

## Reporting Requirements

### FINRA Provides Additional Guidance Regarding Reporting Requirements Under Rule 4530

#### Executive Summary

In February 2011, FINRA issued [Regulatory Notice 11-06](#) informing member firms of SEC approval of new FINRA Rule 4530 governing reporting requirements. FINRA Rule 4530 became effective on July 1, 2011. In March 2011, FINRA issued [Regulatory Notice 11-10](#) reminding member firms of their obligation to electronically report specified events and quarterly customer complaint information and providing further guidance on automated reporting under the new rule. In this Notice, FINRA is providing questions and answers regarding the application of the new rule to assist member firms in their implementation.

Questions regarding this *Notice* should be directed to Afshin Atabaki, Assistant General Counsel, Office of General Counsel, at (202) 728-8902.

#### Background & Discussion

FINRA Rule 4530 requires member firms to:

1. report to FINRA certain specified events and quarterly statistical and summary information regarding written customer complaints; and
2. file with FINRA copies of certain criminal actions, civil complaints and arbitration claims.

FINRA uses the information for regulatory purposes to identify and initiate investigations of member firms, offices and associated persons that may pose a risk. The requirements of FINRA Rule 4530 are based on similar requirements in NASD Rule 3070 and Incorporated NYSE Rule 351. FINRA Rule 4530 strengthens, clarifies and extends these existing requirements. Among other things, the new rule requires member firms to report certain internal conclusions of violations and financial-related insurance civil litigations and arbitrations and clarifies the obligations of member firms with respect to written customer complaints and former associated persons.

#### July 2011

##### Notice Type

- ▶ Guidance

##### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management

##### Key Topics

- ▶ Customer Complaints
- ▶ Financial-Related Insurance Matters
- ▶ Former Associated Persons
- ▶ Internal Conclusions
- ▶ Reporting Requirements

##### Referenced Rules & Notices

- ▶ FINRA Rule 4530
- ▶ Incorporated NYSE Rule 351
- ▶ NASD Rule 3070
- ▶ Regulatory Notice 08-70
- ▶ Regulatory Notice 10-39
- ▶ Regulatory Notice 11-06
- ▶ Regulatory Notice 11-10

## Questions and Answers

To help member firms implement FINRA Rule 4530, FINRA is publishing the following questions and answers relating to its application. This guidance speaks solely to member firms' reporting obligations pursuant to FINRA Rule 4530, and not to other applicable reporting requirements, including under Forms BD (Uniform Application for Broker-Dealer Registration), U4 (Uniform Application for Securities Industry Registration or Transfer) and U5 (Uniform Termination Notice for Securities Industry Registration). FINRA, however, notes that a member firm is not required to report an event otherwise required to be reported under FINRA Rules 4530(a) or (b) if the member firm discloses the event on the Form U5, consistent with the requirements of that form.<sup>1</sup>

### Internal Conclusions of Violations

**Q1. Are member firms required to report internal conclusions of all rule violations under FINRA Rule 4530(b)?**

- A1. No. FINRA Rule 4530(b) states that each member firm shall promptly report to FINRA, but in any event not later than 30 calendar days, after the firm has concluded or reasonably should have concluded that an associated person of the firm or the firm itself has violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization (SRO).

Further, for purposes of FINRA Rule 4530(b), only those violations that meet the reporting threshold under FINRA Rule 4530.01 are required to be reported. With respect to violations by a firm, FINRA Rule 4530.01 requires the firm to report only conduct that has widespread or potential widespread impact to the firm, its customers or the markets, or conduct that arises from a material failure of the firm's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts. Regarding violations by an associated person, FINRA Rule 4530.01 requires a firm to report only conduct that has widespread or potential widespread impact to the firm, its customers or the markets; conduct that has a significant monetary result on a member firm(s), customer(s) or market(s); or multiple instances of any violative conduct. For instance, if a firm concludes that a violation has occurred and that it has widespread or potential widespread impact to the markets, the firm is required to report that violation.

- Q2. FINRA Rule 4530.01 requires a member firm to report, among other things, violations that have widespread or potential widespread impact to the markets. Is the term "markets" referring only to the securities markets?**

- A2. No. The term “markets” should be read in the context of the enumerated violations under FINRA Rule 4530(b), which requires a member firm to report violations of any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or SRO. Accordingly, the term “markets” in FINRA Rule 4530.01 refers to any organized market relating to any securities, insurance, commodities, financial or investment product.
- Q3. FINRA Rule 4530.01 requires a member firm to report, among other things, if it concludes that an associated person has engaged in multiple instances of any violative conduct. What does the phrase “multiple instances of any violative conduct” mean?**
- A3. It generally means multiple instances of the same violative conduct by an associated person that are not administrative or operational in nature. Among other things, such violations may evidence a pattern of behavior on the part of the associated person. Member firms also are required to report multiple instances of different violative conduct by an associated person where such violations are significant in nature or result in significant customer harm. Additionally, member firms should note that certain disciplinary actions taken by firms against associated persons, such as when an associated person is fined by a member firm in excess of \$2,500, must be reported under FINRA Rule 4530(a)(2), rather than as an internal conclusion of violation under FINRA Rule 4530(b).
- Q4. FINRA Rule 4530(b) requires a member firm to report to FINRA within 30 calendar days after the firm has concluded, or reasonably should have concluded, that an enumerated violation has occurred. For purposes of the “reasonably should have concluded” requirement, how will FINRA determine whether a firm’s conclusions are correct?**
- A4. FINRA will apply a “reasonable person” standard to determine whether a violation should have been reported. If a reasonable person, considering the available facts, would have concluded that a violation occurred, then the matter would be reportable. If a reasonable person, considering the available facts, would not have concluded that a violation occurred or would have been unable to conclude whether a violation occurred, then the matter would not be reportable. Further, FINRA Rule 4530(b) is not intended to hinder a member firm’s ability to carry out effective supervision of its associated persons and address issues with appropriate remediation. Consequently, FINRA recognizes that a member firm may take remedial steps with respect to its associated persons where the firm nevertheless reasonably does not determine a violation has occurred. It is also the case that a member firm’s

determination not to take remedial action in respect of certain conduct is not by itself a basis for asserting a reasonable conclusion that a violation has not occurred, and, where a reasonable person would have determined that a violation has occurred, the firm would potentially be in violation of both FINRA Rule 4530(b) and the firm's duty to reasonably supervise its associated persons.

**Q5. With respect to the reporting of internal conclusions of violations under FINRA Rule 4530(b), what should member firms' procedures address?**

- A5. Member firms should review existing procedures and develop any necessary enhancements and review processes to address the requirements of FINRA Rule 4530(b). Some firms may find that their existing procedures are adequate. At a minimum, firms' procedures should:
- (1) clearly identify the person(s) responsible for determining whether a violation has occurred and whether it is of a nature that requires reporting under FINRA Rule 4530(b), as well as the level of seniority of such person(s) (*e.g.*, General Counsel, Chief Compliance Officer or a senior staff committee);
  - (2) provide a protocol for escalating violations, and potential violations, to such person(s); and
  - (3) provide a protocol regarding the reporting of internal conclusions of violations subject to FINRA Rule 4530(b) to FINRA within 30 calendar days after the firm has concluded, or reasonably should have concluded, that an enumerated violation has occurred.

**Q6. Are member firms eligible to receive credit for extraordinary cooperation for matters that are required to be reported pursuant to FINRA Rule 4530(b)?**

- A6. Depending on the facts and circumstances and on a case-by-case basis, FINRA will consider credit for self-reporting of violations that are required to be reported pursuant to the new rule. However, the type of self-reporting contemplated as extraordinary and deserving of credit would have to go significantly beyond the requirements of the rule.<sup>2</sup> For credit for self-reporting, it would, at a minimum, have to include a detailed account of the discovered conduct and an offer to explain in complete detail all aspects of the conduct and provide relevant documents and witnesses.<sup>3</sup> Furthermore, additional factors to be considered in evaluating credit for cooperation include, but are not limited to: (1) extraordinary steps to correct deficient procedures and systems; (2) extraordinary remediation to customers; and (3) other substantial assistance to FINRA investigations.<sup>4</sup>

## Customer Complaints

- Q7. Are text messages and tweets received from member firm customers complaining about the member firm or its associated persons subject to reporting under FINRA Rule 4530?**
- A7. Yes. FINRA Rule 4530(a)(1)(B) requires that a member firm report within 30 calendar days after the firm knows or should have known<sup>5</sup> that it or an associated person is the subject of any written customer complaint alleging theft or misappropriation of funds or securities or forgery. FINRA Rule 4530(d) requires that a member firm also report quarterly statistical and summary information regarding written customer complaints that have been received. Received text messages and tweets are in a written format. Thus, a member firm must report text messages and tweets received from firm customers expressing complaints about the firm or its associated persons consistent with the requirements of FINRA Rules 4530(a)(1)(B) and 4530(d). For example, if a firm customer sends a tweet to the firm alleging that an associated person sold him unsuitable securities, the firm must report it pursuant to FINRA Rule 4530(d).
- Q8. A member firm's registered representative is also an insurance agent working for an affiliated insurance company. The member firm recently found out through its affiliate that the registered representative is the subject of a written complaint from an insurance customer alleging that the representative did not adequately disclose the surrender charge in connection with the sale of a fixed annuity. After further inquiry, the member firm also found out that the representative had recommended some securities to the insurance customer when he sold the fixed annuity, but the individual decided not to purchase any securities. Does the member firm have to report the complaint under FINRA Rule 4530?**
- A8. No. For purposes of FINRA Rules 4530(a)(1)(B) and 4530(d), a person with whom a member firm has sought to engage in securities activities is considered a customer of the firm. However, the firm is only required to report any securities-related written grievance by such person under FINRA Rule 4530(d) and any written complaints alleging theft or misappropriation of funds or securities, or forgery involving the firm or an associated person under FINRA Rules 4530(a)(1)(B) and 4530(d).<sup>6</sup> Here, for purposes of FINRA Rules 4530(a)(1)(B) and 4530(d), the complainant is considered a customer and there is a written grievance involving the representative, but it is not securities-related as the matter involves a fixed annuity insurance product, and it does not allege theft or misappropriation of funds or securities or forgery.

- Q9.** In Question 8 above, what if the person complaining about the fixed annuity was someone to whom the member firm had sold securities? Would the complaint then be subject to reporting under FINRA Rule 4530?
- A9. Yes. If a firm has engaged in securities activities with a person, the firm is required to report any written grievance by such person involving the firm or an associated person under FINRA Rule 4530(d).<sup>7</sup>
- Q10.** A registered representative who is also a mortgage broker recently obtained a home loan for a person to whom the representative had sold securities through a member firm. The mortgage is financed and serviced by an unaffiliated bank. The member firm recently received an email from the person complaining about the bank that services his mortgage account. Is the member firm required to report the complaint under FINRA Rule 4530?
- A10. No. As noted in Answer 9 above, if a firm has engaged in securities activities with a person, the firm is required to report any written grievance by such person involving the firm or an associated person. Here, because the complaint does not involve the firm or registered representative, the firm does not have to report it under FINRA Rule 4530. However, the firm may want to inform the bank of the complaint so that the bank can address it.
- Q11.** In Question 10 above, what if the person was complaining that the registered representative made some misleading statements during the loan process? Would it then be subject to reporting under FINRA Rule 4530?
- A11. Yes. It would be subject to reporting under FINRA Rule 4530(d) since it would be a written grievance from a customer of the firm involving an associated person.

### Financial-Related Insurance Civil Litigation

- Q12.** During a routine annual branch inspection, a member firm's registered representative informed the firm that he was sued a few days ago by one of his insurance customers in connection with the sale of a term life insurance policy and that the insurance company settled the matter immediately on his behalf for \$20,000. The lawsuit alleged common law fraud. Is the member firm required to report the settlement under FINRA Rule 4530?
- A12. Yes. FINRA Rule 4530(a)(1)(G) requires a member firm to report, among other things, if an associated person is a defendant in any financial-related insurance civil litigation that has been settled for an amount exceeding \$15,000. The term "financial-related" means related to the provision of financial services.<sup>8</sup> The term excludes certain insurance products, such as traditional auto and health insurance. However, its scope is not limited to insurance products that are securities. A term life insurance policy would be considered "financial-related."

### Former Associated Persons<sup>9</sup>

**Q13. A member firm finds out that a registered representative has been indicted, while in the employ of the member firm, on a misdemeanor charge involving the sale of a stock at his previous employer, Firm A. For purposes of FINRA Rule 4530(a)(1)(E), does the member firm have an obligation to report the indictment or does Firm A have to report it?**

A13. In general, the member firm with which the person is associated at the time an event occurs and becomes subject to reporting is responsible for reporting it to FINRA. Consequently, in this example, the employing member firm is responsible for reporting the indictment when it becomes aware of the matter.<sup>10</sup>

Moreover, under FINRA Rule 4530.07, member firms should report an event that is required to be reported under the rule relating to a former associated person if the event involves conduct that occurred while the individual was associated with the firm and the firm becomes aware of the event. Here, because the indictment involves the sale of stock by the registered representative at Firm A (his prior employer), Firm A also should report the indictment if Firm A becomes aware of the action.

**Q14. A member firm receives a customer complaint regarding a former registered representative alleging that the representative churned the customer's account. Is the member firm required to report the complaint under FINRA Rule 4530?**

A14. Yes. Under FINRA Rule 4530.07, where a member firm receives or becomes aware of a customer complaint under FINRA Rules 4530(a)(1)(B) or 4530(d) involving a former associated person and the underlying conduct occurred while the individual was associated with the firm, the firm is expected to report the customer complaint.

**Q15. A member firm is in the process of internally investigating a registered representative's involvement in violative conduct when the representative terminates her association with the firm. Following her departure, the member firm reaches an internal conclusion that the former representative violated several securities laws that had a significant monetary result for customers. Is the member firm required to report the conclusion under FINRA Rule 4530 since it reached the conclusion after the representative left the member firm?**

A15. Yes. Notwithstanding that a firm reaches a conclusion of violation regarding an individual after he or she leaves the firm, the firm remains obligated to report that internal conclusion of violation if it meets the reporting thresholds in FINRA Rule 4530(b).

## Endnotes

1. See FINRA Rule 4530(e). The exception does not extend to the reporting of quarterly statistical and summary complaint information under FINRA Rule 4530(d).
2. See [Regulatory Notice 08-70](#) (November 2008) (FINRA Provides Guidance Regarding Credit for Extraordinary Cooperation).
3. See note 2 above.
4. See note 2 above.
5. The purpose of the “should have known” standard is to ensure that member firms do not intentionally avoid becoming aware of a reportable event.
6. See FINRA Rule 4530.08.
7. See note 6 above.
8. See FINRA Rule 4530.09.
9. Firms should note that Form U5 requires them to disclose specified events regarding former associated persons, including certain criminal matters, customer complaints and internal reviews. See also [Regulatory Notice 10-39](#) (September 2010) (Obligation to Provide Timely, Complete and Accurate Information on Form U5). Moreover, as noted above, a firm is not required to report an event otherwise required to be reported under FINRA Rules 4530(a) or (b) if the firm discloses the event on Form U5, consistent with the requirements of that form. See FINRA Rule 4530(e). Consequently, if a member firm discloses the matters described in Questions 13, 14 and 15 on Form U5, that member firm is relieved of the obligation to report the matters under FINRA Rules 4530(a) or (b).
10. The employing member firm would also have to promptly file with FINRA copies of the indictment pursuant to FINRA Rule 4530(f).