

October 9, 2013

SEC Issues FAQs on Supervisory Liability of Broker-Dealer Compliance and Legal Personnel Under Section 15(B)(4) and 15(B)(6) of the Exchange Act

On September 30, 2013, the US Securities and Exchange Commission (SEC) Division of Trading and Markets issued Frequently Asked Questions (FAQs) in an effort to provide guidance regarding potential supervisory liability of broker-dealer compliance and legal personnel under Sections 15(b)(4) and 15(b)(6) of the Securities Exchange Act of 1934, as amended (referred to below as the “Exchange Act”).

The FAQs restate the SEC’s long-held view that compliance and legal personnel, including chief compliance officers, may be deemed supervisors of broker-dealer employees for purposes of Sections 15(b) of the Exchange Act where such individuals have “the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.” The FAQs advise the broker-dealer compliance and legal community that individuals will not be held to assume supervisory responsibility solely by virtue of their compliance or legal position and do not become supervisors solely because they: (1) provide advice or counsel concerning compliance or legal issues to business line personnel, or assist in the remediation of an issue; (2) participate in, provide advice to, or consult with a management committee or another committee; or (3) provide advice to, or consult with, senior management. Rather, the FAQs provide that the determination of whether compliance and legal officers are supervisors depends on “the facts and circumstances of a particular case.” The FAQs provide factors to consider when making this determination, including, among other things, whether a person has been given or assumed clear supervisory authority (through the broker-dealer’s policies and procedures or otherwise) and whether a person has the ability to hire, reward or punish the employee or otherwise has the authority to prevent the violation from continuing (*e.g.*, firing or demoting the employee).

Background

The issue of potential supervisory liability of broker-dealer compliance and legal personnel under Sections 15(b)(4) and 15(b)(6) of the Exchange Act has received significant attention over the past several years. The SEC issued the FAQs in the long wake of a much-publicized administrative proceeding, *In the Matter of Theodore W. Urban*, SEC Administrative Proceeding File 3-13655, Initial Decision Release No. 402 (September 8, 2010), dismissed by Exchange Act Release No. 66359 (January 26, 2012). In *Urban*, Chief Administrative Law Judge (ALJ) Brenda P. Murray issued a 57-page initial decision in September 2010 dismissing Section 15(b) failure to supervise claims against Theodore Urban, the former General Counsel of Ferris, Baker, Watts, Inc. (FBW), relating to Mr. Urban’s dealings regarding Stephen Glantz, a former FBW broker. ALJ Murray

For more information, please contact your Katten Muchin Rosenman LLP attorney, or any of the following members of the **Financial Services** and **Litigation and Dispute Resolution** practices.

David L. Goldberg
+1.212.940.6787
david.goldberg@kattenlaw.com

Janet M. Angstadt
+1.312.902.5494
janet.angstadt@kattenlaw.com

James D. Van De Graaff
+1.312.902.5227
james.vandegraaff@kattenlaw.com

found that: (1) Mr. Urban was one of Mr. Glantz’s “supervisors” under prevailing law, but (2) Mr. Urban was “honest and credible” and “performed his [supervisory] responsibilities in a cautious, objective, thorough, and reasonable manner,” warranting dismissal of claims that he failed to supervise Mr. Glantz in a reasonable manner. On appeal, the SEC was evenly divided (Luis Aguilar and Troy A. Paredes; the remaining three commissioners not participating) as to whether the SEC had established its allegations. Accordingly, the SEC dismissed the proceeding under Commission Rule of Practice 411(f) (“In the event a majority of participating Commissioners do not agree to a disposition on the merits, the initial decision shall be of no effect”).

Urban engendered significant concern in the broker-dealer compliance and legal community, notwithstanding the interim and ultimate dismissal of the proceeding, given the SEC’s avowed positions that: (1) Mr. Urban functioned as Mr. Glantz’s supervisor (even though Mr. Glantz was not in Mr. Urban’s “line” of supervisory responsibility and FBW management did not follow Mr. Urban’s recommendation that Mr. Glantz’s employment be terminated), and (2) the public interest warranted sanctions (even though ALJ Murray found that Mr. Urban performed his responsibilities “in a cautious, objective, thorough, and reasonable manner”).

The FAQs

In an introduction to the FAQs, the SEC takes pains to note that “[m]ost enforcement actions against individuals for failure to supervise have involved business line personnel” and that the SEC has brought failure to supervise actions against broker-dealer legal or compliance personnel “*only in limited circumstances* in which these individuals have been delegated, or have assumed, supervisory responsibility for particular activities or situations, and therefore have ‘the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue’” (emphasis added). The FAQs also note that compliance and legal personnel will not be held to assume supervisory responsibility solely by virtue of their compliance or legal position and do not become supervisors solely because they provide advice or counsel.

The FAQs pose numerous questions for consideration in the determination of whether legal and compliance personnel may properly be held to function as “supervisors.” Notably, one key question raised by the SEC is whether the personnel possessed “the ability to hire, reward or punish” the person whose conduct is in question. Many in the broker-dealer compliance and legal community have suggested that the ability to hire, reward or punish is the signal factor to be considered in defining who is a supervisor. Indeed, in a recent US Supreme Court decision, *Vance v. Ball State Univ.*, 133 S.Ct. 2434 (2013), Justice Samuel A. Alito, writing for a divided Court, held that in the Title VII context, an employee was a supervisor only if he or she was empowered by the employer to take tangible employment actions (*e.g.*, hiring, firing, promotion, reassignment) against the subject employee. The FAQs suggest that the SEC intends to take a broader view. In a footnote, the FAQs acknowledge *Vance* but purport to limit it to the Title VII context, stating that the opinion does not reflect “all of the factors that are relevant to establishing such [supervisory] responsibility under the Exchange Act.” The FAQs thus suggest that the SEC will continue to pursue failure-to-supervise claims against broker-dealer compliance and legal personnel, even absent a factual record demonstrating that such personnel had the requisite degree of responsibility and/or authority to take adverse personnel action against employees whose behavior is at issue. Written supervisory procedures that carefully delineate line-level supervisory responsibilities from traditional systemic legal and compliance oversight, surveillance and advice may help broker-dealer compliance and legal personnel to avoid failure to supervise liability.

Click [here](#) to read the Frequently Asked Questions.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

AUSTIN | CENTURY CITY | CHARLOTTE | CHICAGO | HOUSTON | IRVING | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SAN FRANCISCO BAY AREA | SHANGHAI | WASHINGTON, DC

Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2013 Katten Muchin Rosenman LLP. All rights reserved.

Circular 230 Disclosure: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997). London: Katten Muchin Rosenman UK LLP.