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Insights

IMPLICATIONS OF FINRA'S RECENTLY RELEASED 2022 SANCTION GUIDELINES

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SUMMARY

Key Takeaways:

- Last December, BCLP's Financial Services Disputes and Investigations Team issued an alert discussing the Sanction Guidelines issued by FINRA on October 20, 2021. A copy of that alert can be found here. Among other things, we noted that:
  - Previous FINRA Sanction Guidelines failed to recommend the largest monetary sanctions for sales practice violations and other conduct that arguably caused the most significant impact to investors; and
  - FINRA regularly negotiated for, and often received, settlements that largely exceeded the ranges outlined in its prior published Sanction Guidelines.
- FINRA's recently published Sanction Guidelines for 2022 surprisingly addresses these two previous critiques. See FINRA Regulatory Notice 22-20 which introduces the most recent Sanction Guidelines. A copy can be found here.
- One issue the latest version of the Sanction Guidelines raises for debate is the rationale for open-ended sanction ranges for offenses such as AML, churning, excessive mark ups, sale of unregistered securities, fraud, best execution, failure to respond to a regulatory inquiry, and systemic failures to supervise. In our view, FINRA's decision to leave those ranges open-ended eliminates the possibility of repeatable, predictable and consistent results.

Overview

FINRA's recent overhaul of its Sanction Guidelines is the largest and most significant in two, if not three, decades. It would be quite the understatement to say that the time had come for FINRA to make a much-needed change to its prior guidelines.

For many years, FINRA published AWCs which reflected settlements with inconsistent monetary fines which often exceeded its published Sanction Guidelines. The inconsistencies highlighted the archaic nature of the prior publications and, as a direct result, securities industry practitioners were ill-equipped to effectively predict or anticipate acceptable settlement ranges during negotiations with FINRA.

In our view, FINRA's Sanction Guidelines should provide predictable guidance to its members regarding the potential negative consequences for certain conduct, especially as it concerns common rule infractions. Moreover, regardless of whether sanctions are awarded in enforcement proceedings or through AWC settlements, there should be consistency and predictability with certain, likely outcomes.

One might also argue that the monetary fines found within AWCs should be slightly lower in comparison to those found in litigated awards in order to give member firms a sufficient enticement to settle matters and ultimately assist FINRA in preserving its resources. Yet, the Sanction Guidelines do not provide explicit credit for negotiating a settlement through the AWC process, as opposed to attempting to resolve a matter through enforcement proceedings. FINRA's repeated efforts to seek monetary fines higher than those called for in the Sanction Guidelines, absent repeat offenses, relevant adverse disciplinary history, or other aggravating circumstances, should be a rarity as opposed to commonplace.

Summary of revisions

The following is a summary of the most notable revisions to the Sanction Guidelines:

- **The Addition of Anti-Money Laundering ("AML") Sanction Guidelines**. Prior versions of the Sanction Guidelines omitted details related to AML rule violations. That is very surprising given that the largest fines levied by FINRA year-after-year over more than a decade have been for AML program failures and related rule infractions. The addition of this section aligns the guidelines with the reality that FINRA continues to focus significant time, attention and resources in enforcement actions on this topic. It is without question that FINRA's largest fines will likely remain in this area.

- **Increase in Monetary Sanctions**. FINRA increased the recommended ranges for most rule infractions, with sales practice violations reflecting the largest increases.

- **Prioritizing Investor Protection**. Prior versions of the Sanction Guidelines called for higher sanctions for violations that did not necessarily have a direct impact on investors. By assigning larger fines commensurate with investor impact, the Sanction Guidelines are better aligned to FINRA's mission of investor protection.

- **Distinguishing Between Monetary Sanctions for "Small Firms" versus "Midsize and Large Firms."** The revised guidelines now distinguish Small Firms from Midsize and Large Firm by attributing larger monetary sanctions for Midsize and Large Firms. FINRA by-laws define a Small Firm to include any broker-dealer that has between 1 and 150 registered representatives, a Midsize Firm to include any broker-dealer that has between 151 and 499 registered representatives, and a Large Firm to include any broker-dealer that has more than 500 registered representatives. FINRA likely made this distinction because Small Firms have historically argued that, where all things are otherwise equal, they should not be subjected to sanctions that are equivalent to their much larger peers.[1]

- **Open-Ended Monetary Fine Ranges**. FINRA removed the upper limit of the fine ranges for Mid-Sized and Large Firms for certain select rule infractions including those involving AML, churning, excessive mark ups, excessive switches, the sale of unregistered securities, fraud, best execution, certain conflicts of interest, failure to respond to an inquiry, and systemic failures to supervise. While these rule infractions arguably have the greatest impact to investors, this is probably the most controversial part of FINRA's recent revisions to its guidelines. In essence, by leaving the ceiling for sanctions open, FINRA eliminates the ability for repeatable, consistent and predictable results. Not to mention, the open-ended ranges also remove a significant tool for holding FINRA accountable and anchoring results to its Sanction Guidelines.[2]

Extra-ordinary cooperation

While FINRA's Sanction Guidelines for 2022 fail to address or acknowledge credit for "extraordinary cooperation," we remind member firms that there are mechanisms for negotiating lower sanctions in the context of enforcement settlements. See, e.g., Regulatory Notice 19-23 which FINRA released on July 11, 2019, a copy of which is available HERE. In substance, FINRA offers extraordinary cooperation credit in enforcement proceedings to member firms that: (1) self-report rule violations before regulators become aware of the activity; (2) engage in extraordinary steps to correct deficient procedures and systems; (3) provide extraordinary remediation to customers; and (4) provide significant assistance to FINRA's investigation. As FINRA notes in Regulatory Notice 19-23, it grants credit for extraordinary cooperation "to incentivize firms and associated persons to voluntarily and proactively assist FINRA." In our experience, most firms with strong compliance cultures are interested in cooperating with FINRA in connection with routine examinations and enforcement matters and should, as a result, seek the benefits of extraordinary cooperation credit.

Conclusion

For the most part, FINRA's newly released Sanction Guidelines attempt to address many critiques raised by securities industry participants over the years. The Sanction Guidelines for 2022 now: (1) provide new guidance for AML-related rule violations, (2) increase monetary sanctions; (3) prioritize investor protection by providing greater sanctions proportionate to customer impact, and (4) differentiate monetary sanctions according to the size of the firm. While FINRA's latest revisions should (in theory) bring the results of enforcement actions more in line with the Sanction Guidelines, only time will tell whether FINRA stays within the published ranges or whether it tests member firms by pushing resolutions well beyond the newly established goalposts without a meaningful showing of aggravating circumstances. A chart reflecting the changes in recommended monetary sanctions can be found here.

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[1] FINRA did not prospectively lower the ranges of sanctions attributable to Small Firms. Rather, it increased the range of possible sanctions for Midsize and Large Firms, therefore creating a disparity in sanctions based on size of the firms.

[2] The Sanctions Guidelines have always left open the possibility of increased fines for multiple rule violations, recidivists, and egregious conduct. In our view, however, greater fines which exceed established ranges should require a specific finding of the aggravating circumstances which justify an increase in the range of sanctions.

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