News and Publications

Reporting broker-dealer misconduct under FINRA Rule 4530

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On July 1, 2011, FINRA Rule 4530 became effective. Under this rule, member firms are required to electronically report to FINRA specified events and quarterly customer complaint information. The scope of Rule 4530 gave rise to a number of questions that FINRA has attempted to address in Notice to Members 11-32. In doing so, FINRA addressed the following categories of information that requires reporting: internal conclusions of violations; customer complaints; financial-related insurance litigation; and former associated persons.

One of the biggest areas of concern arising out of 4530 is the scope of the reporting obligations when a firm internally concludes that there was a rule violation. Notice to Members 11-32 makes clear that not all violations have to be reported, only "conduct that has widespread or potential widespread impact to the firm, its customers or the markets, or conduct that arises from a material failure of the firm's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts." This Notice to Members also addressed those instances where a firm must report because it "reasonably should have concluded" there was a rule violation. FINRA advised that it would apply a "reasonable person" standard to assess whether a violation should have been reported. FINRA further advised that nothing in this rule meant to thwart a member firm from taking remedial action against an associated person even if the member firm should not have reasonably concluded a violation occurred. Conversely, if a member firm does not take remedial action against an associated person, FINRA cautioned that would not necessarily mean that the member firm should

not have reasonably concluded that a violation occurred. Notwithstanding this guidance, an interpretative problem remains — a reasonable conclusion by one firm may not be the same as another.

Also of note in this Notice to Members is the section addressing customer complaints. FINRA addressed the question if text messages and tweets from a customer complaining about the member firm or its associated person gave rise to a reporting obligation under Rule 4530. The short answer was yes. For example, FINRA offered that a customer tweet complaining about the sale of unsuitable securities would require a report under the rule. FINRA's guidance is simply another effort to move compliance into the world of instant information.

Finally, FINRA addressed issues involving former associated persons. One question FINRA addressed was whether the hiring firm has a duty to report when it learns that the associated person is indicted on a misdemeanor charge involving the sale of stock while associated with the prior firm. FINRA also answered this question in the affirmative, further noting that the the prior firm should likewise report the indictment because it involved an associated person previously employed by that firm. FINRA also stated that, if a member firm concludes that an associated person engaged in a reportable violation after the associated person leaves the firm, the member firm must still report as long as it meets the thresholds in Rule 4530(b).

Notice to Members 11-32 provided useful guidance for how member firms can address some of the more prickly issues under Rule 4530. In the end, however, member firms must be certain that their compliance policies and procedures are in place and uniformly enforced to ultimately ensure compliance with Rule 4530, or be sanctioned for failure to timely report a reportable violation.

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