
SEC Staff Issues FAQs on the Liability of Compliance and Legal Personnel at Broker-Dealers

2013-10-08

On September 30, 2013, the staff of the Securities and Exchange Commission's (SEC) Division of Trading and Markets issued a new set of [frequently asked questions](#) (FAQs) regarding the liability of compliance and legal personnel at broker-dealers under Sections 15(b)(4) and 15(b)(6) of the Securities Exchange Act of 1934 (Exchange Act).¹ Emphasizing that liability for failure to supervise under those provisions is a facts and circumstances determination, the staff observed that “[a]s a general matter, the staff does not single out compliance or legal personnel” and that “ultimately, the responsibility for a broker-dealer’s compliance resides with its chief executive officer and senior management.” While the guidance provides some relief to compliance and legal personnel, it also underscores that these employees must ensure that their roles are well articulated and understood in order to avoid being inadvertently deemed a supervisor of business activities or business personnel or implicitly assuming such responsibilities.

Notably, the FAQs address several of the significant concerns recently raised by the securities industry in a [white paper](#) on the evolving role of compliance in securities firms, which was published earlier this year.² Below is a summary of three key points covered in the FAQs.

- **Requisite Degree of Responsibility, Ability or Authority to Affect Conduct.** A person’s actual responsibilities and authority, rather than status as a “line” or “non-line” employee, determines whether he or she is a supervisor for purposes of the Exchange Act. The FAQs provide six questions for firms to consider in assessing the responsibilities and authorities of compliance and legal personnel. In many ways, the questions reflect an endorsement of the broader “affect” test, as opposed to the narrower “control” test, to determine whether an individual is a supervisor.³ In particular, the questions consider, among other things, whether an employee has: supervisory authority or responsibility for business activities; the authority and responsibility to prevent a violation from continuing; or the authority or responsibility to prevent an underlying violation. (FAQ No. 2.)
- **Providing Advice and Counsel to the Business.** Compliance and legal personnel do not become business supervisors solely by virtue of providing advice and counsel concerning compliance or legal issues to the business, or assisting in the remediation of a particular issue. However, if their responsibilities extend beyond their typical job functions such that

they have the “requisite degree of responsibility, ability or authority to affect the conduct of business line personnel,” then they may be deemed business supervisors. (FAQ No. 3.)

- Roles on Committees. Compliance and legal personnel do not become business supervisors merely by participating in, providing advice to, or consulting with a management or other front-office committee. The facts and circumstances of a particular case, including the responsibility or authority to affect employee conduct, are determinative. (FAQ No. 5.)

Although they do not necessarily constrain other regulators such as the Commodity Futures Trading Commission or self-regulatory organizations, the FAQs represent an important step in providing guidance to the industry regarding the structure of supervisory and compliance systems and the types of functions that compliance and legal personnel can perform without necessarily assuming supervisory responsibility over business activities or business personnel. The FAQs also provide valuable clarification after the Urban decision that legal and compliance personnel are not liable merely for being ineffective (notwithstanding independent violations, such as aiding and abetting another’s violation of the securities laws).⁴ Going forward, firms should take note that the staff has encouraged the industry to continue to provide feedback to ensure that the FAQs keep pace with applicable regulatory requirements and industry practices.

¹ Frequently Asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act, SEC (Sept. 30, 2013), *available at* <http://www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm>.

² Securities Industry and Financial Markets Association, *White Paper on The Evolving Role of Compliance* (Mar. 2013), *available at* <http://www.sifma.org/workarea/downloadasset.aspx?id=8589942363>.

³ See *John H. Gutfreund*, Exchange Act Release No. 31554 (Dec. 3, 1992) (addressing the “affect” test); see also *Arthur J. Huff*, Exchange Act Release No. 29017 (Mar. 28, 1991) (addressing the “control” test).

⁴ *Theodore W. Urban*, SEC Administrative Proceeding File No. 3-13655, Initial Decision Release No. 402 (Sept. 8, 2010), dismissed by Exchange Act Release No. 66359 (January 26, 2012) (regarding the supervisory liability of a broker-dealer’s general counsel).

Authors



Yoon-Young Lee

SENIOR COUNSEL

✉ yoonyoung.lee@wilmerhale.com

☎ +1 202 663 6720



Bruce H. Newman

PARTNER

✉ bruce.newman@wilmerhale.com

☎ +1 212 230 8835