Regulatory Notice 15-15

Sanction Guidelines

The National Adjudicatory Council (NAC) Revises the Sanction Guidelines Related to Misrepresentations and Suitability

Effective Immediately

Executive Summary

The NAC has revised the *Sanction Guidelines* related to misrepresentations and suitability. Specifically, the revisions:

- modify the guidelines related to fraud to advise adjudicators to strongly consider barring an individual respondent for intentional or reckless fraud, and expelling a firm where aggravating factors predominate the firm's misconduct;
- modify the guidelines related to suitability to advise adjudicators to strongly consider barring an individual respondent where aggravating factors predominate the respondent's misconduct and ordering expulsion of a firm in egregious cases;
- emphasize that FINRA's disciplinary sanctions should be designed to protect the investing public by deterring misconduct and upholding high standards of business conduct;
- reiterate FINRA's longstanding position that sanctions in disciplinary cases should be more severe for recidivists;
- index the high-end of the monetary sanctions to the Consumer Price Index starting from 1998; and
- reflect the new FINRA rule numbers for rules that have been adopted into the consolidated FINRA rulebook.

The revised *Sanction Guidelines* are effective immediately and available on FINRA's website.

Questions regarding this *Notice* should be directed to:

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Financial Industry Regulatory Authority

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Notice Type

- Guidance

Suggested Routing

- Legal
- Registered Representatives
- Senior Management

Key Topics

- FINRA Sanction Guidelines

Referenced Rules and Notices

- FINRA Rule 2010
- FINRA Rule 2020
- FINRA Rule 2114
- MSRB Rule G-17
- MSRB Rule G-19
- MSRB Rule G-47
- NASD Rule 2310
- SEA Rule 10b-5
- Section 10(b) of the Securities Exchange Act of 1934
- Section 15(c)(1) of the Securities Exchange Act of 1934

Background and Discussion

FINRA's *Sanction Guidelines* familiarize FINRA firms with some of the typical securities-industry rule violations that occur and the range of disciplinary sanctions that may result from those rule violations. The goal of the *Sanction Guidelines* is to assist FINRA's adjudicators in determining the appropriate sanctions in disciplinary proceedings. The *Sanction Guidelines* do not provide predetermined or fixed sanctions for particular violations. Rather, the central idea contained in the *Sanction Guidelines* is that adjudicators start with a range of appropriate sanctions for a particular violation and consider aggravating and mitigating factors in order to arrive at an appropriate sanction for the particular circumstances. FINRA's NAC initiates periodic reviews of the *Sanction Guidelines* to ensure that the *Sanction Guidelines* reflect recent developments in the disciplinary process, comport with changes in FINRA's rules and accurately reflect the levels of sanctions imposed in FINRA disciplinary proceedings.[1] The NAC initiated a review of the *Sanction Guidelines* to determine whether the sanctions imposed in FINRA's disciplinary proceedings are sufficient to achieve deterrence and reflect sanction trends in litigated and settled cases. The amendments to the monetary and non-monetary sanctions in the *Sanction Guidelines* are the result of this review.

Revisions to the Sanction Guideline Related to Fraud, Misrepresentations or Material Omissions of Fact

The NAC revised the sanction guideline related to fraud, misrepresentations or material omissions of fact. This guideline applies when a respondent's misconduct violates the antifraud provisions of the Securities Exchange Act of 1934, FINRA's antifraud rule, or FINRA's rule that prohibits negligent misrepresentations and omissions.

The modifications to the sanction guideline for fraud, misrepresentations, or material omissions of fact reinforce the tenet that fraudulent conduct is unacceptable and warrants the imposition of strong sanctions. For intentional or reckless fraud by individuals, the amended guideline eliminates the guidance that individuals should merely be "considered" for a bar in egregious cases. The revision states that adjudicators should "strongly consider" barring an individual unless mitigating factors predominate. The NAC made similar amendments to the guidance concerning intentional or reckless fraud by firms. As amended, the sanction guideline for a firm's intentional or reckless fraud advises that adjudicators should "strongly consider" expelling a firm where aggravating factors predominate the firm's misconduct. The revised sanction guideline also advises adjudicators to suspend an individual for 31 calendar days to two years for negligent misrepresentations or material omissions of fact.

Revisions to the Sanction Guideline Related to Suitability – Unsuitable Recommendations

The NAC increased the non-monetary range of sanctions for violations of FINRA's suitability rule, FINRA Rule 2111, to ensure that the sanctions imposed for unsuitable recommendations to customers are meaningful and have significant deterrent effect. The revisions to the sanction guideline for suitability violations also harmonize the sanction guideline with the current state of the cases in this area.

For unsuitable recommendations by individual respondents, the NAC revised the *Sanction Guidelines* to increase the high-end of the suspension from one year to two years. The amended sanction guideline for suitability violations also advises adjudicators to "strongly consider" barring an individual respondent where aggravating factors predominate the respondent's misconduct. When the unsuitable recommendations involve a firm, the revised sanction guideline advises 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.

Revisions to the General Principles Applicable to All Sanction Determinations, Nos. 1 and 2

The NAC revised General Principles Applicable to All Sanction Determinations, Nos. 1 and 2, to emphasize that FINRA's disciplinary sanctions are designed to protect the investing public, deter misconduct, and uphold high standards of business conduct by the individuals and firms that participate in the securities industry. The amended general principles also reiterate FINRA's longstanding position that sanctions in disciplinary cases should be more severe for recidivists.

As amended, General Principle No. 1 incorporates the concept that sanctions in disciplinary cases should be significant enough to achieve deterrence, and not a mere cost of doing business. The revisions advise adjudicators to consider imposing sanctions in excess of the recommended range of sanctions when a respondent's misconduct has widespread impact, is intentional or results in significant ill-gotten gains. The modifications to General Principle No. 2 reinforce this policy of imposing meaningful sanctions and advise adjudicators to impose progressively escalating sanctions on individuals and firms with disciplinary history. General Principle No. 2, as amended, explains what constitutes "disciplinary history" for purposes of applying this principle in FINRA disciplinary cases and notes that pending, settled, and litigated arbitration proceedings, pending investigations, and ongoing regulatory proceedings prior to a final decision are not disciplinary history.

Indexing of Monetary Sanctions

This set of revisions to the *Sanction Guidelines* will implement the indexing of the high-end of the monetary sanctions for each sanction guideline to the Consumer Price Index. This initial set of indexed fine amounts will be rounded in increments of $1,000 and will date back to June 1998 because the NAC has not amended the fines for a significant number of *Sanction Guidelines* since that time.[2] Going forward, the NAC will index the *Sanction Guidelines* every three years, rounding the indexed fine amount in increments of $1,000. The low-end of the monetary sanctions ranges in the *Sanction Guidelines* will remain the same.

Revisions to Reflect FINRA Rule Numbers

Finally, the revised *Sanction Guidelines* use "FINRA" instead of "NASD," where appropriate, and refer to the new FINRA rule numbers for rules that have been adopted into the new consolidated FINRA rulebook.

Endnotes

1. The NAC is FINRA's appellate tribunal for disciplinary cases. It is a 14-member committee composed of industry and non-industry members.

2. In 1998, the NAC revised the *Sanction Guidelines* to increase the high-end of fine ranges for 12 categories of violations, including forgery, conversion, unauthorized trading and net capital violations. *See NASD Notice to Members 98-39* (May 1998).