

# Information Barriers at Broker-Dealers

October 15, 2012

The SEC's staff has released a report<sup>[1]</sup> of its observations following an examination of 19 brokerage firms' programs to protect against the misuse of material nonpublic information (MNPI).<sup>[2]</sup> The reviews assessed each broker-dealer's information barriers for compliance with Section 15(g) of the Exchange Act<sup>[3]</sup> and evaluated how each firm integrated new business activities, structures and technologies into its compliance protocols. Below is a summary of some specific concerns and effective practices highlighted by the staff. For a more in-depth discussion of the staff's findings, please see the complete article on our [Broker-Dealer and Investment Management Regulation web page](#).

## Summary

### *Concerns*

- A significant amount of interaction between groups that have MNPI and internal and external groups that have sales and trading responsibilities occurred on an informal (undocumented) basis, making it difficult to trace inadvertent (or even intentional) disclosures.
- At some broker-dealers, senior executives, referred to as "above-the-wall," received MNPI without its documentation and with no monitoring or restrictions. Many of these senior executives had managerial responsibilities for sales and trading. The absence of any documentation or controls raises serious concerns about the ability of broker-dealers to guard adequately against misuse of MNPI in firm and customer trading.
- Formal and documented discussions may occur between internal business groups, in which MNPI is provided to sales, trading or research personnel for business purposes. In some cases, broker-dealers were not conducting any focused review of the trading that occurred after traders were provided with MNPI.

- The staff identified gaps in oversight coverage at most broker-dealers. Some broker-dealers did not review trading within accounts of institutional customers, assets management affiliates, or retail customers; or did not conduct any review when MNPI came through business activities outside of the investment banking department – such as participation in bankruptcy committees, employees serving on public company boards, changes in research ratings or company insiders placing unusual trades.

### *Effective Practices*

- Broker-dealers are developing processes that differentiate between types of MNPI based on the source (e.g., business unit) from which the information originated or the nature (e.g., transaction type) of the information. In some cases, firms are creating tailored exception reports taking into account the different characteristics of the information.
- Broker-dealers are expanding the scope of instruments they review for potential misuse of MNPI by traders, including: credit default swaps, equity or total return swaps, loans, components of pooled securities such as unit investment trusts and exchange traded funds, warrants and bond options.

[1] Staff Summary Report on Examinations of Information Barriers: Broker-Dealer Practices under Section 15(g) of the Securities Exchange Act of 1934 (Exchange Act) by the Staff of the Office of Compliance Inspections and Examinations of the United States Securities and Exchange Commission (SEC), September 27, 2012.

[2] Examinations were conducted by examiners from the SEC, FINRA and NYSE's Division of Market Regulation, all of whose observations were incorporated into the report. Six of the largest brokerage firms were examined by the SEC and an additional 13 firms were examined by the NYSE or FINRA.

[3] Originally enacted as Section 15(f) and renumbered by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 15(g) of the Exchange Act requires registered broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed, taking into account the nature of their business, to prevent the misuse of MNPI by the firm or its associated persons in violation of the Exchange Act.