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The Year in Review: 2015 FINRA Enforcement Actions

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Over the past several years, the Financial Industry Regulatory Authority ("FINRA"), the self-regulatory organization responsible for regulating every brokerage firm and broker doing business with the U.S. public, brought between 1,300 and 1,600 disciplinary actions each year. In 2014, the most recent year for which full-year statistics are available, it ordered $134 million in fines and $32.2 million in restitution. During the same period, it barred or suspended nearly 1,200 individuals, and expelled or suspended 23 firms. It also referred over 700 fraud cases to other federal or state agencies for potential prosecution. FINRA orders also often trigger automatic "statutory disqualifications" under Section 3(a)(39) of the Securities Exchange Act and Article III, Section 4 of FINRA's By-Laws. Absent relief, these disqualifications prohibit persons from associating with a broker-dealer or prohibit firms from acting as broker-dealers.

We review below how the FINRA disciplinary process works, some of the results in litigated FINRA enforcement actions, and the most significant enforcement actions against broker-dealers in 2015. Most FINRA cases are resolved for less than $50,000. We focus principally on roughly two dozen enforcement actions that resulted in fines or restitution orders of $1 million or more, as well as eight enforcement actions that resulted in firms being expelled from FINRA membership. Thus, the cases we focus on are cases that FINRA treated as the most serious.

I. The FINRA Disciplinary Process

As is true with other enforcement agencies, most FINRA actions are filed as settled actions. The principal means by which FINRA settles formal enforcement actions is through a Letter of Acceptance, Waiver and Consent ("AWC"). An AWC sets forth the staff's central allegations and the relief to which the parties have agreed. It permits a respondent to settle without the filing of a complaint and without admitting or denying FINRA's findings.

Between January 1, 2015 and December 31, 2015, FINRA entered into 1,042 AWCs. During the same period, an additional 81 cases were settled after a complaint was filed but before the case was decided on the merits. Only 69 cases were decided through a contested hearing, and only 21 were decided on appeal to FINRA's National Adjudicatory Council ("NAC"). An even smaller number—13—were decided on appeal to the Securities and Exchange Commission, and only one was decided on appeal from the SEC to a U.S. Court of Appeals. In the aggregate, more than 90 percent of enforcement actions are resolved through settlements.

The results of FINRA disciplinary actions are public. Each month, FINRA issues a publicly-available collection of "Disciplinary and Other FINRA Actions," which identifies the respondents and summarizes the charges and relief. In addition, FINRA issues press releases on its more noteworthy enforcement actions. FINRA also provides access to a

searchable database of its enforcement actions on its website under the heading, "Disciplinary Actions Online." The database contains searchable copies of settlement documents, complaints and decisions. In addition, FINRA enforcement actions require disclosure on registered representatives' U4s (Uniform Application for Securities Industry Registration or Transfer) and U5s (Uniform Termination Notice for Securities Industry Registration) and a broker-dealer's Form BD and are available through BrokerCheck on FINRA's website.

If a matter is not settled, FINRA disciplinary proceedings are initiated by the Department of Enforcement or the Department of Market Regulation filing a complaint. A complaint is required to specify in reasonable detail the conduct alleged and the rules or statutes the respondents are alleged to have violated. There are over 70 distinct types of rule violations that FINRA charges, with the most common ones involving violations of rules related to anti-money laundering ("AML"), the distribution of securities, quality of markets, reporting and recordkeeping, sales practices, and supervision. FINRA's rule violation of choice is the breathtakingly vague Rule 2010, which requires that members observe "high standards of commercial honor and just and equitable principles of trade." Out of 1,042 AWCs in 2015, at least 962 referenced Rule 2010; out of 81 settlement offers accepted by hearing panels in 2015, at least 77 referenced Rule 2010; all 69 hearing panel decisions in 2015 referenced Rule 2010. In many of these cases, however, FINRA also relied on other more specific rule violations.

In addition to the underlying violations, FINRA routinely alleges that the supervisory procedures were inadequate—either because they were not tailored to prevent the specific misconduct that occurred or because they were not rigorously followed. Overwhelmingly, FINRA's predisposition is that if a violation occurred, there must have been a supervisory failure that contributed to it. The focus on supervisory procedures often puts chief compliance officers ("CCOs") in the hot seat in FINRA actions because FINRA often blames CCOs for not implementing or adequately enforcing procedures related to the underlying violations. In addition, FINRA often charges that firms failed to adequately follow up on signs of wrongdoing. In 2015, at least 45 AWCs, 25 hearing panel orders accepting settlements, and 11 hearing panel decisions on the merits referenced so-called "red flags." Of course, red flags often may not look red until after the misconduct has been uncovered. An entire body of literature exists documenting the bias of people with after-the-fact knowledge of outcomes to unconsciously exaggerate the prior predictability of those outcomes.[1]

Once a complaint is filed, respondents are entitled, subject to limited exceptions, to non-privileged documents prepared or obtained by FINRA staff in connection with the investigation that led to the proceeding. Indeed, one reason respondents sometimes settle only after a complaint is filed (rather than through an AWC) is so that they can obtain discovery from FINRA that will enable them better to evaluate the strength of FINRA's case. Respondents may also request that FINRA use Rule 8210 to compel the production of documents or testimony at the hearing from persons over whom FINRA has jurisdiction. Rule 8210 grants FINRA staff the right to require a member or persons associated with a member to provide information orally, in writing, or electronically and to testify at a location specified by FINRA staff.

[1] E.g., Erin M. Harley, *Hindsight Bias in Legal Decision Making*, 25 Soc. Cognition 48 (2007).

The Year in Review: 2015 FINRA Enforcement Actions

All persons named as respondents in a disciplinary proceeding have a right to a hearing. FINRA has 10 hearing officers, and one hearing officer chairs each hearing panel. The hearing officer is a FINRA employee, but is independent of the FINRA department initiating the proceeding. The hearing officer appoints two industry panelists, who are drawn primarily from a pool of current and former securities industry members from FINRA's District Committees, as well as from its Market Regulation Committee, former members of the NAC, and former FINRA Governors. The hearings are governed by FINRA's Code of Procedure.

Although far more often than not FINRA prevails in contested cases, each year there are many cases in which hearing panels dismiss all or substantially all of the charges lodged by the staff. In that sense, the FINRA hearing process appears to be more balanced than the SEC's administrative process, in which the SEC enforcement staff almost always prevails. Cases in 2015 in which the respondents prevailed in FINRA hearings include the following:

1. On October 2, 2015, a hearing panel dismissed all charges against a broker-dealer and CEO/CCO accused of making fraudulent or negligent misrepresentations or omissions in a private placement memorandum. The panel found that in light of the extensive disclosures in the offering materials, the offering materials' failure to include the disclosure that the staff alleged should have been included was immaterial. It also found that, contrary to the hearing panel's conclusions, the respondents had not acted with scienter or negligently.
2. On October 1, 2015, a hearing panel dismissed all charges that an individual had acted in a principal and supervisory capacity during a suspension period. Indeed, it granted respondent's motion for summary disposition on the ground that an earlier NAC decision precluded the charges brought by the staff.
3. On September 15, 2015, a hearing panel ruled against one of three respondents, but dismissed charges that a firm and the firm's CEO/CCO made unsuitable recommendations, distributed misleading sales literature, and failed to establish and maintain a reasonable system of supervision.
4. On August 13, 2015, a hearing panel sustained charges related to the suitability of certain variable annuities, but dismissed charges that) 13 specific variable annuity transactions were unsuitable, 2) 38 variable annuity applications were not forwarded to insurance companies prior to the completion of the required suitability review, 3) the firm lacked appropriate policies and procedures to address inappropriate exchanges, and 4) the firm failed to develop and document adequate training policies and procedures for principals who reviewed variable annuity transactions.
5. On August 7, 2015, a hearing panel dismissed charges that a trader in oil and gas stocks engaged in unlawful insider trading.
6. On June 29, 2015, a hearing panel dismissed charges that a firm's CEO engaged in insider trading.
7. On June 24, 2015, a hearing panel dismissed charges that a trader who made 18 purchases near the open or the close of the market had done so with a manipulative purpose.
8. On May 18, 2015, a hearing panel dismissed charges that a trader disclosed material nonpublic information and violated supervisory and compliance procedures on insider trading.

9. On May 4, 2015, a hearing panel dismissed charges that a broker opened accounts on behalf of eight customers and initiated trades in those accounts without their authorization, and that he created and maintained new account documentation that was false and inaccurate.

10. On March 17, 2015, a hearing panel sustained charges that a broker had failed to disclose two customer complaints on his Form U4, but dismissed charges that he fraudulently failed to disclose material information in connection with the sale of securities.

11. On March 10, 2015, a hearing panel dismissed charges that respondent had defrauded a bank by failing to disclose material information in connection with the re-collateralization of six collateralized mortgage obligations.

Either the respondent or the Department of Enforcement (or the Department of Market Regulation) may appeal a hearing panel decision to the NAC, and the NAC may, on its own, initiate a review of a decision. There are 14 members of the NAC, of which seven are industry representatives and seven are public representatives. NAC performs a de novo review of the entire record and may take new evidence. While the case is on appeal to the NAC, the sanctions are stayed. Unless the Board of Governors decides to review the NAC decision, which is exceedingly rare, that decision represents FINRA's final action.

The NAC may affirm, dismiss, modify, or reverse any hearing panel finding, or remand for further proceedings. In the vast majority of cases, it affirms the findings of violations. There are, however, exceptions. For example, in a July 28, 2015, decision, the NAC reversed a decision by a hearing panel holding that the respondent acted as the de facto financial and operations principal of a member firm without proper registration and that he caused the firm's books and records to be inaccurate. It found that the staff's evidence was inadequate.

The NAC may also affirm, increase or reduce any sanction, and it often does modify the sanction. For example, in a December 22, 2015, decision, the NAC upheld a finding that a broker exercised time and price discretion and made an unauthorized purchase, but reversed the suspensions imposed by the hearing panel. It stated that the violations were not egregious, that respondent understood his mistakes, that there was little danger of recidivism, and that the unauthorized trade resulted from a mistake or oversight rather than bad faith. It further stated, "Adjudicators should impose sanctions that are remedial and not punitive. Moreover, sanctions should protect the public, not penalize brokers…." On the other hand, there are many cases in which, on appeal, the NAC concludes that the conduct merits a greater sanction than that imposed by a hearing panel.

A firm or individual may appeal the NAC's decision to the SEC. The SEC exercises de novo review. The SEC is required to consider, among other factors, whether the sanction is "excessive or oppressive" and any aggravating or mitigating factors relevant to the determination of an appropriate sanction. Out of the 13 SEC decisions on appeals of FINRA actions in 2015, only one reversed any significant part of FINRA's findings of violations or sanctions. That brings into question whether the SEC's review is truly de novo or, in practice, deferential.

A respondent, but not FINRA, may appeal the SEC's decision to the United States Court of Appeals, which reviews the SEC's conclusions under an arbitrary, capricious, or abuse of discretion standard. Far less than 1 percent of FINRA cases end up being resolved by a court.

Oddly, FINRA has no authority to go to court to enforce its sanctions. Fiero v. FINRA, 660 F.3d 569 (2d Cir. 2011). As a result, firms and individuals that leave the industry may leave the industry without paying FINRA-ordered penalties and restitution. Only if they later seek to re-enter the industry does FINRA have the leverage to collect. In some cases, the fact that sanctions are not stayed while the litigation is pending coupled with the fact that FINRA has no ability to collect from those who leave the industry may cause respondents to litigate even when they have weak defenses. For those who will eventually be barred, litigation delays the day of reckoning without the risk that they will end up paying the penalties or restitution ordered by FINRA.

II. FINRA Sanction Guidelines

Unlike the SEC and many other enforcement agencies, FINRA has published detailed Sanction Guidelines. In May 2015, FINRA revised the guidelines to toughen the sanctions and to underscore FINRA's policy of imposing progressively escalating sanctions. It also indexed the sanctions to the Consumer Price Index starting from 1998. The Sanction Guidelines, including the index, are 112 pages long, and cover both "General Principles Applicable to All Sanctions Determinations" and principles applicable to over 70 distinct violations. The violations are divided into 11 distinct categories, such as sales practices, reporting, distribution of securities, impeding regulatory investigations, quality of markets, and supervision.

Several guidelines are based on the nature of the violation. These include whether the respondent engaged in numerous acts and/or a pattern of misconduct, whether the conduct occurred over an extended period of time, whether the conduct caused injury to investors and, if so, the extent of the injury, whether the conduct was the result of an intentional act, recklessness, or negligence, whether the firm relied on competent legal or accounting advice, whether the conduct resulted in the potential for monetary gain to the respondent, and the customer's level of sophistication. Others involve the firm's response to the conduct, including whether the firm reported the misconduct to a regulator prior to detection, whether the firm employed subsequent corrective measures prior to detection, whether the firm voluntarily and reasonably attempted to pay restitution prior to detection, whether the respondents cooperated fully with FINRA in its examination of the underlying conduct, and whether the firm disciplined the individual responsible for the misconduct prior to detection. Still others involve the respondent's relevant disciplinary history, and whether the respondent engaged in the misconduct despite prior warnings from FINRA or another regulator that the conduct was unlawful. Significantly, the guidelines provide that aggregation or "batching" of violations may be appropriate for purposes of determining sanctions—for example, if the violations resulted from a single systemic problem or cause that has been corrected. As a general matter, the greater the number of violations, the longer the period of which they occurred, the higher the level of culpability, and the greater the harm to customers, the more onerous the sanctions will be.

The Sanction Guidelines, while useful starting points, involve a wide range of sanctions for the same violation depending on the factors identified in the Sanction Guidelines. We list some examples below:

Best Execution Violations	$ 5,000 to $292,000
Excessive Trading	$ 5,000 to $110,000

Excessive Markups	$ 5,000 to $146,000
Failure to Supervise	$ 5,000 to $ 73,000
Fraud/Misrepresentation	$ 2,500 to $146,000
Late Filing of Forms U4/U5	$ 2,500 to $ 73,000
Late Reporting	$ 5,000 to $146,000
Net Capital Deficiencies	$ 1,000 to $ 73,000
Outside Business Activities	$ 2,500 to $ 73,000
Recordkeeping Violations	$ 1,000 to $146,000
Sale of Unregistered Securities	$ 2,500 to $ 73,000
Selling Away	$ 2,500 to $ 73,000
Unsuitable Recommendations	$ 2,500 to $110,000
Untimely Response to FINRA	$ 2,500 to $ 37,000
Untruthful Response to FINRA	$25,000 to $ 73,000

The difficulties posed by the wide range of sanctions for the same violation are compounded by the fact that the staff may characterize conduct as involving a single continuous violation or series of related violations meriting a single fine or, instead, may characterize the conduct as involving multiple violations justifying multiple fines.

In addition to fines, the Sanction Guidelines also address suspensions and bars. As noted above, where a firm is expelled or an individual is barred, the fines set forth in the Sanction Guidelines are not particularly meaningful because FINRA has no means of collecting them.

III. Fines/Restitution of $1 Million or More

In 2015, FINRA brought roughly two dozen cases in which it imposed fines or other monetary relief of $1 million or more. We start with the largest fines and restitution amounts of the year.

1. Failure to Provide Mutual Fund Fee Waivers: Multiple Cases Involving $55 Million in Restitution

On July 6, 2015, FINRA ordered three firms to pay more than $30 million in restitution to retirement accounts and charities because the mutual funds' prospectuses offered waivers of certain sales charges but the firms failed to provide these waivers. The restitution amounts ranged from $6.3 million to $15 million.The AWCs stated:

> Notwithstanding the availability of these waivers, the Firm failed to apply the waivers to mutual fund purchases made by Eligible Customers and instead sold to them Class A shares with front-end sales charges or Class B or Class C shares with back-end sales charges and higher ongoing fees and expenses. These sales disadvantaged Eligible Customers by causing such customers to pay higher fees than they were actually required to pay.

They further stated that the firms' supervision of sales charges was unreasonable because the firms "relied on [their] registered representatives to determine the applicability of sales

charge waivers, but failed to maintain adequate written policies or procedures to assist registered representatives in making this determination," including failing to compile applicable sales charge waivers in fund prospectuses for eligible customers.

While FINRA required restitution of more than $30 million, it did not impose additional fines. Instead, it credited the firms with self-reporting the violations, establishing a plan of remediation for customers who did not receive appropriate sales charge waivers, and taking corrective measures before detection or intervention by FINRA.

On October 27, 2015, FINRA ordered five firms to pay $18 million in restitution to charities and retirement accounts for conduct similar to the conduct that led to the $30 million in restitution orders discussed above. The restitution orders ranged from $150,000 to $13.5 million. In its press release, FINRA stated that collectively $55 million in restitution would be paid to more than 75,000 eligible retirement accounts and charitable organizations in which broker-dealers failed to provide sales charge waivers offered by mutual funds. It repeated that it was unreasonable for firms to rely on registered representatives to waive the charges without providing them with critical information and training.

2. *Excessive Leverage and Concentration in Puerto Rico Securities: $11 Million in Restitution and $7.5 Million in Fines*

On September 29, 2015, FINRA ordered a firm to pay close to $11 million in restitution and a $7.5 million fine because, for four years, it failed to adequately monitor the combination of leverage and concentration levels in customer accounts to ensure that the transactions were suitable given the customers' risk objectives and profiles. The charges involved retail investors in Puerto Rico, and the AWC acknowledged that retail customers in Puerto Rico typically maintained high levels of concentration in Puerto Rico assets because of the tax advantages these assets provide. The AWC stated, "Despite the Firm's knowledge of these common practices, the Firm failed to adequately monitor concentration and leverage levels to identify whether certain customers' [closed-end fund] transactions were suitable in light of the increased risk in their existing portfolio." FINRA's press release stated that the firm had also agreed to pay $15 million in disgorgement, interest, and penalties to settle related SEC charges.

3. *Unsuitable Mutual Fund Transactions: $10 Million in Restitution and $3.75 Million Fine*

On December 29, 2015, FINRA ordered a firm to pay more than $10 million in restitution and a $3.75 million fine based on unsuitable mutual fund transactions. The three principal charges were the following:

First, the firm engaged in 4,409 mutual fund transactions that were inconsistent with the customers' stated risk tolerance, investment objectives, or account holdings, or involved unsuitable short-term trading.

Second, the firm engaged in over 6,100 unsuitable mutual fund "switches," i.e., recommendations to switch mutual funds. FINRA's position is that switches are unsuitable if the purchased funds are equivalent to the redeemed funds or an alternative fund with no fees was available. The AWC stated that the firm's automated system generated 8,008 switch alerts during the period under review, but that the firm only sent 155 disclosure letters because it incorrectly excluded switch transactions unless they involved at least three

separate mutual fund transactions within a certain time frame. In addition, 91 percent of the disclosure letters did not disclose the costs associated with the switches. Of the total restitution ordered, $8.63 million was linked to unsuitable switches.

Third, the firm lacked a centralized system for aggregating mutual fund purchases to ensure customers received available mutual fund breakpoint discounts. For example, many mutual funds provide discounts based on the total amount invested in a particular mutual fund family by a customer or related customer accounts and allow customers to meet applicable breakpoints through rights of accumulation. Funds also offer breakpoints through letters of intent, which are statements of intent by investors to purchase a certain amount of mutual fund shares over a specified period (typically 13 months). The AWC stated that the firm's supervisory system was not reasonably designed to ensure that mutual fund purchases were properly aggregated so that customers were provided available discounts.

Although FINRA imposed a substantial fine, it recognized the firm's cooperation in investigating the switches prior to FINRA's detection, retaining an outside consultant to conduct mutual fund reviews extending beyond the staff's investigation, establishing plans to identify customers harmed by the conduct, and providing substantial assistance to FINRA in its investigation.

4. Failures Related to Complex Product Sales, Trade Surveillance, and Trade Confirmation Delivery: $10 Million Fine and $1.7 Million in Restitution

On May 6, 2015, FINRA fined a firm $10 million and ordered it to pay $1.7 million in restitution related to sales of certain complex products, including non-traditional exchange-traded funds ("ETFs"), variable annuity contracts, non-traded real estate investment trusts ("REITS"), as well as the failure to monitor and report trades and deliver to customers more than 14 million trade confirmations. In announcing the settlement, FINRA's chief of enforcement stated that the firm's supervisory breakdowns "resulted from a sustained failure to devote sufficient resources to compliance programs integral to numerous aspects of its business."

The AWC stated that the firm's rapid growth had not been accompanied by a concomitant dedication of sufficient resources to meet its supervisory obligations. It identified the following deficiencies:

a. With respect to ETFs, it failed to monitor the length of time the securities were held in customer accounts, permitted the breach of the firm's allocation limits, failed to deliver prospectuses to customers buying these securities, and permitted sales by certain representatives who had not taken the mandatory training on the risks of these products.

b. With respect to variable annuities, it stated that in some instances the firm had permitted sales without disclosing surrender fees.

c. With respect to mutual fund transactions, it stated that the firm used a faulty automated surveillance system that excluded certain mutual fund "switch" transactions from supervisory review, and that it failed to reasonably supervise sales of Class C mutual fund shares.

d. With respect to non-traded REITS, it stated that the firm failed to identify accounts eligible for volume sales charge discounts.

e. The firm's surveillance system had technical flaws that caused it to fail to generate alerts for certain high-risk activity, including low-priced equity transactions, actively-traded accounts, asset movements, and potential employee front-running.

f. The firm failed to deliver trade confirmations to customers investing in its advisory programs, which affected over 67,000 accounts and 14 million trades.

g. The firm failed to report certain trades to FINRA and the Municipal Securities Rulemaking Board.

h. The firm failed to verify the prior employment of approximately 1,782 representatives when they joined the firm.

i. The firm failed to make timely filings of Form U4 amendments and Forms U5.

j. The firm violated Rule 204 of Regulation SHO by failing to timely close out fail-to-deliver positions.

In addition to ordering restitution and a fine, FINRA required the firm to submit a written plan to review and improve supervision and to certify that its policies, systems, procedures and training were reasonably designed to address the conduct at issue in the AWC. FINRA noted that the firm had made a substantial commitment of additional resources, including the hiring of additional legal and compliance personnel.

5. Selling Unregistered Penny Stocks and Related Anti-Money Laundering Deficiencies: $6 Million Fine and $1.3 Million in Disgorgement

On December 21, 2015, FINRA fined a firm $6 million and ordered it to disgorge $1.3 million in commissions for selling 73.6 billion shares of microcap securities without conducting adequate due diligence. In addition, FINRA fined and suspended both the executive managing director of equity capital markets and an equity trader. In announcing the settlement, FINRA's Chief of Enforcement stated, "If a broker-dealer is looking to increase its revenues by expanding a high-risk business line, the firm and its supervisors must tailor their supervision to the risks associated with those businesses. This is especially true when the new business involves the mass liquidation of microcap securities, which presents overwhelming risks of fraud and investor harm. FINRA has no tolerance for firms and business executives who choose to engage in this business without robust systems designed to ensure that they do not become participants in illegal, unregistered distributions."

The AWC stated that the firm's supervisory system did not (a) contain adequate procedures requiring the firm to determine whether the shares sold were restricted or control securities; (b) provide adequate guidance on how to determine whether sales of restricted and control securities were exempt from registration; or (c) provide an adequate way for supervisors to identify red flags that might indicate unlawful distributions of unregistered securities. It also stated that the firm failed to establish and implement an AML program that was reasonably designed to detect and cause the reporting of potentially suspicious activity related to its microcap securities business, including the failure to train the staff on the red flags most commonly associated with suspicious microcap securities activity. While this was the largest

fine for penny stock and AML violations, FINRA brings a large number of smaller penny stock and AML cases each year.

6. Failure to Provide Sales Charge Discounts for Customers' Purchases of Unit Investment Trusts: $4 Million in Restitution and $2.6 Million in Fines by 12 Firms

On October 20, 2015, FINRA announced actions against 12 firms for failing to apply available sales charge discounts to customers' purchases of unit investment trusts ("UIT") and related supervisory failures. UIT sponsors often offer sales charge discounts to investors based on the dollar amount of the purchase or termination from one UIT to purchase another UIT. In announcing the settlements, FINRA's Chief of Enforcement stated, "Firms need to ensure that their registered representatives are providing customers the sales charge discounts to which they are entitled. The firms sanctioned today fail,ed to provide these discounts, resulting in customer harm in the form of higher costs for which customers have been or will be reimbursed." The AWCs stated that the firms' supervisory procedures relied primarily on registered representatives to identify and apply sales charge discounts, but the firms had no system to ensure that the registered representatives did so.

7. Supervisory Failures Related to the Sale of Puerto Rico Bonds: $4.3 Million in Restitution and $2 Million Fine

On October 13, 2015, FINRA ordered a firm to pay $4.3 million in restitution and a $2 million fine in connection with the firm's sale of Puerto Rico municipal bonds and Puerto Rico closed-end funds. In announcing the settlement, FINRA's Chief of Enforcement stated, "This is a strong reminder to firms that they must focus on customers' exposure to market risks and suitability, particularly in markets like Puerto Rico that present unique risks and challenges."

The AWC stated that Puerto Rico municipal bonds had historically been a preferred investment for Puerto Rico residents due to the fact that for Puerto Rico residents they are exempt from federal, state, local, and estate taxes. It stated that the firm failed to re-evaluate the risks of Puerto Rico municipal bonds for customers after the bonds were downgraded and the firm largely stopped purchasing Puerto Rico municipal bonds that its customers were seeking to sell. It also stated that while the firm had reports that identified concentration levels in customer accounts, it failed to set forth the steps for brokers or supervisors to take in using the reports to assess the impact of concentrated positions and that it lacked guidelines for registered representatives and supervisors concerning the appropriate use of margin, especially in light of customers' high concentration levels. The AWC also stated that the firm failed to enforce the requirement that employees obtain pre-approval before executing transactions for their own accounts, and that, during the period at issue, its employees were permitted to trade with their customers and that the firm had no mechanism in place to monitor these trades for potential conflicts of interest and ensure that required disclosures were made.

8. Inaccurate Blue Sheet Data: Two Cases with Fines of $2.95 Million and $1 Million

On December 23, 2015, FINRA fined a firm $2.95 million for failing to provide complete and accurate trade data in an automated format when requested by the SEC and FINRA.

Requests for such data, known as “blue sheets,” are used to assist regulators in investigations. In the last few years, the SEC has also imposed a number of multi-million-dollar fines on broker-dealers for blue sheet violations. In announcing the settlement, the Head of FINRA’s Office of Fraud Detection and Market Intelligence said, “FINRA’s ability to conduct market surveillance and complex investigations is dependent on the accuracy of member firm blue sheet data. All introducing and clearing firms should take inventory of their processes for producing accurate trading data to ensure that they are in a position to comply with blue sheet requests from regulators in a complete and timely manner.”

The AWC stated that the firm submitted at least 1,143 inaccurate blue sheets to the SEC that misreported at least 178,318 transactions, and submitted at least 600 inaccurate blue sheets to FINRA that misreported at least 160,971 transactions. The data reversed buy/sell codes on certain trade allocations, miscalculated the net amount of allocations, failed to report post-trade cancels and corrections, and failed to provide or provided incomplete customer information for certain transactions. In addition to imposing a fine, FINRA required the firm to review its policies, systems, and procedures relating to its compilation and submission of blue sheet data. FINRA noted that the firm had detected the violations, self-reported them to FINRA, initiated internal reviews upon discovery of the violations, and taken corrective steps.

On August 27, 2015, a hearing panel imposed a $1 million fine based on the firm’s submission of 816 incomplete or inaccurate blue sheets to the SEC and for failing to have in place an audit system providing for accountability in connection with blue sheet responses. The hearing panel also found that the violations were “willful,” and that because the violations were willful, the firm was subject to a statutory disqualification under Section 3(a)(39) of the Securities Exchange Act.[2] The hearing panel stated that the firm had no system for auditing the information entered into its blue sheet responses or any written supervisory procedures for supervising the submission of the firm’s blue sheets, that firm personnel did not take sufficient responsibility for the accuracy of the blue sheet responses, and that if it had spot-checked its submissions, it would have discovered many of the errors.

9. Failure to Supervise Registered Representative Who Stole Money from Customers and Excessively Traded Their Accounts: $2.5 Million Fine and $1.25 Million in Restitution

On March 26, 2015, FINRA fined a firm $2.5 million and ordered it to pay restitution of $1.25 million for failing to supervise a former registered rep, who stole money from his customers by convincing them to wire funds to entities that he owned or controlled, and for failing to prevent excessive trading in their accounts. In announcing the settlement, FINRA’s Chief of Enforcement said, “Firms must ensure that they implement supervisory systems that are reasonably designed to both identify and respond to red flags that may indicate broker misconduct.”

The AWC stated that the firm (a) failed to adequately investigate the broker prior to hiring him even though he was subject to 12 reportable events, including criminal charges and seven customer complaints; (b) failed to place him under heightened supervision even after learning that his business partners had sued him for defrauding them out of several million dollars; (c) took insufficient steps after it became aware that the registered representative

[2] The hearing panel held that “willfully” means intentionally committing the act that constitutes the violation, not intentionally committing the violation, and that it does not require either deliberate or reckless disregard of a regulatory requirement.

engaged in several outside business activities that he had not previously disclosed to the firm; (d) failed to identify 22 wires that were received into customer accounts by three bank accounts held in the name of entities with the same or virtually identical names as the registered representative's outside business activities; (e) failed to respond to "red flags" in correspondence and wire transfer requests demonstrating that the registered representative was wiring funds from customer accounts to entities he owned or controlled; and (f) failed to adequately supervise his trading of his customers' accounts despite the fact that the firm's surveillance analysts detected that he was trading at presumptively excessive levels. In addition, the AWC stated that the firm failed to timely make more than 300 required updates related to arbitrations and other legal matters on Forms U4 and U5. In addition to the fine and restitution, FINRA required the firm to retain an independent consultant to conduct a comprehensive review of the adequacy of the firm's supervisory systems and procedures and training relating to wire transfers, Form U4/U5 reporting, and excessive trading.

10. Inadequate Retention of Electronic Records, Including Emails: $2.6 Million Fine

On November 16, 2015, FINRA fined a firm $2.6 because, over a three-year period, the firm failed to retain a significant number of its business-related electronic records in a non-rewritable, non-erasable format known as Write-Once, Read-Many, or WORM. This included suspicious activity reports, written supervisory procedures, customer account statements, certain trade confirmations, customer identity verification records, customer tax forms, social media advertisements and communications, and third-party email communications. It also failed to retain over 160 million automatically generated notifications and mass marketing emails sent on its behalf by third parties. Finally, it failed to disclose to FINRA the settlement of nine customer complaints. FINRA noted the firm's cooperation in self-reporting the document retention and preservation issues, undertaking an internal review, and promptly taking remedial steps prior to FINRA's intervention.

11. Unsuitable Recommendations and Inadequate Disclosure in the Sale of Collateralized Mortgage Obligations: $1.6 Million in Restitution, $1 Million Fine and Individual Bars and Suspensions

On April 16, 2015, the NAC affirmed a hearing panel's findings of fraud and unsuitable recommendations involving the sale of inverse floating-rate and interest-only tranches of collateralized mortgage obligations ("CMOs"). CMOs are complex mortgage-backed securities in which multiple pools of mortgage securities or loans are structured with different "tranches" that each operate under its own set of rules for distributing the cash flows from the underlying mortgages. The NAC ordered $1.6 million in restitution and a $1 million fine and imposed bars and suspensions on individuals, including on the CCO. The decision merits attention because the sanctions were extreme despite the firm's contention that it disclosed the risks and that the customers understood and agreed to the risks.

According to the decision, the firm recommended that customers purchase high-risk CMOs, often on margin, without reasonably believing that the securities were suitable for those customers. The customers ranged in age from 59 to 92 and all were in or near retirement. The NAC found that the recommendations were inconsistent with the customers' conservative investment objectives and financial needs; that the concentration created the

risk of a significant, negative change in portfolio value in response to even moderate changes in interest rates; and that leverage through the use of margin increased the risk.

The NAC rejected a number of defenses that many firms might consider plausible. First, with regard to the defense that the customers were looking for greater interest income and that their account forms listed "aggressive income" as their primary investment objective, the NAC stated, "[A] customer's investment objectives constitute only one factor for a broker to consider when determining the suitability of an investment recommendation" and "a recommendation is not rendered suitable because the customer acquiesces in the recommendation." It stated that even if the registered representatives understood that their customers were interested in pursuing higher returns through riskier investments, "these facts did not justify recommendations that were clearly inconsistent with the customers' other investment objectives."

Second, with respect to the defense that the customers understood and accepted the risks of CMO trading, as reflected in various risk disclosures provided to the customers, the NAC stated, "A registered representative… does not satisfy his obligations… simply by disclosing the risks of an investment that he has recommended to his customer. 'Although it is important for a broker to educate clients about the risks associated with a particular recommendation, the suitability rule requires more from a broker than mere risk disclosure.'" The firm had an obligation to assess suitability "that was wholly independent of the customer's understanding of the transactions or desire to proceed with them."

Third, with respect to the argument that the firm should not be held responsible for an unpredictable and unprecedented interest rate environment during the review period and that the investments had performed well in the prior period, the NAC stated that securities professionals must "'make customers aware of the potential downside of an investment even if a decline in an investment's value is outside the salesperson's experience'" and that "'[t]he prior favorable performance of inverse floaters in no way lessened the associated risks.'"

Fourth, regarding the argument that the customers would have recovered their losses if they had held on to the investments after 2007 when interest rates dropped, the NAC stated, "'Suitability is determined at the time the recommendation is made; unsuitable recommendations do not become suitable if they later result in a profit.'"

With regard to the argument that the customers' testimony about their lack of financial sophistication and low risk tolerance was not credible, the NAC stated that, absent substantial evidence to the contrary, the hearing panel's credibility determinations are entitled to deference.

The NAC also affirmed a finding that the firm, acting through the persons who recommended the investments, engaged in fraud because they (a) they told them that their accounts were doing "fine" even when they knew the portfolios had declined substantially, (b) failed to disclose to customers that CMOs are high-risk securities that are only suitable for sophisticated customers, (c) failed to disclose the level of concentration in inverse floating rate securities, and (d) failed to disclose the substantial risks of margin trading. With regard to the defense that the firm provided ample written disclosures of these risks, the NAC stated, "As a general matter, both the Commission and we have concluded that a broker's written disclosures do not work to insulate him from disciplinary claims for fraud." It distinguished cases arising in private litigation on the ground that "[t]he reasonableness of an investor's reliance is not an element of a FINRA enforcement action for fraud."

The NAC also found that the firm, acting through the CCO, failed to comply with NASD Rule 2510 because the CCO did not review each discretionary order and did not review at frequent intervals all of the accounts. It stated that it was not enough that he conducted a random review of specific discretionary customer transactions, and on a monthly basis he reviewed a random sampling of customer accounts.

In addition to imposing a fine and restitution, the NAC barred the firm's CEO (who was involved in making the recommendations) and a registered representative from associating with a FINRA member, and barred the CCO from acting in a supervisory or principal capacity, and suspended him from acting in any capacity for two years. The NAC noted that at the time of the decision, none of the three individuals were associated with a FINRA member.

12. Failure to Comply with Large Options Positions Reporting Requirements: Two Cases Each With a $2.4 Million Fine

On March 19, 2015, FINRA and The Nasdaq Options Market fined a firm $2.4 million because it failed to report, or failed to accurately report, an unknown but significant number of positions required by the Large Options Positions Report ("LOPR"), which regulators use to identify holders of large options positions and analyze potential violations related to insider trading, position limits, exercise limits, front-running, capping and pegging, manipulation, and marking-the-close. The violations related, in part, to the firm's failure to aggregate positions for acting in concert. The AWC stated that FINRA had taken into consideration the remedial measures taken by the firm, the voluntary implementation of an extensive plan to conduct in-depth reviews of the firm's completeness and accuracy of its LOPR reporting, and the voluntary submission of reports to FINRA related to those reviews.

On October 6, 2015, FINRA fined another firm $2.4 million for failing to report and/or inaccurately reporting options positions to the LOPR. FINRA found that in approximately 14.9 million instances the firm had failed to report and/or reported inaccurately to LOPR. It also found that it effected opening transactions that exceeded position limits in 12 different securities. In addition to imposing a fine, FINRA required the firm to submit a written report to FINRA representing that the deficiencies had been addressed.

13. Net Capital Deficiencies: $2 Million Fine

On August 24, 2015, FINRA fined a firm $2 million because on three separate occasions it had net capital deficiencies. The net capital deficiencies ranged from $287 million to $775 million. The deficiencies arose because on each occasion the broker-dealer held cash as a result of customer funds received late in the day that it was unable to invest with its approved investment counterparties and, as a result, it transferred funds to its parent company for overnight investment. The Treasury group approved the transfer as an unsecured loan, but failed to communicate with the Regulatory Reporting group to consider the impact on the firm's net capital position. The loan resulted in a net capital deficiency. The firm identified and self-reported the net capital violations to FINRA and adopted remedial measures.

14. OATS and Trade Reporting Failures: $1.8 Million Fine

FINRA rules require firms to transmit all applicable order information to the Order Audit Trail Systems ("OATS") in a complete and accurate manner. In addition, firms are required to

provide accurate and complete trade reports to the appropriate FINRA Trade Reporting Facility. On July 27, 2015, FINRA fined a clearing firm $1.8 million because, during one review period, it failed to transmit 6.3 billion Reportable Order Events for its Alternative Trading System to OATS and transmitted 42.1 billion inaccurate and/or incomplete data elements to OATS. For another period, it transmitted 15 billion Reportable Order Events to OATS that failed to report order event timestamps in milliseconds even though the firm captured the events in milliseconds. FINRA also found that the firm submitted 38.6 million trade reports that failed to report execution timestamps in milliseconds. FINRA stated that in determining to resolve the matter, it gave significant weight to the fact that the firm self-reported to FINRA's Market Regulation staff that it had failed to submit a portion of its OATS reportable activity and that it took steps to remediate the issues and conducted a broader review of its OATS reporting. In addition to imposing a $1.8 million fine, FINRA required the firm to provide a representation that the firm has implemented procedures that are reasonably designed to achieve compliance with the rules and regulations cited in the AWC.

15. Fraud and Unsuitable Recommendations in Connection with a Private Placement Involving a Convicted Felon: $1 Million in Restitution, $500,000 Fine, and a Bar for the Broker-Dealer's President

On March 12, 2015, a FINRA hearing officer accepted an offer of settlement from a broker-dealer and the firm's president, who also was the principal at the firm responsible for creating written supervisory procedures related to due diligence for private placements. Under the terms of the offer of settlement, the firm was ordered to pay $1 million in restitution and a $500,000 fine, and the president of the firm was barred from association with any FINRA member in all capacities.

The hearing officer found that during the time the firm was soliciting customers to invest in a private placement, it learned that persons associated with that private placement had checkered histories—the CEO of the issuer had been convicted of a felony by the state of Florida and fined by the SEC for securities fraud, and the escrow company associated with the transaction was controlled by a person who also had been sanctioned by the SEC. Nevertheless, the firm continued to solicit investors and did not disclose the criminal or regulatory background. After the investments in the private placement, a court, at the SEC's request in connection with a separate fraud, froze all of the issuer's assets, including the investments by the broker-dealer's customers, and they were unable to access their funds. The hearing officer found that the due diligence was inadequate, that there were numerous red flags that were disregarded, and that the broker-dealer and its CEO had no reasonable basis for believing the investment was suitable for any customer.

16. Unsuitable Sales of Reverse Convertibles: $1 Million Fine and $433,898 in Restitution

On February 27, 2015, FINRA fined a broker-dealer $1 million and ordered it to pay $433,898 in restitution because of unsuitable sales of reverse convertibles, which are interest-bearing notes in which principal repayment is linked to the performance of a stock, or basket of stocks, or an index rather than the issuer of the note. The AWC stated that during the relevant period, the firm offered at least 3,000 different reverse convertible products to customers, and that at least 5,000 customers engaged in a total of more than 100,000 reverse convertible transactions. While the firm had suitability guidelines tailored to the sale

of reverse convertibles (for example, requiring $100,000 in annual income, $100,000 in liquid assets, $250,000 net worth, and two years of prior investment experience), the firm's surveillance system did not generate reports unique to reverse convertible transactions or that measured reverse convertible transactions against applicable requirements and guidelines. In addition, certain exceptions reports that were tailored to reverse convertible transactions were found to be inadequate because they were issued only on a quarterly basis and only after the transactions had been effected and because there were not written escalation procedures requiring notification and/or consultation with the firm's compliance department when potentially violative transactions were identified.

17. Short Interest Reporting: Two Cases With Fines of $2 Million and $1.4 Million

On May 13, 2015, FINRA fined a broker-dealer $2 million based on the results of four FINRA short interest reviews. For example, during one review period, the firm under-reported its short interest position by approximately 4 billion shares, or 6.8%, and also failed to report 1,000 short interest positions totaling 18.4 million shares because: a) certain short positions held for other broker-dealers were incorrectly coded and determined not to be reportable; b) certain proprietary accounts of foreign affiliates were incorrectly treated as non-reportable; c) short interest positions accumulated in connection with syndicate offerings were incorrectly reported; and d) sales of restricted stock were incorrectly reported. During a different review period, a coding error resulted in the firm reporting 492 short interest positions when it should have reported 69 short interest positions. Although FINRA imposed a $2 million fine and required an undertaking by the firm, it also stated that the firm had retained an independent consultant on three separate occasions to review its short interest reporting process, had addressed the issues identified by the consultants, had self-reported certain of the short interest reporting violations at issue, and had provided "extraordinary cooperation" to FINRA.

On October 13, 2015, FINRA fined a broker-dealer $1.4 million because, for a 10-year period, the firm included as part of its net positions in securities numerous securities positions of a non-US broker-dealer affiliate in violation of Rule 200(f) of Reg SHO, and, for an eight-year period, the firm reported certain short interest positions on a net, instead of a gross, basis in violation of FINRA Rule 4560. The firm had previously been fined $575,000 for other violations of Reg SHO. In addition to imposing a $1.4 million fine, FINRA required the firm to provide a representation that it has revised its written supervisory procedures to address the deficiencies described in the AWC.

18. Excessive Markups and Markdowns: $1 Million Fine and $333,083 in Disgorgement

On December 7, 2015, a hearing officer entered a default decision expelling a firm, fining it $1 million, and ordering it to disgorge $333,083 for charging excessive markups and markdowns on riskless principal transactions in corporate bonds. The markups deemed excessive ranged from 3.01 percent to 6.76 percent. The order stated that a FINRA investigation revealed that the firm charged substantially more (generally at least 33 percent more) than other brokers for the bonds in the same period and that there was no justification for higher markups and markdowns that the firm charged. In agreeing to an order expelling the firm, the order cited the intentionality of the misconduct, monetary loss to customers, failure to accept responsibility, and failure to implement supervisory procedures to prevent

further similar violations. While not cited as factors, the firm did not appear for the hearing and its FINRA membership had previously been terminated for failure to pay its registration fees.

19. Identification, Fingerprinting, and Screening of Non-Registered Associated Persons: $1.25 Million Fine

On December 16, 2015, FINRA fined a firm $1.25 million because over nearly a four-year period, the firm failed to conduct adequate background checks on approximately 4,500 of its 20,000 non-registed persons: 1,115 were not fingerprinted and another 240 were not fingerprinted until after they began work at the firm; and the firm failed to screen them for certain types of felony convictions and regulatory actions to determine whether they were subject to a statutory disqualification under Section 3(a)(39) of the Securities Exchange Act. FINRA also required the firm to certify that the firm has adopted policies and procedures reasonably designed to ensure compliance with the securities laws referenced in the AWC.

20. Failure to Prevent Theft Involving Eight Senior Citizens: $500,000 Fine and $530,000 in Restitution

On December 18, 2015, FINRA fined a firm $500,000 and ordered it to pay nearly $530,000 in restitution for failing to detect or prevent thefts from nine of its customers, including eight senior citizens. In that case, a registered representative who had been terminated at another broker-dealer falsely represented to former customers and others that she was now working at a new firm and used their personal information to open and control individual accounts at the new firm. Without their knowledge, she created more than 50 joint accounts with these individuals on which she and the customer were treated as co-owners. She then converted assets from a number of these accounts for her own personal benefit primarily by transferring funds from each victim's individual account to the joint account and then initiating electronic fund transfers to her individual account or to a bank account that she owned.

The AWC stated that all of the individual and joint accounts at the new firm shared one or more elements, such as a common email address, a common physical address, or a common phone number, and all of them listed the perpetrator as a beneficial owner. It stated that these were "red flags" to which the firm should have, but failed to, respond. It also stated that the firm overlooked red flags in telephone calls handled by its customer-service call center, in which the perpetrator impersonated customers to facilitate illicit fund transfers—for example, not becoming suspicious after she was unable to answer account-verification questions on file. The AWC stated that while the firm had a common-email alert to identify scenarios where an individual was associated with multiple unrelated accounts, it assigned only one person to review thousands of alerts and that the alert generated by the activity referenced in the AWC (which listed 35 different names associated with the perpetrator's email address) was not reviewed for more than a year after it was generated and was not followed up on until another institution had already detected the fraudulent scheme. In announcing the settlement, FINRA's Chief of Enforcement stated, "Protection of senior investors is a core mission for FINRA…. This case is a reminder to firms to ensure their supervisory systems and procedures are designed to protect senior investors from harm and to adequately follow-up on red flags to detect potential fraudulent account activity."

21. Publishing Inaccurate Index Information: $1 Million Fine

On November 19, 2015, FINRA fined a firm $1 million because over a 39-month period, it published the Pan Euro ABS Floating Rate Index with materially inaccurate coupon return information. The index consisted of 861 bonds with an aggregate market value of €279 billion. It was marketed as offering broad performance benchmarks for securitization market investors and as providing an accurate measurement of the credit and prepayment performance of the investment-grade European asset-backed securities market. The AWC stated that even after management determined that the coupon return information in the index was inaccurate and would necessitate a restatement of the index, it waited eight months before disclosing the inaccuracies to subscribers. FINRA acknowledged that the firm self-reported the issues to a European regulator, undertook a comprehensive internal review of its supervisory policies related to the issues, and cooperated fully with FINRA, including making persons in Europe available for interviews by FINRA staff.

IV. Firms Expelled

At least eight firms were expelled from FINRA membership in 2015:

As noted above, on December 7, 2015, a firm was expelled for charging excessive markups on riskless principal transactions in corporate bonds. The firm did not appear at the hearing, and its membership had previously been terminated for failure to pay its FINRA registration fee.

On October 6, 2015, a hearing panel accepted an offer of settlement in which the firm agreed to be expelled based on numerous findings of violations, including that one of the respondents caused the firm to serve as a bogus placement agent to conceal a kickback of a private placement fee, caused the firm to serve as a false sales agent so that a now expelled broker-dealer could charge commissions to both buyers and sellers in certain private sales of securities, falsified the firm's books and records to conceal a now-barred registered representative's sales of securities in states where he was not registered, and engaged in unauthorized and excessive trading in customer accounts.

On September 25, 2015, the NAC issued a decision in which it expelled a firm for engaging in securities fraud related to the sale of its parent company's securities and selling unregistered securities without the benefit of an exemption. The NAC stated that the firm had orchestrated, implemented and recruited others to participate in a "profound fraud," and that the fraud had caused $13.7 million in losses to 59 investors. It also stated that the firm had engaged in a "disturbing pattern of misconduct" even after FINRA warnings, that the firm had an extensive disciplinary history, and that the firm had been denied registration in both Utah and Alaska.

On May 8, 2015, the SEC affirmed the expulsion of a firm because it failed to respond to FINRA's Rule 8210 requests related to an investigation of, among other things, whether the firm had misused customer funds and whether certain promissory notes were suitable investments for customers and facts related to a registered rep's failure to report a tax lien on his Form U4. The SEC rejected the firm's defense that certain information and documents did not exist or were not in its possession, custody, or control, that other information had to be withheld from FINRA because it was confidential, and that other information was outside of FINRA's jurisdiction. In affirming the expulsion, the SEC agreed with FINRA that the firm's

disciplinary history "reflects a serial disregard of fundamental regulatory obligations, including requirements to keep accurate records…."

On March 30, 2015, a hearing panel issued a decision expelling a broker-dealer for misrepresenting and omitting material facts in a solicitation of investments in certain notes offerings by the broker-dealer. FINRA charged that the firm failed to inform investors of the broker-dealer's deteriorating financial condition and the poor performance of the guaranteed notes. The panel rejected the firm's reliance on counsel defense on the ground that the firm had not provided complete information to counsel and that the firm had not relied on counsel in deciding what to disclose or omit from the offering materials. The panel, however, rejected the staff's request for the entry of an order of restitution, stating that the staff had not shown that the conduct proximately caused the losses.

On March 9, 2015, a hearing panel expelled a firm for failing to supervise a registered rep's private securities transactions and failing to record the transactions on the firm's books and records. Although not mentioned as a basis for the decision, the firm was no longer a member of FINRA at the time of the decision. In justifying the sanctions, the hearing panel stated that the firm had ignored regulatory warnings, had failed to take responsibility for its misconduct, had a prior disciplinary history, and had engaged in the misconduct over a four-year period. It rejected the firm's reliance on counsel defense because, in light of FINRA guidance, the firm had not demonstrated the reliance on counsel was reasonable.

On January 20, 2015, a hearing panel expelled a firm for, among other things, knowingly or recklessly selling securities issued by the firm's parent company on the basis of false statements or omissions of material fact and for recommending the parent company's securities without a reasonable basis. In justifying the sanctions, the panel stated that the misconduct was intentional or at least extremely reckless, and that the parent company's securities were sold with knowledge that it was operating in a "Ponzi-like manner" using monies from new investments to pay dividends to existing investors.

On January 9, 2015, a hearing panel expelled a firm because it traded ahead of customer orders, failed to maintain accurate and complete books and records, provided false information to FINRA, and harassed and intimidated individuals associated with a member firm. In justifying the sanction, the hearing panel pointed to the firm's concealment or destruction of a number of unexecuted order tickets.

Conclusion

The above cases, which involved FINRA's most significant sanctions against firms in 2015, suggest that the following areas merit particular attention by FINRA members:

1. AML procedures
2. Background checks
3. Blue sheet responses
4. Breakpoints and fee waivers
5. Complex securities (e.g., CMOs, reverse convertibles, non-traditional ETFs)
6. Concentration of investments
7. Due diligence on private placements

8. Excessive markups and markdowns
9. Excessive trading
10. Failure to provide accurate and timely responses to FINRA requests
11. Failure to tailor supervisory procedures to unique markets (e.g., Puerto Rico closed-end funds)
12. Mutual fund switches
13. Net capital violations
14. Outside business activities
15. Penny stock sales
16. Private securities transactions
17. Procedures to prevent theft and conversion by registered representatives
18. Prospectus delivery, especially with regard to ETFs
19. Risk disclosures
20. Communication of inaccurate information
21. Red flags
22. Reg SHO
23. Retention of electronic communications
24. Sales of securities issued by affiliates
25. Trade and order reporting (OATS, LOPR, and TRACE)
26. Unsuitable recommendations, especially involving complex products, leverage, and/or unsophisticated investors

In the vast majority of these cases, FINRA charged not only underlying violations but failure-to-supervise violations as well.

Of course, most violations in these areas result in sanctions that are far lower than the sanctions imposed in the cases discussed above. Key factors that led to higher sanctions in many of the above cases include the number of transactions involved, the length of time over which the violations occurred, whether there was customer harm, and the firm's level of culpability. Given the size and complexity of their businesses, it is not surprising that the largest firms tend to be involved in the cases with the largest fines and restitution orders. For many firms, areas meriting the greatest focus include the failure to provide appropriate discounts on the sale of mutual funds, sales of various types of complex securities to unsophisticated investors, unique markets (e.g., Puerto Rico), delivery of prospectuses involving ETFs, penny stocks, coding errors that lead to systemic reporting errors, and inaccurate responses to regulatory requests. When things go wrong, factors identified by FINRA as leading to less onerous sanctions include self-reporting, prompt corrective steps, remediation, and cooperation. As the above cases demonstrate, however, monetary sanctions may be substantial even when some or all of these mitigating factors are present.

The Year in Review: 2015 FINRA Enforcement Actions

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