



2019 FINRA Midwest Region Member Forum

October 3, 2019 | St. Louis, Missouri

Welcome and Opening Remarks

Thursday, October 3, 2019

9:00 a.m. – 9:05 a.m.

Speaker: Ed Wegener
Senior Vice President and Midwest Regional Director, Sales Practice
FINRA Midwest Region

Speaker Biography:

Ed Wegener is Senior Vice President and Midwest Regional Director for FINRA. In that role, he is responsible for leading the department of Member Regulation's regulatory efforts for the region including its surveillance and examination programs. Mr. Wegener started with FINRA (fka NASD) in 1998. Since that time, he has lead or been involved in several significant fraud, sales practice and financial and operational examinations and investigations. He has served in a leadership role in a number of key strategic initiatives for the organization including the design and implementation of FINRA's risk-based, offsite, cybersecurity and digital asset examination programs. FINRA is responsible for regulating brokerage firms and licensed brokers doing business in the United States. The Midwest Region covers firms and individuals conducting securities business in the states of Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin. FINRA's Midwest Region is made up of approximately 130 surveillance and examination staff. Mr. Wegener is a graduate of Illinois State University and he has a Certified Regulatory and Compliance Professional™ designation from the FINRA Institute at the Wharton School of the University of Pennsylvania. He is also a Certified Anti-Money Laundering Specialist and Certified Fraud Examiner. Mr. Wegener has completed the FINRA Leadership Program at the Wharton School and the Leadership Development Program at the Center for Creative Leadership.

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Welcome and Opening Remarks



Panelist

■ Speaker

- **Ed Wegener, Senior Vice President and Midwest Regional Director, Sales Practice, FINRA Midwest Region**



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Regulation Best Interest Fireside Chat With FINRA Vice President and Associate General Counsel Jim Wrona and Senior Director of Member Relations and Education John Veator

Thursday, October 3, 2019

9:05 a.m. – 9:35 a.m.

Speakers:

John Veator
Senior Director
FINRA Member Relations and Education

James Wrona
Vice President and Associate General Counsel, Regulatory
FINRA Office of General Counsel

Regulation Best Interest Fireside Chat With FINRA Vice President and Associate General Counsel Jim Wrona and Senior Director of Member Relations and Education John Veator Panelist Bios:

Speakers:

John Veator is Senior Director in FINRA's Office of Member Relations and Education. His duties include advising firms on FINRA initiatives, rules and resources. He also collects feedback from the industry and advocates for changes to FINRA's programs where appropriate. Previously, he was a senior counsel in FINRA's Regulatory Policy Office, where he advised FINRA exam staff on rule interpretations and conducted administrative actions. He was also a senior staff member of FINRA's Registration and Disclosure Department, where he advised on state securities laws and processes. Prior to joining FINRA, Mr. Veator served as the North American Securities Administrators Association's (NASAA) Deputy General Counsel and was NASAA's Acting General Counsel when he left the association to join NASD. Mr. Veator received his bachelor's degree from Colgate University and his JD from Vanderbilt Law School.

James S. Wrona is Vice President and Associate General Counsel for FINRA in Washington, DC. In this role, he is responsible for various policy initiatives, rule changes and litigation regarding the securities industry. Mr. Wrona formerly was associated with the law firm of K&L Gates LLP, where his practice focused on complex federal litigation. He also previously served as a federal law clerk for the Honorable A. Andrew Hauk of the United States District Court for the Central District of California (Los Angeles). Mr. Wrona is a frequent speaker at securities and litigation conferences and author of numerous law review articles, including *The Best of Both Worlds: A Fact-Based Analysis of the Legal Obligations of Investment Advisers and Broker-Dealers and a Framework for Enhanced Investor Protection*, 68 Bus. Law. 1 (Nov. 2012); *The Securities Industry and the Internet: A Suitable Match?*, 2001 Colum. Bus. L. Rev. 601 (2001).

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**Regulation Best Interest Fireside Chat With FINRA Vice
President and Associate General Counsel Jim Wrona
and Senior Director of Member Relations and Education
John Veator**



Speakers

■ Speakers

- **John Veator, Senior Director, FINRA Member Relations and Education**
- **James Wrona, Vice President and Associate General Counsel, Regulatory, FINRA Office of General Counsel**



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Transformation of FINRA's Examination and Risk Monitoring Program

Thursday, October 3, 2019

9:50 a.m. – 10:50 a.m.

Join FINRA staff to hear more about our new exam program transformation.

Moderator: Colleen Diles
Surveillance Director, Sales Practice
FINRA Los Angeles District Office

Speakers: Jeff Aelmore
Surveillance Director, Sales Practice
FINRA Denver District Office

Anna Garabedi
Associate Principal Examiner, Sales Practice
FINRA Los Angeles District Office

Jennifer Luginbill
Associate District Director, Sales Practice
FINRA Kansas City District Office

Transformation of FINRA's Examination and Risk Monitoring Program Panelist Bios:

Moderator:

Colleen Diles is Surveillance Director for the Los Angeles District Office of FINRA. Ms. Diles oversees the District Office risk-monitoring program, which is responsible for identifying and addressing current and emerging risks at member firms and within the industry. She has been instrumental in the evolution of the risk-monitoring program over the years and is involved in the current transformation efforts at FINRA, working on various national initiatives that will shape the risk monitoring and examination programs going forward. Ms. Diles has 23 years of securities industry experience, including 19 years in securities regulation. Prior to her current role as Surveillance Director, Ms. Diles was an Examination Manager in the Los Angeles District Office. Prior to joining FINRA, Ms. Diles was a Mutual Fund Administration Supervisor at Chase Global Fund Service Company in Boston, Massachusetts. Ms. Diles earned a Bachelor of Science with a concentration in Accounting from Merrimack College, and she completed the Excellence in Management Program at Wharton School of Business.

Speakers:

Jeff Aelmore is the surveillance director of the Denver District office of FINRA with more than 10 years of experience in examination roles. He currently manages a team of Regulatory Coordinators and is responsible for risk assessment, financial, operational and sales practice surveillance for approximately 200 broker-dealers. Mr. Aelmore was previously an examiner for FINRA in the Dallas District office from 2005 through 2010 and was an Examination Manager in the Seattle District office from 2010 through 2015. Mr. Aelmore is a Certified Regulatory and Compliance Professional™ (CRCP™) from the FINRA Institute at the Wharton School of Business and is a graduate from Kansas State University with a bachelor's degree in finance and a minor in economics.

Anna Garabedi is Associate Principal Examiner at FINRA. In this past year, she oversaw a team of national staff members across business lines for the transformation that determined the future organizational framework of Member Supervision for the Risk Monitoring and Examination Programs. Ms. Garabedi joined FINRA in 2017. Prior to joining FINRA, Ms. Garabedi spent a significant portion of her career at Barclays, where she served as the primary business liaison between front office and technology; in that role, she defined the strategic roadmap for regulatory projects in fixed-income institutional sales and investment banking divisions. Ms. Garabedi started her career in Wealth Management at Smith Barney Morgan Stanley. She also served in the honors program for the U.S. Securities and Exchange Commission in OCIE (Office of Compliance Inspections and Examinations) and as a Legal Extern for FINRA Enforcement. Ms. Garabedi earned her J.D. degree from Pepperdine School of Law, with a Certificate in Alternative Dispute Resolution from the Straus Institute for Dispute Resolution, and a high-honors Bachelors of Science undergraduate degree in Finance from Rutgers Business School.

Jennifer Anne Luginbill is Associate District Director of FINRA's Kansas City District Office where she oversees the planning and execution of the Kansas City District Office's firm exam program and is responsible for guiding staff in the execution of exams and investigation of regulatory issues. Ms. Luginbill began her career with NASD in 2000 as a Compliance Examiner conducting routine examinations of member firms and completing cause related investigations. Prior to joining NASD/FINRA, Ms. Luginbill obtained banking and securities experience while employed at a couple of broker-dealers in several different capacities including Registered Representative and Compliance Manager. In addition, Ms. Luginbill was employed as a Compliance Examiner for the Kansas Securities Commissioner's Office where she was responsible for reviewing both Broker-Dealers and Investment Advisers for regulatory compliance. She holds a B.S. in Business Administration from Drake University and obtained the Certified Regulatory and Compliance Professional™ (CRCP™) designation from the FINRA Institute at Wharton in 2008.

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Transformation of FINRA's Examination and Risk Monitoring Program



Panelists

■ Moderator

- **Colleen Diles, Surveillance Director, Sales Practice, FINRA Los Angeles District Office**

■ Panelists

- **Jeff Aelmore, Surveillance Director, Sales Practice, FINRA Denver District Office**
- **Anna Garabedi, Associate Principal Examiner, Sales Practice, FINRA Los Angeles District Office**
- **Jennifer Luginbill, Associate District Director, Sales Practice, FINRA Kansas City District Office**

News Release

> [MEDIA CENTER](#)

News Release

October 01, 2018

[Jessica McCormick](#) (212) 858-5145

[Ray Pellecchia](#) (212) 858-4387

FINRA Announces Plan to Consolidate Examination and Risk Monitoring Programs

WASHINGTON – FINRA announced today that it plans to consolidate its Examination and Risk Monitoring Programs, integrating three separate programs into a single, unified program to drive more effective oversight and greater consistency, eliminate duplication and create a single point of accountability for the examination of firms. The effort is a result of FINRA360, the organization's ongoing comprehensive self-evaluation and improvement initiative.

FINRA regulates more than 3,700 firms and 630,000 individual brokers, and regularly examines every firm for compliance with FINRA's rules and those of the SEC and the MSRB. Those examination responsibilities are currently divided among three different programs responsible for business conduct, financial and trading compliance. The consolidation will bring those programs under a single framework designed to better direct and align examination resources to the risk profile and complexity of member firms. Among other benefits, FINRA expects the new structure to increase the efficiency and effectiveness of the program.

Planning for the consolidation is already underway, overseen by Bari Havlik, who joined FINRA in April as Executive Vice President of Member Supervision. She will be supported by a steering committee of senior executives.

Firm Groupings

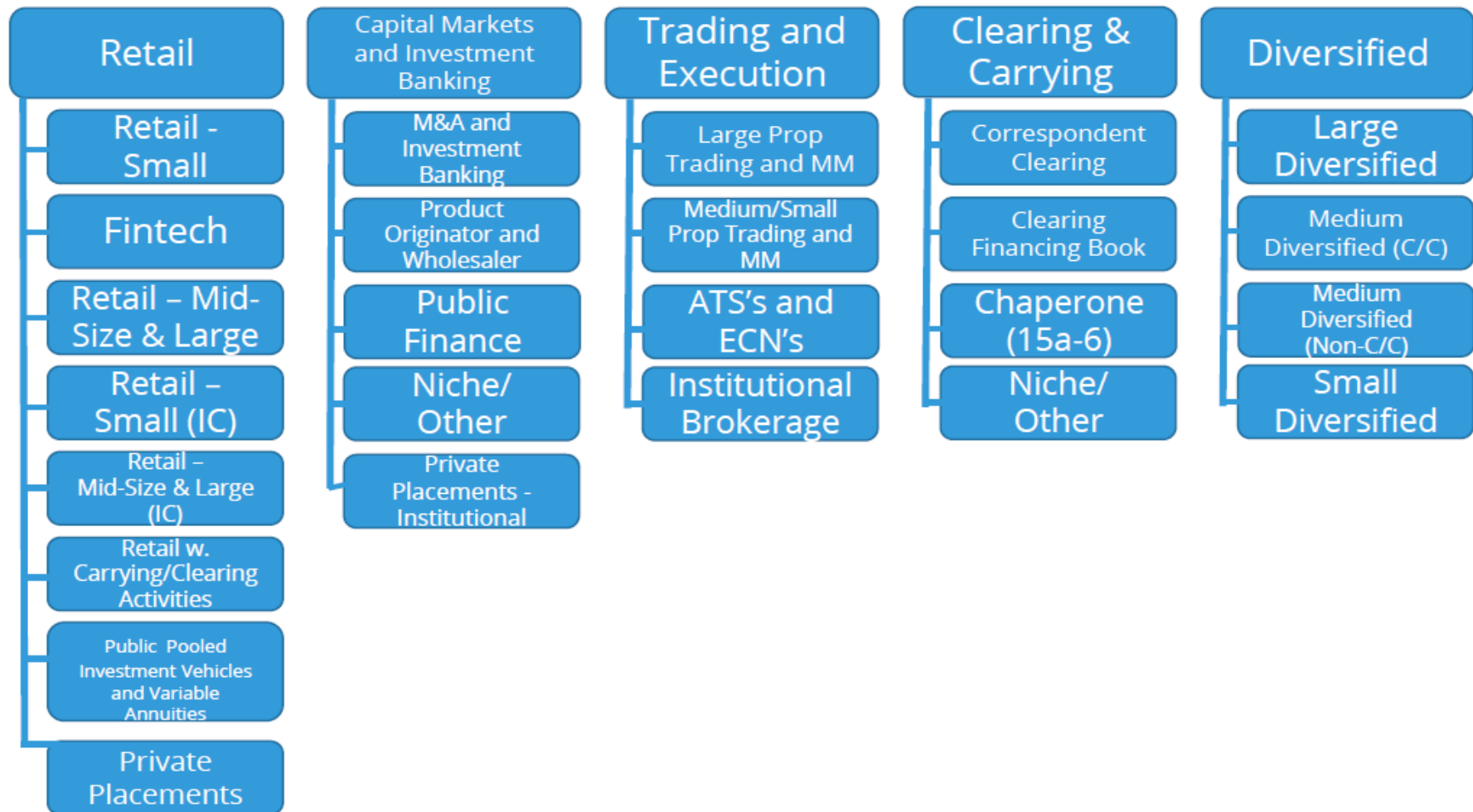
Retail

**Capital
Markets and
Investment
Banking**

**Trading and
Execution**

**Clearing/
Carrying**

Diversified



FINRA Transformation: Organization Structure

- Key points of the new frameworks structure
- Decision-making factors and considerations in selecting the new frameworks structure
- How the new structure will affect member firms

FINRA Transformation

- **Staffing**
- **Process**
- **Preliminary Findings Pilot**



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Identifying and Assessing High-Risk Activity

Thursday, October 3, 2019

11:00 a.m. – 11:50 a.m.

Join FINRA staff and industry panelists as they share helpful insight on identifying and assessing activity of registered representatives as high-risk and how that intelligence can be more broadly used to assess risk across and within branch offices.

Moderator: Shawn O'Neill
Associate District Director, Sales Practice
FINRA Chicago District Office

Speakers: Stephen Berkeley
Chief Compliance Officer and Regulatory Counsel
Loop Capital Markets, LLC

Brett Flansburg
Vice President and Chief Compliance Officer
Ameriprise Financial, Inc.

Bryan Varvel
Regulatory Principal, Sales Practice
FINRA Kansas City District Office

Identifying and Assessing High-Risk Activity Panelist Bios:

Moderator:

Shawn O'Neill joined FINRA in March of 1998 and is currently Associate District Director in the Chicago District Office. In this regard, Mr. O'Neill manages the office's supervisory staff and indirectly manages the examination and administrative staff to ensure the effective execution of the office's regulatory programs. Prior to joining FINRA, Mr. O'Neill served in various capacities in the banking industry including working as a registered investment representative for a bank broker dealer. Mr. O'Neill received his MBA from Loyola University of Chicago and his BA from Saint Xavier University.

Speakers:

Stephen Berkeley serves as Chief Compliance Officer and Regulatory Counsel of Loop Capital Markets LLC and as Chief Compliance Officer of MJE-Loop Capital Partners, LLC. Prior to joining Loop Capital in 2008, Mr. Berkeley spent nine years in private legal practice representing broker-dealers and investment advisors in arbitrations, regulatory investigations and on general compliance matters. Mr. Berkeley started his career as an enforcement attorney with the Securities Division of the Arizona Corporation Commission where he investigated and prosecuted securities enforcement actions against broker-dealers and investment advisors. He is a licensed attorney in Illinois and Arizona and holds series 7, 24, 53, 63, 79 and 87 licenses. Mr. Berkeley earned his Juris Doctorate from Chicago-Kent College of Law and earned a Bachelor's of Arts from Hamilton College.

Brett Flansburg has been in the industry for 20 years and currently holds the role of Chief Compliance Officer of Ameriprise's clearing broker. In addition to having oversight responsibility for all regulatory obligations of the clearing broker, Mr. Flansburg and his team also provide compliance support of all cash, lending and banking products, introducing firm operations activities (e.g. new business, call center, etc.), FinOp activities, technology department functions and due diligence of all recruited brokers. Mr. Flansburg has a finance degree with a focus in financial planning and economics from Minnesota State University, holds FINRA Series 4, 7, 24, 27, 63 and 99 registrations and is a current member of FINRA's Midwest Regional Compliance Committee.

Bryan Varvel is Regulatory Principal with the Kansas City District Office of FINRA where is he a member of the Midwest Region High Risk Examination team. As a member of this team, he is responsible for conducting investigations of member firms, branch offices and registered representatives that are designated as high risk by FINRA. Mr. Varvel began his career with NASD/FINRA in 1990 and during his tenure, he has been a Cycle, Membership and Cause Examiner, a Regulatory Coordinator, and now a member of the High Risk examination team. He has also been designated as a Regulatory Specialist in Mutual Funds and Variable Contracts. Prior to joining NASD/FINRA, he worked at Ameritrade, Inc. in Omaha, Nebraska; here he was registered as a Series 7 General Securities Representative and functioned in several capacities including acting as a Correspondent Services Representative for the firms that cleared through Ameritrade, Inc. He holds a B.S in Economics from the University of Nebraska and obtained the Certified Regulatory and Compliance Professional™ (CRCP™) designation from the FINRA Institute at Wharton in 2005.

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Identifying and Assessing High-Risk Activity



Panelists

■ Moderator

- **Shawn O'Neill, Associate District Director, Sales Practice, FINRA Chicago District Office**

■ Panelists

- **Stephen Berkeley, Chief Compliance Officer and Regulatory Counsel, Loop Capital Markets, LLC**
- **Brett Flansburg, Vice President and Chief Compliance Officer, Ameriprise Financial, Inc.**
- **Bryan Varvel, Regulatory Principal, Sales Practice, FINRA Kansas City District Office**



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Branch Office Inspections: Implementing a Risk-Based Program and Identifying Red Flags

Thursday, October 3, 2019

1:00 p.m. – 1:50 p.m.

Panelists discuss practices observed in implementing effective risk-based branch office inspection programs. The panel also features a discussion around common findings and observations from FINRA branch exams, including examples of strong controls and red flags identified.

Moderator: Jennifer Luginbill
Associate District Director, Sales Practice
FINRA Kansas City District Office

Speakers: Jeffry Freiburger
Managing Director and Chief Compliance Officer
Robert W. Baird & Co.

David Kelley
Surveillance Director, Sales Practice
FINRA Kansas City District Office

Kevin Miller
Executive Vice President and General Counsel
Securities America, Inc.

Branch Office Inspections: Implementing a Risk-Based Program and Identifying Red Flags Panelist Bios:

Moderator:

Jennifer Anne Luginbill is Associate District Director of FINRA's Kansas City District Office where she oversees the planning and execution of the Kansas City District Office's firm exam program and is responsible for guiding staff in the execution of exams and investigation of regulatory issues. Ms. Luginbill began her career with NASD in 2000 as a Compliance Examiner conducting routine examinations of member firms and completing cause related investigations. Prior to joining NASD/FINRA, Ms. Luginbill obtained banking and securities experience while employed at a couple of broker-dealers in several different capacities including Registered Representative and Compliance Manager. In addition, Ms. Luginbill was employed as a Compliance Examiner for the Kansas Securities Commissioner's Office where she was responsible for reviewing both Broker-Dealers and Investment Advisers for regulatory compliance. She holds a B.S. in Business Administration from Drake University and obtained the Certified Regulatory and Compliance Professional™ (CRCP™) designation from the FINRA Institute at Wharton in 2008.

Speakers:

Jeffrey F. Freiburger, Managing Director and Chief Compliance Officer, joined Robert W. Baird & Co. in 1993. He has served as Baird's Chief Compliance Officer since 2002 and has more than 37 years of experience in the field of securities compliance. From 1981-1991 he was employed at Blunt Ellis & Loewi, a Milwaukee based regional broker/dealer, as Assistant Compliance Director, and from 1991-1993 at Kemper Clearing Corporation as Director of Internal Audit. Mr. Freiburger is currently serving as a Member of FINRA's Midwest Region Committee and FINRA's Regulatory Advisory Committee and has served as a Member and Chairman of FINRA's District 8 Committee from 2008-2011. He is a Chair of the Securities Industry Continuing Education Council, and is a former member of FINRA's Series 14 Exam Committee. He is a member of the SIFMA Compliance Committee and Regional Firm Committee. He became an industry arbitrator in 1987 and currently serves as a Hearing Panel Officer for FINRA Dispute Resolution. Mr. Freiburger has been a speaker at many industry regulatory seminars over the last 25 years. Mr. Freiburger is Treasurer and on the Board of Directors for the Better Business Bureau Serving Wisconsin and is the Executive Sponsor for Baird's Veteran's Associate Resource Group. He was past Corporate Chair for the JDRF Walk to Cure Diabetes in Milwaukee, WI. He is a 1981 Graduate of the University of Wisconsin with a degree in Finance. He holds the Series 7, 9, 10, 14, 24, 53, 55, 63 and 66 Securities Industry qualifications.

Dave Kelley is Surveillance Director based out of FINRA's Kansas City District office. He has been with FINRA for nine years and leads the regulatory surveillance team based in Kansas City. Mr. Kelley also leads FINRA's Sales Practice exam program for cybersecurity and the Regulatory Specialist team for Cyber Security, IT Controls and Privacy. Prior to joining FINRA, he worked for more than 19 years at American Century Investments in various positions, including Chief Privacy Officer, Director of IT Audit and Director of Electronic Commerce Controls. He led the development of website controls, including customer application security, ethical hacking programs and application controls. Mr. Kelley is a CPA and Certified Internal Auditor, and previously held the Series 7 and 24 licenses.

Kevin J. Miller, Executive Vice President and General Counsel, joined Securities America in 2000 and brings more than 27 years of legal and compliance experience to the firm. As General Counsel, he manages the firm's litigation and regulatory matters and provides counsel to the management and executive leadership team on issues regarding the firm, its registered representatives and its registered investment advisor representatives. Mr. Miller also has responsibility for the oversight of the firm's Supervision Department where he provides strategic direction to the department and oversees the development, implementation, communication and review of all policies, procedures and technology. During his tenure at Securities America, Mr. Miller has served in many roles including Chief Compliance Officer, Chief Risk Officer, Privacy Officer, AML Officer and Identity Theft Prevention Officer. Prior to joining Securities America, he served as in-house counsel and was a partner in a management consulting firm. Mr. Miller has been a featured speaker and panel member at various industry and regulatory conferences, and is an author and contributor of articles related to arbitration, compliance and regulatory

issues. He currently serves as a member of the Compliance Council, and a member of the Arbitration and DOL Task Forces for The Financial Services Institute, an advocacy organization for independent financial services firms and independent financial advisors. He also serves as a member of the FINRA Membership Committee which represents a cross-section of the securities industry and advises FINRA on wide-ranging matters of interest and concern to firms, as well as, the Arbitration Task Force Committee whose mission is to consider possible enhancements to its arbitration forum by improving the transparency, impartiality and efficiency of the forum for all participants. He received his bachelor's degree in business administration from Iowa State University and a Juris Doctorate from the Creighton University School of Law. He is a member of the Association of Corporate Counsel, Financial Planning Association, National Society of Compliance Professionals, American Bar Association and the Minnesota Bar Association. Mr. Miller holds the series 7, 24 and 66 securities licenses.

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Branch Office Inspections: Implementing a Risk-Based Program and Identifying Red Flags



Panelists


■ Moderator

- **Jennifer Luginbill, Associate District Director, Sales Practice, FINRA Kansas City District Office**

■ Panelists

- **Jeffry Freiburger, Managing Director and Chief Compliance Officer, Robert W. Baird & Co.**
- **David Kelley, Surveillance Director, Sales Practice, FINRA Kansas City District Office**
- **Kevin Miller, Executive Vice President and General Counsel, Securities America, Inc.**

To Access Polling

- Under the “Schedule” icon on the home screen,
- Select the day,
- Choose the **Branch Office Inspections: Implementing a Risk-Based Program and Identifying Red Flags** session,
- Click on the polling icon: 

Polling Question 1

- 1. Does your firm conduct unannounced branch inspections?**
 - a. Yes**
 - b. No**
 - c. Don't know**

Polling Question 2

- 2. Does your firm conduct risk focused branch inspections?**
 - a. Yes**
 - b. No**
 - c. Don't know**

Polling Question 3

- 3. Does your firm have a formalized method for gathering and analyzing branch office inspection findings to identify trends?**
- a. Yes**
 - b. No**
 - c. Don't know**

Things to Consider Prior to Any Branch Inspection

- **Announced vs. Unannounced Inspections**
- **Inspection Frequency**
- **Tailoring of Inspections**
 - **Focusing audits on specific risks**
- **Use of Individual Inspection Findings to Identify Trends**

Polling Question 4

- 4. Does your firm utilize public information to prepare for branch inspections?**
- a. Yes**
 - b. No**
 - c. Don't know**

Polling Question 5

- 5. Does your firm require a written response to each inspection report that contains findings?**
- a. Yes**
 - b. No**
 - c. Don't know**

Life Cycle of Inspection

■ Intelligence Gathering

- Systems utilized
- Availability of information for auditors

■ Onsite

■ Report of Inspection

- Inclusion of findings in written reports
- Timeline for addressing deficiencies

■ Escalation of Red Flags and Findings

- Avoiding “checking the box”
- Ensuring proper follow-up

Examples of Items Included on Pre-Inspection Checklist

- Data from surveillance systems that identifies alert patterns by individual or alert
- Heightened supervision plans
- Correspondence
- Gift and Non-Cash Compensation Logs
- Check Blotter
- Daily Sales Blotter
- Securities Received Blotter
- E-Mail Correspondence File
- Any phonebook listings or phonebook advertisements for any location, with copy of company approval
- Office sharing arrangements

Pre-Inspection Checklist – Example (cont.)

- Social media sites
- Websites
- Access to all client files
- Copy of the previous three months of any Checking Account(s) where commissions or fee are paid and that is used for paying operating expenses
- Outside business activities
- List of Discretionary Accounts
- List of Private Securities Transactions
- Annual Attestation
- Form U4 and Form BR
- Complaints and/or Regulatory inquires

Pre-Inspection Checklist – Example (cont.)

- **Disciplinary action and/or consequence management**
- **Previous years branch audits**
- **Compliance Policies, Procedures and Operations Manual(s)
Fee/Billing Errors and how they were corrected for the previous year**
- **Supervision file (requirement for OSJ branches)**
- **Code of Ethics files including Annual Holdings and employee trading account reviews**
- **List of personal accounts where you are a direct or indirect owner, or have limited power of attorney**
- **Copy of previous regulatory audit (SEC, State), and resolution of any deficiencies**

Cybersecurity Controls at Branch Locations

- **Branch Policies / Procedures**
- **Training of Branch Examiners**
- **What data is stored by the branch and where**
- **Technical Controls – Encryption, Virus Protection, Patching, Network Controls etc.**
- **Access Controls (Passwords, Multifactor Authentication)**
- **Mobile Devices – Endpoint Management**
- **Communication Issues (Email, Skype, Bloomberg, WhatsApp, Text, etc.)**
- **Understanding Vendors used including use of the Cloud**

Branch Inspection and Examination Findings

■ Findings From the Industry Panelists

- Tools and resources that led to the findings
- The action(s) taken as a result of the findings
- Ensuring reasonable follow-up and/or corrective action

■ FINRA Inspection Findings

- Common findings
- How to improve existing processes

Cybersecurity Issues at Branch Locations

- **Phishing Emails**
- **Account Compromise / Takeover**
- **Fraudulent Wires**
- **Open Wireless Networks**
- **Malware**

National Examination Risk Alert – Reg Notice 11-54



National Examination Risk Alert

By the Office of Compliance Inspections and Examinations

in cooperation with the Financial Industry Regulatory Authority¹

Information for Managers and Chief Compliance Officers

Volume I, Issue 2

November 30, 2011

The Dos and Don'ts of Branch Inspections

- Do tailor the focus of the exam to the business at that branch
- Do use a frequency schedule commensurate with the risk at that branch
- Do include a significant number of unannounced visits – derived through both random selection and risk based analysis
- Do establish procedures that avoid conflicts by examiners
- Do ensure the branch examiners are experienced, tenured, and understand the business well enough to challenge anything that doesn't appear consistent with their knowledge
- Don't utilize generic exam procedures for all branches
- Don't perform a “check the box” inspection
- Don't devote minimal time to each exam
- Don't fail to follow firm's procedures by not inspecting branches as required
- Don't overlook an adequate heightened supervision program for individuals with disciplinary histories

Questions?





National Examination Risk Alert

By the Office of Compliance Inspections and Examinations

in cooperation with the Financial Industry Regulatory Authority¹

Information for Managers and Chief Compliance Officers

Volume I, Issue 2

November 30, 2011

In this Alert:

Topic: Broker-dealer branch inspections

Objectives: Encourage firms to create effective policies and procedures for their branch inspections.

Key Takeaways:

A broker-dealer's branch inspection program is a key part of its supervisory system.

Exam staff have found a number of deficiencies in branch inspections conducted by firms.

This Risk Alert presents a joint report by OCIE staff and FINRA staff, highlighting a number of practices that examiners have observed that are found in effective branch office supervisory systems.

Broker-Dealer Branch Inspections

The branch inspection process is a critical component of a comprehensive risk management program and can help protect investors and the interests of the firm. OCIE and FINRA examination staff have observed that firms that execute this process well typically:

- tailor the focus of branch exams to the business conducted in that branch and assess the risks specific to that business;
- schedule the frequency and intensity of exams based on underlying risk, rather than on an arbitrary cycle, but examine branch offices at least annually;
- engage in a significant percentage of unannounced exams, selected through a combination of risk based analysis and random selection;
- deploy sufficiently senior branch office examiners who understand the business and have the gravitas to challenge assumptions; and
- design procedures to avoid conflicts of interest by examiners that may serve to undermine complete and effective inspection.

¹ The Securities and Exchange Commission ("SEC"), as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the staff of the Office of Compliance Inspections and Examinations ("OCIE") in coordination with other SEC staff, including in the Division of Trading and Markets, and do not necessarily reflect the views of the Commission or the other staff members of the SEC. This document was prepared by OCIE staff in consultation with the staff of the Financial Industry Regulatory Authority ("FINRA") and is not legal advice.

Conversely, firms with significant deficiencies in the integrity of their overall branch inspection process, typically:

- utilize generic examination procedures for all branch offices, regardless of business mix and underlying risk;
- try to leverage novice or unseasoned branch office examiners who do not have significant depth of experience or understanding of the business to challenge assumptions;
- perform the inspection in a “check the box” fashion without questioning critically the integrity of underlying control environments and their effect on risk exposure;
- devote minimal time to each exam and little, if any, resources to reviewing the effectiveness of the branch office exam program;
- fail to follow the firm’s own policies and procedures by not inspecting branch offices as required, announcing exams that were supposed to be unannounced, or failing to generate a written inspection report that included the testing and verification of the firm’s policies and procedures, including supervisory policies and procedures;
- fail to have adequate policies and procedures, particularly in firms that use an independent contractor model and that allow registered personnel to also conduct business away from the firm; and
- lack heightened supervision of individuals with disciplinary histories or individuals previously associated with a firm with a disciplinary history.

A well-designed branch inspection program is both: (1) a necessary element (but not the only element) of a firm’s compliance and reasonable supervision of its branch offices and branch office personnel under Section 15(b)(4)(E) of the Securities Exchange Act as well as FINRA rules; and (2) an integral component of the firm’s risk management program. The branch inspection provides the firm with the opportunity to validate its surveillance results from branch offices and to gather on-site intelligence that supplements the ongoing management and surveillance of the branch from a business and risk management standpoint.

Risk-Based Inspections

An effective risk assessment process will help drive the frequency, intensity and focus of branch office inspections; it should also serve as an important consideration in the decision to conduct the exam on an announced or unannounced basis. Therefore, branch offices should be continuously monitored with respect to changes in the overall business, products, people and practices. Branch inspections should be conducted by persons that have sufficient knowledge and experience to evaluate the activities of the branch, and should be overseen by senior personnel such as the CCO or other knowledgeable principal. Further, procedures should be designed to avoid conflicts of interest that may serve to undermine complete and effective inspections because of the economic, commercial or financial interests that an examiner holds in the associated person or branch being inspected.

Branch office inspections provide an opportunity for oversight that should enhance the firm’s routine surveillance and supervisory activities. For instance, branch office inspections may allow a firm to better identify the nature and extent of outside business activities of registered branch office personnel. Outside business activities conducted by registered persons may carry added risk because these activities may be perceived by customers as part of the member’s business.

Confirming that the scope of outside business activities of registered branch office personnel conform to those activities authorized by the firm is an important component of the branch office inspection, and addresses a risk that may be more difficult to monitor. For much the same reasons, unannounced inspections (which do not provide an opportunity to hide, alter or destroy documentation or other information reflecting such activities) are a critical element of any well designed branch office inspection program and should constitute a significant percentage of all exams conducted.

This ongoing risk analysis should be a key element of the firm's exam planning process and lead to more frequent examinations of offices posing higher levels of risk than dictated by the firm's non-risk based cycle, and lead firms to engage in more unannounced exams of such offices. Some areas of high risk to consider are: sales of structured products; sales of complex products, including variable annuities; sales of private or otherwise unregistered offerings of any type; or offices that associate with individuals with a disciplinary history or that previously worked at a firm with a disciplinary history. NASD IM-3010-1 also lists additional factors to consider in making this determination.

Pursuant to NASD Rule 3010(c)(2), each branch office inspection must include a written report that includes, at a minimum, testing and verification of the firm's policies and procedures in specified areas. As discussed further below, it is a good practice for this report to note any deficiencies and areas of improvement, as well as outline agreed-upon actions, including timelines, to correct the identified deficiencies.

Oversight of Branch Office Inspections

A broker-dealer's internal branch inspection program is a necessary part of its supervisory system and a strong indicator of a firm's culture of compliance. To test the quality of broker-dealers' required inspections of branch offices, SEC and FINRA examiners may seek to review and verify items related to an effective branch examination program, particularly matters such as supervisory procedures regarding customer accounts and sales of retail products. For example, examiners may review the following:

- policies and procedures, including supervisory procedures as they pertain to the supervision of customer accounts, including those serviced by income producing managers;
- policies and procedures relating to the handling of money and securities physically received at the branch;
- validation of changes in customer addresses and other account information in accounts serviced by the branch;
- procedures related to transmittals of funds between customers and third parties, and between customers and registered representatives ("RRs");
- firm testing of policies and procedures related to specific retail products, including:
 - sales of structured products;
 - private and other unregistered offerings;
 - municipal securities;
 - mutual funds; and
 - variable annuity sales and exchanges;

- firm testing in retail sales practice areas, including:
 - verification of customer account information;
 - supervision of customer accounts;
 - written supervisory procedures (“WSPs”);
 - new account review, suitability of investments;
 - unauthorized trading;
 - churning;
 - allocations of new issues;
 - licensing; and
 - training;
- advertising and other communications with the public or with customers (such as email and other written correspondence) and compliance with approval procedures;
- evidence of unreported outside or other unauthorized business activities by review of: customer files, written materials on the premises and at any satellite locations, branch office accounting records, appointment books and calendars, phone records, bank records;
- procedures for handling of customer complaints;
- risk-based reviews of bank accounts of the branch and affiliated entities, third-party wire transfers, and branch signature guarantee log; and
- procedures to uncover use of unauthorized computers or other electronic devices and/or social media.

Requirements and Guidance Pertaining to Broker-Dealer Branch Inspections

The responsibility of broker-dealers to supervise their associated persons is a critical component of the federal regulatory scheme. Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act authorize the Commission to impose sanctions on a firm or any person that fails to reasonably supervise someone that is subject to the supervision of such firm or person who violates the federal securities laws. In order to defend such a charge, a broker-dealer could show that it has established procedures that would reasonably be expected to prevent and detect a violation by such other person, and has a system for applying such procedures that has been effectively implemented. Such a system must be designed in such a way that it could reasonably be expected to prevent and detect, insofar as practicable, securities law violations.

The staff of the SEC’s Division of Trading and Markets (formerly known as the Division of Market Regulation) has noted that an effective branch office inspection program is a vital component of a supervisory system reasonably designed to oversee activities at remote branch offices.² A number of Commission decisions in the area, both settled and litigated, set forth principles that can guide firms in constructing an effective branch office inspection program.³

² Staff Legal Bulletin No. 17, Remote Office Supervision (March 19, 2004) (“SLB 17”).

³ See, e.g., *Consolidated Investment Services, Inc.*, Rel. No. 34-36687 (Jan. 5, 1996) (where the Commission notes that: “We also agree with the law judge that surprise inspections of [the branch office] would have been a prudent course of action”); *Signal Securities, Inc.*, Rel. No. 34-43350 (Sep. 26, 2000) (citing *Consolidated Investment Services*); and *Quest Capital Strategies*, Rel. No. 34-44935 (Oct. 15, 2001) (where the Commission stated that : “A surprise inspection is a compliance tool that is necessarily available to every securities firm in carrying out its supervisory responsibilities.”); *Royal Alliance Associates, Inc.*, Rel. No. 34-38174 (Jan. 15, 1997) (settled matter); see also SLB 17.

Those cases suggest that regular branch office inspections over reasonably short intervals, including unannounced inspections, are the cornerstone of a well designed branch office inspection program.⁴ The Commission has sanctioned firms that have not conducted unannounced examinations of their branch offices.⁵ Where a firm only conducts pre-announced examinations, that could create opportunities for branch office personnel to alter or destroy, documents, or commit other securities law violations, resulting in major fines for the firm.⁶ As a result, OCIE and FINRA staff believe that a well-constructed branch office inspection program should include unannounced inspections, based on a combination of random selection, risk-based selection and for cause exams.

Beyond the timing and nature of the inspections, OCIE and FINRA staff also believe that past guidance suggests that a well-constructed branch office supervisory program should include: procedures for heightened supervision of remote branch offices that have associated persons with disciplinary histories; independent verification of the nature and extent of outside business activities; senior management's involvement in assuring that adequate procedures are in place and that sufficient resources are devoted to implementing those procedures; periodic reassessment of supervisory responsibilities; adequate delineation of supervisory responsibilities; periodic reassessment of supervisory responsibilities; thorough investigation and documentation of customer complaints; and a system of follow up and review of those and other red flags.⁷

FINRA rules and rule interpretations provide additional requirements and guidance in the area. NASD Rule 3010(b) requires every member broker-dealer to establish, maintain and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of RRs, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable FINRA rules.

[Notice to Members 99-45](#) instructs broker-dealers to adopt and implement a supervisory system that is "tailored specifically to the member's business and must address the activities of all its registered representatives and associated persons."⁸ Procedures that merely recite the applicable rules or fail to describe the steps the firm will take to determine compliance with applicable securities laws and regulations are not reasonable.⁹ A broker-dealer's procedures should instruct the supervisor on the requirements needed to be in compliance with the regulations.¹⁰ The

⁴ See, e.g., *Consolidated Investment Services, Inc.*, Rel. No. 34-36687 (Jan. 5, 1996); *Signal Securities, Inc.*, Rel. No. 34-43350 (Sep. 26, 2000); *Quest Capital Strategies*, Rel. No. 34-44935 (Oct. 15, 2001).

⁵ See, e.g., *Quest Capital Strategies, Inc.*, Rel. No. 34-44935 (Oct. 15, 2001) and *NYLIFE Securities Inc.*, Rel. No. 34-40459 (September 23, 1998) (settled matter).

⁶ See, e.g., *Fidelity Brokerage Services, LLC*, Rel. No. 34-50138 (Aug. 3, 2004) (pre-announced inspections resulted in, among other things, employees altering and destroying documents; sanctions included a \$1,000,000 fine payable to the SEC, plus a \$1,000,000 fine payable to the NYSE) (settled matter).

⁷ See, e.g., *Prospera Financial Services*, Admin. Pro. File No. 3-10306, Rel. No. 34-43352 (September 26, 2000) (settled matter) for a discussion of the above elements of a branch office supervisory program; see also SLB 17 for further discussion of these and other elements of an effective branch office supervisory system. See also NASD IM-3010-1 (Standards for Reasonable Review).

⁸ *NASD Notice to Members 99-45* (June 1999) at 294.

⁹ *Id.* at 295. See also *NASD Notice to Members 98-96* (Dec. 1998).

¹⁰ *NASD Notice to Members 99-45* (June 1999) at 293-94 (giving examples of situations in which "written supervisory procedures would instruct the supervisor" in how to document compliance).

procedures should describe the activities the supervisor will conduct along with the frequency as to when the reviews will be conducted.¹¹

NASD Rule 3010(c)(1) requires each member to conduct a review, at least annually, of the businesses in which it engages. A broker-dealer must conduct on-site inspections of each of its office locations; Office of Supervisory Jurisdictions (“OSJs”)¹² and non-OSJ branches that supervise non-branch locations at least annually, all non-supervising branch offices at least every three years; and non-branch offices periodically. For these other branch offices, firms should consider whether a cycle of less than three years would be more appropriate, using factors such as the nature and complexity of the branch’s securities business, the volume of business done, and the number of associated persons assigned to each branch.¹³ Pursuant to NASD Rule 3010(c)(1), broker-dealers must document the examination schedules for each non-supervisory branch and non-branch office in their WSPs, including a description of the factors used to determine the examination cycle for such locations. The rule also requires broker-dealers to record the dates each inspection was conducted.¹⁴

Pursuant to NASD Rule 3010(c)(2) the reports reflecting these reviews and inspections must be kept on file by the broker-dealer for a minimum of three years. NASD Rule 3010(c)(3) generally prohibits a branch office manager or any other person within the office with supervisory duties (or any person supervised by such person) from conducting an inspection of the office.¹⁵

¹¹ *Id.*

¹² An OSJ is defined under NASD Rule 3010(g) as any office of a member at which any one or more of the following functions take place: (a) order execution and/or market making; (b) structuring of public offerings or private placements; (c) maintaining custody of customers' funds and/or securities; (d) final acceptance (approval) of new accounts; (e) review and endorsement of customer orders; (f) final approval of advertising or sales literature, except for an office that solely conducts final approval of research reports; or, (g) responsibility for supervising the activities of associated persons at one or more other branch offices.
¹³ NASD Rule 3010(c)(1)(B).

¹⁴ NASD Rule 3010(c), which governs “Internal Inspections,” requires that each broker-dealer review the activities of each of its offices including the periodic examination of customer accounts to detect and prevent irregularities or abuses. The rule also requires that the written inspection report include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:

- Safeguarding of customer funds and securities;
- Maintaining books and records;
- Supervision of customer accounts serviced by branch office managers;
- Transmittal of funds between customers and RRs and between customers and third parties;
- Validation of customer address changes; and
- Validation of changes in customer account information.

¹⁵ However, the rule provides an exception from this requirement for a firm so limited in size and resources that it cannot otherwise comply. Under NASD Rule 3010(c)(3) the basis for this exception must be documented in the report for each inspection conducted in reliance on the exception.

Review of Effective Practices

As noted throughout this Risk Alert, SEC and FINRA examiners have identified some practices that are characteristic of many effective supervisory procedures and effective branch office supervisory systems.¹⁶ Such practices are consolidated here:

- Using risk analysis to identify whether individual non-supervising branches should be inspected more frequently than the FINRA-required minimum three-year cycle. Branches that meet certain risk criteria based on risk ratings are inspected more often. In addition, some firms conduct “re-audits” more frequently than required when routine inspections reveal a higher than normal number of deficiencies, repeat deficiencies or serious deficiencies. Typically, these re-audits and audits for cause are unannounced inspections.
- Using surveillance reports, employing current technology and techniques as appropriate, to help identify risk and develop a customized approach for the firm’s compliance program and branch office inspections that considers the type of business conducted at each branch.
- Employing comprehensive checklists that incorporate previous inspection findings and trends from internal reports such as audit reports.
- Conducting unannounced branch inspections. Firms elected to conduct unannounced examinations either randomly or based on certain risk factors. These “surprise” exams may yield a more realistic picture of a broker-dealer’s supervisory system, as it reduces the risk that individual RRs and principals might attempt to falsify, conceal or destroy records in anticipation for an internal inspection.
- Including in the written report of each branch inspection any noted deficiencies and areas of improvement. The report should also outline agreed upon actions, including timelines, to correct the identified deficiencies.
- Using examiners with sufficient experience to understand the business being conducted at the particular branch being examined and the gravitas to challenge assumptions.
- Designing procedures to avoid conflicts of interest by examiners that may serve to undermine complete and effective inspection.
- Involving qualified senior personnel in several branch office examinations per year.
- Incorporating findings on results of branch office inspections into appropriate management information or risk management systems; and using a compliance database that enables compliance personnel in various offices to have centralized access to comprehensive information about all of the firm’s RRs and their business activities. Such a system appears to be highly useful to the compliance personnel at the OSJ and elsewhere for quickly accessing information and for supervising independent contractor RRs dispersed across a broad geographic area.
- Providing branch office managers with the firm’s internal inspection findings and requiring them to take and document corrective action.

¹⁶ Firms are encouraged to consider the practices described herein in assessing their own procedures and implementing improvements that will best protect their clients. Firms are cautioned that these factors and suggestions are not exhaustive, and they constitute neither a safe harbor nor a “checklist” for SEC staff examiners. Other practices besides those highlighted here may be appropriate as alternatives or supplements to these practices. While some of the effective practices above are existing regulatory requirements, the adequacy of a supervisory program can be determined only with reference to the profile of the specific firm and the specific facts and circumstances.

- Tracking corrective action taken by each branch office manager in response to branch audit findings.
- Elevating the frequency and/or scope of branch inspections where registered personnel are allowed to conduct business activities other than as associated persons of a broker-dealer, for example away from the firm.

Conclusion

This alert reminds broker-dealers that their branch office inspections must be conducted with vigilance. It describes certain supervisory tools that, based on OCIE and FINRA staff examinations and Commission enforcement cases, are characteristic of good supervisory procedures for branch office inspections, including the use of unannounced onsite inspections. While this alert summarizes recognized precedent and standards, and provides OCIE and FINRA staff views with regard to means to enhance branch inspections, it does not provide an exhaustive list of steps to effectively discharge responsibilities. A well-designed branch office inspection program is a necessary element – but not the only element – of reasonable supervision of a firm’s branch offices and branch office personnel.

We recognize that each firm is different and that firms need flexibility to adopt procedures to suit their individual structures and business needs. Our suggestions as to compliance methods are not meant to be exclusive or exhaustive and do not constitute a safe harbor. Rather, this report may assist firms in crafting more effective policies and procedures for branch office inspections to prevent and detect misconduct. We urge firms to review their policies and procedures in this regard to determine if they are reasonably designed to prevent and detect violations of applicable law and rules.



2019 FINRA Midwest Region Member Forum

October 3, 2019 | St. Louis, Missouri

Ask FINRA Senior Staff **Thursday, October 3, 2019** **1:00 p.m. – 1:50 p.m.**

FINRA senior leaders discuss the regulatory environment and a range of topics affecting broker-dealers.

Moderator: Thomas Nelli
Senior Vice President and South Regional Director, Sales Practice
FINRA South Region

Speakers: Scott DeArmey
District Director, Sales Practice
FINRA Kansas City District Office

Laura Trotz
District Director, Sales Practices
FINRA Chicago District Office

Ed Wegener
Senior Vice President and Midwest Regional Director, Sales Practice
FINRA Midwest Region

Ask FINRA Senior Staff Panelist Bios:

Moderator:

Thomas Nelli is Senior Vice President and Regional Director overseeing FINRA's South Region, which includes offices in Atlanta, Boca Raton, Dallas and New Orleans. Prior to joining FINRA, Mr. Nelli was a Managing Director Deputy Chief Compliance officer in Morgan Stanley Wealth Management Compliance. In this role, Mr. Nelli headed the Investment Products and Services, Advisory, Research Equity, Futures and Options and Fixed Income Compliance Groups.

Speakers:

R. Scott DeArmey is District Director of the Kansas City District Office of FINRA where he is responsible for regulatory oversight of FINRA member firms, branch offices, registered representatives and associated persons located in seven states throughout the Midwest: Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota. Mr. DeArmey began his FINRA career 29 years ago as an examiner in the Atlanta District Office and has participated in a variety of examinations and investigations involving brokerage firms and registered representatives. He has been in management positions for 22 years and has also been involved in various regulatory and educational initiatives including developing and teaching supervision courses at the FINRA Institute. He received his Finance degree from Georgia State University and is a graduate of FINRA's Leadership Program at Wharton.

Laura Trotz is District Director of the Chicago District Office of FINRA. In her role as District Director, Ms. Trotz is responsible for overseeing District's Risk Monitoring and Examination programs. She has been with the Chicago District Office for 20 years; previously, as an Associate District Director responsible for the execution of the District's cycle and cause examination programs, Examination Manager responsible for managing a team of examiners for the cycle, cause and membership programs and as an examiner conducting cycle and cause examinations of member firms. Throughout her tenure, Ms. Trotz has been involved in several significant fraud and sales practice examinations and investigations. Ms. Trotz is a graduate of Illinois Benedictine College and has the Certified Regulatory and Compliance Professional™ designation from the FINRA Institute at the Wharton School of the University of Pennsylvania. She has completed the FINRA Leadership Program at the Wharton School and the Leadership Development Program at the Center for Creative Leadership.

Ed Wegener is Senior Vice President and Midwest Regional Director for FINRA. In that role, he is responsible for leading the department of Member Regulation's regulatory efforts for the region including its surveillance and examination programs. Mr. Wegener started with FINRA (fka NASD) in 1998. Since that time, he has lead or been involved in several significant fraud, sales practice and financial and operational examinations and investigations. He has served in a leadership role in a number of key strategic initiatives for the organization including the design and implementation of FINRA's risk-based, offsite, cybersecurity and digital asset examination programs. FINRA is responsible for regulating brokerage firms and licensed brokers doing business in the United States. The Midwest Region covers firms and individuals conducting securities business in the states of Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin. FINRA's Midwest Region is made up of approximately 130 surveillance and examination staff. Mr. Wegener is a graduate of Illinois State University and he has a Certified Regulatory and Compliance Professional™ designation from the FINRA Institute at the Wharton School of the University of Pennsylvania. He is also a Certified Anti-Money Laundering Specialist and Certified Fraud Examiner. Mr. Wegener has completed the FINRA Leadership Program at the Wharton School and the Leadership Development Program at the Center for Creative Leadership.

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Panelists

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