



## Risk Management Update September 2012

### COORDINATED EXAMINATIONS IDENTIFY TOP BROKER-DEALER COMPLIANCE VIOLATIONS

In early September, the North American Securities Administrators Association (“NASAA”) released their 2012 Broker-Dealer Coordinated Examination Report<sup>1</sup> (“Report”) at their annual conference, which details the results of coordinated examinations by the state securities regulators. The current top compliance violations throughout the broker-dealer firms in the United States were highlighted.

An interesting statistic from the Report shows that from the 236 examinations conducted during a six month time period, 453 violations were found in five compliance areas. This number is down from the violations found in 2010, when 567 total violations were cited. The five major areas of violations were: Books and Records; Operations; Sales Practices; Supervision; and Registration and Licensing.

Within the Books and Records reviewed, 131 violation types were found:

- Advertising and Sales Literature
- Outgoing/Incoming Correspondence
- Complaints, Arbitrations and Litigation
- Trade Blotters, Exception Reports, and Order Tickets
- Supervisory Approval of Customer Account Information
- Maintenance of Customer New Account Information
- Customer Statements, Confirmations, and Providing Customers a Copy of New Account Information

Under the Operations Review, violation types reported were:

- Handling Money and Securities
- Margin
- Financial Statements and Net Capital
- Cold Calling and Telemarketing
- Penny Stocks and Options
- Commission Agreements and Statements
- Prospectus Delivery
- Discretion and Third-Party Accounts
- Order Room Activity and Market Making
- Privacy and Regulation S-P

Sales Practices Violations included:

- Suitability, Outside Business Activity and Selling Away
- Variable Product Suitability and Variable Annuity 1035 Exchanges

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<sup>1</sup> See 2012 Broker-Dealer Coordinated Examinations Project available at [http://www.nasaa.org/wp-content/uploads/2012/09/2012-BD-Coordinated-Exams-PowerPoint\\_FINAL.pdf](http://www.nasaa.org/wp-content/uploads/2012/09/2012-BD-Coordinated-Exams-PowerPoint_FINAL.pdf)

- Unauthorized Trades, Excessive Trading and Churning
- Sales Seminars and Sales of Unregistered Products
- Mutual Fund Switching and Mutual Fund Breakpoints
- Conversion and Misappropriation, Order Ticket Not Reflecting the Order Taker
- Fraud

For Supervision, there were 123 violations in the following areas:

- Written Supervisory Procedures (“WSP”): Failure to Follow Procedures and Maintenance of Current Procedures
- Adequate Written Procedures, WSP’s Not Readily Available to Registered Representatives
- Internal Audits – OSJ Branch and Non-OSJ Branch
- Use of Professional Designations, Hiring Procedures
- Anti-Money Laundering
- Branch Manager Approving Own Trades
- Continuing Education – Firm Element

And lastly, Registration and Licensing:

- Qualifications and Licenses, Form U4 Information, and Form U5 Terminations
- Form BR (Branch Offices) and Form BD Accuracy
- Special and Heightened Supervision

Of the multitude of violations found, however, the top violation was failure to follow the firm’s Written Supervisory Procedures Manual. Jack E. Herstein, NASAA President stated that, “We highlighted types of violations to help broker-dealers strengthen their internal compliance programs. Our best practices are designed to help broker-dealers to address their compliance challenges and provide better client service”.<sup>2</sup>

The importance of enforcing your firm’s Written Supervisory Procedures is an ongoing process. With such high importance being placed on compliance with the firm’s WSPs, as evidenced by the multitude of violations recorded by NASAA, firms need to make sure to do the following:

- Develop your WSPs – make sure your firm’s procedures are tailored and customized to the firm
- Update your WSPs – make sure your firm is reviewing WSPs on a regular basis and updating as needed. It is important to document when and what has been updated in the WSPs
- Enforce your WSPs – train, train, train. Employees need to be trained at the onset and on an ongoing basis of the importance of following the firm’s WSPs. If an infraction occurs, it needs to be documented, addressed and resolved.

Even though the number of violations is down in 2012, the types of violations found in the Report illustrate the deficiencies in firms’ compliance programs and can be used as an effective tool for enhancing your own. NASAA has outlined what the regulators will be focusing on when

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<sup>2</sup> Id.

they come into your firm to do an examination. By using this Report as a guideline for your firm's annual review process, you will be able to prevent gaps in your audit program. Most importantly, stay ahead of the curve by periodically assessing your WSPs and compliance procedures and you will be able to identify additional efficiencies and controls.

For more information or to learn how Core Compliance & Legal Services, Inc. may be of assistance with evaluating your current procedures, please do not hesitate to contact us at (619) 278-0020.

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