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Regulatory: Surviving a regulatory inspection

Advance preparation for a regulator's arrival can mitigate the challenges a firm faces during the inspection itself

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One of in-house counsel's most challenging responsibilities can be surviving a regulatory inspection of the firm's regulated business activities. This article discusses several important principles to consider when preparing for a regulatory inspection, managing the inspection process and responding to findings from the inspection.

Preparing for a regulatory inspection

An inspection is inevitable for any regulated business. Counsel responsible for managing the inspection should use this inevitability to the firm's advantage by preparing for the inspection. This preparation takes two general forms:

1. Ongoing, daily preparation taken in advance of the inspection
2. Preparation specific to the inspection.

Prior to an inspection, counsel should monitor regulatory developments affecting the firm and amend the firm's policies, procedures and practices to address areas of focus by the regulator and its staff. The firm should also amend policies, procedures and practices to address changes in its businesses and in regulations affecting those businesses. Finally, counsel should confirm that the policies, procedures and practices adequately address any deficiency or weakness that the regulator's staff identified during prior inspections of the firm, as recidivism is often a primary factor leading to enforcement actions.

Once the firm receives a notice of inspection, counsel should assemble a team of personnel who will be responsible for gathering information

responsive to requests for information from the staff of the regulator. Counsel should forward a copy of the regulator's communication to the firm's outside counsel, and request that outside counsel be ready if needed. The firm should designate one individual, often counsel, who will be responsible for interacting with the regulatory staff during the inspection. That individual should oversee all production of documents for the inspection. If the regulatory staff will conduct interviews of firm personnel, counsel should prepare potential interviewees, advising them to be truthful and responsive to inquiries, but to avoid speculation in responding to questions. Counsel also should attend the interviews and record the matters discussed during the meetings.

Managing the regulatory inspection

Managing a successful regulatory inspection requires effective organization because prompt responses to regulatory requests for information evidence a firm's commitment to compliance. Effective organization addresses at least three activities:

1. Obtaining information necessary to respond to a specific request for information
2. Reviewing that information for responsiveness and privilege prior to its production
3. Retaining copies of the produced information

Counsel should review each request for information and delegate responsibility for the corresponding response to a member of the inspection team, setting a deadline for production of the response. Counsel or a designated team member should review each document or record to be produced and assess whether the document is responsive to the request for information, seeking clarification from the regulatory staff where the scope of the request is not adequately defined. Counsel or the designated team member should also assess whether the document contains privileged information, seeking assistance from outside counsel for such determination, if necessary, and creating a privilege log of any information for which the firm will seek privilege. Finally, counsel should ensure that the firm retains copies of all information it produced for the regulator and seek confidential treatment of such produced information to the extent the information contains confidential business information. Confidential treatment requests can prevent unintended dissemination of the information by a regulator.

Responding to findings from the regulatory inspection

Often, the regulatory staff will convey to the firm in an exit or other similar

interview its initial findings from the inspection. Counsel should take this opportunity to correct any misunderstandings of the staff. If the firm has corrected a potential deficiency or weakness identified during the inspection prior to inspection's conclusion, counsel should attempt to persuade the regulatory staff that it has adequately addressed the deficiency or weakness, thereby seeking to avoid a written deficiency or finding on the matter.

Once the firm receives written notice of regulatory findings, counsel should assess the findings, determining those with which the firm agrees and disagrees. Counsel should coordinate modifications to the firm's policies, procedures and practices promptly to address the findings with which the firm agrees, incorporating the modifications into the company's daily, ongoing procedures to the extent possible. Counsel should coordinate the preparation of a written response to the regulatory staff that describes the modifications.

Occasionally, the firm may disagree with a regulatory finding because the finding reflects a misunderstanding of the firm's business or policies or practices or the finding reflects the application of a legal principle to the firm with which the firm disagrees. Counsel should coordinate the preparation of the written response to the regulatory staff with respect to the finding, ensuring that the response presents the factual or legal basis for the firm's position. Contested findings often require further interaction with the regulatory staff to resolve the finding and the firm's response.

While preparing for and surviving a regulatory inspection can be one of the most challenging aspects of an in-house counsel's job, adequate preparation and organization can mitigate the challenges a firm faces once an inspection begins.

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