

March 1, 2011

Annual Sutherland FINRA Study Shows Enforcement Actions on the Rise

Sutherland Asbill & Brennan LLP announced that it completed its annual Sutherland FINRA Sanction Study – a review of the disciplinary actions brought by the Financial Industry Regulatory Authority (FINRA) against broker-dealers and associated persons. Sutherland Partners Deborah G. Heilizer and Brian L. Rubin and Associate Andrew M. McCormick found that in 2010 FINRA reported a significant increase in the number of cases despite a slight decrease in the total amount of fines. Sutherland also identified the top enforcement issues for FINRA in 2010, as well as trends in enforcement cases.

The Results

Disciplinary Actions and Fines

FINRA's disciplinary actions in 2010 grew from 1,158 to 1,310, an increase of more than 13%. This reverses the substantial slowdown in disciplinary actions filed between 2006 and 2008 (when there were 1,204, 1,177, and 1,073 disciplinary actions filed each year), and brings FINRA almost back to 2005 levels, when 1,412 disciplinary actions were filed. In 2010, FINRA fined firms and individuals approximately \$45 million in 2010, falling just short of 2009's \$50 million in fines. Despite the increase in the number of matters, the total of the fines imposed by FINRA in 2010 is still significantly less than in 2005, 2006, and 2007 when the fines were \$184 million, \$111 million, and \$77 million, respectively.

Top Enforcement Issues

1. Advertising cases generated the largest amount of total fines in 2010. Advertising violations were found in 24 FINRA disciplinary actions this past year, which yielded approximately \$4.75 million in total fines. Internal advertising accounted for a small percentage of this year's total (only two cases, with aggregate fines of \$300,000). In comparison, out of 2009's \$5.5 million in advertising fines, \$1.45 million in fines were imposed in the seven cases that involved internal advertisements.
2. Credit Default Swap (CDS) cases generated the second largest amount of fines in 2010, producing \$4.5 million in fines in six cases. These actions primarily concerned alleged improper communications about customers' proposed brokerage rate reductions in the wholesale CDS market. In 2009, in comparison, there were two fines issued for CDS-related violations, totaling \$3.15 million. Five of the 2010 cases (with fines totaling \$4.3 million) related to the same conduct as one of the 2009 cases (where the fine was \$2.8 million). No cases directly related to credit default swaps were brought in 2008. It is unclear whether this high 2010 ranking for CDS cases signals a change in FINRA's enforcement program or whether these cases represent the completion of FINRA's work in this area.
3. Electronic Communication violations were found in 34 FINRA disciplinary actions in 2010, which yielded about \$4 million in fines. This includes more than \$2.1 million in fines for failing to adequately maintain and preserve company e-mails in 23 cases.

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4. Suitability cases generated approximately \$3.75 million in fines in 2010. These fines were imposed in 53 cases. Some of the more significant cases involved the sale of collateralized mortgage obligations (five cases, \$760,000 in total fines), closed-end funds (three cases, \$1 million in total fines), and reverse convertible notes (two cases, \$710,000 in total fines).

5. Short Selling violations were found in about 50 FINRA disciplinary actions in 2010, resulting in nearly \$3.5 million in fines. Short selling violations have not previously made Sutherland's list of top enforcement issues, and the fines in this area were up nearly 50% from 2009's \$2.4 million. While 34 of the cases related to the accurate reporting of short sales, nearly \$1 million in fines from 14 actions were imposed for allegedly accepting a short sale without borrowing the security or entering into an agreement to borrow the security.

Trends

- **Mutual Funds.** Fines in mutual fund cases have been on the decline. After yielding the greatest amount of fines in both 2008 and 2009, the total dropped dramatically in 2010. In fact, in 2010, there were 20 such disciplinary actions that resulted in fines totaling only \$2.4 million. In comparison, mutual fund cases generated more than \$12 million in fines in 2009 and \$10.3 million in 2008. Furthermore, 2010's total pales in comparison to 2005 and 2006 when FINRA fined firms \$104 million and \$95 million, respectively, for mutual fund violations.
- **Advertising.** Advertising cases seem to be of growing importance to FINRA. Advertising made its debut on Sutherland's list of top enforcement issues in 2009, ranking fifth with \$5.5 million in total fines. Although that total dropped to \$4.75 million in 2010, advertising cases moved up to first place on Sutherland's list in 2010. This likely demonstrates that FINRA will continue placing greater emphasis on regulating advertising materials distributed to investors as well as materials distributed to and used by internal sales forces.
- **Supersized Fines.** There was a significant drop in the number of "supersized" fines (fines of more than \$1 million) in 2010—six compared to 10 in 2009. These numbers are substantially less than the 19 supersized fines imposed by FINRA in both 2006 and 2007.
- **Electronic Communications.** Although electronic communications cases rank third in Sutherland's analysis for 2010, the total fines remains largely unchanged from 2009. However, the fines imposed in each of these years are still substantially less than the amounts imposed for electronic communications violations in some recent years (for example, \$30.6 million in 2005 and \$15.8 million in 2008). This likely indicates that more firms are installing systems to effectively manage and supervise electronic communications. While FINRA has yet to bring any cases involving social media, cases involving this new type of electronic communication may come in the next year or two.



If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Brian L. Rubin
Deborah G. Heilizer

202.383.0124
202.383.0858

brian.rubin@sutherland.com
deb.heilizer@sutherland.com