A Goldfish is the Happiest Animal, a Securities Respondent is Not: Ted Lasso, SEC, FINRA, and DOL Enforcement Actions (October 2021)

By Brian Rubin and Ariana Cheng

About the Authors:
Brian Rubin is a Partner at Eversheds Sutherland.
He can be reached at brianrubin@eversheds-sutherland.com.
Ariana Cheng is an Associate at Eversheds Sutherland.
She can be reached at arianacheng@eversheds-sutherland.com.

You know what the happiest animal on Earth is?
It's a goldfish. Y'know why? It's got a 10-second memory. Be a goldfish[1].

During the pandemic, we have had a lot of lows, as well as a few highs. And that's just in pop culture. For example, who could forget the *Tiger King*? (Probably, many lows with an occasional high—and we're not talking about drug usage.) And the *Queen's Gambit*. (Low: pill-popping. High: Queen's pawn to d4—for you chess geeks out there.) We've had heroes and villains and everything in between. And we've had a streaming show starring a knight in shining armor—well, a big mustache, an even bigger heart, and strong Southern accent–that provides us with heroes, villains, rules to live by, homespun humor and rules subject to interpretation (*see, e.g.*, "offsides"). No, we're not talking about securities enforcement and compliance or NSCP's annual conference. (At least, not yet.) We're talking about Ted Lasso, the irrepressible former football coach of the Wichita (Kansas) State Shockers, who ends up coaching the other futbol (a/k/a soccer) for AFC Richmond in England's Premier League. He is initially brought in because the team owner doesn't want the team to succeed (long story, involving a divorce and a way to punish the owner's ex-husband).

Not surprisingly, to anyone who has read our prior compliance and enforcement articles,[2] Ted Lasso provides lessons for compliance officers, as well as lessons for the rest of us on how to live better lives. Or, as Ted would say (and, in fact, did say), "the harder you work, the luckier you get." He also said, "I do love a locker room. It smells like potential." We're not exactly sure how that relates (but we'll let you figure it out).

Policies and Initiatives

FINRA Sanctions Guidelines: causing some discomfort

> *Taking on a challenge is a lot like riding a horse, isn't it? If you're comfortable while you're doing it, you're probably doing it wrong.*

FINRA revised Sanctions Guidelines

FINRA has Sanction Guidelines to help adjudicators "determin[e] appropriate remedial sanctions,"[3] or in other words, make respondents "discomfortable" (or worse). On October 20, 2021, FINRA's National Adjudicatory Council revised its Sanctions Guidelines to include Consolidated Audit Trail System (CAT) reporting violations guidelines.[4] The prior version of FINRA's Sanction Guidelines did not have a guideline for CAT reporting violations. The NAC adopted the CAT guideline to reflect the transformation of audit-trail reporting from the Order Audit Trail System (OATS) to CAT. The sanctions relate to late reporting; failing to report; and false, inaccurate or misleading reporting, where the sanctions are $5,000 to $155,000 per violation,

1. The Ted Lasso quotes come from the following sources: https://people.com/tv/ted-lasso-inspirational-quotes/; https://www.scarymommy.com/ted-lasso-quotes/; https://www.buzzfeed.com/evelinamedina/ted-lasso-best-quotes-jokes; https://noguiltlife.com/inspirational-quotes-from-ted-lasso/; https://lolalambchops.com/best-ted-lasso-quotes/; https://everydaypower.com/ted-lasso-quotes/; https://www.cnet.com/news/best-vps-hosting/; https://transcripts.foreverdreaming.org/viewtopic.php?f=1095&t=47789.
2. *See, e.g.*, "Shaken, Stirred and Sanctioned: SEC, FINRA and 007 Enforcement Actions (August – September 2021)," *Current* (Sept. 2021); "You Can't Handle the Truth: A Few Good Enforcement Actions from the SEC and FINRA in July 2021," *Currents* (August 2021); "Indiana Jones and Raiders of the Lost Enforcement Actions: SEC and FINRA Enforcement from June 2021," *Currents* (July 2021); *"Inconceivable: The Princess Bride Fences with SEC and FINRA Enforcement Matters from May 2021," Currents* (June 2021); *"*We are not Amused: The Crown and SEC and FINRA Enforcement Matters from April 2021," *Currents* (May 2021); "Pun-ishment by SEC and FINRA: Enforcement Actions in March 2021," *Currents* (April 2021); "How You Doin': Friends and SEC/FINRA Enforcement from February 2021," *Currents* (March 2021); "Offers They Can't Refuse: SEC and FINRA Enforcement Settlements from January 2021," *Currents* (February 2021); "'Luke, I am your father.' (Or not.) Collective False Memory and SEC and FINRA Enforcement Issues from November and December 2020," *Currents* (January 2020); "Back to the Future, But SEC and FINRA Enforcement Issues from the Present (October 2020)," *Currents* (November 2020); "Not Dead Yet: Just Flesh Wounds, Suspensions, and Fines (SEC, CFTC and FINRA Enforcement Actions in September 2020)," *Currents* (October 2020); "The Show, er, um, Article About Nothing (other than SEC, CFTC, FINRA, and State Securities Enforcement Actions in August 2020)," *Currents* (September 2020); "Just When You Thought It Was Safe to Go Back in the Office (Or at Least Think About It): SEC and FINRA Examinations and Enforcement Actions in July 2020," *Currents* (August 2020); "Curb Your Enforcementism: SEC and FINRA Enforcement Cases in June 2020," *Currents* (July 2020); "Killing Eve (all others are fined or suspended): SEC and FINRA Enforcement Cases in May 2020," *Currents* (June 2020); "The Last Dance (But not the Last Enforcement Action): SEC and FINRA Enforcement Actions in April 2020," *Currents* (May 2020); "Tiger King: Murder, Mayhem and March 2020 Enforcement Matters," *Currents* (May 2020).
3. https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf.
4. https://www.finra.org/sites/default/files/2021-10/Regulatory-Notice-21-37.pdf.

depending on the number of actions the firm has had. For failure to synchronize clocks, the sanctions can be between $5,000 to $77,000 per violation, depending on the number of actions.

SPACS: potential or mysterious?

> *You are more mysterious than David Blaine reading a Sue Grafton novel at Area 51.*
>
> **FINRA began a sweep of firms that deal with Special Purpose Acquisition Companies (SPACs)**

In October 2021, FINRA announced that it launched a sweep of firms' dealings with SPACs, a move that comes as the US Securities and Exchange Commission and lawmakers are also increasing scrutiny towards the alternative to initial public offerings.[5] FINRA is examining firms' offering of, and services provided to, SPACs and their affiliates (sponsors, principal stockholders, board members, and related parties).

In general, the requests cover the period from July 1, 2018 through September 30, 2021. Among the requests are the following:

- Provide a list of training offered.
- Describe all services offered by the firm and its affiliates to SPAC issuers during the Relevant Period.
- Describe any efforts undertaken by the firm or its registered representatives to identify customers for promotion or recommendation of SPAC securities in the primary or secondary market.

Business-Related Communications: and other things that (could) last forever

> *What I can tell you, is with the exception of the wit and wisdom of Calvin and Hobbes, not much lasts forever.*
>
> **SEC Enforcement Director warns against improper use of personal devices for business-related communications**

On October 6, 2021, Gurbir Grewal spoke at a conference in his first speech as SEC Enforcement Division Director.[6] Mr. Grewal called for "proactive compliance," which is "more than putting together a stock policy and giving a check-the-box training." He used a specific example of an enforcement action the Commission brought last year against a California broker-dealer for failing to preserve business-related text messages. He noted that the SEC's order found that some of the firm's registered representatives used their personal devices when communicating with each other, with firm customers, and with other third-parties concerning, among other things, the size of orders, the timing of trades, and the pricing of certain securities. Mr. Grewal stated that, unfortunately, this was not an isolated example: "we continue to see in multiple investigations instances where one party or firm that used off-channel communications has preserved and produced them, while the other has not. Not only do these failures delay and obstruct investigations, they raise broader accountability, integrity and spoliation issues."

After that speech, the news media reported that the SEC enforcement staff had contacted a number of firms "to check whether they have been adequately documenting employees' work-related communications, such as text messages and emails, with a focus on their personal devices."[7]

5. https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/special-purpose-acquisition-companies-spacs.
6. https://www.sec.gov/news/speech/grewal-pli-broker-dealer-regulation-and-enforcement-100621.
7. https://www.reuters.com/legal/litigation/exclusive-us-sec-opens-inquiry-into-wall-street-banks-staff-communications-2021-10-12/.

Takeaways:

- First, firms may want to consider employing a "proactive compliance" approach, which means not waiting for enforcement actions to put in place appropriate policies and procedures.
- Second, firms may want to review their policies and procedures, as well as their office inspections and other monitoring tools, regarding the use of personal devices, new communications channels, and other technological developments like ephemeral apps.

Neither Admit nor Deny Settlements: are they the equivalent of ties?

If God would have wanted games to end in a tie, she wouldn't have invented numbers.

Back where I'm from, you try to end a game in a tie; well, that might as well be the first sign of the apocalypse.

SEC Enforcement Director announces return to admissions-settlements.

On October 13, 2021, at another conference, Mr. Grewal signaled that the SEC would be pivoting back toward the practice of requiring defendants to admit wrongdoing in certain enforcement action settlements.[8] Under the previous administration, the SEC shied away from seeking admissions in favor of its longstanding but controversial no-admit, no-deny policy. Before that, for the first time ever, the SEC, on occasion, required admissions.

Mr. Grewal noted that, "When it comes to accountability, few things rival the magnitude of wrongdoers admitting that they broke the law." He further stated that "in an era of diminished trust, we will, in appropriate circumstances, be requiring admissions in cases where heightened accountability and acceptance of responsibility are in the public interest. Admissions, given their attention-getting nature, also serve as a clarion call to other market participants to stamp out and self-report the misconduct to the extent it is occurring in their firm."

Takeways:

- In the past, we have seen the SEC try to impose this standard, but it did not stick. There was strong pushback from firms and from the defense bar, and we expect to see the same this time around.

- If the SEC does push this issue, we expect to see more firms and individuals litigating, rather than settling.

The Department of Labor: can't they make up their minds?

It's kind of like back in the '80s when "bad" meant "good."

The Department of Labor announces delay in enforcement of rollover exemption.

In December 2020, the Department of Labor (DOL) adopted a prohibited transaction exemption that impacts rollover recommendations provided by financial services firms.[9] The exemption precludes firms from receiving payments that create conflicts of interest unless they comply

8. https://www.sec.gov/news/speech/grewal-sec-speaks-101321.
9. https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2021-02.

with the conditions set forth in the prohibited transaction exemption. Since a conflict of interest exists when a firm recommends to investors that they roll assets out of a retirement plan into an IRA that they will then manage for a fee, firms must comply with PTE 2020-02 to make such recommendations.

The DOL previously granted transitional relief through December 20, 2021, stating that it would not pursue enforcement actions against firms that do not fully comply with all of the conditions of PTE 2020-02 provided that they work diligently and in good faith to comply with the Impartial Conducts Standards. On October 25, 2021, the DOL extended this transitional relief to January 31, 2022. In its announcement of the extension, the DOL recognized the challenges facing many firms to timely comply with all of PTE 2020-02 conditions, including implementing the rollover documentation and disclosure requirements in a systemic manner.

Takeways: Stay tuned.

Cases

Net Capital: firms need to pay attention (and warm up)

All right, fellas, you gotta remember, your body is like day-old rice. If it ain't warmed up properly, something real bad could happen.

FINRA sanctioned a firm for net capital violations following arbitration settlement.

On October 18, 2021, through a Letter of Acceptance, Waiver, and Consent (AWC), FINRA settled a case related to a firm's net capital violations, fining the firm $20,000.[10] In June 2019, the firm settled a customer arbitration for $150,000, which caused an increase to its aggregate indebtedness and its minimum net capital requirement. From June to July 2019, the firm effected 18 securities transactions on behalf of its customers while it was net capital deficient by approximately $55,000. However, the firm did not file a notice of net capital deficiency with the SEC or FINRA until July 2019.

Also, in August 2019, the firm settled another customer arbitration for $73,000, again increasing its aggregate indebtedness and minimum net capital requirement. Although the settlement did not cause the firm to fall below its minimum net capital requirement, it did not record the settlement on its books and records until September 11, 2019. The firm's failure to timely record the June 2019 and August 2019 settlements caused it to maintain inaccurate books and records regarding its aggregate indebtedness and net capital, and to file a FOCUS report for month-end of August 2019 that inaccurately reported the firm's required minimum and excess net capital.

Takeaways

- First, firms can be sanctioned for net capital violations related to a number of different issues, including arbitration awards. Both the SEC and FINRA view financial stability of firms very seriously.
- Second, firms may want to review their policies and procedures with regard to whether they address how the firm records litigation settlements for net capital and books and records purposes.

10. https://www.finra.org/sites/default/files/fda_documents/2019063249601%20Northwest%20Investment%20Advisors%2C%20Inc.%20CRD%20109737%20AWC%20jlg.pdf.

Arbitration Settlement Agreements: firms need to pay attention (and read and listen)

> *Boy, I love meeting people's moms. It's like reading an instruction manual as to why they're nuts.*
>
> *You should do a TED Talk, 'cause right now you're getting a whole heap of "Ted listen."*
>
> **FINRA sanctioned a firm for a non-compliant arbitration settlement agreement.**

On October 19, 2021, through an AWC, a firm settled with FINRA related to the firm's non-compliant arbitration settlement agreement, agreeing to pay a fine of $20,000.[11] In December 2018, the firm settled a FINRA arbitration brought by a customer against it and one of its registered representatives. When the parties settled, the firm improperly signed an arbitration settlement agreement providing that the customer would not oppose, or otherwise interfere with, a request to expunge the dispute information related to the customer's claims from the Central Registration Depository (CRD) System. Although the firm did not insert the violative language relating to expungement to the agreement, through inadvertence, it failed to detect and remove that provision before signing.

FINRA Rule 2081 prohibits firms from conditioning or seeking to condition settlement of a customer dispute on, or otherwise compensating the customer for, "the customer's agreement to consent to, or not to oppose, the member's or associated person's request to expunge such customer dispute information from the CRD system." As noted in Regulatory Notice 14-31, the rule was enacted to remove parties' ability to bargain for expungement relief as part of settlements with customers.[12]

Takeaways

- First, firms can be sanctioned for improper settlement agreements.
- Second, firms may want to periodically review standard and case-specific settlement agreements to determine whether they comply with FINRA rules.
- Third, firms can be sanctioned even if they do not draft or insert violative provisions. It appears that FINRA's message is that if a firm is a party to an agreement, the firm is responsible for everything in the agreement.

Mutual Funds: firms need to be careful about sales and branding.

> *Rebecca: Speaking as we were mere moments ago, about time, I unfortunately don't have any. I have a branding meeting, so…*
>
> *Ted: I always feel so bad for the cows, but you gotta do it otherwise they get lost. That was a branding joke. If we were in Kansas right now, I'd just be sitting here waiting for you to finish laughing.*
>
> **FINRA sanctioned a firm for mutual fund switches.**

On October 25, 2021, FINRA settled a case related to mutual fund switches, fining a firm $200,000, ordering restitution of approximately $63,000, and mandating updated procedures and training.[13]

11. https://www.finra.org/sites/default/files/fda_documents/2020067328101%20Equitable%20Advisors%2C%20LLC%20CRD%206627%20AWC%20sl.pdf.
12. FINRA Regulatory Notice 14-31, July 2014.
13. https://www.finra.org/sites/default/files/fda_documents/20170561971102%20NYLIFE%20Securities%20LLC%20CRD%205167%20AWC%20jlg.pdf.

From January 2015 through March 2019, the firm failed to establish, maintain, and enforce a supervisory system, including Written Supervisory Procedures (WSPs), reasonably designed to achieve compliance with FINRA suitability requirements as it pertains to mutual fund and cross-product switches. The firm's WSPs defined mutual fund switching as using the "proceeds from the redemption of one mutual fund to purchase one or more other mutual funds" and noted that mutual fund switching was problematic when the "benefit to the client does not justify the incidental costs." The firm surveilled for mutual fund switches on a weekly basis, identifying transactions that the firm deemed "letterable," such as a switch from an A share to A share where accounts incurred front-end sales charges. A letterable switch resulted in a letter to the customer that disclosed the mutual fund purchase and sale at issue, but did not disclose the sales charges incurred on either transaction.

However, the firm did not have written supervisory procedures or adequately trained supervisors on how to determine whether the clients benefitted from the mutual fund switch transactions or whether the transactions were suitable. The firm provided Managing Partners with the sales charges incurred on mutual fund purchase transactions, but the firm did not provide Managing Partners with other critical information such as the holding periods and costs associated with the mutual fund shares sold, and the Managing Partners also could not readily access historic transaction information for the customers' accounts.

The firm also failed to reasonably supervise one representative's mutual fund trading when it failed to take reasonable steps to review his recommended short-term trades of Class A mutual funds in ten customers' accounts, belonging to senior customers. Specifically, on hundreds of occasions between January 2015 and March 2019, this representative recommended that these ten customers buy and sell Class A mutual funds after holding the shares for short periods of time. As a result of these short-term trades, the ten customers paid approximately $175,000 in unnecessary front-end sales charges for Class A mutual fund shares.

Finally, the firm's system flagged registered representatives' cross-product switch activity on a report for supervisory review when multiple switch transactions met one or more tests during one quarter. In around April 2016, due to a software upgrade, a database connectivity issue caused incomplete information to flow to the firm's mutual fund switching reports and cross-product switching reports. While the firm conducted limited spot checks after the software upgrade, it did not adequately continue to monitor the system, failing to identify red flags of potential system issues. The firm discovered the cause of the software failure in March 2019 during FINRA's investigation.

Takeaways

- First, mutual fund switching has continued to be an issue of regulatory importance to FINRA, although we have not recently seen a lot of cases in this area.
- Second, in light of this AWC, firms may want to revisit their WSPs and training in this area.
- Third, firms and individuals can be sanctioned for software glitches. We have seen this issue in other cases as well.[14] Therefore, after upgrades, firms may want to take steps to determine the effects of the changes.

Forms U4 and U5: more than just checking boxes and pushing buttons

There's two buttons I never like to hit: that's panic and snooze.

I gotta say, man, sometimes you remind me of my grandma with the channel hopper. You just push all the wrong buttons.

14. *See, e.g.,* https://www.sec.gov/litigation/opinions/2021/34-91268.pdf. Note that one of the authors of this article represented the respondent.

FINRA charged a firm and principals with failure to amend or to timely amend Forms U4 and U5.

On October 19, 2021, FINRA charged a firm and its principals for their failure to amend or timely amend Forms U4 and U5.[15] The parties are litigating FINRA's charges.

According to FINRA, from January 1, 2015 to December 31, 2020, the firm failed to file, or to timely file, 223 amendments to Forms U4, and Forms U5 for 72 of its registered representatives. As a result, the firm failed to disclose, or to timely disclose, hundreds of reportable events involving its representatives, including customer arbitrations, customer complaints, bankruptcies, and unsatisfied liens and judgments.

Among its disclosure failures, the firm failed to amend, or to timely amend, the Forms U4 and U5 of its executive officers and a branch manager to disclose customer arbitrations, including the Forms U4 of the firm's two most senior executives: the Chief Executive Officer (CEO), the Chief Administrative Officer (CAO) and Chief Compliance Officer (CCO).

Two of the firm's principals were personally responsible for ensuring that the information on their own Forms U4 was current, accurate, and complete. They each failed to amend, or to timely amend, their Forms U4 to disclose arbitration filings and resolutions on 38 and 15 occasions, respectively.

The firm's failure to amend, or to timely amend, the Forms U4 and U5 of its executive officers and a branch manager was willful, as were the principals' failures to amend, or to timely amend, their own Forms U4. According to FINRA, this willfulness was demonstrated by, among other things, the firm's continuing refusal to disclose arbitrations despite warnings from FINRA in 2017 and 2018 of the requirement to do so.

Takeaways

- First, note that this is a litigated matter, meaning that the parties could not reach a settlement. It is possible that since FINRA is charging the CEO, the CAO, and the CCO, the firm would not be able to stay in business if each was sanctioned.
- Second, firms and individuals may be sanctioned when individuals supervise themselves.
- Third, firms and individuals can be sanctioned for Form U4 and U5 failures.

Lessons

If Ted's soccer coaching career doesn't work out, and if he's too much of a scaredy-cat to put on his big-boy pants and enter the securities industry (where he could easily become a firm president and maybe even a CCO), he could consider becoming a life coach. And luckily for us, many of his life lessons apply to all of us (even those of us in the securities industry). For example:

- Listen

  Rule number 1: even though it's called girl talk sometimes it needs to be more like Girl listen.

15. https://www.finra.org/sites/default/files/fda_documents/20190615280001%20Spartan%20Capital%20Securities%2C%20LLC%20BD%20146251%2C%20et%20al%20Complaint%20jlg.pdf.

- Be wise

  You know how they say that "youth is wasted on the young"? Well, I say don't let the wisdom of age be wasted on you. I just came up with that. I feel pretty good about it.

- Believe in

  - Communism

    I believe in Communism. Rom-communism, that is. If Tom Hanks and Meg Ryan can go through some heartfelt struggles and still end up happy, then so can we.

  - Curiosity

    Guys have underestimated me my entire life. And for years, I never understood why. It used to really bother me. But then one day, I was driving my little boy to school, and I saw this quote by Walt Whitman, and it was painted on the wall there. It said, "Be curious, not judgmental." I like that.

  - Sugar

    I've never met someone who doesn't eat sugar. Only heard about 'em, and they all *live in this godless place called Santa Monica.*

  - Coincidences

    That's the funny thing about coincidences, ain't it? Sometimes they just happen.

  - Others' opinions

    I want you to know, I value each of your opinions, even when you're wrong.

  - Ghosts

    Rebecca: "Do you believe in ghosts?"
    Ted: "I do, but more importantly, I believe they need to believe in themselves."

  - Hope and belief

    So I've been hearing this phrase y'all got over here that I ain't too crazy about. "It's the hope that kills you." Y'all know that? I disagree, you know? I think it's the lack of hope that comes and gets you. See, I believe in hope. I believe in belief.

- Know when to stop talking

  Ted: I'm sorry Roy. But I came here tonight because when you realize you want to spend the rest of your life coaching with somebody, you want the rest of your life to begin ASAP.
  Roy: Please stop.
  Ted: You complete our team.
  Roy: You're an [expletive deleted]
  Ted: I'm also just a coach, standing in front of a boy, asking him if-
  Roy: Shut up, just shut up. You had me at Coach.

- You may want to rethink tea[16]

  I always thought tea was going to taste like hot brown water. And do you know what? I was right.

  If you would have told me that I'd be drinking tea at 3 o'clock every day, about a year ago… I would have punched you in the mouth.

  Be honest with me. It's a prank, right? The tea? Like when us tourist folks aren't around, y'all know it tastes like garbage? You don't love it. It's pigeon sweat.

  Rebecca: "How do you take your tea?"
  Ted: "Well, normally right back to the counter because there's been a terrible mistake."

- And, finally, when facing adversity, don't forget

  - Goldfish

    This is a sad moment right here. For all of us. And there ain't nothing I can say, standing in front of you right now, that can take that away. But please do me this favor, will you? Lift your heads up and look around this locker room. Yeah? Look at everybody else in here. And I want you to be grateful that you're going through this sad moment with all these other folks. Because I promise you, there is something worse out there than being sad, and that is being alone and being sad. Ain't nobody in this room alone. Let's be sad now. Let's be sad together. And then we can be a gosh-darn goldfish. Onward. Forward.

  - Ice cream

    Ice cream's the best. It's kinda like seeing Billy Joel live. Never disappoints.

  - And Willie Nelson

    Our goal is to go out like Willie Nelson — on a high! ■

16. Some of us, respectfully, disagree with Ted on this point. And we're not just saying that because Mr. Edward Evershed, one of our law firm's founders, was British, as well as an English cricketer. https://en.wikipedia.org/wiki/Edward_Evershed.