

Investigations and Formal Disciplinary Actions

FINRA Provides Guidance on Its Enforcement Process

Executive Summary

FINRA is providing this guidance to provide transparency into its enforcement process, and to assist firms and their associated persons with their understanding of how the investigative process works and to highlight procedural safeguards in this process, including:

- Enforcement Procedures and Managerial Oversight
- Conducting Investigations
- Sufficiency of Evidence Reviews
- Wells Process
- Disciplinary Advisory Committee Review
- Litigation Group Consultation Process
- Independent Office of Disciplinary Affairs
- Independent Office of Hearing Officers

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Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topic(s)

- Enforcement Process
- Investigations
- Formal Disciplinary Actions
- Wells Process

Referenced Rules & Notices

- FINRA Rule 8210

Background & Discussion

One of FINRA's most important functions is the fair and effective enforcement of rules contained within the FINRA Rulebook, the rules of the Municipal Securities Rulemaking Board and the federal securities laws and rules. FINRA's Enforcement and Market Regulation Departments are responsible for investigating and bringing all FINRA formal disciplinary actions against firms and their associated persons. The Enforcement Department handles a broad range of investigations and cases, while the legal section of the Market Regulation Department focuses on trading and quality of market cases. The staff of these departments (also collectively referred to as Enforcement) work closely with other FINRA offices such as Advertising Regulation and Corporate Financing. Similarly, the Enforcement Department works closely with FINRA's Member Regulation Department, which requests information and takes testimony in the course of its examinations of firms and reviews of customer complaints. If another department believes, in consultation with Enforcement staff, that a formal disciplinary action is warranted, the matter will be referred for formal action.

FINRA investigations may be opened from various sources, including but not limited to, automated surveillance reports, examination findings, filings made with FINRA, customer complaints, anonymous tips, referrals from other regulators or other FINRA departments, and press reports.

Enforcement Procedures and Managerial Oversight

The staff investigates and litigates cases pursuant to comprehensive internal procedures that set forth uniform policies and procedures that govern the investigative and enforcement process.¹ In addition, all cases are also subject to a multilayered managerial review that focuses on, among other things, the substantive evidence developed during the investigation and an analysis of applicable rules and case precedent. Investigations are assessed at various points to ensure that Enforcement resources are being deployed appropriately.

Conducting Investigations

All FINRA investigations are non-public and confidential, and firms and individuals are entitled to be represented by counsel. The staff engages in an objective fact-finding process when conducting an investigation, without bias for or against the parties involved. To conduct its investigations, the staff requests documents and takes sworn testimony from firms and associated persons pursuant to FINRA Rule 8210, which requires firms and associated persons to respond to requests for information; failure to respond may result in a fine, suspension or bar from the industry. The staff may also contact customers and other individuals who are not within FINRA's jurisdiction and who provide information voluntarily.

Rule 8210 requests inform the recipient that FINRA investigations are non-public and confidential. Information acquired during an investigation may be disclosed in connection with an investigation or disciplinary proceeding, in response to requests from the Securities and Exchange Commission or other governmental agencies and pursuant to a lawfully issued subpoena and/or information-sharing agreements entered into between FINRA and other regulators. Rule 8210 requests for testimony also inform the witness that he or she has the right to have an attorney present, the right to review a copy of his or her transcript, and may request, in writing, a copy of the transcript, which shall be released unless the staff has good cause to withhold it.

Sufficiency of Evidence Review

At the conclusion of the investigation, the staff analyzes the evidence and applicable law and makes a preliminary determination of whether or not a violation appears to have occurred. This process is called a Sufficiency of Evidence review and is conducted under the supervision of the senior manager responsible for the investigation. If it appears that rules have been violated, the senior manager will determine whether the conduct merits a recommendation of formal disciplinary action. If the violation is of a minor nature and there is an absence of customer harm or detrimental market impact, the matter may be resolved with an informal disciplinary action, such as the issuance of a Cautionary Action. While Cautionary Actions are considered by the staff in any future disciplinary matter, these actions do not constitute formal discipline and are not reportable on FINRA's Central Registration Depository (CRD) system or Form BD.

Wells Process

If a preliminary determination to proceed with a recommendation of formal discipline is made, the staff will call the potential respondent or counsel and inform the individual or firm that FINRA intends to recommend formal disciplinary action. This is generally referred to as a Wells Call.² During the Wells Call the staff informs the potential respondent of the proposed charges and the primary evidence supporting the charges. The purpose of a Wells Call is to give the potential respondent an opportunity to submit a writing, called a Wells Submission, which discusses the facts and applicable law and explains why formal charges are not appropriate. The Wells Call is followed with a letter confirming that the Wells Call has been made (Wells Notice). An associated person who receives a written Wells Notice is required to report that event on his or her Form U4. Firms also may have disclosure obligations depending upon, for example, whether the firm is a publicly traded company. While the Wells process is used in virtually every case, the process is discretionary and there may be instances where senior Enforcement staff determines that it must move forward without providing this opportunity, such as when customer funds are at risk.

The Enforcement staff, including senior managers, carefully review the Wells Submission in assessing the case and may ask for additional information or obtain additional evidence in the matter. In many cases, after reviewing the charges that the staff is considering, the potential respondent initiates settlement discussions instead of making a Wells Submission. FINRA's independent Office of Disciplinary Affairs, discussed below, also reviews each Wells Submission before approving a settlement or authorizing the staff to issue a formal complaint. All cases where Wells Notices have been issued, particularly those involving individual prospective respondents, are reviewed regularly to ensure timely disposition of those matters. Finally, a closing letter is sent to each individual who has received a Wells Notice if the matter is closed without formal disciplinary action.

Disciplinary Advisory Committee

The Disciplinary Advisory Committee (DAC) reviews all significant cases and those matters where novel legal or factual issues exist. The DAC consists of senior managers from the Enforcement and Market Regulation Departments. The DAC considers the evidence supporting each recommended charge and vets charging decisions and sanction recommendations to ensure consistency and proportionality. The DAC recommends the charges and sanction ranges for each case for purposes of settlement discussions. In addition, the DAC considers the issue of whether credit for extraordinary cooperation is appropriate. As discussed below, however, no settlement may be finalized nor may any complaint be filed prior to review and approval by the independent Office of Disciplinary Affairs.

Litigation Group Consultation Process

While most cases settle prior to litigation through the issuance of a settlement document called a Letter of Acceptance Waiver and Consent, a Litigation Group consultation takes place for any case in which a complaint will be filed. During this process, experienced FINRA trial lawyers and a litigation manager review the matter to ensure, among other things, that there exists sufficient evidence to support the proposed charges.

Independent Office of Disciplinary Affairs

FINRA's Office of Disciplinary Affairs (ODA) is independent of Enforcement and is not involved in the investigation or litigation of cases. ODA is charged with reviewing each proposed settlement or complaint, including any Wells Submissions, to provide an independent review of the legal and evidentiary sufficiency of the charges proposed by the staff. ODA also reviews settlements for consistency with the Sanction Guidelines as well as applicable precedent. ODA approval is required before the issuance of a settlement or complaint.

Independent Office of Hearing Officers

FINRA's Code of Procedure governs the hearing process. FINRA hearings are administered by a Hearing Officer who is employed by FINRA in the Office of Hearing Officers (OHO). OHO is independent of Enforcement and, like ODA, is not involved in the investigative process. Employment protections exist for Hearing Officers to further ensure their independence; they may not be terminated except by the FINRA Chief Executive Officer, with a right to appeal to the Audit Committee of FINRA's Board of Governors.

Hearings are held before a Hearing Officer and two industry panelists. Panelists are drawn from a pool of current and former securities industry members of FINRA's District Committees, as well as its Market Regulation Committee, former members of FINRA's National Adjudicatory Council (NAC) and former FINRA Governors. Appeals from hearing decisions are made to the NAC, and respondents may further appeal an adverse decision of the NAC to the Securities and Exchange Commission, and further to a United States Court of Appeals.

Endnotes

- 1 All employees are also subject to FINRA's Code of Conduct and FINRA policies which ensure appropriate handling of potential and actual conflicts of interest, among other things.
- 2 The term Wells Notice originated in 1972 from a committee (chaired by former Senator John Wells and commonly referred to as the Wells Committee) appointed to review and evaluate the SEC's enforcement policies and practices. The Committee recommended providing notice to prospective respondents of charges that the SEC staff was considering. This notice has subsequently been referred to by securities regulators as a Wells Notice, and is used by FINRA in its disciplinary process.