

Thoughtful Analysis - Key to Successful Compliance

A Primer for New Compliance Officers

By Paul B. Uhlenhop and Michael Wise

INTRODUCTION

A key to successful compliance is thoughtful analysis. Broker-dealer supervisory procedures and compliance systems have been significantly strengthened during the last five years, and now include enhanced training, documentation, testing and exception reporting. Notwithstanding these tools, the key to a successful compliance program is thoughtful analysis by supervisory personnel.

I. Compliance Basics

A good compliance system includes:

1. training for line personnel;
2. training of supervisors;
3. supervisory procedures and manual;
4. documentation of supervision;
5. preparation and review of exception reports and compliance programs;
6. testing of supervisory system and compliance procedures.

But with even the best compliance system, violations may escape detection, without thoughtful analysis and follow-up.

II. Thoughtful Analysis

A number of measures can stimulate and implement thoughtful analysis. Each supervisor should be trained to follow-up when he feels that something is out of place, or seems unusual or noteworthy. This type of follow-up is not always intuitive, and should be stressed in training through examples, such as those described below.

The easy route for a supervisor is to ignore unusual or anomalous events, because they may not on first blush appear specific or urgent. Thoughtful

analysis includes looking at the big picture, examining the little pictures, and following up when something seems inappropriate or unusual.

Thoughtful analysis entails "running it out." What does it mean to run it out? First, it means don't put it off until a later, more convenient time. Second, it means ascertaining the underlying facts until you are satisfied that you have a comfortable degree of certainty.

Examples of underlying facts include oral and written statements from registered representatives, communications from customers, and related documentation. However, thoughtful analysis goes beyond relying exclusively on such items. Letters or e-mails from customers in many cases may not be reliable. The key is developing your own analysis of this situation.

Developing an analysis may entail contacting individual customers. Registered representatives often resist supervisory contacts with customers out of fear that customer relationships may be threatened. In fact, such resistance might instead indicate that the compliance officer definitely should contact the customer directly. We have seen cases where a registered representative, perhaps with good intentions, talked to a customer first and "primed" the customer's recollection. Letters from customers affirming suitability or ratifying specific trades may in fact have been suggested by the account executive.

Group interviews of personnel generally should be avoided. Interviews normally should be conducted in person in order to gauge the reaction and credibility of the interviewee. Compliance personnel should consider discussing proposed interviews with a supervisor, and if

warranted, senior management, before conducting them. If a supervisor raises a regulatory concern with a compliance officer, senior management might be brought into the analysis process. If a compliance officer does not comfortably believe that he can perform a comprehensive review, senior management should be consulted, to consider requesting outside counsel or auditors to conduct the review.

III. Analysis Tools

Preparation of a chronology is important to a thoughtful analysis. The chronology should list assembled facts and relevant documents. In today's computer-based environment, a chronology often is essential in sorting out the electronic record, particularly e-mail strings. In studying chronologies, one will often find temporal gaps or anomalous events. Chronologies are particularly helpful in isolating areas of inquiry, since a detailed chronology will show deficiencies, missing information and possibly point to problems.

A chronology may also resolve certain issues, or suggest the presence of reasonable compliance measures. A chronology can pinpoint positive actions that have been taken and known facts at a given point in time.

A chronology should be developed as soon as it is practical to do so. In fast moving situations, it may be necessary to proceed without a chronology. If a firm takes action without a chronology, the firm should consider preparing a confidential memorandum setting forth the action taken, and the basis for it, including facts known at that time. Afterwards, a more detailed chronology might be developed as a follow-up measure.

IV. Role of Counsel

Consider contacting in-house or outside counsel at an early juncture. By involving counsel, the created analysis

© Lawrence, Kamin, Saunders & Uhlenhop, L.L.C. 2007.

Paul B. Uhlenhop and Michael Wise are members of Lawrence, Kamin, Saunders & Uhlenhop, L.L.C. in Chicago, Illinois. Their e-mail addresses are puhlenhop@lksu.com and mwise@lksu.com.

tools (chronologies, memoranda, interviews) may be protected by the confidentiality of the attorney-client privilege.

A drawback in constructing a chronology is that it might provide an enforcement road map to regulators. A chronology prepared with assistance of counsel may help keep the chronology privileged. In any event, preparation of a chronology may be helpful in preparing arguments to convince regulators that the firm did a thorough and complete job in evaluating a compliance scenario.

V. Analysis and Follow-up

Thoughtful analysis also includes consideration of follow-up activity. If warranted, follow-up may be done by internal auditors or inside or outside counsel.

A supervisor should consider convening a group meeting to review findings and the events evidenced by the chronology. At that point, additional thoughtful analysis should be undertaken to determine what has occurred and what, if anything, needs to be done.

Again, training, experience, and in many cases good intuition, are essential to thoughtful analysis. It is the authors' experience that some compliance officers and supervisors have particularly good intuition when they see something that is out of place, and follow up diligently. However, there often is a natural reluctance to actively follow up, due to work schedules and the need to move ahead on other pressing matters. That is almost always the wrong thing to do, and its dangers should be emphasized in training.

VI. Steps After Analysis

Thoughtful analysis includes implementing procedures and creative measures in response to red flags or unusual events. In the case of a violation regulators, as a matter of course, often look to see if there was a failure to supervise. Regulators often may charge a supervisory principal. The regulators may consider the measures undertaken in the analysis process as a reasonable response.

If a violation is detected,

appropriate remedies must be implemented. The first question is, has the violation ceased? If not, steps must be immediately taken to prevent further violations. The second question is what, if any, client or customer damage has been done and how and in what manner will recompense be made to customers? Third, should the regulators be notified? If so, how and when? In some cases when a violation has been detected, it is appropriate to conduct further investigation using outside counsel. Last but not least, what sanctions, if any, should be imposed upon the violator? These issues demand thoughtful analysis, often with advice of counsel, in reaching the proper decision.

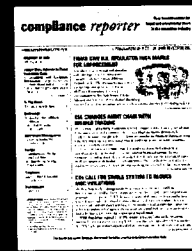
Consider documenting the analysis process, the factual basis, and the conclusion reached, through a memorandum, preferably prepared to/or with the assistance of, counsel. The process of pulling materials and supporting documents together in a memorandum engenders thoughtful analysis, and ultimately assists in reaching an appropriate conclusion.

CONCLUSION

Thoughtful analysis should be a part of training programs for employees, supervisors and compliance officers. Supervisory procedures should include provisions encouraging thoughtful analysis to investigate and resolve compliance issues raised by an employee, a supervisor or a compliance professional.

compliance reporter

The Most Trusted Daily Source for
Financial Compliance News in the
Securities Industry



For a free trial or more information go to
www.compliancereporter.com
or call 714.224.3000

Bingham McCutchen LLP Securities Area

- Compliance (BD/IA/IC)
- Consulting
- Hedge Funds
- Internal Investigations
- Investment Management
- Market Regulation
- Private Client
Defense/Arbitration
- Securities Enforcement
- Securities Litigation

www.bingham.com

BINGHAM McCUTCHEN

Legal insight. Business instinct.