Client Alert

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FINRA's Revised Sanction Guidelines: Higher, Tougher, Fairer?

By Daniel Nathan

FINRA's newly revised Sanction Guidelines, effective immediately, signal that the upward trend in sanctions against broker-dealers is likely to continue.

The Sanction Guidelines, which establish the range of sanctions that FINRA may impose in formal disciplinary proceedings, affect several specific types of violations, as well as the principles behind levying sanctions and the overall levels of monetary sanctions. The Guidelines are also meant to catch up to the sanctions that FINRA actually is levying; as FINRA stated, in revising the guidelines, it is seeking to "harmonize the Sanction Guidelines with the current state of the cases in this area."

FINRA explained that the Sanction Guidelines are not meant to prescribe fixed sanctions for particular violations. Rather, the Guidelines are used by FINRA's adjudicators to determine appropriate sanctions and impose them consistently and fairly in disciplinary proceedings. FINRA's Departments of Enforcement and Market Regulation also consult the Sanction Guidelines to determine the appropriate level of sanctions to seek in settled and litigated cases.

INCREASED SANCTIONS FOR FRAUD AND SUITABILITY VIOLATIONS

FINRA amended the Sanction Guidelines to encourage individual bars and firm expulsions with respect to two of the most serious violations:

- The amended Guidelines indicate that violations involving fraud, misrepresentations, or material omissions of fact warrant the imposition of "strong sanctions," and adjudicators should consider barring individuals or expelling firms found to have engaged in intentional or reckless fraud.
- Reflecting FINRA's historic and recently increasing focus on the suitability of recommendations to customers—in particular with respect to sales of complex products—the amendments increase the non-monetary range of sanctions for violations of FINRA's suitability rule. For unsuitable recommendations by individuals, FINRA increased the time period for suspensions from one year to two years, and encouraged adjudicators to strongly consider barring individual respondents in the presence of aggravating factors. FINRA also encouraged adjudicators to consider suspending a firm with respect to a limited set of activities for up to 90 days and, in egregious cases, to "strongly consider" suspending a firm for any or all activities for longer than 90 days or ordering expulsion.

GENERAL PRINCIPLES—TOUGHER AND ESCALATING SANCTIONS

FINRA also revised the General Principles Applicable to all Sanction Guidelines to emphasize that FINRA's disciplinary sanctions should be more than a mere cost of doing business but rather serious enough to achieve deterrence. In addition, the revisions reinforce FINRA's longstanding position that sanctions in disciplinary cases should be more severe for recidivists, and adjudicators should impose progressively escalating sanctions on individuals and firms with an existing disciplinary history. FINRA noted, however, that pending, settled, and litigated arbitration proceedings, pending investigations, and ongoing regulatory proceedings prior to a final decision do not constitute disciplinary history.

RETROACTIVE INFLATION ADJUSTMENT

Observing that the range of potential sanctions had not increased since 1998, FINRA increased the high-end of the range consistent with the Consumer Price Index and retroactive to that year. It also established a procedure to repeat the process every three years. The amounts resulting from the current exercise will be rounded to increments of $1,000.

OUR TAKE

The credibility of FINRA's enforcement program depends on members believing that they are being treated fairly. That is, when violations are found following a hearing or agreed to in a settlement, the sanctions should be consistent with established precedent and with the treatment of other similar firms found to engage in similar violations. It has been observed of late that sanctions sought in litigated or settled cases do not always meet those criteria, and that the precedent cited by FINRA staff to support those fines does not always meet that standard of consistency.

If the revised Sanction Guidelines provide more predictability and a greater sense of fairness, they will benefit both the brokerage industry and FINRA's reputation as the industry's regulator. Notwithstanding the potential significant increases in sanctions resulting from these revisions, the focus on strong guidance and consistency is a good start.

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