

# BDWEEK

Regulatory news and compliance best practices.

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## Broker-dealers expect rule 3012 compliance to get more scrutiny

Go back and take a look at any shortcomings you found in last year's annual review of supervisory control procedures required under **NASD's** rule 3012. The reason: Regulators will expect to see that you've at least taken steps to address them as you complete this year's review to meet NASD's upcoming April 1<sup>st</sup> deadline.

"That's the number one thing that regulators will look at," believes **LaRae Bakerink**, CEO of San Diego-based **WBB Securities**. "If you found an issue last year, they'll want to see that at least you have a plan with a timeline in place to fix it. It's not something you want to mess with."

"The regulators are going to ask for your 2006 review and they're going to ask questions about it," echoes compliance consultant **Amy Lynch** of **FrontLine Compliance, LLC**. "They may have looked last year but they didn't give it much credence because the firms didn't really know what the regulators expected."

Since the advent of rule 3012, however, NASD regulators have been sharing more about their expectations at compliance meetings and conferences. In essence, they want broker-dealers to fully assess areas of risk in their supervisory policies and test them to determine if they work or not. In cases where they don't, NASD expects firms to amend their procedures to correct any problems.

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Lynch says there is still "some anxiety" among broker-dealer firms about whether they've properly addressed rule 3012's provisions. "Firms have either gone overboard and do a huge review of every system, policy and procedure, or they're not doing enough," she says.

In conversations with consultants and broker-dealers, *BD Week* found several areas that broker-dealers are addressing to comply with rule 3012:

#### √ **Customer complaints and arbitrations.**

Bakerink says these can indicate a potential problem with supervisory policies and procedures. Her firm revisits them to determine if any adjustments should be made to its policies.

√ **Changes in your business.** The compliance officer for a Midwest firm says it switched from self-clearing to fully disclosed in the past year—a change that means additional policies for interacting with a new clearing firm to meet the 3012 rule. Those types of changes create a "whole new category of risk" that your supervisory control policies should address, Lynch says.

√ **Oversight of outside business activities.** "It's not a very large portion of our business but it's getting that way," Bakerink says. She's using a third-party software system to track and monitor these activities. She and others note it can sometimes be difficult to obtain the information needed to verify client financial status and properly evaluate the suitability of some investments. For example, a person who bought a variable annuity seven years ago may have had a life-changing event—death of a spouse, retirement, etc.—that may make it no longer suitable. "It's still our responsibility to monitor that," she says.

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✓ **Documentation back-ups.** Compliance manager **Russ Fisher** of **JLM Securities**, Farmington Hills, Mich., says he's working to find a way to create off-site storage of customer sheets and trade documentation. The effort flows from the recognition that a fire could threaten documents stored at the firm and regulators require a back-up system.

Fisher also says the firm has prohibited using e-mail for anything other than strictly administrative purposes. The firm made the move to avoid having to back-up communications that might contain fees, terms and other stipulations for which regulators require back-ups. "It's sometimes annoying but the alternative of storing all that is unacceptable." ■

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