Gresham
Real-time Financial Certainty®

Regulatory Compliance Series
Data Integrity and Governance

for FINRA registered broker-dealers

Compliance Risk Concepts and Gresham Guide

March 2016

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This Gresham Guide is written in conjunction with Compliance Risk Concepts

CRC is a business-focused team of senior compliance executives providing top tier compliance risk management services to clients on an as-needed, project or part-time basis. We provide clients with the critical skills and expertise required to establish, maintain and enhance a balanced and effective compliance operational risk management program. We help organizations demonstrate a commitment to a strong risk management culture.

Find out more

Data Integrity and Governance

Regulatory scrutiny – what else is new?

Today, there is a new paradigm of regulatory expectations, creating increasingly daunting compliance and operational risk management challenges on FINRA registered broker-dealers. Many of these challenges are related to the governance and control environments specific to the data that is so heavily relied upon to ensure broker-dealers continue to meet the ever expanding list of ongoing regulatory and compliance requirements aimed at customer protection and market integrity.

More transactions equals more data

As transaction volumes have increased exponentially over the last several years, the amount of data being created and stored by broker-dealers has increased accordingly. To make matters more complicated, this data often exists and cuts across many platforms – some sophisticated, some not so much. These can include antiquated proprietary systems, third party vendor systems, spreadsheets, emails, word documents, etc.

*"**Order Audit Trail System (OATS)** data is integral to FINRA's automated market surveillance program to detect manipulative activity and other potential violations of FINRA rules and federal securities laws. It is critical that firms have the necessary systems and supervision in place to ensure compliance with their OATS and trade reporting obligations."*

Thomas Gira, Executive Vice President of FINRA Market Regulation

When you bifurcate – you exacerbate!

Since much of the information relied upon by compliance departments tends to exist in bifurcated and disparate systems and locations, the role of the Compliance Officer has become increasingly challenging and risky. While regulatory expectations dictate that firms have the appropriate compliance systems and controls in place, anyone who is acting in a broker-dealer Compliance Officer capacity understands this issue and invariably feels there is a "target on their back" due to the lack of consistency and availability of quality data to conduct efficient and meaningful oversight and reviews.

The amount of effort to research, investigate, monitor and report ongoing activities has become unduly burdensome and onerous on Compliance Departments. In many instances, it can take up to several weeks to gather required information to respond to a regulatory inquiry, create a management reports or complete an internal review. Since data can be coming from many different sources, it then becomes a greater burden to harmonize / normalize this information. Once this is done, Compliance Officers often find themselves in the position of having very little time to not only ensure the accuracy of the data but to provide the critical analysis that is required to assess any patterns or practices of behaviors warranting further review, escalation and mitigation.

Big Brother is watching - regulators to the rescue

FINRA understands that its members are dealing with data quality and governance issues.

FINRA recently released its **Regulatory and Examinations Priorities Letter for 2016**. This letter serves as an advance warning for broker-dealers as to what areas will be of primary concern and focus to FINRA in the coming year. As it relates to data quality and integrity, FINRA will be specifically focusing on the following areas:

1. Operational breakdowns specific to changes from legacy to new compliance systems
2. Technology governance and change management practices related to algorithm maintenance (including order-routing algorithms)
3. Back-office and vendor system changes
4. Lifecycle development and new system implementation
5. Data quality controls and reporting practices
6. Verification of the accuracy of data sources relied upon to conduct monitoring and surveillance

"FINRA's ability to conduct market surveillance and complex investigations is dependent on the accuracy of member firm blue sheet data. All introducing and clearing firms should take inventory of their processes for producing accurate trading data to ensure that they are in position to comply with blue sheet requests from regulators in a complete and timely manner."

Cameron Funkhouser, Executive Vice President and Head of FINRA's Office of Fraud Detection and Market Intelligence

The cost of compliance

Historically, firms were willing to forgo making strategic investments in their compliance programs. If you've been around long enough, you know there is only so much budget to go around each year.

Projects and initiatives that get funded first are the ones that will be revenue generating. As compliance is typically viewed as a cost center, it's always a difficult to build a business case and show a return on investment (ROI).

The old approach was – we will continue to operate as we always have and if we get fined, we will pay the traffic ticket; "It's the cost of doing business". Nothing could be further from the truth.

In today's environment, the cost of doing business can put you out of business! There are roughly 4,000 broker-dealers in the United States. Unfortunately, the majority are not Goldman Sachs and can't afford to take a hit in the form of a large fine and censure.

Broker-dealers need to read the writing on the wall and understand the inherent risk they undertake operating in a heavily regulated environment. Post 2008, there is substantial evidence in the form of regulatory fines and censures proving that compliance is not a cost center – rather a profit preservation center. In 2015 alone there were several fines and censures levied on broker-dealers large, medium and small specific to data integrity and data quality issues. With fines ranging from $5,000 - $3,000,000.

Broker-dealer fines all have common themes:

1. Inaccurate, incomplete and improperly formatted data
2. Surveillance systems that failed to generate alerts
3. Flawed automated systems to review transactional activity
4. Failure to report trades to FINRA and MSRB
5. Failure to provide accurate information to Federal and State regulators
6. Inadequate systems and controls in place to prevent and detect violations

FINRA is responsible for regulating every broker and brokerage firm doing business with the U.S. public

in 2015

1,512 disciplinary actions

$95.1 million in fines

$96.6 million in restitution to harmed investors

736  individuals were suspended

496  individuals were barred

25  firms were suspended

31  firms were barred

* finra.org statistics March 2016

Do we have your attention now?

While the fines and themes outlined should serve as a wake-up call for firms, FINRA offers very little in the way of practical guidance in terms of how firms should begin to thoughtfully and pragmatically deal with their data quality and data governance related issues and chip away at the stone.

Believe it or not – many compliance departments are still operating in manually intensive environments. While this tends to be thought of as a problem specific to small independent broker-dealers, it isn't. Large broker-dealers that exist within complex integrated financial services organizations also face these problems. While there may be instances where there is technology being leveraged, it is often antiquated and hasn't been optimized and supported in a manner that enables firms to keep pace with regulatory change and expectations.

The amount of manual work required to investigate data quality issues, conduct system tuning and clean out queues of "false positive" exception reports presents an abundance of risk for organizations. Once a firm has invested in a compliance technology solution, it is incumbent on the firm to deal with the output from the exception reports being generated. It is all too common that compliance departments generate reports with flagged transactions that in most instances yield little or no benefit to the organization. In most instances, this is due to the poor quality of the data feeding these systems. In many instances, the amount of resources deployed to conduct the required analysis, escalation and disposition of such "erroneous exceptions, disproportionately outweighs the resources deployed to provide high quality analytical guidance and advice to the businesses supported by Compliance Officers. This should be viewed as a key performance indicator (KPI) for broker-dealers – as the resources deployed to clear "false positive" transactions could be far better utilized to generate and yield greater value for organizations.

Kicking it old school?

As noted, many firms utilize spreadsheets and various other manual processes to conduct their ongoing compliance responsibilities. This manually intensive approach yields a significant amount of information that requires an abundance of time and attention to not only maintain, but to decipher into meaningful and useful data that enables firms to conduct meaningful surveillance, establish patterns and practices of problematic behaviors and ultimately produce quality management reporting. It's all too frequent that the information maintained in multiple formats isn't harmonized to easily establish a repeatable process. The truth is - Compliance Officers are spending most of their valuable time administering the program, with little or no time to really understand the quality or the accuracy of the information being culled together to evidence execution of their ongoing responsibilities.

Talk about personal liability!

How should we approach data integrity?

Quite often, when firms are asked about why certain processes exist – the answer that is uttered is – "That's the way we always did it". Given the regulatory shift as referenced in FINRA's 2016 Regulatory and Examination Priorities (discussed earlier), this type of response will surely not pass muster with the regulators– and will likely lead firms down a path they don't want to take! This is what is called low hanging regulatory fruit. Don't say you weren't warned!

Firms that are truly committed to understanding their data (and the quality of that data) must make a commitment to change the way they have historically approached their internal processes and be "agents of change" – forcing themselves out of their comfort zones – and the "status-quo".

Change is difficult - what's a firm to do?

It's one thing to understand the discrete challenges discussed. It's a completely different animal to create a long term strategic approach to deal with these issues in a meaningful, repeatable and efficient manner. Historically, there haven't been any cost effective, data agnostic solutions available that enable organizations relying on manual processes, technology solutions (or a combination of both) to cleanse and harmonize data and effectively ensure the quality of information being relied upon.

More regulatory bodies or new compliance technology systems will not necessarily solve these issues. With that said, is there a cost-effective solution that will enable broker-dealers to address data quality gaps and issues, even in the face of increasing transaction and data volumes?

FINRA reaffirms that there is little room in the industry for lax supervision and that it will not hesitate to order firms to review and correct substandard supervisory systems and controls, and pay restitution to affected customers."

Brad Bennett, FINRA Executive Vice President and Chief of Enforcement

Conclusion – better control is an investment in opportunity

For too long, firms have been afraid to invest in data risk management from a fear of what lies under the hood. But good data risk protection can be about augmentation, instead of wholesale replacement.

As we continue to understand and adapt to FINRA and SEC's regulations, the technology is available to help. When new regulations and guidance are announced such as FINRA's Priority Letter which has a heavy focus on data quality and governance, the availability of smarter, plug and play data handling platforms removes the need for wholesale process change. New legislation can be implemented quickly, while strategic controls can be introduced in a matter of days.

As a consequence, processes are safer, more robust, and better aligned with the speed of modern institution. The front office will always be more innovative, creating new products and services and solving customer challenges (before someone else does). Failure to implement a flexible control framework is a barrier to innovation. When new controls can be added as a simple change to an agile framework, the opportunities for banks are exponential.

How easy is it to control risk with your existing systems?

The most intuitive and agile data integrity platforms, like CTC from Gresham, shoulder the regulatory compliance burden.

With core regulation built into the platform, additional controls can be added quickly and efficiently at any time. Automated verification and validation of data remove the risk of human error (or unscrupulous behavior), while data can be aggregated and reported on at any time.

The result is a fully transparent integrity architecture, which assures compliance and removes internal risk.

Test the integrity of your data with CTC

Take a free demo of CTC using your live data and discover where the risks in your control systems currently lie. A no obligation session with our product experts to identify any data integrity gaps and opportunities to align and augment your existing processes.

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