

Sanction Guidelines

FINRA Revises the Sanction Guidelines

Effective Immediately

Executive Summary

This *Notice* advises FINRA firms of modifications to the *FINRA Sanction Guidelines*. The changes reflect the experience of FINRA's Departments of Market Regulation and Enforcement in settling and litigating cases, and incorporate the teachings of federal appellate court and SEC precedent in recent FINRA disciplinary cases. Specifically, the revisions:

- ▶ remove the Minor Rule Violation Plan Letter from the definition of a disciplinary "action" for purposes of considering prior actions and the provision that discusses respondents charging fines and costs to credit cards;
- ▶ modify the guidelines for violations related to the sale of unregistered securities to reflect that adjudicators should consider higher fines and firm suspensions in egregious cases;
- ▶ incorporate into the FINRA Rule 8210 guidelines relevant federal court and SEC precedent. The FINRA Rule 8210 guidelines also now delineate principal considerations for the three categories of violations. And for a partial but incomplete response to a FINRA Rule 8210 request, the guidelines now reflect parity with the fine for a failure to respond or respond truthfully;
- ▶ expressly provide for restitution or disgorgement in certain trading halt and best execution cases, and amend the suitability guidelines for use in cases where respondents have violated the "Recommendation Rule";
- ▶ add new guidelines for failing to comply with rule requirements related to customer confirmations and extended hours trading risk disclosure; and
- ▶ reflect the new FINRA rule numbers for rules that have been adopted into the consolidated FINRA rulebook.

The revised *Sanction Guidelines* are effective immediately and available on FINRA's website at www.finra.org/Industry/Enforcement/SanctionGuidelines.

February 2011

Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Legal
- ▶ Registered Representatives
- ▶ Senior Management

Key Topics

- ▶ FINRA Sanction Guidelines

Referenced Rules & Notices

- ▶ FINRA Rule 2010
- ▶ FINRA Rule 2114
- ▶ FINRA Rule 2265
- ▶ FINRA Rule 5260
- ▶ FINRA Rule 8210
- ▶ NASD Rule 2230
- ▶ NASD Rule 2310
- ▶ NASD Rule 2320
- ▶ SEA Rule 10b-10
- ▶ SEA Rule 19d-1
- ▶ Section 5 of the Securities Act of 1933

Questions concerning this *Notice* may be directed to:

- ▶ Emily Gordy, Department of Enforcement, at (202) 974-2916;
- ▶ Louise Corso, Department of Market Regulation, at (240) 386-5241; and
- ▶ Jennifer Brooks, Office of General Counsel, at (202) 728-8083.

Background & Discussion

The *FINRA Sanction Guidelines* are designed to address a wide variety of potential violations of FINRA's rules and provide fact-specific guidance for crafting appropriately remedial sanctions. FINRA's adjudicators rely on the guidelines to determine sanctions, and FINRA's Departments of Market Regulation and Enforcement and the defense bar rely on them when negotiating settlements in disciplinary matters. The National Adjudicatory Council approved these revisions, several of which are small adjustments designed to reflect the experience of FINRA's Departments of Market Regulation and Enforcement in settling and litigating disciplinary cases.

Revisions to Technical Matters

The revised *Sanction Guidelines* remove the Minor Rule Violation Plan Letter (MRVP) from the definition of an "action." MRVPs (that do not exceed \$2,500) are not "final disciplinary actions" as that term is defined in SEA Rule 19d-1 and therefore, FINRA is not obligated to file notice of the "action" with the Securities and Exchange Commission (SEC). Eliminating the MRVPs from the definition of an action is consistent with their being a nonreportable event. While MRVPs, Cautionary Action Letters and other informal actions are not "actions" as defined in the *Sanction Guidelines*, FINRA's Departments of Market Regulation and Enforcement retain the option of considering them in settlement discussions when negotiating an appropriate level of monetary sanction or when determining whether subsequent findings of violations should result in formal or informal action.

The revised *Sanction Guidelines* also remove the sentence that respondents may charge fines and costs to credit cards. Because FINRA seeks to minimize the credit card fees that it pays when it accepts payments via credit cards, going forward FINRA will be managing the payment method for fines and costs through its Billing Services Department. FINRA is not immediately changing its acceptance of credit card payments; it will communicate a new policy before it takes effect.

Revisions to Distributions of Securities Guidelines

FINRA amended the guidelines for sales of unregistered securities, which address the unlawful distributions of securities in violation of Section 5 of the Securities Act of 1933

and FINRA Rule 2010. The rules prohibiting the sale of unregistered securities are an important component of maintaining the integrity of the securities registration process. Broker-dealers perform an important gatekeeper role. When broker-dealers properly assume their regulatory responsibilities, they guard against the entry of unregistered securities into the markets and against market manipulations and pump-and-dump schemes. These schemes are often accompanied by unlawful distributions of unregistered securities. The revisions emphasize that adjudicators consider, in egregious cases, suspending a firm with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied and imposing a fine higher than the recommended range in the *Sanction Guidelines*. These revisions allow adjudicators to impose increased sanctions, in egregious situations, and reflect the importance of deterring market manipulations that are often accompanied by unregistered securities.

Revisions to Impeding Regulatory Investigations Guidelines

In order to harmonize the *Sanction Guidelines* with federal court and SEC precedent, and to clarify several aspects, FINRA amended the FINRA Rule 8210 guidelines. The revisions reflect that violations of FINRA Rule 8210 threaten FINRA's ability to ensure investor protection and market integrity and should, in appropriate cases, result in significant sanctions to protect the public from industry members who prevent FINRA from fully investigating their activities.

- ▶ The revisions delineate principal considerations for the three categories of violations under FINRA Rule 8210: failure to respond or to respond truthfully, providing a partial but incomplete response, and a failure to respond in a timely manner.
- ▶ The revisions incorporate the SEC's guidance that the importance of the information sought is from FINRA's perspective.¹
- ▶ The guidelines also clarify that a failure to respond completely is really a partial but incomplete response. Consistent with the existing sanction for a complete failure to respond, the revised guidelines state that if a respondent does not respond to an information request until after FINRA files a complaint in a matter, a bar should be the presumptive sanction.²
- ▶ Likewise, to emphasize the seriousness of failing to provide FINRA with complete information, the guidelines revise the high end of the fine range for a partial but incomplete response from \$25,000 to \$50,000 to reflect parity with the fine for a failure to respond or respond truthfully. The amendment further reflects this point by stating that a bar is recommended for a partial but incomplete response unless the person can demonstrate that the information provided substantially complied with all aspects of the information request.
- ▶ The revised guidelines also make clear that the lack of customer harm or benefit to a violator does not mitigate a FINRA Rule 8210 violation.³

Revisions to Quality of Markets Guidelines

The revised *Sanction Guidelines* expressly allow for restitution or disgorgement in cases where respondents have executed trades or published quotes or indications of interest during a trading halt in violation of FINRA Rules 2010 and 5260 and where respondents failed to comply with best execution requirements under FINRA Rule 2010 and NASD Rule 2320. Inclusion of these provisions aims to deprive respondents of monetary benefits from their misconduct when it resulted in quantifiable losses for customers.

Revisions to Sales Practices Guidelines

The revisions address the lack of guidelines for the “Recommendation Rule,” FINRA Rule 2114 (Recommendations to Customers in OTC Equity Securities, formerly NASD Rule 2315), by specifying that the suitability guidelines for violations of FINRA Rule 2010 and NASD Rule 2310 are appropriate for use in cases where respondents have violated the Recommendation Rule.

New Guidelines

The revisions create two new *Sanction Guidelines* for the failure to comply with SEA Rule 10b-10 and NASD Rule 2230 requirements related to customer confirmations, and FINRA Rule 2265 related to extended hours trading risk disclosure. The addition of these new guidelines sets forth violation-specific principal considerations and eliminates the need to use analogous guidelines. The extended hours trading risk disclosure guidelines are located in the Quality of Markets section of the *Sanction Guidelines*, and the customer confirmations guidelines are in the Financial and Operational Practices section.

Revisions to Reflect FINRA Rule Numbers

The revised *Sanction Guidelines* refer to “FINRA” instead of “NASD,” where appropriate, and to the new FINRA rule numbers for rules that have been adopted into the new consolidated FINRA rulebook.

Endnotes

- 1 *See PAZ Sec., Inc.*, Exchange Act Rel. No. 57656, 2008 SEC LEXIS 820, at *21 (Apr. 11, 2008) (“We emphasize that the importance of the information requested must be viewed from NASD’s perspective at the time it seeks information.”), *aff’d*, 566 F.3d 1172 (D.C. Cir. 2009).
- 2 *See Joseph Ricupero*, Exchange Act Rel. No. 62891, 2010 SEC LEXIS 2988, at *12 (Sept. 10, 2010) (“Ricupero’s failure to respond until after NASD filed a complaint constitutes a complete failure to respond . . .”).
- 3 *See PAZ Sec.*, 566 F.3d at 1175 (“We hold the Commission did not abuse its discretion in determining the lack of direct harm or benefit does not mitigate a complete failure to respond in violation of Procedural Rule 8210.”).