

An Introduction to FINRA Enforcement Proceedings

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For the commercial litigator, their first foray into the world of enforcement actions brought by the Financial Industry Regulatory Authority (FINRA) can be disorienting. Many elements will seem familiar: substantive rules govern the conduct of FINRA members and their employees; procedural rules guide enforcement actions; in-person hearing with testimony and an adjudication. While sanctions can and often are imposed, no one goes to jail.

But below the surface are fundamental differences that can catch even experienced counsel off-guard. Discovery is a one-way street: FINRA Enforcement has the power to depose witnesses at any time, but respondents have no such ability. Causes of action are broadly written, and references to “high standards of commercial honor,” for example, may leave a civil litigator at a loss as to what the elements of such a claim might be.

Role and Function

FINRA is a limited purpose, *private* organization that oversees broker-dealers in the United States. It is a self-regulatory organization (SRO) authorized by the Securities and Exchange Act of 1934 with oversight by the Securities & Exchange Commission (SEC). FINRA has jurisdiction over securities broker-dealers (known as members) and their employees who handle securities transactions (known as representatives). The organization is generally considered a private actor not subject to the Due Process Clause.

Before the Complaint

Most FINRA enforcement actions begin as requests for information under FINRA Rule 8210, which permits the organization to, at any time, seek documents and information from any member or associated person under FINRA’s jurisdiction and to depose them under oath.

Unlike the SEC or an attorney general, FINRA cannot compel documents or testimony from persons outside its jurisdiction. Nonetheless, the scope of Rule 8210 is generally sufficient for enforcement actions.

Rule 8210(c) provides that “No member or person shall fail to provide information or testimony or to permit an inspection and copying of books, records, or accounts pursuant to this Rule.” As a result, persons (whether under investigation by FINRA or not) have no choice but to comply with requests for information and to appear for depositions. FINRA panels regularly impose permanent bars for failing to comply with Rule 8210 requests. Accordingly, respondents must be prepared to submit to deposition (and likely more than once) before receiving any notice of the charges.

This may come as a surprise to a lawyer who expects to be able to research and respond to a complaint before discovery begins. But that is not the case in FINRA enforcement proceedings. Respondents should expect to testify

early and often. That they may do so without the benefit of any documentary discovery or even knowledge of the charges against them is simply the nature of the proceeding.

If FINRA Enforcement finds that charges are warranted, it will formally initiate an investigation by providing what is called a “Wells Notice.” This is a bare-bones description of the charges that identifies the conduct and alleged rule violations. Receipt of the Wells Notice by itself creates significant obligations. As the recipient is now the target of an investigation (and no longer just a person responding to requests for information), they have an obligation to amend their U4s or make other similar regulatory disclosures.

The Wells Notice will also give the respondent a window of time to file what is called a Wells Submission, which provides an opportunity to make an argument as to why charges should not proceed. Following the Wells Notice, FINRA decides whether or not to proceed with a particular case and generally does so quickly regardless of whether a Wells Submission is filed. If charges are brought, and they generally will be, the affected person or entity is served with a complaint. This is the first time in the process when the affected person, now known as the respondent, must receive detailed information about the charges against them.

Before or after the complaint is filed, a respondent may resolve the case through the Advice, Waiver and Consent (AWC) process—essentially plea-bargaining. Depending on the nature of the underlying conduct as well as the expectations of FINRA Enforcement, resolution may be possible at this stage.

Discovery Rights

FINRA Rule 8210 remains available throughout the proceedings for FINRA Enforcement. It can continue to request documents and information from members and their employees and so continue to build their case.

With no subpoena power of their own, respondents have just two formal avenues to obtain material for their defense. First, under FINRA Rule 9251, they are entitled to a copy of the investigative file and the transcripts of any on-the-record interviews conducted by FINRA, except for FINRA Enforcement’s attorney work product, including notes of witness conversations. Second, under FINRA Rule 9252(b), respondents can seek a motion to compel Enforcement to obtain information from FINRA members under Rule 8210. The standard appears undemanding but, in practice, such requests are often denied.

Moreover, because FINRA Enforcement proceedings often move quickly (4-6 months from the time an answer is filed to when the in-person hearing is held), respondents will have limited time to examine the investigative file and see what, if anything, they may want to try to obtain under FINRA Rule 9252(b).

Rule 2010 and Due Process

FINRA Rule 2010 states: “A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” Because of this expansive definition, virtually any violation of another FINRA rule or securities regulation will also constitute a violation of FINRA Rule 2010. Indeed, FINRA Enforcement often charges violation of Rule 2010 alongside more specific rules for the same conduct.

This type of charge can be disorienting for a civil litigator not experienced in defending FINRA proceedings. How can a rule such as this be enforced? Doesn’t that violate the requirements of fair notice? The Supreme Court has ruled “It is established that a law fails to meet the requirements of the Due Process Clause if it is so vague and standardless that it leaves the public uncertain as to the conduct it prohibits[.]” *City of Chicago v. Morales*, 527 U.S. 41, 56 (1999) (citation and internal quotation marks omitted).

However, courts addressing such challenges have denied them, holding that FINRA, as a private actor, is not subject to the requirements of Due Process. While FINRA *proceedings* must comply with statutory directives that provide a minimum level of procedural due process, *see Cody v. S.E.C.*, 693 F.3d 251, 257 (1st Cir. 2012)(provisions of Exchange Act require FINRA to “bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record.”), FINRA substantive rules need not comply with Due Process because FINRA is not a state actor. *See Santos-Buch v. Fin. Indus. Regulatory Auth., Inc.*, 32 F. Supp. 3d 475, 485 (S.D.N.Y. 2014), *aff’d*, 591 F. App’x 32 (2d Cir. 2015).

After the Hearing

The Hearing Panel will hand down a decision within 60 days of the last submission by the parties. FINRA may only impose censures, suspensions and bars. While it can (and frequently does) impose fines as part of its sanctions decision, FINRA cannot enforce them against persons who are no longer FINRA members, including those who have lost their membership as a result of a FINRA-imposed bar.

After a decision by the hearing panel, both FINRA Enforcement and the respondent can take an appeal to the National Advisory Council within FINRA. Aggrieved respondents can go further and appeal to the SEC, which will review the matter *de novo*. Furthermore, a limited right of appeal to a federal appellate court is available after the SEC action.

It is important to note that, while FINRA is limited to broker-dealers, its sanctions may influence state, federal or other SRO regulators who have overlapping jurisdiction. Accordingly, FINRA sanctions can have severe consequences even for people who no longer operate in the broker-dealer business.

Conclusion

FINRA Enforcement proceedings are designed to quickly punish or remove those who violate FINRA’s rules or the rules and regulations governing the securities industry. As such, they lack many of the procedural protections applicable in civil or criminal litigation and the rules themselves, particularly FINRA Rule 2010, make it easier for Enforcement to obtain an adverse finding. However, that makes the role of an informed advocate more, not less, important. Counsel should be prepared.

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