

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65643 / October 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14605

In the Matter of

**FINANCIAL INDUSTRY
REGULATORY
AUTHORITY, INC.,**

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTION
21C OF THE SECURITIES EXCHANGE ACT
OF 1934, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against the Financial Industry Regulatory Authority, Inc. (“FINRA” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over FINRA and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

These proceedings arise out of FINRA's production of altered documents in response to a document request made by the Commission's Chicago Regional Office inspection staff ("the Commission inspection staff").

Specifically, on August 7, 2008, the Director of FINRA's Kansas City District Office ("the Director") caused the alteration of three records of staff meeting minutes just hours before producing them to the Commission inspection staff, making them inaccurate and incomplete.

The Director's misconduct is the third instance during an eight year period in which a FINRA employee, or an employee of its predecessor, the National Association of Securities Dealers, Inc. ("NASD"), provided altered or misleading documents to the Commission. Although FINRA has endeavored to improve its procedures and training since document integrity issues came to light in May 2006 and December 2007, those efforts were not effective in preventing the Director's misconduct.

Respondent

FINRA, located in Washington, DC, is a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act. It was created on July 30, 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange ("NYSE"). As a registered association, FINRA has the statutory obligation to comply with the Exchange Act and to enforce compliance by its members with the Exchange Act and its own rules. It is the largest independent regulator of securities firms doing business with the public in the United States. As of December 31, 2010, FINRA oversaw nearly 4,600 brokerage firms, approximately 163,000 branch offices and almost 631,000 registered securities representatives.

Other Relevant Entities

NASD, formerly located in Washington, DC, was a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act until it was consolidated with the member regulation, enforcement and arbitration operations of the NYSE to form FINRA in July 2007.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Facts

FINRA Fails to Furnish Complete and Accurate Records

On July 28, 2008, FINRA's Kansas City District Office received a document request from the Commission inspection staff. The request related to a previously announced inspection of FINRA's Kansas City District Office, which is responsible for conducting FINRA's regulatory programs in seven states.

Item 36 of the document request letter asked for "Minutes of District staff meetings conducted between November 1, 2005 and the present." On August 7, 2008—hours before furnishing the Commission inspection staff with FINRA's response to Item 36—the Director caused the minutes for meetings that took place on August 28, 2006, September 22, 2006 and January 31, 2007 to be altered. Specifically, certain information was deleted or edited, while in other instances, entire passages were removed or changed. With respect to all three altered documents, the original author's signature was changed to the Director's.

FINRA Alerts the Commission Staff To Document Integrity Issues in Kansas City Inspection

FINRA learned of the Kansas City District's document integrity issues through a whistleblower complaint submitted on June 11, 2010. Using FINRA's EthicsPoint System, an anonymous individual alleged that the Director instructed another FINRA employee to alter Staff Meeting Minutes before they were burned to a CD and provided to the Commission in connection with an oversight inspection of the District Office. Within days of receiving the complaint, FINRA initiated an internal investigation led by its Internal Audit staff. Also, FINRA's Internal Audit staff verbally communicated the whistleblower allegations to FINRA's Audit Committee on July 13, 2010.

Based on Internal Audit's findings, the Director tendered his resignation from FINRA on September 20, 2010. That same day, FINRA sent a letter notifying staff from the Commission's Chicago Regional Office and its Division of Enforcement about the Director's conduct. Internal Audit reported the results of its investigation to FINRA's Audit Committee on September 21, 2010.

FINRA's Internal Guidance on Document Integrity

FINRA employees have produced altered or misleading documents to Commission inspection staff on three separate occasions over the past eight years. In one instance during 2004, an NASD director misled Commission examiners by providing misdated or otherwise altered documents. In a separate, unrelated instance in 2005, misleading documents, purportedly intended for internal-use only, were produced to a Commission inspection team.

NASD took corrective actions to address these specific failures prior to NASD's consolidation with certain regulatory functions of the NYSE to form FINRA in July 2007. In

addition, FINRA cooperated with the Commission staff investigating FINRA's document integrity problems and implemented improved procedures and training related to document integrity.

Notwithstanding these improvements, the Commission finds that FINRA has not ensured the integrity of documents provided to the Commission, as demonstrated by the Kansas City Director causing the alteration of three records just hours before FINRA produced them to Commission inspection staff, rendering them inaccurate and incomplete.

Violation of Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1

As a result of the conduct described above, FINRA violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1. Section 17(a)(1) of the Exchange Act requires a national securities association such as FINRA to make and keep for prescribed periods such records, and to furnish such copies thereof, as the Commission by rule prescribes as necessary or appropriate in the public interest, for the protection of investors, or for other purposes set forth in the Exchange Act. Exchange Act Rule 17a-1(a) requires a national securities association to keep and preserve at least one copy of all correspondence, records, and other documents made or received by it in the course of its business as such and in the conduct of its self-regulatory activity. Rule 17a-1(c) requires a national securities association promptly to furnish the Commission with a copy of any such document that the Commission requests. The requirement that a national securities association keep and furnish records to the Commission includes the requirement that those records be complete and accurate.

The preparation, maintenance and furnishing of complete and accurate records are essential to the proper functioning of a national securities association as a self-regulatory organization. As described above, FINRA failed to keep and furnish complete and accurate records made or received by it in the course of its business as such and in the conduct of its self-regulatory activity.

FINRA's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertakings

Respondent FINRA has undertaken to:

- A. Provide training to all of its employees outlining past document integrity issues, which will incorporate a fact scenario based upon the Kansas City conduct, and emphasize FINRA's zero-tolerance policy regarding the alteration of documents.
- B. Develop a podcast on document integrity to be shown to all current staff and to all new employees upon hiring.

- C. Address directly the importance of document integrity at a company-wide town hall meeting, annual regulatory meetings, and during Senior Management onsite visits to all district offices.
- D. Require senior members of its Office of Liaison and Counsel to meet in-person or remotely with every business unit scheduled for an on-site exam prior to the production of documents to the Commission to emphasize the importance of document integrity.
- E. Engage an Independent Consultant (the “Consultant”), not unacceptable to the Commission, within thirty (30) days of the issuance of this Order.
 - i. FINRA will require the Consultant to: (1) conduct a one-time comprehensive review of FINRA’s policies and procedures and training relating to document integrity; (2) assess whether the policies and procedures and training are reasonably designed and implemented to ensure the integrity of documents provided to the Commission; and (3) make recommendations for the enhancement of FINRA’s policies and procedures and training as may be necessary in light of the Consultant’s review and assessment.
 - ii. FINRA will require the Consultant to submit a report of his/her findings and recommendations (the “Report”) to the FINRA Board within three (3) months of the Consultant’s engagement. Within thirty (30) days of receiving the Report, the FINRA Board will adopt all recommendations made by the Consultant, subject to Section E.iii below, and take steps necessary to commence implementation of all such recommendations. FINRA will direct the Consultant to provide promptly copies of the Report to the Commission’s Deputy Director of Enforcement.
 - iii. Within thirty (30) days of receiving the Report, the FINRA Board may notify the Consultant, in writing, of any recommendation(s) that it considers to be unduly burdensome or impractical with an explanation of why the recommendation is unduly burdensome or impractical. The FINRA Board and the Consultant shall attempt in good faith to reach an agreement on an alternative recommendation that is reasonably designed to accomplish the same objectives as the recommendation in question. If an agreement is reached, FINRA will direct the Consultant to amend his/her recommendation(s), reissue the Report within fifteen (15) days of reaching an agreement, and the FINRA Board shall adopt the Consultant’s recommendation(s) within thirty (30) days of receiving the amended Report. In the event that the FINRA Board and the Consultant are unable to agree on an alternative recommendation within forty five (45) days of the FINRA Board’s written notification, the Consultant’s recommendation shall be binding and the FINRA Board shall adopt the Consultant’s original recommendation(s) within thirty (30) days.

- iv. Within nine (9) months of the FINRA Board's receipt of the Consultant's Report, or receipt of the Consultant's amended Report if applicable under Section E.iii above, FINRA will certify in writing to the Commission's Deputy Director of Enforcement that all of the Consultant's recommendations adopted by the FINRA Board have been implemented or, if the Consultant determines that any recommendation cannot be implemented within nine (9) months, will be implemented within the period specified by the Consultant.
 - v. FINRA shall require the Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with FINRA, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Commission's Deputy Director of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with FINRA, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.
 - vi. FINRA shall expend sufficient funds to permit the Consultant to discharge all of their duties, including, but not limited to, providing adequate funds for the retention of outside counsel and/or professionals.
- F. Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to the Commission's Deputy Director of Enforcement, with a copy to the Office of Chief Counsel of the Commission's Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent FINRA's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent FINRA shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-1 thereunder; and
- B. Respondent FINRA shall comply with its undertakings as enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy
Secretary