

Broker-dealer e-mail systems must keep pace with firm growth, FINRA says

Daniel A. Nathan and Kelley A. Howes

Daniel A. Nathan is a Partner at Morrison & Foerster LLP, Washington, District of Columbia, USA. Kelley A. Howes is Of Counsel at Morrison & Foerster LLP, Denver, Colorado, USA.

Abstract

Purpose – *The purpose of the paper is to explain the implications of a FINRA disciplinary action and recommend ways for broker-dealers to assess their compliance with supervisory and recordkeeping obligations related to electronic communications.*

Design/methodology/approach – *The paper explains supervisory failures related to e-mail retention leading to a FINRA disciplinary action, discusses lessons learned, and recommends best practices that broker-dealers should consider implementing to ensure their systems are consistent with relevant FINRA rules including compliance audits, remediation of identified issues, training, and disciplinary actions.*

Findings – *FINRA is clearly signaling that directing firm resources to the building of a business without a similar commitment to compliance will not be tolerated.*

Originality/value – *The paper provides expert guidance from experienced financial services lawyers.*

Keywords *United States of America, E-mail retention systems, Financial Industry Regulatory Authority*

Paper type *Technical paper*

A recent FINRA disciplinary action^[1] sends a strong message to broker-dealers that the development of their compliance systems – particularly with respect to e-mail review and retention – must keep pace with the growth of their businesses.

FINRA fined LPL Financial LLC (“LPL”) \$7.5m for significant failures in its e-mail system that prevented LPL from accessing hundreds of millions of e-mails and from reviewing tens of millions of other e-mails over an approximately six-year period. FINRA stressed that LPL’s inadequate systems and procedures caused the firm to provide incomplete responses to e-mail requests from regulators, and also likely affected the firm’s production of e-mails in arbitrations and private actions. Accordingly, FINRA required the firm to establish a \$1.5m fund to pay discovery sanctions to customer claimants that were potentially affected by the system failures and to notify regulators that may have received incomplete e-mail production.

Also notable are FINRA’s findings about the firm’s failure to be fully candid with the regulator in its self-report of the e-mail lapses (FINRA has a strong focus on the obligation of firms to report internal conclusions of violations under Rule 4530), and the breakdown of the firm’s internal audit processes in following through on preliminary findings about its e-mail systems (Nathan and Ignat, 2013).

FINRA’s findings suggest some “best practices” that broker-dealers should consider implementing to ensure their systems are consistent with relevant FINRA rules, as discussed below.

The firm’s supervisory failures

FINRA attributed LPL’s supervisory lapses, at least in part, to the firm’s rapid expansion without a concomitant investment in technology and compliance resources. As a result,

e-mails subject to supervisory review and retention obligations were captured from a variety of sources, including numerous financial institutions and several separate outside e-mail vendors. The resulting “patchwork” of e-mail systems did not provide LPL with adequate access to and oversight over the e-mail correspondence of its registered representatives.

FINRA also focused on the nature of the firm’s business model, in which many of its registered representatives are independent contractors, rather than employees, and frequently operate under more than one or more DBA names and use more than one DBA e-mail address in addition to their firm address.

FINRA found the following supervisory failures, among others:

- *DBA accounts* – For almost a year, LPL’s systems could not accommodate DBA e-mail, and therefore the firm had not been reviewing those e-mails. After discovering that problem, the firm modified its system, but it still failed to capture more than one DBA e-mail address per representative. A subsequent project to pull in more DBA addresses was stopped before completion, as was a resulting review by internal audit.
- *E-mail archives* – LPL failed to ensure that its e-mails were archived properly when it moved to a new e-mail retention system. As a result, LPL was unable to respond completely to certain regulatory requests for e-mails.
- *Bloomberg archives* – LPL failed to review or archive Bloomberg messages for seven years prior to 2011. Moreover, the firm failed to take action to rectify this situation in a timely manner once it was brought to its attention.
- *Failure to supervise certain registered employees’ e-mail* – Prior to 2011, LPL did not review the e-mails of its registered employees, such as home office personnel.
- *Failure to enforce policies against the use of unauthorized e-mails* – Although the firm’s examination of its branch offices identified instances of independent contractors using unauthorized e-mail addresses to conduct firm business, the firm did not discipline these individuals for such use, nor did it prohibit such individuals from continuing to use these e-mail addresses.
- *Failure to archive e-mails sent through third-party advertising platforms* – LPL allowed independent contractors to send e-mails through third-party e-mail based advertisement platforms, and even though firm employees were aware that these e-mails were not being archived, the firm took no action to address this issue for at least two years.

Lessons learned

Registered broker dealers should take careful note of this disciplinary matter and assess their compliance with supervisory and recordkeeping obligations with respect to electronic communications.

1. Consider conducting a comprehensive compliance audit of existing systems, policies and procedures related to surveillance, retention and recordkeeping obligations for electronic communications. Among other things, such audits should seek to ensure that:
 - the firm is capturing, retaining and reviewing e-mails of all registered representatives, including e-mails used by registered representatives in the conduct of their employment outside of the firm’s e-mail systems;
 - the firm has procedures for identifying all e-mail addresses and platforms used by its registered representatives; and
 - the firm has established appropriate recordkeeping policies providing, among other things, when records may be destroyed, and ensuring that such policies are consistently applied.
2. Ensure that the firm’s procedures contemplate an internal audit function that has adequate resources, authority and support to investigate identified issues and make recommendations for corrective action.

3. Remediate any identified issues promptly. One of the central themes of FINRA's formal disciplinary action is that while the firm's business grew rapidly, attention to compliance issues did not receive the same amount of attention or resources. FINRA is clearly signaling that directing firm resources to the building of a business without a similar level of commitment to compliance will not be tolerated.
4. Take steps to ensure that annual training includes adequate instruction regarding a registered representative's use of e-mail and other electronic communication media (see FINRA's "Guide to the web for registered representatives", available at www.finra.org/industry/issues/advertising/p006118). Representatives should annually demonstrate their understanding of their obligations under the firm's compliance policies related to use and retention of emails and other electronic forms of communication.
5. When compliance breaches are identified, firms should take deliberate and immediate disciplinary action against registered representatives involved, consistent with firm policies.

Note

1. FINRA Letter of Acceptance, Waiver and Consent No. 200901657000 (January 20, 2011).

Reference

Nathan, D.A. and Ignat, A.-M. (2013), "FINRA Rule 4530 – Recent revisions remind broker-dealers of the importance of the new requirements to report internal findings of violative conduct", Morrison & Foerster client alert, February 27, available at: [at www.mofo.com](http://www.mofo.com)

Corresponding author

Daniel A. Nathan can be contacted at: dnathan@mofo.com

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