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When Advisors Go Rogue: Common Scenarios and Tips for Safeguarding Your Firm

July 5, 2022

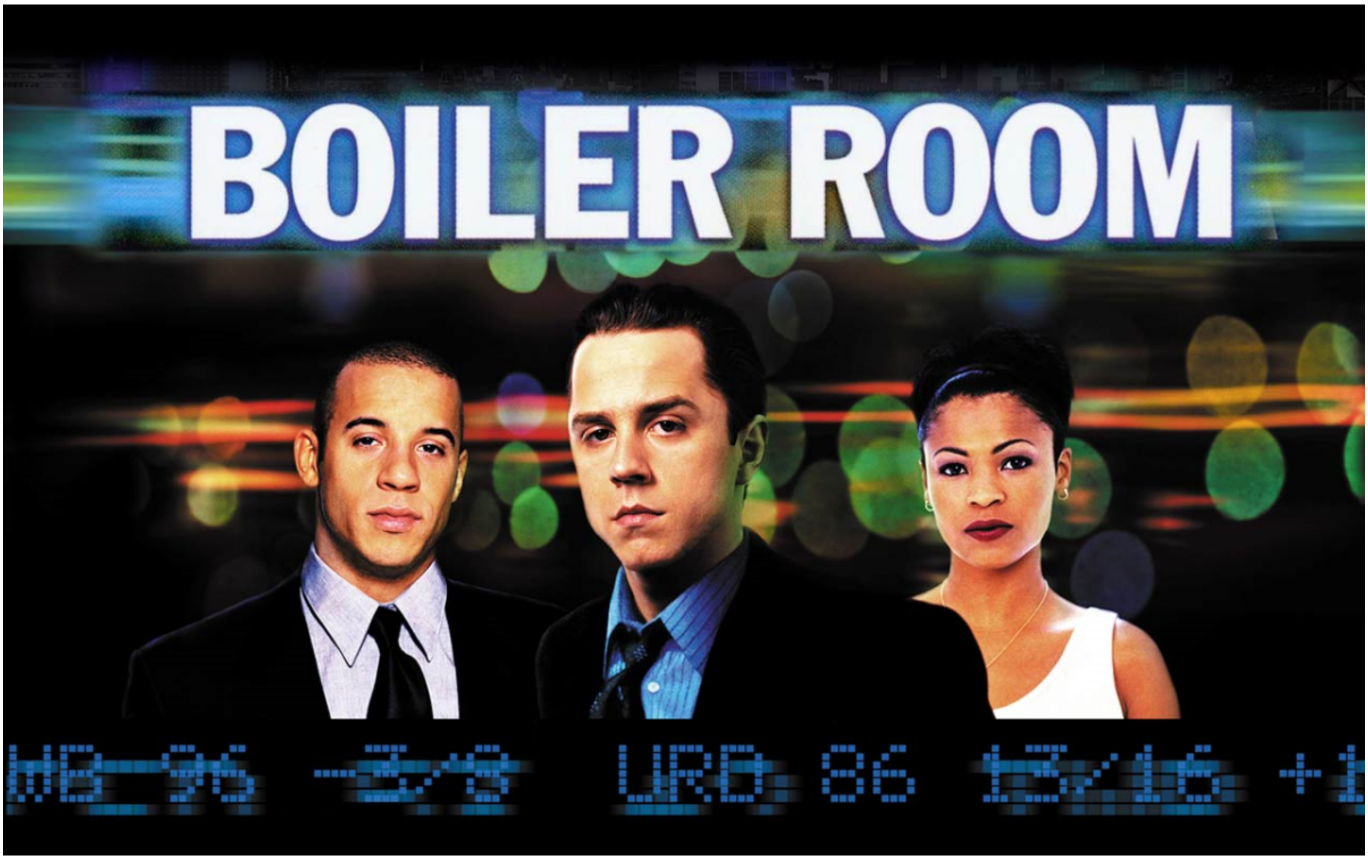
In case you haven't noticed, we are living in an environment where regulators are keen to address advisor relationship practices that jeopardize retail investors. Historically, the U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) have been (and, of course, still are) very focused on client abuse.

Last year, the SEC levied $3.9 billion in fines. Globally, there is also a trend towards more rules. For instance, in 2020, the U.K. Financial Conduct Authority (FCA) fined Charles Schwab UK £8.96 million for failing to protect client assets. More recently, the FCA has introduced the Consumer Duty regulation, which is designed to increase consumer protections in the retail financial services market. Rules are advancing in other regions as well.

Rogue Behavior is Abundant

The subject of misconduct has had a folklore quality to it. Hollywood certainly embraces it by making movies like "Boiler Room" and glamorizing Jordan Belfort's crimes in "The Wolf of Wall Street." Meanwhile, there are a range of advisor misconduct practices that almost seem subtle in comparison but are of course very serious.

It is more likely than not that most of us have experienced advisor misconduct or know someone who has. To date there are four types of prevalent misconduct impacting investors: wine & dine, friends and family targeting, elderly targeting, and generational wealth transfer. Perhaps unsurprisingly, all of them rely on a trust factor and a client's relationship with their advisor.



Source: New Line Cinema

Firms Need to Do More

Unfortunately, not all advisors have a super hero complex and want to uphold their clients' best interests. Firms need to do more, as elderly targeting is set to be a top form of abuse for years to come because of the way generations evolve.

Compliance officers can arm themselves with technology to safeguard against advisor misconduct and other problems. Both technology and regulations will continue to evolve. Firms and compliance personnel need to have their ducks in a row in areas such as know your client (KYC) and know your product (KYP) guidelines.

The variety of communications that need to be captured is key and has grown to include email, phone conversations, video conferencing and many varieties of texting and chats. Compliance teams must have the capability to collect and monitor data points to be sure a firm is compliant and its reputation is being upheld. Tools must be flexible enough to tackle a Regulation Best Interest, or Reg BI, world that's established a best interest standard of conduct for broker-dealers when they make a recommendation to a retail investor.

Additionally, the machinery and delivery of information-– which is evolving away from a tabular world-– includes more tools like data visualization to help compliance professionals achieve best practices. The advisor world is "there" in terms of mirroring the iPhone's success with its dashboard containing icons and applications. Having an easily accessible dashboard with the proper alerts and measures give firms what they need as regulations will continue to come down the pipeline and firms will continue to have to adapt and make adjustments to analytics to meet these demands and help clients to meet them as well.

Sign of the Times

Reputational risks are at all-time high levels. This has translated into a call to action for firms to overhaul their surveillance technology and processes. One of the more challenging features compliance officers need to consider is the new work from home and hybrid models that have fostered the use of many more communication channels.

The SEC has recently levied massive fines against financial institutions, including one case in which the financial institution allowed employees to circumvent recordkeeping rules by conducting business on apps like WhatsApp. One of the firm's key executives noted, "As technology changes it is even more important that registrants ensure that communications are appropriately recorded and not conducted outside of official channels." This is a sign of the times.

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