Financial Industry Regulatory Authority

2014 FINRA

South Region Compliance Seminar

November 20 – 21, 2014

Fort Lauderdale, FL

Harbor Beach Marriott

2014 South Region Compliance Seminar

Agenda

THURSDAY, NOVEMBER 20

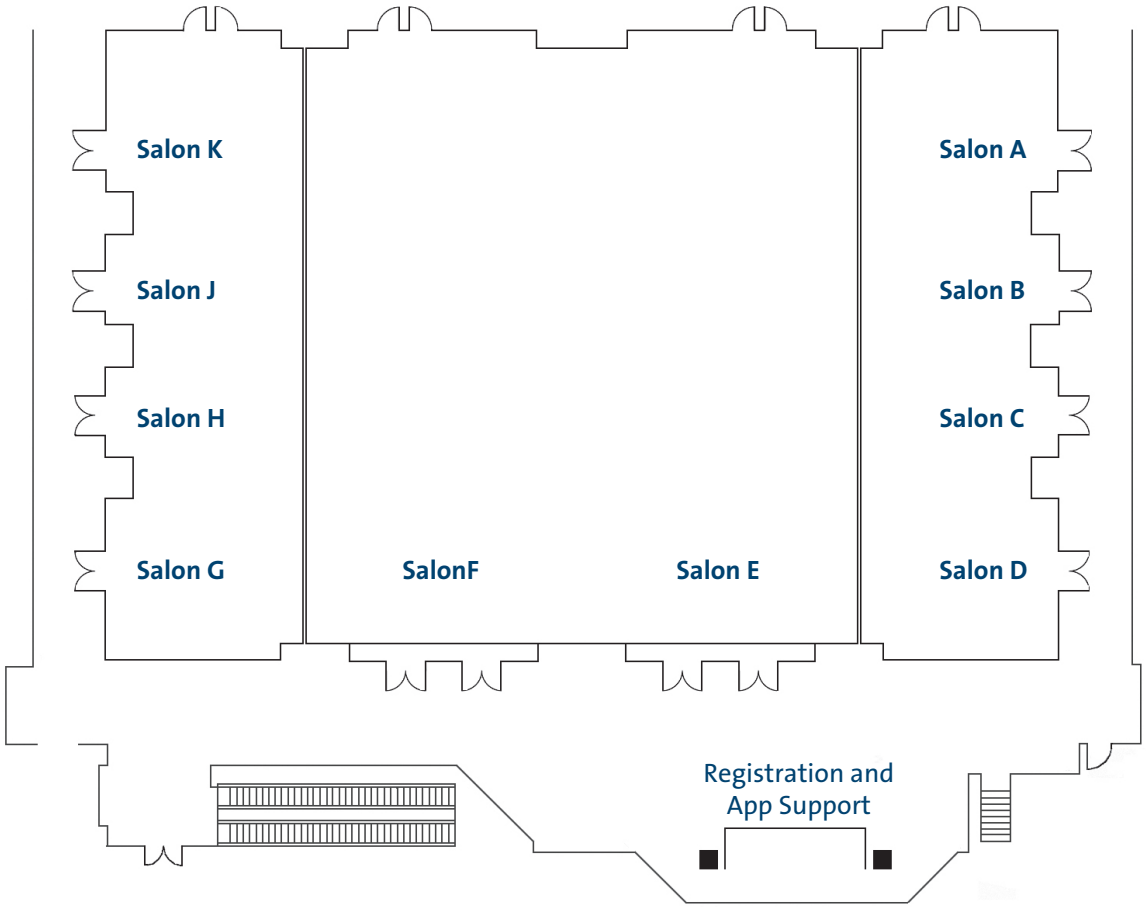
8:00 a.m. – 5:00 p.m.	Seminar Registration
10:00 a.m. – 10:35 a.m.	**Welcome Remarks / Keynote Address**
10:35 a.m. – 11:45 a.m.	**General Session: 2014 Regulatory Priorities**
11:45 a.m. – 1:00 p.m.	Lunch
1:00 p.m. – 2:15 p.m.	**Concurrent Workshops** ► Challenges of Supervising Independent Contractors ► Municipal Advisor Rules ► Suitability
2:20 p.m. – 3:35 p.m.	**Concurrent Workshops** ► Cybersecurity ► New and Existing Products Due Diligence ► FINRA's New Supervision and Supervisory Controls Rules
3:35 p.m. – 4:00 p.m.	Break
4:00 p.m. – 5:15 p.m.	**Concurrent Workshops** ► Anti-Money Laundering ► Branch Office Supervision ► Fixed Income – Examination and Enforcement Updates
5:15 p.m. – 6:15 p.m.	Reception

FRIDAY, NOVEMBER 21

7:30 a.m. – 8:30 a.m.	Continental Breakfast
8:30 a.m. – 9:30 a.m.	**General Session: Ask FINRA Staff**
9:30 a.m. – 9:50 a.m.	Break
9:50 a.m. – 11:00 a.m.	**Concurrent Workshops** ► Financial and Operational Issues ► JOBS Act / Crowdfunding ► Managing Conflicts of Interest
11:00 a.m. – 11:20 a.m.	Break
11:20 a.m. – 12:30 p.m.	**General Session and Repeat Workshop** ► General Session: Enforcement Developments ► Challenges of Supervising Independent Contractors (Repeat Session)
12:30 p.m.	Closing Remarks / Seminar Adjourns

Harbor Beach Marriott – Floorplan

Third Floor Grand Ballroom



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Welcome and Opening Remarks

November 20, 2014 / 10:00 a.m.

Welcome and Opening Remarks

Jeffrey M. Pasquerella, Vice President and Regional Director, FINRA South Region and Boca Raton District Office

Jeffrey M. Pasquerella is Vice President and Regional Director of FINRA's South Region and the District Office located in Boca Raton. He has been employed by FINRA since August of 1999. Prior to joining FINRA, Mr. Pasquerella served as an assistant district attorney in the Westchester County District Attorney's Office for three years. He is a 1993 graduate of Villanova University, Villanova, Pennsylvania, and a 1996 graduate of Pace University School of Law, White Plains, New York. Mr. Pasquerella is a member of the New York and Connecticut State Bars.

Session Notes

Keynote Address

November 20, 2014 / 10:00 a.m. – 10:35 a.m.

Keynote Speaker

Susan F. Axelrod, Executive Vice President of Regulatory Operations, FINRA

Susan Axelrod is FINRA's Executive Vice President of Regulatory Operations. In this capacity, she oversees Enforcement, the Office of Fraud Detection and Market Intelligence, and Member Regulation. Before being named to her current role, Ms. Axelrod was Executive Vice President and Head of Member Regulation – Sales Practice, with responsibility for ongoing surveillance and examinations, both routine and investigative, of FINRA-regulated securities firms. She was appointed to this position in July 2010. Previously, Ms. Axelrod was FINRA Senior Vice President and Deputy of Regulatory Operations. Her responsibilities included assisting in the oversight of the Market Regulation, Enforcement and Member Regulation functions at FINRA. She also played a key role in the integration of NASD and NYSE Member Regulation. Prior to joining FINRA in 2007, Ms. Axelrod was Chief of Staff to the CEO of NYSE Regulation for three years. In this position, her responsibilities included overseeing operations on a day-to-day basis and acting as a liaison with various business areas, including finance, human resources, government relations and communications. Ms. Axelrod joined the NYSE in 1989 as a staff attorney in the division of enforcement and became an enforcement director in 1997. Among the cases she handled were those involving specialist and floor broker misconduct, insider trading, upstairs trading, sales practice violations, and financial and operational compliance issues. She received her law degree from the Hofstra University School of Law in 1989 and her bachelor's degree from Emory University in 1986.

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Keynote Speaker
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Keynote Speaker

- Susan Axelrod – Executive Vice President, Office of Regulatory Operations, FINRA

Session Notes

General Session: 2014 Regulatory Priorities

November 20, 2014 / 10:35 a.m. – 11:45 a.m.

2014 Regulatory Priorities

Erin Vocke, Vice President and District Director, FINRA, Dallas and New Orleans District Offices

Erin C. Vocke is Vice President and District Director of the FINRA Dallas and New Orleans District Offices. Ms. Vocke began her career in 1995 as an examiner in the New Orleans District Office. During this time, she conducted numerous routine and cause examinations of member firms and focused examinations in the areas of variable products and mutual funds. In January 2004, Ms. Vocke became Supervisor of Examiners, where she performed supervisory functions, including reviewing examinations and providing guidance to examiners on case development. In August 2004, she relocated to the Florida District Office. At this time, she assumed responsibilities for supervising Continuing Membership Applications and financial surveillance of member firms, in addition to routine and cause examinations. In June 2007, Ms. Vocke transferred to the Dallas District Office as the Associate Director. In this position, she was responsible for overseeing the District Cycle, Cause, Financial Surveillance and Membership Application Programs. In February 2010, she assumed the role of District Director of the Dallas Office. In February 2014, she assumed the role of District Director in the New Orleans Office. Ms. Vocke completed the Accelerated Development Program in 2007 and the Certified Regulatory and Compliance Professional (CRCP) designation in 2003. She received a bachelor's degree in accounting from the University of New Orleans.

Lee Kell, Chief, Bureau of Enforcement, Florida Office of Financial Regulation

Lee Kell is the Chief of the Bureau of Enforcement for the Florida Office of Financial Regulation, a position to which he brings a wealth of management and leadership experience. Mr. Kell has been with the Florida Office of Financial Regulation since April 2012; most recently serving the division in the capacity of Financial Administrator for the Tallahassee, Tampa and Orlando offices. His background includes five years as General Manager with The Tallahassee Coca-Cola Bottling Company, followed by 25 years at Northwestern Mutual Financial Network in Tallahassee, serving in management, training, compliance and financial representative capacities. He graduated in 1979 from the University of West Florida with a degree in accounting.

John Mattimore, Associate Regional Director, U.S. Securities and Exchange Commission

John C. Mattimore has been an SEC Associate Regional Director overseeing the MIRO examination program since May 2004. Previously, he had been an Assistant Regional Director in the MIRO's enforcement program since 1997, and has served as a Branch Chief and staff attorney. Mr. Mattimore joined the SEC in 1993, after having been an associate with Cravath Swaine & Moore in New York City and Cadwalader Wickersham & Taft in West Palm Beach. Mr. Mattimore was a judicial law clerk for Judge Lenore Nesbitt, United States District Court for the Southern District of Florida from 1986 to 1987; and for Judge Robert Varner, United States District Court for the Middle District of Alabama, from 1985 to 1986. Mr. Mattimore graduated from the University of Miami Law School in 1983. From 1980 to 1981, he attended the University of North Carolina Law School, where he was invited onto Law Review. Mr. Mattimore received his bachelor's degree in 1974 and M.B.A. in 1979 from Florida International University.

Daniel Stefek, Associate Vice President and District Director, FINRA Atlanta District Office

Daniel J. Stefek, Associate Vice President, is District Director of FINRA's Atlanta District Office. The Atlanta office is responsible for the examination and regulation of the FINRA member firms located in Georgia, North Carolina and South Carolina (approximately 180 main offices and 10,500 branches). Mr. Stefek has extensive regulatory experience, starting his career in FINRA's Los Angeles District Office in 1983. While in Los Angeles, he worked in a variety of positions for NASD (FINRA's predecessor), first conducting financial and sales practice examinations, then managing the district's examination programs as Exam Manager and then as Associate Director. Mr. Stefek moved to Georgia in 2004, where he became Director of the Atlanta Office. He received his business degree in finance from the University of Southern California.

South Region Compliance Seminar

2014 Regulatory Priorities
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2014 Regulatory Priorities

- Moderator – Erin Vocke, VP and District Director, FINRA New Orleans and Dallas District Offices
- Panelist – John Mattimore, Associate Regional Director, U.S. Securities and Exchange Commission
- Panelist – Lee Kell, Chief, Bureau of Enforcement, Florida Office of Financial Regulation
- Panelist – Daniel Stefek, AVP and District Director, FINRA Atlanta District Office

FINRA

Session Notes

Challenges of Supervising Independent Contractors

November 20, 2014 / 1:00 p.m. – 2:15 p.m.

November 21, 2014 / 11:20 a.m. – 12:30 p.m.

Challenges of Supervising Independent Contractors

Casey Harper, Examination Manager, FINRA, Dallas District Office

Casey Harper is an examination manager in FINRA's Dallas District Office. He began his career with FINRA in 2005, and is currently responsible for managing a staff of six examiners who conduct routine cycle examinations. Mr. Harper holds a bachelor's degree in finance from Texas A&M University.

Ken Bell, Vice President, Audit, Cetera Financial Group

Ken Bell is Vice President, Audit, for Cetera Financial Group, a position he has held since Cetera's inception in 2010. Prior to the formation of Cetera, he held the same position with ING Advisors Network. He is responsible for leading a compliance audit program for the group's independent broker-dealers, and is involved in other group risk management projects and initiatives. Prior to joining ING in 2000, Mr. Bell was with NASD's (nka FINRA) Atlanta District Office, where he spent most of his 17 years managing a field examination staff. He was also significantly involved in developing a training and performance support system for NASD examiners. Prior to his work with NASD, Mr. Bell worked in corporate accounting. He is a graduate of the University of Georgia and received the designation of Certified Regulatory and Compliance Professional (CRCP) through the FINRA Institute at Wharton. Mr. Bell is frequent speaker at industry conferences and is an active member of the National Society of Compliance Professionals (NSCP), the Financial Services Institute (FSI), the Securities Industry Financial Markets Association (SIFMA) and the Georgia Society of CPAs. He recently completed a three-year term on the NSCP Board of Directors, and currently serves on the FINRA District 7 Committee.

Brooks Brown, Examination Manger, FINRA, Atlanta District Office

Brooks Brown joined FINRA's New Orleans District Office in 2001, and then transferred to FINRA's Atlanta District Office in 2006. Since April 2011, Mr. Brown has supervised five staff members who conduct routine examinations to review for compliance with FINRA and SEC rules. Prior to joining FINRA, Mr. Brown worked with Trustmark National Bank in Jackson, Mississippi, from 1999 to 2001 as an equity analyst in Trustmark's Trust Department. He earned the Certified Regulatory and Compliance Professional designation from the Wharton School in 2013. Mr. Brown is a graduate of Millsaps College in Jackson, Mississippi, and he also earned an M.B.A from Millsaps College's Else School of Management.

Abel Garcia Jr., Senior Vice President, Risk Management, and Chief Compliance Officer, Prospera Financial Services

Abel Garcia Jr. is the Senior Vice President, Risk Management & CCO of Prospera Financial Services. As such, he directs the firm's risk management and regulatory compliance issues. Prior to joining Prospera, Mr. Garcia began his career in internal audit for a regional banking institution. He qualified for the Certified Public Accounting certificate in 1988 and transitioned from the accounting field to the financial industry in 1993. He accepted the position as controller of Prospera in 1994 and progressed from CFO to CCO in 2005, taking over the firm's compliance functions that year. Mr. Garcia graduated from the University of Texas at Austin with a bachelor's degree in accounting and currently holds the Series 7, 63, 27 and 87 securities licenses.

South Region Compliance Seminar

Challenges of Supervising Independent Contractors

November 20, 2014

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Challenges of Supervising Independent Contractors

- Moderator – Casey Harper, Examination Manager, FINRA Dallas District Office
- Panelist – Abel Garcia Jr., Senior Vice President, Risk Management, and Chief Compliance Officer, Prospera Financial Services
- Panelist – Ken Bell, Vice President, Audit, Cetera Financial Group
- Panelist – Brooks Brown, Examination Manager, FINRA Atlanta District Office

FINRA

Challenges of Supervising Independent Contractors

- **Common Challenges**
  - Direct Business
  - Cybersecurity
  - Outside Business Activities
  - Social Media/Web Presence
  - Outside RIAs
  - Onboarding and Vetting of New Representatives
  - Branch Inspection Program

Challenges of Supervising Independent Contractors

- **Direct Business**
  - Supervisory Systems
    - Transaction blotters
    - Commission reconciliation
    - Suitability considerations (e.g., source of funds)
  - Surveillance
    - Manual vs. automated
    - Patterns of red flag transactions (e.g., switches, exchanges)
    - Sufficiency of blotter data

Challenges of Supervising Independent Contractors

- **Cybersecurity**
  - Information Security
    - Data breaches
    - Encryption for data transmission
    - Branch office safeguards and standards
  - Procedures and Controls
    - Information security standards, data breaches, data encryption
    - Process for verification and surveillance
    - Branch supervision

Challenges of Supervising Independent Contractors

- **Outside Business Activities**
  - Supervisory Review
    - Consideration of red flags
    - Documentation
    - Branch inspections
  - Training
    - Robust education regarding Form U4 disclosure requirements

Challenges of Supervising Independent Contractors

- **Social Media / Web Presence**
  - Initial Approval
    - Prior approval requirements
    - Documentation
  - Ongoing Supervision
    - Periodic reviews
    - Third party vendors
    - Branch inspections
  - Detection of Undisclosed Activities
    - Internet alerts

Challenges of Supervising Independent Contractors

- **Outside RIAs**
  - Supervisory Systems
    - Automatic data feed when possible
    - Written Supervisory Procedures assessing:
      - Supervisory obligations (reference Notice to Members 94-44 and 96-33)
      - Red flag identification and sampling methodology
      - BD-to-IA client movements
    - Recording/supervising and identifying red flags
    - Branch inspections
  - Correspondence and Advertising
    - Incorporate IA communications into supervisory processes
    - Consolidated Account Reports (reference Notice to Members 10-19)

Challenges of Supervising Independent Contractors

- **Onboarding and Vetting of New Representatives**
  - Background Investigations
    - Undisclosed matters:
      - OBAs, web presence, financial impairments, criminal matters
    - Disclosed matters/activities (e.g., OBAs)
  - Defining "Independence"
    - Expectations and role of supervisor/compliance
    - Consequences of non-disclosure

Challenges of Supervising Independent Contractors

- **Branch Inspection Program**
  - Program Implementation (reference Regulatory Notice 11-54)
    - Tailored and scheduled in a risk based manner
    - Corrective action
    - Quality control
  - Inspection Scope
    - Identify other risks (e.g., OBAs, PSTs, cybersecurity, other undisclosed activities)
    - Investigate known risks
    - Confirm status of known activities
  - Conflicts of Interest
    - Mitigating conflicts of inspectors/auditors

Regulatory Notice 11-54

Branch Office Inspections

FINRA and the SEC Issue Joint Guidance on Effective Policies and Procedures for Broker-Dealer Branch Inspections

November 2011

Executive Summary

FINRA and the Securities and Exchange Commission's Office of Compliance Inspections and Examinations are issuing the attached National Exam Risk Alert to provide broker-dealer firms with information on developing effective policies and procedures for branch office inspections. The Alert reminds firms of supervisory requirements under FINRA's supervision rule and notes common deficiencies and strong compliance practices.

Questions concerning this *Notice* should be directed to:

- Michael Rufino, Chief Operating Officer, Member Regulation Sales Practice, at (212) 858-4487; or
- George Walz, Vice President, Office of Risk, at (202) 728- 8211.

Notice Type

- Guidance

Suggested Routing

- Compliance
- Internal Audit
- Risk
- Senior Management

Key Topics

- Branch Office Inspections
- Risk Management
- Supervision

Referenced Rules & Notices

- NASD Rule 3010
- NTM 98-96
- NTM 99-45

National Examination Risk Alert

By the Office of Compliance Inspections and Examinations

in cooperation with the Financial Industry Regulatory Authority [1]

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] Those cases suggest that regular branch office inspections over reasonably short intervals, including unannounced inspections, are the cornerstone of a well designed branch office

[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.

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

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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]

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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.

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[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.

Regulatory Notice 10-19

Consolidated Reports

FINRA Reminds Firms of Responsibilities When Providing Customers With Consolidated Financial Account Reports

Executive Summary

The practice of providing customers with consolidated financial account reporting has become increasingly common in the financial services industry. In many cases, these reports offer a single document that combines information regarding most or all of the customer's financial holdings, regardless of where those assets are held. Firms are reminded that these reports represent communications with the public by the firm; the dissemination of these reports must comply with all applicable FINRA rules as well as the federal securities laws.

As investor demand for this service has grown and as increasingly sophisticated software and data service providers have become available, firms have developed differing practices for generating these communications. If not rigorously supervised, this activity can raise a number of regulatory concerns, including the potential for communicating inaccurate, confusing or misleading information to customers, lapses in supervisory controls, and the use of these reports for fraudulent or unethical purposes.

This *Notice* reminds firms of their responsibilities to ensure that they comply with all applicable rules when engaging in this activity, and highlights a number of sound practices. Firms are strongly encouraged to review the overall adequacy and effectiveness of their current policies and procedures relating to their consolidated reporting. Any firm that cannot properly supervise the dissemination of consolidated reports by its registered representatives must prohibit the dissemination of those reports and take the necessary steps to ensure that its registered representatives comply with this prohibition.

April 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Operations
- Registered Representatives
- Senior Management
- Systems
- Training

Key Topics

- Account Statements
- Communications with the Public
- Correspondence
- Internal Controls
- Supervision
- Supervisory Controls Systems

Referenced Rules & Notices

- NASD Rule 2210
- NASD Rule 2340
- NASD Rule 3010
- NASD Rule 3012
- NYSE Rule 342
- NYSE Rule 409
- Regulatory Notice 08-27
- NTM 05-48

General questions about this *Notice* should be directed to:

- Steve Kasprzak, Associate Director & Principal Counsel, Sales Practice Policy, Member Regulation, at (646) 315-8603; or
- Bill Hayden, Director, Emerging Regulatory Issues, at (202) 728-8860.

For questions about communications with the public, contact Amy Sochard, Director, Programs & Investigations, Advertising Regulation, at (240) 386-4508.

Discussion and Background

Many firms, as a service to their customers, provide documents that consolidate information regarding a customer's various financial holdings.[1] For the purpose of this *Notice* we will refer to this practice and document as "consolidated reporting" and "consolidated reports," respectively. These consolidated reports offer a broad view of customers' investments, may include assets held away from the firm, and may provide not only account balances and valuations, but performance data as well. In many cases these consolidated reports are prepared at the request of the customer, who may also direct which of his or her accounts to include and provide access to data for non-held accounts. These communications may supplement, but do not replace, the customer account statement required pursuant to NASD Rule 2340 and NYSE Rule 409,[2] which is prepared and disseminated to the customer through a separate process. Consolidated reports may not be represented as a substitute for, and must be distinguished from, account statements that are required by rule.

Firms create consolidated reports through fully integrated, in-house data gathering and reporting systems, fully outsourced solutions from third-party vendors,[3] "off-the-shelf" software applications or a combination of these methods. Firms also disseminate these consolidated reports through a variety of means, such as direct mailing to customers, providing access to secure servers via the Internet and hand delivery during face-to-face meetings. The consolidated reports themselves may contain a variety of information and may be produced as a highly customized document created by an individual representative, or as a standardized report created by a firm system. To the extent individual representatives create consolidated reports, firms are required to supervise this activity, and both the firm and the individual representatives are responsible for compliance with all applicable rules.

Consolidated reports are communications with the public. Therefore, they must be clear, accurate and not misleading.[4] For assets held at the firm, this includes providing information, including valuations, that is consistent with the customer's official account statement.[5] For assets held away, this includes, among other things, taking reasonable steps to accurately reproduce information obtained regarding outside accounts and not to include information that is false or misleading.

Consolidated reports, particularly those published on firm letterhead, can create a misconception that the firm produced or verified all of the data, including the valuation of assets held away. Therefore, these reports should be constructed and provided in such a manner that neither customers nor third parties with whom the customer interacts (*e.g.*, banks, mortgage companies, other broker-dealers) are likely to be confused or misled as to the nature of the information presented, or mistake these documents for official account statements regarding the reported assets. The reports should clearly delineate between information regarding assets held on behalf of the customer, which are included on the firm's books and records, and other external accounts or assets.

If a firm is unable to test or otherwise validate data for non-held assets, including valuation information, the firm should clearly and prominently disclose that the information provided for those assets is unverified. In addition, to the extent a consolidated report contains information regarding financial products that are outside a registered representative's area of proficiency, representatives must discuss and present these financial products in a manner that does not mislead customers as to the scope of the representative's financial expertise.[6]

Consolidated reports are also subject to the regulatory requirements regarding supervision and internal controls, records retention, privacy and safeguarding of customer information.[7] Effective firm controls would include procedures to vet and approve consolidated report templates for compliance with regulatory requirements before they are put into production. These reviews can help ensure that any new consolidated report-generating process complies with regulatory requirements and firm policies, and that it is integrated into the firm's supervisory control program. Similar controls should be put in place for any programming that permits customization, as well as any subsequent changes to the approved templates or programming.

The risks associated with a firm's failure to maintain adequate safeguards over the use and dissemination of customer account information are well established. Beyond the obvious concern regarding the use of account information for fraudulent activity, even well-intentioned but incautious consolidated reporting could result in customers being misled or confused. Given the reliance that customers may place on consolidated reports and the potential consequences if these communications contain mistakes or are misused by firm personnel, firms must review their consolidated reporting programs with particular care. The more complex a firm's program for consolidated reporting, the more difficult it may be to conform that reporting to applicable rule requirements. Factors that contribute to program complexity include:

- the production within a firm of a large number of varying types of consolidated reports, especially consolidated reports that are highly customizable;
- reporting on a wide variety of asset classes, especially assets held outside the firm; and
- a decentralized consolidated reporting structure employing multiple reporting systems.[8]

If a firm provides this service to customers, it must ensure that the size and complexity of the consolidated reporting program does not exceed the firm's ability to supervise the activity and to subject it to a rigorous system of internal controls. Any firm that cannot properly supervise the dissemination of consolidated reports by its registered representatives must prohibit the dissemination of those reports and take necessary steps to ensure that its registered representatives comply with this prohibition.

Sound Practices

FINRA encourages firms to consider the practices described below when reviewing their consolidated reporting programs. This *Notice* is not intended to be a comprehensive roadmap for compliance and supervision; rather, it outlines measures that may assist firms in complying with their various supervisory obligations. Firms should consider these practices in assessing their own procedures and in implementing improvements that will best protect their customers. Firms must adopt procedures and controls that are most effective given the firm's size, structure and operations.

1. **Ongoing audits and reviews**

   Due to the potential risks related to consolidated reporting, some firms have incorporated a review of the consolidated reporting process as a standard element in their testing and oversight programs. These firms test for regulatory compliance, data accuracy and adherence to supervisory procedures in audits, branch office reviews and as an ongoing part of their program of internal inspections required by NASD Rule 3010. Some firms require branch offices that produce consolidated reports to obtain an annual third-party audit of the process.

2. **Centralize reporting systems**

   Maintaining multiple consolidated reporting systems can create a patchwork of processes and applications that may be difficult to adequately supervise. Some firms have chosen to centralize their consolidated reporting programs by requiring use of a single firm-wide system. Other firms that allow multiple report-producing systems, subject them to a centralized review and approval process. Participants in this review and approval process may include personnel from information technology, compliance and legal departments.

3. Customer addresses

Some of the stronger programs require that all consolidated reports be mailed centrally using the customer's address of record,[9] and have processes in place that reconcile address information used for account statements and consolidated reports. In the limited circumstances where different addresses are used to deliver customer account statements and consolidated reports, firms should maintain documentation explaining the discrepancy and indicating that the customer was provided notice or acknowledged the differing addresses.[10]

4. Assets held away

Some firms verify, when possible, information pertaining to assets held away. Some of these firms have opted not to include assets in the consolidated report when the firm cannot verify their existence or cannot validate the valuations.

5. Supporting documentation

Some firms maintain supporting documentation for reported assets with the customer file, or otherwise have it available to be reviewed alongside the consolidated report. This documentation may include information regarding source of data and methods used to determine accuracy and asset valuation. The information may be useful in discussing the consolidated reports with customers, in validating the accuracy of consolidated report-generating systems and for internal control/audit testing purposes.

6. Source documents

It is sound practice to encourage customers to review and maintain the original source documents that are integrated into the consolidated report, such as the statements for individual accounts held away from the broker-dealer. Customers may be tempted to disregard these source documents because of the convenience of the consolidated report. However, source documents may contain notices, disclosures and other information important to the customer, and may also serve as a reference should questions arise regarding the accuracy of the information in the consolidated report.

7. Report design

The design and formatting of consolidated reports is important for ensuring information is clearly communicated. In addition to the requirements outlined above, firms are encouraged to include, when applicable, the following disclosures:[11]

- that the consolidated report is provided for informational purposes and as a courtesy to the customer, and may include assets that the firm does not hold on behalf of the customer and which are not included on the firm's books and records;
- the names of the entities providing the source data or holding the assets, their relationship with each other (*e.g.*, parent, subsidiary or affiliated organization) and their respective functions (introducing/carrying brokerage firms, fund distributor, banking/insurance product providers, etc.);
- a statement clearly distinguishing between assets held or categories of assets held by each entity included in the consolidated report;
- the customer's account number and contact information for customer service at each entity included in the consolidated report;
- identify that assets held away may not be covered by SIPC[12]; and
- if the consolidated report provides aggregate values for several different assets, an explanation of how the aggregated values of the different types of assets were arithmetically derived from separate asset totals.

8. Disclosures and attestations

To help ensure that a customer is apprised of the nature of the consolidated reporting process, and to ensure delivery of any disclosures or other pertinent information, firms may consider obtaining the customer's signed acknowledgement that he or she has been provided with the relevant disclosures and understands the nature and limitations of the consolidated reporting process. These disclosures may, for example, be included with applicable communications regarding privacy protections. Firms should consider a means to refresh this notice on a periodic basis.

Endnotes

1 This reporting is most commonly issued by firms that maintain an affiliated investment adviser or by registered representatives who also provide investment advisory services to their customers.

2 The FINRA rulebook currently consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and the Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, *see Information Notice 3/12/08* (Rulebook Consolidation Process). For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

3 Vendors include Web-based application service providers (ASPs) that aggregate financial data and create reports to firm specifications that may be mailed to customers or, if the firm desires, can be accessed on a read-only basis from the ASP's Web server. To the extent that firms rely on third-party vendors, firms are responsible for complying with applicable requirements regarding outsourcing, as discussed in *Notice to Members 05-48*. The *Notice* clarifies firm responsibilities when outsourcing "covered activities," which the *Notice* identifies as activities or functions that, if performed directly by firms, would be required to be the subject of a supervisory system and written supervisory procedures pursuant to NASD Rule 3010.

4 Depending on the form, content and method of dissemination, these consolidated reports may be considered sales literature or correspondence. As such, they may be subject to various requirements outlined in NASD Rules 2210 and 2211 and associated guidance, such as the requirement for clear and prominent display of the firm's name on communications and disclosures related to use of performance information.

5 Inaccuracies may include discrepancies associated with having consolidated reports and customer account statements produced through separate systems or by different entities. For example, firms have reported finding numerous instances in which the same in-house transaction was reflected differently in each document, thereby requiring a correction before publication or dissemination.

6 NASD Rule 2210(d)(1)(A). *See also Regulatory Notice 08-27* (May 2008) (Misleading Communications About Expertise).

7 The better information security programs routinely test controls over access to systems and data related to the reporting process as part of the firm's internal controls regime. Access controls must be rigorously supervised to avoid unauthorized use or manipulation of customer account data.

8 These multi-system situations often arise when a firm affiliates with or acquires a new group of representatives or branch offices that bring with them legacy systems. In some instances, a reporting system may be unique to a single branch office, even to the extent that a single branch may maintain a separate contractual relationship with a third-party vendor to provide these services.

Endnotes continued

9 Firms are required to have procedures to review, monitor and validate customer changes of address. These policies and procedures must include "a means or method of customer confirmation, notification, or follow-up that can be documented." NASD Rule 3012(a)(2)(B) and NYSE Rule 401.

10 This is consistent with NYSE Rule 409(b) and FINRA's proposed rule change to adopt NASD Rule 2340 (Customer Account Statements) as FINRA Rule 2231. Proposed Supplementary Material .01 (Transmission of Customer Account Statements to Other Persons or Entities) would expressly require a firm to obtain written instructions from the customer in order to send/deliver customer statements, confirmations or other communications to other persons or entities. *See* Securities Exchange Act Release No. 59921 (May 14, 2009), 74 FR 23912 (May 21, 2009).

11 These elements are drawn from existing guidance relating to multi-account reporting practices for customer account statements in NYSE Rule Interpretations 409(a)/04 (Assets Externally Held and Included on Statements Solely as a Service to Customers) and (a)/06 (Use of Summary Statements) and are consistent with FINRA's proposed rule change to adopt NASD Rule 2340 (Customer Account Statements) as FINRA Rule 2231. The multi-account reporting guidance in proposed FINRA Rule 2231, Proposed Supplementary Material .04 (Assets Externally Held and Included on Statements Solely as a Service to Customers) and Proposed Supplementary Material .06 (Use of Summary Statements) are substantially unchanged from existing NYSE Rule Interpretations 409(a)/4 and 409(a)/6. *See* Securities Exchange Act Release No. 59921 (May 14, 2009), 74 FR 23912 (May 21, 2009).

12 Firms should consider including a disclosure clarifying that their firm's SIPC coverage would only apply to those assets held at the firm, and to the extent some of the other reported entities may be SIPC members, customers should contact their financial representative or the other entity or refer to the other entity's statement regarding SIPC membership.

NASD Notice to Members 96-33

NASD Clarifies Rules Governing RR/IAs

Suggested Routing

- [x] Senior Management
- [ ] Advertising
- [ ] Corporate Finance
- [ ] Government Securities
- [ ] Institutional
- [x] Internal Audit
- [x] Legal & Compliance
- [ ] Municipal
- [ ] Mutual Fund
- [ ] Operations
- [ ] Options
- [x] Registration
- [ ] Research
- [ ] Syndicate
- [ ] Systems
- [ ] Trading
- [x] Training

Executive Summary

On May 15, 1994, the NASD® issued *Special Notice to Members 94-44*, which clarified the applicability of Article III, Section 40 of the NASD Rules of Fair Practice to investment advisory activities of registered representatives (RRs) who also are investment advisers (RR/IAs). In particular, the Notice addressed the supervision of securities transactions conducted by RR/IAs away from the NASD members with which they are associated. Since the issuance of *Notice to Members 94-44*, the NASD has responded to questions concerning the types of records that may be used and recordkeeping systems that may be established by an NASD member to ensure that investment advisory transactions subject to Article III, Section 40 are properly recorded and the RR/IA adequately supervised. The NASD also has responded to other general compliance and interpretive questions relating to Article III, Section 40. To further facilitate member firm compliance with Article III, Section 40, this Notice discusses recordkeeping approaches and presents the answers to some of the most frequently asked questions regarding Section 40 since the release of *Notice to Members 94-44*.

Questions regarding this Notice may be directed to Daniel M. Sibears, Director, Regulation, at (202) 728-6911; or Mary Revell, Senior Attorney, Regulation, at (202) 728-8203.

Background

As reviewed in *Notice to Members 94-44*, Article III, Section 40 requires that any person associated with an NASD member who participates in a private securities transaction must, before participating in the transaction, provide written notice to the member with which he or she is associated. The written notice must describe the transaction, the associated person's role, and disclose whether the associated person will or may receive selling compensation. Thereafter, the NASD member must advise the individual in writing whether it approves or disapproves the associated person's participation in a private securities transaction. If the member approves the transaction, the transaction must be recorded on the member's books and records, and the member must supervise the associated person's participation as if the transaction were executed on behalf of the member.

Most notably, *Notice to Members 94-44* clarifies the analysis that members must follow to determine whether the activity of an RR/IA falls within the parameters of Section 40. Fundamental to this analysis is whether the RR/IA participates in the execution of a securities transaction such that his or her actions go beyond a mere recommendation, thereby triggering the recordkeeping and supervision requirements of Section 40.

Where the RR/IA does not participate in the execution of securities transactions, *Notice to Members 94-44* reminds members and their RR/IAs that while Section 40 may not apply, the activity, nonetheless, may be subject to the notification provisions of Article III, Section 43. That section requires an RR to provide written notice to the NASD member with which he or she is associated of any proposed employment or outside business activity pursuant to which he or she will receive compensation from others. The form and content of an Article III, Section 43 notice is to be determined by the NASD member.

Article III, Section 40 Books And Records Relating To Investment Advisory Transactions

Where a member has approved an RR/IA's participation in private securities transactions for which he or she

will or may receive selling compensation, the member must develop and maintain a recordkeeping system that, among other things, captures the transactions executed by the RR/IA in its books and records and facilitates supervision over that activity. Recordkeeping systems that simply record all transactions will not result in adequate supervision under Article III, Section 27 of the Rules of Fair Practice. Rather, the records created and recordkeeping system used, together with relevant supervisory procedures, must enable the member to properly supervise the RR/IA by aiding the member's understanding of the nature of the service provided by an RR/IA, the scope of the RR/IA's authority, and the suitability of the transactions.

Since the transactions subject to Section 40 by definition occur at and through another member or directly with a product sponsor, the NASD member licensing the RR/IA is not required to record the activity in the same manner it records transactions executed on behalf of its own firm (i.e., on its purchase and sales blotter). Rather, members may develop and use alternative approaches that meet their specific needs and business practices, such as special blotters, separate Section 40 recordation forms and files, and unit systems, for capturing the RR/IA activity that occurs through other firms. In this regard, Section 40 recordkeeping systems may involve many of the following books and records:

• dated notifications from the RR/IA detailing the services to be performed by the RR/IA and the identity of each RR/IA customer serviced at another firm in a private securities transaction;

• dated responses from the NASD member to the RR/IA acknowledging and approving or disapproving the RR/IA's intended activities;

• a list of RRs who also are IAs;

• a list of RR/IAs approved to engage in private securities transactions;

• a list of RR/IA customers, including those that are customers of both the member firm and the RR/IA, with a cross reference to the RR/IA;

• copies of customer account opening cards to determine, among other things, suitability;

• copies of discretionary account agreements;

• duplicate confirmation statements;

• duplicate customer account statements;

• a correspondence file for RR/IA customers;

• investment advisory agreements between the RR/IA and each advisory client;

• advertising materials and sales literature used by the RR/IA to promote investment advisory services wherein the RR/IA holds himself or herself out as a broker/dealer, complemented by a process that shows whether proper filings have been made at the NASD and whether the RR/IA is using any electronic means, such as the Internet, to advertise services or correspond with customers;

• exception reports, where feasible, based on various occurrences or patterns of specified activity, such as frequency of trading, high compensation arrangements, large numbers of trade corrections, and cancelled trades; and

• supervisory procedures fully responsive to Article III, Section 27 requirements and designed to address Section 40 compliance. The procedures may include such items as the identity of persons responsible for Section 40 compliance, the recordkeeping system to be used and followed, and memoranda or compliance manuals that notify RR/IAs of the member's procedural requirements for Section 40 compliance.

Neither the federal securities laws nor the NASD Rules of Fair Practice mandate the supervisory system or structure that a member must use. Rather, each member can develop and implement its own supervisory system that is reasonably designed to detect and prevent violations. In this regard, no single document or combination of the referenced documents is specifically required or necessarily adequate to comply with Section 40 requirements. Rather, each member that determines to permit its associated persons to transact securities business through another broker/dealer must decide which tailored combination of records is necessary to develop an adequate supervisory system that addresses the allowable activities of RR/IAs. For example, obtaining duplicate confirmation statements directly from the RR/IA alone would permit a member to fulfill recordation requirements for the trades represented by confirmations received, but would not necessarily permit a member to reasonably ensure that it is capturing all trades. However, an arrangement under which the member obtains duplicate confirmation statements directly from the firm (or firms) that executes transactions for the RR/IA should be sufficient to ensure that the member captures all trades.

Member firms have tremendous flexibility to develop and implement recordkeeping and supervisory systems that meet the unique nature and scope of their own operations, and the permitted activities and services provided by their dually registered persons. In all circumstances, however, recordkeeping and supervision

must be adequate to ensure that full and complete transaction information is captured, and be reasonably designed to detect and/or prevent misconduct that could violate the federal securities laws and NASD Rules.

Answers To Frequently Asked Questions Concerning The Application Of Article III, Section 40 To Investment Advisory Activities

Question #1: Does Article III, Section 40 require prior approval of each transaction executed by an RR/IA away from his or her NASD member firm if the compensation received by the RR/IA is not transaction based?

Answer: An RR/IA may be involved in numerous transactions on a daily basis for which he or she receives asset-based or performance-based fees. Requiring prior notice of each trade effected under these conditions may hinder investors from properly receiving the investment advisory services provided by RR/IAs. Accordingly, the Board of Governors, acting on the recommendation of a special Ad Hoc Committee, has interpreted Article III, Section 40 to require prior notice of the investment advisory services that will be provided by the RR/IA for an asset-based or a performance-based fee, rather than prior notice of each trade effected by an RR/IA for a particular customer. This interpretation is intended to vigorously apply the investor protection concepts of Article III, Section 40 to investment advisory activities in a practical manner.

A member must receive prior written notice from an RR/IA requesting approval to conduct investment advisory activities for an asset-based or performance-based fee on behalf of each of his or her advisory clients. This notice must include details such as:

• a declaration that the individual is involved in investment advisory activities;

• the identity of each customer to whom the notice would apply;

• the types of securities activities that may be executed away from the firm;

• a detailed description of the role of the RR/IA in the investment advisory activities and services to be conducted on behalf of each identified customer;

• information regarding the RR/IA's discretionary trading authority, if any;

• compensation arrangements;

• the identity of broker/dealers through which trades away will be executed; and

• customer financial information.

Only after written approval from the NASD member may the RR/IA engage in the disclosed activities. If there is a change in the RR/IA's proposed role or activities for any customer from what the member initially approved, the RR/IA must provide the member with a subsequent written notice that details the changes and requests the member's further approval to conduct advisory activities on behalf of the customer. The employer member must thereafter record subsequent transactions on its books and records and supervise activity in the affected accounts as if it were its own.

Members are reminded, however, that if the RR/IA receives transaction-based compensation, the member's prior approval of each trade is required.

Question #2: Does Article III, Section 40 apply to persons employed by or associated with registered investment advisory firms if such persons are not registered in an individual capacity with the Securities and Exchange Commission (SEC) or various states?

Answer: Yes. Article III, Section 40 of the Rules of Fair Practice applies to all of an associated person's private securities transactions, regardless of whether or not such associated persons are also registered with other regulatory authorities such as the SEC or the states. The reference to registered investment advisers in *Notice to Members 94-44* does not limit the applicability of Article III, Section 40 to only those persons individually registered as such with other regulatory entities. In addition, if the advisory service is not registered with any regulatory agency, a member should ensure that such registration is not required.

Question #3: Is it appropriate for a limited principal (i.e., a Series 26 Investment Company Principal) to supervise Article III, Section 40 transactions in products such as equity securities that are not covered by that registration category?

Answer: Limited principals may not supervise Article III, Section 40 transactions in products not covered by their registration category. Therefore, if a firm only has principals registered in a limited capacity, associated persons engaging in Article III, Section 40 transactions may do so only in products covered by the licenses of the firm's principals.

Question #4: Is it appropriate for a limited representative (i.e., a Series 6 Investment Company Representative) to execute Article III, Section 40 transactions in products such as equity securities that are not covered by that registration category?

Answer: A limited RR who is otherwise in compliance with applicable

federal and state registration requirements, such as the SEC's investment adviser registration requirements, may not execute transactions in securities not covered by his or her NASD registration. Registration with the NASD as a representative subjects an individual to all NASD rules, regulations, and requirements, including qualification requirements. Those rules preclude a limited representative from acting as a representative in any area not covered by his or her registration category. A limited representative who wishes to execute transactions in securities not covered by his or her registration category is required to pass an appropriate qualification exam.

Question #5: If an RR/IA is registered with more than one NASD member, must all members approve, supervise, and record the Article III, Section 40 transactions?

Answer: All members with whom a person is registered are responsible for the registered representative's involvement in Section 40 transactions. Members may develop a detailed, formal allocation arrangement whereby at least one member agrees and is able to provide the supervision and recordkeeping required by Article III, Section 40. However, the other members would be required to take the reasonable steps necessary to ensure that Section 40's recordkeeping and supervisory requirements are being carried out since members cannot delegate, by contract or otherwise, their ultimate responsibility for compliance with regulatory requirements.

Question #6: What is a member's responsibility with regard to supervising Section 40 securities transactions where an advisory client of an RR/IA refuses to provide information to the member, citing the confidentiality of client information provisions of an investment advisory agreement?

Answer: Article III, Section 40, which was adopted in 1985, and its predecessor Interpretation of the Board of Governors have always stipulated that a member that allows an associated person to participate in a Section 40 transaction is responsible for supervising that transaction as if it were its own. If a member determines that in order to meet its supervisory obligations under Section 40, it must have certain information from the customer and if the customer refuses to provide the information, the member should deny the associated person's request who would then be precluded from participating in the Section 40 activity.

Question #7: Are there circumstances under which income received as salary payments may be deemed selling compensation as defined by Article III, Section 40?

Answer: As explained in *Notice to Members 94-44*, selling compensation is broadly defined to include any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security. If salary payments are direct or indirect compensation for an RR/IA's participation in the execution of securities transactions away from his or her member firm, the salary payments would be deemed "selling compensation," and the activities would be subject to Article III, Section 40.

Question #8: Where investment seminars are conducted by RR/IAs away from their employing NASD member and seminar participants are charged a fee for attendance, would any income derived from the seminar for this investment advisory activity be governed by Article III, Section 40 or Section 43 of the Rules of Fair Practice?

Answer: If an investment seminar itself does not result in the execution of securities transactions, Article III, Section 43 would govern the investment advisory activity. In determining whether Article III, Section 40 applies, the NASD has focused primarily upon the RR/IA's participation in the execution of securities transactions and whether the participation goes beyond a mere recommendation. If after an investment seminar, however, participants decide to engage in securities transactions with the participation of the RR/IA, that subsequent activity and any compensation received in connection therewith would be subject to Section 40.

Question #9: Must a member review performance reports produced by RR/IAs to properly discharge its supervisory responsibilities under Article III, Section 40?

Answer: It has come to the NASD's attention that some RR/IAs use information supplied by the broker/dealer through which they conduct private securities transactions or by the investment advisory service corporations with which they are associated to create performance reports for their advisory clients. These reports may be individualized performance reports that provide customized information for a specific client or standardized performance reports that provide general information to multiple clients. With regard to this practice, members and RR/IAs are cautioned that in creating or recreating performance reports, a risk is taken that calculations for securities transactions may be inaccurate, incomplete, or misleading, thus resulting in material misrepresentations being made or material facts being omitted. NASD member supervisory responsibilities should include a determination as to whether to permit associated persons to develop performance reports for securities transactions. If this activity is permitted, the member firm must review the performance reports.

Standardized reports sent to multiple clients are considered sales literature and must be reviewed by a registered principal at the member firm before distribution by the RR/IA to clients. If the RR/IA uses the same standardized format for different clients, principal approval before use is required only on the performance report prototype. This review must ensure that the reports are accurate, not misleading, or otherwise in violation of NASD or SEC Rules. In particular, members should review the standards set forth in Article III, Section 35 of the NASD Rules governing member communications with the public, as well as applicable SEC regulations.

Individualized performance reports are considered correspondence. As such, review by the member firm before RR/IA distribution to clients is not required. However, the firm must have appropriate procedures in place, as required by Article III, Section 27 of the NASD Rules of Fair Practice, for review and retention of individualized performance reports and other correspondence.

Question #10: Must NASD members that employ RR/IAs provide training to this segment of their associated persons under the Firm Element of the Continuing Education requirements?

Answer: The Firm Element of the Continuing Education requirements (see Schedule C of the NASD By-Laws) is designed to be flexible and to permit firms to develop tailored educational programs based on their business practices and needs. In this regard, each member that permits its associated persons to conduct securities transactions through another firm should assess the need to provide specific Firm Element training with regard to Section 40 requirements. Where the assessment establishes a need for educational initiatives for all or some portion of the covered persons conducting business away from the member, the firm's written training plan should include defined and scheduled Section 40 training for specified individuals.

Although this Notice and previously issued *Notices to Members 91-32* and *94-44* clarify the application of Article III, Section 40 to investment advisory activities, Section 40 has been in effect since November 12, 1985 (see *Notice to Members 85-84*). Accordingly, members and their RR/IAs are expected to be in compliance with Article III, Section 40.

Print

94-44 Board Approves Clarification On Applicability Of Article III, Section 40 Of Rules Of Fair Practice To Investment Advisory Activities Of Registered Representatives

SUGGESTED ROUTING
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Executive Summary

The Board of Governors, acting on the recommendation of a special Ad Hoc Committee, is clarifying the applicability of Article III, Section 40 of the NASD Rules of Fair Practice to the investment advisory activities of registered representatives. This Notice describes those investment advisory activities that constitute private securities transactions within the scope of Article III, Section 40.

Summary Of Article III, Section 40

Article III, Section 40 provides that any person associated with a member who participates in a private securities transaction must, prior to participating in the transaction, provide written notice to the member with which he or she is associated. The required notice must describe the transaction, the associated person's role, and state whether the associated person has received or may receive selling compensation. The member must respond to the notice in writing indicating whether it approves or disapproves the proposed transaction. Where the registered person has received or may receive selling compensation, the member approving the transaction must record the transaction in its books and records and must supervise the registered person's participation in the transaction as if it was the member's own under Article III, Section 27 of the Rules of Fair Practice.

Section 40 defines "private securities transaction" as any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the U.S. Securities and Exchange Commission (SEC).

"Selling compensation" is defined as any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements.

Notice to Members 85-84, which announced the approval of Article III, Section 40, broadly defined the scope of selling compensation and deliberately meant to include the receipt of any item of value received or to be received, directly or indirectly, from the execution of any such securities transaction. The Notice also discussed that Article III, Section 40 was specifically designed to apply to situations where the registered person was acting as a salesperson or in some other capacity.

Background Of The Application Of Section 40 To RR/RIAs

The National Business Conduct Committee (NBCC), at its May 1991 meeting, considered the issue of the applicability of Article III, Section 40 of the Rules of Fair Practice to certain activities of individuals who are registered both as representatives of an NASD member firm and with the SEC as a Registered Investment Adviser ("dually registered person" or "RR/RIA"), and who conduct their investment advisory activities "away from" their NASD member employer. The issue was considered by the NBCC as a result of a number of requests for interpretations relating to programs under which registered representatives directed securities transactions for their investment advisory clients to a broker/dealer other than the firm with which they are registered.

The NBCC concluded that Article III, Section 40, consistent with the policy announced when the section was adopted, applied in such a manner as to cover certain activities of individuals who are registered both as a representative of an NASD member and with the SEC as an investment adviser. The NBCC stated that Section 40 should apply to all investment advisory activities conducted by these dually registered persons that result in the purchase or sale of securities by the associated person's advisory clients, with the exception of their activities on

behalf of the member. The NBCC also determined that the receipt of compensation as a result of investment advisory activities constituted the receipt of selling compensation as defined in Section 40.

The NBCC then issued *Notice to Members 91-32,* explaining its position and soliciting comments on other advisory compensation arrangements, including "wrap" fees, that had not been before the Committee. In response to *Notice to Members 91-32,* the NASD received over 150 comment letters. Few of the letters addressed the NBCC's request for information on other compensation arrangements but rather sought to clarify the NBCC's view on the application of Section 40 to various factual scenarios involving the activities of dually registered persons. After reviewing the comments, the NBCC and the Board appointed an Ad Hoc Committee of the Board to examine this entire area. This special committee met numerous times to review the comment letters, the history and intent of Section 40, and to receive input from various segments of the securities industry, including those most affected by the NBCC's position.

Following extensive discussions and deliberations, the Ad Hoc Committee formulated a clarification which the Board considered and adopted. The following discussion explains the Board's clarification of its position on the scope of transactions that would be deemed to be "for compensation" under Article III, Section 40 with respect to registered representatives/registered investment advisers.

Clarification

In clarifying its previous position in *Notice to Members 91-32,* the Board focused primarily upon the RR/ RIA's participation in the execution of the transaction—meaning participation that goes beyond a mere recommendation. Article III, Section 40, therefore, applies to any transaction in which the dually registered person participated in the execution of the trade.

An example of a RR/RIA clearly participating in the execution of trades is where he or she enters an order on behalf of the customer for particular securities transactions either with a brokerage firm other than the member they are registered with, directly with a mutual fund, or with any other entity, including another adviser, and receives any compensation for the overall advisory services. As a result, the "for compensation" provisions of Article III, Section 40 would apply, thereby requiring the RR/RIA adviser to provide notice to his or her firm and requiring that firm, if it approved the activities, to record the transactions and supervise the conduct of the RR/RIA. The Board has determined to exclude from Section 40 coverage arrangements under which the account is "handed off' to unaffiliated third-party advisers that make all investment decisions. This, and most other advisory activities, would fall under and be subject to the requirements of Article III, Section 43 of the Rules of Fair Practice.

Activities that would fall under either Sections 40 or 43 of the Rules of Fair Practice can be generally categorized as follows:

1. Transactions executed on behalf of the customer in which the RR/RIA participated in the execution would be subject to the full "for compensation" provisions of Section 40, thereby requiring the member to record and supervise the transactions. This would be the case whether the RR/RIA received transactionally related, commission-type compensation, asset-based management fees, wrap fees, hourly, yearly, or per-plan fees, as long as fees paid include execution services by the RR/RIA. Also included are situations where the dually registered person has an arrangement with a third-party money manager to handle the customer's account and the RR/RIA makes individual investment decisions for the client, based on recommendations or alternatives provided by the third-party manager.

2. Only transactions executed on the customer's behalf without any form of compensation would be subject to the "non-compensation" provisions of Section 40. It is unlikely that activity of this sort would exist to any substantial degree outside of a familial type relationship.

3. All other investment advisory activities that do not include the RR/RIA's participation in the execution would be subject to the notification provisions of Article III, Section 43. These activities would include securities transactions executed by customers independently through another broker/dealer or directly with a fund or other entity based on specific recommendations of the dually registered person, timing services where the service makes the investment decision, the utilization of unaffiliated third-party advisers where the RR/RIA does not participate in investment decisions for the client, financial plan creation and other such activities.

Analysis Of Various Scenarios Under The Clarification

The following are issues raised in correspondence from members and the results under this interpretation.

1. A service offered by many discount brokerage firms includes the firm providing "back office" services for the dually registered person which include collection of the asset-based advisory fee. Here, the RR/RIA has opened an account on behalf of a customer and has discretionary authority to execute transactions on the customer's behalf. Under these facts, the "for compensation" of Section 40 would apply.

2. Some RR/RIAs engage in activities limited to the writing of financial plans for a fee which do not include specific securities purchase recommendations or executions. Under this approach, such activities would be governed by Section 43.

3. Some asset management firms offer "wrap fee" programs to registered investment advisers. The "wrap fee" includes a fee for management, accounting, and reporting. This fee is shared with the investment adviser who is also a registered representative. Portfolio transactions are handled through a broker/dealer firm at substantial discounts and are not known to or handled by the RR/RIA. Investment advisers receive a part of the asset management fee only and receive no part of any transaction fee. The adviser is registered with the SEC and any states as necessary. This activity would be subject to Section 43 rather than Section 40 of the Rules of Fair Practice.

4. There are firms offering market timing services where the firm, operating as an independent investment adviser, directs the switches within a family of mutual funds, either load or no-load. There are no transaction charges and the investment adviser, also a registered representative, is not involved in handling switches among funds. The dually registered person does receive some part/percentage of the market timing fee. If the customer or timing firm effects the switches with no involvement by the RR/RIA, this fact pattern would be considered as falling under Section 43.

5. Investment advisers who are also registered representatives often charge an advisory fee to "time" a group of load or no-load mutual funds for clients. This process could also be described as asset allocation or a monitoring service. The exchange of funds is handled directly by the investment adviser with the fund group. This pattern differs from number 4 in that the adviser effects the transactions. These are "for compensation" transactions pursuant to Section 40.

6. There are several firms which provide asset allocation models, software, computer hardware, and direct linkup and execute the transactions as necessary. Each adviser can produce statements for clients based on downloaded information. The RR/RIA receives a portion of the asset-based fee for his or her monitoring of the account. The firm to which the account is referred actually handles all implementation, and the dually registered person has no part in the actual transactions. These third-party arrangements are covered by Section 43.

7. Institutional advisers offer services to individual investment advisers which include permitting the adviser to implement, via computer, purchases and sales in institutional funds. Assets are held at banks and the RR/RIA produces statements and confirms for a client. The RR/RIA also handles the allocation of assets and places transactions. The client can pay one combined fee or two separate fees. One is paid to the mutual fund (internal fee) and the second is paid separately to the dually registered person for handling the account. To the degree that the RR/RIA participates in the execution of the transactions, this would produce a "for compensation" Section 40 result.

8. Investment advisers may advise clients on assets held and transacted at another broker/dealer without being involved in implementation or execution. The RR/RIA may receive copies of statements and charges an advisory fee which is for investment advice and monitoring not related to any transactions in the account. This scenario does not involve either the recommendation or execution of transactions. Since the service is solely advice and monitoring "not related to any transactions in the account," the activities would fall under Section 43.

9. Varying situation number 8, such that the adviser calls the representative of the other broker/dealer to implement or execute transactions but receives no fee or commission for the handling thereof, results in "for compensation" transactions under Section 40.

Members and RR/RIAs are expected to be in compliance with the Board's Interpretation as clarified in this Notice. Those firms and RR/RIAs who have not been operating in accordance with the provisions of *Notice to Members 91-32* must immediately conform their activities in order to ensure compliance with the concepts and requirements that have been clarified in this Notice. NASD district examiners will be closely reviewing for compliance with this Interpretation during the course of their field examinations, and violations will be reviewed by DBCCs for consideration of disciplinary action. This clarification should enhance members' abilities to design internal policies and procedures to protect customers who deal with dually registered persons and to prevent potential violations of NASD rules and regulations, particularly Article III, Section 40 of the Rules of Fair Practice. directed to Daniel Sibears, Director, Any questions or inquiries concerning the applicability of Article in, Section 40 to the activities of RR/RIAs may be directed to Craig Landauer, Associate General Counsel at (202) 728-8291. Questions relating to members' general compliance and recordkeeping responsibilities under Article III, Section 40 may be Regulatory Policy at (202) 7286911.

Municipal Advisor Rules

November 20, 2014 / 1:00 p.m. – 2:15 p.m.

Municipal Advisor Rules

Gene Davis, Regulatory Principal, FINRA, New Orleans District Office

Gene Davis is a regulatory principal located in the New Orleans District Office and has been employed with FINRA since 1997. As an examiner, he has conducted numerous routine and cause examinations of member firms. Specifically, Mr. Davis has conducted numerous focused examinations with regard to fixed-income related issues. Mr. Davis has completed the NASD Institute-Wharton Certificate Program, obtaining the Certified Regulatory and Compliance Professional (CRCP) designation in 2004.

Cynthia Friedlander, Director, Fixed Income Regulation, FINRA

Cynthia Friedlander is the Director, Fixed Income Regulation within FINRA Regulatory Operations. Ms. Friedlander is responsible for directing FINRA's policies and national programs related to fixed income securities, including related regulatory matters in FINRA district offices. Specifically, she is responsible for the design, development and delivery of fixed income policy guidance to staff throughout FINRA, as well as to member firms, and is one of FINRA's primary representatives in fixed income regulatory matters with the Municipal Securities Rulemaking Board (MSRB) and the Securities and Exchange Commission (SEC). Ms. Friedlander represents FINRA at government agency, SRO, and industry and advisory meetings, and is a staff liaison to FINRA's Fixed Income Committee. She holds a bachelor's degree from the University of Virginia and an M.B.A. from George Mason University.

Saliha Olgun, Counsel, Municipal Securities Rulemaking Board

Saliha Olgun is Counsel for the Municipal Securities Rulemaking Board (MSRB), where she participates in the development of rulemaking and regulatory policy. Prior to this role, Ms. Olgun acted as the Regulatory Education Manager at the MSRB where she designed legal educational content, developed webinars, conducted trainings and evaluated educational efforts related to the MSRB's rules and municipal market activities. Prior to joining the MSRB, Ms. Olgun was an associate at Sullivan & Cromwell, LLP, where she worked on varied corporate matters, such as complex structured finance deals, securities issuances, and regulatory matters for financial institutions. Ms. Olgun received a bachelor's degree from George Mason University and a law degree from New York Law School.

Rebecca Olsen, Chief Counsel, Office of Municipal Securities U.S. Securities and Exchange Commission

Rebecca Olsen is Chief Counsel in the Office of Municipal Securities of the U.S. Securities and Exchange Commission, which is responsible for administering SEC rules on practices of broker-dealers, municipal advisors, investors, and issuers in the municipal securities area and coordinating with the Municipal Securities Rulemaking Board (MSRB) on rulemaking and enforcement actions. The Office of Municipal Securities advises the commission and other SEC offices on policy matters, enforcement, and other issues affecting the municipal securities market and oversees MSRB rulemaking and the SEC's municipal advisor registration program. Prior to joining the SEC, Ms. Olsen worked as public finance attorney at the law firm of Ballard Spahr LLP for more than a decade, where she served as underwriter's counsel, bond counsel, lender's counsel, and borrower's counsel on a wide variety of public debt offerings and private placements. Ms. Olsen has a bachelor's degree in political science from Boston College, a law degree from the Georgetown University Law Center and an LL.M. in international business law from the Vrije Universiteit Amsterdam, The Netherlands.

Lawrence P. Sandor, Deputy General Counsel, Municipal Securities Rulemaking Board

Lawrence Sandor is the Deputy General Counsel of the Municipal Securities Rulemaking Board. He joined the MSRB in December 2008 and has held several positions including Associate General Counsel and Senior Associate General Counsel. As Deputy General Counsel, Mr. Sandor has responsibility for the MSRB's support of regulators that examine regulated entities for compliance with MSRB rules and enforce those rules, corporate governance, professional qualifications and internal legal matters. Mr. Sandor has extensive experience in broker-dealer issues, policies and procedures, and compliance practices. He previously served as Chief Compliance Officer of Wachovia Securities and Wachovia Securities Financial Network, and as General Counsel of a regional broker-dealer. He represented large and small financial institutions as Counsel at the law firm of Dickstein, Shapiro, Morin & Oshinsky LLP, and as an associate attorney at McGuire Woods LLP in Washington, D.C. Mr. Sandor has published material in a variety of publications regarding the securities industry and has spoken at numerous industry conferences and seminars, including securities conferences sponsored by the Securities Industry and Financial Markets Association, Bond Dealers of America, New York Stock Exchange, American Bar Association, American Bankers Association, National Association of Compliance Professionals, and National Regulatory Service. He graduated from Boston University School of Management, *cum laude*, in 1983 and Emory University School of Law in 1986.

South Region Compliance Seminar

Municipal Advisor Rules

November 20, 2014

FINRA
Financial Industry Regulatory Authority

Municipal Advisor Rules

- Moderator - Gene Davis, Regulatory Principal, FINRA New Orleans District Office
- Panelist - Rebecca Olsen, Chief Counsel, Office of Municipal Securities, U.S. Securities and Exchange Commission,
- Panelist - Cynthia Friedlander, Director Fixed Income Regulation, FINRA Regulatory Operations
- Panelist - Lawrence Sandor, Deputy General Counsel, MSRB
- Panelist - Saliha Olgun, Counsel, MSRB

FINRA

Municipal Advisor Rules

- **Municipal Advisor Resources**
  - U.S. Securities and Exchange Commission Office of Municipal Securities
    - http://www.sec.gov/municipal
  - Municipal Securities Rulemaking Board
    - http://www.msrb.org/MSRB-For/Municipal-Advisors.aspx

Municipal Advisor Rules

- **Contact Information**
  - Gene Davis - Gene.Davis@finra.org – (504) 412-2414
  - Rebecca Olsen - Office of Municipal Securities Main Number: (202) 551-5680
  - Lawrence Sandor - lsandor@msrb.org - MSRB Main Number: (703) 797-6600
  - Saliha Olgun - solgun@msrb.org - MSRB Main Number: (703) 797-6600

Last Updated on May 19, 2014

Registration of Municipal Advisors
Frequently Asked Questions
Office of Municipal Securities

In responding to these Frequently Asked Questions ("FAQs"), the Office of Municipal Securities ("staff") is providing general interpretive guidance on certain aspects of the final rules for the registration of municipal advisors.[1] Responses to these FAQs were prepared by and represent the views of the staff. These FAQs are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved these FAQs or the interpretive answers to these FAQs.

The staff may update these questions and answers periodically. Any updates will include appropriate references to dates of new or modified questions and answers.

For Further Information Contact: Any of the following members of the staff: John Cross, Director; Jessica Kane, Deputy Director; Rebecca Olsen, Chief Counsel; Mary Simpkins, Senior Special Counsel; Edward Fierro, Attorney-Adviser; or Cori Shepherd, Attorney-Adviser; Office of Municipal Securities, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010. Contact phone number: (202) 551-5680.

Background

Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended Section 15B of the Securities Exchange Act of 1934 ("Exchange Act") to add a new requirement that "municipal advisors" register with the Securities and Exchange Commission ("Commission" or "SEC"), effective October 1, 2010.

The Commission adopted, and subsequently extended until December 31, 2014, an interim final temporary rule to establish a temporary means for municipal advisors to satisfy the registration requirement ("Temporary Registration Rule").[2] On September 20, 2013, the Commission adopted final rules for municipal advisor registration ("Final Rules").[3] Among other things, the

[1] The staff initially issued these FAQs on January 10, 2014. *See* Press Release, Interpretive Guidance on Municipal Advisor Registration Rules (January 10, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540602870. On January 13, 2014, the Commission temporarily stayed the final rules for municipal advisor registration until July 1, 2014. *See* Registration of Municipal Advisors; Temporary Stay of Final Rule, Release No. 34-71288 (January 13, 2014), 79 FR 2777 (January 16, 2014), available at http://www.sec.gov/rules/final/2014/34-71288.pdf. On January 16, 2014, the staff modified certain references to the effective date in the Background and in the Answer to Question 9.2 to reflect the temporary stay of the final rules for municipal advisor registration until July 1, 2014. On May 19, 2014, the staff issued additional FAQs.

[2] *See* Extension of Temporary Registration of Municipal Advisors, Release No. 34-70468 (September 23, 2013), 78 FR 59814 (September 30, 2013), available at http://www.sec.gov/rules/interim/2013/34-70468.pdf.

[3] *See* Registration of Municipal Advisors, Release No. 34-70462 (September 20, 2013), 78 FR 67467 (November 12, 2013), available at http://www.sec.gov/rules/final/2013/34-70462.pdf.

Final Rules interpret the statutory definition of the term "municipal advisor." In addition, the Final Rules interpret the statutory exclusions from that definition and provide certain additional regulatory exemptions. In the Final Rules and the adopting release accompanying the Final Rules ("Adopting Release"), the Commission limited the scope of these exclusions and exemptions to certain identified activities as opposed to focusing on the status of the particular market participants.

The Final Rules were effective on January 13, 2014; however, on January 13, 2014, the Commission temporarily stayed the Final Rules until July 1, 2014 and made conforming, non-substantive amendments to Rule 15Ba1-8 regarding recordkeeping requirements to conform the dates referenced in certain provisions of that rule to the July 1, 2014 date ("Temporary Stay Release").[4] This stay of the Final Rules means that persons are not required to comply with the Final Rules until July 1, 2014. In the Adopting Release, the Commission provided a phased-in compliance period, beginning on July 1, 2014 and ending on October 31, 2014, for municipal advisors to comply with the requirement to register as municipal advisors using the final registration forms under the Final Rules.[5] The temporary stay of the Final Rules does not affect this phased-in compliance period.[6]

Responses to Frequently Asked Questions

SECTION 1: THE ADVICE STANDARD

Question 1.1: The General Information Exclusion from Advice versus Recommendations: What are some relevant considerations regarding the content, context, and manner in which a person may provide information (either in writing or in oral communications) to a municipal entity or obligated person without giving "advice" that would require registration as a municipal advisor?

Answer: *Overview of Advice Standard*. Under the Commission's interpretation in the Adopting Release of the term "advice" solely for purposes of the municipal advisor definition,[7] the term "advice" is not susceptible to a bright-line definition and can be construed broadly, and the determination of whether a person provides advice to or on behalf of a municipal entity or an obligated person regarding municipal financial products or the issuance of municipal securities depends on all of the relevant facts and circumstances. Further, in the Adopting Release, the Commission stated that "for purposes of the municipal advisor definition, advice includes, without limitation, a '*recommendation*' that is particularized to the specific needs, objectives, or circumstances of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, based on all the

[4] *See* Registration of Municipal Advisors; Temporary Stay of Final Rule, Release No. 34-71288 (January 13, 2014), 79 FR 2777 (January 16, 2014), available at http://www.sec.gov/rules/final/2014/34-71288.pdf.
[5] *See* Adopting Release, 78 FR at 67581-67583.
[6] *See* Temporary Stay Release, 79 FR at 2777.
[7] Adopting Release, 78 FR at 67479.

facts and circumstances (emphasis added)."[8] Conversely, in the Final Rules, the Commission adopted new Exchange Act Rule 15Ba1-1(d)(1)(ii) which expressly provides that "advice" excludes, among other things, the provision of general information that does not involve a recommendation regarding municipal financial products or the issuance of municipal securities ("general information exclusion"). In the Adopting Release, the Commission provided certain examples of general information, including information of a factual nature without subjective assumptions, opinions, or views, and information that is not particularized to a specific municipal entity or type of municipal entity.[9]

The focus of the advice standard in the Final Rules is whether or not, under all the relevant facts and circumstances, the information presented to a municipal entity or obligated person is sufficiently limited so that it does not involve a recommendation that constitutes advice. In other words, the determination of whether a person provides advice under the advice standard for municipal advisor registration purposes generally involves whether the person makes a recommendation. In the Adopting Release, the Commission stated "for purposes of the municipal advisor definition, the Commission believes that the determination of whether a recommendation has been made is an objective rather than a subjective inquiry. An important factor in this inquiry is whether, considering its content, context and manner of presentation, the information communicated to the municipal entity or obligated person reasonably would be viewed as a suggestion that the municipal entity or obligated person take action or refrain from taking action regarding municipal financial products or the issuance of municipal securities."[10]

Examples of the General Information Exclusion from Advice. The staff believes that a person could rely on the general information exclusion from advice under the Final Rules when providing a municipal entity or obligated person with information that does not involve a recommendation, such as factual information that does not contain subjective assumptions, opinions, or views. Examples of this type of general information include: (a) information regarding a person's professional qualifications and prior experience (e.g., lists, descriptions, terms, or other information regarding prior experience on completed transactions involving municipal financial products or issuances of municipal securities); (b) general market and financial information (e.g., market statistics regarding issuance activity for municipal securities or current market interest rates or index rates for different types of bonds or categories of credits); (c) information regarding a financial institution's currently-available investments (e.g., the terms, maturities, and interest rates at which the financial institution offers these investments) or price quotes for investments available for purchase or sale in the market that meet criteria specified by a municipal entity or obligated person; (d) factual information describing various types of debt financing structures (e.g., fixed rate debt, variable rate debt, general obligation debt, debt secured by various types of revenues, or insured debt), including a comparison of the general characteristics, risks, advantages, and disadvantages of these debt financing structures; and (e) factual and educational information regarding various government financing programs

[8] Adopting Release, 78 FR at 67480.
[9] Adopting Release, 78 FR at 67479.
[10] Adopting Release, 78 FR at 67480.

and incentives (e.g., programs that promote energy conservation and the use of renewable energy).

In addition, the staff believes that information that is particularized to the municipal entity or obligated person in limited respects could be consistent with the general information exclusion from advice, provided that the information is factual in nature and does not contain or express subjective assumptions, opinions, or views, or constitute a recommendation. For example, the staff believes that a person could provide general market information regarding a municipal entity's particular outstanding bonds, such as current market prices and yields, without this information constituting a recommendation.

Potential Implied Recommendations. The staff further believes, however, that information that is particularized in more than the limited respects described above in the immediately preceding paragraph to a municipal entity or obligated person potentially could imply a recommendation that could constitute advice under the Final Rules, depending on all of the relevant facts and circumstances. The more individually tailored the information is to a specific municipal entity or obligated person or group of municipal entities or obligated persons that share similar characteristics, the more likely the information will be considered to be a recommendation. For example, if a person provided information regarding debt financing structuring options that was tailored to address the specific needs, objectives, or circumstances of a municipal entity or obligated person, such as information tailored to address particular fiscal needs or to incorporate particular revenue projections, the staff believes that presenting these particularized options likely would suggest a preferred financing approach that likely would imply a recommendation.

Effect of Disclosures and Disclaimers on Advice Analysis. The staff believes that disclosures and disclaimers regarding a person's intentions in providing information to a municipal entity or obligated person are factors that bear upon whether or not the person's communications would be a recommendation that constitutes advice under the Final Rules. The staff believes that the following disclosures and disclaimers, clearly and conspicuously stated, in written materials that accompany communications to a municipal entity or obligated person, would be factors that weigh against treatment of information as a recommendation that constitutes advice: (a) this person is not recommending an action to the municipal entity or obligated person; (b) this person is not acting as an advisor to the municipal entity or obligated person and does not owe a fiduciary duty pursuant to Section 15B of the Exchange Act to the municipal entity or obligated person with respect to the information and material contained in this communication; (c) this person is acting for its own interests; and (d) the municipal entity or obligated person should discuss any information and material contained in this communication with any and all internal or external advisors and experts that the municipal entity or obligated person deems appropriate before acting on this information or material.

Effect of Overall Course of Conduct on Advice Analysis. The staff further believes that, while the presentation of information with the disclosures and disclaimers described above are factors that suggest that a person may not be making a recommendation that would constitute advice under the Final Rules, such disclosures and disclaimers are not controlling and must be considered in the context of a person's overall course of conduct, taking into account all of the

relevant facts and circumstances. Thus, any actions or communications that are inconsistent with these disclosures and disclaimers or inconsistent with the arm's length nature of a non-advisory business relationship between a person and a municipal entity or obligated person could suggest that the person is making a recommendation and acting as a municipal advisor, which, absent an available exemption, would require registration with the Commission as a municipal advisor. [January 10, 2014]

Question 1.2: Treatment of Business Promotional Materials Provided By Potential Underwriters Under the General Information Exclusion from Advice: What are some relevant considerations regarding the content, context, and manner in which a broker-dealer may provide business promotional materials (either in writing or in oral communications) to a municipal entity or obligated person for which the broker-dealer seeks to serve as underwriter on a future issuance of municipal securities under the general information exclusion from advice?

Answer: *Introduction and Overview*. The Final Rules permit a broker-dealer to communicate with a municipal entity or obligated person as part of an effort to obtain business and such communication could include business promotional materials that present factual information that does not involve a recommendation. In relevant part, the Adopting Release includes the following statement:

> The Commission notes that not all communications with a municipal entity or obligated person constitute municipal advisory activities. If the person has identified himself or herself as seeking to obtain business, such as serving as an underwriter on future transactions, whether such communications and analyses constitute municipal advisory activities or the provision of general information (as discussed further above) will depend on the specific facts and circumstances. For example, pursuant to the Commission's interpretation of the treatment of the provision of general information, the Commission believes that a broker-dealer who provides information to a municipal entity regarding its underwriting capabilities and experience or general market or financial information that might indicate favorable conditions to issue or refinance debt likely would not be treated as engaging in municipal advisory activity.[11]

Absent an available exclusion or exemption, such as the exclusion for a registered broker-dealer serving as underwriter on a particular issuance of municipal securities after engagement in such capacity, a broker-dealer cannot provide advice on an issuance of municipal securities without registering with the Commission as a municipal advisor.

Examples of the General Information Exclusion from Advice in the Context of Business Promotional Materials from Potential Underwriters. The staff believes that a potential underwriter could rely on the general information exclusion from advice under the Final Rules when providing a municipal entity or obligated person with information that does not involve a recommendation, such as business promotional materials that are factual in nature and do not contain subjective assumptions, opinions, or views. In addition to those examples set forth in

[11] Adopting Release, 78 FR at 67514.

"Examples of the General Information Exclusion from Advice" in the Answer to Question 1.1, examples of this type of general information include: (a) information regarding a broker-dealer's underwriting capabilities and experience (e.g., lists, descriptions, terms, or offering materials of municipal securities transactions previously underwritten by the broker-dealer); (b) general market or financial information that might indicate favorable conditions to issue debt or refinance outstanding debt; (c) certain educational materials[12] (e.g., information describing the requirements of state laws that authorize municipal entities to issue certain types of bonds to finance capital projects); and (d) factual information regarding the different types of debt financing structures available to such municipal entity to finance capital projects under applicable state law.

In addition, the staff believes that business promotional materials could include the following types of information without constituting a recommendation: (a) an indication of hypothetical new issue pricing range that takes into consideration current market conditions and certain factual information particularized to an issuer, such as the issuer's credit rating, geographic location, and market sector; (b) information regarding an issuer's outstanding municipal securities, such as current market prices and yields; (c) information regarding a range of hypothetical interest rates or debt service requirements for a new money debt with various maturities (e.g., a level debt service payment schedule for a fixed rate debt with a 20-year or 30-year maturity) based on the facts described in clause (a) of this paragraph; (d) public information regarding the terms and a range of interest rates for the special U.S. Treasury Securities of the State and Local Government Series ("SLGs") that are available for direct purchase from the U.S. Treasury Department for use as refunding escrow investments; and (e) mathematical calculations of a municipal issuer's hypothetical potential interest cost savings if it were to issue refunding bonds to refinance its outstanding municipal securities at a range of estimated current market rates, based on the assumption that the refunding bonds have the same debt structure (i.e., principal and interest is payable at the same times, in the same or proportionate amounts, and with the same final maturity date) as the issuer's outstanding bonds to be refunded and further based on the facts described in clause (a) of this paragraph.

For example, if a municipal entity had outstanding fixed rate municipal securities with a debt structure involving substantially level annual debt service payments and a 30-year final maturity date, the staff believes that the business promotional materials could include mathematical calculations showing hypothetical potential interest cost savings if the municipal issuer were to refund those municipal securities at a range of estimated current market rates, based on the assumption that the refunding bonds had the same debt structure involving substantially level annual debt service payments and the same final maturity date as the outstanding bonds without constituting a recommendation.

Potential Implied Recommendations in the Context of Business Promotional Materials from Potential Underwriters. The staff further believes that the more individually tailored the information is to a specific municipal entity or obligated person or group of municipal entities or obligated persons that share similar characteristics, the more likely the information will be

[12] *See* Adopting Release, 78 FR at 67480.

considered to be a recommendation. For example, if a broker-dealer provided debt structuring options that were tailored to address the specific needs, objectives, or circumstances of a municipal issuer, such as tailored sizing, maturity, or security structures to address particular needs, circumstances, or objectives of the municipal issuer within the issuer's overall debt structure, the staff believes that presenting these particularized debt structuring options likely would suggest a preferred financing approach that likely would imply a recommendation.

Similarly, in the case of a potential refunding or refinancing, while the provision of information regarding estimates of hypothetical potential interest cost savings for a refunding of outstanding debt at a range of estimated current market interest rates within the issuer's existing debt service structure and final maturity date generally represents a way to convey factual information about current market conditions that could meet the general information exclusion from advice, the staff believes that presentations of more particularized refunding options that involve restructuring the issuer's outstanding debt likely would imply a recommendation. For example, if a municipal issuer had outstanding fixed rate municipal securities involving a debt structure with level annual payment debt service payments and a 30-year final maturity date, the staff believes that if business promotional materials included mathematical calculations showing hypothetical potential interest cost savings if the municipal issuer were to issue refunding bonds to refinance those outstanding municipal securities using a different debt structure that had features tailored or particularized for the municipal issuer that went beyond the existing structure of the outstanding bonds to be refunded (such as a structure involving nonlevel annual debt service payments, non-interest paying capital appreciation bonds, or any extension of the final maturity date beyond that of the outstanding bonds to be refunded), those business promotional materials likely would imply a recommendation.

In addition, if business promotional materials include particularized or subjective views regarding interest rates that a broker-dealer expects that it can achieve for an underwriting of municipal securities for a municipal entity or obligated person (as contrasted with a range of hypothetical interest rates that takes into consideration current market conditions and factual information particular to the issuer), that particularized information likely would imply a recommendation.

Effect of Disclosures and Disclaimers on Advice Analysis in the Context of Business Promotional Materials from Potential Underwriters. In the context of broker-dealers seeking to serve as underwriters, the staff believes that the disclosures and disclaimers referenced in the Answer to Question 1.1 of these FAQs, together with the following additional disclosures and disclaimers, would be factors that weigh against treatment of business promotional materials as a recommendation that constitutes advice: (a) a statement that the broker-dealer seeks to serve as an underwriter on a future transaction and not as a financial advisor or municipal advisor consistent with the MSRB Rule G-23 interpretive guidance; [13] (b) a description of the arm's

[13] *See* Answer to Question 5.1 herein discussing how a broker-dealer's unilateral action to identify itself in writing as an underwriter and not as a financial advisor under MSRB Rule G-23 for purposes of that conflicts rule is insufficient to establish that the broker-dealer has been engaged to serve as underwriter on a particular issuance of municipal securities and thereby does not meet the underwriter exclusion.

length nature of the underwriter's role consistent with the disclosure required by MSRB Rule G-17 in this regard; and (c) a statement that the information provided is for discussion purposes only in anticipation of being engaged to serve as underwriter.

Effect of Overall Course of Conduct in the Context of Business Promotional Materials from Potential Underwriters. The staff further believes that, while the presentation of business promotional materials with the disclosures and disclaimers described above are factors that suggest that a broker-dealer may not be making a recommendation that would constitute advice under the Final Rules, such disclosures and disclaimers are not controlling and must be considered in the context of the broker-dealer's overall course of conduct, taking into account all of the relevant facts and circumstances. Notably, a broker-dealer's identification of itself in writing as an underwriter and not as a financial advisor under MSRB Rule G-23 is only a factor in this analysis and the broker-dealer's overall course of conduct, including written or oral communications made before and after the MSRB Rule G-23 disclosures, will inform the analysis as to whether the broker-dealer made a recommendation that constitutes advice under the Final Rules. Thus, any actions or communications that are inconsistent with these disclosures and disclaimers or that are inconsistent with the arm's length nature of the relationship between a broker-dealer seeking to obtain underwriting business and a municipal entity or obligated person could suggest that the broker-dealer is making a recommendation and acting as a municipal advisor, which, absent an available exception, would require registration with the Commission as a municipal advisor. [January 10, 2014]

Question 1.3: Indirect Advice: A municipal entity has engaged a registered municipal advisor to advise it on municipal financial products or a planned issuance of municipal securities. If a market participant provides advice to the municipal entity's registered municipal advisor regarding municipal financial products or such issuance of municipal securities without satisfying the independent registered municipal advisor exemption, would such market participant be required to register as a municipal advisor?

Answer: Yes, in the staff's view, absent an available exclusion or exemption, a market participant who provides advice directly to a municipal entity or obligated person or indirectly to a municipal entity or obligated person through a third-party professional engaged by such municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities would be required to register with the Commission as a municipal advisor. In relevant part, the Exchange Act and the Final Rules define a "municipal advisor" and "municipal advisory activities," respectively, to cover a person that "provides advice *to or on behalf of* a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities . . . ."[14] These definitions cover both direct advice to a municipal entity or obligated person and indirect advice "on behalf of" a municipal entity or obligated person that is given through communications with third parties. Thus, for example, if a person provides advice regarding municipal financial products or the issuance of municipal securities to a third-party that is a registered municipal advisor to a municipal entity or obligated person without satisfying the independent registered municipal advisor exemption (which would

[14] *See* 15 U.S.C. 78o-4(e)(4) and Exchange Act Rule 15Ba1-1(e) (emphasis added).

permit provision of such advice without requiring municipal advisor registration) or another available exclusion or exemption, the staff believes that the person would be providing indirect advice "on behalf of" such municipal entity or obligated person through that third-party and would be required to register as a municipal advisor. [May 19, 2014]

Question 1.4: Terms for the Purchase of Securities in a Principal Capacity: An institutional buyer, such as a mutual fund, seeks to purchase municipal securities for its own account from a municipal entity. If this institutional buyer provides the municipal entity with the structure, timing, and terms under which the institutional buyer would purchase securities for its own account, would the institutional buyer be engaged in municipal advisory activity under the Final Rules?

Answer: If an institutional buyer only provides information regarding the terms under which the institutional buyer would purchase securities for its own account and does not provide advice to the municipal entity with respect to the structure, timing, terms, or other similar matters regarding an issuance of municipal securities to be offered to other investors, the staff believes that this institutional buyer would not be engaged in municipal advisory activity under the Final Rules. The Answer to Question 1.1 of these FAQs regarding the advice standard generally applies and is relevant to this analysis. In the staff's view, the information regarding the terms for this institutional purchase is in the nature of factual information that would meet the general information exclusion to advice under Exchange Act Rule 15Ba1-1(d)(1)(ii). Further, in the scenario described above, the institutional buyer is acting as a principal to purchase securities for its own account, which is consistent with the arm's length nature of a non-advisory business relationship. Absent other facts and circumstances evidencing advice, the staff believes this transaction would not constitute advice to a municipal entity with respect to an issuance of municipal securities. The staff notes that this advice analysis is applicable to a bank's purchase of municipal securities for its own account and that the bank exemption also expressly addresses this type of transaction in the particular context of banks, as discussed further in the Answer to Question 13.2 of these FAQs. [May 19, 2014]

SECTION 2: REQUEST FOR PROPOSALS / REQUEST FOR QUALIFICATIONS EXEMPTION

Question 2.1: Parameters and Formality of RFP/RFQ Process: Describe a request for proposals ("RFP") or request for qualifications ("RFQ") process that is consistent with the exemption to the municipal advisor definition for any person who provides a written or oral response to an RFP or RFQ? Does that process need to follow a municipal entity's formal procurement process?

Answer: The RFP exemption represents a way for municipal entities and obligated persons to solicit ideas, including advice, from market participants regarding municipal financial products or the issuance of municipal securities in a competitive process. In the staff's view, an RFP or RFQ process with the following parameters generally would be consistent with the requirements of the RFP exemption: (a) the municipal entity or obligated person, or a registered municipal advisor acting on their behalf, conducts the RFP or RFQ; (b) a particular objective is identified in

the RFP or RFQ (e.g., ideas on how to structure a particular issuance of municipal securities to finance an identified capital project or program); (c) the RFP or RFQ is open for a specified period of time that is reasonable under the facts and circumstances and that is not indefinite (e.g., absent particular complexity or exigent or other circumstances that might support a longer or shorter specific period of time, an open period of up to six months generally is considered reasonable); and (d) the RFP or RFQ involves a competitive process under the facts and circumstances (e.g., the RFP or RFQ is sent to at least three reasonably competitive market participants or the RFP or RFQ is publicly disseminated by posting it on the official website of the municipal entity or obligated person). These parameters represent an illustrative example for an RFP or RFQ process to be consistent with the RFP exemption.

In the staff's view, an RFP or RFQ does not need to be part of a municipal entity's formal procurement process to be consistent with the requirements of the RFP exemption. [January 10, 2014]

Question 2.2: Use of RFP Exemption to Solicit Ideas from Pre-Screened or Pre-Qualified Market Participants: A municipal entity or obligated person is interested in soliciting ideas on how to structure a financing involving the issuance of municipal securities or the use of municipal financial products from market participants that the municipal entity has pre-screened or pre-qualified. What are some relevant considerations regarding the parameters of the RFP exemption in this context?

Answer: The RFP exemption also covers responses to so-called "mini-RFPs" that may be distributed in a targeted way to market participants that the municipal entity or obligated person has pre-screened or pre-qualified. While it is permissible for a mini-RFP to be distributed in a more discrete and targeted manner than a general RFP or RFQ, the staff believes that, to be consistent with the RFP exemption, the process should still follow the types of parameters similar to those described in the Answer to Question 2.1 above, but with slight modifications that take into consideration that the recipients of the mini-RFP will already have been pre-screened and pre-qualified in a process administered by the related municipal entity or obligated person, or a municipal advisor acting on their behalf.

Accordingly, in the staff's view, a mini-RFP process with the following parameters generally would be consistent with the requirements of the RFP exemption: (a) a municipal entity or obligated person, or a registered municipal advisor acting on their behalf, conducts the mini-RFP; (b) one or more particular questions is identified in the mini-RFP; (c) the mini-RFP is open for a specified period of time that is reasonable under the facts and circumstances and that is not indefinite (e.g., absent particular complexity or exigent or other circumstances that might support a longer or shorter specific period of time, an open period of up to three months generally is considered reasonable); and (d) the mini-RFP is sent to either the entire pool of pre-screened or pre-qualified market participants or at least three members of such pool. [January 10, 2014]

SECTION 3: INDEPENDENT REGISTERED MUNICIPAL ADVISOR EXEMPTION

Question 3.1: Use of Independent Registered Municipal Advisor Exemption: How does the independent municipal advisor exemption operate to allow municipal entities and obligated persons to obtain advice from market participants?

Answer: The Final Rules include a new exemption for persons providing advice in circumstances in which a municipal entity or obligated person has an independent registered municipal advisor with respect to the same aspects of a municipal financial product or an issuance of municipal securities. Set forth below is a summary of the requirements for this exemption:

- *First*, the "independent registered municipal advisor" must be a person that is registered as a municipal advisor pursuant to the Exchange Act and that is not, and within at least the past two years was not, associated with the person seeking to use this exemption.

- *Second*, the person seeking to use this exemption must receive a written representation from the municipal entity or obligated person that the municipal entity or obligated person is represented by, and will rely on the advice of, the independent registered municipal advisor. The person seeking to use this exemption must have a reasonable basis for relying on this representation.

- *Third*, the person seeking to use this exemption must provide written disclosures to the municipal entity or obligated person, with a copy to the independent registered municipal advisor, stating that the person is not a municipal advisor and is not subject to the fiduciary duty to municipal entities that the Exchange Act imposes on municipal advisors. Furthermore, this disclosure must be made at a time and in a manner reasonably designed to allow the municipal entity or obligated person to assess the material incentives and conflicts of interest that such person may have in connection with the municipal advisory activities.

In the Adopting Release, the Commission stated that it does not seek to curtail the receipt of important advice and information so long as the municipal entities and obligated persons are represented by and rely on independent registered municipal advisors who are subject to a fiduciary or other duties and who can help the municipal entities and obligated persons evaluate the advice and identify potential conflicts of interest.[15] If the conditions in the exemption are satisfied, the independent registered municipal advisor will be positioned to help the municipal entity both to evaluate any advice the municipal entity receives from other market participants and to identify any potential conflicts of interest. [January 10, 2014]

Question 3.2: Registered Municipal Advisor Serving in a General Capacity: A municipal entity has an independent registered municipal advisor who serves in a general capacity (as compared, for example, to a municipal advisor that advises on a particular municipal securities transaction), on retainer. A person wants to rely on the independent registered municipal advisor

[15] Adopting Release, 78 FR at 67511.

exemption. Can the independent municipal advisor exemption apply in circumstances involving a registered municipal advisor that serves in a general capacity?

Answer: Yes. In the staff's view, the independent municipal advisor exemption can apply in circumstances involving a registered municipal advisor that serves in a general capacity, provided that the scope of that municipal advisor's representation of the municipal entity or obligated person covers advice with respect to the same aspects of the issuance of municipal securities or municipal financial products as the person who is seeking to rely on the exemption and all other requirements of the exemption are met. [January 10, 2014]

Question 3.3: Representations about Independent Registered Municipal Advisors: A municipal entity has engaged a registered municipal advisor to advise it on a planned issuance of municipal securities. There are multiple transaction participants who would like to rely on the independent registered municipal advisor exemption. If the municipal entity provides one written representation to all the transaction participants that it is represented by, and will rely on the advice of, its independent registered municipal advisor, would this written representation satisfy the requirement set forth in the second clause of the exemption (set forth in Rule 15Ba1-1(d)(3)(vi)(B) and described in the Answer to Question 3.1 above)? Would the analysis change if the municipal entity posted one written representation on its website that was intended for all market participants who may want to rely on the exemption?

Answer: The staff believes that a municipal entity could provide its required representations in any reasonable manner, including one written disclosure to multiple transaction participants, to show that it is represented by, and will rely on the advice of, its independent registered municipal advisor. The staff further believes that a municipal entity could provide the required representations in one written disclosure to multiple market participants by posting it publicly on its official website and clearly stating in the written disclosure that by publicly posting the written disclosure the municipal entity intends that market participants receive and use it for purposes of the independent registered municipal advisor exemption. [January 10, 2014]

Question 3.4: Communications When a Municipal Entity has an Independent Registered Municipal Advisor: A municipal entity has engaged a registered municipal advisor to advise it on a planned issuance of municipal securities. A market participant, such as a broker-dealer, would like to rely on the independent registered municipal advisor exemption. Assuming all the requirements of the exemption have been satisfied, may the broker-dealer discuss issues relating to the planned issuance of municipal securities with the municipal entity if the municipal advisor is not present?

Answer: Yes. It is the staff's view that the underwriter may discuss issues relating to the planned issuance of municipal securities with the municipal entity if the independent registered municipal advisor is not present if the municipal entity does not object. Since the independent registered municipal advisor is advising the municipal entity with respect to the same aspects of the issuance of municipal securities, it is the staff's view that the municipal advisor will be able to subsequently meet or have discussions with the municipal entity and evaluate any advice provided by the broker-dealer and does not need to be present for every conversation. The Final

Rules require the broker-dealer to provide to the independent registered municipal advisor a copy of the written disclosure it provides to the municipal entity stating that it is not a municipal advisor and is not subject to a fiduciary duty. Accordingly, the staff believes that the independent registered municipal advisor will be informed in a timely manner if the broker-dealer intends to rely on the independent registered municipal advisor exemption and that the broker-dealer may provide advice to the municipal entity beyond the type of advice permitted to be provided pursuant to the underwriter exclusion. [January 10, 2014]

Question 3.5: "Rely on" Advice of Independent Registered Municipal Advisor: A municipal entity has engaged a registered municipal advisor to advise it on a planned issuance of municipal securities. A participant in this transaction would like to rely on the independent registered municipal advisor exemption. Pursuant to the requirements to qualify for this exemption, the transaction participant requests a written representation from the municipal entity that the municipal entity is represented by, and will "*rely on*" (emphasis added) the advice of, the independent registered municipal advisor. For purposes of this exemption, what does it mean for the municipal entity to represent that it will "rely on" the advice of the independent registered municipal advisor?

Answer: The staff believes that the requirement under the independent registered municipal advisor exemption that the municipal entity or obligated person represent in writing that it is represented by, and will "rely on" the advice of, an independent registered municipal advisor, together with the transaction participant's required disclosures regarding its role, are intended to clarify the role of the independent registered municipal advisor (who, in the case of a municipal entity client, has a federal statutory fiduciary duty to the municipal entity) in comparison to the role of the transaction participant with respect to the municipal entity or obligated person. In the staff's view, for purposes of this exemption, the term "rely on" means that the municipal entity or obligated person will seek and consider the advice, analysis, and perspective of the independent registered municipal advisor. The staff does not believe, however, that, for purposes of this exemption, "rely on" means that the municipal entity or obligated person must follow the advice of the independent registered municipal advisor. [May 19, 2014]

Question 3.6: Independence of a Registered Municipal Advisor: What are some relevant considerations for determining whether a registered municipal advisor is independent from a transaction participant seeking to rely on the independent registered municipal advisor exemption under the Final Rules?

Answer: Under the Final Rules, a registered municipal advisor is independent if it is not, and within at least the past two years was not, "associated" with the person seeking to rely on the independent registered municipal advisor exemption. In the Adopting Release, the Commission stated that "a two year cooling-off period represents an appropriate period of time to help remove any actual or perceived influence over a municipal advisor's ability to exercise independent judgment when engaging in municipal advisory activities."[16]

[16] *See* Adopting Release, 78 FR at 67510.

The Final Rules define the term "associated"[17] by reference to the definition of a "person associated with a municipal advisor" or an "associated person of an advisor" in Exchange Act Section 15B(e)(7), which defines such an associated person to mean the following persons: (A) any partner, officer, director, or branch manager of such municipal advisor (or any person occupying a similar status or performing similar functions); (B) any other employee of such municipal advisor who is engaged in the management, direction, supervision, or performance of any activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities; and (C) any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor.[18]

In the Adopting Release, the Commission stated that the criteria for association in Exchange Act Section 15B(e)(7) apply for purposes of the definition of independent registered municipal advisor under the Final Rules.[19] Therefore, as discussed further below, it is the staff's view that, in applying this standard, the determination of whether or not a registered municipal advisor is independent from another transaction participant seeking to rely on the independent registered municipal advisor exemption requires consideration of whether or not the registered municipal advisor has been "associated" with such transaction participant at an entity level or at an individual employee level during the relevant two-year period.

Entity Level Analysis. The entity level analysis focuses on whether the registered municipal advisor *firm* is independent from the transaction participant *firm* seeking to rely on the exemption. With respect to entities who may be associated persons of a municipal advisor firm, Exchange Act Section 15B(e)(7) provides, in relevant part, that such an associated person means "any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor."[20] The Commission defines "control" for purposes of the Final Rules as "[t]he power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise."[21] Accordingly, in the staff's view, if the registered municipal advisor firm is not, and within the last two years was not, directly or indirectly, controlling, controlled by, or under common control with the transaction participant firm seeking to rely on the exemption, then such registered municipal advisor firm would be independent at an entity level from the transaction participant firm.

Individual Employee Level Analysis. The individual employee level analysis focuses on whether an individual, such as a current employee of a registered municipal advisor firm who formerly was employed by a transaction participant firm seeking to rely on the independent registered municipal advisor exemption, affects such municipal advisor firm's independence from the

[17] Exchange Act Rule 15Ba1-1(d)(3)(vi).
[18] 15 U.S.C. 78o-4(e)(7).
[19] *See* Adopting Release, 78 FR at 67510, note 566.
[20] 15 U.S.C. 78o-4(e)(7)(C).
[21] *See* Glossary of Terms, Adopting Release 78 FR at 67655, for definition of "control" and for specific examples of "control," (examples generally indicating that control is presumed if a person has rights with respect to 25% or more of an entity's voting power or capital, depending on the type of entity). The staff notes that an individual also would need to be taken into account as an associated person in the analysis if the individual controls an entity.

transaction participant firm due to the individual's actual or perceived influence over the registered municipal advisor firm's ability to exercise independent judgment when engaging in municipal advisory activities for a particular municipal entity client or obligated person client.

With respect to individuals who may be associated persons of a registered municipal advisor firm, Exchange Act Section 15B(e)(7) provides, in relevant part, that such an associated person means "(A) any partner, officer, director, or branch manager of such municipal advisor (or any person occupying a similar status or performing similar functions)" and "(B) any other employee of such municipal advisor who is engaged in the management, direction, supervision, or performance of any activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities."[22]

For reference in these FAQs, the term "Associated Individual" shall be used to refer to an individual serving in one of the capacities described in Exchange Act Section 15B(e)(7)(A) or (B) with respect to either a municipal advisor firm or a transaction participant firm seeking to use the independent registered municipal advisor exemption, as applicable, including specifically the following individuals:

> (A) any partner, officer, director, or branch manager (or any person occupying a similar status or performing similar functions); or
>
> (B) any other employee who is engaged in the management, direction, supervision, or performance of any activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities.

In the staff's view, a registered municipal advisor firm is not considered to be independent from a transaction participant firm for purposes of the independent registered municipal advisor exemption under the Final Rules if (1) an individual is a current employee of a registered municipal advisor firm in the capacity of an Associated Individual and that individual formerly was employed, within the past two years, by the transaction participant firm in the capacity of an Associated Individual; and (2) such Associated Individual of a registered municipal advisor firm participates in any matter, including participation in the management, direction, supervision, or performance of activities relating to the matter, that involves municipal advisory activity for a particular municipal entity or obligated person client in which such Associated Individual's former employer is involved in any role as a transaction participant firm, during the applicable two-year period.

Converse Situation. The fact pattern in this Answer focuses on the situation in which a current employee of a registered municipal advisor firm formerly was employed, within the past two years, by a transaction participant firm seeking to rely on the independent registered municipal advisor exemption under the Final Rules. It is the staff's view that the same "associated" person

[22] 15 U.S.C. 78o-4(e)(7)(A)-(B).

analysis described above also should apply to the converse situation in which a current employee of a transaction participant firm formerly was employed, within the past two years, by a registered municipal advisor firm. In the staff's view, this converse situation also informs the determination of whether or not a registered municipal advisor firm is independent from a transaction participant firm for purposes of the independent registered municipal advisor exemption under the Final Rules.[23] [May 19, 2014]

SECTION 4: REGISTERED INVESTMENT ADVISER EXCLUSION

Question 4.1: Scope of Advice Concerning Municipal Derivatives: Under the Final Rules, is an SEC-registered investment adviser required to register with the Commission as a municipal advisor if the registered investment adviser provides advice to a client that is a municipal entity or an obligated person on a municipal derivative that is or could be part of an investment portfolio on which this investment adviser provides investment advice?

Answer: In accordance with Section 15B(e)(4)(c), the Final Rules exclude from the definition of municipal advisor any "investment adviser registered under the Investment Advisers Act of 1940 [15 U.S.C. 80b-1 et seq.] or any person associated with such registered investment adviser to the extent that such registered investment adviser or such person is providing investment advice in such capacity."[24] The Final Rules further provide that, solely for purposes of this exclusion, "investment advice" does not include, among other things, the following types of advice: (a) advice concerning whether or how to issue municipal securities and advice concerning the structure, timing, and terms of an issuance of municipal securities and other similar matters; and (b) advice concerning municipal derivatives.[25]

It is the staff's view that the scope of "advice concerning municipal derivatives" under clause (b) in the previous paragraph that is outside the registered investment adviser exclusion is limited to advice concerning those municipal derivatives that are or would be entered into by a municipal entity or obligated person in connection with the issuance of municipal securities (e.g., debt-related swaps or other derivatives used to hedge interest rate risk in connection with a municipal entity's issuance of municipal debt securities as contrasted with investment asset-related derivatives used by a municipal entity in connection with its investment of municipal bond proceeds or other investment assets).[26]

Solely for purposes of "investment advice" in the registered investment adviser exclusion under the Final Rules, the staff believes that "advice concerning municipal derivatives" was intended to

[23] *See generally* 15 U.S.C. 78o-4(e)(7) and Exchange Act Rule 15Ba1-1(d)(3)(vi)(A). *See also* Adopting Release, 78 FR at 67510, note 566 (stating that "[f]or purposes of the definition 'independent registered municipal advisor' in Rule 15Ba1-1(d)(3)(vi), the criteria for association set forth in Section 15B(e)(7) (15 U.S.C. 78o-4(e)(7) will apply").
[24] Exchange Act Rule 15Ba1-1(d)(2)(ii).
[25] *Id.*
[26] *See generally* S. Rep. No 111-176, at 38 (2010), which suggests a focus on those derivatives used by municipal issuers in connection with the issuance of municipal securities in the municipal securities markets (as contrasted with derivatives used with investments).

be limited to advice concerning those municipal derivatives used by municipal entities or obligated persons in connection with the issuance of municipal securities (as contrasted with investment advisory services regarding municipal derivatives in an investment portfolio). The staff believes that the scope of this interpretation would be consistent with the scope of advice under clause (a) in the first paragraph of this Answer that is outside the registered investment adviser exclusion (i.e., advice concerning whether or how to issue municipal securities and advice concerning the structure, timing, and terms of an issuance of municipal securities and other similar matters).

Therefore, the staff would not object if those SEC-registered investment advisers that provide advice on municipal derivatives in an investment portfolio for clients that are municipal entities or obligated persons do not register with the Commission as municipal advisors. [January 10, 2014]

SECTION 5: UNDERWRITER EXCLUSION

Question 5.1: Engagement to Serve as Underwriter: How can a broker-dealer demonstrate that a municipal entity or obligated person has engaged the broker-dealer to serve as an underwriter on a particular issuance of municipal securities so that the broker-dealer meets the underwriter exclusion under the Final Rules?

Answer: In regard to the underwriter exclusion to the municipal advisor definition, the Commission explained in the Adopting Release that, in order for a person to be "serving as an underwriter" with respect to the issuance of municipal securities within the meaning of the underwriter exclusion, there must be a relationship to a particular transaction, and that, for example, a contractual "engagement" by a municipal entity of a broker-dealer to serve as underwriter on a specific planned transaction for the issuance of municipal securities would constitute the requisite engagement on a particular issuance of municipal securities.[27]

In general, the staff believes that a broker-dealer can demonstrate that a municipal entity or obligated person has engaged the broker-dealer to serve as underwriter on a particular issuance of municipal securities so that the broker-dealer meets the underwriter exclusion under the Final Rules either through a writing, such as an engagement letter that has the features discussed in the paragraph below, or through other actions as discussed in the final paragraph of this Answer. Further, in the staff's view, an important basic component of the underwriter exclusion involves a decision by the municipal entity or obligated person to select a broker-dealer to serve as underwriter on a particular issuance of municipal securities that is affirmative in nature and is informed by the full disclosure about the role of the underwriter as required by MSRB Rule G-17.[28] (By contrast, in the staff's view, a broker-dealer's unilateral action to identify itself in

[27] Adopting Release, 78 FR at 67512.
[28] *See* Adopting Release, 78 FR at 67512 (describing the Commission's belief that MSRB Rule G-17 disclosure requirements should assist a municipal entity or obligated person in clarifying the duties of underwriters to municipal issuers, identifying conflicts of interest, and appropriately evaluating the advice they receive from underwriters with that informed perspective).

writing as an underwriter and not as a financial advisor under MSRB Rule G-23 for purposes of that conflicts rule is insufficient to establish that the broker-dealer meets the underwriter exclusion and thus does not allow the broker-dealer to give advice in reliance on the underwriter exclusion, because such action lacks the required affirmative selection by the municipal entity or obligated person of the broker-dealer to serve as an underwriter on a particular issuance of municipal securities to enable the broker-dealer to come within the underwriter exclusion under the Final Rules.)

Thus, it is the staff's view that a requisite engagement as underwriter for purposes of the underwriter exclusion under the Final Rules may be established at an early stage of a transaction, with reasonable recognition that some aspects of the underwriting may be preliminary or subject to conditions at that time. In this regard, if a municipal entity or obligated person engages a broker-dealer on a preliminary basis to act as the underwriter for an issuance of municipal securities, such engagement could be consistent with the underwriter exclusion. The staff would view as consistent with the underwriter exclusion, an engagement by a municipal entity or obligated person of a broker-dealer to serve as an underwriter on a particular issuance of municipal securities if it were evidenced by an agreement, engagement letter, or letter of intent (an "engagement letter") with the following features: (a) the governing body or any duly authorized official of the municipal entity responsible for municipal finance has executed, approved, or acknowledged the engagement letter in writing; (b) the engagement letter clearly relates to providing underwriting services; (c) the engagement letter clearly states the role of the broker-dealer in the transaction; (d) the engagement letter relates to a particular issuance of municipal securities that the municipal entity or obligated person anticipates issuing and is not a general engagement for underwriting services that does not relate to any particular transaction; and (e) the engagement letter or a separate writing done at or before the time of the engagement provides all disclosures that are required to be made by underwriters by the time of an engagement under MSRB Rule G-17, including disclosures about the role of the underwriter, the underwriter's compensation, and actual or potential material conflicts of interest (excluding only those permitted to be disclosed after the time of engagement under MSRB Rule G-17). The staff is also of the view that, in the case of a conduit issuance of municipal securities, the engagement letter could be executed, approved, or acknowledged in writing by a duly authorized official of an obligated person responsible for municipal finance, even if the selection of the underwriter and the engagement of the underwriter are subject to the final approval of the conduit issuer.

In addition, in the case of an otherwise-qualified engagement letter that includes the factors described above, it is the staff's view that such an engagement letter would not disqualify a broker-dealer from meeting the underwriter exclusion under the Final Rules if the letter also included reasonable conditions or limitations under the circumstances, such as the following: (a) a statement that the engagement is preliminary in nature and that the issuer intends or reasonably expects to engage the broker-dealer as the underwriter for an identified issue of municipal securities; (b) a statement specifying that the engagement is subject to conditions, such as formal approval of the selection of the underwriter by the governing body or finalizing the structure of the issue of municipal securities; (c) a statement that the engagement is nonbinding and that it can be terminated by either party; or (d) a term that limits liability of a party to the engagement

letter. Moreover, a municipal entity or obligated person may furnish engagement letters to more than one underwriter, provided that the municipal entity or obligated person reasonably expects to engage each such underwriter to serve as an underwriter on the identified issue of municipal securities.

The parameters for an engagement letter described in the paragraphs above do not represent an exclusive means for establishing that a broker-dealer meets the underwriter exclusion under the Final Rules. The Final Rules do not require a broker-dealer to have a written engagement letter to demonstrate that the broker-dealer is serving as an underwriter with respect to a particular transaction, but a broker-dealer must be able to demonstrate that it is engaged to rely on the underwriter exclusion. While issuers may have different practices regarding engagement of underwriters (e.g., in some instances, there may not be a written agreement until the stage of the transaction where the municipal securities are priced and the bond purchase agreement is executed), it is the staff's view that a broker-dealer could demonstrate a sufficient relationship to a particular transaction if the broker-dealer received an oral or written acknowledgement of engagement from a duly authorized official of the issuer responsible for the area of municipal finance (e.g., a telephone call or e-mail from an issuer official to acknowledge the selection of an underwriter after the governing body of the issuer has met and voted to approve the selection of the broker-dealer as underwriter for a particular issuance of municipal securities) and if the broker-dealer has made the disclosures required to be made under MSRB Rule G-17 at or before the time of engagement. [January 10, 2014]

Question 5.2: Switching Roles From Municipal Advisor to Underwriter: May a broker-dealer that is also a registered municipal advisor serve as the municipal advisor to a municipal entity in the early stages of a financing transaction involving the issuance of municipal securities and then switch roles to serve as the underwriter when the municipal entity decides to proceed with that issuance of municipal securities?

Answer: No. If a broker-dealer acts as a municipal advisor to a municipal entity with respect to an issuance of municipal securities, it owes a fiduciary duty to the municipal entity with respect to that issue and must not take any action inconsistent with its fiduciary duty to the municipal entity. Additionally, the broker-dealer must comply with MSRB Rule G-23, which prohibits persons from switching from the role of financial advisor to the role of underwriter with respect to the same issuance of municipal securities. [January 10, 2014]

SECTION 6: ISSUANCE OF MUNICIPAL SECURITIES/POST-ISSUANCE ADVICE

Question 6.1: Updating Omissions in an Offering Document: A broker-dealer served as underwriter for an issuance of municipal securities. After the issuance has closed and the underwriting period has terminated, the broker-dealer realizes that there is a material omission in the offering document. If the broker-dealer contacts the municipal entity and advises it that a supplement should be prepared, can the broker-dealer continue to rely on the underwriter exclusion?

Answer: The Adopting Release provides that any advice with respect to the issuance of municipal securities given after the underwriting period has terminated would generally be municipal advisory activity outside the scope of the underwriter exclusion.[29] In this example, however, the broker-dealer would be providing advice that is (a) integral to its underwriting responsibility in connection with the issuance of municipal securities (i.e., to review the offering document and reasonably conclude that the municipal entity prepared materially sufficient disclosure) and (b) promoting compliance with the anti-fraud provisions of the federal securities laws. Accordingly, it is the staff's view that such advice would be within the scope of the underwriter exclusion. [January 10, 2014]

Question 6.2: Continuing Disclosure Filings: A market participant assists municipal entities with completing continuing disclosure filings. The assistance includes preparing annual disclosure forms and helping determine whether an event notice is required to be filed. Would such assistance be considered municipal advisory activity under the Final Rules?

Answer: The Answer to Question 1.1 of these FAQs regarding the advice standard generally applies and is relevant to this analysis. If the market participant provides advice, such assistance would be considered municipal advisory activity. For example, in the staff's view, absent the availability of another exemption,[30] a market participant could not assist a municipal entity with assessing whether an event is "material" under the federal securities laws and whether the municipal entity is required to file an event notice pursuant to a continuing disclosure agreement without falling within the scope of the municipal advisor definition. Such assistance would require the market participant to express an opinion that would be considered advice under the Final Rules.

If the market participant provides general information that does not involve a recommendation, such assistance would not be considered municipal advisory activity. For example, in the staff's view, a market participant could assist a municipal entity in compiling specific factual information to complete an annual disclosure filing so long as the assistance does not include subjective assumptions, opinions, or views. Such assistance could include collecting data to update charts originally included in the offering document (e.g., updating current property assessments or the realization rate for billing and collecting ad valorem property taxes). It is also the staff's view that, if a market participant learned that the credit rating for an issuance of municipal securities had been changed, the market participant could contact the municipal entity, notify it of the rating change, and remind the municipal entity that its continuing disclosure agreement requires the municipal entity to file an event notice upon a rating change without providing advice under the Final Rules. In this instance, the market participant only would be providing the municipal entity with factual information that does not contain or express an opinion or view. It is also the staff's view that a market participant could provide the following services without engaging in municipal advisory activity: (a) remind a municipal entity generally of its continuing disclosure filing obligations; (b) provide a municipal entity with

[29] *See* Adopting Release, 78 FR at 67515.
[30] For example, an attorney could assist a municipal entity with this assessment and rely on the exclusion for attorneys providing legal advice.

assistance submitting continuing disclosure filings to the MSRB's Electronic Municipal Market Access ("EMMA") system; and (c) notify a municipal entity whether, and to what extent, any of its continuing disclosure filings actually appeared on EMMA. [January 10, 2014]

Question 6.3: Offering Document Disclosure Regarding Continuing Disclosure Filings: A broker-dealer is engaged to serve as underwriter for an issuance of municipal securities. While performing due diligence to confirm the accuracy of statements included in the offering document, the broker-dealer discovers that the municipal entity failed during the past five years to comply with a continuing disclosure agreement it had entered into in connection with an outstanding issuance of municipal securities. Can the broker-dealer rely on the underwriter exclusion and advise the municipal entity to take corrective actions such as completing the missed filings and adopting written policies and procedures to ensure future compliance?

Answer: Yes, if a broker-dealer who is engaged to serve as underwriter for an issuance of municipal securities learns during the due diligence process that a municipal entity has failed during the past five years to comply with a continuing disclosure agreement entered into pursuant to Exchange Act Rule 15c2-12, the staff believes that the broker-dealer could rely on the underwriter exclusion and advise the municipal entity to take corrective actions such as completing the missed filings and adopting written policies and procedures to ensure future compliance. In this instance, in the staff's view, the broker-dealer would not be providing the municipal entity with post-issuance advice on an outstanding issuance of municipal securities. Rather, the staff believes that the broker-dealer would be fulfilling its obligation under the federal securities laws to ensure that the offering document for the current issuance of municipal securities is materially accurate and complete and its obligation to reasonably determine that the municipal entity had entered into an undertaking to provide continuing disclosure for the current issuance of municipal securities. In the staff's view, the broker-dealer's action also would be promoting compliance with the anti-fraud provisions of the federal securities laws, which would help to ensure investors who purchase the municipal securities of this municipal entity in the secondary market received annual continuing disclosure filings and event notices in a timely manner. Accordingly, in the staff's view, this type of advice would be consistent with the underwriter exclusion. [January 10, 2014]

SECTION 7: REMARKETING AGENT SERVICES

Question 7.1: Remarketing Agent Services and Advice: A broker-dealer has been engaged by a municipal entity to remarket its variable rate demand municipal securities from time to time. If the broker-dealer serving in its capacity as remarketing agent provides advice, would it be considered advice with respect to an issuance of municipal securities covered by the Final Rules? If it is covered by the Final Rules, may the remarketing agent rely on the underwriter exclusion? If not, what services may the remarketing agent provide that would not be considered advice?

Answer: The Answer to Question 1.1 of these FAQs regarding the advice standard generally applies and is relevant to this analysis. If the remarketing agent provides advice to a municipal entity in the scenario described above, the staff believes it would be advice with respect to an issuance of municipal securities covered by the Final Rules. The Adopting Release provides that, generally, if an issuance has closed and the underwriting period has terminated, a broker-

dealer serving in the role of remarketing agent is not acting as an underwriter with respect to the issuance of municipal securities. Accordingly, in the staff's view, this broker-dealer could not rely on the underwriter exclusion.

If there were a remarketing of the issue of the municipal securities that constituted a primary offering, the remarketing agent should reevaluate its activities to determine if an exclusion from registration (such as the underwriter exclusion) applies. The remarketing agent may be able to perform all of the standard services that are typically covered by the remarketing agreement and related authorizing documents because these services may not constitute advice. For example, in the staff's view, the remarketing agent could set the rate, remarket tendered bonds, and provide factual information regarding current market conditions. It is also the staff's view that the remarketing agent could provide factual information on how the interest rate would be impacted by a change from a weekly to a daily interest rate mode or change in the liquidity facility provider. While the information presented can be particularized to the municipal entity, the staff cautions that it must be limited to factual information. If the remarketing agent's communications with the municipal entity also included a recommendation, opinion, or view as to whether the interest rate mode or liquidity facility provider should or should not be changed, this communication would constitute advice in the staff's view. [January 10, 2014]

SECTION 8: PUBLIC DISCOURSE; PUBLIC OFFICIALS AND EMPLOYEES OF MUNICIPAL ENTITIES AND OBLIGATED PERSONS

Question 8.1: No Impediments to Public Discourse: The exemption for public officials excludes advice by appointed and elected officials acting within the scope of their official capacity, but does not expressly exclude opinions or advice offered by citizens. May a concerned citizen publish an op-ed piece proposing, supporting, or opposing the issuance of municipal securities? May a business owner oppose an issuance of municipal securities that would facilitate a taking of his or her business through eminent domain proceedings? May a political supporter or community leader express his or her views concerning the issuance of municipal securities?

Answer: Yes. The Final Rules do not impede public discourse. The Adopting Release provides, in relevant part, as follows:

> The Commission does not intend to impede the deliberative process that municipal entities engage in with their citizens. Accordingly, the registration requirement for municipal advisors does not apply to persons who comment on municipal financial products or the issuance of municipal securities by making use of public comment forums provided by municipal entities or other public forums.[31]

In all the examples described in Question 8.1, it is the staff's view that each citizen is providing comments and opinions in a public forum and would not be required to register as a municipal advisor. [January 10, 2014]

[31] Adopting Release, 78 FR at 67506.

Question 8.2: Employees Acting Within the Scope of Official Capacity or Employment: The Final Rules provide a broad exemption for public officials and employees of municipal entities and obligated persons to the extent that such persons act within the scope of their official capacity or employment.[32] May an employee in a state's office of the treasurer provide advice on an issuance of municipal securities to a municipal entity located within such state without being required to register as a municipal advisor?

Answer: Yes, an employee of a state-level municipal entity may provide advice to another municipal entity within the state to the extent the employee acts within the scope of his or her employment. In the Adopting Release, the Commission stated that "an employee of one municipal entity that provides advice, within the scope of his or her employment as such, to another municipal entity or obligated person would be exempt from the definition of municipal advisor."[33] [May 19, 2014]

SECTION 9: EFFECTIVE DATE OF THE FINAL RULES AND COMPLIANCE PERIOD FOR USING THE FINAL REGISTRATION FORMS

Question 9.1: Effective Date of the Final Rules: When are municipal advisors required to comply with the Final Rules, other than the requirement to register using the final registration forms?

Answer: The Final Rules were effective on January 13, 2014; however, on January 13, 2014, the Commission temporarily stayed the Final Rules until July 1, 2014 to provide market participants with a limited amount of additional time to analyze, implement, and comply with the Final Rules.[34] This stay of the Final Rules means that persons are not required to comply with the Final Rules until July 1, 2014. Thus, to illustrate, absent an available exclusion or exemption, the Final Rules apply to any person who provides "advice" that occurs on or after July 1, 2014 to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, and to any person that undertakes a "solicitation of a municipal entity" that occurs on or after July 1, 2014, all within the meaning and interpretation of the Final Rules.

A person who meets the definition of "municipal advisor" and does not qualify for an exclusion or exemption on or after the July 1, 2014, must register with the Commission using Form MA-T under the Temporary Registration Rule, unless this person is already registered with the Commission under the Temporary Registration Rule. A person who meets the definition of "municipal advisor" and does not qualify for an exclusion or exemption on or after October 1, 2014 is not required to register with the Commission using Form MA-T under the Temporary Registration Rule (and instead is required to register using the final forms as discussed in the Answer to Question 9.2 below). The compliance period for municipal advisors to register using

[32] Exchange Act Rule 15Ba1-1(d)(3)(ii).
[33] Adopting Release, 78 FR at 67506.
[34] *See* Temporary Stay Release, 79 FR at 2778.

the final registration forms is discussed in the Answer to Question 9.2 below. [Modified on January 16, 2014]

Question 9.2: Compliance Period for Using the Final Registration Forms: When are municipal advisors required to comply with the requirement to register as municipal advisors using the final registration forms under the Final Rules?

Answer: The Commission provided a phased-in compliance period, beginning on July 1, 2014, for municipal advisors to comply with the requirement to register as municipal advisors using the final registration forms under the Final Rules. Municipal advisors that register with the Commission under the Temporary Registration Rule before October 1, 2014 receive a temporary registration number. As set forth in the table below, a municipal advisor's temporary registration number determines the applicable compliance period during which the municipal advisor is required to file a complete application for registration as a municipal advisor on the final registration forms under the Final Rules.

Temporary Registration Number Range	**Period for Filing Complete Application for Registration**
866-00001-00 through 866-00400-00	July 1, 2014 - July 31, 2014
866-00401-00 through 866-00800-00	August 1, 2014 - August 31, 2014
866-00801-00 through 866-01200-00	September 1, 2014 - September 30, 2014
After 866-01200-00	October 1, 2014 - October 31, 2014

A person who becomes a municipal advisor on or after October 1, 2014 is required to register as a municipal advisor using the final registration forms under the Final Rules. In the interim period, pending registration of municipal advisors on the final registration forms under the Final Rules, all municipal advisors are required to be registered under the Temporary Registration Rule.

The Final Rules require municipal advisors to submit complete applications for registration to the Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system. To access EDGAR, municipal advisors need an access code. To obtain such code firms must electronically submit a Form ID using the SEC's website. To minimize processing delays municipal advisors should submit a Form ID as soon as possible. [January 10, 2014]

SECTION 10: OBLIGATED PERSONS

Question 10.1: Obligated Person Capacity: Advice on a New Money Issuance of Municipal Securities: A market participant, such as a broker-dealer, provides advice to a private nonprofit university regarding debt financing alternatives to implement the university's capital program, including advice on the possible option to seek financing from a new money issuance of municipal securities by a municipal entity, such as a state educational authority. The debt financing alternatives do not relate to any outstanding issues of municipal securities. If the university is considering its debt financing alternatives and has not begun the process of applying to, or negotiating with, a municipal entity to issue the new money municipal securities on the

university's behalf, would such broker-dealer be providing advice to an obligated person with respect to the issuance of municipal securities under the Final Rules?

Answer: No. In the Adopting Release, the Commission stated as follows:

> A person will not be a municipal advisor to an obligated person until the obligated person has begun the process of applying to, or negotiating with, a municipal entity to issue conduit bonds on behalf of the obligated person. Activity that never results in solicitation of or actual contact with a municipal entity does not have a sufficient nexus to municipal financial products or the issuance of municipal securities to require registration as municipal advisor. Merely advising a client on debt financing alternatives that include conduit financing is not a municipal advisory activity, because the client would not be sufficiently close to being an obligated person with respect to an issuance of municipal securities.[35]

Accordingly, if the university is considering its debt financing alternatives and has not begun the process of applying to, or negotiating with, the municipal entity to issue the new money municipal securities on the university's behalf, the university is not an obligated person with respect to such issuance of municipal securities. Therefore, the broker-dealer's advice would not be provided to the university in its capacity as an obligated person with respect to the issuance of municipal securities and such advice would not have a sufficient nexus to the issuance of municipal securities to require the broker-dealer to register with the Commission as a municipal advisor. Once the university determines to seek financing from a new money issuance of municipal securities and begins the process of applying to, or negotiating with, a municipal entity to issue the new money municipal securities on the university's behalf, however, the broker-dealer's activities would fall within the scope of the municipal advisor definition under the Final Rules. Absent an available exclusion or exemption, such as the underwriter exclusion, the broker-dealer would be required to register with the Commission as a municipal advisor. [May 19, 2014]

Question 10.2: Obligated Person Capacity: Advice on an Outstanding Issue of Municipal Securities: If a market participant, such as a broker-dealer, provides advice to a private nonprofit university regarding an outstanding issue of municipal securities on which the university is an obligated person, such as either advice to redeem that outstanding issue early from equity funds or advice to refinance that outstanding issue with the proceeds of a refunding issue of municipal securities, would such broker-dealer be providing advice to an obligated person with respect to the issuance of municipal securities under the Final Rules?

Answer: The staff believes that the broker-dealer's advice to the university with respect to an outstanding issue of municipal securities on which the university is an obligated person, including advice to redeem that outstanding issue early from equity funds or advice to refinance that outstanding issue with the proceeds of a refunding issue of municipal securities would constitute advice to an obligated person with respect to the issuance of municipal securities under

[35] *See* Adopting Release, 78 FR at 67485.

the Final Rules. The staff believes that, in the case of either type of advice, the broker-dealer is providing advice to the university in its capacity as an obligated person because the university has an established nexus to the outstanding issue of municipal securities since it already is serving in the capacity as an obligated person with financial responsibilities on that issue. Thus, in the staff's view, the broker-dealer is providing advice with respect to an outstanding issue of municipal securities on which the university is an obligated person. Additionally, in the Adopting Release, the Commission stated that "'advice with respect to the issuance of municipal securities' should be construed broadly from a timing perspective to include advice throughout the life of an issuance of municipal securities, from the pre-issuance planning stage for a debt transaction involving the issuance of municipal securities to the repayment stage for those municipal securities."[36] Absent an available exclusion or exemption, such as the underwriter exclusion, the staff believes that the broker-dealer's advice to the university with respect to early redemption or refinancing of an outstanding issue of municipal securities would fall within the scope of the municipal advisor definition under the Final Rules and would require that the broker-dealer register with the Commission as a municipal advisor. The Answer to Question 10.1 of these FAQs generally applies and is relevant to the analysis of the broker-dealer's advice on the refunding issuance of municipal securities. [May 19, 2014]

SECTION 11: INVESTMENT STRATEGIES AND PROCEEDS OF MUNICIPAL SECURITIES

Question 11.1: Transitional Guidance for Identifying Proceeds of Municipal Securities: A market participant may have municipal entity or obligated person clients who, prior to July 1, 2014, have deposited proceeds of municipal securities in existing accounts and invested such proceeds in existing investments held by the market participant. In determining whether or not such existing accounts and existing investments contain proceeds of municipal securities under the Final Rules, is the market participant required to obtain a written representation from its municipal entity or obligated person client regarding the nature of the funds held in existing accounts or existing investments or may the market participant rely on another process?

Answer: In general, the Final Rules apply to a market participant who provides investment advice on or after July 1, 2014 to a municipal entity or obligated person regarding investments of proceeds of municipal securities, including those proceeds already existing on that date or those proceeds arising after that date. Thus, the provision of such covered investment advice regarding proceeds of municipal securities constitutes municipal advisory activity that, absent an available exclusion or exemption, would require the market participant who provides such advice to register with the Commission as a municipal advisor under the Final Rules. Under Exchange Act Rule 15Ba1-1(m)(3), in determining whether or not funds to be invested constitute proceeds of municipal securities, a market participant *may* rely on representations in writing made by a knowledgeable official of the municipal entity or obligated person regarding the nature of such funds, provided that the market participant seeking to rely on such representation has a

[36] Adopting Release, 78 FR at 67490.

reasonable basis for such reliance.[37] In the staff's view, this written representation process does not represent an exclusive means for determining whether or not funds to be invested constitute proceeds of municipal securities, and market participants may use other reasonable procedures to determine whether funds to be invested constitute proceeds of municipal securities.

Transitional Guidance and Relief for Identifying Proceeds Held in Existing Accounts or Existing Investments. In recognition of the administrative burdens and challenges market participants raised with respect to identifying existing proceeds of municipal securities, and as transitional guidance and relief for purposes of the Final Rules with respect to investment advice provided on or after July 1, 2014 regarding investments of existing proceeds of municipal securities that already were held in existing accounts or existing investments before that date,[38] the staff believes that, unless a market participant actually knows or reasonably should have known that an existing account or existing investment contains proceeds of municipal securities, a market participant may determine that such existing accounts or existing investments do not contain proceeds of municipal securities. For purposes of this transitional guidance and relief, a market participant could utilize a reasonable diligence process as a transitional means for determining whether funds in existing accounts or existing investments constitute proceeds of municipal securities for purposes of the Final Rules.[39]

The staff believes that, for this purpose, a reasonable diligence process should include a review of relevant information within the market participant's possession. Thus, for example, a market participant reasonably could know that an existing account or existing investment may contain proceeds of municipal securities if the account holder is a municipal entity or the account name suggests a connection to municipal securities (e.g., the name of the account refers to municipal securities, municipal bonds, or fund names commonly known to be related to municipal securities, such as a debt service reserve fund account).

The staff also believes that, as part of a reasonable diligence process, a market participant could provide written notice (including by electronic or other means) to a client and make provision for a contingent approach in the event that the client fails to respond. For example, for clients with existing accounts or existing investments prior to July 1, 2014, a market participant could provide written notice to such clients inquiring whether the funds on deposit or held in existing investments in the client's account include proceeds of municipal securities and requesting that clients return written representations to the market participant, with a contingency provision that the market participant will assume, unless notified otherwise, that the funds on deposit or held in existing investments in the client's account do not include proceeds of municipal securities.

[37] *See* Adopting Release, 78 FR at 67495 (describing the Commission's belief that a determination of whether or not a person has a reasonable basis to rely on a written representation requires reasonable diligence based on all the facts and circumstances, including review of the written representation and other relevant information reasonably available to the person).

[38] The Final Rules were effective on January 13, 2014; however, on January 13, 2014, the Commission temporarily stayed the Final Rules until July 1, 2014.

[39] The staff notes that documentation of the steps undertaken in a reasonable diligence process to determine whether funds in an existing account or existing investment constitute proceeds of municipal securities could help to support a market participant's determination if this determination were questioned.

In the staff's view, a reasonable diligence process could permit a market participant to form a reasonable belief, based on all the facts and circumstances, that the funds in an existing account or existing investment do not constitute proceeds of municipal securities. Examples of factors that a market participant may consider in its reasonable diligence process could include, but are not limited to, the quantity of existing accounts and the relative administrative burdens and costs of determining whether such accounts contain proceeds of municipal securities, the nature and term of existing investments and the relative potential for future advice on those investments, and an assessment of the potential likelihood that a particular client uses proceeds of municipal securities in light of the nature of the particular client's business.

Identifying Proceeds Received On or After July 1, 2014. With respect to investment advice provided on or after July 1, 2014 regarding investments of newly-arising proceeds received from municipal securities that are issued on or after that date, market participants should develop policies and procedures consistent with the Final Rules and the Commission's guidance in the Adopting Release to determine whether or not the advice provided involves investments of proceeds of municipal securities.[40] The staff notes that the same guidance applies to municipal escrow investments under Exchange Act Rule 15Ba1-1(h)(2). [May 19, 2014]

Question 11.2: Proceeds of Pension Obligation Bonds: Suppose a municipal entity issues pension obligation bonds to finance an unfunded actuarial liability for a municipal entity's public pension plan[41] and contributes those proceeds to such public pension fund where they are commingled with other pension funds for collective investment and treated as spent to carry out their authorized purposes to fund the public pension plan under applicable state law upon their contribution to the public pension plan. Funds in these public pension plans are required to be used for the exclusive benefit of the pension beneficiaries. In these circumstances, do such proceeds of pension obligation bonds cease to be considered "proceeds of municipal securities" under the Final Rules upon their contribution to the public pension plan?

Answer: Yes, in the staff's view, under the circumstances described in Question 11.2, such proceeds of pension obligation bonds lose their character as proceeds of municipal securities under the Final Rules upon their contribution to the public pension plan. Exchange Act Rule 15Ba1-1(m)(1) provides that proceeds of municipal securities cease to be treated as proceeds of municipal securities when they are spent to carry out the authorized purposes of municipal securities. The staff notes that, under existing accounting practices, municipal entities commonly treat proceeds of taxable[42] pension obligation bonds as spent for their authorized

[40] *See id.* (describing reliance on representations in writing made by a knowledgeable official of the municipal entity or obligated person whose funds are to be invested regarding the nature of such funds).
[41] Public pension plans broadly include "governmental plans" and other types of public pension plans that are sponsored by municipal entities, as described generally in note 191 in the Adopting Release, 78 FR at 67482.
[42] The staff notes that, in general, municipal entities do not issue tax-exempt bonds to fund public pension plans because the Federal tax arbitrage investment restrictions under Section 148 of the Internal Revenue Code treat proceeds of such bonds as unspent and subject to arbitrage investment restrictions until used to carry out their governmental purpose to pay retirement benefits.

purposes under applicable state law upon contribution to public pension funds and thereafter they no longer segregate, account for, or track such funds as proceeds of municipal securities.

By contrast, however, in the staff's further view, if a municipal entity segregates proceeds of pension obligation bonds and continues to account for them separately as proceeds of the pension obligation bonds or retains control over the ability to use such funds for any purpose other than the exclusive benefit of pension beneficiaries, such proceeds continue to constitute proceeds of municipal securities under the Final Rules until used ultimately to pay pension benefits to pension fund beneficiaries or to carry out other authorized purposes of the pension obligation bonds. [May 19, 2014]

SECTION 12: THE ENGINEERING EXCLUSION

Question 12.1: Scope of the Engineering Exclusion: What are some relevant considerations regarding the scope of advice an engineer may provide to a municipal entity or obligated person under the exclusion for engineers providing engineering advice if such advice relates to a new project that will be financed, in whole or in part, by an issuance of municipal securities? Does the analysis change if the advice relates to an existing project that was financed, in whole or in part, by one or more outstanding issues of municipal securities?

Answer: *Overview*. In accordance with Exchange Act Section 15B(e)(4)(C), the Final Rules exclude engineers from the definition of municipal advisor "to the extent that the engineer is providing engineering advice."[43] In the Adopting Release, the Commission provided several examples of engineering activities within the scope of the engineering exclusion (those activities where the engineer's advice focuses on a project's engineering aspects and considerations) and several examples of engineering activities outside the scope of the engineering exclusion (those activities where the engineer's advice focuses on advice relating to the structure, timing, terms, and other similar matters for the issuance of municipal securities or municipal financial products).[44]

New Project to be Financed by an Issuance of Municipal Securities. The staff believes an engineer could rely on the engineering exclusion when providing advice on the engineering aspects of a new project that will be financed, in whole or in part, by an issuance of municipal securities; provided that such advice does not include advice with respect to structure, timing, terms, or other similar matters concerning such issuance of municipal securities. For example, an engineer could provide a municipal entity or obligated person with advice on a new project's specifications, including overall cost, a projected construction schedule, anticipated funding requirements, and a projected in-service date. The municipal entity, obligated person, or other financing transaction participant, in turn, could use such information to structure the related issuance of municipal securities, including determining the length of any capitalized interest period and the amount of capitalized interest to be financed from bond proceeds. The staff believes, however, that an engineer providing advice on how to structure the related issuance of

[43] Exchange Act Rule 15Ba1-1(d)(2)(v).
[44] Adopting Release, 78 FR at 67530-67531.

municipal securities, including the length of any capitalized interest period and the amount of capitalized interest to be financed, would constitute municipal advisory activities outside the scope of the engineering exclusion. Absent an available exclusion or exemption, the staff believes that an engineer providing such advice would fall within the scope of the municipal advisor definition under the Final Rules and would be required to register with the Commission as a municipal advisor.

In the Adopting Release, the Commission stated its belief "that the provision of engineering feasibility studies that include certain types of projections, such as projections of output capacity, utility project rates, project market demand, or project revenues that are based on considerations involving engineering aspects of a project are within the scope of the engineering exception." [45] Similarly, as part of providing advice on the engineering aspects of a new project, an engineer could provide a municipal entity or obligated person with projected gross revenues that are derived from the physical connections to the project (e.g., water and sewer system), as well as projected operating and maintenance expenses and net revenues for such project. The municipal entity, obligated person, or other financing transaction participant, in turn, could use such information to structure the timing and terms of debt service payments on the related issuance of municipal securities and, based on such debt service structure and projected net revenues, provide a projected debt service coverage table for inclusion in the offering document for the issuance of municipal securities. The staff believes, however, that an engineer providing advice on how to structure the related issuance of municipal securities, including the timing and terms of debt service payments, would constitute municipal advisory activities outside the scope of the engineering exclusion. Absent an available exclusion or exemption, the staff believes that an engineer providing such advice would fall within the scope of the municipal advisor definition under the Final Rules and would be required to register with the Commission as a municipal advisor.

Existing Project Financed by an Issuance of Municipal Securities. The staff believes an engineer could rely on the engineering exclusion when providing advice on the engineering aspects of an existing project that was financed, in whole or in part, by one or more outstanding issues of municipal securities; provided that such advice does not include advice with respect to restructuring or refinancing such issuance of municipal securities. For example, a municipal entity engages an engineer to provide a compliance report with respect to an existing project that includes evaluating the state of the physical plant, the useful life of parts, the routine maintenance being conducted, and the proposed capital improvements program and, based on such evaluation, the engineer provides the municipal entity with advice on complying with covenants in existing bond documents. In such a compliance report, the engineer may provide advice on rates and whether the proposed rate structure is sufficient, or recommend a rate increase to achieve compliance with an existing rate covenant. The staff believes, however, that an engineer providing advice on how to structure a new issuance of municipal securities for the

[45] *See* Adopting Release, 78 FR at 67531. By contrast, absent other relevant facts and circumstances, the staff believes that an engineer providing a municipal entity or obligated person with projected gross revenues for a new project that are based exclusively on market forces, such as ticket sales for a sports arena (as distinguished from engineering aspects), would not be within the scope of the engineering exclusion under the Final Rules.

proposed capital improvement program or restructure or refinance an outstanding issuance of municipal securities to achieve compliance with covenants in existing bond documents would constitute municipal advisory activities outside the scope of the engineering exclusion. Absent an available exclusion or exemption, the staff believes that an engineer providing such advice would fall within the scope of the municipal advisor definition under the Final Rules and would be required to register with the Commission as a municipal advisor. [May 19, 2014]

Question 12.2: Engineering Advice Regarding Loan Applications for State Revolving Funds: If an engineer assists a municipal entity or obligated person with completing a loan application for state revolving funds, would such assistance be considered municipal advisory activity under the Final Rules?

Answer: The Answer to Question 1.1 of these FAQs regarding the general information exclusion from advice generally applies and is relevant to this analysis. If the engineer provides general information that does not involve a recommendation with respect to a municipal financial products or the issuance of municipal securities, such assistance would not be considered municipal advisory activity. The Answer to Question 12.1 of these FAQs regarding engineering advice on a new project to be financed by an issuance of municipal securities also generally applies and is relevant to this analysis. If the engineer provides advice on the engineering aspects and consideration of a project to be financed by the proceeds of the state revolving loan funds, the staff believes such advice would be within the scope of the engineering exclusion. If the engineer's advice includes advice with respect to structure, timing, terms or other similar matters concerning a related municipal financial product or issuance of municipal securities, it would constitute municipal advisory activity outside the scope of the engineering exclusion. Absent an available exclusion or exemption, the staff believes that an engineer providing such advice would fall within the scope of the municipal advisor definition under the Final Rules and would be required to register with the Commission as a municipal advisor. [May 19, 2014]

SECTION 13: THE BANK EXEMPTION

Question 13.1: Advice by Dual Employees: An individual is employed by a bank and is an associated person of the bank's broker-dealer affiliate (a "dual employee"). May a dual employee provide advice to a municipal entity or obligated person within the scope of the bank exemption under the Final Rules when acting in the employee's capacity as a bank employee and advice within the scope of the underwriter exclusion under the Final Rules when acting in the employee's capacity as a broker-dealer?

Answer: The staff believes that a dual employee may provide advice within the scope of the bank exemption while acting in the capacity of a bank employee and may provide advice within the scope of the underwriter exclusion while acting in the capacity of a broker-dealer if such dual employee discloses to the municipal entity or obligated person the capacity in which the dual employee is acting in advance of providing any advice. To provide advice in both capacities, the dual employee must meet and fulfill the requirements of the bank exemption and the underwriter exclusion under the Final Rules. The staff notes that, in each such capacity and absent additional

facts and circumstances, the nature of the relationship between the dual employee and the municipal entity or obligated person would be an arm's length and non-advisory relationship. The staff further notes, however, that persons serving in more than one capacity on the same transaction should consider any potential conflicts of interest that may arise. [May 19, 2014]

Question 13.2: Direct Purchase of Municipal Securities by a Bank: A bank seeks to purchase municipal securities directly from a municipal entity for the bank's own account. May the bank rely on the bank exemption under the Final Rules to make recommendations concerning the structure, timing, terms, and similar matters with respect to such securities to be purchased and held by the bank for its own account?

Answer: Pursuant to an express provision in the bank exemption in the Final Rules, a bank may provide advice to a municipal entity or obligated person with respect to "the purchase of a municipal security by the bank for its own account."[46] In the Adopting Release, the Commission stated in relevant part that "banks providing municipal entities or obligated persons with the terms under which they would purchase securities for their own account are not engaging in municipal advisory activity."[47] Accordingly, a bank may rely on the bank exemption in the Final Rules to give advice to a municipal entity regarding the structure, timing, and terms under which the bank would purchase securities for its own account.

In the staff's view, however, if a bank provides advice to a municipal entity or obligated person regarding the structuring, timing, terms, and similar matters with respect to an issuance of municipal securities that extends beyond those municipal securities that the bank plans to purchase for its own account, such advice would constitute municipal advisory activity that is outside the scope of the bank exemption under the Final Rules. For example, if a bank provides advice to a municipal entity or obligated person regarding the structure, timing, terms, and other similar matters with respect to an issuance of municipal securities to be offered in the public markets, the staff believes that such advice would be outside the scope of the bank exemption. In this regard, the Answer to Question 1.1 of these FAQs regarding the advice standard generally applies and is relevant to this analysis. [May 19, 2014]

SECTION 14: THE ATTORNEY EXCLUSION

Question 14.1: Advice Provided by Bond Counsel: A municipal entity engages bond counsel in connection with an issuance of municipal securities involving conduit bonds for the benefit of an obligated person. The municipal entity has asked the obligated person to contact bond counsel directly regarding certain legal questions. May bond counsel rely on the attorney exclusion to provide legal advice directly to such obligated person regarding the issuance of municipal securities?

Answer: Exchange Act Section 15B(e)(4)(C) excludes from the municipal advisor definition attorneys offering legal advice or providing services that are of a traditional legal nature with

[46] *See* Exchange Act Rule 15Ba1-1(d)(3)(iii)(B).
[47] Adopting Release, 78 FR at 67535, note 894.

respect to the issuance of municipal securities or municipal financial products. The Final Rules limit the scope of the attorney exclusion to such advice or services the attorney provides to the attorney's client that is a municipal entity, obligated person, or other participant in the transaction.[48] In the Adopting Release, the Commission stated that "if another participant in the issuance or transaction, who is not a client of the attorney, receives and acts upon the legal advice the attorney provides to its client, the attorney will not have to register as a municipal advisor. In this situation, the attorney is still only advising its client, even if the advice affects the actions of other participants in the transaction."[49]

The role of bond counsel on a transaction to issue municipal securities customarily includes providing an objective legal opinion with respect to the validity of the bonds and other subjects, including the tax treatment of interest on the bonds. To fulfill this function, bond counsel may need to share its views with, or provide legal advice to, members of the transaction team other than bond counsel's client regarding state law authority for issuing the bonds and the federal and state tax status of the interest on the bonds. In the staff's view, an attorney may state its client's position (or provide advice that it would provide to its client if asked) without requiring the client to be present, provided that the attorney's client does not object to such arrangement. The staff notes that attorneys are required to comply with rules of professional conduct and ethical standards for attorneys under applicable state law. Accordingly, in the case of conduit bonds, in the staff's view, if bond counsel's statements to the obligated person are within the scope of its representation of the municipal entity and its role as bond counsel and are otherwise consistent with applicable law, bond counsel would not be required to register as a municipal advisor.[50] [May 19, 2014]

[48] Exchange Act Rule 15Ba1-1(d)(2)(iv).
[49] Adopting Release, 78 FR at 67528.
[50] The content of such statements must also be consistent with the requirements of the exclusion included in the Final Rules. To the extent an attorney represents himself or herself as a financial advisor or financial expert regarding the issuance of municipal securities or municipal financial products, the attorney would not be excluded with respect to such financial activities. *See* Exchange Act Rule 15Ba1-1(d)(2)(iv).

MUNICIPAL ADVISOR RESOURCE

PREPARE | PARTICIPATE | PUT INTO PRACTICE

Preparing for Regulation

A GUIDE FOR MUNICIPAL ADVISORS

MSRB

Produced by the
Municipal Securities Rulemaking Board

Preparing for Regulation

The Municipal Securities Rulemaking Board (MSRB) is providing a checklist and additional information to help newly registered municipal advisors begin to assess their readiness for regulatory oversight. The MSRB recognizes that many municipal advisors also act as municipal securities dealers, which is a class of financial professionals that has been regulated by the MSRB since 1975. However, Congress determined that all municipal advisors, as defined by the Securities and Exchange Commission (SEC), should be subject to federal regulatory oversight, and designated the MSRB as the primary regulator responsible for implementing new rules and standards. Congress also established a federal fiduciary duty for municipal advisors, obligating them to put their municipal entity clients' interests before their own.

As the MSRB puts in place additional rules of conduct for municipal advisors, this guide is intended primarily to serve as a starting point for municipal advisor professionals who, while experienced in their field, may be unfamiliar with the development of a federal regulatory regime. The MSRB will continue its outreach to municipal advisors as it develops rules and standards, and will provide extensive opportunities for municipal advisors to ask questions, provide input and participate in the rulemaking process.

DEFINING "MUNICIPAL ADVISOR"

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) broadly defines municipal advisors as including financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders and certain swap advisors that provide municipal advisory services. The Securities and Exchange Commission (SEC) issued a final rule in September 2013 that provides guidance for determining whether a firm or professional is engaging in municipal advisory activities requiring registration with the SEC and the MSRB. The MSRB does not provide legal advice on SEC rules. Possible municipal advisors who want to verify whether they are subject to registration requirements and MSRB oversight should review the SEC's final rule and related fact sheet and consult their legal professionals. Municipal market participants also should consult their legal professionals to determine whether they are subject to the registration requirements of other regulatory agencies or organizations.

Municipal Advisor Checklist

✓ **STEP 1:** Understand the Importance of Registration

Learn about what it means to register with the MSRB . . . . . *page* **4**

✓ **STEP 2:** Learn about the MSRB

Get to know the primary regulator of the municipal securities market . . . . . *page* **8**

✓ **STEP 3:** Learn about Being Regulated

Learn about the responsibilities and benefits of being a regulated professional. . . . . . *page* **11**

✓ **STEP 4:** Review Existing Business Practices

Assess firm policies and procedures . . . . . *page* **16**

✓ **STEP 5:** Access Available Resources

Take advantage of information and educational resources available for registered municipal advisors . . . . *page* **18**

✓ **STEP 6:** Stay Informed

Stay up to date with regulatory notices, news and other information from the MSRB . . . . . *page* **19**

Understand the Importance of Registration

Municipal advisory firms and sole proprietorships are required to register with the MSRB, the self-regulatory organization for the municipal market. They must first register with the Securities and Exchange Commission (SEC), the federal agency that conducts examinations and enforces MSRB rules for municipal advisors. Municipal advisors are subject to rules designed to promote a fair, transparent and efficient municipal securities market, and requiring registration with the SEC and MSRB is the first step in ensuring an effective regulatory process. Registration also establishes an official communication channel for the MSRB to contact firms and individuals in the municipal advisory business. This communication is essential to inform municipal advisors about their regulatory obligations and opportunities to participate in the rulemaking process. The MSRB also encourages state and local governments and other municipal entities to verify the registration of their municipal advisor with the MSRB.

Compliance with Rules

Rulemaking in the municipal securities market sets the foundation for ensuring a fair and efficient market. MSRB rules for municipal advisors help prevent fraud and other unfair practices. These rules are approved by the SEC and have the force and effect of federal law. The full list and text of MSRB rules is available on the MSRB's website at www.msrb.org. To view only rules that apply to advisors, click the "Rules for" tab and select the "Municipal Advisor" role from the drop-down menu. Note that some of the listed rules currently apply to all municipal advisors, whereas others apply only to municipal securities dealers that provide financial advisory services.

MSRB rules are categorized by rule type. General, or "G" rules, create responsibilities and standards for dealers effecting municipal securities transactions and for municipal advisors that engage in municipal advisory

REGISTERING AS A MUNICIPAL ADVISOR

Municipal advisors that have not yet registered with the MSRB can begin the process by first registering with the Securities and Exchange Commission (SEC). Following the passage of the Dodd-Frank Act, the SEC implemented a temporary registration regime for municipal advisors. Beginning in July 2014, the SEC plans to transition from this temporary registration regime to a permanent regime, with transition dates phased across four consecutive months. Firms registering with the SEC either under the temporary or permanent regime must also register with the MSRB. Each municipal advisor must have an SEC municipal advisor registration number in order to register with the MSRB.

For more information on registering with the SEC through the temporary Form MA-T, or permanent Forms MA or MA-I, visit the SEC website at www.sec.gov.

Registration with the MSRB is performed online through MSRB Gateway, the single, secure access point for all MSRB systems. To begin the registration process as a municipal advisor, go to www.msrb.org and click "Register here." Additional help with registration is available here.

activities. Administrative, or "A" rules, set forth the structure, authority and membership of the MSRB and assessments and fees. Definitional, or "D" rules, provide definitions for terms used in MSRB rules.

For more information on the principles that support municipal securities regulations, see *Step 3: Learn about Being Regulated* on page 11.

Official Communication

The MSRB's online registration process requires municipal advisors to provide various contact information, including designating an email contact to serve as the primary contact person for purposes of electronic communications with the MSRB. This requirement provides for an efficient and reliable means of official communication between the MSRB and regulated entities, and allows the MSRB to alert municipal advisors to time-sensitive developments, rule changes, notices and other information. Firms must promptly update this information if it changes and verify it on an annual basis.

Registration Verification

Part of the MSRB's mission includes protecting state and local governments and other municipal entities that may interact with municipal advisors. The MSRB encourages municipal entities that retain municipal advisory firms to verify the firm's registration status with the MSRB and the SEC. The MSRB's website includes a list of all municipal advisors registered with the MSRB.

The MSRB cautions municipal entities against working with unregistered firms and professionals that provide municipal advisory services. Unregistered municipal advisors are in violation of federal law in conducting municipal advisory business. The MSRB's policy is to report any unregistered municipal advisors to the SEC for appropriate action.

Fees

The MSRB's operations, including rulemaking, market transparency initiatives and education and outreach, are not funded by the federal government. The MSRB assesses fees on

municipal securities dealers and municipal advisors. As part of the registration process, each firm the MSRB regulates, whether the firm is a municipal securities dealer, municipal advisor or both, is required to pay the MSRB a one-time initial fee and its first year's annual fee. Municipal advisors and municipal securities dealers also must pay an annual fee for each subsequent year in which they remain registered with the MSRB and continue to be subject to the MSRB's jurisdiction. Learn more about municipal advisor annual and initial fees on the MSRB's website.

In addition to annual and initial fees, which fund less than 5 percent of the MSRB's activities, municipal securities dealers are assessed other types of fees. The MSRB is working to establish appropriate and equitable assessments on municipal advisors, with input from the municipal advisory community and other market stakeholders, to fairly distribute assessments across all regulated entities and ensure adequate funding of the MSRB.

REPORT UNREGISTERED MUNICIPAL ADVISORS

Registration and regulation protect the integrity of the financial markets. If the MSRB becomes aware of any unregistered firm engaging in municipal advisory activities, it refers the matter to the appropriate regulatory authority for possible investigation and discipline. To report an unregistered municipal advisor to the MSRB, file a complaint online. Complaints may be made anonymously.

Learn about the MSRB

The MSRB is the self-regulatory organization charged by Congress with regulating the activities of municipal securities dealers and municipal advisors to promote a fair and efficient municipal securities market. The MSRB is governed by a 21-member Board of Directors that includes a majority of public (i.e., non-regulated) members, as well as members from regulated firms, including municipal advisors and municipal securities dealers. Board members serve three-year terms and new members are selected by the Board through a thorough application and review process following a public call for applicants. Informed by insights from actual market participants, the MSRB protects investors, state and local governments and other municipal entities, and the public interest. The MSRB fulfills this mission in a number of ways, including:

- Regulating municipal securities dealers and municipal advisors
- Operating market transparency systems
- Engaging in education, outreach and market leadership

WHAT IS AN SRO?

In the United States, financial securities regulation is accomplished through a combination of federal and state oversight and self-regulatory organizations (SROs). The MSRB is the SRO for the municipal securities market. SROs complement federal regulation by ensuring that industry expertise and experience inform the development of rules and standards. The MSRB's rulemaking and other activities benefit from the insight of actual participants in the municipal marketplace. The MSRB Board of Directors is a majority-public board that includes members selected from the non-regulated public at large and regulated municipal advisors and municipal securities dealers. This provides diverse perspectives on the public interest and the practical realities of implementing regulatory goals. In addition, the MSRB engages in an extensive notice and comment process in connection with virtually all of its rulemaking initiatives, allowing all municipal market stakeholders to submit their feedback on proposed rules for MSRB consideration prior to adoption.

The SEC is charged with overseeing the activities of the MSRB and most other securities industry SROs. The SEC reviews, approves and enforces the MSRB's rules, which have the force and effect of federal law. The SEC and other regulatory authorities examine MSRB-regulated entities for compliance with MSRB rules and enforce the rules. The MSRB does not perform these functions.

The MSRB develops rules and standards of professional qualification for the municipal securities dealers and municipal advisors that engage in municipal securities and advisory activities. To further protect market participants, the MSRB provides market transparency through its Electronic Municipal Market Access (EMMA®) website, at emma.msrb.org. The EMMA website is the official repository for trade data and disclosure information on virtually all municipal securities. The MSRB also serves as an objective resource for information on the municipal market, conducts extensive education and outreach to market stakeholders, and provides market leadership on key issues. The MSRB is subject to oversight by the Securities and Exchange Commission.

Participation by regulated firms and professionals in the regulatory process is central to achieving the MSRB's goal of a fair and efficient market. Municipal advisors and other market participants have a number of opportunities to provide input, including commenting on MSRB rule concepts and proposals and serving on the Board of Directors. Learn more about the methods and value of participation in a self-regulatory organization on page 13.

STEP 3

Learn about Being Regulated

Firms and professionals in regulated securities industries are governed by rules designed to establish standards for their business practices, to promote fair dealing and to protect against fraud and other illegal conduct. As required by Dodd-Frank, regulatory standards protect state and local governments and other municipal entities that engage the services of a municipal advisor, as well as municipal securities investors. Regulation also serves to promote fair competition and protect the municipal market as a whole. As the MSRB implements its framework for municipal advisor regulation, municipal advisors are expected to:

- Understand and comply with applicable MSRB rules
- Meet professional qualification standards as set by the MSRB
- Establish adequate business policies and procedures
- Prepare for examinations from enforcement agencies and regulatory organizations

Regulatory Principles

It is important for newly registered municipal advisors to begin to understand the principles that underlie municipal securities regulations. The Dodd-Frank Act established a federal fiduciary duty for municipal advisors, which among other things, subjects them to a duty of loyalty and duty of care to their municipal entity clients and obligates them to put their clients' interests above their own. The MSRB is responsible for developing additional standards for municipal advisors. A cornerstone of the MSRB's regulatory framework that is currently in effect for municipal advisors is MSRB Rule G-17 on fair dealing, which requires all MSRB-regulated entities, including municipal advisors, to act fairly and not engage in any deceptive or dishonest practices.

As the MSRB puts in place its body of municipal advisor rules, certain general tenets of municipal securities regulation are likely to play a significant role in the regulatory obligations of municipal advisors, such as:

- *Supervision:* Adequate internal policies and procedures to supervise the activities of regulated firms and their employees is a critical aspect of preserving market integrity. As the MSRB considers rules mandating specific supervisory duties, municipal advisors should be assessing practices for consistency with good supervision to help ensure that the firm and its professionals meet their existing federal fiduciary duty and MSRB fair practice duty.
- *Conflicts of Interest:* Disclosure of conflicts of interest enables market participants to assess the relationships among financial and other professionals and evaluate the impartiality of any advice provided by a regulated firm and its employees. As municipal advisors prepare to transition to a regulatory regime, they should be assessing conflicts disclosure practices for consistency with generally understood fiduciary principles.
- *Gifts and Gratuities:* Personal gifts to employees of state or local governments and to employees of other market participants may serve to improperly influence those employees' decisions. As the MSRB considers rules potentially extending its existing gift rule to non-dealer municipal advisors, municipal advisors should prepare to comply with any restrictions and consider whether gifts intended to influence clients and other

market participants could be viewed as inconsistent with generally understood fiduciary principles.

- *Political Contributions:* One form of conflict of interest in the municipal market can arise if financial professionals seek to influence the award of business by state and local government officials by making political contributions to those officials or soliciting contributions on their behalf. MSRB rules seek to address the perception and practice of "pay-to-play" in the municipal securities business. As the MSRB considers rules specifically prohibiting pay-to-play practices for non-dealer municipal advisors, municipal advisors should be assessing whether they engage in activities such as quid pro quo arrangements that could be covered by generally understood fiduciary principles.
- *Compensation:* The MSRB's fair practice rule, Rule G-17, has been interpreted to prohibit regulated firms and individuals from charging excessive compensation. Rule G-17 currently applies to municipal advisors, and municipal advisors should take appropriate measures for assuring compliance with this principle.
- *Books and Records:* Maintaining sufficient books and records allows regulated firms to document the activities of the firm and its employees and will be an essential component of examination and enforcement activities related to current and future rules. As the MSRB considers rules mandating specific recordkeeping requirements, municipal advisors should be assessing practices to determine if they appropriately document their municipal advisory activities, both with respect to their business activities and their regulatory compliance.

To understand how these principles have been codified for municipal securities dealers, consult the MSRB rule book online. Regulatory notices published by the MSRB on its website provide current information on upcoming and currently effective rules.

Participation in Rulemaking

Municipal advisor participation in the rulemaking process helps ensure that rules for municipal advisors reflect current industry practices and market activities. As the MSRB undertakes further rulemaking relating to municipal advisors, refer to the Municipal Advisors page of the MSRB's

website for news and information on MSRB regulatory and other developments that may affect all municipal advisors.

The MSRB publishes electronic notices designed to keep the rulemaking process transparent and market participants informed about regulatory developments, including requests for comment on rule proposals. These notices are provided by email to the primary contact for all registered entities and other subscribers. Learn more about subscribing to additional MSRB email updates on page 19.

The MSRB considers reasonable regulatory alternatives to its rule proposals. The MSRB also assesses the costs and benefits of its proposals to evaluate potential burdens on competition in light of each proposal's intended purpose and expected benefits to the fairness, transparency and efficiency of the municipal market. Municipal advisors are encouraged to review any proposed MSRB rules and submit comments. Comments received are posted on the MSRB's website and are part of the record in any rule filing submission to the SEC.

The MSRB will provide additional education and timely information on participating in the rulemaking process as rules for municipal advisors are developed.

Professional Qualifications

The MSRB is charged by Congress with establishing minimum professional qualifications for municipal advisors. The development of professional qualification standards to establish the competency of municipal advisors is a process that relies on the input of practicing municipal advisors. Any applicable professional qualification standards, related resources and information on how to participate in the future development of professional qualification standards are available on the MSRB's website.

Policies and Procedures

Policies and procedures are the foundation for helping ensure that individuals engaged in municipal advisory activities are acting in accordance with MSRB rules and federal securities laws. See page 16 for more information.

Regulatory Inspections

Municipal advisors may be examined by one or more regulatory authorities to determine if they are in compliance with currently applicable MSRB rules and federal securities laws. Municipal advisors should be prepared for future inspections by reviewing applicable MSRB rules and law, and ensuring that they are in compliance. Regulatory authorities that conduct examinations may refer any findings to their enforcement divisions for further action.

The SEC's Office of Compliance, Inspections and Examinations provides information about its examination process for municipal securities dealers and other regulated entities and methods used to resolve problems found during inspections. This information, which the SEC provides to firms under examination, can help municipal advisors better understand the objectives of regulatory inspections.

If rule violations are established as a result of an inspection, penalties can include fines, restitution and suspension or prohibition from engaging in municipal advisory activities or other securities business. Matters may be referred to law enforcement agencies for civil or criminal charges.

Review Existing Business Practices ahead of Rulemaking

One aspect of regulatory oversight is the development of uniform business practices and consistent professional conduct across an industry. For newly registered municipal advisors, assessing existing business policies and procedures will be useful in preparing to make any necessary changes in response to regulatory developments and for possible examinations by enforcement authorities. Areas to consider in advance of future rulemaking include:

- *Supervisory Procedures:* Has your firm prepared and implemented adequate written procedures for supervising the activities of the firm and its employees?
- *Conflicts of Interest:* Are policies in place for identifying, addressing and disclosing whether certain business relationships create conflicts of interest?
- *Gifts and Entertainment:* Does your firm have the ability to monitor entertainment expenses, particularly when entertaining public employees, to ensure that these expenses are allowable by local law and reasonable? Can your firm monitor any gifts provided on behalf of your firm to any public employee?

- *Political Contributions:* Does your firm have the ability to monitor the political contributions made by all employees?
- *Books and Records:* Does your firm prepare and maintain adequate books and records? Does your firm conduct internal reviews of books and records?
- *Business Communications:* Does your firm have policies in place and the technical capability to capture and retain all relevant business communications, including advertising?
- *Compensation and Contracts:* Does your firm have policies and procedures in place to monitor compensation on individual transactions and ensure that compensation is fair and reasonable according to MSRB Rule G-17 on fair dealing? Are policies in place applicable to contracts with clients?
- *Training:* Does your firm continue to evaluate and update policies, procedures and practices to reflect current industry and regulatory developments? If so, is ongoing training made available for the relevant staff on existing policies and procedures?

Municipal advisors may also consider the recommendations of professional associations. After assessing existing policies and procedures, municipal advisors may begin to identify possible changes in preparation for future rulemaking and examinations.

STEP 5

Access Available Resources

The MSRB provides educational resources for municipal advisors, state and local governments, investors and other municipal securities market participants to advance understanding of the municipal market. Municipal advisors can access a growing library of information and resources specifically for municipal advisors on the Municipal Advisors page of the MSRB's website at www.msrb.org.

The MSRB holds periodic education and training events in cities across the country for municipal market participants, including municipal advisors. The MSRB makes some of these events available to a nationwide audience via webcast and hosts educational webinars. Learn more about upcoming events and webinars on the MSRB's website.

Municipal advisors can also point their clients to the MSRB's resources for state and local governments. The online State and Local Government Toolkit includes information about using the MSRB's Electronic Municipal Market Access (EMMA®) website, evaluating trade data, meeting continuing disclosure obligations and working with financial professionals.

STEP 6

Stay Informed

In addition to the electronic communications the MSRB sends to a registered organization's primary contact, optional MSRB email updates are a helpful way to stay informed about rule proposals and additional topics of interest, such as resources for state and local governments and updates on the EMMA website. Subscribers to MSRB email updates can elect to receive updates on a daily or weekly basis, or may sign up to receive the MSRB Monthly Update, a monthly roundup of MSRB news. Sign up on the MSRB's website by clicking "Email Updates" at the top of the page.

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ONLINE
www.msrb.org
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MSRB
Municipal Securities Rulemaking Board

MSRB Rules

- MSRB Rule A-11 (Assessments for Municipal Advisor Professionals)

  www.msrb.org/Rules-and-Interpretations/MSRB-Rules/Administrative/Rule-A-11.aspx

- MSRB Rule A-12 (Registration)

  www.msrb.org/Rules-and-Interpretations/MSRB-Rules/Administrative/Rule-A-12.aspx

- MSRB Rule G-17 (Conduct of Municipal Securities and Municipal Advisory Activities)

  www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx

MSRB Rule Filings

- Proposed Rule Change Consisting of Proposed New Rule G-44, on Supervisory and Compliance Obligations of Municipal Advisors; Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers and Municipal Securities Dealers; and Proposed Amendments to Rule G-9, on Preservation of Records, (File No. SR-MSRB-2014-06) (July 2014)

  www.msrb.org/Rules-and-Interpretations/SEC-Filings/~/media/Files/SEC-Filings/2014/MSRB-2014-06.ashx

- Rule A-11 on Assessments for Municipal Advisor Professionals (File No. SR-MSRB-2014-03) (April 2014)

  www.msrb.org/Rules-and-Interpretations/SEC-Filings/~/media/Files/SEC-Filings/2014/SR-MSRB-2014-03.ashx

MSRB Regulatory Notices

- Request for Comment on Draft Amendments to MSRB Rule G-37 to Extend its Provisions to Municipal Advisors, Regulatory Notice 2014-15, (August 2014)

  www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-15.ashx?n=1

- Request for Comment on Revised Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors, Regulatory Notice 2014-12, (July 2014)

  www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-12.ashx?n=1

- SEC Approves New Consolidated Registration Rule and Registration Form for Dealers and Municipal Advisors, Regulatory Notice 2014-05, (February 2014)

  www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2014-05.ashx

- Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors, Regulatory Notice 2014-01, (January 2014)

  www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-01.ashx

- Guidance on the MSRB Municipal Advisor Registration Process, Regulatory Notice 2014-10, (May 2014)

  www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2014-10.ashx

MSRB Publications

- The Municipal Advisor's Introduction to MSRB Rules

  www.msrb.org/msrb1/pdfs/Municipal-Advisor_Introduction-to-MSRB-Rules.pdf

- Participating in the Rulemaking Process: A Guide For Municipal Advisors

  www.msrb.org/msrb1/pdfs/Municipal-Advisor_Participating-in-the-Rulemaking-Process.pdf

- Preparing for Regulation: A Guide For Municipal Advisors

  www.msrb.org/msrb1/pdfs/Municipal-Advisor_Preparing-for-Regulation.pdf

- Municipal Advisor Professional Fee Payment Guidelines

  www.msrb.org/msrb1/pdfs/Municipal-Advisor-Professional-Fee-Payment-Guidelines.pdf

Suitability

November 20, 2014 / 1:00 p.m. – 2:15 p.m.

Suitability

Tony Cognevich, Examination Manager, FINRA, New Orleans District Office

Tony Cognevich is an examination manager in the New Orleans FINRA District Office. He joined NASD/FINRA in 1987 as an examiner. Prior to his current position, Mr. Cognevich served as an examiner for more than 13 years. Mr. Cognevich left NASD in 1991 and served in both sales and compliance at two large member firms. Mr. Cognevich re-joined the New Orleans FINRA Office in 1996, and was promoted to examination manager in 2004. As an examination manager, Mr. Cognevich has been involved in supervising very large and complex cycle and cause exams. Mr. Cognevich received a bachelor's degree in finance from the University of New Orleans in 1987 and an M.B.A. from Tulane University in 1998. Mr. Cognevich is also a graduate of the FINRA Institute at Wharton and is a past recipient of FINRA's Excellence in Service Award.

Mitch Atkins, Principal, FirstMark Regulatory Solutions, Inc.

Mitchell Atkins is Founder and Principal of FirstMark Regulatory Solutions, Inc., which is based in Fort Lauderdale, Florida. He is a consultant to FINRA-registered broker-dealers and registered investment advisers. His recent compliance focuses include cybersecurity, FINRA membership applications, risk-based branch inspections, non-traded REITs, business development corporations, exchange-traded funds, anti-money laundering, and Regulations SP and S-ID. Mr. Atkins has 20 years of experience in various roles at FINRA (previously NASD), most recently as Senior Vice President and Regional Director, with overall responsibility for four districts comprising FINRA's South Region (home to 850 brokerage firms). He oversaw the region's routine inspection program, sales practice special investigations, financial surveillance and membership application programs. Mr. Atkins oversaw the development of innovative initiatives such as the National Anti-Money Laundering Investigative Unit in 2012. Mr. Atkins oversaw the successful startup of the Florida District Office of FINRA in 2005. Mr. Atkins frequently addresses financial services industry groups. He is a Certified Regulatory and Compliance Professional through the FINRA Institute at Wharton. He is a graduate of Louisiana State University and a member of the Florida Securities Dealer's Association and the SIFMA Compliance and Legal Society.

Ron King, Chief Compliance Officer, Capital Investment Companies

Ronald L. (Ron) King is Chief Compliance Officer with the Capital Investment Companies in Raleigh, NC, where he oversees the compliance function for two broker-dealer firms and two affiliated SEC-registered investment advisers. He has been with the firm since 2007 and in the financial securities industry since 1994. Immediately prior to joining Capital, Mr. King worked as an investigator for the North Carolina Secretary of State Securities Division. Mr. King is a graduate of The Southeastern Trust School of Campbell University and attended Georgia Tech.

Emilio Mahia, Examination Manager, FINRA, New Orleans District Office

Emilio Mahia is an examination manager in the FINRA New Orleans District Office. Mr. Mahia joined NASD/FINRA in 1999 as an examiner. Prior to his current position, Mr. Mahia served as an examiner for 14 years. Mr. Mahia has participated in numerous high profile cycle, cause and special initiative examinations, involving a broad scope of sales practice issues. Mr. Mahia received a bachelor's degree in economics from the University of Southern Mississippi. Mr. Mahia is designated as a Certified Regulatory and Compliance Professional (CRCP) through the FINRA Institute at Wharton.

South Region Compliance Seminar

Suitability
November 20, 2014

FINRA
Financial Industry Regulatory Authority

Suitability

- Moderator – Tony Cognevich, Examination Manager, FINRA, New Orleans District Office
- Panelist – Emilio R. Mahia, Examination Manager, FINRA, New Orleans District Office
- Panelist – Mitchell C. Atkins, Founder, FirstMark Regulatory Solutions, Inc., Ft. Lauderdale, FL
- Panelist – Ronald L. King, Chief Compliance Officer, Capital Investment Companies, Raleigh, NC

FINRA

Variable Annuity Suitability - Share Classes

- **L Shares:** A class of annuity that offers a shorter surrender period but at a higher cost than traditional "B" share annuities.

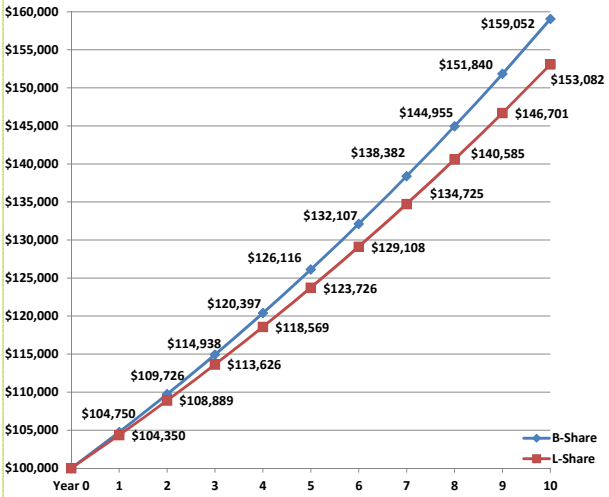
Feature	B Shares	L Shares
Surrender Period	7 years	3-5 years
M&E	1.25%	1.65%
Up Front Commissions	5%-6%	3%-6%
Trail Commissions	Minimal .25% - .40% per yr	Significant Incentive for RR .80% - 1.10% starting at yr 2-4
All Other Features	Generally Identical	

- Over time, the higher M&E starts to take its toll. If a customer holds on to annuity in excess of the 4 year surrender period, the higher fees of the L share start to eat into any profits. Significance will depend on how much higher the M&E for the L share is than the B share.

VA Shares Classes - Hypothetical No. 1

- **$100,000 investment with assumed growth rate of 6% over 10 years, after sub-account fees (but not including M&E fees). You have the choice of:**
  - Variable Annuity ABC B-Share: 7-year surrender product with a 1.25% M&E fee. Typical Surrender Schedule: 7%, 7, 6, 5, 4, 3, 2, 0%
  - Variable Annuity ABC L-Share: 4-year surrender product with a 1.65% M&E fee. Typical Surrender Schedule: 8%, 7, 6, 5, 0%
- **If you take no withdrawals, at the end of 10 years:**
- **The B-Share account value will be $159,052**
  - 6% growth less 1.25% M&E fees
- **The L-Share account value will be $153,082**
  - 6% growth less 1.65% M&E fees
- **Because of the higher M&E fees on the L-Share product, your account value would be $5,970 (or 3.75%) less than the B-Share product.**

VA Share Classes - Hypothetical No. 1

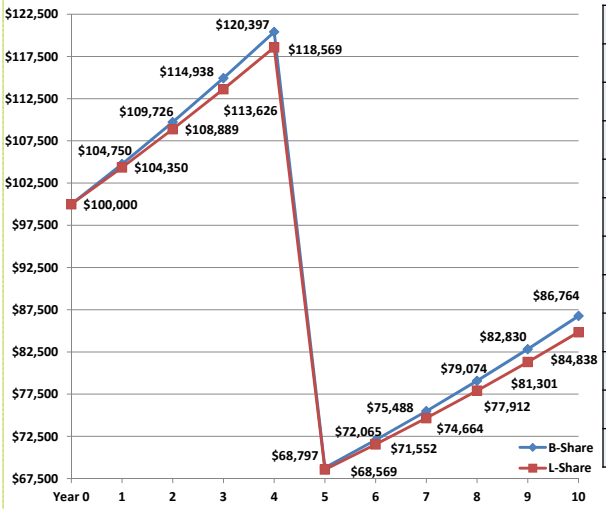


	B-Share	L-Share	Difference
Year 0	$100,000	$100,000	$0
Year 1	$104,750	$104,350	$400
Year 2	$109,726	$108,889	$836
Year 3	$114,938	$113,626	$1,312
Year 4	$120,397	$118,569	$1,828
Year 5	$126,116	$123,726	$2,390
Year 6	$132,107	$129,108	$2,998
Year 7	$138,382	$134,725	$3,657
Year 8	$144,955	$140,585	$4,369
Year 9	$151,840	$146,701	$5,139
Year 10	$159,052	$153,082	$5,970

VA Share Classes - Hypothetical No. 2

- **Now, let's suppose that for some reason you had to withdraw $50,000 at the beginning of the 5th year, a point in time at which there would be no penalty in the L-share, but a 4% penalty in the B-share.**
- **The B-Share product will have a $1,600 surrender penalty**
  - No fee on first $10,000 taken + 4% on the remaining $40,000
- **The B-Share product account value will be $68,797**
- **The L-Share product account value will be $68,569**
- **Subtract the $1,600 surrender penalty on the B-share product, and you would still be better off by $228 than if you bought the L-Share.**

VA Share Classes - Hypothetical No. 2



	B-Share	L-Share	Difference
Year 0	$100,000	$100,000	$0
Year 1	$104,750	$104,350	$400
Year 2	$109,726	$108,889	$836
Year 3	$114,938	$113,626	$1,312
Year 4	$120,397	$118,569	$1,828
Year 5	$68,797	$68,569	$228
Year 6	$72,065	$71,552	$513
Year 7	$75,488	$74,664	$824
Year 8	$79,074	$77,912	$1,161
Year 9	$82,830	$81,301	$1,528
Year 10	$86,764	$84,838	$1,926

Variable Annuity Suitability – Share Classes

- **Things to Consider:**
  - Firms should properly monitor the sale of various VA share classes and ensure that customer's are properly informed of the cost/benefit associated with the various classes.
    - Are firm's properly monitoring the sale of L share annuities, especially where the client has indicated a long term time horizon?
    - Are firm's monitoring the combination of L share annuities with certain riders to ensure that they compliment each other?
    - When questions arise, does the firm confirm the information with the customer?
    - Do the firm's WSPs properly discuss the appropriate sale of various VA share classes?
    - Are RRs and reviewing principals properly trained?

Variable Annuity Suitability

- **Source of Funds**
  - Are firms properly monitoring the source of funds for VA trades?
    - New Money vs. Exchange
    - Are cancellations a red flag?
      - In connection with the source of funds and for AML purposes?

Variable Annuity Suitability

- **1035 Exchange Transactions**
  - Are firm's properly reviewing the info being disclosed to customers when comparing the costs of an existing product to a new product?
  - Is this info accurate?
  - If a bonus feature is part of the transaction, is the firm disclosing the full surrender charge to the customer, or does the firm net the surrender against the bonus?

Qualified Rollovers

- **Are firms reviewing qualified rollovers?**
  - Are the costs of the customer's employer sponsored plan compared with the costs of the proposed IRA rollover transaction?
  - Are customers age 55-59 ½ informed that withdrawals from their IRA will be subject to the 10% early withdrawal penalty?
  - Is the customer made aware that they may be able to continue their employer sponsored plan?
  - Does the firm properly document the reason for the rollover recommendation, and why the transaction is in the best interest of the customer?

Non Traded REITS and BDC Products

- **Illiquidity of Non-Traded REIT and BDC Products**
  - Liquid Net Worth Thresholds
    - State LNW Requirements (training)
    - Currency of Subscription Agreements
    - Firm LNW/NW Requirements
    - Definitional Issues (Including definitions on Account Docs)
    - Including Illiquid or Restricted Products (IRAs, etc.) in LNW
  - Supervisory Systems
    - Review of Prior Purchases
    - Volume Discounts
    - Adequacy of Training

Documentation

- **Adequacy of Suitability Documentation**
  - Broker notes – Supplementary to new account documents, must preserve
  - Training representatives on benefits of good documentation
  - Clarity of definitions (objectives and other terms such as liquid net worth)
  - Home office review and maintenance of notes

Suitability

Questions?

Cybersecurity

November 20, 2014 / 2:20 p.m. – 3:35 p.m.

Cyber Security

Clint Johnson, Surveillance Director, FINRA, Atlanta District Office

Clint Johnson is Surveillance Director of FINRA's Atlanta District Office. In this role, he is responsible for the district's financial and sales practice risk surveillance programs. Prior to his current role, Mr. Johnson spent nearly 13 years conducting and managing examinations of FINRA member firms within the district's cycle, cause and membership application programs. Mr. Johnson has earned a bachelor's of business administration degree from the University of Georgia, and M.P.A. from Georgia State University.

Kevin Carreno, Principal, International Assets Advisory, LLC

Kevin A. Carreno is currently part owner and a principal of International Assets Advisory, LLC based in Orlando, FL. IAA is a small FINRA member firm involved in investment banking, institutional and retail business. Mr. Carreno has more than 25 years of experience as a lawyer in private practice, in-house counsel and in a variety of senior management positions, including Chief Compliance Officer, Chief Operating Officer and Chief Executive Officer with several brokerage firms. He has represented individuals and small firms in FINRA enforcement proceedings, new and continuing membership applications, examinations and investigations. Mr. Carreno has been appointed as an independent consultant in SEC, FINRA and various state enforcement matters. Mr. Carreno has served on the Board of the Florida Securities Dealers Association and as a member of the State Legislation and Regulation Committee of the Securities Industry Association (nka SIFMA). Mr. Carreno is a graduate of the United States Air Force Academy in Colorado Springs with an engineering degree. He is also a graduate of the University of Denver College of Law with a Juris Doctor. He currently holds the Series 4, 7, 24 and 53 licenses, and is a member of the Colorado and Florida Bars. Mr. Carreno was commissioned as a Second Lieutenant in the U.S. Air Force after graduation from the Academy. He served for five years on active duty and 18 years in the AF Reserve before retiring as a Lieutenant Colonel.

Dave Kelley, Surveillance Director, FINRA, Kansas City District Office

Dave Kelley is Surveillance Director of FINRA's Kansas City District Office, and has more than 20 years' experience dealing with cyber security, IT controls, and the privacy of customer and company information. He has been with FINRA for more than two years at the Kansas City District office as a regulatory coordinator and now the Surveillance Director, and leads FINRA's Regulatory Specialist team for Cyber Security, IT Controls and Privacy. Prior to joining FINRA, Mr. Kelley worked for 20 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 CIA, and holds the Series 7 and 24 securities registrations.

Tom Shaw, VP of Enterprise Financial Crimes Management and the Identity Theft Officer, USAA

Tom Shaw is the Vice President of Enterprise Financial Crimes Management and the Identity Theft Officer for USAA. He has direct overall responsibility for financial crimes prevention, detection, investigations and recovery. Mr. Shaw has more than 25 years of experience in the financial services industry, with over 16 years of this time at Bank of America. He has held leadership and direct contributor roles in fraud management, anti-money laundering, bank operations, credit/debit card operations, project management, consumer banking, ecommerce, call center management, small business lending and

private banking. Mr. Shaw participates in various working groups for financial crimes mitigation, such as the American Bankers Association, BITS and MasterCard US Fraud Advisory Council. He serves on the Board of Directors of the Identity Theft Assistance Center, which is a non-profit organization that educates consumers on ways to prevent and detect identity theft and helps consumers restore their identities when identity theft occurs. Mr. Shaw is also Chairman of the Board for the Association of Certified Fraud Examiner's Financial Foundation. He is a member of the MasterCard US Fraud Advisory Council. Mr. Shaw earned his bachelor's degree in international economics from Texas Tech University and a M.B.A. from Our Lady of the Lake University. He is a Certified Anti-Money Laundering Specialist (CAMS) and a Certified Fraud Examiner (CFE).

New and Existing Products Due Diligence

November 20, 2014 / 2:20 p.m. – 3:35 p.m.

New and Existing Products Due Diligence

Scott H. Maestri, Associate Director, FINRA, Dallas District Office

Scott H. Maestri is the Associate District Director in FINRA's Dallas Office. He began his career with NASD in 1999 as an examiner in the New Orleans District Office. Mr. Maestri was promoted to management in September of 2003 and became responsible for a team of examiners who monitored member firms through cycle and cause investigations, as well as the Membership Application Process and Financial Surveillance. Mr. Maestri was promoted to the Associate District Director position in May of 2010, where his primary responsibility is the review and approval of the district office's major program areas. During the course of his career, Mr. Maestri has been selected for Advanced Management training and successfully obtained the Certified Regulatory and Compliance Professional designation (CRCP) both issued through The Wharton School at the University of Pennsylvania. In addition, Scott received a bachelor's of business administration in finance from The Else School of Management at Millsaps College.

Bill Clark, Founder, MicroVentures

With more than a decade of top level management experience in the credit risk management and financial services industry, Bill Clark brings key strategic focus and critical evaluation skills essential to both the investor and startup business components of MicroVentures. As Risk Manager at an online payment processing company, Mr. Clark's responsibilities included managing risk on the merchant side of the business. His comprehensive approach to the company stems from key experience previously helping manage a billion dollar portfolio of small business accounts as Credit Risk Manager in the Small Business Risk Management Division of a captive financial institution. He holds a bachelor's degree in finance from Michigan State University as well as Series 7, 24, 63 and 79 licenses.

Thomas Crook, Examination Manager, FINRA, Dallas District Office

Tom B. Crook is an examination manager in the FINRA Dallas District Office. He began his career with FINRA in 2000 as an Examiner in the Dallas District Office. Mr. Crook was promoted to examination manager in July 2008. He is a designated FINRA Regulation Specialist in the area of Private Offerings. Prior to joining FINRA in 2000, Mr. Crook worked in both sales and compliance for four regional and national brokers and held his FINOP, General Principal, Options and Municipal Principals licenses as well as the Equity Trader and Investment Advisor designations. Tom holds a bachelor's degree in communications from Brigham Young University.

Brian Kovack, President, Kovack Securities, Inc.

Mr. Brian Kovack is Co-Founder and President of Kovack Securities, Inc., a Fort Lauderdale, Florida-based national full-service independent broker-dealer with approximately 290 registered representatives located throughout the U.S. In February 2006, Mr. Kovack was elected and served on the NASD Board of Governors as a mid-size industry representative and the FINRA Interim Board of Governors. He currently is serving on the District 7 Committee until December 31, 2014, and in 2013 served on the newly formed FINRA Regulatory Advisory Committee. In 2004, Mr. Kovack completed the FINRA Institute at Wharton Program, earning the Certified Regulatory and Compliance Processional (CRCP) designation. Prior to that, Mr. Kovack received a bachelor's degree in finance from the University of Florida, where he also played varsity football earning two Letter and SEC Academic Honor Roll awards. He also has a master of accounting and law degrees, and has been a member of the Florida Bar and American Bar Association

since 2000. Mr. Kovack has served as a FINRA Dispute Resolution arbitrator since 2003 and is Series 7, 24, 27, 53, 63 and 65 licensed.

South Region Compliance Seminar

New and Existing Products Due Diligence

November 20, 2014

FINRA
Financial Industry Regulatory Authority

New and Existing Products Due Diligence

- Moderator – Scott Maestri, Associate District Director, FINRA Dallas District Office
- Panelist – Thomas Crook, Examination Manager, FINRA Dallas District Office
- Panelist – Brian Kovack, President, Kovack Securities, Inc.
- Panelist – Bill Clark, Founder, MicroVentures

FINRA

FINRA's New Supervision and Supervisory Controls Rules

November 20, 2014 / 2:20 p.m. – 3:35 p.m.

FINRA New Supervision and Supervisory Controls Rules

Michael Boteler, Examination Manager, FINRA, Atlanta District Office

Mike Boteler is an examination manager for FINRA within the Atlanta District Office. He manages a team of five staff members who conduct routine examinations to review for compliance with FINRA and SEC rules. Mr. Boteler joined FINRA in May 2011 after six years at Wachovia Capital Markets, LLC and Wells Fargo Securities, LLC in Charlotte, NC, where he served in various compliance roles including managing the supervisory controls and branch inspection programs. Prior to these roles, Mr. Boteler worked as an NASD examiner in Atlanta for five years between 2000 and 2005. Mr. Boteler is a graduate of the University of Georgia.

Patricia Albrecht, Senior Director of Member Relations, FINRA

Patricia Albrecht is a senior director with FINRA's Member Relations and Education Department. Previously, she was an associate general counsel in FINRA's Office of General Counsel, and served in the same role at NASD before its 2007 consolidation with NYSE Member Regulation, which resulted in the formation of FINRA. She also has worked at the U.S. Securities and Exchange Commission in various offices and departments, including the Office of General Counsel and the Division of Trading and Markets, and serving as a counselor to Commissioner Norman Johnson. In addition, Ms. Albrecht worked for several years as a staff attorney at the U.S. Federal Fifth Circuit Court of Appeals and completed a federal judicial clerkship with U.S. District Court Judge Harry Lee Hudspeth.

Beth Burns, Senior Vice President and Director of Compliance, Synovus Financial Management Services

Beth Burns is Senior Vice President and Director of Compliance for Synovus Securities, Inc. (SSI), Synovus Trust Company, and GLOBALT Investments (collectively, Financial Management Services, FMS). As Director of Compliance, she is responsible for developing, directing, and monitoring the overall compliance and risk programs for the brokerage, investment advisory, trust and insurance functions. Her responsibilities include understanding and addressing all applicable laws and regulations, as well as acting as liaison with regulatory agencies and other internal control groups on compliance-related issues. Ms. Burns joined Synovus in 1983 and has more than 30 years of experience in the brokerage and investment advisory industry. Prior to her current role, Ms. Burns served as Synovus Securities' Chief Compliance Officer. Other positions held during her tenure at Synovus Securities include Controller and Operations Manager. Ms. Burns is a director of Synovus Securities, Inc., a member of the Synovus Financial Regulatory and Risk Committee, and is also a member of the National Society of Compliance Professionals. Registrations include Series 4, 7, 24, 27, 63 and 65. She holds a bachelor of business administration from Columbus State University.

South Region Compliance Seminar

FINRA's New Supervision and Supervisory Controls Rules

November 20, 2014

Financial Industry Regulatory Authority

FINRA's New Supervision and Supervisory Controls Rules

- Moderator – Mike Boteler, Examination Manager, FINRA Atlanta District Office
- Panelist – Patricia Albrecht, Senior Director with FINRA's Member Relations and Education Department
- Panelist – Beth Burns, Senior Vice President and Director of Compliance for Synovus Securities, Inc., Synovus Trust Company, and GLOBALT Investments (collectively, Financial Management Services, FMS)

FINRA's New Supervision and Supervisory Controls Rules

- **FINRA Rules 3110 (Supervision) and 3120 (Supervisory Control System) become effective on December 1, 2014**
  - FINRA Rule 3110 – Supervision
    - Principal Review of all Securities Transactions
    - Review of Correspondence, Communications, and Complaints
    - OSJ Supervision and Office Inspections
    - Insider Trading Transaction Review and Investigation
    - Supervision of Firm Supervisory Personnel
  - FINRA Rule 3120 – Supervisory Control System
    - Testing Program and Annual Report to Senior Management
    - Content Requirements

Anti-Money Laundering

November 20, 2014 / 4:00 p.m. – 5:15 p.m.

Anti-Money Laundering

Jason Foye, Examination Manager, FINRA, Anti-Money Laundering Investigations Unit

Jason Foye is an examination manager in FINRA's Anti-Money Laundering Investigations Unit (AMLIU). He manages a team of seven examiners located throughout the country, and has responsibility for managing AML-related examinations conducted by the AMLIU and consulting with other FINRA staff on AML issues. In addition to his exam-related responsibilities, Mr. Foye provides training to district staff on trends and best practices, including analytical techniques used by AMLIU staff during examinations. Mr. Foye has been with FINRA for seven years and worked as an examiner in both the Florida District and AMLIU. Jason is both a Certified Anti-Money Laundering Specialist (CAMS) and a Certified Fraud Examiner (CFE).

Jeri Dresner, Senior Special Counsel, Securities and Exchange Commission

Jeri Dresner is the Senior Special Counsel for the National Exam Program in the SEC's Miami Regional Office. In this position, she is the legal counsel to the assistant directors, exam managers, and examiners of the Investment Adviser, Investment Company, Broker-Dealer, and Transfer Agent branches, and is liaison to the Division of Enforcement. Ms. Dresner has directed high profile examinations that resulted in important commission enforcement actions and serves on the Office of Compliance Inspections and Examinations' Anti-Money Laundering working group. She has also organized and conducted conferences in South Florida in connection with the SEC's Senior Summit to Protect Older Americans from Investment Fraud. Ms. Dresner joined the SEC as a staff attorney in the Division of Enforcement in 1986 and later served as branch chief, prior to joining the Division of Regulation in 1996. Before her employment with the SEC, Ms. Dresner was in private practice in Miami, FL. She is a member of the California and Florida State Bars, and completed the FINRA Institute-Wharton Certificate Program and is a Certified Regulatory and Compliance Professional, and is a member of the Association of Certified Anti-Money Laundering Specialists and is CAMS certified.

Sarah Green, Senior Director of Enforcement, FINRA

Sarah D. Green is a senior director in the Enforcement Department at FINRA, specializing in anti-money laundering (AML) and other Bank Secrecy Act issues. She has responsibility for consulting with both examination and enforcement staff on AML and other issues, as well as training staff organizationwide on the handling of suspicious activity reports (SARs). Ms. Green is also responsible for FINRA AML guidance and external training of financial industry professionals domestically and internationally. Previously, she was the Bank Secrecy Act Specialist in the Division of Enforcement's Office of Market Intelligence (OMI) at the U. S. Securities and Exchange Commission (SEC). In this role, she oversaw the commission's review and use of SARs, consulted with Enforcement staff on anti-money laundering and SAR-handling issues, and facilitated information-sharing between Enforcement and SEC's Office of Compliance Inspections and Examinations (OCIE). Prior to joining OMI, Ms. Green was a branch chief in OCIE, managing the commission's AML examination program for broker-dealers on a day-to-day basis, including developing examination modules, conducting training for SEC and self-regulatory organization (SRO) staff, and coordinating with the SROs on all aspects of AML examination and enforcement. Ms. Green represents FINRA on the Bank Secrecy Act Advisory Group, which advises the Financial Crimes Enforcement Network and the Department of Treasury on anti-money laundering issues. She is a frequent speaker on AML, and regularly provides technical assistance to domestic and international audiences. Prior to joining the SEC, Ms. Green was an associate in the Corporate and Securities practice

group at Gardner Carton & Douglas LLP. She received her law degree from the William and Mary School of Law and her bachelor's degree from Hamilton College.

South Region Compliance Seminar

Anti-Money Laundering
November 20, 2014

FINRA
Financial Industry Regulatory Authority

Anti-Money Laundering

- Moderator – Jason Foye, Examination Manager, FINRA Boca Raton District Office
- Panelist – Sarah Green, Senior Director, AML Compliance, FINRA
- Panelist – Jeri Dresner, Senior Special Counsel, U.S. Securities and Exchange Commission, Miami

FINRA

Branch Office Supervision

November 20, 2014 / 4:00 p.m. – 5:15 p.m.

Branch Office Supervision

Sandra Sensebe, Examination Manager, FINRA, Dallas District Office

Sandra Sensebe is an examination manager for FINRA within the Dallas District Office. Ms. Sensebe began her career in 1998 as an examiner in the New Orleans District Office, relocating to the Dallas District Office in 2005. Her responsibilities centered primarily on cause matters, with a focus on Class B Mutual Fund Share issues, as well as the mutual fund breakpoint sweep. In 2012, Ms. Sensebe was promoted to an examination manager, where she supervises a team of examiners and oversees the execution of cause examinations. She graduated with a bachelor's degree in Finance from Louisiana State University.

Greg Brown, Examination Manager, FINRA, Dallas District Office

Greg Brown is an examination manager in FINRA's Dallas District Office. He began his career in 2006 as an examiner in the Florida District Office, where he conducted reviews involving routine, cause and membership application matters. Specifically, Mr. Brown spent the majority of his time participating in high-profile examinations involving issues with private offerings, improper trading and outside business activities. In 2012, he relocated to Dallas to become an examination manager, where he supervises a team of examiners and oversees the execution of routine examinations. Greg graduated with a bachelor's degree in finance from the Florida State University.

Laura Cognetti-Bornheimer, Senior Vice President and Chief Compliance Officer, GWN Securities, Inc.

Laura J. Cognetti-Bornheimer is currently Senior Vice President and Chief Compliance Officer of GWN Securities, Inc. She entered the securities industry in 1987 as an operations manager with a national broker-dealer. With an extensive background in broker-dealer operations, she transferred into compliance in 1992. In 1994, she became Vice President and Chief Compliance Officer of PMG Securities, Inc. In 2004, she joined GWN Securities, Inc. as Vice President and Chief Compliance Officer. As a start-up firm, her primary task was to create and establish the compliance model for the firm. Today, her current responsibilities include overseeing the overall compliance of the firm as well as reviewing and monitoring the firm's compliance with FINRA rules. Ms. Cognetti-Bornheimer is currently a chair arbitrator and obtained the Certified Regulatory and Compliance Professional (CRCP) designation in 2004.

Ron Klimas, Senior Vice President and Director of Compliance, Securities Service Network, Inc.

Ron Klimas is Senior Vice President, Director of Compliance with Securities Service Network, Inc., a Knoxville, TN-based independent contractor broker-dealer with approximately 400 producing registered representatives. He has been the head of compliance at SSN since 1998. Mr. Klimas graduated from Widener University School of Law in 1992 and is a member of the Florida Bar Association. He initially started in the industry as a retail broker but quickly moved onto compliance. In the early part of his career, he worked as compliance examiner with INVEST Financial Corporation, and also served as in-house counsel for InterSecurities, Inc. and Western Reserve Life. Mr. Klimas' registrations include Series 4, 7, 24, 63 and 65.

South Region Compliance Seminar

Branch Office Supervision
November 20, 2014

FINRA
Financial Industry Regulatory Authority

Developing a Supervisory Program

- Moderator – Sandra Sensebe, Examination Manager, FINRA Dallas District Office
- Panelist – Greg Brown, Examination Manager, FINRA Dallas District Office
- Panelist – Ron Klimas, Compliance Director, Securities Service Network, Inc.
- Panelist – Laura Cognetti-Bornheimer, SVP and CCO, GWN Securities, Inc.

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Developing a Supervisory Program

- **Key considerations for an effective supervisory program**
  - Firm model / business lines
    - U.S. vs. foreign-based operations
    - Introducing vs. self-clearing
    - Independent contractor model
    - FINRA, NYSE, SEC and state-registered investment advisory business
    - Niche-based business
    - Proprietary trading, market making, employee stock services, public finance, etc.
  - Products offered
    - Complexity of the products
    - Concentration in certain products
  - Types of customers serviced
    - Seniors, high net-worth investors, etc.

Developing a Branch Office Inspection Program

- **Inspection cycles**
  - Office of supervisory jurisdiction and non-OSJ branches that supervise non-branch locations
    - Annually
  - Non-supervising branch offices
    - Every three years
- **Factors to consider when developing an inspection program**
  - Use a “risk-based” approach
  - Know your resources
  - Consider frequency of visits
  - Perform announced vs. unannounced visits

Branch Office Inspection Program Implementation

- **A broker-dealer's branch inspection program is a key part of its supervisory system**
  - Firms with an effective branch office inspection program, typically have:
    - Tailored the focus of branch exams to the business conducted in that branch
    - Engaged in a significant percentage of unannounced exams, selected through a combination of risk-based analysis and random selection
    - Scheduled the frequency and intensity of exams based on underlying risk posed at the branch
    - Deployed senior branch office examiners who understand the business and will challenge assumptions

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Roles and Responsibilities

- **Supervision of branch offices can be centralized (offsite) or decentralized (onsite)**
  - Field supervisor / branch manager may perform the following supervisory responsibilities
    - Review and approve new accounts and trades
    - Monitor trends
    - Handle and investigate customer complaints
    - Review and approve correspondence
    - Maintain office such as physical safeguards, information security (e.g., shredding)
    - Hiring / firing
    - Preparation of advertising or marketing materials
    - Monitor and report gifts, gratuities and entertainment
    - Conduct annual compliance interviews with registered representatives and client file reviews
    - Conduct firm Element (Annual Compliance Meeting)

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Roles and Responsibilities

- **Home office may perform the following supervisory responsibilities**
  - Review of field supervisor's / branch manager's producing and supervisory activities
  - Conduct onsite visits
  - Report and investigate customer complaints
  - Approve advertising and marketing materials
  - Conduct certain specialized reviews (e.g., unique product oversight, broad-based email reviews, etc.)

Roles and Responsibilities

- **The compliance department should**
  - Maintain and support supervisory procedures
  - Develop compliance training programs
  - Review, approve and archive advertising and sales materials
  - Handle reporting of customer complaints
  - Conduct investigations of representatives
  - Facilitate periodic reporting requirements
  - Conduct email and social networking reviews
  - Conduct personal trading and outside activity reviews

Preparing for a Branch Office Inspection

- **Exam preparation pre-onsite visit**
  - Examiners should prepare by gathering as much information as possible
    - Google representatives to help identify outside business activities
    - Notify other areas in home office of upcoming visit to solicit any concerns and / or areas to be reviewed
    - Review areas of concern identified during monthly home office OSJ oversight meetings
    - Review transaction and trend monitoring system reports to identify any concerns / areas to be reviewed
    - Obtain completed questionnaires from representatives prior to inspections

Executing a Branch Office Inspection

- **What to do when onsite?**
  - Discuss completed representative questionnaires
  - Review required books and records
  - Review client files for suitability documentation
  - Review supervision files
  - Tour the branch
- **Pursuant to NASD Rule 3010, the written inspection report must also include the testing and verification of the firm's policies in**
  - Safeguarding of customer funds and securities
  - Maintaining books and records
  - Transmittal of funds between customers and registered representatives and between customers and third parties
  - Validation of customer address changes
  - Validation of changes in customer account information

Learning from a Branch Office Inspection

- **Assess the risk associated with findings by weighing aggravating and mitigating factors**
  - Isolated or systemic
  - Procedural deficiency
  - Customer harm
  - Repeat finding
  - Administrative oversight

How to Address Branch Office Inspection Findings

- **There are several best practices to address findings from the branch inspection process**
  - Develop and implement escalation process
  - Communicate findings to branch office management
  - Implement corrective action process
  - Leverage findings in ongoing training efforts
  - Implement heightened supervision
  - Develop feedback loop

Branch Office Inspection Program Deficiencies

- **FINRA and the SEC have noted that firms with significant deficiencies in their overall program, typically**
  - Utilize generic examination procedures for all branch offices
  - Leverage novice or unseasoned branch office examiners
  - Perform the inspection in a “check the box” fashion
  - Devote minimal time to each exam

Branch Office Inspection Program Deficiencies

- **FINRA and the SEC have noted that firms with significant deficiencies in their overall program, typically (cont’d)**
  - 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
    - Failing to generate a written inspection report
  - Fail to have adequate policies and procedures
  - Lack heightened supervision of individuals with disciplinary histories or individuals previously associated with a firm with a disciplinary history

Branch Office Inspection Program Sound Practices

- **FINRA and the SEC have identified some strong compliance practices, which include**
  - Using risk analysis to determine frequency of branch inspections
  - Using surveillance reports and current technology to help identify risk
  - Employing checklists that incorporate previous inspection findings and trends from internal reports
  - Tracking corrective action that is taken
  - Elevating the frequency and/or scope of branch inspections when necessary

Branch Office Inspection Program Sound Practices

- **FINRA and the SEC have identified some strong compliance practices, which include (cont'd)**
  - Conducting unannounced branch inspections
  - Including in the written report of each branch inspection any noted deficiencies and areas of improvement
  - Using examiners with sufficient experience
  - Designing procedures to avoid conflicts of interest
  - Involving qualified senior personnel in several branch office examinations per year
  - Providing branch office inspection findings to management
  - Using a centralized compliance database
  - Requiring branch office managers to take corrective action on findings

FINRA and SEC Examinations

- **Common Areas of Review**
  - Supervision
  - Customer Specific Suitability
  - Correspondence
  - Outside Business Activities
  - Onboarding Process
  - Items on the FINRA Examination Priorities Letter

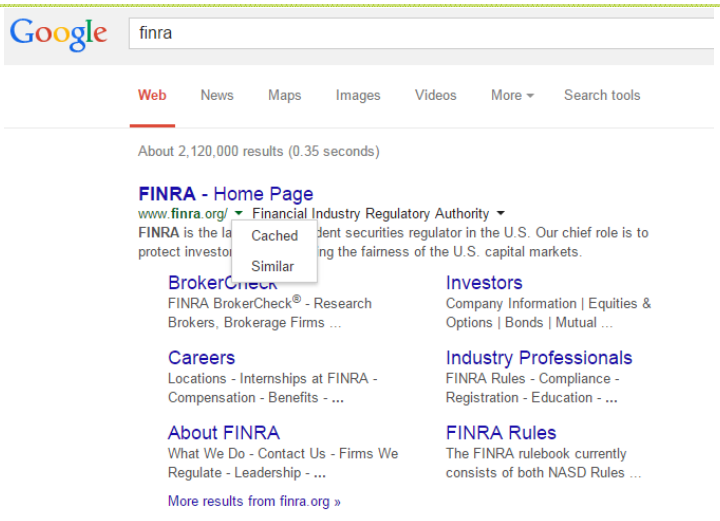
FINRA and SEC Examinations

- **Common Findings**
  - Supervision of Outside Business Activities
    - Investment Advisor Activities
    - Non-Securities Activities that Trigger a Suitability Requirement
  - Outside websites and email addresses
  - Social Media

Detection Tips

- **Popular Resources**
  - Internet Search Engines
  - Archive.org
  - Social Networking Sites
    - Facebook, Twitter, MySpace, LinkedIn
  - SEC EDGAR
  - State-Specific Division of Corporations
    - Sunbiz.org, etc.
  - Public Records Sites/Lexis-Nexis

Detection Tips



Detection Tips

INTERNET ARCHIVE
WayBackMachine

Searched for http://www.yahoo.com 6734 Results

Search Results for Jan 01, 1996 - Nov 28, 2008

1996	1997	1998	1999	2000	2001
12 pages	27 pages	26 pages	36 pages	217 pages	2963 pages
Oct 17, 1996 *	Jan 09, 1997 *	Feb 10, 1998 *	Jan 16, 1999 *	Feb 29, 2000 *	Jan 24, 2001 *
Oct 20, 1996 *	Jan 24, 1997 *	Feb 10, 1998 *	Jan 17, 1999	Feb 29, 2000 *	Mar 01, 2001 *
Oct 22, 1996 *	Feb 01, 1997 *	Feb 13, 1998 *	Jan 17, 1999 *	Feb 29, 2000 *	Mar 05, 2001 *
Oct 23, 1996 *	Feb 09, 1997 *	Feb 13, 1998 *	Feb 08, 1999 *	Mar 01, 2000 *	Mar 05, 2001 *
Nov 28, 1996 *	Feb 27, 1997 *	Feb 14, 1998 *	Feb 08, 1999 *	Mar 01, 2000 *	Mar 06, 2001 *
Dec 19, 1996 *	Mar 30, 1997 *	Feb 15, 1998 *	Feb 08, 1999 *	Mar 02, 2000 *	Mar 07, 2001 *
Dec 20, 1996	Mar 30, 1997 *	Feb 15, 1998 *	Feb 08, 1999 *	Mar 02, 2000 *	Mar 31, 2001 *
Dec 21, 1996	Apr 16, 1997 *	Jun 30, 1998 *	Feb 08, 1999 *	Mar 02, 2000 *	Mar 31, 2001 *
Dec 23, 1996	Apr 18, 1997 *	Jul 03, 1998 *	Feb 08, 1999 *	Mar 02, 2000 *	Mar 31, 2001 *
Dec 26, 1996 *	Apr 24, 1997 *	Jul 04, 1998 *	Feb 08, 1999 *	Mar 03, 2000 *	Mar 31, 2001 *
Dec 27, 1996	May 05, 1997 *	Jul 05, 1998 *	Feb 08, 1999 *	Mar 03, 2000 *	Apr 01, 2001 *
Dec 28, 1996	May 17, 1997 *	Jul 05, 1998 *	Feb 08, 1999 *	Mar 03, 2000 *	Apr 01, 2001 *

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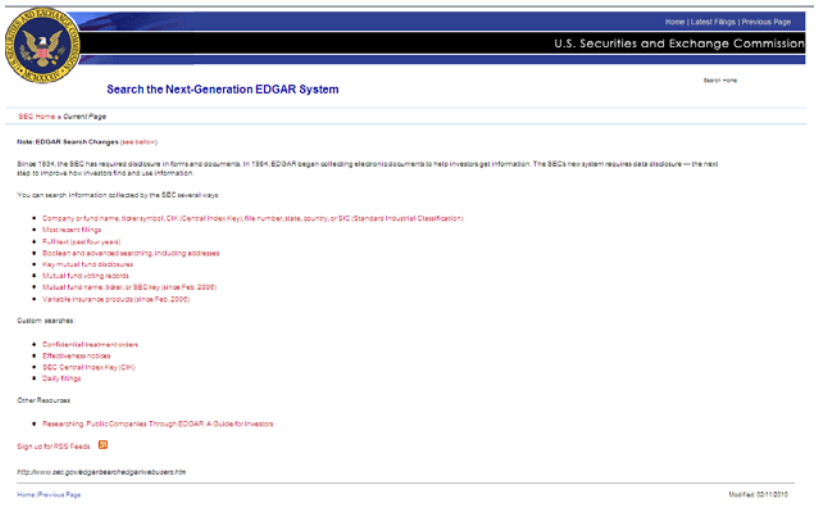
Detection Tips



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Detection Tips

Detection Tips

Tools and Resources

- **SEC Resources**
  - Staff Legal Bulletin No.17: Remote Office Supervision
    www.sec.gov/interps/legal/mrslb17.htm
- **FINRA Resources**
  - FINRA *Regulatory Notice 11-54*, *FINRA and SEC Issue Joint Guidance on Effective Policies and Procedures for Broker-Dealer Branch Inspections* (November 2011)
    www.finra.org/Industry/Regulation/Notices/2011/P125205
  - NASD *Notice to Members 99-45, NASD Provides Guidance on Supervisory Responsibilities* (June 1999)
    www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p004311.pdf
- **Branch CRD registration**
  www.finra.org/Industry/Compliance/Registration/CRD/index.htm

Fixed Income – Examination and Enforcement Updates

November 20, 2014 / 4:00 p.m. – 5:15 p.m.

Fixed Income – Examination and Enforcement Updates

Don DeBlanc, Managing Regulatory Coordinator, FINRA, New Orleans District Office

Donald DeBlanc is a managing regulatory coordinator in FINRA's New Orleans District Office. Mr. DeBlanc has worked in the securities industry for more than 25 years. The majority of this time, he has been employed with FINRA. He started his career with NASD as an examiner in 1987. He was promoted to examination manager in 1995. In 2013, he became a managing regulatory coordinator. During his tenure with FINRA and NASD, Mr. DeBlanc has been involved in conducting and supervising examinations and managing examining staff in every regulatory program performed by the district office. He has also been involved in many national initiatives relating to FINRA's Member Regulation Department's regulatory programs. Prior to joining FINRA, Mr. DeBlanc spent a brief period as a registered representative with Hattier, Sanford & Reynoir, LP in New Orleans. Mr. DeBlanc received a bachelor's degree in finance from Louisiana State University in 1987. He received FINRA's Excellence in Service Award in 1995 and FINRA's Chairman's Award in 2000. He also received the Certified Regulatory and Compliance Professional (CRCP) designation from the FINRA Institute at Wharton in 2004.

Bonnie Bowes, Associate Director of Fixed Income Regulation, FINRA

Bonnie Bowes is the Associate Director of Fixed Income Regulation within FINRA Member Regulation. Ms. Bowes drives key FINRA fixed income initiatives in municipal, corporate and government securities, and securitized products. She focuses on the policy and examination implications of current fixed income regulatory matters in order to provide guidance to FINRA staff and member firms. Prior to joining FINRA in 2013, her career encompassed leadership roles in fixed income compliance, operations, product management, and credit risk. Ms. Bowes has worked at top-tier wealth management and capital markets broker-dealers, an Alternative Trading System (ATS) and the Depository Trust and Clearing Corp. (DTCC). She holds a bachelor's degree in mathematics and economics from the University of Rochester.

Mark Fernandez, Senior Regional Counsel, Department of Enforcement, FINRA, New Orleans District Office

Mark Fernandez joined FINRA in 2007 and is a senior regional counsel in FINRA's New Orleans District Office. Prior to joining FINRA, Mark was in private practice for six years, most recently with the New Orleans law firm of Barrasso, Usdin, Kupperman, Freeman, and Sarver, LLC, specializing in securities litigation, arbitration and regulatory proceedings. Prior to entering private practice, Mark served as a law clerk to the Honorable Eldon E. Fallon in the U.S. District Court for the Eastern District of Louisiana. Mark received his law degree in 2001 from Louisiana State University Law Center, where he served as Editor-in-Chief of the *Louisiana Law Review*. Prior to entering law school, Mark served as Surface Warfare Officer in the U.S. Navy for five years, following graduation from the U.S. Naval Academy.

Craig Noble, Managing Director, Head of Capital Markets Trading, Wells Fargo Advisors

Craig Noble was named Managing Director and Head of Capital Markets Trading for Wells Fargo Advisors in 2014. In this capacity, he is responsible for all taxable, tax-exempt trading, equities, options, commodities and capital market services. He serves on the firm's New Deal and New Product Review and Best Execution committees. He was the Head of Fixed Income Trading at both Wachovia and Wells

Fargo Advisors from 1999 to 2014. Prior to this, he was Executive Vice President and Co-Director of the Municipal Securities Group of the Tax-Exempt Fixed Income Sales and Trading department at EVEREN. Preceding his time with EVEREN, Mr. Noble was with Lehman Brothers, from 1991 to 1993, where he was First Vice President and Manager of the retail sales liaisons of the western region. During his 11-year career at Shearson Lehman Hutton, he served as manager of several of the firm's municipal bond and trading liaison desks. Mr. Noble began his career in the securities brokerage industry in 1981 as an investment broker for E.F. Hutton. In addition to the aforementioned, Mr. Noble is currently on the Board of Directors of the MSRB and on the FINRA's Fixed Income Committee. Mr. Noble was the past Chairman of the Securities Industry and Financial Markets Association's Regional Advisory Committee and was on their Municipal Executive Committee. He was also the Vice Chairman of the board of the Bond Dealers of America. He is Series 7, 9/10, 24, 53, 99 and 63 registered.

South Region Compliance Seminar

Fixed Income – Examination and Enforcement Updates

November 20, 2014

FINRA
Financial Industry Regulatory Authority

Fixed Income – Examination and Enforcement Updates

- Moderator – Don DeBlanc, Managing Regulatory Coordinator, FINRA New Orleans District Office
- Panelist – Mark Fernandez, Senior Regional Counsel, FINRA New Orleans District Office
- Panelist – Bonnie Bowes, Associate Director of Fixed Income Regulation, FINRA
- Panelist – Craig Noble, Managing Director and Head of Capital Markets Trading, Wells Fargo Advisors

FINRA

General Session: Ask FINRA Staff

November 21, 2014 / 8:30 a.m. – 9:30 a.m.

Ask FINRA Staff

Chip Jones, Senior Vice President of Member Relations, FINRA

Chip Jones is the Senior Vice President of Member Relations and Education for FINRA. In leading the Member Relations and Education Department, Mr. Jones' responsibilities include maintaining and enhancing open and effective dialog with FINRA member firms. Mr. Jones also oversees FINRA's Member Education area, which includes FINRA conferences and other member firm educational offerings such as the FINRA Institute at Wharton for the Certified Regulatory and Compliance Professional (CRCP) designation. In addition, Mr. Jones oversees the FINRA Compliance Resource Provider Program, where FINRA works with companies that offer compliance-related products and services to regulated firms at negotiated discounts. Prior to joining FINRA, Mr. Jones spent six years as Vice President of Regulatory and Industry Affairs at American Express Financial Advisors (AEFA). Previous to AEFA, he spent two years as Advocacy Administrator for the Association for Investment Management and Research (AIMR). Mr. Jones was employed by the Virginia Securities Division as a senior examiner/investigator for more than six years prior to joining AIMR. He received a master's degree in business administration and a bachelor's degree from Radford University in Radford, Virginia.

J. Bradley Bennett, Executive Vice President of Enforcement, FINRA

J. Bradley Bennett, Executive Vice President, is responsible for FINRA's Department of Enforcement. In this capacity, Mr. Bennett directs investigating and bringing all formal disciplinary actions against firms and associated persons for violations of FINRA rules and federal securities laws. Mr. Bennett received his undergraduate degree from St. Lawrence University and his law degree from Georgetown University Law Center. He started his career at the SEC as a senior attorney in the Division of Enforcement, focusing on cases of all facets of securities law, including accounting, broker-dealer regulation, tender offers and insider trading.

Cameron Funkhouser, Executive Vice President, FINRA Office of Fraud Detection and Market Intelligence

Cameron Funkhouser is Executive Vice President of FINRA's Office of Fraud Detection and Market Intelligence. He has been with FINRA, formerly known as NASD, since 1984, serving in various roles of increasing responsibility with a focus on the surveillance of securities traded on The Nasdaq Stock Market, New York Stock Exchange, American Stock Exchange and the over-the-counter markets. Mr. Funkhouser has extensive experience conducting securities fraud investigations and is regularly called upon by civil and criminal law enforcement authorities to provide training, technical assistance, investigative/litigation strategy consulting and expert testimony. Currently, he is responsible for overseeing the Office of Fraud Detection and Market Intelligence, which includes the Insider Trading and Fraud Surveillance units responsible for monitoring the trading activity of more than 10,000 publicly traded securities, FINRA's Complaint Center and FINRA's Whistleblower program. Mr. Funkhouser and his staff have been responsible for uncovering numerous cases of Internet fraud, insider trading, market manipulation, Ponzi schemes and other white collar misconduct, which have been successfully investigated and prosecuted by FINRA, the Securities and Exchange Commission and other law enforcement agencies across the country and internationally. He graduated from Georgetown University with a bachelor's degree in business and George Mason University with a law degree. Mr. Funkhouser is a member of the Virginia State Bar.

Jeffrey M. Pasquerella, Vice President and Regional Director, FINRA South Region and Boca Raton District Office

Jeffrey M. Pasquerella is Vice President and Regional Director of FINRA's South Region and the District Office located in Boca Raton. He has been employed by FINRA since August 1999. Prior to joining FINRA, Mr. Pasquerella served as an assistant district attorney in the Westchester County District Attorney's Office for three years. He is a 1993 graduate of Villanova University and a 1996 graduate of Pace University School of Law. Mr. Pasquerella is a member of the New York and Connecticut State Bars.

South Region Compliance Seminar

Ask FINRA Staff
November 21, 2014

FINRA
Financial Industry Regulatory Authority

Ask FINRA Staff

- Moderator – Chip Jones, Senior Vice President of Member Relations, FINRA
- Panelist – J. Bradley Bennett, Executive Vice President of Enforcement, FINRA
- Panelist – Cameron Funkhouser, Executive Vice President, FINRA Office of Fraud Detection and Market Intelligence
- Panelist – Jeffrey M. Pasquerella, Vice President and Regional Director, FINRA South Region and Boca Raton District Office

FINRA

Financial and Operational Issues

November 21, 2014 / 9:50 a.m. – 11:00 a.m.

Financial and Operational Issues

Dawn Calonge, Surveillance Director, FINRA, Boca Raton District Office

Dawn Calonge is a surveillance director in FINRA's Boca Raton District. She manages regulatory coordinator staff that is responsible for the ongoing financial monitoring and sales practice surveillance of member firms in the Florida District Office. Prior to becoming a surveillance director, she served as an examination manager responsible for managing examination staff that conducted cycle and cause examinations. Ms. Calonge joined FINRA as an examiner, investigating a wide range of member firm activities. Prior to joining FINRA, she worked at the U.S. Securities and Exchange Commission and the New York Stock Exchange. Prior to her regulatory work, Ms. Calonge worked in the accounting field and received her bachelor of business administration degree with a major in accounting from the University of Miami in Coral Gables, Florida.

Kris Dailey, Vice President, Risk Oversight & Operational Regulation, FINRA

Kris Dailey is a vice president in the Risk Oversight & Operational Regulation department in FINRA's Member Regulation division. Ms. Dailey oversees the development of broker-dealer financial and operational policies and rule interpretations, FINRA's margin rules and credit regulation policy, evaluation of market and credit risk methodologies and examination-related automation initiatives. Ms. Dailey was previously a managing director at FINRA's predecessor, NYSE Regulation, where she held various staff and managerial positions and was responsible for financial surveillance of member firms and the supervision of member firm examinations. Ms. Dailey received a bachelor's degree from St. John's University and a M.B.A. from Fordham University.

Susan Demando Scott, Associate Vice President, Financial Operations, FINRA

Susan DeMando Scott, Associate Vice President, Risk Oversight and Operational Regulation, FINRA, is responsible for the supervision of the Financial Operations Policy Department (FinOp). FinOp is responsible for researching and providing interpretative guidance with respect to the SEC's Net Capital, Customer Protection, and Books and Records rules for approximately 3,800 FINRA member firms that are supervised by FINRA's 15 District Offices. In conjunction with her responsibilities as Director of FinOp, Ms. Scott has represented FINRA as a panelist, and also as a featured speaker, at various FINRA conferences, as well as at events sponsored by The American Institute of Certified Public Accountants (AICPA), The District of Columbia Bar Association, The Public Company Accounting Oversight Board (PCAOB), the New York State Society of CPAs, and Securities Industry and Financial Markets Association (SIFMA). Ms. Scott has been with FINRA and its predecessor NASD for 21 years. Prior to joining FINRA, Ms. Scott worked in the securities industry for approximately 12 years in various capacities. Her last industry position was as the Chief Financial Officer of Mitchum, Jones, and Templeton located in Los Angeles, California. Ms. Scott has a bachelor's degree from California State University, Los Angeles, where she majored in finance.

South Region Compliance Seminar

Financial and Operational Issues

November 21, 2014

FINRA
Financial Industry Regulatory Authority

Financial and Operational Issues

- Moderator – Dawn Calonge, Surveillance Director, FINRA Boca Raton District Office
- Panelists – Kris Dailey, VP, Office of Risk Oversight & Operational Regulation, FINRA
- Panelist – Susan DeMando Scott, Associate VP, Financial Operations, FINRA

FINRA

Overview

- FINRA Financial and Operational Update
- SEC Amendments to the Financial Responsibility Rules for Broker-Dealers
- SEC Amendments to the Broker-Dealer Reporting Rules
- SEC Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934

1 FINRA Financial and Operational (FinOp) Update

2014 FinOp Examination Priorities
FinOp Examination Findings
Regulatory Issues and Concerns

Financial Industry Regulatory Authority

FINRA Examination Priorities

- **2014 FINRA Examination Priorities**
  - Accuracy of Firm's Financial Statements and Net Capital
    - Prepare Financial Statements Throughout the Year
    - Financial Statements Prepared in Accordance with GAAP
    - Accurate Net Capital Computation
  - Funding and Liquidity Risk
  - Risk Control Documentation and Assessment
  - Cybersecurity & IT Governance
  - Auditor Independence

FINRA Examinations – Issues - Concerns

- **Examination Findings**
  - Failure to Properly Value Assets, Failure to Properly Classify Assets, Improper Netting of Assets and Liabilities
  - Failure to Record Liabilities, Improper Exclusion of Items from Aggregate Indebtedness, Improper Add-Back to Net Worth
  - Improper Application of Expense Sharing Agreements
  - Guarantees and Contingencies
  - Customer Protection Issues - for Firms Claiming an Exemption from SEA Rule 15c3-3 & Carrying/Clearing Firms
  - Books and records issues
  - Other findings
- **FinOp Regulatory Issues and Concerns**
  - Part-time/Off-site FinOp Arrangements
  - Supervisory issues at firms of limited size (risk of fraud)

2 Amendments to the Financial Responsibility Rules for Broker-Dealers

Includes Amendments to:
- Net Capital Rule – Rule 15c3-1
- Customer Protection Rule – Rule 15c3-3
- Books and Records Rules – Rules 17a-3 and 17a-4
- Notifications Rule – Rule 17a-11

SEC Release Number 34-70072

FINRA Financial Industry Regulatory Authority

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Financial Responsibility Rules Amendments

- **On July 30, 2013 the Commission published a final rule, amending the broker-dealer financial responsibility rules**
  - Financial Responsibility Rules for Broker-Dealers
    - Release 34-70072
- **Addresses items of concern regarding the financial responsibility requirements for broker-dealers such as:**
  - Liabilities or Expenses Assumed by Third Parties
  - Non-Permanent Capital Contributions
  - SEC Authority to Restrict Withdrawals of Capital
  - New Definition of "Insolvent"
  - Risk Management Procedures

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Financial Responsibility Rules Amendments

- **Additional items addressed in the final rule:**
  - Codification of PAB requirements
  - Banks where Special Reserve Deposits Can Be Held
  - Treatment of Free Credit Balances
  - Securities Lending and Borrowing and Repurchase/Reverse Repurchase Arrangements
  - Allocation of Customers' Fully Paid and Excess Margin Securities to Short Positions

- **All Amendments Effective by March 3, 2014**

3 Amendments to the Broker-Dealer Report Rules

Includes Amendments to:
- Broker-Dealer Reports Rule – Rule 17a-5
- Notification Rule – Rule 17a-11

SEC Release Number 34-70073

Financial Industry Regulatory Authority

Broker-Dealer Report and Notification Rules

- **On July 30, 2013 the Commission published a final rule, amending the broker-dealer reporting rules and notifications rule**
  - Release 34-70073
- **Highlights of the Amendments include:**
  - Statement Regarding Independent Public Accountant
    - FINRA Reg Notice 14-39
  - Requirement to File Reports
    - Compliance Report
    - Exemption Report
- **Amendments Effective by June 1, 2014**

4 Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934

Includes Amendments to:
- Net Capital Rule – Rule 15c3-1
- Customer Protection Rule – Rule 15c3-3
- Books and Records Rule – Rule 17a-4
- Confirmation of Transactions - Rule 10b-10

SEC Release Number 34-71174

Financial Industry Regulatory Authority

Deletion of NRSRO References

- **On January 8, 2014, the Commission published a final rule, Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934**
  - Release 34-71194, 79 FR 1521
  - Amendments in response to Section 939A of the Dodd-Frank Act.
  - Amendments are effective July 7, 2014. Applicable to broker-dealers that maintain positions in commercial paper, nonconvertible debt, or preferred stock.
  - Changes the manner in which firms determine the haircuts on positions in each of the above referenced securities.
  - The Release references several factors that may be considered by a broker-dealer to establish that the securities involve a minimal amount of credit risk.
- **No-Action Letters Discussion**

5 FINRA Financial or Operational Rules: Adopted, Proposed, or Under Discussion

Financial Industry Regulatory Authority

Topics and Status Update

- Form SIS
- Proposed Changes to the Rule 4210 Margin Requirements for TBA Transactions
- Frequently Asked Financial/Operational Questions
- Customer Account Statements
- Proposed FINRA Rule regarding Discretionary Accounts and transactions by Persons Other Than the Customer

What Questions Do You Have?

Financial Industry Regulatory Authority

JOBS Act / Crowdfunding

November 21, 2014 / 9:50 a.m. – 11:00 a.m.

JOBS Act/Crowdfunding

Alistair Johnson, Surveillance Director, FINRA, New Orleans District Office

Alistair E. Johnson, Surveillance Director in FINRA's New Orleans District Office, manages regulatory coordinator staff responsible for the ongoing financial monitoring, sales practice surveillance and examination planning for member firms in the New Orleans District. Prior to becoming Surveillance Director, she was a senior regulatory specialist in FINRA's Regulatory Programs Group working on the development and support of FINRA's National Examination Program. This included authoring and approving examination policies and procedures on a variety of topics. She also serves as an Anti-Money Laundering Regulatory Specialist and has been involved in most aspects of interpretation and enforcement of FINRA and federal AML rules. She has designed and conducted AML training for both FINRA staff and the financial services industry. She is also a frequent speaker on the topic of AML. Prior to joining Regulatory Programs in 2006, she was a special investigator in the New Orleans District Office since 1999, conducting cycle, sweep and cause examinations. Ms. Johnson received her bachelor's degree from Tulane University in New Orleans. She is also a designated Certified Regulatory and Compliance Professional (CRCP) and Certified Anti-Money Laundering Specialist (CAMS).

Dan Nathan, Partner, Morrison Foerster

Dan Nathan is a partner in Morrison Foerster's Securities Litigation, Enforcement and White-Collar Defense Group. Mr. Nathan's practice includes representation of companies and individuals who are involved as witnesses or subjects in investigations conducted by the SEC, the CFTC, FINRA, and other regulatory entities involving financial institutions or transactions. Mr. Nathan also consults with financial institutions on examinations, supervisory procedures, product disclosure and supervision, and other regulatory matters. Mr. Nathan is the former Vice President and Regional Enforcement Director for the Financial Industry Regulatory Authority (FINRA). During his five-year tenure at FINRA, Mr. Nathan oversaw 70 lawyers across 15 offices responsible for bringing up to 900 disciplinary actions annually against broker-dealer firms, registered representatives and associated persons. This included many of FINRA's most significant nationwide enforcement actions, including actions and sweeps involving mutual fund breakpoints, structured products sales practices and supervision, auction-rate securities advertising, disclosure and supervision, private placement due diligence and disclosure, mutual fund prospectus delivery, anti-money laundering procedures and market timing. Mr. Nathan also closely collaborated with FINRA's Member Regulation examination staff. In his 12 years at the SEC, Mr. Nathan served as Assistant Director in the Division of Enforcement, where he supervised federal securities investigations of insider trading, market manipulation, financial fraud and accounting misconduct. In nine years with the CFTC, Mr. Nathan served as Deputy Director of Enforcement, with responsibility for oversight of the agency's Enforcement Division. He also created the CFTC's Office of Cooperative Enforcement, which dramatically expanded the joint enforcement efforts between the CFTC, the Department of Justice, the SEC and state authorities. In those roles, Mr. Nathan closely focused on market manipulation, trade practices, commodity trading advisor practices and foreign exchange dealer practices. Mr. Nathan received his law degree from New York University School of Law, where he served as articles editor for the *Journal of International Law and Politics*, and graduated from the Massachusetts Institute of Technology with a B.Sc. in Economics. He is admitted to practice in New York and Washington, D.C.

Lisa Robinson, Director, Membership Application Program, FINRA

Lisa Robinson has been in the Member Application Program group since it became centralized in January 2011 and was promoted to Director in July 2014. Ms. Robinson is responsible for overseeing a staff of approximately 45 examiners and six managers, who review all member application matters filed with FINRA. She also proposed the concept for and oversees the newly formed MAP Triage Group. Prior to

joining MAP, Ms. Robinson was an associate director in District 10 (New York), where she was responsible for the oversight and execution of the District 10 examination plan, including cycle, cause and branch examinations, for several member firms. Ms. Robinson also spent seven years as a cycle and cause supervisor. She has served on several special projects on both a national and regional level. Before joining FINRA, Ms. Robinson worked at a large mutual fund company. She is a Certified Regulatory and Compliance Professional and received a bachelor's degree from Nova Southeastern University.

Joe Savage, Vice President and Counsel, Regulatory Policy, FINRA

Joseph P. Savage is a vice president and counsel in FINRA's Regulatory Policy Department. Mr. Savage specializes in a broad range of securities regulatory matters, including investment management, investment company, advertising and broker-dealer issues, and regularly appears at conferences regarding these issues. Prior to joining FINRA, he was an associate counsel with the Investment Company Institute and an attorney with the law firms of Morrison & Foerster LLP and Hunton & Williams. Mr. Savage also served as a judicial law clerk for United States District Judge John P. Vukasin of the Northern District of California. Mr. Savage holds a bachelor's degree from the University of Virginia, a master's degree in public policy from the University of California, Berkeley, and a law degree from the University of California, Hastings College of the Law, where he served as Note Editor of the Hastings Law Journal.

Managing Conflicts of Interest

November 21, 2014 / 9:50 a.m. – 11:00 a.m.

Managing Conflicts of Interest

Michael Malone, Examination Manager, FINRA, Dallas District Office

Michael Malone is an examination manager in FINRA's Dallas District Office. He began his career with FINRA in 1994, and is currently responsible for managing a staff of six examiners who conduct field examinations of FINRA member firms. Mr. Malone holds a bachelor's of business administration in accounting from Baylor University, has a CRCP designation from the FINRA Institute at Wharton, and is currently studying to obtain a CAMS certification from the Association of Certified Anti-Money Laundering Specialists.

Laura Leigh Blackston, Senior Regional Counsel, Department of Enforcement, FINRA, New Orleans District Office

Ms. Blackston joined FINRA as an attorney in 2002. Prior to joining FINRA, she was an associate and partner with the General Litigation group of the law firm Jones Walker. As Senior Regional Counsel, Ms. Blackston has handled numerous enforcement actions involving conflicts of interest. Ms. Blackston graduated from the University of Mississippi in 1988 with honors and received her law degree from Washington and Lee University with honors in 1992. She is also a graduate of the FINRA Institute at Wharton and a member of FINRA's Anti-Money Laundering Regulatory Expert Group.

Bob Mooney, Managing Director and CCO Wells Fargo Advisors

Bob Mooney is a managing director and Chief Compliance Officer of Wells Fargo Advisors, where he is a member of the firm's Operating Committee and is responsible for the compliance, regulatory affairs and internal controls functions for Wells Fargo's retail broker-dealers. Mr. Mooney also chairs the firm's Governance Committee and Conflict of Interest Committee. He joined Wheat First in 1992 and during his 22 years with the company has held a variety of leadership positions, including Chief Governance Officer, Chief Administrative Officer, Chief Compliance Officer, Regional Director – Private Client Group and Assistant General Counsel. He has been in his current role since 2008. Prior to joining the firm, Mr. Mooney spent four years as a special assistant U.S. attorney for the Southern District of New York – Securities and Commodities Fraud Task Force, and three years as Senior Counsel for the SEC's Division of Enforcement. A 1981 graduate of Mary Washington College, Mr. Mooney received his law degree from the Columbus School of Law, the Catholic University of America in 1985. Mr. Mooney is a member of the FINRA Compliance Advisory Group.

Steven Polansky, Senior Director, Office of Regulatory Programs, FINRA

Steven Polansky is Senior Director in FINRA's Office of Regulatory Programs. Mr. Polansky is responsible for leading cross-firm reviews—including the recent conflicts and ongoing cybsecurity reviews—and special projects. Previously, Mr. Polansky worked in FINRA's International Department, where he was responsible for analyzing international regulatory developments and leading FINRA's relationships with select financial regulators in Europe and Asia as well as international financial institutions. In addition, Mr. Polansky led advisory projects in a number of jurisdictions related to, among other things, risk-based supervision (including associated training), prudential oversight and market surveillance. Prior to joining FINRA, Mr. Polansky was a management consultant with PricewaterhouseCoopers, and he served for seven years as a professional staff member on the Committee on Foreign Relations in the United States Senate. Mr. Polansky received his master's in business administration in finance from The Wharton School at the University of Pennsylvania, his

masters of public administration from the Kennedy School of Government at Harvard University, and his bachelor's degree in history from Colgate University.

South Region Compliance Seminar

Managing Conflicts of Interest

November 21, 2014

FINRA
Financial Industry Regulatory Authority

Panelists

- Moderator – Michael Malone, Examination Manager, FINRA Dallas District Office
- Panelist – Steven Polansky, Senior Director, Office of Regulatory Programs, FINRA
- Panelist – Laura Leigh Blackston, Senior Regional Counsel, Department of Enforcement, FINRA New Orleans District Office
- Panelist – Bob Mooney, Managing Director and Chief Compliance Officer, Wells Fargo Advisors

Definition: What is a conflict of interest?

- **There is no universal definition of conflict of interest; however, there are combinations of circumstances that are the breeding ground for conflicts:**
  - An explicit or implied duty by one party towards another (*e.g.*, meeting a suitability or fiduciary obligation)
  - An incentive that may compromise, or appear to compromise, the ability of that party to fulfill its obligation
  - Frequently, an asymmetry of information

Conflicts categories

- **Some firms group conflicts into the following major buckets or categories:**
  - Firm vs. client conflicts
  - Client vs. client conflicts
  - Employee vs. client conflicts
  - Employee vs. firm conflicts
  - Vendor vs. client conflicts

Areas of focus

- **Three critical areas:**
  - Conflicts of Interest Framework
  - New Product Conflicts
  - Compensation Practices

Conflicts of Interest Framework

- **Conflicts of Interest Framework**
  - Defining conflicts of interest in a way that is relevant to a firm's business and which helps staff identify conflict situations.
  - Articulating employees' roles and responsibilities with respect to identifying and managing conflicts.
  - Establishing mechanisms to identify conflicts in a firm's business as it evolves.
  - Defining escalation procedures for conflicts of interest within and across business lines.
  - Avoiding severe conflicts, even if that avoidance means foregoing an otherwise attractive business opportunity.
  - Disclosing conflicts of interest to clients, taking into consideration the different needs of retail and institutional clients.

Conflicts of Interest Framework (cont.)

- Training staff to identify and manage conflicts in accordance with firm policies.
- Reporting on significant conflicts issues, including on a firm's own measures to identify and manage conflicts, to the Chief Executive Officer (CEO) and board.

New Products

- **New Products Conflicts**
  - New product review process to identify and mitigate conflicts.
  - Disclosure of conflicts in plain English.
  - Know-Your-Distributor policies and procedures.
  - Post launch reviews of new products to identify potential problems.
  - Carefully evaluate and decline to offer products when conflicts associated with new products are significant.

Compensation

- **Compensation Practices**
  - "Product agnostic" compensation grids (i.e., a flat percentage of the revenue generated regardless of product).
  - Link surveillance of representatives' recommendations to thresholds in a firm's compensation structure.
  - Enhancing supervision and surveillance of recommendations as a representative approaches compensation milestones.
  - Enhancing surveillance around key liquidity events in investor's lifecycle. (e.g., 401k rollovers, inheritance, insurance claims)
  - Reduce the incentive for a representative to prefer one mutual fund or variable annuity family over another by capping the credit a representative may receive for a comparable product across providers.

Issues Surrounding RR Agreeing to Fiduciary Roles

- **Potential Roles**
  - Power of Attorney
  - Beneficiary
  - Trustee
  - Executor

Issues Surrounding RR Agreeing to Fiduciary Roles

- **Common Fact Pattern**
  - RR befriends elderly customer with no close relatives
  - RR runs errands for customer, involves customer with own family, keeps others away from customer
  - RR is named as beneficiary in will
  - RR does not tell firm until after inheritance
  - Firm and RR become involved in dispute with relatives
  - Disciplinary action by FINRA based upon Firm's procedures

Issues Surrounding RR Agreeing to Fiduciary Roles

- **Preventative Measures**
  - Require annual disclosure of acting as power-of-attorney, trustee, executor
  - Require annual disclosure of being named as beneficiary, successor beneficiary, successor trustee, executor
  - Require annual disclosure of immediate family being named or acting in these roles
  - If there is approval of any of these roles, require transfer of account to a different representative
  - Educate RRs that receipt of funds as a trustee or executor is an outside business activity

Issues Surrounding RR Agreeing to Fiduciary Roles

- **Case Studies**
  - *Ronald G. Klebba*, 20080149742 (Sept. 14, 2010)
  - *Robert Gesdorf*, 20100231574 (Sept. 24, 2013)
  - *Kent M. Houston*, Exchange Act Release No. 71589A (Feb. 20, 2014).

Resources

- **Report on Conflicts of Interest**
  - http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf
- **A few minutes with FINRA - Interview with Rick Ketchum and Chip Jones on Managing Conflicts of Interest**
  - http://www.finra.org/industry/regulation/guidance/communicationstofirms/p369762

Questions?

General Session: Enforcement Developments

November 21, 2014 / 11:20 a.m. – 12:30 p.m.

Enforcement Developments

David Klafter, Regional Chief Counsel, FINRA South Region

David B. Klafter, Regional Chief Counsel of FINRA's South Region, has been employed with FINRA for approximately 15 years. Mr. Klafter supervises FINRA's South Region Enforcement staff. Mr. Klafter has prosecuted numerous cases involving a broad array of misconduct, including fraud, sales practice violations, AML violations, forgery, falsification of records, conversion, registration violations, net capital violations and various supervision violations. For several years prior to joining FINRA, Mr. Klafter was in private practice in Manhattan, primarily involved in securities litigation and arbitration. Mr. Klafter graduated from Syracuse University's School of Management with a bachelor's degree and received his law degree from New York Law School.

J. Bradley Bennett, Executive Vice President, Department of Enforcement, FINRA

J. Bradley Bennett, Executive Vice President, is responsible for FINRA's Department of Enforcement. In this capacity, Mr. Bennett directs investigating and bringing all formal disciplinary actions against firms and associated persons for violations of FINRA rules and federal securities laws. Mr. Bennett received his undergraduate degree from St. Lawrence University and his law degree from Georgetown University Law Center. He started his career at the SEC as a senior attorney in the Division of Enforcement, focusing on cases of all facets of securities law, including accounting, broker-dealer regulation, tender offers and insider trading.

Eric I. Bustillo, Regional Director, US Securities and Exchange Commission

Eric I. Bustillo currently serves as the Regional Director of the Miami Regional Office (MIRO) of the U.S. Securities and Exchange Commission (SEC). As Regional Director, he is responsible for leading the functions of the MIRO, including the supervision of the office's Enforcement and Examination programs, with jurisdiction covering the states of Florida, Mississippi and Louisiana, as well as the U.S. Virgin Islands and Puerto Rico. The MIRO employs numerous professionals, including attorneys, accountants and examiners, as well as support personnel who are assigned to these programs. Between March 1995 and January 2010, Mr. Bustillo was employed by the United States Attorney's Office for the Southern District of Florida (USAO-SDFL) as an assistant United States attorney (AUSA), where for the last five years of his tenure with the office he served as *Chief* of the USAO-SDFL's Economic & Environmental Crimes Section, in charge of supervising a group of AUSAs and other professionals. Mr. Bustillo supervised and prosecuted criminal matters involving, among other things, securities/corporate fraud, health care fraud, environmental crimes, commodities fraud, mail fraud, wire fraud, bank fraud, tax fraud and/or money laundering violations. Between February 1990 and March 1995, Mr. Bustillo was employed by the SEC's Miami Office, where he last served as Chief of one of the office's Enforcement Branches, in charge of supervising a group of enforcement attorneys and an accountant. He supervised and prosecuted complex matters involving, among other things, financial fraud, insider trading, stock manipulation, fraudulent sale of unregistered securities, broker-dealer/investment adviser fraudulent practices, and corporate accounting controls violations. Prior to joining the SEC, Mr. Bustillo worked briefly at a private law firm doing commercial litigation and some corporate/real estate transactional work. Mr. Bustillo currently serves as an adjunct faculty member of the Litigation Skills Program at the University of Miami School of Law, where he teaches Trial Advocacy Skills. He also is a frequent speaker at securities and white collar crime seminars around the country.

Jeffrey Ziesman, Counsel, Bryan Cave LLP

Jeffrey Ziesman's practice focuses on investment adviser and broker-dealer regulatory and compliance issues. He represents firms in SEC, FINRA and state regulatory examinations, investigations and enforcement proceedings. Mr. Ziesman also advises investment advisers and broker-dealers on compliance and supervisory issues, and has assisted firms in structuring their compliance programs and written supervisory systems and procedures. Mr. Ziesman has spoken to industry groups on a wide variety of investment adviser and broker-dealer regulatory concerns. Mr. Ziesman is also a member of Bryan Cave's Data Privacy and Security Team. In that capacity, he advises financial services firms on a wide array of data privacy issues, including the handling of data security breaches. Mr. Ziesman has also provided guidance to industry participants on the ever-changing requirements regarding protecting confidential customer data. Mr. Ziesman was previously the Deputy Regional Chief Counsel for the Midwest Region of FINRA. In that capacity, he brought significant enforcement cases in such diverse areas as Regulation D, Anti-Money Laundering (AML); Regulation S-P; failure by firms to timely deliver prospectuses to customers; and supervisory controls and procedures. Mr. Ziesman brought one of the leading FINRA cases in 2011 relating to giving credit-for-cooperation, under FINRA *Regulatory Notice* 08-70, for a firm's sel- reporting violations. Mr. Ziesman was on Regulatory Disposition Groups for supervisory controls and AML at FINRA. In 2005, he received the FINRA Excellence in Service Award (only given to 1 percent of employees at FINRA), and in 2007 and 2004 was awarded FINRA President's Award for his work on major matters. Mr. Ziesman is affiliated with the National Society of Compliance Professionals, the Securities Industry and Financial Markets Association, the Missouri Bar Association and the Iowa Bar Association.

South Region Compliance Seminar

Enforcement Developments

November 21, 2014

Financial Industry Regulatory Authority

Enforcement Developments

- Moderator – David Klafter, Regional Chief Counsel, FINRA South Region
- Panelist – J. Bradley Bennett, Executive Vice President of Enforcement, FINRA
- Panelist – Eric I. Bustillo, Regional Director, U.S. Securities and Exchange Commission
- Panelist – Jeffrey Ziesman, Counsel, Bryan Cave LLP

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