Regulatory Notice 17-13

Sanction Guidelines

FINRA's NAC Revises the Sanction Guidelines

Effective Immediately

Executive Summary

This *Notice* advises FINRA firms of revisions to FINRA's *Sanction Guidelines*. FINRA initiated a periodic review of the *Sanction Guidelines* through the National Adjudicatory Council (NAC) to ensure that the 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. These revisions:

- establish a new factor requiring that the exercise of undue influence over a customer be considered for all violations addressed by the *Sanction Guidelines*;
- introduce three new *Sanction Guidelines*: Systemic Supervisory Failures, Short Interest Reporting, and Borrowing From or Lending to Customers;
- present a new factor related to the mitigative effect of regulator or firm-imposed sanctions and corrective action;
- amend 12 sections of the *Sanction Guidelines* to revise sanctions for more serious FINRA rule violations; and
- harmonize the *Sanction Guidelines* to the relevant precedent, prior amendments to the *Sanction Guidelines* and FINRA's rulebook consolidation process.

The revised *Sanction Guidelines* are effective immediately and available on FINRA's website at *www.finra.org/Industry/Enforcement/SanctionGuidelines*.

Questions concerning this *Notice* may be directed to:

- Alan Lawhead, Office of General Counsel, at (202) 728-8853; and
- Jante Turner, Office of General Counsel, at (202) 728-8317.

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Notice Type

- Guidance

Suggested Routing

- Legal
- Registered Representatives
- Senior Management

Key Topics

- FINRA Sanction Guidelines

Referenced Rules and Notices

- FINRA By-Laws, Article V
- FINRA Rules 1122, 2010, 2111, 2121, 3110, 3240, 3270, 4511, 4560, 5310, 7230A and 7330
- MSRB Notice 2004-3
- MSRB Rules G-7, G-8, G-9, G-17, G-18, G-27 and G-30
- NASD Rules 2150 and 3010
- Regulation SHO
- Securities Act of 1933, Section 5
- Securities Exchange Act of 1934, Section 17, and SEA Rules 17a-3 and 17a-4

Financial Industry Regulatory Authority

Background

FINRA's *Sanction Guidelines* familiarize 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 initiates periodic reviews of the *Sanction Guidelines* through the NAC 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. The revisions discussed in this *Notice* are the result of FINRA's most recent review of the *Sanction Guidelines*. Further review is underway of changes to make the *Sanction Guidelines* more effective.

New Guidance

FINRA has introduced one new principal consideration that analyzes whether a respondent has exercised undue influence over a customer, three new *Sanction Guidelines* (Supervision—Systemic Supervisory Failures, Borrowing From or Lending to Customers, and Short Interest Reporting), and one new general principle that examines the mitigative effect of regulator or firm-imposed sanctions and corrective action.

1. **Consideration for Vulnerable Customers.** FINRA has introduced a new principal consideration that examines whether a respondent has exercised undue influence over a customer. This new consideration reaffirms that financial exploitation of senior and other vulnerable customers should result in strong sanctions. While FINRA's decisions have acknowledged that exercising undue influence is an aggravating circumstance on a case-by-case basis, the new principal consideration makes clear that the *Sanction Guidelines* contemplate coverage for vulnerable individuals or individuals with diminished capacity, which may include senior investors.
2. **Supervision—Systemic Supervisory Failures.** The current *Sanction Guidelines* related to supervision violations focus on limited supervisory failures, such as those involving an individual or a small number of associated persons. The new guideline applies to violations related to systemic supervisory failures and firm wide supervisory problems. The introduction of the guideline for Supervision—Systemic Supervisory Failures results in related changes to the guideline for Supervision—Failure to Supervise.
3. **Short Interest Reporting.** Currently, sanctions for violations involving short interest reporting are determined in accordance with the guideline related to Short Sale Violations. The use of this analogous guideline, however, fails to account for the unique set of factors that short interest reporting violations typically present. Accordingly, the introduction of the guideline for Short Interest Reporting sets forth principal considerations unique to short interest reporting cases. The introduction of the guideline for Short Interest Reporting results in related changes to the guideline for Short Sale Violations.

4. **Borrowing From or Lending to Customers.** There are large numbers of litigated and settled cases involving borrowing and lending arrangements between registered representatives and customers, but the current iteration of the *Sanction Guidelines* has no guideline related to these types of violations. The introduction of a guideline related to borrowing and lending arrangements between representatives and customers provides adjudicators with guidance on the assessment of sanctions in these cases.
5. **Consideration of Regulator or Firm-Imposed Sanctions.** FINRA also has established a new general principle, General Principle No. 7, which addresses the potential mitigative effect of regulator or firm-imposed sanctions and corrective action. The new general principle provides FINRA adjudicators with more detailed guidance for sanctions imposed by another regulator or corrective action imposed by a member firm. General Principle No. 7 will replace the guidance provided in Principal Consideration in Determining Sanctions, No. 14. Principal Consideration No. 14 has been deleted.

Revisions to Existing *Sanction Guidelines*

FINRA modified the non-monetary (suspension) and monetary (fine) range of sanctions for several guidelines that involve more serious violations of FINRA rules. For example, the guideline for Sales of Unregistered Securities, as amended, raises the sanctions for unregistered securities sales that involve a high volume of "penny stock" transactions.[1] The amended guideline adds principal considerations that focus on a respondent's penny stock activities and advises adjudicators to consider lengthier suspensions and higher fine ranges if an individual respondent's conduct involves a high volume of penny stock transactions or recurring penny stock transactions.

FINRA implemented similar changes to violations that involve churning or unauthorized transactions. The low-end of the suspension range for an individual respondent who engages in churning or unauthorized transactions increased from 10 business days to one month. The high-end suspension range for churning and unauthorized transactions for an individual respondent has increased from one year to two years and the revised guidelines for Churning or Unauthorized Transactions recommend that FINRA adjudicators strongly consider barring an individual respondent when the respondent acted recklessly or intentionally.

Endnotes

1. FINRA adopted the use of the term "penny stock," as it is defined in Section 3(a)(51) of the Securities Exchange Act of 1934 (SEA) and SEA Rule 3a51-1.