

SECURITIES LAW ALERT

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FINRA Fines Firm \$1.2 Million For Email Review Failures

In late-November, FINRA announced an Acceptance, Waiver and Consent (“AWC”) with Metlife Securities Inc. and three affiliated broker-dealers imposing a fine of \$1.2 million for failing or neglecting to implement a supervisory system, including written procedures, designed to achieve compliance with the firm’s email correspondence review obligations. In assessing the fine, FINRA found especially significant that the failure to properly review email correspondence lead to the firm missing “clear indications” of representatives’ violations of the firm’s outside activities policies. In one case, the failure to properly review emails allowed a \$6 million fraud to go undetected for several years.

As the AWC indicates, for nearly a seven-year period, even though the firm’s written supervisory policies mandated the review of all incoming and outgoing securities-related email communications, that review required the representatives themselves to forward those emails to their supervisor for review. During this period, there was no system in place to directly monitor representatives’ email communications in order to determine whether they were, in fact, being forwarded for review. Further,

annual branch audits and spot checks of representatives’ computers did not reliably detect any deficiencies because of the limited scope of such reviews and, in the case of the spot-checks, limited electronic access to email archives.

Although the firm rolled out a system for the automated surveillance of electronic communications at the end of 2008, the prior system failed to detect significant, ongoing undisclosed outside business activity and fraud. The undisclosed outside business activity escaped detection even though that activity was reflected in over 100 separate emails. In one instance, the review system failed to detect a registered representative’s participation in numerous private securities transactions to raise money for a real estate development company he owned, controlled or had contracted with, and the misappropriation of nearly \$6 million from his customers in connection with those transactions.

While there have not been many disciplinary cases this year involving email-related allegations (a firm was fined \$350,000 for email retention issues in February 2009), this case serves as a reminder that strong systems and procedures to

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capture and review email correspondence (as well as other electronic and hard-copy communications) are of critical importance. Not only are such systems required by FINRA rules, but the failure to employ strong systems and procedures, and the failure to test those systems to ensure that bad actors cannot game the supervisory system, can result in significant customer harm and substantial sanctions.

As this AWC illustrates, undisclosed outside business activities, by their very nature, often are difficult to detect and a robust email review system is an essential tool for preventing such misconduct. And, although most firms' systems are far more advanced than the one described in the AWC, firms should continue to strive to make sure such systems are effective. ■

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