A Tale of Two Enforcement Actions Against Compliance Officers: An analysis applying the NSCP Firm and CCO Liability Framework

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1. Mr. Rubin is an NSCP board member and was a member of the committee that authored the framework.

It was the best of compliance*, it was the worst of compliance, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way,* to be sanctioned by a regulator. . . .[2]

If there were no bad people, there would be no good lawyers.[3]

Many compliance officers believe they have targets on their backs. (If you wish to get two mirrors and look for yourself, we'll wait.) Indeed, according to industry-wide surveys conducted by the National Society of Compliance Professional (NSCP), 72% of compliance professionals are concerned that regulators have expanded the role of compliance officers and the scope of their responsibilities in imposing personal liability, and 63% believed that personal liability will be imposed even where compliance did not participate in the violations caused by the company or other executives.[4] It is not surprising that compliance professionals feel this way. After all, when regulatory examinations or investigations begin, who is the initial point of contact at the firm? The Chief Compliance Officer (CCO) or one of her direct reports. Who usually coordinates with different departments at the firm to coordinate production? The CCO. When regulators want to know what a document means or why production differs from the regulators' expectations, who is involved in providing the answer? The CCO. Who generally drafts procedures and often is involved with surveillance? The CCO. Finally, who is often brought in for questioning under oath by the regulators regardless of whether compliance played a role in the conduct being investigated? You guessed it, the CCO. Thus, compliance officers seem to believe that regulators look at them the same way that Mrs. Gamp viewed the living young man: "He'd make a lovely corpse."[5]

In light of these issues, on January 10, 2022, NSCP issued its "Firm and CCO Liability Framework" to "more effectively address the issue of CCO liability."[6] The Framework focuses on "the larger context of the compliance function within firms," evaluating real-world issues such as whether the compliance officer had actual responsibilities to affect conduct and the resources to do the job. As such, the Framework presented nine questions to be "considered by regulators where a compliance failure may have occurred." According to the Framework, a "yes" answer to any of the questions "mitigates against CCO liability." These questions are important for applying a holistic approach for CCO liability. (And they stand in contrast to the maxim, "Ask no questions and you'll be told no lies."[7])

We decided to use the Framework to see how it might affect two recent compliance officer enforcement actions, one brought by the SEC and one brought by FINRA. Where the relevant facts are unknown, we presented hypothetical "yes" and "no" answers to show the possible effect.

SEC CCO Enforcement Action

On September 30, 2020, a CCO with a Registered Investment Adviser (RIA) settled an administrative proceeding with the SEC, agreeing to pay a $25,000 penalty and to be barred for three years in a compliance capacity and denied the privilege of appearing or practicing before the Commission as an attorney for 12 months for backdating and failing to produce records.[8]

The SEC found that the CCO's supervisor asked the CCO to memorialize her compliance review that she had conducted "in the preceding weeks" regarding her firm's decision to invest its

2. *See A Tale of Two Cities*: https://en.wikiquote.org/wiki/A_Tale_of_Two_Cities (with apologies to Charles Dickens).
3. *The Old Curiosity Shop*: https://www.magicalquote.com/bookquotes/if-there-were-no-bad-people-there-would-be-no-good-lawyers/.
4. https://static1.squarespace.com/static/61a9074028e505179c284c97/t/61e19a0f1d3d656f1cfbbf3c/1642174991168/NSCP+Firm+and+CCO+Liability+Framework+Jan+2022.pdf.
5. *Life and Adventures Of Martin Chuzzlewit*: http://www.literaturepage.com/read/dickens-martin-chuzzlewit-480.html.
6. https://static1.squarespace.com/static/61a9074028e505179c284c97/t/61e19a0f1d3d656f1cfbbf3c/1642174991168/NSCP+Firm+and+CCO+Liability+Framework+Jan+2022.pdf.
7. *Great Expectations*: https://etc.usf.edu/lit2go/140/great-expectations/2546/chapter-2/.
8. https://www.sec.gov/litigation/admin/2020/34-90061.pdf.

clients' assets in the securities of a company shortly before it announced an agreement to be acquired by another company on October 22, 2016. The CCO's supervisor "made clear to her that he was making this request because he was concerned about possible future regulatory inquiries" about the investment, "including by the Commission." The CCO, however, failed to do so. In September 2017, "after receiving an inquiry from her supervisor about multiple open compliance matters, the CCO "drafted and backdated two versions of a memorandum that purported to memorialize her review" about the investment, "[w]ithout reviewing any substantive contemporaneous written analysis or notes of the prior year's events, or otherwise taking sufficient steps to confirm her recollection of those events[.]"

One version of the Compliance Memo, which she emailed to her supervisor in September 2017, was "dated" October 28, 2016 (which would have been approximately one week following the announcement). An hour after the CCO emailed that version of the Compliance Memo, she created and saved another version, "dated" October 21, 2016 (which would have been a day before the acquisition announcement). Both versions of the Compliance Memo also contained inaccuracies.

About six weeks later, on October 30, 2017, she provided the October 21, 2016 version of the Compliance Memo to SEC examination staff during an exam in response to a request for documentation demonstrating the RIA's internal review of the investment. She did not provide the October 28, 2016 version. When she produced the document to the Staff, she described the October 21, 2016 version as "a contemporaneous memorialization of the events it described." On November 15, 2017, she "repeated the inaccuracies contained in the backdated October 21, 2016 Compliance Memo and further perpetuated the notion that she wrote the document in October 2016." On May 8, 2018, in response to a February 2018 subpoena issued by Enforcement Staff, the RIA produced multiple backdated versions of the Compliance Memo that the CCO had created "without correcting [the CCO's] prior misstatements to the SEC staff concerning the provenance of the Compliance Memo." The settlement order stated that the CCO's conduct "substantially delayed and impeded the SEC staff's inquiry[.]"

Framework Analysis

While the SEC's settlement order does not answer all of the questions set forth in the Framework, it does provide the answer to many of them, as shown below:

Did the CCO have nominal rather than actual responsibility, ability, or authority to affect the violative conduct?	The answer appears to be "no," she had actual authority. The CCO's supervisor asked her to memorialize her compliance review. She decided what to draft and how to date the documents. In addition, according to the SEC, "[a]s the CCO and only compliance professional at Adviser A at that time, [she] was responsible for Adviser A's responses to the SEC Exam."
Was there insufficient support from firm leadership to compliance, including, for example, insufficient resources, for the CCO to affect the violative conduct?	There is no evidence to answer this question. Hypothetically, the answer could be "yes" if, for example, there was evidence that the CCO asked firm leadership if she could retain outside counsel to discuss how to draft her Compliance Memo after the fact, without it being misleading, but firm leadership denied the request. Hypothetically, the answer could be "no" if, for example, there was evidence that the CCO's supervisor asked the CCO if she needed assistance writing the Compliance Memo contemporaneously, but the CCO declined the offer.

Did the CCO escalate the issue or violative conduct to firm management through a risk assessment, annual review, CEO certification meeting/report, or otherwise?	The answer appears to be "no," she did not escalate the issue. The CCO created the misleading Compliance Memos and provided inaccurate information to the Staff without apparently escalating the issue to firm management.
Did firm management fail to respond appropriately after becoming aware of the issue (through the CCO or otherwise)?	The answer appears to be "no," management did not fail to respond appropriately. There does not appear to be evidence that management knew of the CCO's violative issues. Hypothetically, the answer could have been "yes" if, for example, management knew what she had done and approved of her conduct, either implicitly or explicitly.
If the firm made misstatements or omitted material information, did the CCO have nominal rather than actual responsibility, ability, or authority for reviewing or verifying that information?	There is no evidence to answer this question because there were no charges about misstatements or omissions.
Was firm leadership provided the opportunity to review and accept the policies and procedures?	There is no evidence to answer this question because there were no charges about policies and procedures.
Did the CCO consult with legal counsel (in-house or external) and/or securities compliance consultants and adhere to the advice provided?	There is no evidence to answer this question. Hypothetically, the answer could be "yes" if, for example, the CCO consulted with legal counsel and/or securities compliance consultants who told her that she could create the Compliance Memos in the manner that she did because they reflected when she provided her compliance review. Hypothetically, the answer could be "no" if, for example, the CCO consulted with legal counsel and/or securities compliance consultants who told her that she could *not* create the Compliance Memos in the manner that she did because they were misleading, but she, nonetheless, created them.
Did the CCO otherwise act to prevent, mitigate, and/or address the issue?	The answer appears to be "no," the CCO did not act to prevent, mitigate, and/or address the issue. Hypothetically, the answer could have been "yes" if, for example, after she created the Compliance Memos, she acted to mitigate the issue by correctly telling the Staff when she actually created the memos and the circumstances surrounding their creation, rather than initially producing them as "a contemporaneous memorialization of the events it described" and subsequently "perpetuat[ing] the notion that she wrote the document in October 2016."
Did the CCO reasonably rely on information from others in the firm or firm systems?	The answer appears to be "no," the CCO did not rely on information provided by others in the firm.

For this CCO enforcement action, the Framework suggests little mitigation. If however, other facts existed, the CCO might have been able to argue that her sanction should have been reduced. In any event, this case demonstrates that the Framework presents issues for regulators to focus on, as well as for CCOs and firms to consider as they go about their daily business.

FINRA Compliance Officer Enforcement Action

On February 11, 2022, through a Letter of Acceptance, Waiver, and Consent (AWC), FINRA sanctioned an Anti-Money Laundering Compliance Officer (AMLCO) for failing to properly establish and implement a reasonably designed Anti-Money Laundering (AML) program at his firm.[9] The AWC cited a litany of his failures, including that he:

- failed to regularly perform the monthly review of at least one of the firm's surveillance reports;
- did not assess whether the firm's AML analysts were reviewing the firm's AML surveillance reports on a timely basis and he did not evaluate the adequacy of the firm's surveillance reports;
- did not take steps to determine whether the firm's AML investigations were adequate;
- failed to monitor other AML compliance activities at the firm, such as due diligence;
- learned about, but failed to recognize the import of, receiving wire deposits from unknown remitters; and
- incorrectly believed that the firm did not need to file a Suspicious Activity Report (SAR) concerning suspicious activity the firm first learned about from regulators or law enforcement agencies.

Despite all of this apparently egregious misconduct, the sanctions imposed by FINRA were relatively light: a two-month suspension from principal association, a $25,000 fine, and an undertaking to complete 10 hours of continuing education. These sanctions are even more perplexing when they are contrasted to the regulatory actions taken against the AMLCO's firm. Last year, the firm agreed to pay fines and penalties totaling $38 million to settle AML actions with FINRA ($15 million),[10] the Securities and Exchange Commission (SEC) ($11.5 million),[11] and the Commodity Futures Trading Commission (CFTC) ($11.5 million and disgorgement of $706,214).[12] The firm's AML failures were obviously significant, as shown by the fact that three regulators sanctioned the firm, and the firm's fines and penalties were very large.

9. https://www.finra.org/sites/default/files/fda_documents/2015047770302%20Arnold%20J.%20Feist%20CRD%201296808%20AWC%20sl.pdf.
10. AWC No. 2015047770301, Interactive-brokers-awc-081020.pdf (finra.org).
11. Admin. Proc. File No. 3-19907, Interactive Brokers LLC (sec.gov).
12. CFTC Docket No. 20-25, CFTC Orders Interactive Brokers LLC to Pay More Than $12 Million for Anti-Money Laundering and Supervision Violations | CFTC.

Framework Analysis

For this case, because we have facts from the AMLCO's AWC as well as from three settlement orders against the firm, we can answer many of the Framework's questions.

Did the CCO have nominal rather than actual responsibility, ability, or authority to affect the violative conduct?	The answer appears to be "yes," he had only nominal authority. On its face, the AMLCO's AWC suggests that the answer is "no," meaning that he had actual authority, because the firm's written supervisory procedures vested him with "full responsibility" for the firm's AML program. However, in contrast to the *written* procedures, his actual responsibility and authority may have been nominal. First, it appears that he did not have supervisory responsibility. His AWC states that he had "'dotted line' supervisory responsibilities" over the firm's AML analysts and their supervisors, likely meaning that he could not hire, fire, and affect the conduct of those employees. Second, it does not appear likely that he yielded sufficient power to impact the firm's wholesale failures, which (according to the firm's FINRA AWC), "was deficient in many respects," including failing to: reasonably surveil certain money movements; develop and implement reasonably designed surveillance tools for certain money movements and securities transactions; reasonably investigate potentially suspicious activity; file SARs; conduct adequate AML testing; provide adequate resources; and respond to red flags. The AMLCO's AWC does not contain facts that he had the ability to affect all of these issues.
Was there insufficient support from firm leadership to compliance, including, for example, insufficient resources, for the CCO to affect the violative conduct?	The answer to this question appears to be "yes," he had insufficient resources. For example, FINRA found that the firm: • "failed to add sufficient personnel to review those reports as the Firm's business grew, and the Firm also failed to provide analysts with the tools and resources needed to conduct reasonably effective reviews"; • took more than 14 months to correct "programming errors, or 'bugs,'" causing hundreds of accounts to be omitted from review; • "failed to reasonably staff its AML compliance department"; • failed to "implement a reasonable case management system"; and • did not have a "system to track analysts' progress in completing investigations and surveillance report reviews," taking the firm three years to establish a system "after a compliance manager requested that the Firm purchase or develop one." The SEC found that the firm: • "did not have sufficient resources in its compliance function to adequately review and/or address the issues identified by its surveillance systems. For example, during the relevant period, a single

	employee was responsible for reviewing all of the hits on the incoming stock transfer report, which included over 3,000 incoming transfers of U.S. microcap securities." The CFTC found that the firm: • "failed to commit adequate resources to its AML program during the Relevant Period to ensure that it was reasonably equipped to monitor, detect, escalate, and report suspicious activity in practice" and • "failed to employ a sufficient number of compliance analysts to adequately review" suspicious activity surveillance reports. All of these examples show a serious lack of resources dedicated to the AML program. The AMLCO's AWC and the firm's settlement documents do not contain facts that he had the authority to expend resources to address these deficiencies.
Did the CCO escalate the issue or violative conduct to firm management through a risk assessment, annual review, CEO certification meeting/report, or otherwise?	There is no evidence to answer this question. Hypothetically, the answer could be "yes" if, for example, there was evidence that he reported some of the issues contained in the firm's settlement documents to firm management. Hypothetically, the answer could be "no" if, for example, there was evidence that he knew about some of the issues contained in the firm's settlement documents, but did not report them to firm management.
Did firm management fail to respond appropriately after becoming aware of the issue (through the CCO or otherwise)?	The answer to this question appears to be "yes," firm management knew about multiple unaddressed red flags. For example, in the firm's AWC, FINRA highlighted the following escalated issues: • In 2015, a compliance manager informed his supervisor about "numerous surveillance reports that contained programming 'bugs, and informed his supervisor that the Firm's programmers had not fixed the 'bugs' after repeated requests." The firm took more than 14 months to correct that "bug." • In 2016, the compliance manager informed his supervisor that, "we often find bugs in our tools and reports and can't get them to fix them until the situation hits emergency status." The manager suggested assigning dedicated programmers to the surveillance department, but noted that, "it seems management has been hesitant to do this in the past." • The manager suggested that, instead of dedicated programmers, the firm acquire a nonproprietary trade surveillance system, but the firm did not approve that request. • In April 2018, the firm identified additional accounts that the "bug" had excluded from timely review. • A compliance manager requested a case management system, but the firm did not establish one for approximately three years.

If the firm made misstatements or omitted material information, did the CCO have nominal rather than actual responsibility, ability, or authority for reviewing or verifying that information?	There is no evidence to answer this question. Hypothetically, the answer could be “yes” if, for example, the firm made misstatements or omitted material information to customers, prospects or regulators about, say, the quality of the firm’s AML program, but the AMLCO did not have the ability or authority to review or verify those statements. Hypothetically, the answer could be “no” if, for example, the firm made misstatements or omitted material information to customers, prospects or regulators about, say, the quality of the firm’s AML program, and the AMLCO had the ability or authority to review or verify those statements.
Was firm leadership provided the opportunity to review and accept the policies and procedures?	There is no evidence to answer this question. Hypothetically, the answer could be “yes” if, for example, firm leadership had the ability to review and accept the firm’s policies and procedures, which FINRA found to be deficient. Hypothetically, the answer could be “no” if, for example, firm leadership did not have the ability to review and accept the firm’s policies and procedures because the AMLCO never showed them to firm leadership.
Did the CCO consult with legal counsel (in-house or external) and/or securities compliance consultants and adhere to the advice provided?	There is no evidence to answer this question. Hypothetically, the answer could be “yes” if, for example, the AMLCO consulted with legal counsel and/or securities compliance consultants who incorrectly told him that the firm did not need to file a SAR concerning suspicious activity the firm first learned about from regulators or law enforcement agencies. Hypothetically, the answer could be “no” if, for example, the AMLCO consulted with legal counsel and/or securities compliance consultants who correctly told him that the firm needed to file a SAR concerning suspicious activity the firm first learned about from regulators or law enforcement agencies, but he did not listen to that advice. Hypothetically, the answer could be “no” if, for example, the AMLCO did not know whether the firm needed to file a SAR concerning suspicious activity the firm first learned about from regulators or law enforcement agencies, but he did not consult with legal counsel and/or securities compliance consultants.
Did the CCO otherwise act to prevent, mitigate, and/or address the issue?	There is no evidence to answer this question. Hypothetically, the answer could be “yes” if, for example, the AMLCO reported these issues to the firm’s board when firm management was not responsive. Hypothetically, the answer could be “no” if, for example, the AMLCO realized that the firm had AML issues, but he decided not to tell anyone about them.

Did the CCO reasonably rely on information from others in the firm or firm systems?	While the record is not clear on this issue, the AMLCO may have relied on the firm's internal auditors, which did not note any deficiencies about him or the AML program. FINRA cited multiple failures by the internal auditors that may have resulted in the auditors' failure to find deficiencies. For example, FINRA found that testing failed to assess the following: whether the firm utilized reasonable surveillance reports; the integrity of the surveillance data; whether AML analysts reasonably reviewed surveillance reports and properly investigated potentially suspicious conduct; whether analysts adequately memorialized their results; whether supervisors reasonably reviewed the analysts' determinations; whether SAR filing decisions were reasonable and adequately documented; and whether the firm dedicated reasonable resources to its AML program. According to FINRA, if the firm's internal auditors had conducted reasonable independent testing, "they would have learned that the Firm's AML program had deficiencies in all of those respects." Thus, the AMLCO and the firm appear to have relied on the firm's internal auditors, which did not highlight any deficiencies.

For this case, the Framework highlights a number of factors that the AMLCO's AWC did not address, although they were discussed in the firm's settlement documents. It is, therefore, possible that if FINRA had applied the Framework's holistic approach, the AMLCO may have been sanctioned differently—or not at all. The fact that the AMLCO committed violations, which certainly appears to be the case, does not necessarily mean that he should have been charged. Regulators frequently bring cases against firms, without also naming individuals. For example, since January 2021, FINRA has brought 12 AML cases against firms, but charged only two AMLCOs,[13] even though by virtue of FINRA's rules most AMLCOs perform the same tasks. Thus, regulators apply prosecutorial discretion regularly when deciding whether to charge an individual.

Conclusion

NSCP has highlighted that compliance professionals have concerns about their potential liability. To alleviate that concern, at least in part, regulators may want to focus on the holistic issues contained in the NSCP's Framework, even if they do not adopt it completely. FINRA may already be applying some of the Framework's factors (albeit before the Framework was even drafted). For example, the AMLCO's relatively light sanctions compared with the significant and multiple sanctions assessed against his firm suggest this is the case. The SEC is also likely considering some of the highlighted questions. The Framework should help the industry better understand what issues regulators view as significant when assessing individual liability and sanctions. Compliance officers, in particular, need to know that their careers will not be jeopardized if they commit a mistake of judgment or if their firm committed a violation, but the compliance officer played a minimal role. (If that were not the case, as Mr. Bumble, a regulator of sorts, might say, "the law is a ass — a idiot."[14]) The marketplace, the industry, and regulators would benefit if compliance officers ran toward problems, rather than away from them because they feared being second-guessed by regulators.[15] ■

13. 2018056458302 William Assatly CRD 2152563 AWC va (2021-1620606010144).pdf (finra.org); https://www.finra.org/sites/default/files/fda_documents/2015047770302%20Arnold%20J.%20Feist%20CRD%201296808%20AWC%20sl.pdf.
14. *Oliver Twist:* https://www.goodreads.com/quotes/22816-it-was-all-mrs-bumble-she-would-do-it-urged.
15. *See* Former SEC Commission Daniel M. Gallagher, "Statement on Recent SEC Settlements Charging Chief Compliance Officers With Violations of Investment Advisers Act Rule 206(4)-7," (June 18, 2015), https://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html ("as regulators, we should strive to avoid the perverse incentives that will naturally flow from targeting compliance personnel who are willing to run into the fires that so often occur at regulated entities").