



The ABCs of WSPs

By: Ryan P. Smith¹

Most movie fans can quote some parts of the classic courtroom showdown between Tom Cruise's Lieutenant Kaffee and Jack Nicholson's Colonel Jessep in the 1992 movie [A Few Good Men](#) ("You want answers?" "I WANT THE TRUTH!" "YOU CAN'T HANDLE THE TRUTH!").

However, before this legendary showdown is an exchange between Kevin Bacon's Captain Ross, who is prosecuting Lt. Kaffee's clients for murder, and Noah Wyle's Corporal Barnes, concerning the defense's contention that they were ordered to give the "Code Red" that led to their colleague's death:

Capt. Ross: "Ah, we're in luck then. Standard Operating Procedures, Rifle Security Company, Guantanamo Bay, Cuba. Now, I assume we'll find the term code red and its definition in that book. Am I correct?"

Cpl. Barnes: "No, sir."

"No? Corporal Barnes, I'm a Marine. Is there no book, no manual or pamphlet, no set of orders or regulations that lets me know that, as a Marine, one of my duties is to perform code reds?"

"No, sir. No book, sir."

"No further questions."

Capt. Ross wanted the jury to believe that no Marine can take any action without following some sort of procedure. Of course, fans know how this turned out:

Lt. Kaffee: "Corporal, would you turn to the page in this book that says where the mess hall is, please?"

Barnes: "Well, Lt. Kaffee, that's not in the book, sir."

"You mean to say in all your time at Gitmo, you've never had a meal?"

"No, sir. Three squares a day, sir."

"I don't understand. How did you know where the mess hall was if it's not in this book?"

"Well, I guess I just followed the crowd at chow time, sir."

Strangely, this scene has particular relevance in the financial services community. [SEC Rule 206\(4\)-7\(a\)](#) requires registered investment advisers to implement written policies and procedures reasonably designed to prevent violation of the Investment Advisers Act of 1940 and related rules. Similarly, under [FINRA Rule 3110\(b\)\(1\)](#) broker-dealers must “establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.” But how? Should a firm follow Capt. Ross’ example or Lt. Kaffee’s view of the world when crafting its own procedures?

I think that Capt. Ross has it mostly right. Procedures are the backbone of any broker-dealer’s or registered investment adviser’s compliance program as, among other things, these articulate the firm’s expectations of its associates. I have reviewed a lot of procedures in my time as a lawyer, compliance officer and regulator. Some were very good; others were well-intended, but suffered in execution. From these, I have put together a few “ABCs” for writing effective compliance procedures.

A is for “Always”

Always have a firm’s procedures state what the firm does, and similarly, always have the firm actually do what its procedures state.

B means “Be . . . wary”

Be wary of adopting a regulatory interpretation as if it was a statute or rule. Rule interpretations, such those found on the [SEC’s Frequently Asked Questions page](#) or [FINRA’s Regulatory Notices](#), are just that – interpretations. While these are helpful to flesh out some of the grey areas of the law, interpretations can, and sometimes do, change. Moreover, these have not gone through the same rigor and scrutiny as rules. Interpretations are not the foundation upon which to build procedures.

C is for “Compliance”

Compliance is not solely responsible for every compliance-related obligation. I have seen too many procedures manuals in which the Chief Compliance Officer or the compliance department generally owns and/or conducts every single compliance function. Compliance with the applicable regulatory standards is the firm’s responsibility. As such, business must be the first line of defense and take responsibility for certain compliance functions. Compliance is the second.

D is for “Don’t”

Don’t make it difficult for associates to understand what is expected of them. Don’t bury policies and procedures concerning associates’ conduct in sections that no one would expect them to

read, such as those articulating the standards concerning compliance meetings. Clearly identify the firm’s standards and expectations for its associates. Better still, place those procedures in clearly-identified sections. It can be worse to have procedures that no one can find or follow than to have no procedures at all.

E stands for “Evaluate”

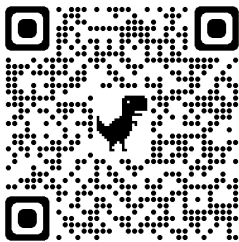
Evaluate your procedures frequently. As noted, I was once a regulator and conducted and supervised investigations of registrants. In doing so, I would invariably ask for a firm’s supervisory procedures. Procedures for outdated or repealed rules or statutes were clear signals to dig further.

F means “Forgo”

Forgo adopting lengthy procedures for business that a firm does not conduct. I realize that this has often been to respond to a regulator’s comments, but this practice adds bulk to a firm’s procedures, and worse, possible confusion for its associates. Instead, consider adopting a procedure that prohibits certain conduct until the firm adopts procedures to accommodate that new business.

From where I sit, writing procedures is part science and part art. Yet art is also based on certain principles and techniques. These “ABCs” (and “DEFs”) are a start.

Please contact me at www.ryanpsmith.com or 571.317.0605 if you have any questions or seek assistance with writing procedures – or any matter involving the SEC, FINRA or a state regulatory agency.



Because you want to spend more time serving your clients, not your regulators.

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