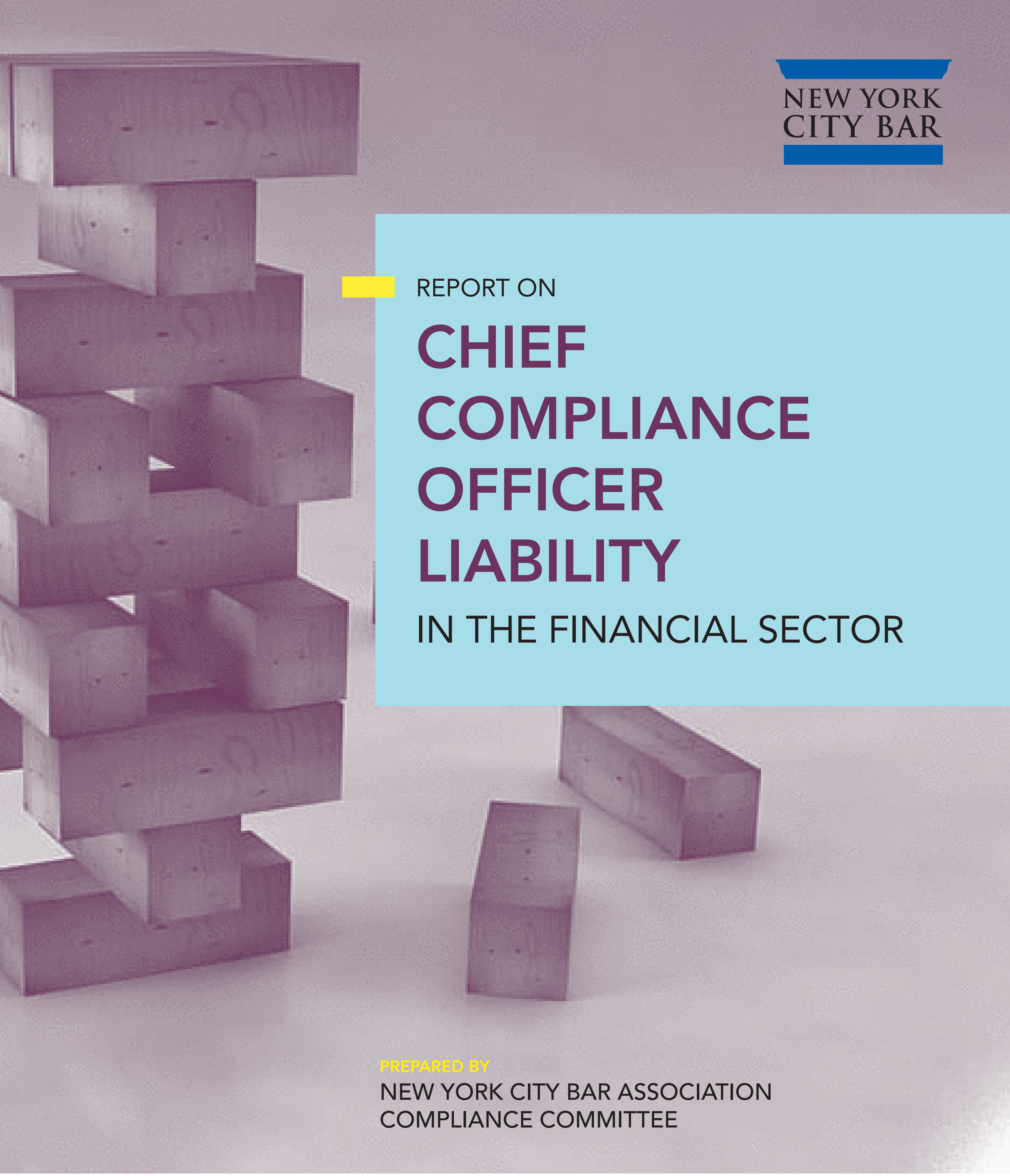

NEW YORK CITY BAR

REPORT ON

# CHIEF COMPLIANCE OFFICER LIABILITY

## IN THE FINANCIAL SECTOR

PREPARED BY

NEW YORK CITY BAR ASSOCIATION
COMPLIANCE COMMITTEE

IN PARTNERSHIP WITH

ACG® Association for Corporate Growth

AMERICAN INVESTMENT COUNCIL

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## Introduction

Financial firm compliance officers serve as essential gatekeepers to prevent, detect, and remediate violations of laws, regulations, and internal policies and rules. Because of their role, compliance officers are inherently at risk of becoming subject to regulatory investigations and personal liability. While the intent of such investigations and liability risks may be to strengthen the "gatekeeper" function, they can also discourage appropriate activity by compliance officers, isolate compliance officers from other business processes, or, at the extreme, lead individuals to leave compliance roles for fear of bearing liability for the misconduct of others. This paper explores the ways in which the compliance community and the regulating agencies can better achieve their shared goals.

Based on recent regulatory enforcement actions, compliance officers face and, equally importantly, perceive, a growing risk of personal liability from the day-to-day performance of the compliance function. In particular, there is a risk of liability arising out of an assessment made in hindsight regarding what a compliance officer or program ought to have detected and prevented. This risk of liability threatens to reduce the ranks of effective, qualified candidates seeking and remaining in compliance positions.[1] Compliance officers also face an enforcement culture focused on individual accountability, a greater regulatory focus on the compliance function, and an increase in state and federal regulations potentially implicating personal liability. This increase in exposure is often coupled with uncertain prevailing standards of liability and insufficient guidance regarding regulatory expectations.

Enforcement actions against compliance officers in their individual capacity remain an important regulatory tool to deter malfeasance, punish misconduct, and prevent fraud. And, to their credit, regulators have attempted to reassure compliance officers by stating that they do not intend to target compliance officers and use enforcement actions as a method of last resort only to punish compliance officers who engage in truly egregious conduct. But this tool is most effective when compliance officers understand the boundaries of their duties and responsibilities and can clearly demonstrate those boundaries to other stakeholders in their firms. Despite the recent regulatory pronouncements, compliance officers remain concerned that their good faith efforts and well-intentioned conduct may be punished. This Report attempts to outline compliance officers' regulatory concerns, recent enforcement actions against compliance officers and meaningful ways for compliance officers in the financial services industry to bolster regulatory and compliance communication, interaction, and understanding with their regulatory counterparts. Through this approach, we hope to reduce the apprehension regarding personal liability that threatens the quality of service in the regulated community, clarify the principles that underwrite regulators' approach to

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[1] Certain institutions already face difficulties in attracting and maintaining qualified individuals to serve in the compliance function, which will be compounded if effective and qualified candidates leave the field. *See* Kristin Broughton, *Recruiting and Retaining Compliance Staff Is Key Risk for Banks, Regulator Says*, WALL ST. J. (May 20, 2019), https://www.wsj.com/articles/recruiting-and-retaining-compliance-staff-is-key-risk-for-banks-regulator-says-11558395878?mod=hp_minor_pos10 (last visited Jan. 15, 2020).

enforcement, and generate more consistent liability outcomes without sacrificing the achievement of regulatory goals.

In Part I, this Report examines ways in which liability risks may undermine compliance officer effectiveness and efficiency. Through both quantitative and qualitative analysis, the Report articulates compliance officer risks and concerns and describes how these concerns affect the quality of service in the compliance function. Part II of the Report examines recent enforcement actions from a variety of regulatory agencies, including the Securities and Exchange Commission (the "SEC"), Department of Justice (the "DOJ"), Financial Industry Regulatory Authority, Inc. ("FINRA"), and Financial Crimes Enforcement Network ("FinCEN").[2] Through this analysis, it highlights recent trends in compliance officer liability and enforcement. In Part III, this Report recommends certain regulatory undertakings that would serve regulatory goals, improve compliance results, and dispel the uncertainty and apprehension associated with compliance officer liability. These recommendations seek to establish stronger ex-ante relationships between regulators and the compliance profession and better equip compliance officers to accomplish the mutual goals of industry actors and the regulatory agencies that oversee them.

## Part I: Compliance Officers Face Unnecessary Risks that Undermine Effectiveness and Regulatory Goals

Compliance officers face a perceived increased risk of individual liability in recent years. This flows from an increase in enforcement actions brought against compliance officers, recent regulatory focus on holding individuals liable for compliance failures,[3] and an expanding set of regulatory requirements that stretch the compliance function's resources and present greater exposure for compliance officers in their individual capacity.[4] In recent years,

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[2] This Report does not discuss the unique concerns of CCOs in the banking sector, or regulatory oversight of that function by regulators focused on the banking sector such as the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve. Similarly, it does not discuss the unique concerns of CCOs or regulatory oversight of swap dealers or major swap participants or other categories of registrants by the Commodity Futures Trading Commission or National Futures Association (or security-based swap dealers or major security-based swap participants by the SEC and FINRA, when and where applicable).

[3] *See* Andrew Ceresney, Dir., Div. of Enf't, U.S. Sec. & Exch. Comm'n, Keynote Address at Compliance Week 2014 (May 20, 2014) (noting that the SEC has brought "and will continue to bring – actions against legal and compliance officers").

[4] The long-term increase in the risk of individual liability is well documented. As just one example, in its 2005 *White Paper on the Role of Compliance*, the Securities Industry Association (now the Securities Industry and Financial Markets Association ("Sifma")) noted that "[o]nly in limited circumstances have the [SEC] and [self-regulatory organizations] brought failure to supervise actions against non-line personnel, such as Compliance Department officers." *White Paper on the Role of Compliance*, THE SEC. INDUS. ASS'N 11 (Oct. 2005), https://www.sifma.org/wp-content/uploads/2017/08/2005RoleofComplianceWhitePaper.pdf (last visited Jan. 15, 2020). By 2013, Sifma noted, in *The Evolving Role of Compliance*, that "the view of enforcement authorities of Compliance's role" had "recently" changed, as compliance personnel had been named in enforcement actions advancing then-novel theories under which compliance personnel could be held liable for failures to "supervise" others who engaged in alleged violations. *See The Evolving Role of Compliance*, THE

regulators have also placed a greater focus on individual accountability, an atmospheric consideration that underlies the numerous recent cases where compliance officers are the only officers held individually accountable for compliance failures.[5] Further, despite recognition of the "vital role" that compliance officers face, a perception exists that regulators have lowered the standard for holding compliance officers liable in their personal capacity.[6] Collectively, these factors have resulted in an increase in enforcement actions against individual compliance officers and driven up compliance officer apprehension of personal liability, which may deter individuals from seeking or taking compliance positions. Given the structural importance of the compliance function as "pivotal" to effective regulation,[7] this Report recommends that attempts be made to reasonably reduce such apprehension without sacrificing regulatory goals such as fraud prevention and the protection of markets, investors, and customers.

### *Compliance Officers Face Increasing Risk of Individual Liability*

The first, and perhaps most immediate, cause of heightened anxieties in the corporate compliance community is that compliance officers increasingly see themselves as targets of enforcement actions. This is not unfounded. In recent years, a number of prominent enforcement actions have been brought against compliance officers,[8] leading to commentary

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SEC. INDUS. AND FIN. MARKETS ASS'N 9 (Mar. 2013), https://www.sifma.org/wp-content/uploads/2017/05/the-evolving-role-of-compliance.pdf (last visited Jan. 15, 2020).

[5] *See, e.g.*, Thaddeus J. North, Exchange Act Release No. 84500, 2018 WL 5433114, at *11 (Oct. 29, 2018) (holding North as the only officer liable for flawed policies and procedures); ); SFX Fin. Advisory Mgmt. Enter. Inc., Investment Advisers Act Release No. 4116 (June 15, 2015); Brown Bros. Harriman & Co., FINRA AWC No. 2013035821401 (Feb. 04, 2014); Complaint, United States v. Haider, No. 14 cv 9987 (S.D.N.Y. Dec. 18, 2014).

[6] *Compare Thaddeus J. North*, 2018 WL 5433114, at *12 (stating that liability will generally attach when a CCO "engages in wrongdoing, attempts to cover up wrongdoing, crosses a clearly established line, or <u>fails meaningfully to implement compliance programs, policies, and procedures</u>") (emphasis added), *with* Andrew Ceresney, Dir., Div. of Enf't, U.S. Sec. & Exch. Comm'n, Keynote Address at the 2015 National Society of Compliance Professionals, National Conference (Nov. 4, 2015) (stating that liability will generally attach when a CCO is "affirmatively involved in misconduct that is unrelated to their compliance function," "engage[s] in efforts to obstruct or mislead the Commission staff," or "<u>exhibits a wholesale failure to carry out his or her responsibilities</u>") (emphasis added).

[7] *See Thaddeus J. North*, 2018 WL 5433114, at *11.

[8] *See, e.g.*, *id.*; Raymond James & Assoc., Inc., et al., *Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No. 2014043592001* (May 18, 2016), https://www.finra.org/sites/default/files/RJFS_AWC_051816_0.pdf (last visited Jan. 15, 2020) ; *see also* U.S. Dep't of the Treasury v. Haider, No. 15-1518, 2016 WL 107940 (D. Minn. Jan. 8, 2016) (order denying motion to dismiss); Blackrock Advisors, LLC, Investment Advisers Act Release No. 4065, Investment Company Act Release No. 31558 (Apr. 20, 2015), https://www.sec.gov/litigation/admin/2015/ia-4065.pdf (last visited Jan. 15, 2020); Dep't of Enf't v. Aegis Capital Corp., No. 2011026386001 (Fin. Indus. Regulatory Auth. Aug. 3, 2015) (order accepting offer of settlement); *SFX Fin. Advisory Mgmt. Enterprises, Inc.*, Investment Advisers Act Release No. 4116; Brown Bros. Harriman & Co., *Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No. 2013035821401* (Feb. 4, 2014), https://docplayer.net/12485371-Financial-industry-

highlighting the heightened risk of individual liability.[9] These increases have not necessarily grown out of legislative action, but rather, by regulators deciding that they will use their considerable enforcement discretion to bring enforcement actions against compliance officers more frequently than in the past.

Regulators, to their credit, have on multiple occasions attempted to reassure compliance officers that they are not targets of regulatory enforcement actions and that they take seriously their responsibility to use discretion in charging compliance officers. Despite the generalized good faith that such statements have generated, and the relative paucity of enforcement actions in recent years involving arguably good-faith conduct, the standards guiding the discretion regulators exercise remains unclear. For example, in 2015, then-Director of the SEC Division of Enforcement Andrew Ceresney stated that the SEC "take[s] the question of whether to charge a CCO very seriously and consider[s] it carefully," and elaborated that the SEC charges individual CCOs in three circumstances: (1) when the CCO is affirmatively involved in misconduct; (2) when the CCO engages in efforts to obstruct or mislead the Commission; and (3) when the CCO exhibits "a wholesale failure to carry out his or her responsibilities."[10] While SEC commissioners and staff have since made a number of speeches addressing the roles of compliance officers, then-Director Ceresney's 2015 speech still provides the most direct guidance on the factors the SEC will consider when determining whether to hold compliance officers personally liable for compliance failures.[11]

Of the three categories of circumstances discussed, the first two seem relatively straightforward. Compliance officers do not seek a shield from the same kinds of liability that would attach to other firm employees in connection with such misconduct.

But the third category—what then-Director Ceresney described as "wholesale failure to carry out" compliance responsibilities—has not been sharply delineated from operational failures or missteps that fall short of a "wholesale failure" to discharge duties. For example, in the

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regulatory-authority-letter-of-acceptance-w-aiver-and-consent-no-2013035821401.html (last visited Jan. 15, 2020).

[9] *See, e.g.*, Court E. Golumbic, *"The Big Chill": Personal Liability and the Targeting of Financial Sector Compliance Officers*, 69 HASTINGS L.J. 45, 49 (Dec. 22, 2017); Emily Glazer, *The Most Thankless Job on Wall Street Gets a New Worry*, WALL ST. J. (Feb. 11, 2016), https://www.wsj.com/articles/now-in-regulators-cross-hairs-bank-compliance-officers-1454495400 (last visited Jan. 15, 2020); Dawn Causey, *Who Should Have Personal Liability for Compliance Failures?*, A.B.A. BANKING J. (Aug. 17, 2015), https://bankingjournal.aba.com/2015/08/who-should-have-personal-liability-for-compliance-failures (last visited Jan. 15, 2020).

[10] *See* Ceresney, *supra* note 3.

[11] *See* Peter Driscoll, Dir., Office of Compliance Inspections and Examinations, Speech at NRS Spring 2019 Compliance Conference (Apr. 29, 2019); Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Costumes, Candy, and Compliance: Remarks at the National Membership Conference of the National Society of Compliance Professionals (Oct. 30, 2018); Andrew J. Donohue, Chief of Staff, U.S. Sec. & Exch. Comm'n, Remarks at the National Society of Compliance Professionals 2016 National Conference (Oct. 19, 2016); Marc Wyatt, Dir., Office of Compliance Inspections and Examinations, Keynote Address for National Society of Compliance Professionals 2016 National Conference (Oct. 17, 2016).

recent case of Thaddeus North, the SEC upheld sanctions imposed on North (the CCO of a brokerage firm) by FINRA for, among other things, failing "meaningfully to implement compliance programs, policies, and procedures,"[12] which appears to apply a different, more expansive range of circumstances than a "wholesale failure."[13]

### *Compliance Officers are Subject to Increased Regulatory Requirements*

A second cause of heightened risk to compliance officers is that state and federal regulators are increasingly imposing additional attestation and certification requirements on compliance officers. These requirements subject the compliance officer to the risk of personal liability and also increase the burden on firms' compliance functions—which itself increases risks inherent in stretching the resources of compliance staff. Such regulatory requirements exist with respect to anti-money laundering ("AML") programs at financial institutions[14] and compliance programs in the virtual currency industry.[15] Specifically, regulators increasingly dictate the responsibilities of compliance personnel, increasing risks to those that serve in these roles in the event of compliance failures.[16] These heightened regulatory requirements not only stretch limited compliance resources, but focus enforcement attention onto particular individuals, often those serving in the compliance function.[17]

Even where no explicit attestation requirements are imposed on compliance officers, increased demands on compliance programs may expose compliance officers to additional

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[12] *See Thaddeus J. North*, 2018 WL 5433114, at *11.

[13] In the *North* enforcement action, the SEC stated that, absent unusual mitigating circumstances, a compliance officer's conduct would give rise to individual liability in four situations: "when a CCO engages in wrongdoing, attempts to cover up wrongdoing, crosses a clearly established line, or fails meaningfully to implement compliance programs, policies, and procedures for which he or she has direct responsibility." *See id.*

[14] *See* N.Y. Comp. Codes R. & Regs. tit. 3, § 504.3.

[15] *See* N.Y. Comp. Codes R. & Regs. tit. 23, § 200.1.

[16] *See* N.Y. Comp. Codes R. & Regs. tit. 23, §§ 200.7, 200.15(c) (requiring the designation of a "qualified individual . . . in compliance" responsible for anti-money laundering program oversight, including specifically enumerated activities).

[17] To the extent regulators focus on compliance personnel as the target of enforcement activity, this may undermine the role of compliance officers as advisers to the management and senior executives principally responsible for the firm's obligation to comply with relevant regulations. *See Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance*, FIN. CRIMES ENFORCEMENT NETWORK (Aug. 11, 2014), https://www.fincen.gov/sites/default/files/advisory/FIN-2014-A007.pdf (last visited Jan. 15,2020) ("A financial institutions leadership is responsible for performance in all areas of the institution including compliance with the BSA"); *The Evolving Role of Compliance, supra* note 4, at 4 (noting that holding compliance personnel liable for supervisory failures undermines the compliance function's traditional role as an advisory and control function); *see also* Press Release, Dep't of Justice, U.S. Attorney's Office, S.D.N.Y., Acting Manhattan U.S. Attorney Announces Settlement of Bank Secrecy Act Suit Against Former Chief Compliance Officer at MoneyGram for Failure to Implement and Maintain an Effective Anti-Money Laundering Program and File Timely SARS (May 4, 2017), https://www.justice.gov/usao-sdny/pr/acting-manhattan-us-attorney-announces-settlement-bank-secrecy-act-suit-against-former (last visited Jan. 15, 2020).

risks. For example, in implementing the Beneficial Ownership Rule,[18] FinCEN added another pillar to the Bank Secrecy Act/Anti-Money Laundering principles governing compliance programs for financial institutions. By requiring banks and other financial institutions to "establish and maintain written procedures" regarding beneficial ownership of certain clients, the rule adds to the responsibilities, and potential liabilities, of compliance officers.[19]

### *Compliance Officers Face Structural Obstacles*

A third reason that compliance officers may face increased risk is that the increasing role and specialization of the compliance function may raise structural barriers to important information reaching compliance officers, thereby impeding their ability to discover and prevent misconduct. One structural tension is nearly inherent in the role of a compliance officer. On the one hand, compliance officers are employees, whose job and livelihood ultimately depend on the profitability of their employer. On the other, many firms are required by statute or regulation to designate at least one compliance officer, and compliance officers bear responsibilities—and sometimes, regulatory duties—to work to reasonably ensure that their employers remain in compliance even (and perhaps especially) when regulatory compliance could conflict with profitability.[20]

Relatedly, compliance officers may depend on access to and input of senior leaders (such as senior business, investment, or finance officers) to implement initiatives or ensure that compliance directives are followed. Accordingly, if a firm's structure excludes compliance officers from strategic decision-making groups, compliance officers may be less able to anticipate risks.[21] In its 2016 survey of the compliance function, PricewaterhouseCoopers found that only 35% of respondents reported "CCOs [were] involved in helping develop or implement corporate strategy."[22] In addition, in certain larger institutions, a compliance officer might serve as a CCO of a particular business segment of the institution and, despite the CCO title, may not have decision-making authority or even supervisory authority across different business lines. Without the ability to influence corporate decision-making,

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[18] *See* 31 C.F.R. § 1010.230. (requiring all financial institutions covered by the Bank Secrecy Act to collect and verify specific information regarding the beneficial owners of the entities with which they transact at the time a new account in opened).

[19] *See* 31 C.F.R. § 1010.230(a).

[20] *See, e.g.*, *The Evolving Role of Compliance*, *supra* note 4, at 5 (explaining that "Compliance's relationships with senior management and with regulators may involve competing or conflicting expectations, and this also may have the effect of unnecessarily constraining Compliance's contribution to a firm's regulatory compliance efforts.").

[21] *See PwC State of Compliance Study 2016,* PRICEWATERHOUSECOOPERS (2016), https://cgx3j41r03fwkmmdtoy3l6aq-wpengine.netdna-ssl.com/wp-content/uploads/2017/11/PWC_State_of_Compliance_Study_2016.pdf (last visited Jan. 15, 2020) (noting that only 36% of executives surveyed said their compliance programs were "inherently integrated" or "played a key role" in "strategic planning").

[22] *See id.*

compliance officers, even CCOs, may not be well positioned to prevent or head off risks, and may be limited to responding to them once discovered.

A firm's internal reporting structure may also limit a compliance officer's ability to "sound the alarm" to address misconduct, even when potential misconduct is reported to compliance in a timely fashion. For example, where a compliance officer does not report directly to the CEO or Board of Directors, response time may be delayed, and communications may be impaired through indirect transmission.[23]

Even where compliance officers benefit from appropriate authority, clear reporting lines, and access to senior leadership and the board of directors, compliance departments have limited resources that they must judiciously allocate. Regulators recognize the effects of resource constraints on compliance personnel, encouraging compliance personnel to advocate for additional resources when necessary and, in certain instances, exercising enforcement discretion on these grounds.[24] Such ad hoc recognition, however, does not alleviate the difficulties compliance officers face when dealing with insufficient resources. Additional guidance on prioritization and best practices for dealing with chronic resource constraints would empower compliance personnel internally within firms to seek greater resource allocation and reduce the risk that qualified candidates exit positions prematurely out of fear of personal liability when compliance issues do arise.

### *Compliance Officers Must Make Decisions in Real Time with Limited Guidance*

Compliance officers must make decisions in real time against the backdrop of heightened individual enforcement, increased regulatory responsibilities, limited resources, and little guidance. The risks inherent in such judgment calls are compounded because the statutory framework governing much of the day-to-day responsibilities of financial industry compliance officers largely prescribes common-law like standards of conduct susceptible to reasonable disagreement. For example, Section 206(4) of the Investment Advisers Act of 1940 (the "Advisers Act") and Rule 206(4)-7 thereunder require the adoption and implementation of written policies and procedures "reasonably designed to prevent

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[23] *See* Brown Bros. Harriman & Co., *supra* note 8. Notably, in some corporate structures, even CCOs may not have a clear line of reporting to the CEO or Board of Directors. The Securities Industry Association observed, nearly fifteen years ago, that a lack of direct communication can hamper the compliance function because "[c]ompliance officials need access to senior management to escalate issues properly." *White Paper on the Role of Compliance*, *supra* note 4.

[24] *See* Pennant Mgmt, Inc., Investment Advisers Act Release No. 5061 (Nov. 6, 2018); Mark Elste, Investment Advisers Act Release No. 5062 (Nov. 6, 2018); Richard Rouse, Exchange Act Release No. 32658, 1993 WL 276149, at *5 (July 19, 1993) (noting the mitigating effects of the "extraordinary demands on the compliance group" during the relevant time period); Andrew J. Donohue, Chief of Staff, U.S. Sec. & Exch. Comm'n, Remarks at the National Society of Compliance Professionals 2016 National Conference (Oct. 19, 2016) ("So a very real challenge for compliance departments and personnel—both today and in the future—will be to insure that they have the funding necessary for discharging their critical function as well as the technological and other resources that are essential to their success. This concern about resource constraints is especially critical as the role of compliance continues to expand in the post-financial-crisis era.").

violation(s)" of the Advisers Act and associated regulations. In practice, a compliance professional's decision on what is "reasonably designed" to prevent a violation will likely be assessed after a violation has actually occurred—which creates the risk that hindsight bias will make what seemed reasonable at the time appear unreasonable after a violation.

These governing statutory standards are only rarely subject to judicial review and interpretation, leaving regulators' enforcement actions and settlements as the primary means from which practitioners can glean insight into enforcement priorities and legal interpretations.[25] Such enforcement actions and settlements are heavily negotiated documents, which do not provide a clear and consistent framework for understanding the appropriate interpretation of legal standards. Disagreements and confusion regarding the appropriate standards of liability and enforcement priorities further exacerbate the disconnection between regulators and the regulated community.[26] As SEC Commissioner Peirce has noted, enforcement decisions should ideally account for the risks of assessing in hindsight whether a judgment call merits personal liability.[27] In addition to the relevant statutory and regulatory authority being easily subject to misunderstanding or misinterpretation, and certainly subject to an interpretation disagreed with by regulators, the facts as conveyed to the compliance officer may not be complete, and/or the compliance officer may not appreciate some of the factual nuances in the frequently highly complex underlying transactions at issue in the few moments in which a decision must be made—compounded by the time pressure frequently provided from others at the compliance officer's institution. These are circumstances that militate in opposition to enforcement action against a compliance officer.

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[25] Only complicating these interpretations by regulators through enforcement adjudications is the Supreme Court's recent decision in *Lucia v. Sec. & Exch. Comm'n*, 138 S.Ct. 2044 (2018). Here, the Supreme Court held that SEC administrative law judges ("ALJs") were unconstitutionally appointed because they are officers of the United States but were not appointed in compliance with the Appointments Clause of the Constitution. Justice Breyer's concurring opinion left open a question of whether the multi-level removal protections of ALJs afforded by the Administrative Procedure Act were unconstitutional under the Supreme Court's holding in *Free Enterprise Fund v. Public Accounting Oversight Board*, 561 U.S. 477 (2010), which "would risk transforming administrative law judges from independent adjudicators into dependent decisionmakers [sic], serving at the pleasure of the Commission." *Lucia*, 138 S.Ct. at 2060. *Lucia* likely applies to ALJs of the OCC and other agencies that would undermine the legitimacy of their enforcement adjudications. *See* Margaret Tahyar, *The Constitutionality of SEC-Appointed Judges*, HARVARD L. SCH. FORUM ON CORP. GOVERNANCE AND FIN. REG. (July 9, 2018), https://corpgov.law.harvard.edu/2018/07/09/the-constitutionality-of-sec-appointed-judges (last visited Jan. 15, 2020).

[26] *See* Golumbic, *supra* note 9. *Compare* J. Bradley Bennett, Exec. Vice President & Dir. Of Enf't, Fin. Indus. Regulatory Auth., Remarks from the SIFMA Anti-Money Laundering and Financial Crimes Conference (Apr. 5, 2016), *with* Ceresney, *supra* note 3, *and* Peirce, *supra* note 11.

[27] *See* Peirce, *supra* note 11 ("A conflict between your judgment and ours, which is always informed by hindsight, should not result in an enforcement action against you").

The result of these trends is an increased concern that compliance officers face a disproportionate risk of individual liability—a risk great enough to question whether they should continue serving in a compliance function. In the years since Director Ceresney's 2015 speech, several studies have supported the conclusion that the "specter of personal liability is causing potential leaders in financial sector compliance to reconsider their career paths."[28] In annual surveys conducted over the last three years, DLA Piper found that 74% of CCOs surveyed were "at least somewhat concerned" regarding their personal liability.[29] Respondents from another survey contend that this risk is expected to increase in the coming years.[30] In DLA Piper's 2016 survey, two-thirds of respondent CCOs indicated they would think more carefully about future roles they might consider given the risk of personal liability.[31] One observer has noted that if compliance officers believe that "even exercising their best judgment will not protect them from the risk of a career-ending enforcement action, many more will leave, or forego the profession entirely, rather than endure the risks."[32] While the compliance profession remains staffed with highly qualified and motivated professionals, these survey results and commentary underscore the negative effects of the uncertainties and risks posed by the specter of career-ending personal liability.

## Part II: Recent Enforcement Activity and Trends

### *Liability for Participation in Misconduct or Obstructing Regulatory Investigations*

As noted above, regulators have stated that they will pursue charges against compliance officers who engage in misconduct or obstruct a regulatory investigation. While enforcement in such circumstances should be straightforward, these enforcement actions give compliance officers acting in good faith relatively little guidance about how to mitigate the risk of personal liability. There are, however, some conclusions that can be drawn from these actions.

For one, when compliance officers fill multiple roles in a business, the potential for a compliance officer to bear personal liability for misconduct may increase. For example,

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[28] *See* Golumbic, *supra* note 9.

[29] *See 2018 Compliance and Risk Report: Compliance Settles In, Personal Liability Concerns Persist and Technology Emerges as the Next Frontier*, DLA PIPER (Nov 15, 2018), https://www.dlapiper.com/en/us/news/2018/11/2018-compliance-risk-report (last visited Jan. 15, 2020); *DLA Piper's 2017 Compliance & Risk Report: Compliance Grows Up*, DLA PIPER (May 22, 2017), https://www.dlapiper.com/en/us/news/2017/05/dla-pipers-2017-compliance-and-risk-report (last visited Jan. 15, 2020); *DLA Piper's 2016 Compliance & Risk Report: CCOs Under Scrutiny*, DLA PIPER (Apr. 19, 2016), https://www.dlapiper.com/en/us/news/2016/04/2016-compliance-and-risk-report (last visited Jan. 15, 2020).

[30] *See* Todd Ehret, *SEC case against outsourced CCO highlights personal liability risk*, REUTERS (Sep. 7, 2017), https://www.reuters.com/article/bc-finreg-cco-personal-liability/sec-case-against-outsourced-cco-highlights-personal-liability-risk-idUSKCN1BI2O1 (last visited Jan. 15, 2020).

[31] *See DLA Piper's 2016 Compliance and Risk Report*, *supra* note 29.

[32] *See* Golumbic, *supra* note 9; *see also* Causey, *supra* note 9 ("Holding CCOs liable for company failures will make compliance folks skittish at best and difficult to hire or keep.").

compliance officers may be directly involved in fraud,[33] or they may be liable for failing to meet financial registration requirements. In these situations, regulators properly assess the conduct of compliance officers acting outside of their compliance obligations just as they would other business professionals.

Compliance officers can also be held liable where their conduct allegedly obstructs a regulatory investigation. Because the compliance function serves as an important link between regulators and the financial industry, compliance officers who obstruct regulatory inquiries may be subject to serious consequences. However, the line between affirmative conduct that obstructs an investigation and negligent conduct in good faith may be difficult to police. In one case, *David I. Osunkwo*,[34] a consulting advisor contracted to provide outsourced CCO services to two investment management firms. Pursuant to the contract, the designated outside CCO prepared and filed Form ADVs for the two firms. To reflect a merger of the two firms, the CCO later prepared and filed an annual Form ADV amendment for one of the firms. That amendment overstated the assets under management of the two investment firms by nearly $120 million. The SEC fined the CCO $30,000 and suspended him because he "willfully violated" the Advisers Act by making an untrue statement in the amendment. The CCO was held personally liable for preparing the relevant Form ADV amendment by relying on an estimate by the Chief Investment Officer that significantly overstated the firm's assets under management and for stating that the Chief Investment Officer certified the contents of the Form ADV amendment without confirming with the Chief Investment Officer beforehand.[35]

### *Liability for Compliance Function Failures*

In a number of regulatory actions, Compliance officers appear to be held personally liable by regulators for having "caused" their firms' failure to design and implement effective policies and procedures. While these actions place the enforcement discretion of regulators into the sharpest relief, the basis for a regulator's conclusion that a compliance officer's conduct merited individual liability is, at times, unclear. Compliance officers may sometimes be

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[33] *See, e.g.*, SEC v. Hope Advisors, LLC, No. 1:16-cv-01752, 2017 WL 6997134 (N.D.Ga. Nov. 28, 2017) (alleging that the CCO, who also served as the controller and a trader at the investment adviser, "aided and abetted" a fraudulent scheme to conceal actual losses where he helped track account balances used to calculate the size and number of misleading trades to be executed); AlphaBridge Capital Mgmt. LLC, Investment Advisers Act Release No. 4135 (July 1, 2015) (finding the CCO, who was also a portfolio manager, liable for multiple violations of the Investment Advisers Act where he fraudulently priced the fund portfolio he managed).

[34] Exchange Act Release No. 81405, Investment Advisers Act Release No. 4745, Investment Company Act Release No. 32783 (Aug. 15, 2017), https://www.sec.gov/litigation/admin/2017/34-81405.pdf (last visited Jan. 15, 2020).

[35] Under the common law in many states, an officer of a company can rely on data provided by another officer without needing to verify that the information provided is correct. That does not necessarily require a similar standard under the federal laws underlying most securities enforcement actions. However, absent specific authority, it is unclear why regulators would subject compliance officers in particular to the strict standard indicated in *Osunkwo*, given that the structural obstacles in many institutions noted above will make it difficult for compliance officers to clearly affirm the truth of representations made by others in many cases.

singled out as the individual responsible for an entity's failure to adopt and follow compliance policies and procedures even though, by statute, these responsibilities fall on the regulated entity rather than any particular employee. For example, in *BlackRock Advisors LLC*,[36] the SEC charged BlackRock's CCO with having "caused" BlackRock to willfully violate Rules under the Advisers Act and certain BlackRock funds to violate the Investment Company Act (the "ICA") even though the statutes and rules impose requirements on the investment adviser generally, not specifically on an adviser's CCO.[37] In *BlackRock Advisers*, the CCO was allegedly aware of the conflict of interest at the center of the firm's failure to comply with the ICA and oversaw a legal and compliance-oriented review of the issue. The SEC's order disagreed with the conclusion of this review that no conflict of interest existed. Accordingly, without elaboration, the SEC's order found that the CCO caused the violation. Although, with the advantage of hindsight, such potential conflicts of interest may appear clear, the regulatory decision to extend liability beyond the firm, to the individual, raises questions regarding the proper scope of liability.

The enforcement action against John Telfer raises similar issues. There, the SEC found Telfer liable as the CCO of Meyers Associates, L.P., for aiding and abetting and causing the firm's failure to file suspicious activity reports under the Bank Secrecy Act (the "BSA").[38] Similar to *BlackRock Advisers*, the SEC's decision to enforce against Telfer blurs the distinction between institutional and personal liability. Despite the BSA's requirements applying solely to the firm, the SEC found that Telfer was "personally responsible" for ensuring the firm's compliance with the BSA's reporting requirements because he served as the firm's AML officer.[39] Accordingly, the SEC found him individually liable for the firm's failure to file suspicious activity reports for certain transactions that presented red flags for anti-money laundering risks.[40] While individuals' internal responsibilities within a firm will undoubtedly be a factor affecting their liability for the firm's compliance failures, equating internal responsibility for a particular task with justification for individual liability with

[36] Investment Advisers Act Release No. 4065 (Aug. 6, 2015), https://www.sec.gov/litigation/admin/2015/ia-4065.pdf (last visited Jan. 15, 2020).

[37] *See* 17 C.F.R. § 275.206(4)-7(a) (requiring registered investment advisors to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation, by [themselves and their] supervised persons, of the Act . . . ."); 17 C.F.R. § 275.206(4)-7(c) ("Chief compliance officer. Designate an individual (who is a supervised person) responsible for administering the policies and procedures that you adopt under paragraph a of this section."); Comm'r Daniel M. Gallagher, *Statement on Recent SEC Settlements Charging Chief Compliance Officers with Violations of Investment Advisers Act Rule 206(4)-7*, U.S. Sec. & Exch. Comm'n (June 18, 2015), https://www.sec.gov/news/statement/sec-cco-settlements-iaa-rule-206-4-7.html (last visited Jan. 15, 2020) (stating that Rule 206(4)-7 "offers no guidance as to the distinction between the role of CCOs and management in carrying out the compliance function").

[38] Windsor Street Capital, L.P, Exchange Act Release No. 80908 (June 12, 2017), https://www.sec.gov/litigation/admin/2017/34-80908.pdf (last visited Jan. 15, 2020).

[39] *See id.*

[40] *See id.*

respect to compliance failures related thereto threatens to eliminate any distinction between legal obligations that fall on institutions as opposed to individuals.[41]

In both *BlackRock Advisers* and the action against Telfer, the SEC confronted what, in hindsight, could be viewed as egregious conduct on behalf of the compliance officers. In *BlackRock Advisers*, the CCO failed to raise or report a significant conflict of interest in which a portfolio manager managed a fund that held considerable holdings of the portfolio manager's family-owned business in which he was an active participant.[42] Similarly, in the SEC's enforcement action against Telfer, the SEC cited instances where Telfer failed to file SARS or even investigate suspicious conduct despite having red flags brought explicitly to his attention.[43] Despite such facts regarding the alleged misconduct being expressed in the settlement orders, these actions nonetheless raise important questions regarding the principle of holding individual compliance officers liable for the firm's failure to meet regulatory requirements.

First, these enforcement actions may represent a shift towards holding compliance officers liable for institutional failures.[44] *U.S. Dep't of Treasury v. Haider*[45] is another indicative example. There, FinCEN and the U.S. Attorney's Office for the Southern District of New York partnered to take action against Haider, the former CCO of MoneyGram, for his alleged failure to implement and maintain an effective AML program and report suspicious activity. MoneyGram enabled customers to transfer money globally and Haider supervised MoneyGram's AML compliance departments. MoneyGram entered into a deferred prosecution agreement with the DOJ on Federal Trade Commission charges that it aided and abetted wire fraud and willfully failed to implement an effective AML program in violation of the BSA. FinCEN alleged that Haider had failed to implement AML compliance policies and procedures, and that this failure resulted in an extensive fraudulent scheme by MoneyGram that caused customers to suffer significant losses. In addition, FinCEN pointed to Haider's acknowledgement of responsibility for failing to stop a particular instance of misconduct. Haider was assessed a $1 million civil money penalty for willfully violating the BSA. Haider later settled a DOJ action to enforce an injunction and collect the fine by consenting to a $250,000 fine and a three-year injunction from compliance for money transfer businesses. *Haider* and similar enforcement actions appear to be products of the enforcement discretion held by regulators because neither the BSA nor its relevant regulations identify

[41] Notably, however, in Telfer's case the SEC did find that Telfer ignored red flags that were brought to his attention by the clearing firm handling the transactions at issue, suggesting that individual liability was not premised solely on internal responsibility for a particular function. *See id.*

[42] *BlackRock Advisors LLC*, Investment Advisers Act Release No. 4065.

[43] *Windsor Street Capital, L.P.*, Exchange Act Release No. 80908.

[44] *See, e.g.*, Brown Bros. Harriman & Co., FINRA AWC No. 2013035821401 (finding a CCO liable for failure to have an adequate surveillance system to review transactions and failure to tailor the firm's AML procedures to adequately detect, investigate, and report suspicious activity where the CCO only knew that the firm's brokerage activity expanded and that heightened risk existed concerning the firm's penny stock activity and the limited ability to obtain beneficial ownership information from clients in bank secrecy havens).

[45] Complaint, U.S. Dep't of Treasury v. Haider, No. 14 cv 9987 (S.D.N.Y. Dec. 18, 2014).

whether compliance officers can be individually liable for their firm's compliance programs, and the BSA requires financial institutions generally to create an AML program.[46]

In addition to demonstrating the enforcement priority of holding individuals accountable for institutional failures,[47] *Haider* raises the question of how compliance personnel should handle situations in which compliance failures are caused or aggravated by noncompliant management. Reuters reported that sales personnel rejected efforts within MoneyGram's fraud department to terminate and discipline agents at its outlets responsible for perpetuating the misconduct at issue.[48] In situations where compliance personnel are overruled by management, or handicapped through indirect means such as understaffing, they may face a difficult decision between deciding to exit the firm, and potentially worsening the compliance failure in the process, or remaining at the risk of personal liability.

In another AML-related enforcement action, *Busby*,[49] an AML compliance officer was held personally liable by FINRA for failure to implement reasonable written policies to detect suspicious activity. Among the grounds FINRA articulated for its sanction were that the CCO improperly relied upon policies scattered among other departments, of which the CCO had no supervisory control, and that the CCO did not commit sufficient resources to AML efforts.

This regulatory approach has led to compliance officers facing individual liability even if they are alleged to have no knowledge of the facts underlying the violation,[50] or have attempted—albeit unsatisfactorily—to remediate the underlying noncompliance. On this second point, *North*,[51] discussed above, is instructive. There, the SEC upheld sanctions imposed on the CCO of Southridge Investment Group LLC ("Southridge") by FINRA for, among other things, failing to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws. The SEC found that Southbridge's procedures were inadequately designed because they did not identify "even the most basic parameters for reviewing electronic communications."[52] Notably, the SEC found this despite the CCO's attempt to amend the procedures at issue, which the SEC determined failed to remedy their existing deficiencies. The SEC sustained FINRA's imposition of a 30-

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[46] 31 U.S.C. § 5318(h).

[47] Nathan Layne & Brett Wolf, *Former MoneyGram Executive Settles Closely Watched U.S. Money Laundering Case*, REUTERS (May 4, 2017), https://www.reuters.com/article/us-moneygram-intl-moneylaundering-idUSKBN1802P3 (last visited Jan. 15, 2020) (quoting acting FinCEN Director Jamal El-Hindi as saying that the prosecution of Haider "strengthens the compliance profession by demonstrating that behavior like this is not tolerated within the ranks of compliance professionals").

[48] *Id.*

[49] FINRA AWC No. 2014043592001 (May 18, 2016).

[50] *See, e.g.*, *SFX Fin. Advisory Mgmt. Enter. Inc.*, Investment Advisers Act Release No. 4116 (finding that the CCO caused SFX's violations for failing to adopt and implement procedures reasonably designed to prevent the misappropriation of client assets and for failing to conduct an annual compliance review where the CCO would have learned of the wrongdoing if an annual compliance review was held).

[51] Exchange Act Release No. 84500.

[52] *Id.* at *7.

day suspension and a $10,000 fine. *North* is one of a number of recent enforcement actions charging CCOs for failure to establish "reasonable" procedures because the procedures in question lacked the detail and specificity that regulators allege would have prevented or identified the firm's wrongdoing.[53] As discussed above, there is a serious risk of hindsight bias when evaluating whether procedures were "reasonable" only after a violation has occurred.[54]

Even if adequate procedures are in place, compliance officers may be charged individually if regulators conclude that violations occurred due to a failure to follow or enforce such procedures. In these cases, too, drawing a line between a compliance officer who made a mistake in good faith and those instances in which a compliance officer's failure to carry out policies rose beyond the level of simple negligence is quite difficult, and the risk of hindsight bias is particularly acute.[55]

### *Regulatory Decisions Not to Charge Compliance Officers*

Not all compliance failures result in personal liability for compliance officers. Examining enforcement actions in which no individual charges were brought against compliance officers helps shed light on what actions compliance officers should take to decrease the potential for individual liability.[56] Consider the twin enforcement actions *Mark A. Elste*,[57] and *Pennant Management, Inc.*,[58] for example. There, the SEC concluded that investment adviser Pennant Management failed to establish policies and procedures regarding initial and ongoing counterparty due diligence and monitoring, which caused investor losses. The Pennant and Elste orders explained that Pennant's CCO highlighted counterparty risks and that, despite repeated requests of the CCO, Pennant failed to provide adequate resources to its compliance

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[53] *See, e.g.*, Foothill Securities, Inc., FINRA AWC No. 20120306704 (Dec. 30, 2014) (finding that the existing procedure was inadequate because it "failed to specify the details of . . . what the CCO's correspondence reviews would entail and how the reviews would be evidenced"); Sbarra, FINRA AWC No. 2011028722202 (Jan. 20, 2016) (finding that the firm's existing procedure for detecting insider trading was inadequate because it failed to include "a provision for listing issuers with whom the Firm had entered into investment banking agreements" on the "Restricted List" as well).

[54] *See, e.g.*, Howard Bernstein, FINRA AWC No. 2013034982602 (Apr. 5, 2016) (finding that Bernstein's AML compliance program was not only inadequate, but that it essentially did not exist because the firm's practice was to not review any trades after a customer's identification was established at the start of their client relationship).

[55] *See, e.g.*, Jerard Basmagy, Exchange Act Release No. 83252 (May 16, 2018), https://www.sec.gov/litigation/admin/2018/34-83252.pdf (last visited Jan. 15, 2020) (finding the CCO and AML officer willfully aided and abetted and caused the firm's securities violations because he failed to file Suspicious Activity Reports or act when confronted with activity that was suspicious under the firm's AML policies); *Windsor Street Capital, L.P.*, Exchange Act Release No. 80908 (finding the same).

[56] Additionally, even orders imposing liability may provide insight into when the SEC or other regulators may exercise discretion. *See Thaddeus J. North*, Exchange Act Release No. 84500, at *11 (enumerating instances in which SEC refrained from pursuing individual liability).

[57] Investment Advisers Act Release No. 5062.

[58] Investment Advisers Act Release No. 5061.

program and cut $80,000 from its budget earmarked to hire additional compliance personnel. The SEC's recitation of the CCO's efforts to address problems in Pennant's compliance program appear intended to guide CCOs that they may avoid personal liability if regulators conclude that they carried out even a flawed program to the best of their abilities and attempted to correct these flaws—even if they were not successful in convincing their firms to dedicate needed resources to compliance.[59] *Pekin Singer Strauss Asset Management Inc., et al.*,[60] presents similar facts. Although the SEC concluded that Pekin Singer failed to conduct annual compliance reviews for two years, the SEC did not take action against the CCO; the order notes that the entire compliance team consisted of the CCO and a part-time former CCO, that the CCO was not given adequate staff, and the CCO was specifically directed to spend only 10–20% of his time on compliance matters.

*Pennant* and *Pekin Singer Strauss* are relatively rare examples of a regulator providing an explanation of why regulatory discretion was exercised in deciding *not* to hold compliance officers liable for their firm's compliance failures. The compliance community would certainly benefit from additional regulatory guidance directing compliance officers on how they may make the best of a bad situation and attempt to address compliance failures without increasing the risk of personal liability for good faith performance of their duties.

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Orders resulting from settled enforcement actions, even if they do convey enforcement priorities, do not always provide clear or consistent standards for the regulated community to follow. The actions described above affirm regulatory focus on compliance personnel and a willingness to hold individuals responsible for institutional compliance failures. While certain factors, such as resource concerns and internal efforts to mitigate compliance failures, may reduce the risk of personal liability, these regulatory actions suggest less predictable standards that give rise to individual liability.

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[59] *See id.; see also* Cantor Fitzgerald & Co., et al., *Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No. 2012034964301* (Dec. 21, 2015), https://www.crowell.com/files/20151214-FINRA-Letter-of-Acceptance-Cantor-Fitzgerald-Co.pdf (last visited Jan. 15, 2020) (refraining from holding compliance officers liable where compliance staff notified the firm's Executive Managing Director about the increasing number of regulatory inquiries and subpoenas relating to certain clients where the Managing Director, in response, failed to adequately inquire into whether the firm was adequately supervising the new business line, continued to suggest methods of expanding the business line, and personally guaranteed against liability); Bennett, *supra* note 26 (proclaiming that the compliance officers in *Cantor Fitzgerald* were not charged because they made several attempts to raise concerns regarding the suspicious activity and inadequate supervisory systems, as well as the fact that the managers pushed for expanding business in the face of the compliance staff's objections).

[60] Investment Advisers Act Release No. 4126 (Jun. 23, 2015), https://www.sec.gov/litigation/admin/2015/ia-4126.pdf (last visited Jan. 15, 2020).

## Part III: Recommendations

An effective compliance community depends upon adequate guidance from regulators to compliance officers regarding how to carry out their duties in order to enhance compliance and reduce their risk of personal liability. These concerns will be most acute in exactly those situations where engaged compliance officers may be most needed—firms where the compliance function may be under-resourced or under significant pressure to bow to management.

In response, this Report offers several recommendations to financial regulators aimed at increasing the dialogue between them and compliance officers. In making these recommendations, we are not advocating for any fundamental legislative or regulatory changes. Instead, with the understanding that the compliance officer title does not serve as a shield to insulate wrongdoers from the exercise of enforcement discretion, we propose these recommendations to strengthen existing regulatory tools and practices to better empower compliance officers and, in turn, strengthen compliance. We believe that successful implementation of even a few of these modest changes will meaningfully reduce some of the uncertainty that shrouds compliance officer liability.

### *Recommendation 1: Formal Guidance on Exercise of Enforcement Discretion*

Formal guidance from financial regulators outlining the principles that will be used to determine whether to pursue regulatory action, individually or personally, against compliance officers will both further regulatory goals and grant compliance officers greater certainty that good faith conduct will not likely lead to personal liability. Such guidance would build upon existing informal guidance presented in public statements and individual enforcement actions but would also represent a step beyond these informal or case-by-case developments.

As an initial matter, formal guidance should explain the circumstances in which a compliance officer will be potentially subject to personal liability. In addition to guidance on what circumstances would potentially deserve enforcement proceedings, as noted above, regulators have made certain statements in settled enforcement cases regarding the reasons why they declined to institute proceedings against a compliance officer. We believe that articulating these factors in the formal guidance document advocated for here would be helpful.

A number of regulatory and enforcement agencies have issued formal policy statements guiding enforcement decisions. For example, the Principles of Federal Prosecution of Business Organizations in the Justice Manual, drafted and issued by the DOJ, lists specific factors considered by prosecutors when making prosecutorial decisions regarding companies.[61] The DOJ's FCPA Corporate Enforcement Policy,[62] Guidelines for Taking

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[61] U. S. DEP'T OF JUSTICE, JUSTICE MANUAL: PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS § 9-28.300.

[62] U. S. DEP'T OF JUSTICE, JUSTICE MANUAL: FCPA CORPORATE ENFORCEMENT POLICY § 9-47.120.

Disclosure, Cooperation, and Remediation Into Account In False Claims Act Matters,[63] and guidance on Evaluation of Corporate Compliance Programs [64] also instruct corporations and their employees about factors the DOJ uses when assessing charging decisions and appropriate sanctions. The DOJ's Evaluation of Corporate Compliance Programs, for example, is designed to "assist prosecutors in making informed decisions as to whether, and to what extent, the corporation's compliance program was effective at the time of the offense," which itself plays an important role in charging decisions.[65] The DOJ recently updated this guidance document which now focuses on three overarching questions that prosecutors should consider when evaluating compliance programs. Presumably, compliance officers can tailor their compliance programs to meet the DOJ's standards of effectiveness—thus helping the DOJ achieve its goal of encouraging corporations to implement effective compliance programs. In addition to serving as a helpful precedent for the kind of formal policy statement we recommend, principles expressed through the DOJ's guidance should also be relevant to financial regulators' evaluation of whether to bring an enforcement action against a compliance officer.

We believe that regulators focusing on the financial services industry have the ability to issue guidance on compliance officer liability and that there would be a great benefit to the compliance and greater financial services community in doing so. Below is suggested guidance.

First, as a general matter, we believe that compliance liability is not likely to achieve regulatory goals unless one (or more) of the following circumstances are present:

- ***Did the Compliance Officer Act Willfully or Recklessly?***

  The first circumstance in which individual liability may be appropriate for regulatory goals is where the compliance officer engaged in willful or reckless conduct.[66] In these circumstances, imposing individual liability is more likely to have a deterrent effect as conduct is more clearly in the control of the compliance officer and the risks of discouraging innocent and efficient conduct are potentially lower. By contrast, where only negligent conduct occurred, it is questionable

[63] U. S. DEP'T OF JUSTICE, JUSTICE MANUAL: GUIDELINES FOR TAKING DISCLOSURE, COOPERATION, AND REMEDIATION INTO ACCOUNT IN FALSE CLAIMS ACT MATTERS § 4-4.112.

[64] U. S. DEP'T OF JUSTICE, CRIMINAL DIVISION, EVALUATION OF CORPORATE COMPLIANCE PROGRAMS.

[65] *Id*.

[66] *See* Ceresney, *supra* note 6 (stating that liability will generally attach when a CCO is "affirmatively involved in misconduct that is unrelated to their compliance function," "engage[s] in efforts to obstruct or mislead the Commission staff," or "<u>exhibits a wholesale failure to carry out his or her responsibilities</u>") (emphasis added).

whether imposing individual liability achieves the intended regulatory goal.[67] These questions are all the more acute where individual liability is sought to be imposed for failures to prevent the intentional misconduct of another person.[68] In addition, as discussed below, regulators should calibrate their determination of recklessness in light of good faith efforts by the compliance officer to fulfill his or her duties as well the specific structural obstacles faced by the compliance officer at the institution in question.

- ***Did the Compliance Officer Fail to Use Good Faith Efforts to Fulfill Duties?***

A second and potentially related circumstance in which individual liability may be appropriate is where a compliance officer failed to undertake any good faith efforts to fulfill his compliance responsibilities. A complete failure to discharge responsibilities may border on the kinds of intentional misconduct described in the circumstance above.[69] By contrast, good faith efforts to achieve compliance should weigh against an enforcement action even if those efforts are ultimately unsuccessful.[70] We believe that evidence of significant, good faith efforts of engagement on the compliance matters at issue should militate against any finding that a compliance officer was reckless or engaged in a "wholesale failure" to fulfill duties, even if such efforts did not ultimately lead to the resolution of the issue to the satisfaction of a regulator. A determination that efforts were significant or in good faith could be demonstrated by, among other things, the absolute amount of time spent, the range of efforts across a long period of time, impact of such efforts on others at an institution, or the quality or quantity of the

[67] *See, e.g.*, Golumbic, *supra* note 9 (discussing the "fundamental policy question" of "whether enforcement actions against compliance officers will motivate them to greater vigilance or risk a demoralizing belief that even exercising their best judgment will not protect them from the risk of . . . enforcement action").

[68] In an August 2015 letter to then-Director Ceresney, the National Society of Compliance Professionals ("NSCP") highlighted that the risks inherent in a negligence-based liability regime, such as hindsight bias, are compounded by the fact that compliance officers typically do not directly supervise management or businesspeople. *See* Letter from Nat'l Society of Compliance Professionals, to Andrew Ceresney, Dir. of Enforcement, U.S. Sec. and Exch. Comm'n (August 18, 2015). In NSCP's view, unless "tempered by prosecutorial discretion," decisions to charge compliance officers for "causing" a violation "unduly places compliance officers in harm's way for real-time judgments of a type that they must routinely make." *Id*.

[69] *See Thaddeus J. North*, Exchange Act Release No. 84500 (SEC found compliance officer liable in his individual capacity where compliance officer engaged in attempts to amend deficient policies and procedures, but failed to remediate any of the deficiencies and, in fact, made them worse "in one respect" by leaving in boilerplate, bracketed draft language in the amended policy that read "ENTER PERCENTAGE OR OTHER DEFINABLE SAMPLE SIZE").

[70] *See, e.g., Pennant Management, Inc*., Investment Advisers Act Release No. 5061; *but see BlackRock Advisors*, Investment Advisers Act Release No. 4065 (SEC found compliance officer liable in his individual capacity despite engaging in a formal review of the alleged misconduct with the firm's Legal and Compliance Department because of the review's conclusion that the alleged misconduct was permissible).

product of such efforts in terms of, among other things, new processes, policies, and procedures.

- ***Did the Compliance Officer Fail to Carry Out Duties and Responsibilities Clearly Delineated by Relevant Law and Guidance?***

  Finally, a third circumstance in which individual liability may be appropriate is where the compliance officer's actions violated clearly established law or regulatory guidance.[71] Compliance officers interpreting laws or rules about which reasonable minds can differ—or laws or rules for which there exists no or little relevant guidance from regulators—should not face individual liability if their reasonable interpretation is seen as incorrect with the benefit of hindsight. To this end, we suggest that individual liability should not be used in enforcement actions or settlements intended to introduce a new rule or clarify interpretation of prior rules.

Second, we believe that regulators should consider the below as mitigating circumstances to any situation where they are considering bringing an action involving compliance officer liability, even those situations identified in the circumstances above.

- ***Whether Structural or Resource Challenges Have Hindered the Compliance Officer's Performance*:**

  Financial regulators should consider as a mitigating factor whether the compliance officer's performance was hindered by structural or resource challenges, such as whether the CCO's position in the organization is inferior to that of other similar control functions (e.g., Chief Information Officer, Chief Human Capital Officer, Chief Legal Officer); is directly involved with or provided the opportunity for input into material strategic and operational decisions; has sufficient authority to make decisions that could have prevented the alleged misconduct; and/or maintains adequate resources. Individual liability has limited deterrent effect if it is imposed on individuals who, for reasons of limited resources, limited decision-making authority, or other structural or circumstantial constraints, could not have prevented a compliance failure. As a result, one important consideration in the exercise of enforcement discretion should be if the compliance officer in question has

[71] *See* Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, Opening Remarks at the Compliance Outreach Program for Broker-Dealers (July 15, 2015), https://www.sec.gov/news/speech/opening-remarks-compliance-outreach-program-for-broker-dealers.html (last visited Jan. 15,2020) (noting that the SEC "do[es] not bring cases based on second guessing compliance officers' good faith judgment, but rather when their actions or inactions cross a clear line") (emphasis added).

sought additional resources to prevent or mitigate a compliance failure or asked other firm officers or employees with authority to take action. Such evidence of a good faith effort to carry out compliance responsibilities should weigh against individual liability.[72] And individual liability is not likely to properly deter misconduct if it is imposed on individuals who neither committed the misconduct in question nor were in any position to prevent it. If a compliance officer is overruled or handicapped by understaffing, imposing liability will not accomplish goals of deterrence but only serve to further discourage compliance officers from engaging with challenging situations or compliance problems.

- ***Whether the Compliance Officer at Issue Voluntarily Disclosed and Cooperated:***

  Financial regulators should consider whether the compliance officer detected or disclosed compliance failures as part of his or her firm's compliance program, cooperated with regulators, and/or assisted in remediating the relevant institution's procedures or conduct. Imposing individual liability on compliance officers is not likely to have the intended deterrent effect if it is imposed on compliance officers who work to proactively remediate compliance failures, including by disclosing such failures to regulators as appropriate. Accordingly, many regulatory and enforcement bodies—such as the DOJ—have expressly identified disclosure, cooperation, and remediation as relevant factors when evaluating prosecutorial decisions.[73] For the same reasons, compliance officers should be incentivized to promptly report, remediate, and, as appropriate, cooperate with regulators in the event of a compliance failure. Enforcement actions to date have largely credited remediation efforts in the context of an institution, not an individual compliance officer.

- ***Whether Effective Policies and Procedures Were in Place:***

  Financial regulators should consider whether a written policy or procedure concerning the alleged misconduct existed, and whether compliance with that policy or procedure was monitored regularly. Individual liability will not have

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[72] *See Mark A. Elste*, Investment Advisers Act Release No. 5062 (noting that despite the fact that the CCO highlighted compliance risks and made repeated requests for additional resources, the firm failed to provide sufficient resources to its compliance program and, in fact, cut $80,000 from its budget that had been earmarked to hire additional compliance personnel); *Pennant Management, Inc.*, Investment Advisers Act Release No. 5061.

[73] *See, e.g.*, FCPA CORPORATE ENFORCEMENT POLICY, *supra* note 62; GUIDELINES FOR TAKING DISCLOSURE, COOPERATION, AND REMEDIATION INTO ACCOUNT IN FALSE CLAIMS ACT MATTERS, *supra* note 63.

> the intended effect when imposed on compliance officers who reasonably carried out their duties. As a result, whether appropriate procedures existed, and whether compliance with those procedures was monitored, are highly relevant factors to be evaluated when attempting to distinguish between an unfortunate but good faith compliance failure, and a failure resulting from culpable conduct.[74] As indicated by previous statements from the SEC, policies need not be formalized or in a central document in order to be effective or evidence of good faith efforts.[75] Moreover, similar to the comment with regard to remediation, regulators should ensure that this factor is not used against a compliance officer by an institution to blame the compliance function for a business failure.

In sum, express guidance[76] from financial regulators regarding the circumstances in which enforcement actions are likely to be taken against an individual and the factors considered in the exercise of enforcement discretion would empower compliance officers internally and significantly improve compliance results. If compliance officers are so empowered, regulatory examinations might become shorter, non-routine inquiries may become less frequent, and regulators would save valuable resources—all while improving trust and transparency between regulators and the compliance industry. [77] This would be especially true with respect to guidance regarding the role that self-initiated investigations and remediation by compliance officer could play in enforcement discretion.[78] While published

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[74] Enforcement actions often consider whether a compliance officer engaged in regular performance and review of the policies and procedures in question. *See, e.g., SFX Fin. Advisory Mgmt. Enter. Inc.,* Advisers Act Release No. 4116 (failure to follow procedures that required review of client accounts weighed in favor of enforcement action where CCO did not review client accounts for four years, failing to detect or prevent significant misappropriation therefrom).

[75] The SEC has noted that "Rule 206(4)-7 does not require advisers to consolidate all compliance policies and procedures into a single document. Nor does it require advisers to memorialize every action that must be taken in order to remain in compliance with the Advisers Act. In some cases, it may be enough for the compliance policies and procedures to allocate responsibility within the organization for the timely performance of many obligations, such as the filing or updating of required forms." Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204, 68 Fed. Reg, 74714 (Dec. 24, 2003).

[76] While express formal guidance stands as the most persuasive, and accordingly, empowering, form of guidance, we encourage financial regulators to consider implementing this recommendation in both formal and informal contexts.

[77] *See, e.g.,* John. F.W. Rogers, Chairman, Sec. Indus. & Fin. Markets Assoc., Remarks as Prepared for SIFMA C&L Society Annual Seminar 2016 (Mar. 15, 2016) ("As an overarching point, there is seen by many to have been a shift away from constructive relationships. More specifically, in recent years, the overall tone of interactions between financial institutions and their regulators has drifted – away from concerted and cooperative, to something else. This shift – expressed by SIFMA constituents of all sizes – has manifested in myriad ways, from refusals to grant extensions to respond to specific information requests, to failures to entertain requests for relief when reviews or audits extend for many years or remain open indefinitely.").

[78] *Id.* ("A further concern being voiced is that there is little-to-no credit for self-initiated investigative and corrective behavior. Some see regulators and law enforcement as assigning less and less value to financial

enforcement settlements indicate that self-reporting and remedial efforts are factored into enforcement decisions, express guidance would further incentivize firms to undertake self-investigation and remediation and bolster efforts by compliance officers to ensure adequate resources and overall management buy-in for putting a firm's "house in order."[79]

### *Recommendation 2: Use Existing Regulatory Communications to Provide Additional Guidance*

Existing regulatory communications—such as risk alerts, enforcement actions and settlements, and reports of examination activities—can be developed to provide more detailed and specific guidance to compliance officers.

**Enforcement Actions:** Greater detail in settlement orders would help the regulated community translate such orders into effective compliance results.[80] Reported enforcement actions and settlements could provide additional detail regarding the reasons for which a compliance officer was subject to individual liability. Regulators could also include additional factual analysis of the role compliance played in enforcement actions in which compliance officers were *not* subject to individual liability. Knowing what regulators believe that compliance officers did correctly in the face of potential misconduct is critical information. In this regard, the SEC's recent *Pennant Management* and *Elste* orders provide helpful guidance to compliance officers regarding what to do when faced with risks of compliance failures and breakdowns. While we recognize the importance of negotiated settlement orders, and of balancing regulatory goals against the needs of any particular matter, including additional detail in settlement orders would provide compliance officers with essential information on appropriate conduct by compliance officers.

**Risk Alerts:** Publishing "risk alerts" or other information regarding regulatory observations and priorities is another tool that regulators can use to inform compliance officers.[81] The SEC's Office of Compliance Inspections and Examinations issues alerts approximately two

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institutions' efforts to unearth and remediate deficiencies – rather than crediting firms for conducting look-backs to address weaknesses or historical issues.").

[79] *Id.* ("Over time, a perceived zero tolerance environment can have unwanted effects on a firm's incentive to investigate aggressively, a willingness to come forward with issues they uncover, or to apply newly developed controls retroactively.").

[80] This recommendation is not limited strictly to settlement orders. Greater detail in other regulatory communications would similarly translate into effective compliance results. Take the recent NYDFS rejection of Bittrex's application for a license to engage in virtual currency business activity. *See* Letter from N.Y. State Dep't of Fin. Services to Bill Shihara (April 10, 2019). Part of the reasoning cited by NYDFS was the "lack of qualification or effectiveness of the compliance officer" and compliance program. *See id*. Where greater guidance is given ex-ante, companies will be better positioned to meet compliance requirements, making licensing and other administrative processes more efficient and effective.

[81] Marc Wyatt, Dir., Office of Compliance Inspections and Examinations, Keynote Address for National Society of Compliance Professionals 2016 National Conference (Oct. 17, 2016) (recognizing that "the information our examiners collect in the course of the exam is invaluable as it may empower compliance staff at a registrant, it may identify a new risk, or it may assist our efforts to inform policy").

to six times a year providing guidance on specific compliance issues frequently seen in examinations. Similarly, FINRA publishes regulatory notices that provide the financial industry with timely and in-depth information on a variety of important issues.[82] These issues range from new rule proposals to reminders for financial firms of their specific regulatory obligations. Similar alerts regarding the risks and vulnerabilities of compliance officers on an individual basis would provide the community with effective guidance on adjusting to evolving risks that advancing technology or changing business practices might bring to bear on our markets.

**Periodic Reporting of Examination and Enforcement Activity:** Regulators can also go beyond "risk alerts" in providing regulated entities with information regarding enforcement and examination activity. Regulators most often speak when something "goes wrong" and leads to an enforcement action. There are clear prudential reasons for not publishing the results of closed investigations—among other reasons, adverse inferences may be drawn from the fact that a firm or individual was the subject of an investigation, even if no enforcement action is pursued. But the fact that regulators do not formally address cases not brought, or investigations closed, often obscures regulators' views on what is "going right." One way to remedy this information deficit would be to publish, in an aggregate way, annual or other periodic reports that collect, in an anonymized fashion, instances where compliance issues arose but charges were not brought against individuals, and the factors considered in those situations.

Similarly, regulatory examination offices such as the SEC's Office of Compliance Inspections and Examinations (the "OCIE") could release additional periodic summary reports regarding their exam results specifically targeted to issues of compliance officer liability. Such reports could include summary information regarding the scope of examinations, responses to recommendations from prior periods, notable improvements, and summaries of essential findings. These proposed disclosures could be based on the Office of Credit Ratings' (the "OCR") annual release of exam results, or build on the OCIE's existing Risk Alerts and other reports summarizing exam findings.[83] The OCR's exam result publications include summaries of their essential findings as well as anonymized results of examinations relevant to these essential findings. In either case, such periodic reports would

[82] *See, e.g.*, *Regulatory Notice: Anti-Money Laundering (AML) Program* (2019), FIN. INDUS. REGULATORY AUTH., https://www.finra.org/sites/default/files/2019-05/Regulatory-Notice-19-18.pdf (last visited Jan. 15, 2020) (providing guidance to firms regarding suspicious activity monitoring and reporting obligations).

[83] Section 15E(p)(3)(B) of the Securities Exchange Act of 1934 requires the OCR to review credit rating agencies based on a list of topic areas. The report discusses at length the inadequacy of the rating organization's conduct and recommendations of the staff to remediate the deficiencies. While the small number of credit rating agencies lends them to easier review reporting compared to the thousands of financial firms, there should be a middle ground that can provide for more useful guidance through similar reporting of compliance program examination/investigation findings. For instance, regulators could choose five compliance examinees to report on their deficient conduct anonymously and make recommendations to remediate their actions. Currently, much of the information that would be useful guidance is confined to nonpublic correspondence, such as deficiency letters issued by financial regulators to target compliance programs.

provide essential information about best compliance practices and help translate prospective statements of regulatory policies and priorities into practical guidance.

**Speeches and Informal Guidance:** Senior regulatory personnel should also clarify the reasons for not bringing an enforcement action against CCOs or compliance personnel in their personal capacity through more informal channels, such as speeches.[84] Even though these communications are not "precedent," they may offer greater clarity and present a less costly way to articulate regulatory priorities and highlight good practices that the regulator would like to see adopted. In particular, regulators should consider substantive speeches that provide direct, if informal, guidance regarding the circumstances in which liability has been imposed or the considerations motivating enforcement decisions. Many speeches and other informal guidance address the multitude of potential conflicts or structural challenges facing compliance officers, but these speeches often, by design, do not offer policy prescriptions or guidance that would help direct compliance officers in these situations.

### *Recommendation 3: Create New Platforms for Informal Communication*

Compliance officers face an information gap when existing guidance does not cover a novel circumstance or close question. They can also face considerable uncertainty when well-intentioned regulations are cryptic and overly complex. These situations can be minimized—and the potential for inadvertent errors decreased—by establishing fora in which compliance officers and regulators can communicate and gain a preliminary understanding of each other's positions, views, and challenges. The LabCFTC program, in which the U.S. Commodity Futures Trading Commission (the "CFTC") established a "dedicated point of contact" for fintech innovators to communicate with the CFTC, is one potential model for such a forum.[85] The roundtables hosted by FINRA as well as the SEC's and FINRA's participation at NSCP roundtables and Regulatory Interchanges serve as other potential models.[86] At these roundtables, FINRA invites groups of firm participants to facilitate discussions on regulatory topics so that FINRA can develop features to address industry needs and challenges. Under a similar platform, firms and compliance officers could share with other regulators their prospective compliance procedures and policies for their firm's financial products and services in order to get tailored regulatory feedback on their obligations and the adequacy of their applicable compliance controls. Regulators would gain

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[84] *See* Ceresney, *supra* note 6 (noting that in the Pekin Singer enforcement action the SEC did not bring an enforcement action against a compliance officer who repeatedly requested additional resources and raised compliance issues with superiors); Bennett, *supra* note 6 (noting that an AML and compliance officer was not charged due to the fact that he "made numerous attempts to question the activity and inadequate supervisory systems" in place while the misconduct occurred).

[85] LabCFTC allows innovators in the FinTech space to engage with regulators far in advance of potential enforcement actions by emailing the CFTC or attending office hours. This program is directed towards early stage innovators that are implementing financial technologies in new activities, services, or entities that possibly fall under CFTC regulation or supervision.

[86] *See, e.g.*, *Be in the Know: CRD Events (2019)*, FIN. INDUS. REGULATORY AUTH., https://www.finra.org/registration-exams-ce/new-crd/events (last visited Jan. 15, 2020).

the forward-thinking insight necessary to proactively update and develop appropriate regulations as the industry evolves. Compliance professionals would gain a direct channel for obtaining regulatory feedback outside of enforcement actions, as well as assurance that regulators genuinely appreciate the risks and competing demands they face.

And it appears that regulators are becoming increasingly willing to listen to the compliance community. At the National Regulatory Services' Spring 2019 Compliance Conference, Peter Driscoll, the Director of the OCIE, announced that the OCIE is taking a step in the right direction by kicking off a pilot initiative to hold regional roundtables with CCOs in select locations.[87] Driscoll noted that the roundtables would aim to encourage productive dialogue with the compliance community and "search for ways to strengthen the role of the CCO, improve the culture of compliance, and deliver on the shared goal of investor protection." Fostering more informal communication would better harmonize the industry, a goal that is sought by compliance personnel and regulators alike. Overall, increasing the number of platforms that allow the compliance industry to communicate with regulators outside of examination and investigative contexts would promote trust and transparency between compliance officers and regulators.

### *Recommendation 4: Create Compliance Advisory Groups*

Finally, to promote a more effective partnership between the compliance industry and their regulators, advisory groups of key representatives from federal regulatory and enforcement agencies, compliance officers for financial institutions, and compliance professional associations should be convened. Those advisory groups could be charged with meeting periodically to discuss current and potential regulatory, examination, and enforcement efforts, and to publish guidance and recommendations to compliance officers and regulators reflecting the insight of both regulators and the regulated.[88]

## Conclusion

Compliance officers can function as effective gatekeepers only if they are given the information and tools necessary to carefully police the boundary between culpable and permissible conduct—and do so without bearing a disproportionate risk of liability for others' misconduct. It is our hope that the proposals outlined above will help regulators and the compliance community to strengthen their relationship and work cooperatively to achieve their shared goals of investor protection and fair and efficient markets.

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[87] *See* Peter Driscoll, Dir., Office of Compliance Inspections and Examinations, Speech at NRS Spring 2019 Compliance Conference (Apr. 29, 2019).

[88] As one example, the Bank Secrecy Act Advisory Group was established by the Secretary of the Treasury as required by the Annunzio-Wylie Anti-Money Laundering Act of 1992. *See* Annunzio-Wylie Anti-Money Laundering Act, Pub. L. No. 102-550, § 1564(a), 106 Stat. 4044, 4073 (1992).

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