THIS MONTH IN COMPLIANCE:
Annual Compliance Meeting, Texting Enforcement & Parameters of Personal Liability for CCOs

MONTHLY COMPLIANCE TASKS

Please be sure to check your SmartRIA CCO portal to keep up with your monthly Compliance tasks.
Please contact the following for:

- **Login and Portal Requests:** Sara Sparks: ssparks@thecomplianceresource.com
- **Task Related Questions:** Nancy Harry: nharry@thecomplianceresource.com
  Stacie Craddock: scraddock@thecomplianceresource.com
  Sara Sparks: ssparks@thecomplianceresource.com

If SmartRIA is not working for you, please refer to the CCO Report Card for a one-page summary of compliance tasks for the month.

ANNUAL COMPLIANCE MEETING

As posted in our October tasks, has your firm's Annual Compliance Meeting been scheduled? This month we provide our clients a 2020 PowerPoint Compliance Meeting presentation. This presentation will need to be customized and tailored to your firm's process and procedures. Feel free to add topics as you see fit or remove slides for topics you have already covered this year.

An annual compliance meeting should be the cornerstone of every investment adviser's compliance program. To be effective, compliance policies and procedures require communication with and training of the adviser's personnel. The annual compliance meeting can serve this purpose. When the CCO does the annual review of the compliance program, the annual compliance meeting is your documentation of the firm's compliance program and supervised person training. Regulators continue to emphasize the need for investment advisers to develop a culture of compliance. Investment advisers must develop a way to make sure that all supervised persons understand their roles in helping the firm maintain a strong culture of compliance. Educating and communicating with all supervised persons is crucial to this process, and although not expressly required under the rule, an annual compliance meeting is an effective way for you to accomplish this instruction.

ATTENTION: **DOES YOUR FIRM ALLOW TEXTING? READ THIS RECENT SEC ENFORCEMENT ACTION!**

Recently, a registered broker-dealer agreed to a settlement after the Securities and Exchange Commission brought proceedings against the firm alleging that ***it failed to preserve business-related text messages (both internal and external text messages)***. Section 17(a) and Rule 17a-4(b)(4) require that brokers-dealers make and **keep current various records relating to their business and preserve for three years originals of all communications received and copies of all communications sent relating to their business as such.** JonesTrading agreed to a censure, a civil monetary penalty of $100,000 for violation of this Rule. Please note, this requirement is applicable to registered investment advisers.

In 2018, the SEC published a Risk Alert encouraging firms to review their "risks, practices, policies and procedures" regarding electronic messaging and consider possible improvements to their compliance programs. At the time, the SEC noted that it had found that changes in the way mobile and personally owned devices are used for business purposes is posing challenges for advisers and broker-dealers in meeting their obligations under the Books and Records Rule and the Compliance Rule.

The firm did maintain policies and procedures to ensure it was retaining business-related records, including communications, in compliance with federal securities laws and the commission's regulation. *But where it appeared to go* *astray was with the **text messages**.* JonesTrading's electronic communications policy stated that, "Electronic business communications must be accessed and transmitted only through firm sponsored systems," and further noted that, "Regulators require retention of business communications and firm systems are designed to comply with retention requirements." However, the ***firm's policies also expressly prohibited its registered representatives from using text messaging to conduct business-related correspondence.*** The policy stated, "Text messaging is not approved to conduct business related correspondence" and "Home computers or other personal devices and external systems may not be used for business purposes." And even though ***JonesTrading relied on annual employee compliance attestations and trainings to monitor its employees' adherence to its policies, including the firm's policy prohibiting the use of unauthorized methods of electronic communication, it later became clear that the policy was not followed.***

The SEC also determined that JonesTrading's senior management knew that the firm's employees were communicating with each other and the firm's customers in text messages. In fact, the SEC notes that the firm's senior management, including compliance personnel themselves, sent and received business-related text messages with others at JonesTrading. JonesTrading did end up taking certain remedial measures after the SEC alerted the firm to this issue, including requiring additional compliance training, reminding all employees via email of their obligations to record and retain all electronic business communications, and reminding that employees are not permitted to communicate via text messaging for business-related communications. The firm's email also advised that, for employees interested in using their personal devices for business purposes, JonesTrading would provide a firm-sponsored software solution that preserves text messages sent or received for business purposes on employees' personal devices.

CCO TAKE-AWAY

- ☐ Does your Firm's Policy allow for use of Text messages with business communications? If so, what system is being used to archive test messages?
- ☐ How is this Policy communicated to employees? Is there continued training or testing on the testing Policy?

PARAMETERS OF PERSONAL LIABILITY FOR COMPLIANCE OFFICERS

Below are some excerpts from Commissioner Hester M. Peirce's remarks in a recent speech before the National Society of Compliance Professionals - "***When the Nail Fails***". Click here to read through the speech in its entirety.

Today, though, rather than focusing on compliance during COVID, I would like to focus on a concern that is not new—the question of how to define the parameters of personal liability for compliance officers. Near the end of my remarks in 2018, I spoke briefly about the role that the Commission's Division of Enforcement plays with respect to compliance functions. I noted that I shared the concerns expressed in some quarters that the increasing specter of personal liability could cause talented individuals to forgo a career in compliance, among other negative effects.

Those concerns have increased over the past two years. Compliance officers' responsibilities are growing, but the nature of the liability they face in executing those responsibilities remains unclear. Indeed, this past February, the New York City Bar published a report that distilled many of the concerns and offered a number of recommendations.

In that speech, the Enforcement Director identified three broad categories of cases where the Commission has charged chief compliance officers:

- cases where the compliance officer participated in the underlying misconduct unrelated to his or her compliance duties
- cases where compliance officers obstructed or misled Commission staff
- cases where, in the Enforcement Director's words, "the CCO has exhibited a wholesale failure to carry out his or her responsibility

CASES WHERE THE COMPLIANCE OFFICER PARTICIPATED IN THE UNDERLYING MISCONDUCT UNRELATED TO HER COMPLIANCE DUTIES

The first category should not be controversial. After all, serving in a compliance capacity is not a get-out-of-jail free card for clearly unlawful conduct. If it were, lots of bad actors would want the compliance officer title to shield them from liability. So, a compliance officer who, outside of her compliance functions, directly violates provisions of the securities laws is liable the same way anyone else would be. For example, when a person knows that an investment adviser is misappropriating client funds, does nothing to stop it, and participates in a scheme to hide the theft, she is liable for that conduct no matter her compliance functions. In cases such as these, compliance personnel are liable on the same terms and to the same extent as any other bad actor. In other words, if you knowingly and intentionally use defective nails or willfully misplace the nails, you are responsible for the thrown shoe, no matter your compliance function.

CASES WHERE COMPLIANCE OFFICERS OBSTRUCTED OR MISLED COMMISSION STAFF

The second category of cases relates more directly to compliance functions. These cases typically involve facts where a compliance officer obstructs or misleads the Commission's staff. In a recent example, a compliance officer created and backdated compliance memoranda. When she subsequently provided them to the Commission's examination staff, she described them as a contemporaneous memorialization of the events, an assertion she knew to be false. I supported this case. The Commission's examination process is essential to its regulatory functions, and conduct that undermines the process must be addressed. In another recent case, a compliance officer similarly misled the Commission's examiners and enforcement staff by producing altered documents. The alteration was material because it created the appearance that the compliance officer had timely performed certain reviews, when she had not. Again, I supported the case because it evidenced the sort of knowing and intentional misconduct that materially undermines the examination process.

CASES WHERE, IN THE ENFORCEMENT DIRECTOR'S WORDS, "THE CCO HAS EXHIBITED A WHOLESALE FAILURE TO CARRY OUT HIS OR HER RESPONSIBILITY

The third category of cases, the ones involving a wholesale failure of a compliance officer is the one that understandably generates the most controversy and is the most challenging area for me. Typically, in such cases, the Commission charges the compliance officer with aiding and abetting the company's violations, causing the company's violations, or both. The distinctions between these charges matters a great deal. To establish that a compliance officer aided and abetted the company's violation, the Commission must show that the compliance officer engaged in reckless conduct. This standard is not simply negligence on steroids; rather, the evidence must show that there was "a danger so obvious that the [compliance officer] must have been aware of the danger."

In contrast, to establish in an administrative cease and desist proceeding that a compliance officer was the cause of a company's violation, it is only necessary to show that the individual committed an "'an act or omission the person knew or should have known would contribute'" to the violation. The phrase "should have known" is "classic negligence language," and the Commission and courts both have concluded that it sets a negligence standard for liability. Thus, where a company has committed a violation that does not require scienter—such as failing to have sufficient policies and procedures—a compliance officer can be held to have caused the violation based on her own negligent conduct.

Rule 206(4)-7, the investment adviser compliance rule, exacerbates the problem. It supports negligence-based charges against an adviser's CCO, whom the rule makes "responsible for administering written policies and procedures" that must be "reasonably designed to prevent violation, by you and your supervised persons, of the Act and the rules that the Commission has adopted under the Act."

A Firm's compliance personnel along with its Code of Ethics play an important role in:

- encouraging their firms to create and implement appropriate systems of supervision;
- assisting their firms in the development and documenting of appropriate policies and procedures;
- participating in appropriate testing and monitoring of the systems of compliance;
- assisting their firms in identifying and developing appropriate mechanisms for identifying, reporting, and responding to compliance issues;
- and striving to enhance the systems and culture of compliance at their firms.

In his 2015 speech, the Enforcement Director noted that "it is the business"—not the compliance officers—"that is primarily responsible for compliance with the law."

To date, most of that conversation has centered around enforcement actions, which I know you all watch closely. Not only the cases that we bring, but also those we do not bring against CCOs, can be instructive. The New York City Bar report on CCO liability recommended that we do a better job of highlighting facts and circumstances underlying decisions to charge and to not charge CCOs. Details about why we are charging a CCO can calm the fears of diligent, well-intentioned compliance personnel. Maybe the CCO being charged participated in the underlying securities violation, and perhaps she did so wearing her non-CCO hat. These kinds of details matter when you are reading an enforcement action and asking, "What does this mean for me? Will I be the next CCO featured in an SEC enforcement press release?" Likewise, by providing sufficient detail when we do not charge a compliance officer, we illustrate what doing the job right looks like. The Commission has declined to impose personal liability on compliance officers who were ill-equipped for their jobs, who were denied the resources necessary to do their jobs, or who were genuinely over-burdened with other duties. We also consider steps a CCO took to prevent and remediate failures. As the New York City Bar report pointed out: "***Knowing what regulators believe that compliance officers did correctly in the face of potential misconduct is critical information."*** In short, context matters, and we can provide more of it.