

Pun-ishment by SEC and FINRA: Enforcement Actions in March 2021

By Brian Rubin and Andrea Gordon



About the Authors:

Brian Rubin is a Partner at [Eversheds Sutherland](#).
He can be reached at brianrubin@eversheds-sutherland.com.

Andrea Gordon is an Associate at [Eversheds Sutherland](#).
She can be reached at andragordon@eversheds-sutherland.com.

Puns are the highest form of literature.

— Alfred Hitchcock¹

*Of puns it has been said that those who most dislike them
are those who are least able to utter them.*

— Edgar Allan Poe²

*Hanging is too good for a man who makes puns;
he should be drawn and quoted.*

— Fred Allen³

When you think about it, puns are kind of like securities enforcement actions. They could make you groan; they could make you laugh (if the conduct is particularly goofy) (or if you don't like the respondent); or they often make you think—causing you to say, “Oh, I see,” (which, of course, is different from OCIE, the prior name of the SEC's Division of Examinations or DOE) (which is different from “doe a deer a female deer,” but we digress...). In this month's article, we try to connect puns and other plays on words with SEC and FINRA enforcement actions and initiatives. As regular readers of NSCP *Currents* know, in the past, we tried to connect enforcement issues with “pop” culture references.⁴ If we succeed here, this article may become our most pop-ular one yet.

SEC Overturns FINRA Disciplinary Action Regarding Calendar Entries

Calendars, and entries in them, are often very important in the securities business. We need to know about upcoming meetings, and sometimes we need to know what we discussed during meetings and calls. Given the importance of these issues, some might consider an enforcement case that discusses calendar entries to be *timely*. As such, let's visit some discussions about calendars and workdays:

- *I got fired from the calendar factory. Don't know why—
all I did was take a day off.*⁵
- *My boss asked me why I only get sick on workdays.
I said it must be my weekend immune system.*

On March 11, 2021, after eight years of litigation, the SEC overturned a FINRA disciplinary proceeding in which the respondent was a registered representative of a national broker-dealer/investment advisor.⁶ FINRA had charged him with unethical conduct for supplementing his customer contact notes (ACT! Notes) after a customer complained about investment recommendations. While the notes were truthful and the only printed version of them recorded the date they were “last edited,” the notes did not record the date each individual entry was modified or added due to a system glitch. FINRA also charged the representative with violating

1. Quote by Alfred Hitchcock: “Puns are the highest form of literature.” (goodreads.com).

2. <https://www.brainyquote.com/topics/puns-quotes>.

3. <https://www.brainyquote.com/topics/puns-quotes>.

4. See, e.g., “How You Doin’: Friends and SEC/FINRA Enforcement from February 2021,” *Currents* (March 2021); “Offers They Can't Refuse: SEC and FINRA Enforcement Settlements from January 2021,” *Currents* (February 2021); “‘Luke, I am your father.’ (Or not.) Collective False Memory and SEC and FINRA Enforcement Issues from November and December 2020,” *Currents* (January 2020); “Back to the Future, But SEC and FINRA Enforcement Issues from the Present (October 2020),” *Currents* (November 2020); “Not Dead Yet: Just Flesh Wounds, Suspensions, and Fines (SEC, CFTC and FINRA Enforcement Actions in September 2020),” *Currents* (October 2020); “The Show, er, um, Article About Nothing (other than SEC, CFTC, FINRA, and State Securities Enforcement Actions in August 2020),” *Currents* (September 2020); “Just When You Thought It Was Safe to Go Back in the Office (Or at Least Think About It): SEC and FINRA Examinations and Enforcement Actions in July 2020,” *Currents* (August 2020); “Curb Your Enforcementism: SEC and FINRA Enforcement Cases in June 2020,” *Currents* (July 2020); “Killing Eve (all others are fined or suspended): SEC and FINRA Enforcement Cases in May 2020,” *Currents* (June 2020); “The Last Dance (But not the Last Enforcement Action): SEC and FINRA Enforcement Actions in April 2020,” *Currents* (May 2020); “Tiger King: Murder, Mayhem and March 2020 Enforcement Matters,” *Currents* (May 2020)..

5. If the puns and wordplay that we cite show up on multiple websites, we will not footnote them; however, if they appear to be unique, we will.

6. <https://www.sec.gov/litigation/opinions/2021/34-91268.pdf>. Note that one of the authors of this article represented the respondent.

FINRA arbitration rules when he produced those notes, without additional explanation, in a subsequent arbitration brought by that customer.

After a FINRA hearing, the Office of Hearing Officers suspended the representative for three months and fined him \$50,000. He then appealed to FINRA's National Adjudicatory Council (NAC), which increased the suspension to one year. He then appealed to the SEC, which remanded to the NAC for clarification of its findings. The NAC again found liability, ordering the same sanctions. The SEC subsequently vindicated the representative, setting aside FINRA's findings on liability.

The case focused on whether the representative acted unethically. The SEC found that he did not. Among the facts highlighted by the SEC were the following:

- The representative modified his notes only after his firm told him that the transactions, which were the subject of the customer complaint, were suitable.
- The overwhelming majority of the modifications had nothing to do with the customer's complaint, and FINRA never alleged that any of the modifications were not truthful. Most of the notes were personal in nature or dealt with other securities.
- The notes were not relevant for the firm's suitability review, and the notes were not used in the subsequent customer arbitration.
- As noted, due to a "bad installation," which was not the representative's fault, each individual note did not indicate when the modification was made. However, a printed version of the notes did state that they were "edited on" a date after the customer complaint letter.
- FINRA did not allege that the representative violated books and records requirements applicable to broker-dealers.
- The representative waived his attorney-client privilege regarding the time period through the conclusion of the arbitration. The SEC noted that the representative "told his lawyer that he would not oppose a forensic examination of his computer" and that "undisputed" conduct "suggests a lack of unethical purpose in supplementing his notes."

Takeaways:

- First, firms may want to train their representatives and employees regarding the recording and modification of customer notes.
- Second, if firms or individuals use electronic recordkeeping systems for note-taking, they may want to review those systems periodically to see whether the systems are capturing all relevant data.
- Finally, although regulators rarely lose in litigation, this win highlights that it sometimes pays to push back against them.

SEC Commissioner Says that the SEC Will Review Regulation Best Interest (Reg BI) Performance

We try not to make fun of securities regulators (because we're not sure if they have good senses of humor). We do, however, know that they are very bright and thoughtful (and hold power over us and our clients). Therefore, before we discuss Reg BI, we will discuss non-securities regulators.

- *The state passed a new regulation that you can only have one dock at a boat landing.
Because if you had two it would be a paradox.⁷*

7. <https://punstoppable.com/regulate-puns>.

- *What do regulators do on work retreats?
Anti-trust falls.*⁸
- *Two regulators (to be clear, they were **not** securities regulators) were on a plane flying across the country to a conference. After flying for a little while, the pilot announced, “We have some bad news. One of the engines just failed, and as a result, we will be delayed by 30 minutes.”*

A bit later, the pilot said, “We have some more bad news. Another engine just failed, and we will be delayed an additional hour.” Shortly thereafter, the pilot said, “Sorry folks, more bad news. A third engine just failed, and so, since we will be running only on the one remaining engine, the flight will be delayed by another two hours.”

At this point, one regulator turned to the other and said, “I sure hope that last engine keeps working or else we’ll be up here all night!”

On March 15, 2021, an interview with SEC Commissioner Caroline Crenshaw was published, in which she discussed Reg BI.⁹ Commissioner Crenshaw noted that the SEC is incorporating Reg BI compliance into examinations and enforcement. She said that, while implementation of Reg BI still is in the early stages, the next step will be to evaluate Reg BI’s impact on the market.

Commissioner Crenshaw emphasized that the SEC is focused on whether Reg BI is resulting in investors getting advice that is in their best interest, and whether Reg BI will result in a change in portfolios over time, reduced conflicts of interest, and clearer conflict of interest disclosures. Based on those findings, the SEC may issue additional guidance on Reg BI or, potentially, conduct additional rulemaking. Commissioner Crenshaw also noted that Dodd-Frank gives the SEC the authority to implement a uniform fiduciary standard and opined that there should not be two standards. She believes that investors should receive advice in their best interest irrespective of whether they work with a broker-dealer or investment advisor.

Takeaways:

- First, if firms haven’t yet been examined for Reg BI, they likely will be examined soon.
- Second, we may see modifications or new regulatory pronouncements on Reg BI as both the SEC and FINRA analyze how it is being implemented.
- Third, because investigations take a year or two, it is possible that we will see enforcement actions on Reg BI this year. However, it is more likely that the first such actions will be brought in 2022.

Analysis on FINRA Disciplinary Actions from 2020

Numbers matter in the securities industry, as well as in life generally. As such, they generate numerous puns. One of the first puns many of us remember is this one: “Why was 6 afraid of 7?” “Because 7 ate 9.” Puns have become more sophisticated since we were young (although not all of us have followed suit) (and very few of us wear suits nowadays). Here are some mind *numbering* thoughts:

8. *Id.*

9. “Q&A: Crenshaw Says SEC to Assess Reg BI Performance,” Patrick Donachie, WealthManagement.com (March 15, 2021), available at <https://www.wealthmanagement.com/regulation-compliance/qa-crenshaw-says-sec-assess-reg-bi-performance>.

- *There are three types of people in the world. Those who can count and those who cannot.*
- *19 and 20 got into a fight... 21.*
- *I was ripped off. I got a three-foot-long ruler at a yard sale.*

On March 15, 2021, an annual study of FINRA’s disciplinary actions was published analyzing FINRA’s monthly disciplinary reports, press releases, and online database from 2020.¹⁰ According to the study, in 2020, the amount of fines and restitution, as well as the number of cases, increased compared with 2019, reversing the downward trend from the past few years even in the midst of the COVID-19 pandemic. The analysis showed that FINRA continues to target anti-money laundering (AML) violations and appears to have focused much of its efforts on protecting retail investors.

The fines reported by FINRA in 2020 increased by 43% to \$57 million from \$40 million in 2019. With the increase in fines, the number of cases with very large fines also increased slightly in 2020. FINRA assessed ten fines of \$1 million or more (called “supersized” fines in the study), totaling \$38.6 million. In contrast, in 2019, FINRA assessed nine “supersized” fines, totaling \$28 million. Similarly, in 2020, FINRA assessed two fines of \$5 million or more (now called “mega” fines in the study, f/k/a “yuuuge” fines), totaling \$21.5 million. In 2019, however, only one case resulted in a mega fine. Coincidentally, the largest single fine in 2020 (\$15 million) matched the largest single fine from 2019.

In 2020, restitution ordered by FINRA also increased. FINRA ordered restitution of approximately \$36 million in 2020, up 29% from the \$28 million in restitution ordered in 2019 and up 38% from the \$26 million ordered in 2018.

The number of cases reported by FINRA remained mostly flat last year. FINRA reported 595 disciplinary actions in 2020, a 1% increase from the 591 disciplinary actions in 2019, and a decrease of 7% from the 638 disciplinary actions in 2018.

The top five categories of cases, based on total fines, were the following:

1. **Anti-Money Laundering** cases resulted in the most fines assessed by FINRA in 2020. This is the fifth consecutive year that AML has been at the top of the study’s list and the seventh consecutive year that AML has appeared on the list.
2. **Books and Records** cases resulted in the second most fines for FINRA in 2020.
3. **Trade Reporting** cases resulted in the third most fines for FINRA in 2020.
4. **Variable Annuity** cases resulted in the fourth most fines for FINRA in 2020.
5. **Unregistered Securities** cases resulted in the fifth most fines for FINRA in 2020.

Enforcement Actions Involving Certain Types of Products

Regulators take into account a variety of factors when deciding whether to charge a firm or a representative in a disciplinary proceeding. For example:

10. [Annual Eversheds Sutherland Analysis of FINRA Disciplinary Actions Shows Surge in Enforcement Activity—Eversheds Sutherland \(eversheds-sutherland.com\)](https://www.eversheds-sutherland.com/en-US/annual-analysis-of-finra-disciplinary-actions-shows-surge-in-enforcement-activity). One of the co-authors of this article is an author of the study.

- Location matters: *Never scam in the jungle; cheetahs are always spotted.*
- Timing matters: *The past, the present, and the future walk into a bar. It was tense!*
- Job function matters: *I used to be a banker, but then I lost interest.*
- Motivation matters: *I got a job at a bakery because I kneaded dough.*
- Communications about product or service matter: *A Roman walks into a bar, holds up two fingers, and says, “Five beers, please.”*

Alternative Mutual Funds

On March 29, 2021, FINRA announced that it sanctioned three firms for failing to supervise representatives who recommended an alternative mutual fund that lost approximately 80% of its value in two days when the market moved against it.¹¹ The three Letters of Acceptance, Waiver, and Consent (AWCs) resulted from 2019 investigations of firms that sold an alternative mutual fund that pursued a risky strategy relying, in part, on purchasing uncovered options. The alternative mutual fund marketed itself as “selling volatility” by seeking to profit from the “volatility premium.” The prospectus noted “the limited upside, and unlimited downside, [and] risk associated with uncovered options” in its prospectus. A fund report noted that the alternative mutual fund was “aggressive” and “high risk.”

Between 2016 and 2018, the three firms’ representatives sold millions of dollars in shares of the alternative mutual fund to hundreds of customers. Two of the firms’ representatives sold the alternative mutual fund to customers with conservative and/or moderately conservative risk tolerances. For all three firms, a single representative was responsible for a disproportionate number of sales. The AWCs for two firms note that one representative was responsible for 60% and 80% of the firm’s total sales, respectively.

In February 2018, the alternative mutual fund lost approximately 80% of its value during an extreme volatility event. The fund ultimately liquidated and closed, resulting in thousands—and for one firm millions—of dollars in losses for investors.

FINRA found that all three firms permitted the sale of the alternative mutual fund on their platforms without conducting reasonable due diligence and without having a sufficient understanding of the investment’s risks and features. Two of the firms did not have a system or procedures for determining whether a new mutual fund constituted a “complex product” or was an alternative mutual fund requiring heightened due diligence. As a result, the firms did not conduct the appropriate level of (or any independent) due diligence on the alternative mutual fund. The third firm did have a system for identifying alternative mutual funds—but its system similarly did not result in the requisite heightened due diligence.

Two of the firms did not provide adequate guidance or training to representatives regarding the risks and features of alternative mutual funds or have reasonable written supervisory procedures (WSPs) in place advising principals on how to supervise such recommendations. The third firm did not have any guidance or training regarding the risks and features of alternative mutual funds, or WSPs advising principals on supervision of these recommendations.

11. https://www.finra.org/sites/default/files/fda_documents/2018056443801%20Cambridge%20Investment%20Research%2C%20Inc.%20CRD%2039543%20AWC%20jlg.pdf;
https://www.finra.org/sites/default/files/fda_documents/2019061765001%20Securities%20America%2C%20Inc.%20CRD%2010205%20AWC%20jlg.pdf;
https://www.finra.org/sites/default/files/fda_documents/2019061764801%20J.W.%20Cole%20Financial%2C%20Inc.%20CRD%20124583%20AWC%20jlg.pdf.

All three firms utilized an electronic trade review system to assist with supervision without considering whether the review system's rules for traditional mutual funds were reasonable for use in reviewing alternative mutual funds, or whether the rules needed to be tailored to address the particular risks and characteristics of alternative mutual funds. As a result, the alternative mutual fund transactions generally were not identified for additional suitability review.

FINRA fined one firm \$400,000 and ordered restitution of more than \$3.1 million plus interest. In determining sanctions, FINRA noted that it had considered the firm's substantial assistance, including hiring an outside financial consultant, in developing a fair restitution methodology, and that the firm had already paid more than \$740,000 in restitution to customers. FINRA fined a second firm \$100,000 and ordered restitution in the amount of \$235,979.77 plus interest. FINRA fined the third firm \$50,000 and ordered restitution in the amount of \$163,527 plus interest. All three firms were ordered to submit certifications that they had established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues.

Takeaways:

- First, firms may be sanctioned if they fail to conduct adequate due diligence when selling products, and if they and their representatives do not understand the risks and characteristics of those products.
- Second, firms may be sanctioned if they fail to provide training on new or complex products.
- Third, when firms sell new types of products, they should consider reviewing their surveillance and supervision systems to determine whether they are appropriate for the new products.
- Finally, firms may receive credit in regulatory actions if they pay restitution without being ordered to and if they engage in extraordinary cooperation. FINRA explicitly recognized one firm's remediation prior to settlement and its cooperation, which likely led to a lesser fine.

Multi-share Class Annuities

On March 17, 2021, FINRA fined a firm \$15,000 for failing to establish, maintain, and enforce written supervisory procedures related to multi-share class variable annuity investment recommendations.¹² This AWC arose from a 2018 FINRA exam.

FINRA found that from October 2017 to September 2018, the firm failed to establish, maintain, and enforce WSPs regarding the recommendation and sale of different variable annuity share classes. However, the firm sold 25 variable annuity contracts with different share class options, including B shares and L shares. The AWC expressly noted that the firm had not updated its procedures with respect to variable annuities despite telling FINRA that it would do so in January 2016. In 2016, the firm also told FINRA it would document its review of variable annuity options with customers; however, the firm failed to follow those procedures for all 25 variable annuity sales.

FINRA previously had notified the firm of its failure to enforce its WSP that required customers to complete a Variable Annuity Disclosure Form prior to a variable annuity investment—but the firm did not change its practices to enforce that WSP. In addition, when the firm decided to change its system and use forms provided by annuity companies, it did not revise its WSPs to reflect that change. Finally, the firm failed to collect investment objective and risk tolerance information for three L-share contract customers.

12. https://www.finra.org/sites/default/files/fda_documents/2018056455201%20The%20Logan%20Group%20Securities%20CRD%2040259%20AWC%20va.pdf.

Takeaways:

- First, variable annuities continue to be of interest to FINRA. As discussed earlier, in 2020, this category generated one of the highest total fines in any category of cases.
- Second, share classes continue to be a subject that FINRA focuses on, regardless of the product type.
- Finally, if you tell FINRA you are going to remediate an issue, do it. The AWC repeatedly notes the firm's failure to implement the necessary changes despite its representations to the contrary.

Private Offerings

On March 19, 2021, FINRA fined a firm \$40,000 for failing to establish and maintain a supervisory system reasonably designed to comply with its due diligence obligations with respect to private offerings.¹³ The firm's WSPs required it to conduct an investigation into, among other things, the issuer's management, business prospects, assets, and use of proceeds, as well as the syndicate managers for the offering, prior to recommending a private placement offering to a customer. However, between March 2017 and December 2018, the firm recommended and sold to customers two private placement offerings even though it had not conducted and documented reasonable investigations of those offerings. Instead, the firm relied almost exclusively on documents and information that the issuers provided. As a result, the firm failed to uncover relevant information.

From April 2017 through February 2019, the firm also did not timely submit the required offering documents to FINRA for 26 private placements. Instead of filing the documents within the required 15 calendar days, the firm made the filings from 16 days to 335 days after the first sale.

Takeaways:

- First, private placements continue to be of interest to FINRA.
- Second, having adequate procedures in place is not sufficient—firms may be sanctioned if they do not follow their own procedures.
- Finally, remediation may result in a lower fine. The AWC expressly noted that the firm implemented new written procedures for enhanced due diligence in 2019.

Anti-Money Laundering

Money motivates many actions. (We imagine that many of you are now asking yourself, "How did I end up working in compliance?") As such, puns about money are good and plentiful (which is different from Good & Plenty) (and puns sometimes leave a bitter taste in your mouth).

- *One day a skunk got arrested for counterfeiting.
He got caught because he was giving out bad scents.*
- *If it's a penny for your thoughts and you put in your two cents worth,
then someone, somewhere, is making a penny.¹⁴*
- *Tip jar at local coffee shop: "Afraid of Change?
Leave It Here."*

13. [https://www.finra.org/sites/default/files/fda_documents/2019060754601 Dalmore Group LLC CRD 136352 AWC va.pdf](https://www.finra.org/sites/default/files/fda_documents/2019060754601%20Dalmore%20Group%20LLC%20CRD%20136352%20AWC%20va.pdf).

14. Quote by Steven Wright: "If it's a penny for your thoughts and you put i..." (goodreads.com).

On March 3, 2021, FINRA fined a firm \$450,000 for failing to establish and implement a reasonably designed AML program.¹⁵ FINRA found that from January 2014 through April 2018, the firm failed to detect, investigate, and respond to potentially suspicious activities because its AML program was not reasonably tailored to detect and cause the reporting of suspicious low-priced securities trading. For example, the firm did not have AML procedures regarding detection and investigation of suspicious activity, or to whom to report suspicious activity. In addition, the firm relied almost exclusively on a manual review of trade blotters to detect suspicious activity, which was unreasonable given the volume and complexity of trading.

The firm also did not establish or implement due diligence procedures and controls to detect money laundering in the correspondent accounts of foreign financial institutions. While the firm's AML procedures stated that specific enhanced due diligence and scrutiny must be applied to such correspondent accounts, they did not reasonably describe the due diligence or scrutiny required. As a result, the firm failed to perform any AML risk assessment or deficient AML risk assessments for several foreign financial institution correspondent accounts.

Even though the firm engaged an outside law firm to perform annual independent testing of its AML program, FINRA found that the testing was not timely or reasonable. The firm did not complete its 2014 audit until 2016, and the firm's testing did not cover critical areas, such as procedures for escalating red flags about suspicious activities.

In addition to the fine, FINRA also required the firm to certify that it had established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues within 60 days.

Takeaways:

- First, this is the latest example of FINRA's focus on AML, and we expect to see more AML cases in the future.
- Second, firms may be sanctioned if they do not review their AML compliance programs and establish and implement reasonably designed AML procedures and controls.
- Third, engaging an outside law firm to conduct AML testing is not necessarily sufficient to meet the annual independent testing requirements.
- Finally, again—don't hesitate to remediate. The AWC notes in three separate footnotes that the firm enhanced its AML program and due diligence procedures. This may have resulted in a lower fine.

Lessons

While our articles try to provide insight into current securities enforcement and compliance issues, we also try to offer some words of wisdom, particularly as we live through this Pun-demic. Not surprisingly, puns and similar jokes can also help get us through the days (and the daze) ahead.

- Master the basics

*My boss told me to attach two pieces of wood together.
Totally nailed it.*

*Why is a doctor always calm?
Because she has a lot of patients.*

15. https://www.finra.org/sites/default/files/fda_documents/2017054643601%20ITG%2C%20Inc.%20CRD%2029299%20AWC%20Jlg.pdf.

- Know your job

*How good are you at PowerPoint?
I Excel at it.
Was that a Microsoft Office pun?
Word.*

*A scarecrow said, "This job isn't for everyone,
but hay, it's in my jeans."*

- Don't be tardy

*An egg arrived at work late. He said to his boss:
"Sorry boss, Omelet."*

- Do things outside of work

*I did a theatrical performance on puns.
It was a play on words.*

*How do you organize an outer space party?
You planet.*

- Watch what you eat

*Why don't cannibals like to eat clowns?
Because they taste funny.*

*How did Spartacus react when he ate his wife for dinner?
He was gladiator!*

- To bring a little joy into your life, consider getting a dog. Or a book. Or both.

*Outside of a dog, a book is a man's best friend.
Inside of a dog, it's too dark to read.¹⁶*

*I picked up a book about anti-gravity.
It was impossible to put down!*

And finally (although not puns or a play on words):

- *My three favorite things are eating my family and not using commas.¹⁷*
- *Why did the chicken cross the road?
To be socially and physically distant from the other chickens.*

If you've made it this far in this article, congratulations, you're the real deal! (You're not a fake noodle—or an impasta). And remember, you're unique. Just like everyone else. As a reward, please send your favorite (or most despised) pun or play on words to BrianRubin@eversheds-sutherland.com, and we'll try to incorporate it into future articles. Thanks for reading. ■

¹⁶. Was this Groucho Marx quote actually published in Boys' Life first? (scoutingmagazine.org) (commonly attributed to Groucho Marx).

¹⁷. Wordplay jokes guaranteed to tickle your funny bone—The San Diego Union-Tribune.