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FINRA Rule 4530 – Recent Revisions Remind Broker-Dealers of the Importance of the New Requirement to Report Internal Findings of Violative Conduct

By Daniel A. Nathan and Ana-Maria Ignat

FINRA recently amended Rule 4530 (Reporting Requirements) to make required reporting by member firms of certain regulatory and disciplinary events less burdensome. Those relatively minor changes will be discussed below. But first, we will take this opportunity to remind firms of the most significant change to FINRA's reporting requirements, made two years ago, when Rule 4530 was first enacted: the obligation of member firms to report internal conclusions of violations.

RULE 4530(b)'S REQUIREMENT TO REPORT INTERNAL CONCLUSIONS OF VIOLATIONS

Effective July 1, 2011, the Securities and Exchange Commission ("SEC") first approved FINRA's new Rule 4530. Modeled largely after NASD Rule 3070, and NYSE Rule 351, Rule 4530 strengthened and clarified those rules' requirements.

FINRA Rule 4530(b), generally modeled after the NYSE rule, extended the following reporting requirement to all FINRA members:

Each member shall promptly report to FINRA, but in any event not later than 30 calendar days, after the member has concluded or reasonably should have concluded that an associated person of the member or the member itself has violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization.

Despite the broad language of Rule 4530(b), FINRA carefully delineated the specific obligations of member firms in the Supplementary Material to the Rule:

- Rule 4530(b) does not require reporting every instance of noncompliant conduct, but only violative conduct by a firm that has "widespread or potential widespread impact to the member, its customers or the markets, or conduct that arises from a material failure of the member's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts." FINRA placed similar limits on the reporting of violative conduct by an associated person, and included conduct that has a significant monetary result, or multiple instances of any violative conduct.
- FINRA created an objective standard for determining whether a violation occurred and should therefore be reported. Rule 4530(b) is limited to "situations where a member has concluded or reasonably should have concluded on its own that violative conduct has occurred," and FINRA stated that it would rely on a firm's good-faith reasonable determination. Therefore, "if a reasonable person would have concluded that a violation occurred, then the matter is reportable; if a reasonable person would not have concluded that a violation occurred, then the matter is not reportable."

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- FINRA allows a firm to determine the person within the firm responsible for reaching such internal conclusions, including the person's level of seniority, and allows senior management to overrule a department's prior determination. However, FINRA makes clear that management's determination that a violation did not merit consideration by the person of required seniority will not be a valid defense to a failure to report the conduct. Further, nothing in the rule prohibits a firm from relying on senior management's determination, even if that determination is different from that reached at a lower level.
- FINRA also considers a firm's reporting obligations under Rule 4530 and the internal review processes set forth in other rules, such as Rule 3130's Annual Certification of Compliance and Supervisory Processes, to be mutually exclusive. FINRA determined that it would not view the discussion in an internal audit report regarding the need for enhanced controls as determinative of a reportable violation, but rather as one factor among others that the firm should consider in determining whether a reportable violation occurred.

FINRA has not yet brought a disciplinary action for violation of Rule 4530(b). Its enforcement efforts to date have focused on paragraphs (a), (d), and (f) of the Rule. But FINRA's head of enforcement indicated shortly before the Rule went into effect that Rule 4530(b) could be a "game changer" in terms of requiring more proactive self-reporting by firms, and the first enforcement action would likely be not "a close one" but rather "a situation in which the firm clearly knew of violations and chose not to self-report."¹

FINRA is likely still looking for an appropriate set of facts to bring an enforcement action for violation of Rule 4530(b), and member firms should be mindful of this in their compliance with the language and spirit of this carefully worded and interpreted rule. Member firms should have procedures that, among other things, identify who will make the determination of whether a violation is reportable, and require that all such considerations be documented. Procedures and documentation are always good inoculants against actions for failure to act in good faith.

FINRA'S RECENT RULE 4530 REVISIONS

FINRA's recent Rule 4530 revisions eliminate duplicative reporting, provide the option to file required documents online using a new form, and provide an exception for reporting findings and actions by FINRA. Filed on January 14, 2013, these revisions to FINRA Rule 4530 received expedited approval from SEC on January 18, 2013, and became effective on February 13, 2013.

The recent amendments clarify that findings and actions by FINRA itself are excluded from the provisions under Rule 4530(a) requiring reporting of findings and regulatory actions against the firm or associated persons. Because FINRA staff has access to such information through its own systems, it is not requiring firms to also provide it. This exception is consistent with the exception under Rule 4530(f) for arbitration claims filed in the FINRA Dispute Resolution forum and for those documents that have already been requested by FINRA's Registration and Disclosure (RAD) staff, provided that the firm produces those requested documents to RAD staff within 30 days after receipt of such request.

¹ Remarks of Brad Bennett, FINRA's Executive Vice President of Enforcement, at a March 2011 panel sponsored by the SRO Sub-Committee of the ABA Securities Litigation Committee, as reported in Bressler, Amery & Ross, *Securities Law Alert: ABA SRO Sub-Committee of Securities Litigation Committee Sponsors Presentation Featuring New FINRA Enforcement Management*, March 2011, available online at: http://www.bressler.com/pub/files/Publications/Securities_March2011_CS2.pdf.

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The other two changes in the Rule are the elimination of the need to report separately information already reported on a Form U-4, and the option to file specified criminal actions, civil complaints and arbitration claims online via the FINRA Gateway.

The implementation date is March 5, 2013, for the first and second amendments, and July 1, 2013, for the third.

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