

Cease and Desist Orders

SEC Approves Amendments to FINRA Rules Regarding Temporary and Permanent Cease and Desist Orders

Effective Date: November 2, 2015

Executive Summary

The SEC recently approved amendments to FINRA rules that lower the evidentiary standard to impose a temporary cease and desist order (TCDO); create a new expedited proceeding for repeated failures to comply with a TCDO or a permanent cease and desist order (PCDO); harmonize the provisions governing how documents are served in temporary cease and desist and expedited proceedings; clarify FINRA's authority to impose a PCDO; and ease FINRA's administrative burden in temporary cease and desist proceedings.¹ The amendments become effective on November 2, 2015.

The amended rule text is available at www.finra.org/notices/15-35.

Questions concerning this *Notice* should be directed to:

- ▶ James S. Wrona, Vice President & Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270 or Jim.Wrona@finra.org; or
- ▶ Michael Garawski, Associate General Counsel, OGC, at (202) 728-8835 or Michael.Garawski@finra.org.

Background & Discussion

Pursuant to the FINRA Rule 9800 Series, FINRA is authorized to seek and impose a TCDO in connection with the violation of specified rules. A TCDO can be imposed by a FINRA hearing panel where the potential harm resulting from violations to investors is likely and significant. It is designed to stop serious violative conduct and maintain the status quo while an underlying disciplinary proceeding is being litigated. FINRA's TCDO authority is a critical investor-protection tool. Relatedly, FINRA Rule 9556 permits FINRA to bring an expedited proceeding against a firm, associated person or person subject to FINRA's jurisdiction who fails to comply with a TCDO or a PCDO.

October 2015

Notice Type

- ▶ Rule Amendment
- ▶ New Rule

Suggested Routing

- ▶ Compliance
- ▶ Legal

Key Topics

- ▶ Disciplinary Proceedings
- ▶ Expedited Proceedings
- ▶ Permanent Cease and Desist Orders
- ▶ Temporary Cease and Desist Orders
- ▶ Temporary Cease and Desist Proceedings

Referenced Rules & Notices

- ▶ FINRA Rule 9200 Series
- ▶ FINRA Rule 9300 Series
- ▶ FINRA Rule 9550 Series
- ▶ FINRA Rule 9556
- ▶ FINRA Rule 9800 Series
- ▶ FINRA Rule 9820(a)
- ▶ FINRA Rule 9840

The SEC recently approved amendments to FINRA rules that will strengthen FINRA's ability to use its TCDO and expedited-proceedings authority to better protect investors. In particular, the approved rule changes lower the evidentiary standard to obtain a TCDO; equip FINRA with stronger authority to sanction a firm, associated person or person subject to FINRA's jurisdiction who repeatedly violates a TCDO or PCDO; reduce FINRA's administrative burdens in processing temporary cease and desist proceedings, including expanding the pool of persons who are eligible to serve on hearing panels; and clarify FINRA's authority to impose PCDOs. The rule amendments also harmonize the provisions governing service of documents and permit email service in temporary cease and desist and expedited proceedings.

TCDO Evidentiary Standard

Prior to the approved rule change, FINRA Rule 9840(a)(1) provided that a TCDO will be imposed if the hearing panel finds "by a preponderance of the evidence that the alleged violation... has occurred." To increase the effectiveness of FINRA's temporary cease and desist authority and improve its capacity to protect investors facing the likelihood of significant dissipation or conversion of assets, FINRA amended FINRA Rule 9840(a)(1) by lowering the evidentiary standard for obtaining a TCDO to "a showing of a likelihood of success on the merits." This change will enable FINRA to initiate and resolve temporary cease and desist proceedings sooner and more efficiently, which will better protect investors' assets and prevent other significant harm until the concurrent disciplinary proceeding is held.²

Expedited Proceeding for Repeated Failures to Comply With a TCDO or a PCDO

Pursuant to FINRA Rule 9556, if a firm, associated person or person subject to FINRA's jurisdiction fails to comply with a TCDO or a PCDO, FINRA staff (with prior written authorization from FINRA's chief executive officer or such other senior officer as the chief executive officer may designate) may issue a notice to the firm or person stating that the failure to comply within seven days will result in a suspension or cancellation of membership or a suspension or bar from associating with any firm, and also stating what the firm or person must do to avoid such action. Prior to the approved rule change, a respondent could potentially abuse this procedure by repeatedly violating a TCDO or a PCDO and then curing that violation before the effective date of the Rule 9556 notice, without being subject to immediate sanctions.

To address FINRA's concerns with such "violate and cure" situations, FINRA has created a new expedited proceeding. Under new FINRA Rule 9556(h), if a firm, associated person or person subject to FINRA's jurisdiction fails to comply with a TCDO or a PCDO and has previously been served under FINRA Rule 9556(a) with a notice for a failure to comply with any provision of the same TCDO or PCDO, FINRA staff (with prior written authorization from FINRA's chief executive officer or such other senior officer as the chief executive officer may designate) may file a petition with the Office of Hearing Officers seeking a hearing and the imposition of any fitting sanctions. In contrast with FINRA Rule 9556(a) proceedings, full compliance with the TCDO or PCDO is not a ground for dismissing a FINRA Rule 9556(h) proceeding.

Administrative Changes to Temporary Cease and Desist Proceedings

The SEC approved amendments to the FINRA Rule 9800 Series that ease FINRA's administrative burdens in temporary cease and desist proceedings. Most significantly, amended FINRA Rule 9820(a) expands the pool of persons who are eligible to serve on hearing panels in temporary cease and desist proceedings. Prior to the rule change, this pool was narrowly circumscribed, which carried the potential to impede the recruitment and appointment of panelists. Amended FINRA Rule 9820(a) alleviates this burden by authorizing the chief hearing officer to appoint panelists from the same, larger group of persons who are eligible to serve on hearing panels in disciplinary proceedings.³

PCDO Authority

FINRA amended the FINRA Rule 9200 and 9300 Series to clarify the process for imposing a PCDO in disciplinary proceedings. These rule amendments are procedural in nature and do not reflect any change to FINRA's prior representations concerning the context in which it will seek to impose a PCDO.⁴

Harmonized Service Provisions in Temporary Cease and Desist and Expedited Proceedings

The approved rule change amends provisions in the FINRA Rule 9550 and 9800 Series that govern service of documents in temporary cease and desist and expedited proceedings. The amended rules will allow service by facsimile and by email, and service on counsel, across all temporary cease and desist and expedited proceedings.

Endnotes

1. See Securities Exchange Act Release No. 75629 (August 6, 2015), 80 FR 48379 (August 12, 2015) (Order Approving File No. SR-FINRA-2015-019).
2. The SEC also approved a corresponding amendment to FINRA Rule 9840(a)(2). Prior to the amendment, FINRA Rule 9840(a)(2) provided that a TCDO shall be imposed if the hearing panel finds “that the violative conduct or continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors prior to the completion of the underlying disciplinary proceeding.” Amended FINRA Rule 9840(a)(2) will require that a TCDO be imposed if the hearing panel makes this finding with respect to the “alleged” violative conduct.
3. FINRA also amended FINRA Rule 9840 to require a firm that is the subject of a TCDO to deliver a copy of the TCDO to its associated persons, within one business day of receiving it. As the SEC stated in its approval order, this provision should help prevent fraudulent and manipulative acts and practices by ensuring that the persons who may act on behalf of the firm are made aware of the contents of a TCDO imposed against the firm.
4. See Securities Exchange Act Release No. 47925 (May 23, 2003), 68 FR 33548, 33550 & n.18 (June 4, 2003) (Order Approving File No. SR-NASD-98-80).