

B-Ds making sure their background check systems measure up

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Many small B-Ds will have to strengthen checks of registration applicants under an SEC-approved FINRA rule that goes into effect July 1. And though the rule only covers first-time applicants and transferees experts recommend checking everybody.

The rule aims to strengthen the requirement that B-Ds verify the accuracy and completeness of the information contained in Form U4 to register associated persons. The rule adoption followed press reports last year that exposed gaps in FINRA's central registration depository and in its BrokerCheck background-check tool for investors. The SRO expressed concern with high-risk and recidivist brokers, including firms due diligence on prospective hires, in its 2015 [exam priorities](#) letter.

"Firms are going to need to document their background checks better and be prepared to be examined on them," says **Buddy Doyle**, managing director, **Oyster Consulting LLC**, Glen Allen, Va. "They are saying as an employer you should have a basis you use to determine that everything on the U4 is accurate besides 'Joe is a good guy.'"

Instituting written procedures

The rule will require firms to institute written procedures that are reasonably designed to verify the information in an applicant's Form U4 no later than 30 calendar days after its filing with FINRA. Firms will be required to conduct a national search of "reasonably available public records," including both civil and criminal files, with an eye out for ones evidencing personal financial problems, such as unsatisfied judgments or liens, bankruptcy filings, and litigation outside FINRA arbitrations.

Doyle offers this process: employees should have to complete formal consent forms to permit credit and criminal history checks, and to verify education and previous employment.

"You should also have a process to routinely go back and check things for existing employees," he says. "Bankruptcies happen. People get arrested." Do not rely on the employee coming to you with that information, he said, adding testing is important to make sure the process stands up to an audit.

Involving HR

In most cases, HR departments, rather than registration personnel, should be doing the background investigations, Doyle says. There is no need to train HR people on how to file a U4, he added. But he said firms need to impress upon HR personnel to openly communicate their findings. "They need to make sure what HR knows the registration group knows," Doyle adds. "That requires some conversations with the HR folks who are inclined to not talk about problems with employees not directly involved in a matter."

"Most of the larger firms already do background investigations. The smaller firms do some investigation but not to the extent this new rule requires," says **Stephen Sussman**, president and CEO of **Regulatory Compliance**, a Londonderry, N.H.-based B-D and IA consulting firm.

"The key is documentation of what you have done. If you cannot verify something on the U4, you need to explain why," Sussman says. Some examples of possibly unverifiable disclosures he cites: details of a 30-year-old arrest when the applicant was in college or a mechanic's lien on a dwelling that was long-ago satisfied.

"Their feeling is, 'If you cannot manage your own finances, how good of a financial adviser could you be?'" Sussman says of the regulators' view of the background checks. "It is like the shoemaker who has holes in his shoes."

Playing catch-up

Some firms will undoubtedly be playing catch-up, says **Joel Beck**, a former NASD examiner and enforcement attorney, who is now in private law practice with **The Beck Law Firm** in Lawrenceville, Ga. They should be lining up vendors and planning and budgeting the time and resources to conduct the checks. "Not only do you have to do the check and verification but if something pops up you may have to investigate that further," he notes. "That will take more manpower. That may or may not delay the hiring and on-boarding process. It is not a one-shot deal."

Beck agrees that firms may do well to expand the checks to all employees. FINRA itself is aggressively conducting checks of its own, and has been disciplining brokers and firms for not surfacing pertinent information.

In December 2013, FINRA censured and fined **Deutsche Bank Securities** for allowing two non-registered employees, one working for an affiliate and the other for a B-D subsidiary, to transfer to the New York-based firm without fingerprinting or a background check. According to the [settlement](#), both individuals were subject to a statutory disqualification, one for a criminal conviction, and the other for failure to cooperate with an NYSE investigation into his termination from a FINRA regulated B-D for misappropriation of customer funds.

"I know some small and large firms that are running checks across the whole company. And I have gotten calls from brokers who know this is coming and are very concerned," Beck says. "FINRA is going to go ahead and do this. I don't think firms want to get caught flat-footed without the information regulators have."