing guidance suggesting that firms may wish to adequately document an evaluation of a recommendation and the basis for that recommendation in particular contexts, such as the recommendation of a complex product, or where a recommendation may seem inconsistent with a retail customer's investment objectives on its face.
>
> In addition, in response to requests from commenters for confirmation that the proposed record-making requirements do not contemplate broker-dealers needing to create and maintain records of why certain products were recommended over others on a recommendation-by-recommendation basis, we confirm that broker-dealers are not expected to maintain records comparing potential investments to one another so long as they are able to demonstrate that each individual recommendation actually made to a customer meets the requirements of Regulation Best Interest on its own. Regulation Best Interest applies to recommendations made to a retail customer, rather than to potential recommendations considered by the broker-dealer but not actually made to the customer. (emphasis in original; internal citations omitted)

This language from the Commission is straightforward and unambiguous: BDs can comply with their Care Obligation without creating any specific records, although it is prudent to create records in specific instances, such as for complex products, or where a recommendation may seem inconsistent with a customer's investment objectives on its face. Notably, these examples offered by the Commission are not specifically covered by the other obligations of Reg BI.

Documentation Expectations Under Regulation Best Interest

SEC Staff has repeatedly emphasized that it takes a much more expansive view than the Commission itself with respect to BDs' documentation creation and retention duties pursuant to the Care Obligation. The Staff has done so by bootstrapping the Care Obligation to the documentation requirements of the Compliance and Conflict of Interest Obligations.[4] In doing

4. See excerpt from SEC Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Adviser (April 20, 2023, updated April 22, 2024):

> 16. **Should firms document the evaluation of reasonably available alternatives?**
> Although there is no requirement of such documentation, in the staff's view, it may be difficult for a firm to demonstrate compliance with its obligations to retail investors, or periodically assess the adequacy and effectiveness of its written policies and procedures, without documenting the basis for certain recommendations.

See also excerpts from SEC Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Account Recommendations for Retail Investors (March 30, 2022):

Regarding the consideration of factors other than cost:

> It is the staff's view that it may be difficult for a firm to assess periodically the adequacy and effectiveness of its policies and procedures or to demonstrate compliance with its obligations to retail investors without documenting the basis for such conclusions.

Regarding retirement account rollover recommendations:

> In the staff's view, when making a rollover recommendation, it may be difficult for a firm to assess periodically the adequacy and effectiveness of its policies and procedures or to demonstrate compliance with its obligations to retail investors without documenting the basis for the recommendation.

Regarding the type of account that was recommended for a customer:

> Additionally, in the staff's view, it may be difficult for a firm to assess periodically the adequacy and effectiveness of its policies and procedures or to demonstrate compliance with its obligations to retail investors without documenting the basis for certain recommendations.

As with all Staff guidance, this bulletin notes that the views expressed therein do not constitute rules, regulations or statements of the Commission, have no legal force or effect, do not alter or amend applicable law, and create no new or additional obligations.

so, the Staff seemingly has elevated their own need to have a means of assessing a BD's compliance with Reg BI above the Commission's stated concern that BDs not be excessively burdened by recordkeeping requirements.

Reasonable Practices

It is tempting to point out that SEC Staff Bulletins are merely guidance from SEC Staff; they are not voted on by SEC Commissioners and do not have any independent "force or effect." While certainly true, this observation likely will provide little comfort to those who find themselves in the crosshairs of an SEC or FINRA examination (or in an arbitration where plaintiffs' counsel insist that such guidance have the force of law). As a practical matter, therefore, most broker-dealers will want to require that brokers document the basis for at least some recommendations.

Would it be even a better practice for BDs to require RRs to document the basis for all recommendations? While such an approach might be preferred by examiners, it is not without risk. Inevitably, some RRs will not document each recommendation, or will do so in a cursory fashion. In such events, regulators could find that the firm "failed to enforce" its policies and procedures. There also is a risk that the burden of documenting every recommendation will result in a diminution in the quality of documentation, leading to formulaic or even incorrect documentation that a regulator may later parse through and find fault with. The quality of the recommendations may also suffer, as RRs may be loathe to create custom documentation for each recommendation and may offer fewer strategies to minimize the time involved in documenting the alternatives.

Accordingly, the best approach for most broker-dealers is likely to be a middle-ground—requiring brokers to document only certain recommendations.

It bears noting that the Commission noted six times in the Adopting Release that a BD's compliance with the Care Obligation is evaluated as of the time of the recommendation and not in hindsight.[5] Examiners review recommendations after the passage of time, however, when the actual performance of securities or strategies may already be known. When a security or strategy has underperformed, contemporaneous documentation can be helpful to demonstrate the perspective at the time of the trade.[6]

What Recommendations Should Be Documented?

For firms that decide to require at least some documentation under the Care Obligation (which these authors recommend), where should they start? As noted above, the Commission advised that BDs should take a risk-based approach when deciding whether to document certain recommendations, and SEC Staff expanded the types of recommendation that they think would warrant documentation. Those circumstances include instances in which:

- the investment "appears inconsistent with" an investor's objectives;
- the recommendation poses a conflict of interest for the firm or broker;
- the recommendation involves a "significant investment decision" such as a rollover or choice of accounts; and
- the investment is complex, risky, or expensive.

5. See excerpt from SEC Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Adviser (April 20, 2023, updated April 22, 2024): Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release 34-86031 (June 5, 2019) ("Regulation Best Interest Adopting Release").
6. Documentation can be double-edged sword when defending civil matters, particularly in arbitration. Plaintiffs' counsel often parse through documentation to identify every possible other fact or rumor that might have been knowable to the RR or BD at the time of the trade (which efforts often exceed the "reasonable diligence, care and skill" requirements by the Care Obligation). Of course, counsel will argue that the absence of documentation is even more compelling evidence of a firm's failure, so there is no way to be protected with certainty.

With regard to this last category, the SEC has not provided any comprehensive definition of "complex" or "risky" products, but SEC Staff have listed as examples: inverse or leveraged exchange-traded products, investments traded on margin, derivatives, crypto asset securities, penny stocks, private placements, asset-backed securities, volatility-linked exchange-traded products, and reverse-convertible notes.

In addition to the categories highlighted by the SEC and Staff, BDs may wish to consider firm-specific factors that may either cause (i) an actual heightened risk of noncompliance with the Care Obligation; or (ii) a more challenging time demonstrating to regulatory examiners that they have met their duty. For example, depending on the particular facts and circumstances, some BDs might wish to impose recommendation-level documentation requirements for:

- RRs who are new to the BD;
- RRs whose conduct has been the subject of exceptions noted in branch or other internal reviews;
- RRs subject to recent customer complaints, particularly if the nature of the complaints is relevant to the duties under the Care Obligation;
- RRs with regulatory or disciplinary history, if the matter is relevant to the duties under the Care Obligation;
- RRs who use the same strategy or securities for an unusually high percentage of their customers;
- Branches or RRs selected at random, for a temporary period, as a way to test that they understand their duties and to confirm that their approaches are consistent with the process described in the firm's procedures; and
- Products/strategies that are new the market or to the BD even if not identified as complex or risky by the SEC or FINRA.

In addition to providing guidance to brokers as to *when* they should document a recommendation, BDs should consider *what* about the recommendation should be documented, and *how* they should document a recommendation. Indeed, in a January 2023 Risk Alert, the SEC's Division of Examination cited as "deficient" firm procedures that directed brokers to document the basis for their recommendations without providing guidance as to "the specific information to be gathered."[7] Some of the elements of the Care Obligation may not need to be documented on a trade-by-trade basis. For example, with respect to the Care Obligation's requirement that the person (BD or RR) making a recommendation understands the potential risks, rewards, and costs associated with the security or strategy, BDs can demonstrate that the RRs are trained in products or strategies by maintaining the content of product training and evidence of which RRs attended, being careful to monitor that the training has not become outdated as the product or market evolve.

Conclusion

Although it is not explicitly required, BDs are likely to have a difficult time defending their compliance with the Care Obligation in regulatory examinations if they do not document any of their securities recommendations. Firms are advised to adopt policies, procedures and practices that are based on the BD's own risk profile and tolerance for regulatory inquiry. That said, most BDs would be well advised to require that RRs document at least some of their recommendations, and BDs should also advise their RRs how and where they should document those recommendations. ■

7. SEC Risk Alert: Observations from Broker-Dealer Examinations Related to Regulation Best Interest (January 30, 2023), at 3-4.

A B C, Easy as 1 2 3: Acronyms and Initialisms in the Securities Industry

By Brian Rubin

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If you are new to securities compliance, your head sometimes spins: What is an RIA v. an IAR v. an IRA v. an AIR? (We made up the latter.) And is "IRA" pronounced "eye" "are" "aaayyy" (as Fonzie would say) or "Ira" (as in Gershwin and my cousin from Brooklyn)?

If you're a securities industry veteran, you may wonder: Why do they keep adding more acronyms every day? And are they really "acronyms" or something else? And why is Reg S-P hyphenated, but Reg BI is not?

This article will attempt to answer some of those questions and more. (And provide some, y'know, actually useful information to help you perform your job better. Or at least help you sound more competent.)

What is an Acronym v. an Initialism?[1]

To begin, let's define some terms to make sure we are on the same page. Both acronyms and initialisms are abbreviations for a series of words. However, acronyms are pronounceable as words, while initialisms are not. So, in the civilian (i.e., non-securities) world, examples of acronyms include POTUS (President of the United States), UNICEF (originally, United Nations International Children's Emergency Fund), NATO (North Atlantic Treaty Organization), FLOTUS (First Lady of the United States), and SCOTUS (Supreme Court of the United States). Some acronyms are so cool that they've taken on a life of their own and people use them as actual words, like scuba (self-contained underwater breathing apparatus), radar (radio detection and ranging), and laser (light amplification by stimulated emission of radiation). Examples of initialisms are FBI (Federal Bureau of Investigation), CIA (Central Intelligence Agency), and TGIF (Thank God it's Friday).

In the securities industry, we have been blessed (or cursed) by having both acronyms and initialisms. For example, SEC (Securities and Exchange Commission) is an initialism. On the other hand, NASAA is an acronym (North American Securities Administrators Association).

If you're looking for patterns, terms with three or fewer words often become initialisms, while those with four or more words become acronyms if they are pronounceable. For example, we use the initials OBA (Outside Business Activities), but we pronounce the word CUSIP (Committee on Uniform Securities Identification Procedures) (pronounced "q sip"). Of course, every rule is meant to be broken (except for securities laws) (unless it wasn't your fault) (or it's rulemaking by enforcement) (or . . . well, we'll save other defenses for another article). So, for example, some three-word terms become acronyms, like the NAC (National Adjudicatory Council) (pronounced "knack," but with a silent first and last "k"). And for some longer terms, personal preference determines whether to use an acronym or an initialism, such as NYSE (New York Stock Exchange), which is sometimes pronounced "en why es ee" and sometimes as "Nice Ee."

Finally, sometimes people add letters to try to make a combination of initials sound more like a word. One example is the Financial Industries Regulatory Authority (FINRA), which added the letter "N" to its acronym. We would have preferred FIRA (pronounced as "feerah") because of the various slogan opportunities. If the SRO (Self-Regulatory Organization) wanted to be "kinder and gentler," it could have used, "Don't FIRA us; we're here to help." Or, if it wanted to convey presidential and historical importance, it could have used, "There is nothing to fear but FIRA itself." Finally, if it wanted to be sporty or show athleticism, it could have used, "Fear the FIRA," like the University of Maryland Terrapin's slogan, "Fear the turtle." Another example of trying to make initials into a word is PCAOB, the Public Company Accounting Oversight Board. Some people (including a former SEC Commissioner) refer to that nonprofit corporation as "Peekaboo."[2]

1. https://www.merriam-webster.com/grammar/whats-an-acronym.
2. SEC Commissioner Paul S. Atkins, "Remarks Before the Federalist Society" (Sept. 21, 2006), https://www.sec.gov/news/speech/2006/spch092106psa.htm.

Now that we have some baseline knowledge, let's jump into some acronyms and initialisms to see how they work (and don't work) and where they come from.

Don't Embarrass Yourself through Misuse or Mispronunciation

- *SEC (U.S. Securities and Exchange Commission) v. the other (powerhouse) SEC*

In the non-securities world, the initials SEC typically refer to the Southeastern Conference, a "pioneer in the integration of higher education and athletic competition" and a "leader on the national landscape for intercollegiate athletics in the 21st century."[3] The following universities are members: Alabama, Arkansas, Auburn, Florida, Georgia, Kentucky, LSU (Louisiana State University), Mississippi, Mississippi State, Missouri, South Carolina, Tennessee, Texas A&M (originally, Agricultural and Mechanical, but today, the letters do not officially stand for anything), and Vanderbilt.

Interestingly, the collegiate SEC was formed in 1933, shortly before the formation of the U.S. SEC, which was founded on June 6, 1934,[4] exactly 10 years before D-Day (the "D" in D-Day stands for "Day," meaning that we celebrate "Day-Day"[5]).

- *North American Securities Administrators Association, Inc. (NASAA) v. the other (super cool) NASA*

In the non-securities world (and possibly in other universes), the acronym NASA stands for National Aeronautics and Space Administration.

Practitioner tip: It's fun to ***tell*** your friends and family, "I have a meeting with the head of NASAA," but to let them ***hear***, "I have a meeting with the head of NASA."

- *Designated examining authority (DEA) v. the other (super tough) DEA*

In our world, DEA means FINRA or an exchange that examines members for compliance. In other worlds (think, Breaking Bad), the DEA is the Drug Enforcement Administration, a different kind of regulator that investigates other products and services such as the manufacture and distribution of drugs (by, for example, a high school chemistry teacher).

- *LOA (Letter of Authorization) v. LOI (Letter of Intent) v. LOL (Laugh Out Loud)*

Generally, people use initials for each of these "L" words (not to be confused with the two television dramas bearing the same name). However, sometimes people say, rather than write, "ell oh ell." The TV show Curb Your Enthusiasm had an episode about this usage. Larry David criticized it (of course), saying, "[I]f you were gonna laugh out loud, why aren't you laughing out loud? Why say it? Why not just laugh? . . . No, you're saying 'L-O-L.' You're verbal texting."[6]

- *AWC (Letter of Acceptance, Waiver and Consent) v. AWAC*

AWC is FINRA's enforcement settlement agreement, signed by the respondent and FINRA. It is pronounced "aaayyy, double you, See," not "aaayyy whack." The latter refers to the E-3 Sentry, an airborne warning and control system also known as an AWACS aircraft.[7]

3. https://www.secsports.com/history.
4. https://en.wikipedia.org/wiki/U.S._Securities_and_Exchange_Commission.
5. https://www.britishlegion.org.uk/stories/ten-things-you-might-not-know-about-d-day#:~:text=The%20term%20D%2DDay%20is,is%20nowhere%20near%20as%20catchy).
6. https://www.youtube.com/watch?v=wRom-BYrAGI.
7. https://www.af.mil/About-Us/Fact-Sheets/Display/Article/104504/e-3-sentry-awacs/#:~:text=The%20E%2D3%20Sentry%20is%20an%20airborne%20warning%20and%20control,the%20Joint%20Air%20Operations%20Center.

- *RIA v. IAR v. IRA (v. RR)*

RIA stands for Registered Investment Adviser, which is generally an entity and must be registered with the SEC or state to provide investment advisory services.[8] IAR stands for Investment Adviser Representative, the title for individuals who provide investment advisory services and who may need to be registered. Finally, IRA is an Investment Retirement Account, which can be pronounced as "eye are aaayyy" or the same as my cousin's name. In contrast, RRs ("are ares") are Registered Representatives, who must be registered and who work for broker-dealer (BD) firms, which are in the business of buying and selling securities.[9]

- *Rev BI v. Reg S-P*

Reg BI is easy. That's an abbreviation ("Reg") and an initialism ("BI") for Regulation Best Interest. Reg S-P is far more complicated. The full name of that regulation is "Privacy of Consumer Financial Information."[10] Apparently, the SEC didn't want to use the initialism "PCFI." Instead, it appears that the SEC kept the "P" for "Privacy" and used the "S" from "Safeguarding," which was part of the name when the rule was proposed, "Privacy of Consumer Financial Information and Safeguarding Customer Information."[11] So, "S-P" appears to be a "mishmash" (that's a highly technical legal term) for Safeguarding-Privacy. (Practitioner tip: sometimes regulators act in mysterious ways.)

Fun and Interesting Acronyms/Initialisms

- *Fun*

The securities regulators have gotten into the business (although not as an OBA) of assigning cute names to systems. For example,

- Electronic Data Gathering, Analysis, and Retrieval (EDGAR), a system to search SEC filings.
- Electronic Municipal Market Access (EMMA), a system that provides data and information about municipal bonds.

Several non-securities government-sponsored enterprises have also adopted cute names for themselves. For example,

- Federal Agricultural Mortgage Corporation (Farmer Mac)
- Federal Home Loan Mortgage Corporation (Freddie Mac)
- Federal National Mortgage Association (Fannie Mae)
- Government National Mortgage Association (Ginnie Mae)

Our last fun example is WORM (Write Once, Read Many). Under the federal securities laws, certain records must be stored electronically in a manner to prevent their alternation or destruction, called WORM. This acronym can be fun to use in conversations, particularly with children. For example, you could tell friends and family, "I'm handling a WORM issue" or "The regulators are examining to see if we have a WORM problem."

- *Interesting*

8. "Regulation of Investment Advisers by the U.S. Securities and Exchange Commission," https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf; A Brief Overview: The Investment Adviser Industry, https://www.nasaa.org/industry-resources/investment-advisers/investment-adviser-guide/.
9. https://www.finra.org/investors/investing/working-with-investment-professional/registered-financial-professionals.
10. https://www.sec.gov/rules/2000/06/privacy-consumer-financial-information-regulation-s-p#:~:text=Under%20the%20Gramm%2DLeach%2DBliley,to%20the%20consumer%20and%20the.
11. https://www.federalregister.gov/documents/2023/04/06/2023-05774/regulation-s-p-privacy-of-consumer-financial-information-and-safeguarding-customer-information.

The history of FINRA's name is fascinating (if you're in the securities business—and something of a nerd). It begins with NASD (the National Association of Securities Dealers), founded in 1939, pursuant to the 1938 Maloney Act amendments to the Securities Exchange Act of 1934, which provided for "the creation of a regulatory entity that would create and enforce securities rules and promote just and equitable principles of trade. NASD's mandate was 'to protect investors and the public interest, and to remove the impediments to and perfect the mechanism of a free and open market.'"[12] Most people pronounce it as "en aaayyy es dee," although some people sarcastically said, "NAS-D" (as in "nasty").

Fast forward several decades. In 2007, NASD "consolidated with the member regulation, enforcement, and arbitration functions of the NYSE."[13] At the time, there was speculation in the news media about what name the new regulator would take:

> *Joseph Borg, president of the North American Securities Administrators Association (that's NASAA, not the rocket scientists), offered some suggestions: MegaReg didn't go over well, he said, and neither did United States Securities Regulation - USSR.*
>
> *Brian Rubin, a former NASD deputy chief counsel now at law firm Sutherland Asbill & Brennan, proposed Coordinator of the Securities Industry, or "CSI: Wall Street."*[14]

In June 2007, NASD announced, "the member regulation arms of the NASD and NYSE Regulation [would] join forces" under the acronym SIRA (Securities Industry Regulatory Authority).[15] Less than a month later, NASD "changed its mind" because "[i]t turns out SIRA sounds similar to an Arabic word, commonly spelled Sirah, which refers to the biographies of the Prophet Muhammad."[16] One article about the "snafu" (situation normal: all—um—"fouled" up)[17] was titled, "Que SIRA, SIRA."[18] NASD quickly regrouped and "determined that it was appropriate to select the alternative name of Financial Industry Regulatory Authority, or FINRA, for our new organization."[19]

FWIW (for what it's worth) – Resources

If we've WYA (whet your appetite), the following resources can help you learn more about acronyms, initialisms, and good ol' fashioned words and phrases commonly used in the securities industry:

- The Federal Reserve Banks: Glossary of Acronyms and Definitions
- FINCEN (Financial Crimes Enforcement Network): Acronyms
- FINRA: BrokerCheck Glossary
- FINRA: Explanation of Terms (U4, U5, BD, BDW, BR)
- FINRA: Terms and Acronyms
- FINRA: Professional Designations
- SEC: Commonly used terms, acronyms, and abbreviations in the EDGAR filer Manual
- SEC: Cutting Through the Jargon From A to Z
- SEC: Glossary
- SEC: Glossary of Terms

Assuming your reaction to this article hasn't been TLDR (too long, didn't read), we would like to TY (thank you). And, finally, please HMU (hit me up) if you have a favorite acronym or initialism.[20]

12. https://www.finra.org/media-center/news-releases/2014/finra-marks-75th-anniversary-protecting-investors.
13. https://www.finra.org/media-center/news-releases/2014/finra-marks-75th-anniversary-protecting-investors.
14. Jaime Levy Pessin, "DJ COMPLIANCE WATCH: Playing The Regulatory Name Game" (May 18, 2007).
15. https://www.wsj.com/articles/SB118235557583742107.
16. https://www.wsj.com/articles/SB118428684001465382.
17. https://www.vocabulary.com/dictionary/snafu#:~:text=Snafu%20was%20originally%20a%20World,the%20word%20%22fouled%22).
18. https://www.meetingsnet.com/financialinsurance-meetings/que-sira-sira.
19. https://www.reuters.com/article/idUSN12365029/.
20. The author can be contacted at BrianRubin@eversheds-sutherland.com.

Artificial Intelligence (AI) Articles

As artificial intelligence (AI) continues to expand into virtually every aspect of financial services, its impact on compliance professionals is growing, creating both opportunities and challenges. NSCP *Currents* published a series of articles in 2024 designed to provide compliance professionals with insights, tools, and strategies to help them navigate the complex landscape of AI in the current regulatory environment and develop strong practices when integrating AI within their organizations.

Below are the first paragraphs from three articles published this year. NSCP members can click through for the full content.

A Walk Down the New Wall Street: Managing the Arrival, Risks, and Promise of AI in Investment Manage ...

By Paul Felsch

With the ever-increasing fervor around the use if AI/GenAI, several colleagues have shared with me over the past several weeks how individuals are hungry for more than mere musings on the SEC's now-rescinded rule proposal on conflicts of interest and predictive analytics. The general sentiment has been that, although content exists around AI/GenAI, much of it is not specific to our industry, and for any content that is relevant, it hasn't yet reached the level of practical application (or even foundational education). This article is intended to be an incremental but foundational step toward curing that.

The Case for Human Compliance Professionals in an AI World

By Adam Schaub

An often-asked question about the use of Artificial Intelligence ("AI") is "Will it take my job?" In 2022 Elon Musk announced a humanoid robot named Optimus intended to replace humans in jobs that are considered dangerous or where there are labor shortages; however, broker-dealer & investment adviser compliance is not likely high on the list of the best use cases for human replacement with AI-powered technology, staffing challenges aside. While we may be safe from robots taking over compliance jobs (though who is going to squabble against robots assuming responsibility for onsite branch inspections!), there are many valid use cases for AI in compliance, surveillance, legal, licensing, insurance and related areas. Rather than replace compliance professionals, we will benefit from AI serving as a secondary means of defense, helping to support oversight and risk reduction rather than acting as the primary means of risk prevention. AI will do this by making humans more effective and efficient in their work, allowing compliance professionals to leverage technology to focus their efforts on the areas that bring the most risk to their firms.

Artificial Intelligence: SEC Focus Areas and Best Practices for Asset Managers

By Ethan Corey and Clifford Kirsch

On July 26, 2023, the Securities and Exchange Commission ("SEC") issued a release proposing a sweeping set of rules that, among other things, would regulate the use of artificial intelligence ("AI") by SEC-registered investment advisers, including asset managers ("SEC Release").[1] The rulemaking has proven to be controversial and the SEC's Spring 2024 Regulatory Agenda notes that the SEC is considering "re-propos[ing] rules related to broker-dealer and investment adviser conflicts in the use of predictive data analytics ("PDA"), artificial intelligence, machine learning, and similar technologies in connection with certain investor interactions." While the rulemaking and its ultimate fate have garnered the bulk of attention from investors, asset managers and the financial media, other actions that the SEC and its staff are currently taking are already having a more immediate impact upon asset managers' use of AI.

Therapeutic Publishing: NSCP Call for Authors

By Dr. Shawn Bostic

Writing can be a therapeutic outlet for sharing compliance challenges, as it allows for reflection, clarity, and the processing of complex issues in a structured way. By putting these challenges into words, individuals can break down problems, better understand their root causes, and gain perspective on their shared viewpoints and concerns. Writing also creates a space to explore and document the steps taken to find solutions, whether through research, collaboration, or seeking advice from peers. This process can lead to a sense of accomplishment and relief as it transforms challenges into learning experiences.

Ongoing compliance challenges are increasingly complex for organizations across various industries. Rapidly evolving regulations, such as those related to cybersecurity, digital assets, compensation arrangements, and reporting obligations, require companies to stay vigilant and adaptive. The proliferation of tools that include artificial intelligence, communication mediums, and complex products has further complicated compliance efforts, making it essential to maintain secure reliable data across diverse platforms. Additionally, businesses must navigate varying compliance requirements in different jurisdictions, which can lead to inconsistencies and increased risk of non-compliance. As regulatory bodies enhance their enforcement capabilities, organizations face mounting pressure to maintain robust compliance frameworks, often necessitating significant investments in technology, training, and auditing processes to mitigate potential risks.

Compliance lessons learned through published disciplinary actions, exam reports, and industry collaboration provide valuable insights for firms to enhance their regulatory practices. Published disciplinary actions highlight common compliance pitfalls, offering firms real-world examples of what went wrong and the consequences of non-compliance. Exam reports provide a detailed look at how regulators assess firm policies and procedures, revealing areas where compliance programs may fall short and recommending improvements. Your articles foster the sharing of best practices, helping firms align with evolving regulations and mitigate risks. Together, these sources emphasize the importance of proactive compliance, robust internal controls, and continuous learning from the experiences of others in the industry.

We invite passionate writers and experts in the field of compliance to contribute to NSCP Currents, which provides valuable information to the compliance community. Join us in creating a diverse collection that inspires and educates readers. Please submit your proposals at https://nscp.org/writing-opportunities and be part of this exciting literary endeavor! Contributing an article to NSCP is a unique opportunity to share your insights, experiences, and creativity with a broader professional audience.

We can’t wait to see your work!

2024 NSCP *Currents* Articles

NSCP *Currents*' history dates back to the 1980s and we are proud of how it has progressed to the premier compliance publication of the financial services industry today. Since NSCP's incorporation in 1987, NSCP *Currents* has evolved in both content and format, yet continues to provide invaluable information to the compliance community. From a paper publication which was mailed to NSCP members, to a digital PDF published through email, NSCP staff, along with members of the Publications Committee, have ensured that NSCP *Currents* has remained "current." Continuing its evolution, NSCP *Currents* articles are now available to NSCP members any time on Currents On Demand.

In addition to the articles that are included in this issue, NSCP *Currents* published a large number of original articles and tools in 2024, developed for readers to customize and use to support their own compliance programs. All of the articles published in 2024 NSCP *Currents* can be found below. Note that NSCP membership is required to access the articles.

Artificial Intelligence: SEC Focus Areas and Best Practices for Asset Managers
By Ethan Corey and Clifford Kirsch

Marketing Rule Charges for Testimonials and Endorsements, Third-party Ratings, and Substantiation
By Jeremy McCamic

2024 Year-End Checklist: Compliance Preparation for Investment Advisers
By Anna Schnitkey

NSCP Celebrates… Native American Heritage Month
By Takesha Pollock

A Walk Down the New Wall Street: Managing the Arrival, Risks, and Promise of AI in Investment Management
By Paul Felsch

How to Prepare for Amendments to Regulation S-P
By Michelle L. Jacko

Developmental Coaching of Junior Compliance Officers
By Ted McCutcheon, Shawn Bostic and Melissa Starr

Breaches When MFA is in Place
By Madison Dewey

NSCP Celebrates… LGBTQ+ History and National Disability Employment Awareness Month
By Takesha Pollock

Cybersecurity Update – Summer 2024
By Craig Watanabe

Maintaining Audit-Ready Private Fund Investment Performance
By Kim Cash and Janice Kitzman

2024 NSCP *Currents* Live Webinars

In addition to the high-level articles and resources NSCP members value and expect, NSCP launched a new member benefit in 2024: NSCP *Currents* Live!

A list of all of the 2024 NSCP *Currents* Live webinars can be found below. Recordings of the monthly webinars are available to NSCP members on Currents On Demand.

Understanding the Department of Justice's New Corporate Whistleblower Awards Pilot Program"
Featuring Patrick Gushue and Lisa Colone ... View Webinar

"T+1, Best Execution, and Trade Reporting Compliance for Broker-Dealers"
Featuring Jeff Gearhart, Susan Light, and Daniel Wright ... View Webinar

"Navigating a Career in Compliance - Advice for Diverse Professionals and Their Allies"
Featuring Takesha Pollock, Kona Mann, and Issa Hanna ... View Webinar

"Artificial Intelligence and Technology Compliance Challenges"
Featuring Chad Nichols, Bart Layton, and Kelly Koscuiszka ... View Webinar

"The Current State of ESG"
Featuring India Williams, Josh Jones, and Justin McGuffee ... View Webinar

"The DOL Fiduciary Rule"
Featuring Jason Berkowitz, David Kaleda, and Jane Riley ... View Webinar

"Navigating Regulatory Exams & Interacting with Regulators During Exams"
Featuring Pete Driscoll, Liz Legacy, and Paul Tyrell ... View Webinar

"FINRA's Residential Supervisory Location (RSL) and Remote Inspection Pilot"
Featuring Jerry Danielson, Andrew Mount, and Jennifer Szaro ... View Webinar

"SEC Private Funds Adviser Rules - How Advisers are Preparing for Implementation"
Featuring Genna Garver, Igor Rozenblit, and Scott Weisman ... View Webinar

"How to Uncover and Address Off-Channel Communications"
Featuring Myles Blechner, Kim Chapman, and Patricia ("Trish") Flynn ... View Webinar

"How to Avoid CCO Liability"
Featuring Patrick Hayes, Rosa Licea-Mailloux, and Brian Rubin ... View Webinar