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Practical Compliance Considerations for Cross Border Marketing

By Mitzie Pierre, Genna Garver & Kimberly Frumkin

Wrangling in a firm's marketing team can be quite a challenge for even the most seasoned compliance professionals. When marketing goes global, so does a firm's risk exposure which could subject it to increased scrutiny by regulators. While the asset management industry may be globalizing, regulation is still very local in that each jurisdiction—whether it be a union of members like the European Union, a sovereign nation state like Canada, or individual states and territories like the United States—takes a different approach on how to govern their market to protect their local participants. This multi-jurisdictional approach requires firms to understand and comply with applicable local and foreign regulations from both a marketing and investment perspective. This article focuses on the cross border marketing aspect of asset management.

Globalization of the Asset Management Industry

As advisers and funds seek opportunities to further diversify their client base and portfolios it is increasingly clear that investing in global markets can provide sustainable, continued growth that adds to long term performance and access to a better investment pipeline[1]. Given this, globalization should be carefully considered in the context of strategic business planning as the plethora of opportunities can be accompanied by significant risks. For example, firms should weigh the potential opportunities in a region as compared to the cost of meeting compliance obligations. There are times when registration or legal expenses may exceed fee revenue, so it is important to understand the potential market opportunity before proceeding.

Extraterritorial Approach to Jurisdiction

Unfortunately, physical presence no longer dictates whether foreign law applies to asset management activities. As countries across the globe strive to protect the financial health of their resident investors, regulators are asserting their jurisdiction over asset managers regardless of whether they have a physical place of business within that jurisdiction. The United States is prime example. The U.S. Securities and Exchange Commission (SEC) takes an expansive approach to jurisdiction and its laws are often triggered merely by using or effecting interstate commerce. This formulation has the effect of regulating a large number of individuals and entities, both situated in the country as well as those located abroad, forcing firms to find an exclusion or exemption if they want to escape the regulatory burden. Regulation can be costly. However, violations can lead to steep monetary fines and financial industry bars. Indeed, if a regulator believes the conduct warrants it, violators can also be prosecuted and jailed.

Types and Triggers of Foreign Securities Regulatory Requirements

Asset managers looking to take their business global must consider multiple types of foreign securities regulatory requirements that might apply to their operations and whether the conduct of their proposed business operations will in fact trigger those requirements.

- **Securities Professional Licensing and Registration Requirements**

  Asset managers should be aware of the licensing and registration requirements in the jurisdictions that they operate in. These registration requirements are often triggered once there is solicitation of services to local residents, regardless of whether the professionals maintain a place of business within the jurisdiction. Many regulators require professionals to pass competency exams (such as the FINRA Series exams in the United States or the Canadian Securities Course in Canada) prior to approving licenses.

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1. See Boston Consulting Group Annual Global Asset Management Survey. https://www.bcg.com/publications/2015/financial-institutions-global-asset-management-2015-sparking-growth-through-go-to-market-strategy.aspx

Each jurisdiction has its own nomenclature (investment adviser, portfolio manager, exempt market dealer, etc.) and definitions for regulated activity so firms must analyze the requirements of each jurisdiction based on the facts and circumstances of their proposed activity. Some regulators, like the U.K.'s Financial Conduct Authority (FCA), offer different types of authorizations depending on whether the firm offers full or limited regulated products and services.

Often jurisdictions will have de minimis exemptions for limited activity. For example, the SEC provides an exemption from investment adviser registration for certain advisers with no place of business in the United States if the adviser, among other conditions, has, in total, fewer than 15 clients (or private fund investors) in the United States and aggregate assets under management attributable to clients (and investors) in the United States of less than $25,000,000.[2]

- **Securities Offering Registration Requirements**

Asset managers who sponsor pooled investment vehicles, whether public or private funds, must analyze under what conditions and restrictions, including registration, will the offering of such funds be permitted in each jurisdiction where the offering will be conducted. In fact, cross-border offerings often involve compliance requirements in multiple jurisdictions. An asset manager sponsoring a U.S. domiciled private investment fund that offers to U.S. and European investors will need to comply with the offering registration or applicable private placement requirements in (i) each State of the U.S. where a solicitation is made (often referred to as "Blue Sky" requirements); (ii) the U.S. Securities Act of 1933, as amended (with Regulation D's safe harbor provisions for private offerings being the most frequently relied upon); (iii) the Alternative Investment Fund Manager Directive (AIFMD); and (iv) if applicable, the national private placement regime of the European state in which a solicitation is made. Each jurisdiction may require an application for registration of the offering or for an exemption, public disclosure of material information regarding the offering as well as restrictions on the types of eligible investors and ongoing reporting requirements.

Some jurisdictions are easier than others. For example, in the United States, a private fund sponsor can rely on Regulation D if it files a notice of such reliance on Form D with the SEC and with each state securities regulator and limits its offering to only those investors who qualify as "accredited investors" as defined under the U.S. Securities Act of 1933, as amended.[3] Other jurisdictions, such as France, are much more challenging. In addition to the numerous notification, transparency, authorization and depositary requirements, there must be a cooperation agreement in place between the fund sponsor's regulator and France's regulator, the Autorite Des Marches Financiers (AFM). In fact, France's conditions for a third-party open-ended fund are so draconian, that at this point in time it is virtually impossible for a non-E.U. fund sponsor to obtain private placement authorization from AFM.

- **Advisory Client Fund Investor Qualifications**

Licensing and registration requirements in certain jurisdictions turn on the type of advisory clients the firm services. Many jurisdictions, such as Israel, may provide exemptions for asset managers servicing only financially experienced clients who do not require regulatory protection (subject to certain anti-fraud and additional conditions). As discussed above, many jurisdictions also provide registration exemptions for investment fund securities offerings made only to financially experienced investors. Similar to the "accredited investor" requirements of Regulation D discussed above for U.S. private placements, these eligibility requirements often qualify investors based on their assets, income, or investment sophistication. Depending on the jurisdiction, the following facts and circumstances might apply with respect to these exemptions:

  - o Where the client/investor is an entity, rather than a natural person, is the client/investor is an institutional investor? If not, will it be considered "sophisticated" or "knowledgeable" and less in need of protecting by regulations?

  - o If the client/investor is a natural person, what is the income level? How much do they have under investment generally and specifically with the asset manager?

2. See Investment Advisers Act of 1940, as amended, sections 202(a)(30) and 203(b)(3). In addition, an adviser relying on this exemption can neither (i) hold itself out generally to the public in the United States as an investment adviser; nor (ii) act as (A) an investment adviser to any investment company registered under the Investment Company Act of 1940; or (B) a company that has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940, and has not withdrawn its election.
3. See U.S. Securities Act of 1933, as amended, rule 501 for the definition of an "accredited investor".

- **Disclosure and Ongoing Reporting Requirements**

  Investment advisers and fund sponsors may have a duty to disclose certain information, such as conflicts of interest, fees and disciplinary history, to investors in different jurisdictions. For those jurisdictions that require registration, required disclosures are often made by publically filing an application for registration. For U.S. registered investment adviser, Form ADV (Uniform Application for Investment Adviser Registration) requires registrants to either use Form ADV or some other means to make full disclosure to clients of all material facts relating to the advisory relationship, which at a minimum must include full disclosure of all material conflicts of interest between the registrant and its clients that could affect the advisory relationship. Asset managers who are investment fund sponsors may need to ensure they are complying with applicable regulatory reporting requirements regarding the funds they sponsor, such as the AIFMD transparency information required by private fund operating in Europe.

- **Custodian/Depositary Requirements**

  The SEC (and some state regulators) required investment advisers with access to client funds and securities to safeguard client assets by maintaining them with a "qualified custodian" (e.g., certain regulated banks and broker-dealers).[4] Certain jurisdictions, such as Denmark and Germany, require alternative investment fund sponsors to appoint a third party depositary (e.g., certain credit institutions and similar entities). Generally, depositaries monitor compliance and cash flows, manage day-to-day fund administration, safe-keep assets (either by custody or recordkeeping) and calculate net asset value of the investment funds.

Additional Foreign Regulatory Requirements

Beyond local securities laws, asset managers looking to take their business global must consider additional foreign regulatory requirements that might apply to their operations. Of course, everyone thinks about tax regulation when entering a foreign jurisdiction, but what about anti-money laundering, anti-bribery and privacy considerations?

- **Anti-Money Laundering**

  Money laundering, by its nature, is an international crime, requiring international laws and cooperation. Over 170 countries have some type of anti-money laundering legislation in force, although they vary significantly depending on the locale. The Financial Action Task Force, (FATF), established by the G-7 summit in 1987 is an inter-governmental organization with members comprised of 35 countries (including the United States) and two regional organizations. The main focus of the group is to encourage jurisdictions to implement anti-money laundering regulations.

  In the United States, banks and broker-dealers are subject to The Bank Secrecy Act and The USA PATRIOT Act, which require those financial institutions to establish anti-money laundering programs (AML) and customer identification programs as well as to monitor for, and report, suspicious activity (so-called SAR reporting). In addition, recent changes to the FinCEN's Customer Due Diligence Rule requires those financial institutions to also incorporate procedures to maintain and update customer information on a risk basis. However, investment advisers in the United States are not yet required to implement those programs, despite FinCEN's multiple attempts (with three proposals of such a rule withdrawn and another proposed in 2015, with comments extended in 2017), we still do not have a final rule applicable to investment advisers.

  Other jurisdictions, such as the U.K., do require investment advisers to comply with anti-money laundering requirements. The U.K. passed the Money Laundering 2017 bill last year, which replaced and updated the country's existing regulations. However, the application of those requirements only apply when the adviser has a place of business in the country. These new regulations apply to "relevant persons" undertaking certain financial activities, including investment managers and stockbrokers. Regulated entities are required to apply risk-based customer due diligence measures and policies and procedures to minimize their money-laundering risk. If a firm is covered, its subsidiaries will also need to comport with the regulations, no matter where they are located. Different requirements will apply, however, depending on whether the subsidiary is located in Europe or another country.

  Even where investment advisers are not directly subject to AML regulation, those that manage offshore private investment funds often need to implement policies and procedures to satisfy the compliance requirements of

4. See U.S. Investment Advisers Act Rule 206(4)-2.

those offshore jurisdictions. For example, the Cayman Islands' expanded anti-money laundering regulations came into force at last October.[5] Among other changes, the regulations will now apply to investment entities, starting on May 31, 2018. The regulations will require private fund managers—including U.S. managers/ sponsors of Cayman investment funds—to develop and maintain systems and programs to take a risk-based approach to understand, monitor, and mitigate any money laundering risks. When assessing whether they are at high or low risk, firms will need to take a look at their customers, the countries they deal with, and the product, service, transaction, and delivery channels that are used. After making this assessment, the firm will then need to take steps to decide what their risk tolerance is, implement appropriate policies, procedures, and controls to manage and mitigate its risks, and put further systems in place to monitor the risks that were identified and asses how they change or evolve over time.[6] Changes in Cayman legislation will now require Cayman domiciled entities to appoint named individuals to fulfill the roles of Anti-Money Laundering Compliance Officer, Anti-Money Laundering Reporting Officer, and Deputy Anti-Money Laundering Reporting Officer. Compliance with this new rule is required by 30 September 2018.

- **Anti-Bribery**

Asset managers also need to consider the various anti-corruption laws found in many jurisdictions. More and more countries are implementing or refining their own anti-corruption laws. For example, in 2017, the Australian government introduced a new law that would add the offense of "failure to prevent bribery of foreign officials" which would require companies to show they implemented adequate procedures to prevent bribery. Such an offense is already in force in the U.K. France also recently updated its previous anti-corruption regime with the implementation of what is known as "Sapin II," which added a new offense for bribery of a foreign official, bringing it into line with other jurisdictions.

Even if the country where you operate doesn't have its own law, the U.S.'s Foreign Corrupt Practices Act (FCPA) and the U.K.'s Bribery Act 2010 could still apply. The FCPA generally prohibits U.S. companies and citizens, foreign companies listed on a U.S. stock exchange, or any person acting while in the United States, from corruptly paying or offering to pay, directly or indirectly, money or anything of value to a foreign official to obtain or retain business.[7] The U.K.'s Bribery Act, while not as far reaching as the FCPA, still extends jurisdiction to both offenses committed within the U.K. as well as those committed elsewhere that retain a "close connection" to the country.

Investment advisers and other financial firms are facing increasing FCPA-scrutiny. SEC-regulated firms are especially susceptible as the SEC has an easy means of reviewing their books and records during OCIE exams. In May 2013, the DOJ filed a case involving a broker-dealer that sprung out of an OCIE exam. Three employees of the New York based broker-dealer Directed Access Partners eventually pleaded guilty to two counts of conspiring to violate the FCPA related to their efforts to bribe foreign officials from two Venezuelan state economic development banks to direct trading business to them.[8] The investigation appeared to have its origins in the SEC's 2010-2011 examination of the broker-dealer.

Investment advisers are particularly susceptible to possible FCPA violations when dealing with sovereign wealth funds. For example, in September 2016, Och-Ziff Capital Management Group LLC became the first hedge fund to be charged with FCPA violations. The fund and its subsidiary, OZ Africa Management GP LLC, agreed to pay the DOJ and SEC a combined $412 million to settle alleged civil and criminal violations of the FCPA's anti-bribery, books and records, and internal controls provisions.[9] The improper conduct first came to the attention of the SEC while it was proactively scrutinizing the way that financial services firms obtained investments from sovereign wealth funds overseas. Further investigation found that the fund used intermediaries, agents, and business partners to bribe government officials in Africa, which were used to obtain investments from the Libyan Investment Authority sovereign wealth found as well as to secure mining rights in Libya and other countries.[10] Och-Ziff is not the only fund manager facing scrutiny over its Libyan business. In November 2017, Société Générale announced it was under investigation for possible bribery offenses related to certain

5. Proceeds of Crime Law (2017 Revision).
6. The Cayman Islands Monetary Authority published a helpful guide on the new regulations in December 2017 which can be accessed here.
7. The Foreign Corrupt Practices Act, 15 U.S.C. § 78(b)(2)(A)–(B) (2006).
8. *See* DOJ, Office of Public Affairs. "Three Former Broker-dealer Employees Plead Guilty in Manhattan Federal Court to Bribery of Foreign Officials, Money Laundering and Conspiracy to Obstruct Justice," (Aug. 30, 2013) *available at* https://www.justice.gov/opa/pr/three-former-broker-dealer-employees-plead-guilty-manhattan-federal-court-bribery-foreign.
9. *See In the Matter of Och-Ziff Capital Management Group et al.*, Admin. Proc. File No. 3-17595 (Sept. 29, 2016); *US v. Och-Ziff Capital Management Group LLC*, Case No. 16-cr-516 (E.D.N.Y. Deferred Prosecution Agreement Filed Sept. 29, 2016).
10. *See* SEC, Newsroom, "Och-Ziff Executives Also Settle Charges," (Sept. 29, 2016) *available at* https://www.sec.gov/news/pressrelease/2016-203.html.

transactions with the Libyan Investment Authority,[11] and on May 30, 2018, Legg Mason announced that it was reserving $67 million to settle alleged FCPA violations by its former London-based subsidiary hedge fund, Permal Group, in connection with Permal's management of assets of Libyan governmental entities between 2005 and 2007.[12]

Another area in which firms could find themselves liable under the FCPA is through acquisitions or participation in joint ventures with companies that operate in foreign markets. According to the DOJ and SEC, when a company acquires another, no matter the form of the acquisition, the successor company assumes the predecessor's liabilities, including any pre-acquisition FCPA violations.[13] In this context, it is especially important that acquiring companies undertake meaningful pre and post-acquisition FCPA due diligence, identify any possible violations, discloses them to the DOJ and/or SEC, cooperates in any federal investigations, and immediately applies a rigorous compliance and anti-corruption program going forward.[14]

- **Privacy**

  Asset managers will also need to consider privacy laws in different jurisdictions, notably Europe's new General Data Protection Regulation (EU) 2016/679 (GDPR). The new law came into force May 2018, and firms of all shapes and size who have any European clients or deal with European citizens' data are scrambling to comply. Similarly, advisers who collect, record, or store information of European residents during the provision of services to them will have to comply, regardless of where they are located. Among other things, compliance will include drafting a policy, providing notice to clients, and updating documents. Advisers may also need to think about the third-parties they use and how personal information is shared. Firms that don't take steps to comply could face steep penalties. Authorities can impose fines of up to 20 million Euros or 4% of worldwide turnover in the preceding financial year for non-compliance with key provisions.

Suggested Steps for Compliance Personnel when Marketing in a New Jurisdiction

If your firm is considering expanding its business operations into a foreign jurisdiction, here are some suggested steps to help you navigate foreign regulatory requirements and communicate these requirements to your marketing team.

- **Engage counsel**

  It is extremely beneficial to have the insight and guidance of local counsel when operating in unfamiliar jurisdictions. Violating local securities laws can result in serious consequences for the firm, such as a complete ban from conducting business in that country, or even personal liability for individual violators. Local counsel can guide you on how to operate in the country and provide key insight on local best practices and regulatory expectations.

  It is highly recommended to engage local counsel when you plan to establish a local presence (i.e. where you intend to open an office or have permanent employees based) in a foreign jurisdiction. It is also important to understand the securities regulations for those jurisdictions where you intend to conduct marketing activities and not establish a local presence.

  If your firm has decided to target a jurisdiction for marketing purposes only, then there are regtech tools that can provide guidance on the local marketing requirements. There is free guidance available online, but there are also subscription tools such as Aosphere[15] or Sales Road Maps Online[16], that provide instant, up to date guidance. One of the benefits to utilizing these services is that they often include the name of the local counsel used to generate the summary, so you have the contact information for a local reputable firm should there be additional questions.

- **Use Disclaimers and Disclosures**

  Some countries have specific disclaimers or disclosures that must be included in marketing materials or constituent documents. For example, materials distributed in Canada and Switzerland require specific

11. Société Générale,Group, November 6, 2017 update to its 2016 Annual Report.
12. Legg Mason, Inc. Form 10-K, filed May 30, 2018.
13. Criminal Div. of the U.S. Dep't of Justice & Enforcement Div. of the U.S. Sec. & Exchange Comm'n, *A Resource Guide to the* U.S. Foreign Corrupt Practices Act 28 (updated Nov. 2, 2015), *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf
14. *See, e.g.*, Opinion Procedure Release, No. 03-01 (Dep't of Justice Jan. 15, 2003), *available at* https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2010/04/11/0301.pdf; Opinion Procedure Release No. 04-02 (Dep't of Justice Jul. 12, 2004), https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2010/04/11/0402.pdf; *In the Matter of Kinross Gold Corporation*, Admin. Proc. File No. 3-18407 (March 26, 2018).
15. Aosphere Marketing Summaries – https://www.aosphere.com/aos/mr-am
16. See "Regulation Best Interest," SEC Release No. 34-83062 (Apr. 18, 2018), available at: https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

disclosures for their investors. A convenient way to address these requirements is to either include all of the jurisdictional requirements in a standard disclaimer at the end of offering and marketing materials, or include jurisdiction specific requirements as a wrapper to the appropriate offering document. While these disclaimers/disclosures may not completely alleviate you from liability, they will show good faith in your dealings with that particular jurisdiction. Ultimately no disclosure or disclaimer will absolve you from liability should you not have the appropriate authorizations to conduct business in the relevant jurisdiction.

- **Communicate With Your Team**

  Once the guidelines of the local jurisdiction are understood, the compliance team will typically communicate to the marketing or business development team the firm's approach to interpreting local guidance. It is helpful to condense the guidance to a one to three page summary that can be used as a reference sheet for those that are marketing in the local market. It is also important to have those operating in the local jurisdiction acknowledge that they have read and understand the guidelines and will consult Compliance should they have any questions. (Please See **Exhibit A** as an example.) The acknowledgement helps with accountability and also provides evidence that they were aware of the firm's policies should there be consequences for breaching the guidelines.

  Updates to marketing guidelines should also be communicated and employees should reacknowledge that they have reviewed the updated guidelines. If there are no updates in a year, then it is helpful to have the guidelines reviewed annually to make sure everyone stays abreast of the rules and acknowledge that they understand and agree to comply. You can also incorporate this into your annual employee's attestation process for other policies and procedures, code of ethics disclosures, etc.

  There may be instances where you have a rogue marketer visit jurisdictions that are not permitted or instances where they have violated the guidelines that have been set forth. It is important to escalate these breaches in accordance with your firm's policy to ensure these matters are handled appropriately. Rogue marketers can cause reputational harm to the firm, including sanctions or a ban from the market by the local securities regulator. This could require disclosure to existing investors who inquire whether the firm has received any adverse action by any regulator, or disclosure to potential investors who inquire about adverse actions during the initial due diligence process.

The goal of this paper is to provide an overview of the compliance considerations that should be contemplated as your firm determines whether or not it should operate in global financial markets. As reiterated throughout the piece, it is important to approach the topic from a practical standpoint while considering the regulations of your home jurisdiction as well as the jurisdiction where you to plan to operate.

Exhibit A – Template for marketing summary acknowledgment

<insert jurisdiction> Marketing Guidance

I confirm that I have read, and fully understand the attached marketing requirements of <insert jurisdiction>. I will consult the Compliance team should I have any questions or require further clarification.

____

Name

____

Date

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EXHIBIT A TEMPLATE

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A Guide to the $25 Referral Fee Under Reg R: A Minnesotan's Perspective

By Ken Cherrier

Does Reg R allow a non-registered bank employee to be paid more than just $25 for a retail brokerage referral?

As they say in Minnesota… Ya, you betcha!!!

Before we analyze the basis for the allowance to pay more than $25 for a retail brokerage referral, let's first take a step back and review the rule a bit. Reg R covers a myriad of exceptions to registering as a broker-dealer in addition to allowances for compensating non-registered bank employees. However, this article is going to focus solely on the topic of how much a non-registered bank employee can be compensated for referring retail business to a broker-dealer, either under a third-party networking agreement, or to the bank's affiliated broker-dealer.

Section 247.700(b)(1) of Reg R defines the terms and parameters of what incentive compensation can be paid to a non-registered bank employee for a retail brokerage referral. Incentive compensation is defined as:

> Compensation that is intended to encourage a bank employee to refer customers to a broker or dealer or give a bank employee an interest in the success of a securities transaction at a broker or dealer.

Section 700(c) of Reg R allows a "nominal one-time cash fee" or a "fixed dollar amount" to be paid to a non-registered bank employee for a retail brokerage referral. It is this section, that the vast majority of banks base their reasoning on limiting retail referrals to only a "nominal" $25 fee. However, Section 700(c) actually allows for three different calculations to derive a "nominal" fee.

Three calculations! O geez!! Hey Ole, that there is a lot of calculations there!

A brief description of the three standards are listed below.

700(c)(1): The payment can be twice the average of the minimum and maximum hourly wage established by the bank for the current or prior year for the job family that includes the employee OR 1/1000th of the average of the minimum and maximum annual base salary established by the bank for the current or prior year for the job family that includes the employee;

700(c)(2): The payment does not exceed twice the employee's actual base hourly wage or 1/1000th of the employee's actual annual base salary;

700(c)(3): The payment does not exceed $25 – which can be adjusted for inflation!!

There are obvious complications of automating and systematizing the salary calculations for referral fees using standards (1) and (2) … let alone deciphering them!! Therefore, most banks rely on standard (3): simply paying $25. As they say in Minnesota, easy peazy lemon squeezy!

But what most banks do not know is, the nominal referral fee of $25 that a majority of banks are paying non-registered bank employees for retail brokerage referrals, can be adjusted for inflation.

Section 700(f)(1) of Reg R clearly states that on April 1, 2012, and every five years thereafter, the $25 amount can be adjusted for inflation. Now, the calculation takes an HP calculator and a doctorate in mathematical philosophy… O geeze, math is hard… but with a green shade and a strong cup of coffee, it can be calculated. For entertainment, I have reproduced 700(f)(1)(i) and (ii) below:

> (i) Dividing the annual value of the Employment Cost Index For Wages and Salaries, Private Industry Workers (or any successor index thereto), as published by the Bureau of Labor Statistics, for the calendar year preceding

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the calendar year in which the adjustment is being made by the annual value of such index (or successor) for the calendar year ending December 31, 2006; and

(ii) Multiplying the $25 by the quotient obtained in paragraph (f)(1)(i) of this section.

Whooo… you awake? Ok, so I gave this a shot … then gave up and had an economics professor at the University of Minnesota do the calculation for me… true story. Go Gophers!!!

As it turns out, given the allowable inflation adjustments in 2012 and 2017, banks using the $25 nominal one-time fee standard, can actually pay … wait for it… $32!!!!

It is actually $31.67 but Reg R even addresses the issue of what to do if the inflation adjusted amount results in pennies. 700(f)(2) allows for rounding to the nearest dollar!! Who says the SEC isn't generous?

So, there you go… you can pay your non-registered bank employees $31.67 for their retail client broker-dealer referrals.

Ya, you betcha!!

Agony of Defeat: An Olympiad Analysis of SEC, FINRA and Treasury Department Enforcement Actions Against Compliance Officers who Crashed and Burned (March to November 2017)

By Brian L. Rubin and Amber S. Unwala

Introduction

"My strategy is to stop the puck." **Tuukka Rask (Finland goaltender)**[1]

The Olympics . . . for different people, it conjures up different thoughts. Once every four years, the most skilled athletes from across the globe gather for the Olympic Winter Games, eager to compete and bring back gold for their countries (and not embarrass themselves by falling too many times or by splitting their pants). We all have favorite memories—the Jamaican bobsled team, Tonya Harding, Apolo Ohno, Kristi Yamaguchi—and the list goes on. This year's Olympics in Pyeongchang, South Korea, was no different. Who can forget Norway (do they ever not have snow on the ground?), Shaun White (and his various hairstyles), the 17-year-old American Snowboarders (when we were 17, we were focused on trying to get through high school), Team USA Women's Hockey (what can we say, other than "Wow!"?), and Winnie the Pooh (and Yuzuru Hanyu)? But for compliance officers of broker-dealers (BDs) and investment advisers (IAs), it's about the rules and the glory of knowing the athletes are doing the right thing. Well . . . maybe it's just a distraction from everyday life.

In any event, the Olympics provide valuable lessons for compliance officers of BD and IAs whether you believe that "[t]he Olympics are a wonderful metaphor for world cooperation, the kind of international competition that's wholesome and healthy, an interplay between countries that represents the best in all of us," or whether you believe that "[s]kiing combines outdoor fun with knocking down trees with your face."[2]

This article, which analyzes enforcement cases brought from March to November 2017, is one in a series of articles that will provides illuminating analyses, astute insights, and a bit of frozen blood, sweat, and tears to provide compliance officers as well as management with some observations regarding conduct that prevented compliance officers from going for the gold.[3]

Failure to Adopt Adequate Supervisory Systems

The good thing about doubles is that when you have a bad run, it's always the other guy's fault."
Christian Niccom (US luger)[4]

While it may be easy, and sometimes effective, to blame the other guy, that doesn't always work in the securities world because the starting point is usually the rules. Financial Industry Regulatory Authority (FINRA) rules require BDs to establish and maintain supervisory systems that are "reasonably designed to achieve compliance" with applicable laws, regulations and rules, and written supervisory procedures (WSPs) that are designed to supervise the business activity of firms.[5] FINRA requires that the supervisory system be "tailored specifically to the member's business."[6]

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1. http://archive.jsonline.com/sports/olympics/best-worst-and-weirdest-quotes-from-the-winter-olympics-b99211654z1-246760861.html/.
2.http://www.quotegarden.com/olympics-winter.html.
3. *See, e.g.*, Brian L. Rubin and Amy Xu, "#CCOsGoingViral: An Analysis of SEC and FINRA Enforcement Actions Against Compliance Officers, Written for Millennials (and those who work with Millennials) (September 2016 to February 2017), *Practical Compliance & Risk Management for the Securities Industry*, July-August 2017 at 11, https://us.eversheds-sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEoapCpC3!/fileUpload.name=/Rubin%20-%20CCOs%20Going%20Viral.pdf; Brian L. Rubin and Amy Xu, "Make America Compliant Again: SEC and FINRA Enforcement Actions Against Compliance Officers During an Election Year (January-August 2016)," *Practical Compliance & Risk Management for the Securities Industry*, January-February 2017 at 19, https://us.eversheds-sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEoO3Cn83!/fileUpload.name=/PCRM_01-17_Rubin-Xu.pdf; Brian L. Rubin, Katherine E. Dumeer and Amy Xu, "Harry Potter and the Compliance Stone: SEC and FINRA Enforcement Actions Against Compliance Officers (July-December 2015)," *Practical Compliance & Risk Management for the Securities Industry*, May-June 2016 at 5. https://us.eversheds-sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEo83CoW3!/fileUpload.name=/PCRM_03-16_Rubin-Dumeer-Xu.pdf.
4.http://archive.jsonline.com/sports/olympics/best-worst-and-weirdest-quotes-from-the-winter-olympics-b99211654z1-246760861.html/.
5. FINRA Rule 3110 (effective Dec. 1, 2014). NASD Rule 3010 regarding supervisory systems and written procedures were substantially similar.
6. Richard F. Kresge, SEC Admin. Proc. No. 3-12402, 2007 LEXIS 1407, at *2 n.24 (June 29, 2007).

Furthermore, FINRA requires the designation of at least one chief compliance officer (CCO), who is the primary advisor to the member on its overall compliance scheme and rules, policies and procedures.[7]

Like BDs, IAs are also required to adopt and implement written policies and procedures that are reasonably designed to prevent violations of the securities laws, regulations and rules.[8] All IAs must also "[d]esignate an individual (who is a supervised person) responsible for administering the policies and procedures" that the IA adopts.[9]

If a CCO fails to adequately follow or put in place policies, procedures and supervisory systems for a BD or an IA, the CCO may be subject to a disciplinary action. For example, in March 2017, FINRA accepted an Offer of Settlement from a CCO, finding that she violated NASD Rule 3010(b) and FINRA Rule 2010 by failing to establish WSPs to address portions of her firm's business, failing to have adequate WSPs, and failing to enforce certain WSPs that the firm did have.[10] The CCO was responsible for ensuring that the firm's compliance and supervision systems operated effectively, and she was further given the task of ensuring that the WSPs were amended when the firm changed or added any supervisory procedures. However, FINRA found that the WSPs were not reasonable because they did not state the firm's actual processes and procedures for reviewing and supervising customer accounts. Additionally, the CCO did not amend the WSPs to reflect the firm's actual procedures.

FINRA also found that the firm's procedures for conducting heightened supervision of its registered representatives were inadequate because they did not detail how reviews would be conducted, how often they would be conducted, and how those reviews were to be documented. Furthermore, the firm recommended and sold exchange-traded funds (ETFs) to customers but did not have written procedures for supervising and approving the transactions. For these and other violations, FINRA suspended the CCO from associating with any member firm in a principal capacity for 10 days and fined her $10,000.

Takeaway: Compliance officers may want to read their firms' policies and procedures carefully to determine what the procedures say about their role. Compliance officers may be sanctioned if they fail to follow their firms' procedures (and they may be responsible for developing and maintaining those procedures) and for their firms' failure to develop and maintain procedures that detect fraudulent behavior and to ensure that proper disclosures are made. CCOs, who are charged with following the WSPs, should ensure that each provision is being followed and is up to date. Furthermore, if a CCO voluntarily assumes the role of ensuring the adequate implementation of WSPs, merely stepping in may not be sufficient to avoid liability. The CCO may still be sanctioned for any inadequacies in following the WSPs, regardless of the intent to try to fix prior failures.

Failure to Update Procedures Regarding Outside Business Activities and Private Securities Transactions

***"Curling is not a sport. I called my grandmother and told her she could win a gold medal because they have dusting in the Olympics now."* Charles Barkley (American basketball Olympiad).**[11]

Depending on your perspective, something might be an Olympics event watched by millions or a task that no one is grateful for and no one cares to watch you doing. Similarly, depending on your perspective (and the facts) an activity may be an outside business activity (OBA) or a private securities transaction (PST). Compliance officers who have responsibilities relating to OBAs and PSTs may face sanctions if they fail to carry out those responsibilities properly.

In August 2017, through a Letter of Acceptance, Waiver and Consent (AWC), FINRA disciplined a CCO for his actions in approving but failing to establish a system reasonably designed to supervise, and failing to actually supervise the PSTs of two registered representatives associated with the firm.[12] The CCO was the owner of the firm and served as the vice president, CCO, and financial and operations principal (FINOP). He was the sole registered principal responsible for all areas of the firm's supervision, including the WSPs. He also was responsible for maintaining the firm's books and records. In particular, he was responsible for ensuring that the firm had a system in place reasonably designed to supervise private securities transactions and for supervising those transactions if engaged in by the firm's registered representatives.

7. FINRA Rule 3130.
8. Rule 206(4)-7 promulgated under Section 206(4) of the Investment Advisers Act of 1940 (Advisers Act).
9. Id; Section 203(e)(6).
10. FINRA, Order Accepting Offer of Settlement, Disciplinary Proceeding No. 2013034966701, (March 8, 2017), http://www.finra.org/sites/default/files/fda_documents/2013034966701_FDA_VA701847.pdf.
11. http://www.topendsports.com/fun/quotes/olympics.htm.
12. FINRA AWC No. 2014038992501 (Aug. 8, 2017), http://www.finra.org/sites/default/files/fda_documents/2014038992501_FDA_SL678219.pdf.

However, FINRA found that the firm did not have a reasonably designed supervisory system and continually failed to require registered representatives to provide the CCO with the relevant documentation and information related to the private securities transactions that he approved. Without those documents, FINRA found that the CCO failed in supervising the activities and conducting the required review of the activities. As a result, the CCO allowed two registered representatives to participate in 21 private securities transactions, but he failed to supervise and failed to record these transactions on the firm's books and records, in violation of NASD Rule 3010(a) and Rule 3040(c).

Additionally, the CCO was responsible for updating the firm's WSPs but he failed to update them to address the requirements of FINRA Rule 3270, which requires a firm to conduct reviews of the outside business activities disclosures. Between July 2012 and December 2013, 10 registered representatives provided the CCO with the written disclosures of their outside business activities, but as previously mentioned, the CCO failed to conduct the reviews. Due to these and other violations, FINRA fined the CCO $20,000 and suspended him from associating with any FINRA member firm in a principal capacity for three months.

Takeaway: Compliance officers could face sanctions if they fail to carry out assigned responsibilities related to OBAs and PSTs.

Insufficient Disclosures and Conflicts of Interest

"So you wish to conquer in the Olympic Games, my friend? And I, too... But first mark the conditions and the consequences. You will have to put yourself under discipline; to eat by rule, to avoid cakes and sweetmeats; to take exercise at the appointed hour whether you like it or not, in cold and heat; to abstain from cold drinks and wine at your will. Then, in the conflict itself you are likely enough to dislocate your wrist or twist your ankle, to swallow a great deal of dust, to be severely thrashed, and after all of these things, to be defeated." **Epictetus (non-Olympiad)**[13]

While preparing for the Olympics may involve dealing with conflict, it's unlikely that Epictetus, a Greek stoic philosopher (for those of you who fell asleep during Western Civilization), ever considered the conflicts of interest issues faced by compliance officers nowadays. Although, truth be told, it is rare for a compliance officer to dislocate a wrist or twist an ankle (except possibly at a rewards trip). (No comment on swallowing dust.) Compliance officers may, however, be severely thrashed by regulators if they play an inadequate role regarding insufficient disclosures or addressing conflicts of interest.

For example, CCOs may be found liable for inaccurate disclosures in Form ADVs. In March 2017, the US Securities and Exchange Commission (SEC) accepted an Offer of Settlement from an IA that was wholly owned and controlled by one person wearing the hats of founder, sole owner, control person and CCO.[14] While the SEC found multiple violations, one violation concerned the failure of the firm's Form ADV to disclose a conflict of interest in which the firm was incentivized to choose share classes carrying 12b-1 fees. The CCO was responsible for reviewing, updating and signing all of the Forms ADV and ensuring their accuracy. The Form ADV was inaccurate because it did not disclose that the CCO was receiving 12b-1 fees from various mutual funds that used client assets to pay the CCO. Furthermore, the SEC found that Part 2A of the Form ADV contained numerous misleading statements, including a statement that the IA did not receive any of the fees charged to the client, even though the CCO was receiving the 12b-1 compensation. The Form ADV also failed to disclose the IA's deteriorating financial condition and its resulting inability to meet contractual commitments to clients. Due to multiple violations, the SEC barred the CCO from the industry with a right to apply for reentry after three years. The SEC did not assess any civil money penalties.

The SEC charged another CCO for providing false statements in a Form ADV when he relied on firm management for data. In August 2017, the SEC entered into a Settlement Order with a "rent-a-CCO" for two affiliated IAs.[15] The CCO served in that role for two years for two IAs that had contracted out the CCO job to a third-party provider for which the CCO was a principal. The contract stated that the CCO would be designated as CCO and would be responsible for preparing and filing amendments to the firms' Form ADV reports. However, the SEC found that the CCO failed to file the annual updates and amendments for one IA's Form ADV because the chief investment officer (CIO) told the CCO to prepare and consolidate a Form ADV for the second IA reflecting a merger with the first IA under common ownership and control of the same corporate parent company. The SEC found that this filing materially overstated the assets under management and the total client accounts for both IAs. An amendment to the Form ADV, which was intended to reflect the merger, overstated the assets under management by more than $119 million and around 1,000 client accounts.

13. https://www.goodreads.com/quotes/97031-so-you-wish-to-conquer-in-the-olympic-games-my.
14. SEC Admin. Proc. File No. 3-17365, (March 29, 2017), https://www.sec.gov/litigation/admin/2017/34-80335.pdf.
15. SEC Admin. Proc. File No. 3-16463 (Aug. 15, 2017), https://www.sec.gov/litigation/admin/2017/34-81405.pdf.

While the outsourced CCO was responsible for the filing, the Order noted that he relied on the estimates that the CIO provided to him. The CIO sent the CCO an email that stated specific numbers for the assets under management and the number of accounts, which the CCO relied on in filing the Form ADV. The SEC found that the CCO should not have relied on this data, stating that the CCO and the consulting firm "adopted these estimates, without taking sufficient steps to ascertain their accuracy." Unfortunately, the SEC Order did not state what the CCO should have done to verify the data. The SEC ordered that the CCO be suspended from the industry for 12 months and ordered him to pay a penalty of $30,000.

Takeaway: CCOs may be sanctioned if they are responsible for Forms ADV, and if they fail to disclose material issues such as conflicts or if they provide incorrect information. Furthermore, compliance officers should remember the Russian proverb, "Doveryai, no proveryai" or "Trust, but verify."[16] (The Russians, after all, love the winter Olympics.)

Failure to Respond Adequately to Staff Requests

"Finishing second in the Olympics gets you silver. Finishing second in politics gets you oblivion." **Richard Nixon (non-Olympiad)**[17]

While Richard Nixon was not an Olympiad (or a compliance officer), he knew a lot about politics and more than a little bit about not responding adequately to inquiries. Indeed, had he been a compliance officer and had he failed to respond to staff requests in a timely and appropriate manner, he may have been sanctioned.

In one case, for example, a CCO was sanctioned when he continually failed to provide adequate and responsive documentation to the staff's requests.[18] The exam staff sent a written request for basic records, such as financial statements, balance sheets and income statements. The exam staff also requested a production of bank statements, promissory notes and agreements, credit card statements or lines of credit, emails, trade blotters and other documents. The CCO confirmed that he received the request and stated that he would be able to produce the documents. After the exam staff did not receive any documentation, the staff sent a letter requesting production seven days after the date of the letter. More than a week after the deadline passed, the firm produced only four records and explained that it still had more records to produce. Several weeks later, the exam staff again sent an email to the CCO stating that the records had not been received and requested a three-day turn-around. While the CCO ultimately produced additional documents, most were non-responsive to the requests. The SEC found that the CCO violated Section 204(a) of the Advisors Act, which requires IAs to maintain and make available to the SEC certain books and records as prescribed by the SEC. Due to multiple violations, the SEC barred the CCO from the industry with a right to apply for reentry after three years and revoked the IA's registration as an IA. There were no civil money penalties or disgorgements ordered in this case.

Takeaway: The SEC may sanction compliance officers not only for lying but also for failing to comply with SEC staff requests for a production of documents.

Anti-Money Laundering

"Top Olympic athletes receive a modest bonus for earning a medal, with the United States Olympic Committee paying $25,000 for gold, $15,000 for silver and $10,000 for bronze. But celebrity endorsements are what fuel the lavish lifestyles of famous athletes."[19] Time **(not a sports publication)**

It goes without saying that top compliance officers win neither medals nor celebrity endorsements. Not even compliance officers who are lucky enough to be anti-money laundering (AML) compliance officers (AMLCOs). Indeed some have likened being an AMLCO to skiing, which is "the only sport [or profession] where you spend an arm and a leg to break an arm and a leg."

AMLCOs may be sanctioned for failing to file Suspicious Activity Reports (SARs) for transactions that are marked with red flags due to possible fraudulent activity. For example, in June 2017, the SEC accepted an Offer for Settlement from a firm and its AMLCO who was responsible for ensuring the firm's compliance with SAR reporting requirements.[20] The firm's written AML program identified certain transaction patterns as "red flags" that could trigger additional investigations on whether a SAR filing was necessary. Specifically, the violations related to the firm's penny stock liquidation business whereby the firm accepted physical deposits of large penny stock shares, liquidated the shares, and the customers would then transfer the sale proceeds. The AML program identified this pattern of

16. https://en.wikipedia.org/wiki/Trust,_but_verify.
17. http://www.quotegarden.com/olympics-winter.html.
18. SEC Admin. Proc. File No. 3-17365 (March 29, 2017), https://www.sec.gov/litigation/admin/2017/34-80335.pdf.
19. http://time.com/money/4459824/2016-rio-olympics-endorsement-deals/.
20. SEC Admin, Proc. File No. 3-17813, (June 12, 2017), https://www.sec.gov/litigation/admin/2017/34-80908.pdf.

transactions as a "red flag" but the AMLCO never performed any investigation relating to the suspicious transactions.

Furthermore, the suspicious transactions should have raised red flags indicating that the customer could be involved in a pump-and-dump fraud scheme. The Order stated that the indicators were:

i. "past securities fraud convictions or settlements by the customer or a related party;
ii. inconsistencies between the customers' representations and documentation submitted to the firm;
iii. customers acquiring shares at very large discounts;
iv. signs that documents submitted were not authentic
v. recent changes in the issuers' business model, including new business ventures relating to illegal industries, such as marijuana production and distribution;
vi. promotion activity;
vii. trading into sudden spikes in price and volume; and
viii. coordinated deposit and trading between one or more customers' accounts."

Even when the firm's clearing firm brought a red flag to the AMLCO's attention, he acted "knowingly" and "recklessly" in failing to file the required SARs. Due to this conduct, the AMLCO violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder which requires BDs to file SARs required by the Bank Secrecy Act. The AMLCO was barred from association with any registered entity; prohibited from servicing or acting as an employee, officer or director; and barred from participating in any offering of a penny stock. He was further ordered to pay a penalty of $10,000.

In May 2017, a former CCO entered into a stipulation with the Department of Treasury for violating the Bank Secrecy Act.[21] The CCO had direct supervisory authority of the Fraud and AML Compliance Departments of a money transfer company, and he failed to conduct adequate audits of the agents and outlets. He also failed to ensure that the company implemented a policy for terminating or disciplining agents who had presented an unreasonable risk of fraud or money laundering. Further, the CCO was aware that a policy needed to be implemented because his subordinates had recommended such a policy to the CCO and even proposed a version of a policy to him. The firm's outside counsel sent a letter to the Federal Trade Commission, stating that the firm was planning to institute a new policy for reviewing fraudulent activity at the individual agent level and that this policy would include warnings to agents, suspensions and terminations. Even still, the CCO failed to implement the policy. Furthermore, the Director of Fraud created a presentation that discussed the need to have a consistent process to restrict agents who received disproportionate amounts of fraudulent wire transfers. Again, the CCO did not implement a policy.

The CCO also failed to ensure the timely filing of SARs on agents and outlets that presented risks of fraud and money laundering. For example, the Director of Fraud provided the CCO with information on 49 outlets accounting for approximately 58% of the reported fraud. Each of the 49 outlets had a characteristic that the compliance department identified as being a strong indicator that the outlet was involved in consumer fraud schemes. Due to these violations, the CCO was ordered to pay the government $250,000 and agreed to a three-year prohibition from performing a compliance function for any money transmitter.

Takeaways: AMLCOs may be sanctioned if they ignore certain patterns of suspicious activity and fail to report the SARs according to the regulations and laws.

Custody Rule

"It's a strange world of language in which skating on thin ice can get you into hot water."[22] **Franklin P. Jones (non-Olympiad)**

While a variety of skating styles are Olympic events, so far skating on thin ice is not one of them. Similarly, the custody rule is multifaceted (although it does not involve ice or skating), and the SEC may hold CCOs responsible for their firms' failures to comply with the custody rule. That rule requires registered IAs who have custody of client funds or securities either to obtain a yearly surprise exam by an independent public accountant or to distribute to investors audited financial statements done by an independent public accountant registered with the Public Company Accounting Oversight Board (PCAOB) and subject to its inspection by the PCAOB.

In July 2017, an IA and two of its principals, including its CCO, entered into a settlement with the SEC for willful

21. United States District Court District of Minnesota, Civil No. 15-1518 (DSD/HB) (May 3, 2017), https://www.justice.gov/usao-sdny/press-release/file/963816/download.
22. https://www.brainyquote.com/quotes/franklin_p_jones_106339.

violations of the custody rule for failing to send audited financials within three months of the fiscal year end in violation of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.[23] The IA had elected to distribute the audited financial statements to the limited partners of two funds. The IA hired an independent auditor which was registered with the PCAOB but was not also subject to the PCAOB's inspection, and therefore was not qualified to perform the audits under the custody rule. Additionally, the firm failed to send the audited financial statements within three months of the fiscal year end. The CCO not only was aware of the policies, but he also was the primary contact for the auditors and therefore failed to take adequate steps to ensure that the audited financial statements were properly and timely distributed to the fund investors by the deadline required in the custody rule. The CCO was ordered to pay a civil money penalty of $30,000 in his individual capacity.

Takeaway: CCOs may be sanctioned for conduct related to the custody rule if they have responsibility for compliance with that rule.

Conclusion

"In the name of all the judges and officials, I promise that we shall officiate in these Olympic Games with complete impartiality, respecting and abiding by the rules which govern them in the true spirit of sportsmanship."
Judge's Olympic Oath[24]

While compliance officers are not judged by Olympics judges for their conduct on the job (although we all know they are judged, every minute of every day), they are subject to significant scrutiny by regulators, supervisors and clients. To avoid being judged too harshly and being benched or placed in the penalty box, compliance officers may want to study previous enforcement actions, review regulatory speeches and notices, and carefully read their firms' procedures. And they likely enjoyed watching this year's Olympics in Pyeongchang and are possibly getting ready for the next winter Olympics in Beijing. Or better yet, get out there, exercise and perhaps, go skiing. But don't forget the words of Steven Wright, "Cross country skiing is great if you live in a small country."[25]

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23. SEC Admin. Proc. File No. 3-18084, https://www.sec.gov/litigation/admin/2017/ia-4734.pdf.
24. http://www.topendsports.com/events/summer/traditions/oath.htm.
25. http://www.quotegarden.com/olympics-winter.html.

Member Perspectives: Emotional Intelligence and Interpersonal Skills

NSCP Executive Director, Lisa Crossley, recently interviewed Jim Downing, Global Chief Compliance Officer with AON, to gain some insight on the importance of emotional intelligence ("EI") and interpersonal skills ("IP Skills") for compliance professionals.

Jim, thanks for taking the time to talk with us. You've been asked to speak at the NSCP National Conference on the topic of "Emotional Intelligence and Interpersonal Skills" What do these terms mean to you?

EI is a person's awareness of their feelings and the actions taken as the result of those feelings. It also includes a person's ability to read other's emotions. Think of it as self-awareness, self-control, and perception of others.

IS are the soft skills or personal attributes a person has when dealing with others, particularly in the workplace. Examples include written and verbal communication skills, presentation skills and networking abilities.

Would you say these are qualities we're born with or can they be learned or developed?

Both. Everyone is born with natural tendencies and there are many ways to learn and develop those that are useful, as well as create new ones.

EI can be developed by taking the time to reflect about each day, journaling or meditating. Also there are a lot of free resources (e.g. articles, TED talks, podcasts) about EI that can be very useful (Hint: we will provide some of these in the materials to the panel).

There are all kinds of classes, workshops and seminars that are offered for improving soft skills. Examples are writing classes and workshops to enhance your presentation abilities. Another way is to ask colleagues who have these skills whom you admire. You would be surprised how often people are willing to share how they honed their skills.

This should be an interesting topic for the National Conference. How do you plan on relating this topic to compliance professionals?

Compliance professionals have many challenges including delivering bad news, having difficult conversations, presenting effective compliance training and liaising with regulators. Many of us have heard the joke that compliance departments are referred to as "Business Prevention Units." This isn't a laughing matter. Knowing, understanding and interpreting regulation is just the beginning to becoming a valued compliance professional. Working with others in their capacities as business leaders with sales goals, pressure from clients and deadlines is essential. Empathy with confidence and mindfulness can be the distinguishing factors that make a compliance professional a leader.

What skills do you look for in an applicant when hiring for your department?

I look for curiosity and ambition. I want to make sure that we hire people who remain curious about our business, the regulatory environment, and the world around us. Ambition is important because I want someone who will raise their hand when tough projects come around. I have always been an advocate for remaining ambitious in a role as a way to keep high energy.

Outside of these traits I also look for technical skill. That can vary widely on what level role you are hiring. Obviously a new college grad will not have much technical skill as a manager or director. However, its also in the application of those technical skills where the rubber meets the road. Being able to apply rules and regulations to real business processes is a vital skill for any compliance officer at any level.

About the Author
Jim Downing is Global Chief Compliance officer with AON. He can be reached at james.downing@aon.com.

Can you give us a little preview of what you might cover at the Conference?

We're in the planning stages now but we already have a lot of ideas. We're looking at different ways to present specific scenarios through video, polling and discussions to help attendees gauge how they interact with boards, regulators and others. It's our intention to help individuals assess their own skills and customize a learning plan to suit the attendee's professional situation and available resources.

That's great! We're looking forward to it. One final question, Rolling Stones or Beatles?

That's a tough one. I have to say Stones because I'm a huge Keith Richards fan. I play the electric guitar and Keith Richards is just amazing.

Jim, thanks for taking the time to share your insights to the greater membership on this topic. We're really looking forward to your presentation at the National Conference.

Extraterritorial Impacts of the GDPR

By Katie Pollock

In an effort to create harmonization across the European Union ("EU"), and in line with a widely acknowledged need to improve security of personal data against misuse, breaches and cyber-attacks, the European Commission adopted the General Data Protection Regulation ("GDPR") which replaced the current directive on May 25, 2018. The GDPR seeks to give people more control over how organizations use their data, and will introduce hefty penalties for organizations that fail to comply with the rules, and for those that suffer data breaches.

The GDPR does not make distinctions between industries and sectors, and has a global reach where personal data of data subjects who are located in the EU by a controller or processor not established in the EU is processed. If there are any significant breaches, fines could reach €20 million or 4% of global turnover, whichever is higher.

The processing of personal data will only be lawful if it satisfies at least one of the following processing conditions:

- Consent - The individual has given consent to the processing
- Necessary for performance of a contract - The processing is necessary for the performance of a contract;
- Legal obligation - The processing is necessary for compliance with a legal obligation to which the controller is subject;
- Vital interests - The processing is necessary in order to protect the vital interests of the individual or of another natural person;
- Public functions - The processing is necessary for the performance of a task carried out in the public interest; or
- Legitimate interests - The processing is necessary for the purposes of the legitimate interests pursued by the controller or by a third party

Does GDPR apply to your firm?

The GDPR significantly expands the territorial reach of EU data protection law by covering non-EU established data controllers and data processors processing EU data subjects' personal data in connection with offering goods and services, regardless of whether payment is received. Therefore, if you are based outside the EU, you may still be caught by GDPR. This is the case where:

- You offer goods or services in an EU language or currency;
- Your business allows EU data subjects to place orders in their local language; and/or
- You refer to EU customers when marketing its goods and services.

The GDPR makes it clear that having your website accessible by an EU data subject, or that they can access your email address or other contact details does not necessarily mean that the GDPR applies. Rather, a business must show intent to draw EU data subjects as customers. However, there are other situations where firms are in receipt of EU personal data, some of which may or may not make you subject to GDPR, for example, if you take an active role in processing (using) or monitoring such data on behalf or another processor or data controller of EU personal data. Additionally, by having an EU based client you will need to be compliant. Each situation needs to be examined in detail to rule out if you are in scope or not.

Another way in which non-EU firms are brought into the scope of GDPR is where your firm monitors behaviors of customers or prospective customers, this may include tracking an EU resident on the internet.

Monitoring takes place when firm track individuals on the internet and use personal data to:

- Profile a natural person to make decisions concerning the; and/or
- Analyze or predict personal preferences, behaviors, and attitudes.

About the Author
Katie Pollock is a Consultant with Bovill. She can be reached at kpollock@bovill.com.

Main aims and powers

Raise the standard for the use of "consent" for the processing of EU residents. Consent must now be:

- Freely given;
- Unambiguous statement of clear affirmative action;
- Able to be withdrawn;
- Informed; and
- Specific to particular processing operations.

EU residents who are classified as data subjects now have the right to:

- Access the data that is being processed;
- Rectify inaccurate data;
- Request erasure of their data ("the right to be forgotten");
- Restrict certain types of processing;
- Request data portability to transfer to another controller;
- Object to certain types of processing; and
- Not be subject to a decision based solely on automated processing.

What you should be doing

To determine whether your firm is subject to GDPR will require an assessment of your situation, in terms of activity with establishments in the EU and /or activity carried out with EU data subjects. If you find that you will need to comply at a minimum, you should take the following steps:

- Evidence governance and accountability, ensuring that operations are compliant with the GDPR principles;
- Update policies, procedures and privacy notices to include GDPR compliance;
- Map likely scenarios for receiving requests from data subjects wanting to exercise their rights and prepare a response package to be sent to data subjects seeking to exercise their data subject rights;
- Review your analysis of the lawful basis for processing the data, and updating consent and privacy notices to reflect this;
- Review any outsourcing contracts and require that, if in possession of personal information of a data subject, there are procedures in place to notify your firm; and
- Provide staff training for those who come in contact with personal data

While many entities subject to GDPR are requesting explicit consent of EU subjects, particularly for marketing, this may lead to a loss of clients or prospects who do not affirmatively provide consent. Alternatively, legitimate interest can be used and defended as a viable alternative, as long as EU data subjects are correctly informed of the purpose of processing and other rights under GDPR. The correct choice of lawful basis is expected under GDPR from the start. The Information Commissioners office (ICO) of the UK has stated "you will be in Breach of GDPR if this determination is not made correctly from the start."

How to Master the Annual Review and Promote a Culture of Compliance

By Elizabeth Cope

A 3-Part Guide for CCOs

Being the Chief Compliance Officer ("CCO") is tough. You are the "NO" person; the "You did that wrong" person; the "You have to report everything to me" person. Your job is critical…and full of liability.

You are one of the people expected to lead the firm with a strong culture of compliance and collaborated to ensure written policies and procedures are in place. You are also responsible for assessing the adequacy and effectiveness of those policies, at least annually, in the form of an annual review.

How to Master the Annual Review and Promote a Culture of Compliance is Part 1 of a 3-part series in which you will learn how to develop an annual review to work for you instead of against you, how to make it realistic to implement and manage, and how to make it support the operations and ever-changing needs of your firm, as opposed to being just another thing you have to do to meet regulatory requirements. This series will cover, step by step, how to develop your risk assessment, how to decide what needs to be tested, how to schedule when the testing occurs, how to document your testing, and how to present that documentation to the regulators.

The Joy of the Annual Review

I know it's a requirement, but the annual review is actually a great tool. If set up correctly, it not only serves as your compass to make sure your firm is in compliance, it can help your firm:

1. promote a culture of compliance,
2. create operational efficiencies,
3. bring to light areas where practices among employees are inconsistent,
4. identify where you may benefit from elaborating more on your policies or refining your procedures, or
5. identify where you may benefit from providing additional compliance training to your employees.

The annual review, in essence, is a big project. It requires all elements of project management, including initiation, planning, execution, monitoring, and closing. The process and the underlying requirements are the same from firm-to-firm, but the application, organization, and specific tasks involved in an annual review differ, depending on the nature and size of the firm. Therefore, it is essential that your annual review be "customized," and it is vital that it be "practical."

This three-part guide will help you develop an effective annual review program, tailored to your firm.

The Importance of "Customized" & "Practical"

First things first. It is crucial that your annual review process be practical. By **practical**, I mean simple, effective, functional, and useful. The key is to develop a system that…not only meets the expectation of the regulators and third parties…but also **works for your firm and increases buy-in from your personnel**. It needs to be a **customized** system that not only you, as the CCO understand, but that personnel at the firm—especially the principals who are guiding the compass of the firm—understand and adopt. When people know "WHY" something is the way it is, they are more likely to get on board and stay on board, which will actually make your job much easier.

You like simplicity, right? Another way to improve buy-in is through **simplicity**. The system you develop for your annual review doesn't have to be overcomplicated. In fact, *I* **urge you** not to overcomplicate your processes. Less is often more, and SIMPLE is often better!

About the Author

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Now that you understand "why" a *customized, practical* annual review is indispensable, let's get started on the "how!" We've tried to make it simple for you…

Part 1: Create a Risk Assessment.

The Risk Assessment will drive the entire annual review process. To make this easy for you, I have attached a template in Microsoft Excel. You don't have to use Excel but if you're starting from scratch, you may consider it as it's easy, almost everyone has it, and you can do quite a bit with it. If not, you can certainly use other tools or technology to develop your risk assessment, but the same principles should be considered. Remember, keep it "practical." Just use a system and method that makes sense to you and your firm.

Step 1: Identify the Risks

Identify the potential risks your firm may incur as a result of the services being offered. If you are unsure of the risks, sit down with the people doing the work, talking to clients, and making the trades. Ask them where they think the risks are. Document this.

In the template provided, this step is in Column A. You will see we have already identified examples of potential risks advisers may incur. You may take these into consideration as you develop your own risk assessment. I suggest only including risks applicable to your firm. For example, if you do not engage in soft dollars, you do not need to address those items as potential risks. (Keep it simple.)

RISK ASSESSMENT
Risks
Compliance Oversight
(Example: Compliance officer and compliance staff are not aware of rules and regulations)
(Example: General staff is not aware of rules and regulations)
(Example: Roles and responsibilities of Firm personnel not clearly defined)
(Example: Staff has disciplinary history that has not been disclosed)
(Example: Outside Business Activities are not properly disclosed)
(Example: emails violate with firm policies)

At the very bottom of this template (starting on Row 161), you will see a section to identify the potential conflicts of interest. These will be identified as a result of the overall risk assessment. The key is to make sure any identified conflicts are disclosed fully and fairly to clients. I suggest taking a moment and putting yourself in the shoes of your clients or potential clients. What kinds of conflicts would you be concerned about? What would you want to know if you were investing your money? The SEC has made it clear that advisers don't have to avoid all conflicts, but they do have to make full and fair disclosures so that investors can make sound decisions.

Step 2: Assess Risk Level

It is not a requirement to identify the level of risk associated with the risks you identified in Step 1. However, doing so, provides guidance for the type and frequency of testing you conduct for your annual review. An item that is of high risk will most likely require a higher priority level of review (i.e., perhaps conducted more frequently, or using a larger sample size, or a deeper, more in-depth review). You will see in Columns B and C of the provided template, we suggested two methods for assessing the risk level. We suggest rating risks in two categories a) the likelihood of this risk actually occurring, which can be based on past experiences and b) the impact should this risk occur. This can be rated as high, medium, low or 1, 2, 3, etc.

Probability that the risk will occur (High, Medium, Low or 1 = Low, 5 = High)	**Effect** the risk would have on Firm's business (High, Medium, Low or 1 = Low, 5 = High)
H	M

When you are first starting out, go with your initial gut feeling, following discussions with the team. Then let the results of the annual review guide your updates for the coming year (i.e., if you find a significant amount of violations, then that area would most likely be high risk for the likelihood of occurring).

Step 3: Document the Controls and Map the Controls to Your Policies

A very common fault that advisers have in their exams is having policies and procedures in place that are not consistent with the firms actual practice or that are not "reasonably" designed to mitigate the risks at the firm. That is why I have broken this up into two areas (1) document the controls and (2) map the controls to your policies and procedures.

Document the Controls

This is Column D of the template. For each risk, document the control in place to mitigate that risk. How? Talk to your people and document what they actually do; get their input and involvement. This is another opportunity for you to get them on board with compliance and to explain the "why." This is where they have the opportunity to let you know what is practical and what is not, understanding that there are items (such a personal trade reporting) where there is not a lot of flexibility. Together, you can compromise on procedures that not only satisfy the regulators' expectations and rules but are also practical for your employees. Getting personnel involved in developing compliance processes and keeping them practical helps ensure that the policies and procedures can and will be followed.

Map the Controls to Your Policies and Procedures

This is Column E in the template. The purpose of this field is to reference the location and title of the identified policy. For example, for the first risk identified in the template, "Compliance officer and compliance staff are not aware of rules and regulations," I would reference the section of your manual that discusses ongoing training and responsibility to stay current with federal securities laws.

This is a great exercise to identify any gaps in your manuals and make updates where necessary. If you do not have controls and policies and procedures in place to mitigate the identified risk…develop them!

Step 5: Identify Responsible Persons/Departments

Identify the individual(s) and/or departments responsible for overseeing and adhering the identified controls and policies and procedures. In many cases, there may be more than one. This will help streamline accountability in the firm. This is Column F.

Step 6: Changes to Risk

Review your risk assessment no less than annually. If violations occur or when new rules are implemented, systems change, or people change, this is the time to assess changes to the overall risk, which trickle down to the controls, policies, procedures, and personnel. This is noted in Column G of the template. We suggest noting why a specific area was change. For example, an adviser might assess "Compliance officer and compliance staff not aware of rules and regulations" as High for both probability and effect because the firm is newly registered. After a year of being registered, administering the annual review, and undergoing training, they could assess this to a lower risk level and then document why the change.

Step 7: Comments

This column, Column H, is an optional field. Only update it if it adds information you feel is relevant to your overall assessment.

Summary

Even though the annual review is a regulatory requirement, it has a lot of benefits that can serve your firm in a positive way and make YOUR job as the CCO much easier. If implemented and reviewed with firm personnel, it can also serve as a tool for promoting a culture of compliance and getting your team onboard with consistently carrying out the practices that adhere to your firm's compliance-related policies. Therefore, it is essential that you customize your annual review to your firm's unique operations and make your annual review as simple and practical as possible.

The first step in tailoring your annual review to your firm is to (1) thoughtfully consider your firm's risks, (2) estimate the likelihood of each risk occurring as well as how serious the effect would be if it did, (3) document the controls your firm has in place to mitigate those risks, (4) map the risks to your written policies and procedures, (5) identify the individuals or departments responsible, and (6) review your risk assessment at least annually, but also after any material change in your firms operations, personnel, or products/services, as well as whenever rules or guidance are implemented or amended.

You have the power to master the annual review!
We hope you join us for Part 2 of How to Master the Annual Review and Promote a Culture of Compliance, which will be published in the July 2018 issue of NSCP Currents. Part 2 is all about testing and reviews. You will learn how to (1) set the testing schedule, (2) define the scope of the testing, and (3) document the results. See you in July!

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Adopting Tech Testing Tools to Tear a Page from Regulators' Rulebooks

By Colleen Corwell

U.S. regulators have been making big investments in Big Data to accelerate exam frequency and more aggressively combat market malfeasance. For instance, the U.S. Securities and Exchange Commission's (SEC) National Exam Analytics Tool (NEAT), enables examiners to access and systematically analyze massive amounts of registrants' trading data along with market data in a fraction of the time it has taken in years past. Following regulators' lead, a growing number of financial firms are leveraging automated data mining, analytics and compliance testing to protect their firms and clients.

A core requirement of the SEC's Rule 206(4)-7 of the Advisors Act (the "Compliance Rule") is to test the adequacy and effectiveness of the compliance program on at least an annual basis. Compliance program testing enables registrants to continuously monitor the efficacy of their compliance controls to mitigate the risks of everything from conflicts of interest, improper asset allocations breaches of client investment mandates, market manipulation and other misconduct.

Regulators allow leeway as to the methods firms employ to assess and review their compliance programs. Naturally, firms use the resources at their disposal to satisfy the testing obligation. This equates to widely varying compliance testing practices. For instance, many small- to mid-sized firms that are not high-volume high-frequency transactional businesses have been able to manually manage compliance testing with legacy tools and tactics, including Microsoft Excel spreadsheets.

Larger firms with more resources were among the first to migrate to automated compliance assessment solutions, and a growing number of firms across the board are following suit. The pace of change in the regulatory landscape is one of the key factors driving the increased uptake of compliance technology.

According to Accenture's 2018 "Comply & Demand" Compliance Risk Report, compliance technology transformation is the top spending priority for respondents, both over the next 12 months (57%) and within the next three years (51%), driven in large part by efforts to enhance integration of risk assessment, monitoring and testing along with compliance program analytics.

There can be push-back when trying to adopt new technology because it requires new skills, there remains an endemic shortage of tech-savvy compliance support, and there is a learning curve along with a cost. Now, several years since compliance technology has hit the market, cultural inertia has hit a flashpoint, and more firms are leaving behind inferior manual processes in favor of cost-effective technology solutions that can be pivotal for a compliance department's performance.

For the growing number of financial firms embracing automation, compliance testing software offers manifold benefits. With technology a firm's policies and data are all centralized and processes are calendared in a web-based program enabling multiple users to interact fluidly. Information is easier to access and analyze than hardcopy reports and data stored in disparate folders on a network.

Data-rich reports can be generated at the touch of a button when needed internally or by regulators. As well, tools that deliver visibility across the three lines of a company's compliance defense – from front line business users to the second line of defense compliance and operations teams to the third line of defense external audit and regulatory professionals – continue to gain momentum.

Explains MyComplianceOffice Chief Executive Officer Brian Fahey, "Adoption of integrated compliance tools that shed light on compliance blind spots by bridging data stores such as human resources, finance and audit will be crucial for the compliance function to maintain authority in the digital age."

About the Author

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Compliance assessment software can really shine by combing large volumes of data and comparing it historically or against benchmarks to detect anomalies or patterns that signal potential problems. Similar to regulators, this allows managers to identify behavioral patterns by individual, group of individuals or area of a firm, to triage resources where they will be best put to use.

Traditional, manual assessment methodologies managed by the "Chief Excel Officer" may remain part of some compliance programs in the near-term. Longer term, compliance automation takes testing to the next level and is becoming the norm. Consistency of reviews, increased productivity and risk-reduction are justifying the shift. Tech testing tools enable firms to produce tangible evidence that they are tearing a page from regulators' rulebooks to manage compliance proactively, instead of reactively.

Accenture's 2018 Comply & Demand brochure is available.

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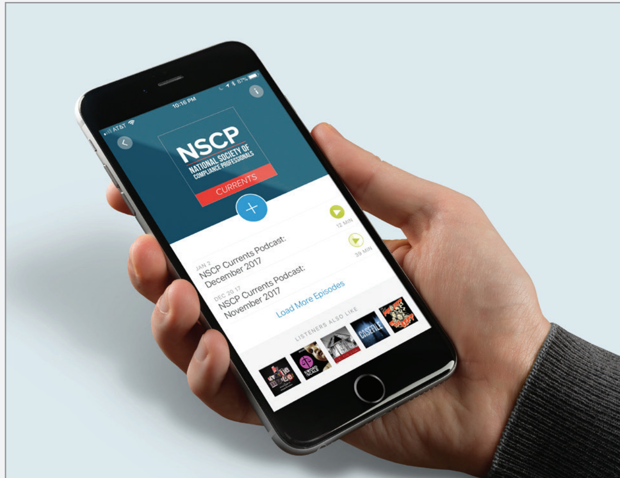

This month's feature Podcast will be Elizabeth Cope's "How to Master the Annual Review and Promote a Culture of Compliance"

"How to Master the Annual Review and Promote a Culture of Compliance is Part 1 of a 3-part series in which you will learn how to develop an annual review to work for you instead of against you, how to make it realistic to implement and manage, and how to make it support the operations and ever-changing needs of your firm, as opposed to being just another thing you have to do to meet regulatory requirements. This series will cover, step by step, how to develop your risk assessment, how to decide what needs to be tested, how to schedule when the testing occurs, how to document your testing, and how to present that documentation to the regulators."

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Big things for your NSCP Member Center are underway this Summer