

Developing Broker-Dealer Written Supervisory Procedures

Key Considerations for Aligning Supervisory Procedures with FINRA Requirements

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By Scott P. Tarra
Managing Principal
starra@financialreg.com

Summary

It can be argued that there is no single compliance document more instrumental to a firm's overall compliance program than written supervisory procedures. Whether you are an existing FINRA member broker/dealer, or applying for a new broker/dealer registration, one of the most important components to an effective compliance program is the establishment of a supervisory system and written supervisory procedures. In accordance with FINRA requirements, regardless of a firm's size, scope or operational function, each firm must adopt and implement a supervisory system that is tailored specifically to its business and must address relevant activities of all its registered representatives and associated persons.¹ Once a firm has designed its supervisory system, it is important to document this system in writing and implement and enforce these written procedures for an effective compliance program.

Establishing, maintaining and enforcing written supervisory procedures is considered an integral part of self-regulation within the securities industry. Preparing written supervisory procedures that are reasonably designed to achieve compliance with applicable rules can potentially increase a firm's ability to promptly detect and deter violations while mitigating risk and exposure to disciplinary action. The information provided herein will serve as a useful guide for preparing FINRA broker/dealer written supervisory procedures and analyzing the

key considerations for aligning supervisory procedures with FINRA requirements.

Regulatory Framework

One of the first steps in recognizing the importance of effective written supervisory procedures is to understand the regulatory framework behind the requirement. The regulatory framework surrounding the requirements for establishing and maintaining FINRA broker/dealer written supervisory procedures is centered around NASD Rule 3010(a) & (b) and supporting Notices-to-Members such as NTM 88-84 (November 1988); NTM 98-96 (December 1998); and NTM 09-45 (June 1999).

NASD Rule 3010(a) states that, "[e]ach member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Final responsibility for proper supervision shall rest with the member." More specifically, NASD Rule 3010(a)(1) states that a firm's supervisory system shall include "...the establishment and maintenance of written procedures..."

NASD Rule 3010(b)(1) states that, "[e]ach member shall establish, maintain, and enforce written procedures to supervise the

¹ NASD Rule 3010(a) & (b); NASD Notice to Members 09-45 (June 1999).

types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD.”

NASD Notice to Members 88-84 (November 1988) states that certain amendments to supervisory rules require each firm to establish and maintain supervisory procedures and practices that provide for, at a minimum, the following:

- Establishment and maintenance of written supervisory and review procedures as specified in the proposed amendments;
- Designation of appropriately registered principals for each type of business in which the firm engages to carry out the firm's supervisory obligations;
- Designation as an OSJ for each location that meets the OSJ definition and any other locations for which such designation is appropriate to enable the firm to supervise properly, viewed in light of certain factors enumerated in the proposed amendments;
- Designation of one or more appropriately registered principal(s) in each OSJ, including the main office, and one or more appropriately registered representative(s) or principal(s) in each branch office to carry out the supervisory responsibilities and activities assigned to that office by the member;
- Assignment of each registered person to a supervisor;
- Reasonable efforts to ensure that all supervisory personnel are properly qualified;
- Participation of each registered representative, individually or collectively and not less than annually, at an interview or meeting

at which compliance matters relevant to the activities of such representative(s) are discussed;

- Designation and identification to the NASD of one or more principals who shall review the firm's supervisory practices and procedures and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations and with the rules of the NASD; and
- Establishment of a schedule for examining the firm's branch offices that takes into account the nature of the activity, volume of business, and number of persons at each office.

NASD Notice to Members 99-45 (June 1999) emphasizes that when establishing a supervisory system, written supervisory procedures should be tailored to a firm's business. In doing so, a firm should conduct an internal analysis to include the following:

- Product lines and customer base (e.g. institutional vs. retail);
- Number and geographic location of offices and personnel;
- Existing reporting systems, operating units, and organizational structures;
- Experience of personnel, including whether the firm employs persons who should be subject to heightened supervisory procedures due to a history of customer complaints, disciplinary actions, or arbitration proceedings; and
- Applicable regulatory requirements, including specific activities required (e.g. principal, approval of transactions) and specific records required to be created and maintained (e.g. new account documentation) in each product or operational area.

NASD Notice to Members 98-96 (December 1996) states that "...appropriately designed and implemented supervisory systems and written supervisory procedures serve as a 'frontline' defense to protect investors from fraudulent trading practices and help to ensure that members are complying with rules designed to promote transparency and integrity of the market." Further, this Notice states that written supervisory procedures should describe the following:

- Specific identification of the individuals responsible for supervision;
- The supervisory steps to be taken by the appropriate supervisor;
- The frequency of such reviews; and
- How such reviews shall be documented.

Written Supervisory Procedures vs. Written Guidelines

In addition to the regulatory framework, another important consideration is the difference between written supervisory procedures and written guidelines on compliance. Although written guidelines on compliance generally provide for a description of applicable rules and prohibited practices,² and may compliment a firm's existing supervisory procedures, they are typically not considered sufficient to adequately address a firm's supervisory system. When preparing supervisory procedures, firms must go beyond a reiteration of regulatory requirements to include a clear description of the firm's execution of supervisory responsibilities in an effort to reasonably deter and detect general misconduct and any violations of applicable securities rule and regulations.

Written Supervisory Procedures vs. Written Supervisory Control System

When establishing a supervisory system, it's important to note that a firm's written supervisory procedures are not to be confused with its written supervisory control systems, which serve separate, although complementary, functions. FINRA

confirms this position on its WSP Checklist by disclosing to its member firms *that the requirements of Rule 3012 (Supervisory Control System) and Rule 3013 (Annual Certification of Compliance and Supervisory Processes) are separate and distinct from the requirement pursuant to Rule 3010(b) (Written Procedures).*³ FINRA member firms seeking guidance on compliance with Rule 3012 and Rule 3013 may review the Supervisory Control Web page⁴ which contains rule filings, *Notices to Members*, and other publications relating to Rule 3012 and Rule 3013.

On September 30, 2004, the SEC approved NASD's Supervisory Control Amendments in their final form. These amendments became effective on January 31, 2005. A fundamental element of the Supervisory Control Amendments is new Rule 3012 (Supervisory Control System). Whereas Rule 3010 requires the establishment of a supervisory system and the adoption of policies and procedures, Rule 3012(a)(1) requires the designation of one or more principals who will establish, maintain, and enforce a system of supervisory control policies and procedures that test and verify that a firm's supervisory procedures are reasonably designed to comply with applicable securities laws and regulations and applicable NASD rules. The procedures must be amended when testing and verification demonstrate a need to do so.

Additionally, new Rule 3013 requires each firm's chief executive officer (CEO) to certify annually that senior executive management has in place processes to: (i) establish, maintain, and review policies and procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules, and federal securities laws and regulations; (ii) modify such policies and procedures as business, regulatory, and legislative changes and events dictate; and (iii) test the effectiveness of such policies and procedures on an ongoing basis.

Importance of the Membership Agreement

With an understanding of the regulatory framework for written supervisory procedures, a firm may begin to prepare procedures from a familiar reference point. A review of a firm's exiting FINRA Membership Agreement serves as a good starting point for preparing written supervisory procedures. A firm's Membership Agreement acts as a

² In re Bryant, Securities Exchange Act Release No. 32357, 54 SEC Docket 345.

³http://www.finra.org/web/groups/corp_comm/documents/home_page/p009839.pdf

⁴ <http://www.finra.org/supervisorycontrol>

contractual agreement between FINRA and the member broker/dealer which will generally disclose, among other things, the various types of approved products in which the firm may engage, its net capital requirement, specific customer protection rule under which the firm may operate, permitted number of personnel and branch offices, in addition to certain restrictions, waivers, and required notifications.

Approved Products. The firm's Membership Agreement will disclose each business line or approved product in which the firm may engage. Each business line or approved product is also disclosed on a firm's Form BD. Procedures should be created with a focus on each business line or approved product whether or not a firm is currently engaging in such products. Although the firm may not currently engage in a particular business line or product for which it is approved, a firm may begin to engage in a business line or product without prior notification to FINRA, and therefore should sufficiently address such areas of approved products.

Customer Protection Rule. SEC Rule 15c3-3 addresses a firm's reserve requirements for holding or otherwise maintaining custody of customer securities. If applicable, some firms may operate under a select exemption under SEC Rule 15c3-3(k)(1) through SEC Rule 15c3-3(k)(3). A firm's Membership Agreement will disclose the appropriate exemption in which the firm will operate. Procedures should be created with a focus on the appropriate exemption, if any, under which the firm is operating, or how it addresses custody of customer securities.

Net Capital Rule. SEC Rule 15c3-1 addresses a firm's requirement for maintaining sufficient net capital based on its handling of customer accounts. In accordance with SEC Rule 15c3-1, firms shall at all times have and maintain net capital no less than the greater of the highest minimum requirement applicable to its ratio requirement under paragraph Rule 15c3-1(a)(1), or to any of its activities under paragraph Rule 15c3-1(a)(2). A firm's Membership Agreement will disclose the appropriate net capital requirement to be maintained. Procedures should be created

with a focus on the ongoing maintenance of its net capital requirement and any contingent financial reporting if such requirement is not maintained.

Number of Personnel and Branch Offices.

A firm's Membership Agreement will also disclose the permitted number of associated persons and registered branch offices with which the firm may operate without triggering an addition filing or notification to FINRA. The importance of both parameters is critical for the establishment of written supervisory procedures because a firm must be able to demonstrate that it operates within the limitations set forth in its FINRA Membership Agreement, but that it also maintains sufficient procedures to oversee a firm's expansion efforts to avoid any filings requirements which may be required beyond current safe harbor provisions.⁵

FINRA WSP Checklist

The FINRA WSP Checklist⁶ is a standard outline published by FINRA which includes the minimum requirements needed when establishing a set of written supervisory procedures. The minimum requirements address general operational rules that apply to all broker/dealer firms regardless of size, scope and/or function, including product specific rules that are applicable based on the firm's approved products.

The FINRA WSP Checklist is most often used by applicants seeking approval to become FINRA members (New Membership Application), or by existing member firms requesting to expand their securities business under the NASD Membership and Registration Rules (Membership Application Change). In both cases, FINRA compares submitted procedures against the current FINRA WSP Checklist to confirm whether a new firm's written supervisory procedures effectively address the minimum requirements. Additionally, during a FINRA routine examination, similar audit checklists may be used to confirm that a member firm is

⁵ NASD Rule 1017; NASD Notice to Members 00-73 (October 2000). Interpretive Material 1011-1 creates a safe harbor for certain business expansions that are presumed not to be material changes and therefore do not require a firm to file an application pursuant to amended Rule 1017.

⁶ http://www.finra.org/web/groups/corp_comm/documents/home_page/p009839.pdf

addressing certain minimum standards and relevant areas as they apply to a firm's securities business.

Aligning Procedures with Process

A firm's written supervisory procedures should be considered the centerpiece for mapping a firm's implementation strategy regarding the execution of its supervisory responsibilities as they pertain to its securities business. One of the critical steps in aligning a firm's procedures with its securities business is to analyze a firm's current size, scope and operational function taking into consideration the totality of a firm's circumstances. Such considerations include: (i) product lines and customer base; (ii) number and geographic location of branch offices and personnel; (iii) existing reporting systems, operating units and organizational structures; experience of personnel; and applicable regulatory requirements.⁷

Additional considerations include: (i) the assignment of key supervisory personnel and registered representatives under such supervisory oversight; (ii) clear disclosure of a firm's supervisory responsibility with respect to each business line, service and/or product; (iii) maintenance of documentary evidence demonstrating the execution of supervisory functions; (iv) appropriate application of technology; and (v) periodic evaluation of a firm's business versus current regulatory requirements.

Focal Points of Disclosure

When preparing an implementation strategy or action plan to describe how a firm will execute its supervisory functions, there are four key focal points which need to be addressed to meet FINRA requirements. All four focal points should take the fundamental approach of addressing the "who, what, when, where, and how" regarding its supervisory functions. Each implementation or action plan should disclose the designation of each supervisory principal ("who"), frequency of review of each supervisory process ("when"), the disclosure of the forms and documents reviewed during supervision ("what"), and the method in which each review is documented ("how"). As a note, although the location of supervisory functions (the "where") could be included in each implementation strategy or action plan, it is generally disclosed on a

separate list disclosing all designated registered and non-registered branch locations.⁸

Designation of a Supervisory Principal.

Each respective business process should have a designated supervisory principal assigned to provide sufficient oversight for compliance with applicable rules and regulation. The designated supervisory principal should have sufficient knowledge in supervising the tasks and processes for which he/she maintains oversight,⁹ and the procedures should clearly disclose the name, title, appropriate licenses and effective date of supervision.

Frequency of Review. Each supervisory review process should include the frequency in which each task is reviewed (e.g. daily, weekly, monthly, quarterly, annual or other acceptable frequency).

Disclosure of the type of forms/documents to be reviewed.

When performing supervisory functions, it is important to disclose the types of forms, documents and/or systems reviewed as part of the overall review process. For example, certain frequently referenced forms and/or documents include new account forms, trades related blotters, journals, ledgers, correspondence (letters, faxes, e-mail, etc.), and activity-based or exception-based reports. If a firm employs the use of automated systems as part of its supervisory system, the firm should include a description of such systems.¹⁰

Documentary Evidence of Review. The most important of the four focal points is addressing how a firm evidences its review

⁷ NASD Notice to Members NTM 09-45 (June 1999).

⁸ NASD Rule 3010(c)(1); NASD Notice to Members 04-71 (October 2004). Amended Rule 3010(c)(1) details mandatory inspection cycles that each member must have in place for its supervisory branch offices, non-supervisory branch offices, and unregistered locations. NASD believes that codifying these mandatory inspection schedules will enhance oversight and supervision of branch and non-branch locations.

⁹ NASD Notice to Members 89-34 (April 1989); Such persons should be knowledgeable with respect to both regulatory requirements and the firm's product line, experienced in the activities that take place in the office they are supervising, and capable of exercising authority over their subordinates; NASD Notice to Members 09-45 (June 1999). When designating supervisory personnel, it is important to remember that a supervisor can only be responsible for supervising those activities for which they are qualified.

¹⁰ NASD Notice to Members 98-96 (December 1998).

of its supervisory obligations. Firms that are providing sufficient supervision of its securities business, but fail to document or properly evidence its review, will find it difficult to defend its position or provide proof to a regulator that sufficient supervision was conducted. Therefore, in an effort to provide sufficient documentary evidence of review, firms should include the signature or initials along with the date of each designated supervisor responsible for conducting the review.

Application of Procedures as a Regulatory Focus

As a regulated entity, broker/dealer firms may be subject to the jurisdictional authority of one or more regulatory agencies such as the SEC, FINRA, local state securities agencies and/or other self-regulatory organizations (SROs) which may serve as the designated examining authority (DEA). During a routine regulatory examination, one of the key factors in assessing a firm's compliance program may begin with a review of a firm's written supervisory procedures. However, it is not enough for a firm to simply prepare its written supervisory procedures in accordance with applicable rules, the FINRA routine examination process will also focus on the actual implementation of such procedures and how such procedures align with a firm's current practice of executing its supervisory functions. In some cases during FINRA routine examinations, firms have received letters of caution for not conducting certain supervisory steps as disclosed in its written supervisory procedures.

WSP Maintenance and Updates

It is not enough to simply prepare written supervisory procedures; a firm must work to provide ongoing updates and maintenance to remain relevant. The establishment of written supervisory procedures should be viewed as a dynamic document subject to constant change. The procedures should also be inclusive of current material changes in SEC, FINRA and/or applicable state rules and regulations based on periodic regulatory notifications, releases, regulatory alerts, rule proposals, and/or relevant industry white papers on best practices. If a firm's procedures are not maintained and/or updated on an ongoing basis, "they often become outdated or ineffective as a result of changes in a firm's business lines, products, practices, or new or amended securities

laws."¹¹ For example, in 2006, there were a total of seventy-four FINRA/NASD Notice-to-Members, seventy-two FINRA rule filings, five FINRA Member Alerts, twenty SEC proposed rules, and nineteen SEC final rule filings, most of which warranted updating certain language regarding regulatory requirements, rule changes and/or internal firm processes. Therefore, procedures are only as current as their last update.

Some of the main references for staying current with proposed, new and amended rules and regulations are FINRA Notices,¹² FINRA Rule Filings,¹³ FINRA Member Alerts,¹⁴ SEC Proposed Rules,¹⁵ and SEC Final Rules.¹⁶ Other references that are helpful in the updating and maintenance of written supervisory procedures include FINRA Exemptive Letters,¹⁷ FINRA Interpretive Letters,¹⁸ and SEC Interpretive Releases.¹⁹

Additionally, firms should periodically check the NASAA Website for the list of state regulatory agency websites²⁰ for the specific state in which the firm maintains its home office for any material changes in regulatory requirements.

As another source for regulatory updates, Consultants and/or Services Bureaus often provide regulatory update services which can also be combined with access to experienced consultants who will provide value added clarification on how such rule changes apply to a firm's particular circumstance. Firms are responsible for conducting their own due diligence before contracting any consulting firm or service bureau.

¹¹ NASD Notice to Members 05-29 (April 2005); Rule 3012(a)(1) recognizes the changing nature of a member's supervisory system by requiring members to submit, no less than annually, a report detailing each member's system of supervisory controls, the summary of the supervisory controls' test results, and any additional or amended supervisory procedures created in response to the test results.

¹² <http://www.finra.org/RulesRegulation/NoticestoMembers/2007NoticestoMembers/index.htm>

¹³ <http://www.finra.org/RulesRegulation/RuleFilings/index.htm>

¹⁴ <http://www.finra.org/RulesRegulation/MemberAlerts/2007MemberAlerts/index.htm>

¹⁵ <http://www.sec.gov/rules/proposed.shtml>

¹⁶ <http://www.sec.gov/rules/final.shtml>

¹⁷ <http://www.finra.org/RulesRegulation/PublicationsGuidance/ExemptiveLetters/index.htm>

¹⁸ <http://www.finra.org/RulesRegulation/PublicationsGuidance/InterpretiveLetters/index.htm>

¹⁹ <http://www.sec.gov/rules/interp.shtml>

²⁰ <http://www.nasaa.org/QuickLinks/ContactYourRegulator.cfm>

Books and Records Requirements

The need for maintenance and updates is further supported by SEC Rule 17a-4, which states, “[e]ach compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the member, broker or dealer with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the member, broker or dealer until three years after the termination of the use of the manual.”

Speed of Adoption and Implementation

Of equal importance is the frequency with which a firm adopts and updates its procedures, and the timeline between rule promulgation and a firm’s implementation in light of regulatory change. More specifically, the more frequently a firm updates its procedures based on material changes in regulatory requirements, and the shorter timeline to implementation, the more a firm is perceived to have an effective supervisory system. Generally, firms that update their procedures only quarterly or annually may not provide for a sufficient timeline to react, interpret and implement material changes before their respective effective dates.

Use of Consultants

When outsourcing or co-sourcing certain functions, the use of consultants to assist in the preparation of written supervisory procedures is often a good idea in an effort to save time, money and expertise by providing the most current procedures based on current regulatory requirements. The three key benefits of using consultants to assist in the preparation of procedures are as follows:

Time. The coordination of key principals and/or staff to prepare a set of procedures often takes a considerable amount of time away from normal assigned tasks and therefore may be analyzed in terms of a utility cost to the firm. To facilitate this process, consultants often work from an existing template or framework of procedures which addresses the regulatory requirements and, depending on methods, will obtain the client information necessary to include in its existing framework of procedures to provide for a customized

version based on compliance requirements and corresponding internal processes.

Cost. From an economic perspective, the allocation of personnel to prepare a set of procedures may be analyzed in terms of a utility cost to the firm, which is a measurable metric. Additionally, for more complex firms with several departmental layers, the allocation of key personnel specializing in particular areas such as equity trading, options, fixed income, back-office, and operations, may take even longer to organize each respective section and manage the production of the final product. Therefore, to reduce the costs associated with preparing a new set of procedures, certain consultants provide a ready-made approach to procedures for a reasonable price as an economically feasible alternative.

Expertise. Because the securities industry is dynamic and subject to constant regulatory change, the use of consultants becomes a value added consideration due to a consultant’s ability to provide up-to-date procedures by focusing on ongoing regulatory updates to SEC, FINRA, state and other applicable rules and regulations. Additionally, a consulting firm or individual consultant who participates in regulatory examinations, and who maintains a national presence with clients across other districts and regions will have the insight of leveraging unforeseen regulatory focal points, changes and expectations as they occur during the examination process. Once learned, consultants will often apply these newly learned requirements to their procedures in anticipation future regulatory requirements and/or expectations.

Common Deficiencies Related to WSPs

To assist firms in developing written supervisory procedures, Notice to Members 98-96 provides guidance on certain frequently found supervisory deficiencies noted during examinations. Although avoiding these deficiencies will not ensure that a firm’s procedures will be deemed to be adequate under regulatory examination, the awareness of common deficiencies may assist firms in improving their written supervisory procedures toward overall compliance with FINRA requirements and industry

best practices. The following is a list of common deficiencies related:

- The Written Supervisory Procedures Merely Recite the Applicable Rules. Reciting rules is generally perceived as compliance guidelines rather than customized written supervisory procedures. Every effort should be made to customize written supervisory procedures based on a firm's size, scope and function. Avoid "off-the-shelf" procedures with a one-size-fits-all approach.
- Failure to Designate Responsible Supervisory Personnel in the Procedures. Avoid referencing "Compliance Department," "Trading Department," or "Principal" when identifying designated supervisors. Provide clear lines of authority by disclosing each designated supervisory principal, by name or by title, and any/all associated persons under supervision.
- Failure to Describe the Review Process Adequately. Avoid vague or abstract descriptions of supervisory actions. Apply certain specificity to describing a firm's execution of supervisory responsibilities and actions.
- Failure to Document Reviews. Maintain certain documentation to support and evidence a firm's supervisory review.
- Failure to Denote Specifically the Frequency of Reviews. Avoid using terms such as "as needed," "on occasion" and replace with more specific terms such "daily," "weekly," "monthly," "quarterly," "annual" or other acceptable frequency.
- Failure to Monitor Adequately the Performance of Automated Compliance Systems. If applicable, firms should periodically test automated compliance systems to ensure compliance with applicable rules.
- Failure to Monitor Adequately the Performance of Service Bureaus and Other Members to Which the Firm has Delegated its Trade Reporting Responsibility. If applicable, firms should periodically monitor performance of its selected service bureaus, clearing firms, or other member firms for accuracy and timeliness of trade

data to ensure compliance with applicable rules.

- Failure to Reflect Supervisory Systems in the Firm's Written Supervisory Procedures. Make every effort to describe in writing a firm's supervisory systems. Provide clear disclosure on linking a firm's supervisory process to its written description.
- Failure to Describe the Steps the Firm Will Take when Potential Deficiencies are Identified. Provide a descriptive process for investigating and resolving potential compliance violations.
- Failure to Update Procedures Within a Reasonable Period to Reflect New Regulatory Requirements or Firm Procedures. Avoid static procedures. Periodically review FINRA, SEC, state and other SRO rules and regulations for regulatory updates and amend supervisory procedures accordingly.
- Failure to Preserve and Maintain Written Supervisory Procedures That Were in Effect During Past Time Periods in Accordance with SEC Rule 17a-3 and 17a-4. Maintain historical updates to written supervisory procedures to demonstrate specific product lines, supervisory procedures or processes for a specified time period.

Improving Examination Results

Another resource for aligning supervisory systems and written supervisory procedures with FINRA requirements is through FINRA's annual publication on Improving Examination Results.²¹ The annual publication is comprised of two sections: "Examination Priorities" and "Frequently Found Violations." While both sections are helpful in assisting firms in updating supervisory procedures in accordance with FINRA routine examination areas, the first section on Examination Priorities focuses on addressing existing, updated and new rules and potential areas for improving a firm's supervisory systems and procedures.

In addressing the area of supervision, FINRA states that "[t]he supervisory structure that firms implement is crucial to achieving overall compliance with applicable rules and regulations. Firms must

²¹<http://www.finra.org/RulesRegulation/ComplianceTools/ImprovingExamResults/index.htm>

establish adequate systems, policies and procedures for all areas of their business, and appropriately review and update their supervisory system. Firms should also have procedures in place for reviewing and identifying individuals or business types that require enhanced scrutiny due to sales practice concerns, such as a pattern of customer complaints.”²²

The second section on Frequently Found Violations addresses commonly cited violations during FINRA routine examinations which often include written supervisory procedures. In the most recent publication of Improving Examination Results issued in May 2007,²³ FINRA emphasizes the importance of written supervisory procedures by stating, “[w]ithout an adequate supervisory system with accountable individuals, firms cannot properly supervise the business of their firms, supervise their associated persons, or achieve compliance with applicable securities laws and rules. Having adequate written supervisory procedures allows firms to properly supervise registered representatives, and also support training registered representatives so that they are aware of firms’ procedures and compliance responsibilities.”²⁴

In conclusion, each FINRA member firm should establish, maintain and enforce its written supervisory procedures with the underlying goal of complying with FINRA requirements. When establishing procedures, firms should have a fundamental understanding of the regulatory framework to build the proper foundation for a well designed set of written supervisory procedures. Having a fundamental understanding of the requirements will also assist firms in distinguishing between written supervisory procedures and other similar, although complementary, forms such as compliance guidelines or written supervisory control system. When preparing procedures, it is important for firms to conduct a thorough internal analysis to properly align supervisory procedures with internal processes. The best protection against regulatory scrutiny is a set of written supervisory procedures that are truly customized to a firm’s size, scope and operations. Once prepared, firms should focus on effective implementation of its procedures and reasonable enforcement of any infractions. As a forward looking measure, firms must be able to

provide ongoing maintenance and updates of written supervisory procedures to promptly respond to an ever changing regulatory environment.

Mr. Tarra is a Managing Principal with Financial Registrations, Inc., a compliance management consulting firm providing registration and compliance advisory services to securities broker/dealers and registered investment advisers. For more information on this topic or other compliance related matters, please contact:

Scott P. Tarra
Managing Principal
starra@financialreg.com

Financial Registrations, Inc.
25602 Alicia Parkway #107
Laguna Hills, CA 92653
www.financialregistrations.com

Toll-free (800) 641-1818
Direct (949) 770-6154
Fax (949) 770-6198

²²<http://www.finra.org/RulesRegulation/ComplianceTools/ImprovingExamResults/p019177>

²³Id.

²⁴Id.