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FAILURE TO SUPERVISE: AN INSIDE PERSPECTIVE

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This article will examine the variety of steps and actions that can and should be taken by a firms' Supervising Principal to assure that the proper degree of supervision of brokers is being performed.

Let's begin with a quick review of why it is that in so many circumstances, supervisory responsibilities are not fully being met.

A review of the typical field Supervisory Principal or Branch Manager compensation package reveals the true priorities of the firm and therefore how field supervisors are encouraged to spend their time and effort. There are two primary results for which Supervising Principals are rewarded; branch sales production and recruiting.

The firm culture may be so centered on these two primary activities as to include constant reinforcement through bulletins, e-mails, meetings, conference calls, quarterly campaigns, reward trips, added bonuses, and other incentives. The message to Supervising Principals in the field becomes quite clear. Spend as much time as possible to obtain these desired results and as little time as possible on other "distractions" (such as the proper supervision of brokers). In some company cultures' the high level of sales production by top producers may be so valued that Supervising Principals are encouraged to not "rock the boat" when it comes to thorough supervision of such highly valued producers..

In my 25 years of personal experience with supervisory responsibilities, I have received significant compensation, including bonuses, stock awards, luxurious trips, and other incentives for branch sales production and recruiting. During the same time period however, no compensation was received for such accomplishments as having surprise branch inspections by regulators conclude with the outcome of "no findings", or having a total lack of customer complaints within the branch, or for having developed and implemented systems to assure thorough supervision of brokers within the branch was occurring.

For a Supervising Principal to have a true dedication and commitment to fulfill his or her supervisory duties and responsibilities he or she must have the ability to resist all of the short-term incentives (as described above), challenge the company culture, and develop and implement local policies and procedures to assure that thorough supervision of brokers are in place and consistently executed. What assisted me in meeting this challenge was to view my role as having the ultimate responsibility to assure that any and all. transactions, trades, or recommendations by brokers within the branch were truly in the best interest of the client. It was also helpful for me to view my career as being long-term, and recognizing therefore that my most valuable of assets included reputation, integrity and an unblemished record. As one who truly valued the good and ethical work being performed by the majority of practitioners within the financial services industry, I have been honored to do my small part to protect the industry and community from the “bad apples” that would spoil the reputation of ethical practitioners.

What are the steps that a Supervising Principal can and should take to assure adherence to FINRA regulations, the highest of ethical standards, and Supervisory duties are being met?

It is my belief that it is most important for the Supervising Principal to develop and maintain a culture of absolute adherence to FINRA regulations, company compliance guidelines, and the highest of ethical standards. To accomplish this desired culture, the Supervising Principal must always be consistent in his or her dealings with brokers and in demonstrating such a mindset in all of the Principal’s behaviors, actions, and policies and procedures.

In many organizations the compliance requirements may be handled simply by following minimum guidelines such as the conducting of an annual compliance meeting. This “check the box” approach is in my view a mistake as it sends the message that compliance requirements are an inconvenient burden that must be met even though it distracts from sales productivity. An atmosphere and culture may develop in which compliance requirements are met by “going through the motions” for the sole purpose of being able to indicate that a compliance requirement has been satisfied.

The Supervising Principal who takes a long-term view recognizes that the preceding attitude and approach is a huge mistake that threatens the best interests of the company, the brokers and managers within the branch, and the investing public.

Steps that a Supervising Principal can take to foster an ethical and compliant culture include:

1) At every group or individual meeting in which specific investment products or recommendations are discussed, always include a discussion of the suitability and other compliance issues associated with the product. Supervising Principals who take this action will help his or her brokers learn and understand the importance of FINRA rule 2090 “Know your customer”, and FINRA rule 2111 “Suitability”. Regularly conducting discussions of this nature clearly help to foster a culture in which only suitable transactions are valued and accepted.

2) During group meetings, moderate discussions in which brokers will share why a specific product, transaction, or recommendation was in the best interest of the client as compared to other alternatives. Supervising Principals who take this action will be able to gauge the degree to which brokers under his or her supervision understand, practice, and comply with FINRA rule 2090 “know your customer”, and FINRA rule 2111 “Suitability”. Providing brokers an opportunity to exhibit their compliance with FINRA rules and their commitment to the highest of ethical standards will greatly enhance the compliance learning experience for all brokers within the branch, and help the Supervising Principal with his or her goal of fostering a culture in which compliance and high ethical standards are the norm.

3) Frequently review disciplinary actions and arbitration awards against brokers. Discuss the harm done to the broker and his or her family, the firm and the investor. Initiate discussion as to what should have been done differently.

4) When discussing various products to be marketed, always emphasize how and in what circumstances such products should be used for the benefit of the client. Care must be taken to not overemphasize the commissions or payout to the broker.

5) The Supervising Principal should monitor what is being discussed by brokers during individual sales appointments by joining brokers periodically on appointments with clients.

6) The Supervising Principal can select a sampling of trades and transactions received and call the client to discuss the transaction. Confirm suitability and financial information and make sure the client understands all aspects of the transaction including charges and expenses, illiquidity and risk. Supervising Principals that take this action will help to assure that several FINRA rules are being observed. FINRA rule 2090 “Know your customer” requires that “every member shall use reasonable diligence in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer…” FINRA rule 2111 “Suitability” requires that “a member or associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer….” The fact that the Supervising Principal is taking this action will be known by all brokers within the branch. Brokers are therefore likely to take extra care to assure that all “know your customer” detail on account applications are accurate and that all transactions are suitable for the customer.

7) The Supervising Principal should regularly attend public sales seminars and workshops conducted by brokers under his or her supervision. Supervising Principals that take this action will help to assure that brokers under his or her supervision are in compliance with applicable sections of FINRA rule 2210 “Communications with the public”.

8) The Supervising Principal can add the names of his or her brokers to “Google alerts” in order to be notified and stay informed of any new events or news stories in which the broker may be named.

9) The Supervising Principal must never “look the other way” when any compliance violation or breach of ethics may occur.

10) Care must be taken to make all hiring decisions not only upon anticipated productivity, but upon anticipated ethical conduct. Great care must be taken to safeguard the ethical and compliant culture once created. Since behaviors tend to be repeated, it is wise to prevent anyone with a poor ethical record to join the branch.

Supervising Principals can and should view their firm’s written compliance guidelines and FINRA rules and regulations as minimum standards. Above are just a sampling of steps that can be taken by the Supervising Principal to assure that supervisory responsibilities are being fulfilled.

When the Supervisor has been successful in fostering an ethical and compliant culture and is fully committed to his or her supervisory duties and responsibilities it is far less likely for incidents of broker misconduct to occur.

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