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RBC Paying $1M FINRA Settlement for Years of Junk Bond Oversight.

A brokerage firm accused of failing to track "junk bond" overconcentration in customer accounts for years has agreed to pay $1 million to settle with FINRA.

The regulator has sanctioned RBC Capital Markets, a New York-based broker-dealer with 2,400 registered representatives in its 275 branch offices, in a case involving potentially unsuitable concentration levels of high-yield bonds in customer accounts between July 2013 and June 2016.

During that period, RBC did not implement a supervisory system to comply with FINRA and Municipal Securities Rulemaking Board rules related to recommendations of high-yield corporate and municipal bonds, according to a letter of acceptance, waiver and consent from FINRA.

As a result, the firm failed to flag more than 100 customer accounts with conservative profiles for this kind of activity.

Additionally, FINRA officials said they have repeatedly reminded member firms of their sales practice obligations in connection with high-yield or "junk" bonds because of the increased risks. These bonds receive lower credit ratings, indicating a higher risk of default.

In settling the case without admitting or denying the charges, RBC agreed to a censure, $456,155 plus interest in restitution and a $550,000 fine. The case originated from a FINRA cycle examination of RBC.

According to the FINRA letter, RBC changed the tax coding of municipal bonds in its system in July 2013. This coding change inadvertently disabled alerts to identify potential concentration issues for further assessment.

RBC did not detect that the alerts were not working, in part, because the firm did not test its alerts during the relevant period, the FINRA letter alleges.

The defective alerts were discovered in September 2015, but the firm allegedly did not address the issue until July 2016. RBC is accused of failing to adopt alternate measures to identify potentially unsuitable concentrations in high-yield bonds and failing to tell supervisors that the alerts were not working as intended.

John Gebauer, president of the compliance firm National Regulatory Services, said this case highlights the importance of thoroughly testing written supervisory policies and procedures as part of the annual 3120 review.

"It appears that RBC thoughtfully designed a supervisory control system and implemented automated controls to ensure that the policies were followed," Gebauer said. "However, when firms implement a technology-based solution, that does not eliminate the need to regularly test the systems to be certain that they are operating as intended. Whether by bug or changing

requirements.

“This unquestioning deference to the results of technology is, unfortunately, an increasingly common occurrence.”

In a number of the impacted accounts, the holdings in high-yield bonds were more than six times the thresholds set by the firm, according to the FINRA letter.

“For example, Customer M, who was over 100 years old, was a trustee for two trust accounts, both of which had the most conservative investment objectives. By June 2015, 86% of one trust account and 100% of the second trust account consisted of high-yield municipal bonds,” said the FINRA letter.

The regulator then described another customer who was more than 70 years old and had a joint account with a conservative investment objective that, at times, consisted of as much as 92% in high-yield bonds.

Financial Planning has reached out to RBC Capital Markets for comment.

Financial Planning

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