# The Girl Who Played with SEC and FINRA Fire: SEC and FINRA Disciplinary Actions Against In-House Counsel and Chief Compliance Officers (June 2011 – June 2012)

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## Introduction

> *"He was sitting in a car with the window rolled down. She ran to the car, poured gasoline through the window, and lit a match. It took only a moment. The flames blazed up."*[1]

In the international bestseller *The Girl Who Played With Fire* (the second book in Stieg Larsson's Millennium Trilogy), Mikael Blomkvist, a journalist, plans a major exposé of the international human trafficking world while also trying to track down Lisbeth Salander, his former investigator, who is on the run because she is being framed for murder (but not the murder of the gentleman in the car because he survived) (the actual murder victims were shot, not set on fire). While slightly less risky than these endeavors, the positions of in-house counsel and chief compliance officer (CCO) for a broker-dealer (BD) or investment adviser (IA) can involve "putting out fires" of a different sort, providing advice and telling people what to do (or what not to do) and how to do it (or how not to do it), but without the power to enforce their decisions or carry out their message. Because of these key functions, their conduct is often carefully scrutinized by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), resulting in some in-house counsel and CCOs getting "burned" by disciplinary actions.

This article, like its predecessors,[2] analyzes recent SEC and FINRA actions against in-house counsel and CCOs to highlight examples of conduct that regulators have identified as sanction-worthy, in the hope that others may avoid "going down in flames" in a similar

manner.[3] From June 2011 through June 2012, the SEC and FINRA brought disciplinary actions against in-house counsel and CCOs for a range of conduct, including: (1) playing a role in their firms' inadequate supervisory systems, inadequate anti-money laundering (AML) compliance systems and inadequate due diligence of private placement investments; (2) failing to supervise; (3) aiding and abetting underlying violations by their firms; (4) providing inaccurate certifications and reports to regulators; (5) failing to meet reporting obligations; (6) playing a role in books and records violations; (7) failing to abide by the terms of settlement agreements with regulators; and (8) failing to appear for testimony.

## Supervisory Systems

> *"Finally she went into the surveillance system and reprogrammed the cameras she would have to walk past. Between 4:30 and 5:00 a.m. they would show a repeat of the previous half hour, but with an altered time code."*[4]

Sometimes supervisory and surveillance systems work as intended and sometimes they don't (particularly when they are the target of a punk-goth cyber genius like Lisbeth Salander). Nonetheless, financial services firms are obligated to have reasonable supervisory systems. More specifically, FINRA requires broker-dealers to establish and maintain supervisory systems "reasonably designed to achieve compliance with applicable securities laws and regulations," including written procedures to supervise the types of business in which the firms engage.[5] Investment advisers are likewise required to adopt and implement policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 (the Advisers Act) and rules promulgated thereunder.[6] CCOs are sometimes responsible for these supervisory systems and, therefore, may be subject to disciplinary actions when they come up short.

### Tailoring WSPs to the firm's business

Supervisory systems must be appropriate for, and correspond with, the firm's business. Thus, for example, in a July 2011 settlement, FINRA found that a firm, acting through its CCO, failed to establish and maintain a supervisory system and failed to establish, maintain d enforce written supervisory procedures (WSPs) related to numerous aspects of the firm's business, including exception report maintenance and review, supervisory branch inspections, and review and retention of correspondence.[7] The firm had purchased off-the-shelf WSPs and, with respect to the areas cited by FINRA, failed to tailor the WSPs to its own business in any way. Based on these deficiencies, FINRA concluded that the firm and the CCO had violated NASD Rule 3010 (requiring reasonable supervisory systems and WSPs). The CCO was suspended in any principal capacity for two months and fined $10,000 for this and other violations.

In February 2012, FINRA found that another CCO had failed to tailor his firm's WSPs to the firm's business model.[8] In that case, the firm opened a branch office in Greenwich, Connecticut, but, "[d]espite the fact that the two primary registered representatives in the Greenwich branch, SBS and MSS, had significant disciplinary histories," the CCO "never amended the firm's WSPs to address the supervision of the Greenwich branch in general or of SBS and MSS in particular." FINRA found that the WSPs failed to address other issues related to the branch office such as administrative and branch office functions, an inspection schedule, and which principal was responsible for supervision of the branch. Also, while the firm's WSPs mentioned email retention, they failed to provide any guidance on how the firm would comply with email retention requirements. Consequently, FINRA determined that the CCO violated NASD Rule 3010 and FINRA Rule 2010. For these and other violations, the CCO was fined $20,000, suspended in any principal capacity for 30 days, and required to undertake 16 hours of training concerning supervision.

In other recent actions, CCOs were disciplined because their firms did not have adequate WSPs (or have any WSPs at all) addressing certain areas of their business including exchanging variable annuities,[9] retaining emails,[10] contacting customers after receipt of written complaints,[11] preventing the sale of unregistered securities,[12] monitoring the transmittal of funds from customer accounts to third-party accounts or outside entities,[13] selling S-8

stock,[14] executing transactions in low-priced securities pursuant to the penny stock rules,[15] reviewing and monitoring of changes in customer investment objectives,[16] ensuring adequate reporting of corporate bond transactions to the Trade Reporting and Compliance Engine,[17] maintaining books and records,[18] maintaining proper registrations,[19] and communicating with the public.[20]

The SEC has also brought enforcement actions where firms failed to have adequate policies and procedures. In a November 2011 SEC settlement, the SEC found that a Utah registered investment adviser "failed to adopt and implement written compliance policies and procedures as required by Section 206(4) of the Advisers Act."[21] The firm also failed to maintain certain books and records, as required by § 204A of the Advisers Act. The CCO, who was also the Chief Executive Officer and sole owner of the firm, "was living in Brazil on a religious mission" when he assumed CCO responsibilities and therefore "failed to perform virtually any compliance responsibilities." As a result, the firm was found to have violated both sections of the Advisers Act, and the CCO was found to have aided, abetted and caused the firm's violations. He was barred from the industry and assessed a civil penalty of $50,000.

### Enforcing written procedures

Other CCOs were disciplined, not for failing to have adequate WSPs, but for failing to enforce them. For example, one CCO was disciplined when he failed to obtain from associated persons statements regarding outside business activity and certifications regarding personal securities accounts outside of the firm, as required by the firm's written procedures.[22] For this and other violations, he was suspended in any principal capacity for one year. Another CCO was disciplined for failing to maintain current information regarding Forms U4 and Uniform Branch Office Registration and failing to obtain fingerprints from unlicensed individuals, despite requirements in the firm's procedures to do so.[23] For this and other violations, he was fined $10,000 and suspended in any principal capacity for 60 days.

### Addressing FINRA's concerns

Failing to pay attention to deficiencies identified by FINRA during examinations can lead to disciplinary actions related to inadequate supervisory systems. For example, in August 2011, a CCO was disciplined in connection with his firm's failure to have adequate WSPs, including procedures related to Regulation S-P, and failure to have a system of supervisory controls.[24] These specific deficiencies were identified by FINRA staff in a prior examination and outlined in a Letter of Caution that "was delivered to [the respondent] in his capacity as President and CCO of the Firm." Because he was responsible for the firm's WSPs and supervisory control procedures and because he had notice of the deficiencies but had failed to take action by the time of the next examination, the CCO was suspended in any principal capacities for ten days and fined $5,000.

*The positions of in-house counsel and chief compliance officer (CCO) for a broker-dealer (BD) or investment adviser (IA) can involve "putting out fires" … , providing advice and telling people what to do (or what not to do) and how to do it (or how not to do it), but without the power to enforce their decisions or carry out their message.*

### Testing procedures

Finally, the regulators have adopted rules requiring firms to review the reasonableness of their supervisory systems. NASD Rule 3012 requires firms to have supervisory controls in place to test and verify the reasonableness of those systems.[25] Investment advisers are similarly required to review the adequacy of their policies and procedures under Rule 206(4)-7.[26] Where CCOs are responsible for their firms' supervisory systems, CCOs could be found liable for a lack of supervisory controls.[27] For example, one CCO was fined $20,000 and suspended in any principal capacity for 30 days for failing to have any system of supervisory control policies and procedures, along with other violations.[28]

## Supervision of Individuals

> *"On the night she [Lisbeth] attacked him [villain, Advokat Nils Erik Bjurman] and established control over his life, she had taken the spare set of keys to his office and apartment. She would be watching him, she told him, and when he least expected it she would drop in.*[29] *. . . He shuddered to remember how she had handcuffed him to his bed. He had been totally under her control then, and he did not doubt that she would make good her threat to kill him if he provoked her.*[30]

Whether a person is a "supervisor" may be established through different actions (such as those described above), and how one person supervises another may also differ depending on facts and circumstances (ditto). Thus, at certain times, in-house counsel and CCOs, may find themselves considered "supervisors" of other individuals even though such responsibilities may not be part of their regular job functions. Specifically, in-house counsel and CCOs may be considered supervisors, and therefore potentially liable as such, when they have sufficient "responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue."[31]

### Urban

The SEC's Division of Enforcement filed an administrative action against Theodore Urban, a general counsel and Executive Vice President of a BD and IA in October 2009, alleging that Mr. Urban had failed reasonably to supervise a broker who was involved with a $50 million Ponzi scheme. After a 13-day hearing, in September 2010, the SEC administrative law judge (ALJ) ruled that Mr. Urban was, indeed, a supervisor, but that he acted reasonably.[32] In that decision, the ALJ analyzed the meaning of "responsibility, ability and authority," suggesting a broader scope of supervisory liability than had been previously understood for non-line supervisors, like in-house counsel and CCOs. In concluding that Mr. Urban was a supervisor, the ALJ noted that, while Mr. Urban did not have any of the traditional powers associated with a person supervising brokers, his opinions were viewed as "authoritative" and his "recommendations were generally followed by people in [the firm's] business units." While the ALJ ultimately found that Mr. Urban had fulfilled his supervisory obligations, the determination that he was a supervisor caused concern in the industry that legal and compliance professionals could face supervisory liability simply for doing their jobs. Indeed, the decision arguably created an incentive for legal and compliance personnel not to involve themselves in potential legal and compliance issues at all, for fear of subjecting themselves to liability.

In February 2012, after agreeing to hear the *Urban* case on appeal and being briefed, the Commission summarily dismissed the case on a one-to-one vote (with Chairman Schapiro and Commissioner Walter recusing themselves). As a result, the significance of the ALJ decision in the *Urban* case is unclear. In a speech at the Practicing Law Institute's SEC Speaks in February 2012, SEC Commissioner Daniel M. Gallagher characterized the question of what makes a legal or compliance officer a supervisor as "disturbingly murky," but he emphasized that the Commission must ensure that "the fear of failure-to-supervise liability never deters legal and compliance personnel from carrying out their own critical responsibilities." [33] Moreover, he suggested that the consequences of the ALJ decision in *Urban* would not be an expansion of liability for legal and compliance personnel, saying, "[I]f a firm employee in a traditionally non-supervisory role has expertise relevant to a compliance matter, that employee shouldn't fear that sharing the expertise could result in a Commission action for failure to supervise."[34] Similarly, Commissioner Luis Aguilar stated that CCOs and general counsel who do their jobs "rationally, reasonably and professionally" have nothing to fear.[35] Commissioner Gallagher has also indicated that specific guidance from the SEC on this issue may not be forthcoming, saying "it's hard to give particular guidance because the facts can be so nuanced—they're infinite in the number of permutations they can take."[36] In the absence of guidance from the SEC, legal and compliance personnel may want to ensure that their roles remain advisory in nature and that firms document that legal and compliance personnel are not supervisors and do not have sufficient responsibility, ability or authority to affect the conduct of employees.[37]

### Other cases

Where CCOs expressly take on supervisory roles, they may be subject to the same liability as traditional supervisors for failure to supervise. For instance, in October 2011, FINRA disciplined a CCO for failing to supervise a registered representative who effected approximately 121 unsuitable exchange-traded fund transactions for his customers.[38] The CCO's liability arose because he "was [the representative's] direct supervisor, responsible for reviewing and approving [the representative's] securities transactions." For this and other violations, the CCO was suspended in all principal capacities for one year. In another case in February 2012, FINRA disciplined a CCO for failing to supervise a registered representative who misappropriated $1.6 million of customer funds.[39] In that case, the CCO was liable because he "had supervisory authority over [the representative] and was responsible for ensuring his compliance with firm procedures and applicable securities rules" and because he was aware of certain red flags, such as unusually large deposits into the representative's personal account. That CCO was suspended in all principal capacities for three months, fined $15,000 (jointly and severally with the firm), and ordered to pay restitution (again jointly and severally with the firm). In a May 2012 case, FINRA disciplined a CCO for failing to supervise two registered representatives who made unsuitable sales of REITs to customers.[40] During the relevant time period, the CCO "was the direct supervisor of the Firm's retail registered representatives and was responsible for conducting suitability reviews for all customer transactions." FINRA found that the CCO knew or should have known that the investments were speculative and not consistent with the customers' investment objectives but failed to take reasonable steps to ensure the suitability of the purchases. The CCO was suspended for 18 months in a principal capacity and fined $20,000. Yet another CCO who "was responsible for supervisory decisions regarding issues raised by salesmen" and who had authority to discipline salesmen was sanctioned by FINRA in May 2012 for failing to supervise a registered representative who engaged in excessive markups of corporate bond transactions.[41] Despite the registered representative's extensive disciplinary history, the CCO did not put in place "any special mechanism for supervising" the registered representative, nor did he review the registered representative's customer orders before they were executed. The CCO was barred in any supervisory capacity. Another CCO was barred from acting in any supervisory or principal capacity for failing to review discretionary accounts in which unsuitable trades were made.[42] That CCO also failed to speak with any discretionary account customers regarding their accounts, despite the fact that the firm's procedures required him to do so annually.

Four other CCOs who had supervisory responsibility for registered representatives were disciplined by FINRA for failure to supervise in December 2012, February 2012, April 2012 and May 2012, respectively.[43] FINRA imposed the following penalties on those CCOs: one was suspended in any principal capacity for five months and fined $20,000; one was censured and fined $50,000 jointly and severally with his firm; one was suspended in any principal capacity for 30 days and fined $20,000; and one was suspended in any principal capacity for 20 days and fined $5,000. The SEC disciplined three other CCOs for failing to supervise registered representatives over whom they had supervisory responsibility in June 2011, September 2011, and October 2011, respectively.[44] Of the those three CCOs, one was assessed a monetary penalty of $25,000, one was barred in any supervisory capacity with the right to reapply after one year, and one was barred in any supervisory capacity with the right to reapply after three years and assessed a civil penalty of $35,000. In addition, the SEC instituted administrative proceedings against another CCO for failure to supervise in November 2011.[45]

## Inadequate Due Diligence

> *"There was only one thing she really had to do. She went to Gibraltar twice. The first time to do an in-depth investigation of the man she had chosen to look after her money. The second time to see to it that he was doing it properly."*[46]

To comply with their obligation to have reasonable grounds for recommending a security to their customers, broker-dealers have to investigate securities by conducting adequate due diligence of the potential risks and rewards.[47] (Based on the

case law, those due diligence trips rarely, if ever, involve going to Gibraltar.) In addition, as discussed above, FINRA requires its member firms to establish, maintain and enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws, regulations and rules. A previous article in this series discussed a series of cases that made clear that adequate product due diligence is a necessary component of a reasonable supervisory system and that CCOs may face liability if those due diligence obligations are not met.[48] A number of recent cases reinforce that point.

In November 2011, FINRA disciplined a CCO who was also his firm's chief legal officer (CCO/CLO) for his firm's failure to supervise the due diligence of a private placement product.[49] The CCO/CLO delegated responsibility for the review of the Medical Capital offering to associated persons in the firm and ultimately approved the offerings for sale. FINRA noted that the firm, acting through the CCO/CLO, failed to do the following:

- Obtain and review financial statements for Medical Capital;
- Research the background of Medical Capital officers; and
- Use third-party due diligence providers that conducted due diligence research and drafted due diligence reports.

FINRA also noted that the firm's due diligence was completed in less than three days and relied upon only self-serving representations of the issuer. In addition to inadequate due diligence, FINRA found that the firm, acting through the CCO/CLO, failed to adequately supervise the sales of the Medical Capital offering, which continued despite indications that prior Medical Capital offerings were failing. The CCO/CLO was suspended for ten business days in any principal capacity and fined $10,000. Due to his wearing multiple hats as both CCO and CLO, this case may be particularly insightful for in-house counsel.

*CCOs are sometimes responsible for [their firms'] supervisory systems and, therefore, may be subject to disciplinary actions when they come up short.*

Another CCO was disciplined for failing to conduct a reasonable investigation of private placement offerings where his firm never obtained the product sponsors' financial statements.[50] In that case, the firm relied on information obtained from registered representatives who wished to sell the private placements, rather than conducting an independent investigation. FINRA also noted that the firm failed to implement supervisory procedures "to prevent general solicitation of investments in connection with offerings made pursuant to Regulation D," which offerings are available only to accredited investors. For those and many other violations, the CCO was suspended in any principal capacity for one year. No fine was imposed because of his demonstrated inability to pay.

Finally, one CCO was sanctioned twice for his role in his firm's inadequate due diligence of two different private placements offerings. In the first case, the CCO, who "was responsible for ensuring that the offering complied with the due diligence requirements set forth in the [firm's written supervisory] procedures," failed to follow the firm's WSPs regarding product due diligence.[51] FINRA fined him $5,000 and suspended him in any principal capacity for three months. In the second case, FINRA found that while the firm had due diligence WSPs for products underwritten by the firm, the firm "did not have written supervisory procedures addressing due diligence for private placements where the firm acted as the selling agent only."[52] Moreover, the CCO did not perform any due diligence beyond reviewing the private placement memorandum for the offerings at issue. FINRA again fined the CCO $5,000 and suspended him in any principal capacity for three months.

## Aiding, Abetting and Causing

> *Police Inspector Sonja Modig to Blomkvist: "I hope we won't have to put you under surveillance. You know of course, that it is illegal to give help to a fugitive. Aiding and abetting anyone wanted for murder is a serious offence."*[53]

While we haven't uncovered any cases where in-house counsel or CCOs have aided and abetted anyone wanted for murder (although we have looked), aiding, abetting and causing securities

violations are also serious offenses (or offences, if you prefer the British translation and spelling of the Swedish original). Liability for aiding and abetting requires an underlying violation, substantial assistance in connection with the primary violation and scienter, which is satisfied by recklessness.[54] CCOs may also be found liable for causing violations, which similarly involves a primary violation and an act or omission by the respondent that causes the violation. Causing liability, however, in some cases requires only a negligent state of mind.[55]

In another aiding-and-abetting case, in a September 2011 SEC settlement, a CCO, who was also the AMLCO for a broker-dealer, was found to have aided and abetted his firm's failure to file a suspicious activity report (SAR) in connection with "international pump-and-dump schemes" perpetrated by the broker-dealer.[56] The SEC found that the CCO, who was responsible for daily reviews of employee and customer transactions and responsible for filing SARs in connection with the firm's AML compliance program, knew or should have known of the firm's obligation to file a SAR. Accordingly, the SEC found that the firm violated § 17(a) of the Exchange Act and that the CCO aided and abetted and caused the firm's violation. The CCO was assessed a civil penalty of $20,000.

The SEC recently filed an action against the general counsel of an investment adviser for, among other things, aiding and abetting.[57] In a November 2011 Order Instituting Proceedings, the SEC alleged that an IA and its two owners (one of whom was also the general counsel and "managing member") willfully violated § 17(a) of the Securities Act, § 10(b) of the Exchange Act and Rule 10b-5, and § 206(4) of the Advisers Act, which prohibit fraudulent conduct in connection with the offer or sale of securities, and that the general counsel aided and abetted the IA's violations of these provisions. The SEC alleged that the respondents raised approximately $2.2 million for investments in a hedge fund through material misrepresentation and omissions about the fund. Those misrepresentations and omissions included concealing respondents' history of customer complaints and the IA's interest in the fund's underlying investments, and misrepresenting the fund's liquidity and the nature of its holdings. The Order specifically noted that the general counsel: (1) advised hedge funds on compliance with federal securities laws and regulations; (2) was responsible for all legal functions on behalf of the fund at issue and most administrative functions; and (3) had practiced before the Commission, representing clients in several Commission investigations. The respondents have a right to file answer and to litigate the merits of the Commission's allegations.

In another case involving misrepresentations and omissions, an ALJ found that a firm and the CCO willfully violated Exchange Act Rule 10b-5 and §§ 206(1) and 206(2) of the Advisers Act (which prohibit fraudulent conduct) by engaging in a "mark-the-close" scheme whereby the CCO instructed a trader to execute trades to inflate the prices of certain thinly-traded securities held by the firm's advisory clients by placing buy orders at prices higher than the most recent previous trades just before the markets closed.[58] Related to this scheme, the SEC also found that the CCO, as the firm's "alter ego and Chief Compliance Officer," willfully aided, abetted and caused the firm's violations of Advisers Act Rule 206(4)-7, which requires investment advisers to implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. For this conduct, an ALJ assessed a civil penalty of $75,000, jointly and severally against the CCO and the firm, and barred the CCO.

## Reporting Obligations

> *After being attacked by Lisbeth Salander and being placed under what could arguably be called "heightened supervision," Advokat Bjurman "wrote up a balance sheet and a report for the Guardianship Agency. He did very precisely what she had demanded: the reports had not a grain of truth in them and made plain that she no longer needed a guardian. Each report was an excruciating reminder of her existence, but he had no choice."*[59]

Broker-dealers and investment advisers would be advised not to follow Advokat Bjurman's standards for filing with the regulators. Indeed, compliance officers have been sanctioned for far less. In a settlement from October 2011, FINRA found that a CCO, along with his firm, violated

reporting obligations when he failed to report an arbitration settlement within the required ten-day period.[60] FINRA also found that the CCO and the firm violated FINRA's by-laws and Rule 2010 for failing to disclose the settlement on the appropriate Form U4. FINRA noted that the CCO "was responsible for ensuring [the firm] filed all necessary Forms U4, Forms U5 and Rule 3070 reports." For these and other violations, he was suspended in any principal capacity for one year. Due to his inability to pay, no fine was imposed.

## Lying to Regulators

*Criminal Investigator Bublanski: "You think Blomkvist is imagining things or lying?"*

*Police Officer Faste: "Don't know. But it sounds to me like a [phony] story. How come a full-grown man couldn't take care of a tiny girl who weighs less than ninety pounds?"*

*Bublanski: "Why would Blomkvist lie?"*[61]

People lie for many reasons (including, possibly, to protect tiny ninety-pound girls who have been falsely accused of murder). Regardless, it is never a good idea to lie to regulators. In a February 2012 case, a CCO, who was also the CEO and FINOP for a firm, provided false and misleading information to FINRA in connection with routine examinations.[62] Specifically, the CCO provided backdated Branch Office Inspection Reports and Rule 3130 CEO Certifications to cover up the firm's failure to keep such records. For this conduct, the CCO was suspended for one year and fined $40,000 jointly and severally with other respondents.

## Books and Records

*"After about two hours she had gone through [uncooperative real estate agent] Persson's records and discovered there were some 750,000 kronor in under-the-table income that he had not reported to tax authorities over the past two years. She downloaded all the necessary files and emailed them to the tax authorities from an anonymous email account on a server in the USA. Then she put Master Persson out of her mind."*[63]

Books and records are a rich source of information for vengeful computer hackers and securities regulators alike. Accordingly, FINRA and the SEC require broker-dealers and investment advisers to maintain accurate books and records under Securities Exchange Act Rules 17a-3 and 17a-5 and NASD Rule 3110. A January 2012 books and records settlement involved Exchange Act Rule 15c3-1, which requires a broker-dealer that effects more than ten transactions a year for its own accounts to maintain a minimum net capital of $100,000. FINRA found that, despite the fact that a firm effected more than ten transactions for its own account, its books and records inaccurately reflected a net capital requirement of $5,000.[64] Stating that the CCO, who was also the FINOP, "knew or should have known that the firm was trading for its own account" and was therefore subject to Rule 15c3-1's net capital requirement, FINRA found that the CCO violated SEC and FINRA books and records rules. The CCO was suspended in any principal capacity for ten days and fined $7,500. In an October 2011 settlement, FINRA disciplined a CCO for completing two annual FINRA Rule 3130 certifications stating that he had reviewed internal reports evidencing his firm's processes for testing its supervisory procedures.[65] FINRA found that the reports "did not evidence any processes for testing" and that no such testing was done. Accordingly, FINRA found that the CCO had violated FINRA Rule 3130, which requires such annual certifications, and FINRA Rule 2010. For this and other violations, the CCO was suspended in any principal capacity for one year, but no fine was imposed due to his inability to pay.

## Failing to Appear for Testimony

*"Her way of not telling the truth was to distract attention."*[66]

FINRA Rule 8210 requires associated persons to provide information orally, in writing or electronically or to testify under oath or affir-

mation when FINRA staff requests.[67] In a June 2012 FINRA settlement, FINRA sanctioned a CCO for failing to appear for on-the-record testimony. FINRA requested testimony related to whether the CCO had engaged in violative conduct by engaging in outside business activities and whether he failed to supervise a registered representative who conducted business while his FINRA registration was inactive. For refusing to appear for testimony, the CCO (who was no longer associated with his or any member firm) was barred in any capacity.

## Not Doing What You Said You'd Do

> *Advokat Blomkvist on Lisbeth Salander: "[S]he gave her word she would keep her mouth shut. I believe she'll keep that promise for the rest of her life. Everything I know about her tells me she is extremely principled."*[68]

Some people keep promises on principle. People who make promises to regulators should keep them to avoid disciplinary action. In one recent case, a firm and CCO submitted a Letter of Acceptance, Waiver and Consent (AWC) to FINRA, in which the firm agreed to undertake a review of its supervisory systems and WSPs and to have an officer of the firm submit within 90 days a certification that it had revised its systems and procedures.[69] When the firm failed to submit such a certification even after FINRA reminded the CCO of the requirement to do so, FINRA found that the firm and the CCO had failed to comply with the terms of the AWC, thereby violating FINRA Rule 2010, which provides that members, "in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." The CCO was suspended in any principal capacity for two months and fined $10,000.

## AML Compliance

> *"Where did the money come from?" [Detective Sonja] Modig asked.*
>
> *"The money was transferred to her account from a bank in the Channel Islands."*[70]

While Lisbeth Salander's money movement wasn't specifically characterized as having AML implications, some CCOs, upon hearing about these facts, might put in a requisition form asking to visit the Channel Islands during the summer months. BDs, of course, have specific obligations that must be followed with regard to AML issues. FINRA Rule 3310 requires broker-dealers to implement an effective AML program designed to achieve compliance with the Bank Secrecy Act, 31 U.S.C. § 5311. In addition, Rule 17a-8 of the Exchange Act also requires broker-dealers to comply with reporting obligations under the Bank Secrecy Act. In recent months, FINRA has disciplined several AML compliance officers (AMLCOs) in connection with their firms' deficient AML compliance programs.

In one such case from February 2012, an AMLCO, who was also the firm's president, Chief Executive Officer, CCO and financial and operations principal (FINOP), "had full responsibility for the firm's AML compliance program," which was deficient and, therefore, he was liable for its numerous deficiencies.[71] Those deficiencies included an inadequate customer identification program. In the AWC, FINRA noted that the firm was a "deep discount on-line brokerage firm" and explained that FINRA Notice to Members 02-21 instructed online firms, which do not generally meet or speak with clients, to obtain information about customers from other sources, such as electronic databases. Because the firm had not obtained adequate customer information, FINRA found that it had not implemented an adequate customer identification program. For this and other violations, the CCO was fined $10,000 and suspended in any principal capacity for 60 days. In another case, an AMLCO was similarly disciplined for his firm's inadequate customer identification program, when it completely failed to verify the identities of four customers.[72] For that and other violations, he was suspended in any principal capacity for one year. Another AMLCO was recently suspended for six months in a principal capacity and fined $15,000 for failing to implement a customer identification program, among other violations.[73]

In another AML case, a firm's AML procedures required the firm's AMLCO to "identify, investigate and report suspicious activity."[74] Even though he learned about activity that met the firm's criteria for suspicious activity, the AMLCO failed to investigate

and report the activity and was disciplined for failing to implement an adequate AML compliance program. Consequently, the CCO was suspended in all capacities for one month and in any principal capacity for an additional month. Two other recent cases also illustrate the importance of having systems in place, such as exception reports, to allow for the identification of red flags and appropriate follow-up.[75] Sanctions in those cases were a $10,000 fine and 60-day principal suspension for one CCO and a $10,000 fine and three-month suspension in all capacities for the other.

According to recent cases, AMLCOs may want to focus on the following issues when assessing their AML supervisory systems (or possibly be sanctioned if their firm fails in any of these areas):

- Testing of AML compliance programs (CCO was suspended in all principal capacities for one year for this and other conduct;[76] CCO was fined $15,0000 and fined for six months in any principal capacity);[77]
- Adhering to AML compliance programs to implement them effectively (AMLCO was fined $5,000 and suspended as a principal for two months for this and other conduct);[78]
- Tailoring AML compliance programs to a firm's business model (AMLCO was fined $10,000 and suspended 60 days in a principal capacity;[79] CCO was fined $15,000 and suspended in any principal capacity for six months).[80]

## Conclusion

*"During her time at the clinic in Genoa she had also had one of her nine tattoos removed—a one-inch long wasp—from the right side of her neck. She liked her tattoos, especially the dragon on her left shoulder blade. But the wasp was conspicuous and it made her too easy to remember and identify. Salander did not want to be remembered or identified. The tattoo had been removed by laser treatment . . . ."*[81]

Unfortunately for in-house counsel and CCOs, while tattoos may be removed by lasers, Forms U4 or U5 that have been "scorched" by disciplinary actions are not so easily cleaned up. Indeed, it is better for CCOs and in-house counsel to avoid getting burned in the first place, while still providing advice and guidance that will help their firms comply and grow. Although this may seem like a tall order (arguably similar to unraveling an international criminal conspiracy), one way to help achieve this goal is to review and analyze cases like those discussed above to gain insight into the thinking of regulators on certain issues. Another way may be to study the hidden compliance messages in novels that seem completely unrelated to compliance. (But the first approach is probably better.)

### ENDNOTES

* Brian Rubin also advises broker-dealers and investment advisers on federal and state regulatory and compliance matters. Brian was previously Deputy Chief Counsel of Enforcement with NASD and Senior Counsel with the SEC's Enforcement Division.

1 Stieg Larsson, *The Girl Who Played With Fire* 5 (Reg Keeland trans., Alfred A. Knopf 2009) (2006) [hereinafter, *The Girl Who Played With Fire*].

2 The last three articles written by the authors on this subject were published in Practical Compliance and Risk Management. See Brian L. Rubin & Katherine L. Kelly, *The Girl With the SEC/FINRA Tattoo: Disciplinary Actions Taken Against Chief Compliance Officers (November 2010 – June 2011)*, Practical Compliance and Risk Management, Sept-Oct 2011 at 9; Brian L. Rubin & Katherine L. Kelly, *While You Were Complying: SEC and FINRA Disciplinary Actions Taken Against Chief Compliance Officers (Again)*, Jan-Feb 2011 at 35 [hereinafter, *While You Were Complying (Again)*], and Brian L. Rubin & Katherine L. Kelly, *While You Were Complying: SEC and FINRA Disciplinary Actions Taken Against Chief Compliance Officers*, Practical Compliance and Risk Management, Sept-Oct 2010 at 39.

3 Certain cases have been omitted due to conflicts of interest or where it was unclear whether the CCO or in-house counsel was charged in his or her capacity as CCO or in-house counsel.

4 *The Girl Who Played With Fire* at p. 451.

5 NASD Rule 3010; *see also* § 15(b)(4)(E) of the Securities Exchange Act of 1934 (the Exchange Act).

6 Section 203(e)(6) of the Advisers Act.

7 Enforcement v. Ayre Investments, Inc., et al., FINRA Disciplinary Proceeding No. 2009016252601, Order Accepting Offer of Settlement (July 15, 2011).

8 Michael Joseph Schunk, FINRA Letter of Acceptance, Waiver and Consent (AWC) No. 2010020872302 (February 7, 2012).

9 Success Trade Securities, Inc., et al., FINRA AWC No. 2009016309801 (Feb. 22, 2012).

10 Enforcement v. Ayre Investments, Inc., et al., FINRA Disciplinary Proceeding No. 2009016252601, Order Accepting Offer of Settlement (July 15, 2011); Enforcement v. William Gregory Vincent, Disciplinary Proceeding No. 2008011650601, Amended Default Decision (May 1, 2012).

11 Hantz Financial Services, Inc., FINRA AWC No. 2008012747901 (Nov. 30, 2011).

12 Enforcement v. Tradespot Markets, Inc., and Mark B. Beloyan, Disciplinary Proceeding No. 2009017590801, Order Accepting Offer of Settlement (Aug. 4, 2011); Robert J. Shapiro, FINRA AWC No. 2010021079601 (Dec. 15, 2011); Enforcement v. Joseph Gaber Messina, Disciplinary Proceeding No. 2010021034801, Order Accepting Offer of Settlement (June 11, 2012).

[13] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[14] Enforcement v. Ron William Howell, Hearing Panel Decision, Disciplinary Proceeding No. 2008013685 (Nov. 22, 2011).
[15] Enforcement v. Jordan Lawrence Loewer, Disciplinary Proceeding No. 20080115970-01, Order Accepting Offer of Settlement (May 3, 2012).
[16] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[17] Department of Market Regulation v. Robert N. Drake, Disciplinary Proceeding No. 20060053785-01, Hearing Panel Decision (May 3, 2012).
[18] Enforcement v. William Gregory Vincent, Disciplinary Proceeding No. 2008011650601, Amended Default Decision (May 1, 2012).
[19] Enforcement v. William Gregory Vincent, Disciplinary Proceeding No. 2008011650601, Amended Default Decision (May 1, 2012).
[20] Word Equity Group, Inc., et al., FINRA AWC No. 20080120991 (December 13, 2011).
[21] In the Matter of OMNI Investment Advisors, Inc., and Gary R. Beynon, Sec. Exch. Act. Rel. No. 65837, 2011 SEC LEXIS 4176 (Nov. 28, 2011).
[22] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[23] Success Trade Securities, Inc., et al., FINRA AWC No. 2009016309801 (Feb. 22, 2012).
[24] Patrick Walker, FINRA AWC No. 2008011724302 (Aug. 19, 2011).
[25] NASD Rule 3012.
[26] Advisers Act Rule 206(4)–7.
[27] *See* Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011); Michael Joseph Schunk, FINRA AWC No. 2010020872302 (Feb. 7, 2012); Patrick Walker, FINRA AWC No. 2008011724302 (Aug. 19, 2011).
[28] Michael Joseph Schunk, FINRA AWC No. 2010020872302 (Feb. 7, 2012).
[29] *The Girl Who Played With Fire* at pp. 30-31.
[30] *Id.* at p. 38.
[31] *George J. Kolar*, Exchange Act Rel. No. 46127, 55 S.E.C. 1009, 2002 SEC LEXIS 1647, *13 (June 26, 2002) (quoting *John H. Gutfreund*, Exchange Act Rel. No. 31554, 51 S.E.C. 93, 113, 1992 SEC LEXIS 2939, *47 (Dec. 3, 1992)).
[32] *Theodore W. Urban*, Initial Decision, Rel. No. 402, 2010 SEC LEXIS 2941 (Sept. 8, 2010).
[33] Daniel M. Gallagher, Remarks at "The SEC Speaks in 2012," (Feb. 24, 2012), available at http://www.sec.gov/news/speech/2012/spch022412dmg.htm.
[34] Id.
[35] Julie Goodman, *Aguilar Queries Value of CCO Liability Guidance*, Compliance Intelligence, Aug. 9, 2012, *available at* http://www.complianceintel.com/Article/3073517/Search/Aguilar-Queries-Value-Of-CCO-Liability-Guidance.html.
[36] Id.
[37] In *While You Were Complying (Again)*, at 37, the authors made the following observations:

To minimize exposure to similar findings of supervisory responsibility in the future, firms, counsel and compliance officers may want to consider implementing the following steps:

Written supervisory policies and procedures could:
- Identify the direct supervisors of all employees; and
- Specifically state that legal and compliance personnel are limited to offering advice and recommendations and do not have the responsibility, ability or authority to affect the conduct of employees outside of their departments.
- Where misconduct of employees or representatives is addressed, the firm could document which business line supervisor is handling the issue and how.
- When attorneys or compliance officers serve on firm committees, the firm could document that their role is only advisory in nature.
- Where a legal or compliance officer does have serious concerns about potential violations of the law, she may want to consider escalating the matter to senior management.

[38] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[39] Enforcement v. Cantone, Inc., and Christine L. Cantone, Order Accepting Offer of Settlement, Disciplinary Proceeding No. 2009020383002 (Feb. 22, 2012).
[40] Erin Ackerman, FINRA AWC No. 200901734667 (May 31, 2010).
[41] Market Regulation v. Robert N. Drake, Disciplinary Proceeding No. 20060053785-01, Hearing Panel Decision (May 3, 2012).
[42] Enforcement v. Brookstone Securities, Inc., Disciplinary Proceeding No. 2007011413501, Extended Hearing Panel Decision (May 31, 2012).
[43] World Equity Group, Inc., et al., FINRA AWC No. 20080120991 (Dec. 13, 2011); Michael Joseph Schunk, FINRA AWC No. 2010020872302 (Feb. 7, 2012); Jeffrey Wayne Cimbal, FINRA AWC No. 2010023001601 (April 4, 2012); Enforcement v. James Arnold Potter, FINRA AWC No. 20100208034-01 (May 12, 2012).
[44] In the Matter of Pegasus Investment Management, LLC, Advisers Act Rel. No. 3215, 2011 SEC LEXIS 2037 (June 15, 2011); In the Matter of Manual Lopez-Tarre, Sec. Exch. Act. Rel. No. 65391, 2011 SEC LEXIS 3311 (Sept. 23, 2011); In the Matter of Hector Gallardo, et al., Sec. Exch. Act Rel. No. 65658, 2011 SEC LEXIS 3848 (Oct. 31, 2011).
[45] In the Matter of Charles L. Rizzo and Gina M. Hornbogen, Sec. Exch. Act Rel. No. 65829, 2011 SEC LEXIS 4174 (Nov. 28, 2011).
[46] *The Girl Who Played With Fire* at p. 66.
[47] NASD Conduct Rule 2310; FINRA Regulatory Notice 10-22, Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings (April 2010).
[48] See Brian L. Rubin & Katherine L. Kelly, *The Girl with the SEC/FINRA Tattoo: Disciplinary Actions Taken Against Chief Compliance Officers (November 2010 – June 2011)*, Practical Compliance and Risk Management, Sept-Oct 2011 at 9.
[49] Enforcement v. ValMark Securities, Inc., et al., Disciplinary Proceeding No. 2009018817601, Order Accepting Offer of Settlement (Nov. 21, 2011).
[50] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[51] Enforcement v. Richard J. Buswell, et al., Order Accepting Offer of Settlement, Disciplinary Proceeding No. 2009017275301 (Sept. 27, 2011).
[52] Mark M. Mercier, FINRA AWC No. 2009019070901 (Sept. 29, 2011).
[53] *The Girl Who Played With Fire* at p. 238.
[54] Section 15 of the Securities Act of 1933 (Securities Act), § 20(e) of the Exchange Act, and § 209(f) of the Investment Advisers Act of 1940 (Advisers Act) provide for aiding and abetting liability for reckless, as well as knowing, conduct.
[55] Mark T. Schwetschenau, Admin. Proc. File No. 3-13995, 2010 SEC LEXIS 2534 *9 (Aug. 5, 2010) ("Negligence is sufficient to establish liability for causing a primary violation that does not require scienter").
[56] In the Matter of Gilford Securities, Inc., Sec. Exch. Act. Rel. 65450, 2011 SEC LEXIS 3419 (Sept. 30, 2011).
[57] In the Matter of LeadDog Capital Markets, LLC, et al., Sec. Exch. Act. Rel. No. 65750, 2011 SEC LEXIS 4013 (Nov. 15, 2011).
[58] In the Matter of Donald L. Koch and Koch Asset Management, LLC, Initial Decisions Release No. 458, 2012 SEC LEXIS 1645 (May 24, 2012); In the Matter of Donald L. Koch and Koch Asset Management, LLC, Sec. Exch. Act. Rel. No. 64337, 2012 SEC LEXIS 1642 (May 25, 2012).
[59] *The Girl Who Played With Fire* at p. 31.
[60] Internet Securities, et al., FINRA AWC No. 20090209303-02 (October 3, 2011).
[61] *The Girl Who Played With Fire* at p. 265.
[62] Enforcement v. Headwaters BD, LLC, et al., Order Accepting Offer of Settlement, Disciplinary Proceeding No. 2010020941501 (Feb. 21, 2012).
[63] *The Girl Who Played with Fire* at p. 63.
[64] Paul Lysan, FINRA AWC No. 20090164525-01 (Jan. 3, 2012).
[65] Internet Securities, et al., FINRA AWC No. 20090209303-02 (10/3/2011).
[66] *The Girl Who Played with Fire* at p. 120.
[67] Naum Voloshin, FINRA AWC No. 2011026263801 and No. 2009018663 (June 28, 2012).

[68] *The Girl Who Played With Fire* at p. 269.
[69] Enforcement v. Ayre Investments, Inc., Order Accepting Offer of Settlement, Disciplinary Proceeding No. 2009016252601 (July 15, 2011).
[70] *The Girl Who Played With Fire* at p. 262.
[71] Success Trade Securities, Inc., et al., FINRA AWC No. 2009016309801 (Feb. 22, 2012).
[72] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[73] Enforcement v. Joseph Gaber Messina, Disciplinary Proceeding No. 2010021034801, Order Accepting Offer of Settlement (June 11, 2012).
[74] Enforcement v. Tradespot Markets, Inc., Disciplinary Proceeding No. 2009017590801, Order Accepting Offer of Settlement (Aug. 4, 2011).
[75] Success Trade Securities, Inc., et al., FINRA AWC No. 2009016309801 (Feb. 22, 2012); James Sloan Altschul, FINRA AWC No. 20090191089 (Jan. 31, 2012).
[76] Internet Securities, et al., FINRA AWC No. 20090209303-02 (Oct. 3, 2011).
[77] Enforcement v. Joseph Gaber Messina, Disciplinary Proceeding No. 2010021034801, Order Accepting Offer of Settlement (June 11, 2012).
[78] Janet L. Gentry, FINRA AWC No. 20080160618 (Feb. 7, 2012).
[79] Success Trade Securities, Inc., et al., FINRA AWC No. 2009016309801 (Feb. 22, 2012).
[80] Enforcement v. Joseph Gaber Messina, Disciplinary Proceeding No. 2010021034801, Order Accepting Offer of Settlement (June 11, 2012).
[81] *The Girl Who Played With Fire* at p. 17.