

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75629; File No. SR-FINRA-2015-019)

August 6, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Amend FINRA Rules Regarding Temporary and Permanent Cease and Desist Orders

I. Introduction

On June 16, 2015, the Financial Industry Regulatory Authority, Inc. (“FINRA”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to amend FINRA Rule Series 9100, 9200, 9300, 9550, and 9800 regarding temporary cease and desist orders (TCDO) and permanent cease and desist orders (PCDO). The proposed rule change was published for comment in the Federal Register on July 7, 2015.³ The Commission received one comment on the proposal, which supported the proposal.⁴ This order approves the proposed rule change.

II. Description of the Proposed Rule Change⁵

The Code of Procedure (Rule Series 9000) governs FINRA’s disciplinary process, and includes: Rule 9120, Definitions, Rule Series 9200, Disciplinary Proceedings, Rule Series 9300,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 75333 (June 30, 2015), 80 FR 38783 (July 7, 2015) (“Notice”).

⁴ See Letter from Joseph C. Peiffer, President, Public Investors Arbitration Bar Association, to Brent J. Fields, Secretary, Commission dated July 28, 2015 (“PIABA Letter”).

⁵ The Notice contains a more detailed description of the proposal. See Notice, supra note 3.

Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review, Rule Series 9500, Other Proceedings, and Rule Series 9800, Temporary Cease and Desist Orders. FINRA’s temporary cease and desist authority, introduced on a pilot basis in 2003⁶ and approved permanently in 2009,⁷ can be used only in connection with the violation of specified rules,⁸ and requires that a Hearing Panel find by a preponderance of the evidence that the alleged violation has occurred in order to impose a TCDO.⁹ FINRA proposed to amend Rule Series 9800 to, among other things, lower the evidentiary standard for finding a violation to “a showing of likelihood of success on the merits.” FINRA also proposed to amend Rule Series 9100, 9200, 9300, and 9550 to adopt a new expedited proceeding for failure to comply with a TCDO or PCDO, to harmonize the provisions governing how documents are served in temporary cease and desist proceedings and related expedited proceedings, to clarify the process for issuing PCDOs, to ease FINRA’s administrative burden in temporary cease and desist proceedings, particularly with respect to appointment of a Hearing Officer and Hearing Panel, and to make conforming changes throughout the Code of Procedure.

⁶ See Securities Exchange Act Release No. 47925 (May 23, 2003), 68 FR 33548 (June 4, 2003) (Order Approving File No. SR-NASD-98-80).

⁷ See Securities Exchange Act Release No. 60306 (July 14, 2009), 74 FR 36292 (July 22, 2009) (Order Approving File No. SR-FINRA-2009-035).

⁸ Rule 9810(a) provides that a temporary cease and desist proceeding may be initiated with respect to alleged violations of Section 10(b) of the Act (15 U.S.C. 78j(b)) and Rule 10b-5 under the Act (17 CFR 240.10b-5); Rules 15g-1 through 15g-9 under the Act (17 CFR 240.15g-1 *et seq.*); FINRA Rule 2010 (if the alleged violation is unauthorized trading, or misuse or conversion of customer assets, or based on violations of Section 17(a) of the Securities Act of 1933 (15 U.S.C. 77q(a))); FINRA Rule 2020; or Rule 4330 (if the alleged violation is misuse or conversion of customer assets).

⁹ Rule 9840(a)(1).

A. TCDO Evidentiary Standard

Rule 9840(a)(1) provides that a TCDO shall be imposed if the Hearing Panel finds “by a preponderance of the evidence that the alleged violation specified in the notice has occurred.” FINRA believes this is too high an evidentiary threshold to obtain a TCDO, which FINRA considers a critical investor protection tool. FINRA notes that the evidentiary standard to get a TCDO is the same one needed to find a violation in the concurrent underlying disciplinary proceeding. FINRA states that it creates an administrative challenge to have to make the same evidentiary presentation in the temporary cease and desist proceeding as in the subsequent underlying disciplinary proceeding, but on an expedited basis. Therefore, FINRA has proposed to lower the evidentiary standard in temporary cease and desist proceedings.

B. Expedited Proceeding for Failure to Comply with TCDOs and Permanent Cease and Desist Orders

FINRA proposed to amend Rule 9556, which sets forth expedited procedures for enforcing violations of TCDOs and PCDOs. Under current Rule 9556, if a member or person fails to comply with a TCDO or PCDO, FINRA may issue a notice stating that the failure to comply within seven days of the notice will result in a suspension or cancellation of membership or a suspension or bar from associating with any member and also stating what the respondent must do to avoid such action. FINRA is concerned that a respondent could abuse the current expedited procedure by a repeated pattern of “violate and cure,” where a respondent could violate a cease and desist order and then cure that violation before the effective date of the notice.

Proposed Rule 9556(h) describes a new expedited proceeding for the respondent of a TCDO or PCDO that fails to comply with that order and has previously been served with a notice under Rule 9556(a) for a failure to comply with any provision of the TCDO or PCDO. In

contrast with other expedited proceedings described by Rule 9556, proposed Rule 9556(h)(3) provides that a respondent's compliance with the TCDO or PCDO is not grounds for dismissing the Rule 9556(h) proceeding.

C. Service Provisions in Temporary Cease and Desist Proceedings and Expedited Proceedings

FINRA proposed to amend the rules that govern service of documents in temporary cease and desist proceedings and other related expedited proceedings to make the rules consistent. Currently, some rules explicitly address service by facsimile and on counsel, while others do not. FINRA proposed to explicitly allow service by facsimile and on counsel, as well as by email, across all temporary cease and desist and expedited proceedings.

FINRA states that email service is particularly important in expedited proceedings and will allow parties to receive information quickly and will remove unnecessary burdens and inefficiencies. FINRA notes that where the proposed revisions permit email service, they also require duplicate service through other means such as overnight courier or personal delivery.

D. PCDO Authority

FINRA also proposed to clarify the process for imposing PCDOs in disciplinary proceedings. FINRA states that these changes are procedural in nature and do not reflect any change to FINRA's prior representations concerning the context in which it will seek PCDOs.¹⁰

E. Administrative and Clarifying Changes to Temporary Cease and Desist Proceedings

1. Eligibility to Serve on a Hearing Panel for Temporary Cease and Desist Proceedings

FINRA seeks to expand the pool of persons eligible to serve on a Hearing Panel. Currently, Rule 9820(a) requires that the three-person Hearing Panel appointed to preside over a

¹⁰ See Order Approving File No. SR-NASD-98-80, at 33550 n.18, supra note 6.

temporary cease and desist proceeding include two panelists who are current or former Governors, Directors, or National Adjudicatory Council members, and at least one Panelist who is an associated person. FINRA states that the current rules limit the pool of potential panelists for temporary cease and desist proceedings and that other adjudicatory proceedings, including the disciplinary proceeding that underlies the temporary cease and desist proceeding and the various Rule 9556 expedited proceedings to enforce a cease and desist order, are not limited in this manner.¹¹ FINRA believes that this limited pool, coupled with the short time in which a temporary cease and desist proceeding must be processed, creates administrative burdens for the Office of Hearing Officers.

FINRA proposed to amend Rule 9820 to permit the following persons to sit on Hearing Panels that preside over temporary cease and desist proceedings: persons who currently serve or previously served on a District Committee; previously served on the National Adjudicatory Council; previously served on a disciplinary subcommittee of the National Adjudicatory Council or the National Business Conduct Committee; previously served as a member of the Board of Directors of FINRA Regulation or of the Board of Governors of FINRA; or currently serve or previously served on a committee appointed or approved by the Board of Governors of FINRA, but do not serve currently on the National Adjudicatory Council or as a member of the Board of

¹¹ See Securities Exchange Act Release No. 73230 (September 26, 2014); 79 FR 59534 (October 2, 2014) approving SR-FINRA-2014-036 which amended Rules 9231 and 9232 regarding eligibility to serve on Hearing Panels and Extended Hearing Panels and Securities Exchange Act Release No. 72543 (July 3, 2014); 79 FR 39440 (July 10, 2014) providing notice of SR-FINRA-2014-031 which amended the definition of Hearing Officer in Rule 9120.

Directors of FINRA Regulation or of the Board of Governors of FINRA. Each panelist must be associated with a member of FINRA or retired therefrom.¹²

2. Procedure for Obtaining Extensions

FINRA also proposed to amend the process to obtain an extension of deadlines for issuing decisions in temporary cease and desist proceedings and responding to requests to modify, set aside, limit or suspend a TCDO. Under current Rule 9840(a), the Hearing Panel's deadline for issuing its written decision can be extended by the Hearing Officer with the consent of the parties "for good cause shown." FINRA believes that the Hearing Panel should have flexibility where it can make a good cause showing of why it needs additional time to prepare its decision or respond to a Rule 9850 request. The proposed changes to Rules 9840(a) and 9850 would permit the Chief Hearing Officer or Deputy Chief Hearing Officer to extend the deadlines for issuing decisions and responding to Rule 9850 applications where good cause is shown and eliminate the requirement for consent of the parties.

3. Additional Administrative Proposals

FINRA also proposed to: (i) require FINRA's prosecuting department to file a memorandum of points and authorities with the notice initiating a temporary cease and desist proceeding; and (ii) permit the Hearing Officer to order a party to furnish to all other parties and

¹² The proposed pool of persons that would be eligible to serve on a Hearing Panel for TCDO proceedings is the same as that for disciplinary proceedings. See FINRA Rule 9231(b) (providing that each panelist shall be associated with a member of FINRA or retired therefrom and that the pool of panelists for disciplinary proceedings includes current or previous members of District Committees, former members of the National Adjudicatory Council, past members of disciplinary subcommittees of the National Adjudicatory Council or the National Business Conduct Committee, past members of the Board of Directors of FINRA Regulation or past members of the Board of Governors of FINRA, and current or previous members of committees appointed or approved by the Board of Governors of FINRA); FINRA Rule 9559(d)(2) (providing for the same pool for FINRA Rule 9556 expedited proceedings).

the Hearing Panel such information as deemed appropriate, including any or all of the pre-hearing submissions described in Rule 9242(a). FINRA states that the requirement to file a memorandum of points and authorities at the initiation of the proceeding will provide more context to the allegations, which will make the process more efficient, improve the quality of the hearing, and increase the fairness of the proceeding. FINRA believes its proposal to authorize the Hearing Officer to order a party to furnish other pre-hearing submissions also serves these objectives.

4. Delivery Requirement

FINRA further proposed to require a member firm that is the subject of a TCDO to provide a copy of the order to its associated persons, within one business day of receiving it. FINRA states that because of the significant nature of the harm that a TCDO is aimed at stopping, there is a heightened need to ensure that the persons who may act on behalf of the member firm are made aware of the contents of a TCDO imposed against the member firm.¹³

III. Discussion and Commission Findings

After careful review, the Commission finds that FINRA's proposal is consistent with the requirements of Section 15A of the Act¹⁴ and the rules and regulations thereunder applicable to a national securities association.¹⁵ In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 15A(b)(2) of the Act,¹⁶ which requires, among other things, that a national securities association have the capacity to be able to carry out

¹³ FINRA also proposed clarifying changes. See Notice, supra note 3, at 38787.

¹⁴ 15 U.S.C. 78(f).

¹⁵ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁶ 15 U.S.C. 78o-3(b)(2).

the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the association; Section 15A(b)(6) of the Act,¹⁷ which requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest; Section 15A(b)(7) of the Act,¹⁸ which requires, among other things, that the rules of a national securities association provide that its members and persons associated with its members shall be appropriately disciplined for violation of any provision of the Act, the rules of regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or the rules of the association by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction; and Section 15A(b)(8) of the Act,¹⁹ which requires that the rules of a national securities association provide a fair procedure for, among other things, the disciplining of members and persons associated with members.

FINRA proposed to amend the evidentiary standard that must be met before imposing a TCDO from a preponderance of the evidence to a likelihood of success on the merits. The commenter expressed support for this amendment, noting that because a lesser showing is required at the TCDO stage, more time and effort could be devoted to meeting the

¹⁷ 15 U.S.C. 78o-3(b)(6).

¹⁸ 15 U.S.C. 78o-3(b)(7).

¹⁹ 15 U.S.C. 78o-3(b)(8).

“preponderance of the evidence” standard at the disciplinary stage.²⁰ The commenter also stated that the change in evidentiary standard would harmonize FINRA’s standard with that used in other jurisdictions.²¹ Finally, the commenter noted FINRA’s commitment to use its TCDO authority judiciously, but argued that the benefits of the new evidentiary standard could not be realized if the proceedings are used judiciously.²²

The Commission believes that FINRA’s proposed change to the evidentiary standard should improve FINRA’s ability to initiate and resolve cases involving conversion of assets more quickly than under the current standard, which requires the same evidentiary showing that is required in the concurrent underlying disciplinary proceeding. The Commission agrees with FINRA’s statement that the proposed rule change “maintains all of the meaningful existing restraints” on its TCDO authority.²³ The Commission expects that FINRA will continue to use its authority in a judicious manner under the new evidentiary standard, consistent with its representation in the notice seeking permanent approval for the use of TCDOs.²⁴

The Commission also believes that the adoption of an expedited proceeding for failure to comply with a TCDO or PCDO will aid in the protection of investors and thus further the public

²⁰ See PIABA Letter, supra note 4, at 2.

²¹ Id. at 2-3.

²² Id. at 3.

²³ See Notice, supra note 3, at 38785.

²⁴ In the Commission’s 2009 order approving FINRA’s temporary cease and desist authority on a permanent basis, the Commission noted approvingly FINRA’s statement that it would use the authority “judiciously.” See Order Approving SR-FINRA-2009-035, supra note 7. In the Notice, FINRA represented that its use of the authority to date has been judicious in that FINRA has sought and obtained TCDOs on only seven occasions since 2003. FINRA intends to continue using its temporary cease and desist authority in a judicious manner. See Notice, supra note 3, at 38784-5. See also Securities Exchange Act Release No. 60028 (June 2, 2009), 74 FR 27364 (June 9, 2009) (Notice of Filing of SR-FINRA-2009-035).

interest and is designed to prevent fraudulent and manipulative acts and practices by removing the opportunity for a respondent to repeatedly violate a cease and desist order and then cure that violation before the effective date of the notice of failure to comply without any consequence to the respondent. The Commission also believes that the proposed expedited proceeding provides a fair procedure for the disciplining of members and persons associated with members because the proceeding can only occur after the respondent has been served with notice of failure to comply with the TCDO or PCDO, and the procedure of the expedited proceeding is governed by existing Rule 9559.

Expanding the pool of persons eligible to serve on Hearing Panels should ensure that there is an adequate pool of persons available to serve on both the temporary cease and desist proceeding and the concurrent underlying disciplinary proceeding. Further, permitting the Chief Hearing Officer or Deputy Chief Hearing Officer to extend the deadlines for Hearing Panels to hold hearings, issue decisions, and respond to Rule 9850 applications where good cause is shown retains the requirement of the current rule that there must be a showing of good cause to obtain an extension, but requires that this showing be made to the Chief Hearing Officer or Deputy Chief Hearing Officer, rather than the Hearing Officer presiding over the proceeding, as the current rule requires. Thus, the requirement for the parties to consent to an extension of time is no longer necessary, as the person who is making the decision is not involved in the proceeding.

FINRA's administrative proposals to (i) require FINRA's prosecuting department to file a memorandum of points and authorities with the notice initiating a temporary cease and desist proceeding; and (ii) permit the Hearing Officer to order a party to furnish to all other parties and the Hearing Panel such information as deemed appropriate, including any or all of the pre-hearing submissions described in Rule 9242(a) should enable FINRA to provide a fair procedure

for the disciplining of members and persons associated with members by providing the parties more information about the allegations at the outset of the proceeding.

Requiring a member firm that is the subject of a TCDO to provide a copy of the order to its associated persons should help prevent fraudulent and manipulative acts and practices by ensuring that the persons who may act on behalf of the member firm are made aware of the contents of a TCDO imposed against the member firm.

For the reasons discussed above, the Commission finds that the proposed rule change is consistent with the Section 15A of the Act and the rules and regulations thereunder.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁵ that the proposed rule change (SR-FINRA-2015-019) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁶

Robert W. Errett
Deputy Secretary

²⁵ 15 U.S.C. 78s(b)(2).

²⁶ 17 CFR 200.30-3(a)(12).