

Huckleberry FINRA and Life on the MissiSECippi: Mark Twain, FINRA, SEC, CFTC and NASAA Enforcement Actions (November and December 2021)

By Brian Rubin and Amanda Oliveira



About the Authors:

Brian Rubin is a Partner at [Eversheds Sutherland](#).
He can be reached at brianrubin@eversheds-sutherland.com.

Amanda Oliveira is an Associate at [Eversheds Sutherland](#).
She can be reached at amandaoliveira@eversheds-sutherland.com.

Samuel Langhorne Clemens, d/b/a Mark Twain,¹ was the author of many outstanding (and often humorous) books and short stories that had good guys (e.g., Huck, Jim, and Tom), bad guys (e.g., Pap Finn; the Duke and the Dauphin, who were the equivalent of 19th century boiler room fraudsters), self-regulators (e.g., Aunt Polly and the Widow Douglas), an actual Judge (well, fictional, but you know what we mean) (Judge Thatcher, father of Becky), and sanctions (the Duke and the Dauphin are tarred and feathered—a bit different from being censured or ordered to cease and desist). In other words, his stories sound a lot like some of the securities enforcement cases we regularly read.

What many people may not realize is that Mark Twain's stories provide more than a good yarn (as they used to say in the old days).² In fact, one real-life legal scholar (*i.e.*, not the authors of this article) wrote in "Of Law and the River," that *Life on the Mississippi* (we'll use the correct spelling here) is "the best book in English about professional training."³ That quote is from Paul D. Carrington, the former Dean of one of our law schools, who used to regularly encourage law students to read Twain's book. Dean Carrington wrote that, "[l]earning to be a steamboat pilot is more like learning to be a lawyer than you may suppose." We will take that statement one step further (or perhaps one "knot" further⁴), and show that Mark Twain, like a lot of other pop culture sources, also provided important lessons for securities and compliance practitioners today.⁵

Regulatory Reports

- *Figures often beguile me particularly when I have the arranging of them myself; in which case the remark attributed to Disraeli would often apply with justice and force: "There are three kinds of lies: lies, damned lies, and statistics."*⁶

- **The SEC's, um, statistics**

On November 18, 2021, the US Securities and Exchange Commission (SEC) announced its "Enforcement Results" for Fiscal Year (FY) 2021.⁷ The Commission announced that from October 1, 2020 through September 30, 2021, it filed 434 new enforcement actions, which was a 7% increase over 2020. The Commission brought 110 actions against broker-dealers (BDs), a 22% decrease from the 142 cases it brought in 2020. In FY 2021, BD cases constituted 16% of the SEC's actions, while in FY 2020, they were 20% of the cases. The Commission also brought 159 actions against Investment Advisers (IAs)/Investment Companies, roughly a 16% increase from the 137 cases brought in FY 2020.

1. "Mark Twain" wasn't really a d/b/a or "doing business as" name; it was the writing pseudonym for Mr. Clemens. The phrase "Mark Twain" means "mark number two," a Mississippi River term for the "second mark on the line that measured depth signified two fathoms, or twelve feet—safe depth for the steamboat." [https://bancroft.berkeley.edu/Exhibits/MTP/mississippi.html#:~:text=%22Mark%20Twain%22%20\(meaning%20%22,a%20%22cub%22%20steamboat%20pilot](https://bancroft.berkeley.edu/Exhibits/MTP/mississippi.html#:~:text=%22Mark%20Twain%22%20(meaning%20%22,a%20%22cub%22%20steamboat%20pilot)

2. Nowadays, we might say, "stream it or skip it." We know you're thinking that "stream it" sounds like a nautical term. However, we found no evidence connecting that phrase to waterways. (Although, to be honest, we didn't spend a lot of time looking.)

3. https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1189&context=faculty_scholarship.

4. We, of course, know that a "knot" is a unit of speed equal to one nautical mile per hour ([https://en.wikipedia.org/wiki/Knot_\(unit\)](https://en.wikipedia.org/wiki/Knot_(unit))), but we do not know (or knot know) what a nautical step is called. If you do, please email us.

5. During the pandemic, we have tried to educate and entertain by writing articles about securities enforcement and compliance issues, while using pop culture references as a "jumping off" point (not to be confused with a "jumping" frog from, say, Calaveras County) (a Mark Twain reference, if you missed it). See, e.g., "A Goldfish is the Happiest Animal, A Securities Respondent is Not: Ted Lasso, SEC, FINRA, and DOL Enforcement Actions (October 2021)," *Current* (Nov. 2021); "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).

6. https://en.wikipedia.org/wiki/Lies,_damned_lies,_and_statistics. Except as otherwise notes, all of the Mark Twain quotes come from one or more of the following sources: https://www.aquotes.com/author/14883-Mark_Twain/tag/wealth; <https://addicted2success.com/quotes/21-inspirational-mark-twain-quotes-to-live-by/>; https://www.goodreads.com/author/quotes/1244.Mark_Twain; <http://blog.acadviser.com/the-unintentionally-brilliant-money-advice-of-mark-twain>; <https://www.hookedonbooks.com/funny-mark-twain-quotes/>; https://www.aquotes.com/author/14883-Mark_Twain/tag/funny.

7. <https://www.sec.gov/news/press-release/2021-238>; <https://www.sec.gov/files/2021-238-addendum.pdf>.

The SEC assessed more than \$1.4 billion in penalties, a 33% increase over the prior year. The SEC also obtained judgments and orders for nearly \$2.4 billion in disgorgement, a 33% decrease from FY 2020. FY 2021 was also a “record year” for whistleblower awards. The SEC awarded \$564 million to 108 whistleblowers. The SEC’s announcement highlighted that its whistleblower program had awarded more than \$1 billion over the life of the program.

Takeaways:

- First, last year was mixed in terms of results, with more cases but fewer penalties. Nonetheless, the SEC did highlight a number of “first-of-their-kind actions,” including cases involving (1) securities using decentralized finance, or “DeFi,” technology; (2) violations on the “dark web”; (3) failures to timely file and deliver Forms CRS; and (4) an order and execution management system provider that facilitated electronic trading for failing to register as a BD.
- Second, we expect the SEC to be far more aggressive this year, with a new Chair, a new Director of Enforcement and a Democratic majority. So, watch this space next year (and www.sec.gov) to see if our predictions are correct.

- **NASAA’s, um, statistics**

On November 4, 2021, the North American Securities Administrators Association (NASAA) issued its “Report and Findings of NASAA’s Regulation Best Interest Implementation Committee; National Examination Initiative Phase II (A)” (which is the longest title of any report that we have ever cited).⁸ The bottom line is that NASAA expressed concerns about firms’ compliance with Regulation Best Interest (Reg BI), stating that “there were slightly more firms engaging in pro-investor best practices and slightly fewer engaging in harmful conflicts. That was a welcome step in the right direction for those firms, but most of the Reg BI firms examined in this initiative have remained fairly stagnant and continue (to operate precisely the same under Reg BI as they had under the suitability rule.)”

NASAA conducted its exam to “collect data⁹ regarding broker-dealer policies, procedures, and practices one year after the SEC’s compliance deadline of June 30, 2020 (the ‘post-BI period’).” NASAA compared those statistics, we mean “data,” with data collected in 2018. To write its report NASAA analyzed electronic questionnaires issued pursuant to formal examination demands to more than 2,000 firms (over 500 BDs and over 1,500 IAs) in 35 jurisdictions. NASAA found the following:

- The number of firms offering complex or risky products (such as private securities, variable annuities, non-traded Real Estate Investment Trusts and leveraged or inverse Exchange Traded Funds) increased by 11% after Reg BI took effect; 93% of firms did not cease selling any products, and 76% did not restrict any product sales in the wake of Reg BI.
- Of those firms selling complex or risky products, 65% of firms did not discuss lower-cost or less-risky products with their clients.
- 19% of firms discussed lower-cost options for clients when those options were available outside the firm.
- Most of the firms sampled did not provide fair and balanced point-of-sale disclosure regarding fees, costs, and risk to retail investors.

8. https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf.

9. Note that NASAA decided to use the word “data” instead of “statistics.” No doubt, many of them have read Mark Twain.

NASAA concluded with the following statement:

[A]s compared to the conduct reported by investment advisers in 2018, the slight gains noted by Reg BI firms fall far short of the fiduciary marker. One full year after the compliance deadline, most of the Reg BI firms sampled are not providing fair and balanced point-of-sale disclosure regarding fees, costs, and risk to retail investors. Meanwhile, these Reg BI firms have steadily increased their participation in complex, costly, and risky products under the new conduct standard and continue to rely on financial incentives that Reg BI was intended to curb, incentives rarely seen with fiduciary advisers. In short, too many Reg BI firms are still placing their financial interests ahead of their retail customers in violation of the rule's chief directive. Clearer regulatory guidance is needed to allow a course correction that would help Reg BI earn the "best interest" label that it bears.

Takeaways:

- First, the ramp up period for Reg BI is over. While the SEC brought some enforcement cases against firms this past year, we expect to see a lot more cases from the SEC and FINRA this coming year, and the years to come.
- Second, it may make sense for firms to review the NASAA report and compare their conduct with the issues highlighted by NASAA.

Proper Communications

While Mr. Twain did not address how communications should be retained, he did address the importance of communicating properly.

- *The difference between the almost right word and the right word is really a large matter, 'tis the difference between the lightning bug and the lightning.*
- *When angry, count to four; when very angry, swear.¹⁰*
- **The SEC and the CFTC assessed \$200 million penalty against a firm for failing to retain and monitor communications.**

On December 17, 2021, a large securities firm agreed to settle charges brought by the SEC¹¹ and the Commodity Futures Trading Commission (CFTC)¹² for failing to maintain and preserve written communications. The firm agreed to pay the SEC a \$125 million penalty and \$75 million to the CFTC. This type of settlement is fairly rare because the firm admitted the facts set forth in the SEC's order and acknowledged that its conduct violated the federal securities laws.

From at least January 2018 through at least November 2020, firm employees often communicated about business on their personal devices, using text messaging applications (including WhatsApp) and personal email accounts. The firm did not preserve these records. The failure was firm-wide and involved employees at all levels of authority. In fact, dozens of managing directors and senior supervisors who were responsible for implementing the firm's policies and procedures and for overseeing compliance with those policies and procedures, similarly failed to comply. The firm's failure to retain such communications affected its ability to respond to regulatory requests.

10. <https://www.goodreads.com/quotes/16767-when-angry-count-four-when-very-angry-swear#:~:text=Quote%20by%20Mark%20Twain%3A%20%E2%80%9CWhen,When%20very%20angry%2C%20swear.%E2%80%9D>.

11. https://www.sec.gov/litigation/admin/2021/34-93807.pdf?utm_medium=email&utm_source=govdelivery.

12. <https://www.cftc.gov/PressRoom/PressReleases/8470-21>.

Takeaways:

- First, this is a back-to-basics issue (much like fishin' and raftin'). These requirements have been in place for decades and regulators have previously sanctioned numerous firms for similar conduct.
- Second, given these enforcement cases and the fact that the SEC's head of enforcement highlighted this issue in his first public speech,¹³ firms may want to review their policies and procedures and, in particular, their employee/representative attestation requirements and their office audits.
- Third, this settlement reflects an October 13, 2021 announcement made by Gurbir Grewal, the SEC's Director of Enforcement, that the SEC would require admissions of wrongdoing in certain cases. Thus, we will likely see more of these types of settlements in the future.

Sales Practice

Mr. Twain had a lot to say about sales and marketing, including the following:

- *If you tell the truth, you don't have to remember anything.*
- *The lack of money is the root of all evil.*
- *Get your facts first, then you can distort them as you please.*
- *Nothing spoils a good story like the arrival of an eyewitness.*

• FINRA sanctioned a firm for excessive trading and improper sales of non-traditional ETFs

Through a November 8, 2021, a Letter of Acceptance, Waiver, and Consent (AWC), FINRA sanctioned a firm for failing to establish, maintain, and enforce a supervisory system, including written supervisory procedures (WSPs), reasonably designed to achieve compliance with the suitability requirements of FINRA Rule 2111 as it pertains to excessive trading and suitability requirements when selling leveraged, inverse, and inverse-leveraged Exchange-Traded Funds (Non-Traditional ETFs) to retail customers.¹⁴ For this conduct, FINRA censured the firm, fined it \$1,050,000, ordered it to pay restitution of approximately \$1.7 million, and ordered it to implement recommendations from an independent consultant.

FINRA found that the firm used boilerplate WSPs prepared by an outside vendor for supervision of registered representatives' trading in customer accounts. The firm's WSPs instructed its branch managers to monitor trading for suitability issues during their daily review of trade blotters, but did not explain how the firm's supervisors should conduct the daily trade review or use the trade blotters and other available customer information to identify potentially unsuitable or excessive trading in customers' accounts. In addition, the WSPs also did not define, or require supervisors to calculate or consider, turnover rate or cost-to-equity ratio. The WSPs also required branch managers to conduct monthly and semi-annual reviews of customer account activity to monitor for suitability and churning, and the firm's CCO or their designee to review whether active accounts were consistent with the customer's investment objectives. However, these reviews were not performed for most of the relevant period.

As a result of this conduct, FINRA found unsuitable trading conducted by eight of the firm's registered representatives in two of the firm's branches who traded in the accounts of 31 customers. The firm also failed to identify customers who purchased and held Non-Traditional ETFs for extended periods of time, or whose purchase was inconsistent with their recorded investment objective, risk tolerance, or finances.

13. <https://www.sec.gov/news/speech/grewal-pli-broker-dealer-regulation-and-enforcement-100621>.

14. AWC No. 2016051704305.

Takeaways:

- First, firms can be sanctioned if they rely on boilerplate procedures without modifying them to apply to their firms.
 - Second, firms can be sanctioned if their procedures do not contain explanations of how people are supposed to carry out their tasks.
 - Third, firms can be sanctioned for failing to follow their own procedures.
 - Fourth, excessive trading and the sale of Non-Traditional ETFs are a regulatory concern. Firms may want to review their procedures regarding these issues.
- **FINRA sanctioned a firm for improper sales of Non-Traditional Exchange Traded Products (ETPs) and for failing to supervise a representative who recommended complex trading options.**

Through a November 3, 2021, AWC, FINRA sanctioned a firm for failing to establish, maintain, and enforce a supervisory system or WSPs reasonably designed to achieve compliance with FINRA's suitability rule as it related to Non-Traditional ETPs.¹⁵ The firm also failed to reasonably supervise a representative with respect to complex options trading strategies recommended to customers with very different investment profiles. For its conduct, FINRA censured the firm and fined it \$35,000.

FINRA found that the firm's supervisory system and WSPs were not reasonably tailored to address the unique features and risks associated with Non-Traditional ETPs. Specifically, the WSPs provided no guidance regarding how supervisors should determine whether a Non-Traditional ETP was suitable for customers given the unique features and risks of those products. The firm also had no alerts, exception reports, restrictions, or approval process that would have detected when Non-Traditional ETPs were purchased and no method for monitoring their holding periods. Finally, the firm failed to enforce the WSPs it had in place and had no review or pre-approval process prior to 2018.

Regarding the representative who recommended complex options trading strategies to customers with very different investment profiles, FINRA found that the firm failed to reasonably supervise him. FINRA noted that the firm was aware of red flags in the risky options trading but failed to reasonably investigate whether the trading was suitable for the customers. Specifically, the firm failed to recognize that the representative used the same strategy for customers regardless of the customer's age, net worth, and investment experience. The firm also did not review the frequency of options trading recommended by that representative to determine whether the size and frequency of options transactions were suitable for each customer.

Takeaways:

- First, firms can be sanctioned if their policies and procedures fail to take into account specific characteristics of products.
 - Second, firms can be sanctioned for failing to enforce their policies.
 - Third, firms and representatives can be sanctioned if they take a "one size fits all" approach to recommendations.
- **FINRA sanctioned a firm for private placement sales and taping rule failures.**

¹⁵ AWC NO. 2018058820103.

On November 22, 2021, a firm agreed to an AWC for the inappropriate sale of private placements and failing to comply with rules regarding the tapings of customer calls.¹⁶ For this conduct, FINRA censured the firm, fined it \$250,000, ordered it to offer rescission to the holders of 19 notes, and ordered it to review and revise, as necessary, the firm's policies, procedures, processes, controls, and systems concerning the taping rule, FINRA Rule 3170.

Relating to the sales, FINRA found the firm made negligent misrepresentations and material omissions in the sale of private placements, which were promissory notes issued by the BD's parent. The misrepresentations and omissions included the following:

- Providing investors with offering documents, which were approved by its CEO, containing material misrepresentations and omitting material facts. The offering documents stated that the company had a \$1 million line of credit with a bank, but failed to disclose that the company had defaulted on the line of credit and had defaulted on successive forbearance agreements with the bank, or that the bank had sued the company and the CEO. Similarly, the offering documents failed to disclose that the company had net operating losses each year from 2012 through 2016.
- The firm sent at least nine prospective investors a misleading "Historical Analysis" document. The document did not explain that this calculation was based on hypothetical returns from distinct investments and not any actual return from the notes.

FINRA concluded the firm and its CEO failed to supervise the offerings by not taking reasonable steps to ensure that registered representatives who solicited investments in the notes understood the terms of the notes, did not provide reasonable training to the registered representatives about the notes, and did not respond reasonably to questions from customers who raised red flags about lacking accurate information about the notes.

Relating to the Taping Rule, FINRA found that the firm's system for compliance was deficient in several respects and was not reasonably designed. For example, the firm's recording system allowed registered representatives, at their discretion, to end recordings at any time, including before a call was complete. In addition, the special Taping Rule procedures provided that supervisors would review a sampling of calls, but provided no meaningful guidance regarding the review process, frequency of review, or methods of escalating information identified during reviews. Finally, the firm failed to enforce the provision in its procedures requiring the firm to test its taping system to ensure that recordings were properly made and retained. As a result, the firm failed to detect that recordings were deleted prematurely.

Takeaways:

- First, the case highlights basic misrepresentations and omissions and issues that firms may want to review when conducting due diligence.
- Second, firms can be sanctioned if representatives do not understand products being sold and if there are indications that customers do not understand the products either. FINRA has sanctioned firms for this type of conduct related to different products, including mutual funds, variable annuities, and ETFs.
- Third, firms can be sanctioned if their procedures do not provide guidance.
- Fourth, firms subject to the Taping Rule need to understand the rule's requirements.
- Finally, firms can be sanctioned for inadvertent technical errors, whether related to the retention of taped conversations or the retention of emails.

¹⁶. AWC NO. 2017054381603.

- **FINRA sanctioned eight firms for 529 Plan failures, ordering \$9.5 million in restitution.**

Through six AWCs accepted in December 2021, FINRA settled with eight firms that allegedly failed to establish and maintain supervisory systems reasonably designed to supervise recommendations about 529 tax-advantaged education savings plans.¹⁷ FINRA ordered the firms to pay a total of \$9.5 million in restitution to affected clients. The restitution ranged from approximately \$60,000 to \$4 million. The firms were not fined for their conduct. Each firm voluntarily self-reported potential issues to FINRA as part of FINRA’s 529 Plan Share Class Initiative announced in Regulatory Notice 19-04. The cases primarily focused on share class suitability, although one case also dealt with rolling over 529 plan investments from one state plan to another.

Takeaways:

- First, if a regulator has a self-reporting initiative, firms need to assess the initiative carefully. The regulators generally use a carrot-and-stick (or possibly corn pone and being forced to wear shoes) approach to provide firms with incentive to self-report.
- Second, firms can be sanctioned if they lose sight of the characteristics of the product they are recommending and selling. One issue that regulators have often addressed, across multiple product lines, is share class.

- **FINRA sanctioned six firms for UIT violations, ordering more than \$16.8M in restitution**

On December 13, 2021, FINRA announced that its targeted examinations of Unit Investment Trust (UIT) early rollovers resulted in AWCs with six firms, including two settlements in December.¹⁸ Overall, FINRA ordered approximately \$16.8 million in restitution to be paid to approximately 10,000 investors. The firms failed to reasonably supervise early rollovers of UITs, which caused customers to incur potentially excessive sales charges.

FINRA’s initial UIT action, brought in September 2017, resulted in a \$3.25 million fine and restitution of \$9.8 million. Since that time, as a result of the sweep, FINRA fined the other six firms \$6.6 million. In June 2021, FINRA published an Investor Insights notice to help investors better understand UITs.¹⁹

Takeaways:

- First, regulators continue to focus on (and bring enforcement actions involving) complex products.
- Second, firms may want to focus on whether their representatives and supervisors adequately understand how particular products work. If firm representatives do not understand the products being recommended, it increases the likelihood that customers will not understand them.

- **FINRA sanctioned a firm more than \$1M for failing to supervise the sale of “junk” bonds.**

On December 15, 2021, FINRA settled a case with a firm for having inadequate supervision over recommendations to purchase high-yield corporate and municipal bonds (or “junk bonds”). The

17. https://www.finra.org/sites/default/files/fda_documents/2019062530101%20LPL%20Financial%20LLC%20CRD%206413%20AWC%20sl.pdf; https://www.finra.org/sites/default/files/fda_documents/2019062531501%20Royal%20Alliance%20Associates%2C%20Inc.%20CRD%2023131%20et%20al%20AWC%20sl.pdf; https://www.finra.org/sites/default/files/fda_documents/2019062873301%20SagePoint%20Financial%2C%20Inc.%20CRD%20133763%20AWC%20jlg.pdf; https://www.finra.org/sites/default/files/fda_documents/2016049188701%20Wells%20Fargo%20Advisors%2C%20LLC%20nka%20Wells%20Fargo%20Clearing%20Services%2C%20LLC%20CRD%2019616%20et%20al%20AWC%20sl.pdf; https://www.finra.org/sites/default/files/fda_documents/2019062532801%20UBS%20Financial%20Services%20Inc.%20CRD%208174%20AWC%20jlg.pdf; https://www.finra.org/sites/default/files/fda_documents/2019062530501%20MML%20Investors%20Services%2C%20LLC%20CRD%2010409%20AWC%20jlg.pdf.

18. <https://www.finra.org/media-center/newsreleases/2021/finra-announces-final-results-targeted-examination-unit-investment>.

19. <https://www.finra.org/investors/insights/pooled-money-understanding-unit-investment-trusts>.

firm was fined \$550,000 (of which \$280,500 pertained to violations of Municipal Securities Rulemaking Board rules) and ordered to pay restitution of approximately \$456,000.

FINRA found that from July 2013 through June 2016, the firm's supervisory system was inadequate, and as a result, the firm failed to identify for review more than 100 customer accounts with conservative profiles for potentially unsuitable concentration levels of high-yield bonds. The firm's supervision was not reasonable in two respects. First, the procedures did not sufficiently address suitability factors for representatives to consider before recommending high-yield bonds. For example, the procedures did not include guidance on how much of a customer's portfolio should be invested in these products based on the customer's investor profile. Second, while the firm used a daily and a monthly alert to identify potentially unsuitable concentrations of high-yield bonds in customer accounts, neither alert functioned as intended. After the firm made modifications to the alerts, they were inadvertently disabled, so they no longer identified potential concentration issues. As a result, the firm did not review the customer accounts referenced above. The firm did not test its alerts and therefore did not learn that these alerts were not working.

Takeaways:

- First, regulatory focus on complex products is not necessarily limited to packaged products (like variable annuities).
- Second, firms can be sanctioned if their policies do not provide basic supervisory requirements describing (1) who should supervise; (2) what should they supervise; (3) when should they supervise; (4) how should supervision be evidenced; (5) where should records of supervision be maintained; and (6) what should be done if irregularities are found.
- Third, firms can be sanctioned if they institute systems changes, but they fail to reasonably test them, and the systems fail to work properly. Regulators have sanctioned other firms where "glitches" were not uncovered.

Worms

Not surprisingly, Mr. Twain was well versed about worms (y'know, the yucky dirty squiggly crawly critters), but not so much about WORM (write once, read many).

- *Wisdom teaches us that none but birds should go out early, and that not even birds should do it unless they are out of worms.*²⁰
- *Rise early. It is the early bird that catches the worm. Don't be fooled by this absurd law; I once knew a man who tried it. He got up at sunrise, and a horse bit him.*²¹
- **FINRA fined two related firms \$2.25 million for improper WORM retention of customer records.**

On December 6, 2021, FINRA settled a case against two related firms, imposing a \$2.25 million fine for the firms' failure to retain Customer Identification Program (CIP) records in the required WORM format.²²

20. http://www.twainquotes.com/Early_rising.html.

21. <https://quotefancy.com/quote/862326/Mark-Twain-Rise-early-It-is-the-early-bird-that-catches-the-worm-Don-t-be-fooled-by-this>.

22. https://www.finra.org/sites/default/files/fda_documents/2020066327501%20Wells%20Fargo%20Clearing%20Services%2C%20LLC%20CRD%2019616%20Wells%20Fargo%20Advisors%20Financial%20Network%2C%20LLC%20CRD%2011025%20AWC%20sl.pdf.

The firms first became aware of the issue in November 2016. At that time, the firms were taking remedial measures regarding a December 2016 AWC. However, after that discovery, the firms continued to store CIP records on the non-WORM compliant platform for more than three years. In April 2019, the firms began reviewing whether certain ongoing projects would have an impact on CIP records. In connection with that review, in January 2020, the firms concluded that the firms were storing CIP records on a system that was not WORM compliant. The firms self-reported the issue to FINRA in April 2020, and by August 2020, the firms migrated the relevant records to a WORM-compliant platform. Overall, approximately 13 million CIP-related records, pertaining to approximately 8.2 million customers, were stored on the non-WORM compliant platform from 2003 to August 2020, with approximately 4 million documents having been stored on the firms' non-WORM compliant platform after the firms discovered the issue in November 2016.

Takeaways:

- First, regulators sanction firms for failing to address violative behavior. Remediation could include stopping the violative conduct, remediating harm caused by that conduct, and reporting to regulators. Under certain circumstances, FINRA requires self-reporting under Rule 4530(b).
- Second, while we often think about WORM issues in connection with email retention (and sometimes in connection with fishing) (but rarely in connection with phishing), other books and records also have WORM retention requirements.
- Third, this is another example of a “back to basics” issue.

Supervision

Mr. Twain had a lot to say about being a supervisor (and generally being intelligent), including the following:

- *You can't depend on your eyes when your imagination is out of focus.*
- *Don't go around saying the world owes you a living. The world owes you nothing. It was here first.*
- *Always do right. This will gratify some people and astonish the rest.*
- *I am different from [George] Washington; I have a higher, grander standard of principle. Washington could not lie. I can lie, but I won't.*²³

- **FINRA sanctioned a branch manager for failing to supervise.**

Through a November 30, 2021, AWC, FINRA sanctioned a branch manager for failing to supervise a representative who made excessive and unsuitable recommendations to three customers, two of whom were senior investors.²⁴ FINRA suspended the branch manager for two months in all principal capacities and fined him \$5,000.

FINRA noted that the branch manager became aware of red flags that the representative was recommending excessive and unsuitable securities transactions in the accounts of three customers. However, FINRA found that the branch manager failed to reasonably investigate these red flags or take appropriate action in response. Specifically, the branch manager was aware of the following conduct:

23. http://www.twainquotes.com/Washington_George.html.

24. AWC NO. 2020065035202.

- The representative engaged in frequent
 - short-term trades in the three affected accounts, including multiple same-day sales and purchases;
 - “round-trip” trading (i.e., the purchase and sale of the same security) in one of his customer’s accounts (occurring 41 times).
- All three accounts appeared on the firm’s monthly “Actively Traded Accounts” list, which required the branch manager to contact the customers of that account.
- One of the customers complained twice to the branch manager about the activity in his account.

Instead of adequately following up, the branch manager accepted at face value the representative’s explanations that the customers understood and desired an aggressive trading strategy, failed to ask the customers whether they wanted the aggressive trading as the representative had claimed, and failed to take any steps to investigate the complaints or take other appropriate action to address the representative’s excessive and unsuitable trading.

Takeaways:

- First, direct supervisors can be sanctioned for the bad conduct of representatives whom they supervise.
 - Second, supervisors can be sanctioned for failing to follow up on red flags and for trusting without verifying.
- **FINRA fined a firm \$1.2 million for failing to comply with Rule 8210 requests.**

On December 20, 2021, FINRA settled a case against a firm for failing to comply with its FINRA Rule 8210 obligations in two separate FINRA Enforcement investigations during 2018 through 2020.²⁵ In both investigations, the firm failed to timely produce responsive documents for approximately two years and, in one instance, the firm failed to produce certain telephone records, which were destroyed by a vendor despite a pending Rule 8210 request calling for their production. FINRA noted that these failures interfered with and delayed its investigations. One matter involved a customer arbitration against a firm representative. Three customers had alleged unauthorized and excessive trading, unsuitable recommendations, and other sales practice violations. As part of its investigation, in May 2018, FINRA issued a Rule 8210 request to the firm, seeking, among other things, telephone records. Among other failures, the firm did not produce responsive telephone records with two of the customers because the firm’s vendor destroyed those documents in 2018 and early 2019 as part of the vendor’s policy to periodically delete records older than three years and because the firm had failed to request all available telephone records from the vendor until February 2019.

The other investigation concerned a customer allegation that a representative had participated in a series of failed investments away from the firm. In June 2018, FINRA issued a Rule 8210 request to the firm, seeking, among other documents, emails related to the representative’s potential selling away. FINRA also issued two subsequent requests seeking records concerning the firm’s supervisory review of emails. Nearly two years after the date of the initial request, the firm produced responsive emails, explaining that the delay was because of, among other things, the improper application of an email “threading” tool by its vendor that excluded certain materials from review. After FINRA asked additional questions about the firm’s production, the firm produced other emails late because, among other several reasons, the firm’s vendor used “defective” search terms.

25. https://www.finra.org/sites/default/files/fda_documents/2018058015702%20Merrill%20Lynch%2C%20Pierce%2C%20Fenner%20%26%20Smith%20Incorporated%20CRD%207691%20jg.pdf.

In determining the sanctions, FINRA considered the following issues: (1) the firm's disciplinary history; (2) the importance of the information requested as viewed from FINRA's perspective; (3) the number of requests made and the degree of regulatory pressure required to obtain a response; (4) the length of time to respond; (5) the firm's explanations for the delayed productions and other deficiencies; (6) that the violations occurred in two separate and concurrent FINRA investigations; and (7) the remedial steps the firm has taken subsequent to the misconduct.

Takeaways:

- First, firms can be sanctioned if they fail to comply with Rule 8210 requests, although such actions are uncommon.
- Second, firms should consider whether they are adequately communicating with regulators about the status of the productions.
- Third, blaming vendors for a firm's production failures may sometimes work (but clearly, it doesn't work all of the time).
- Fourth, do your darndest to make sure documents don't get destroyed. (Maybe, if you look hard enough for missing documents, you'll be able to use a variation of the Mark Twain quote: "The reports of our document destruction are greatly exaggerated.")

Tax Disclosure

Mr. Twain made a lot of statements criticizing taxes, including the following:

- *A tax is a fine for doing well, a fine is a tax for doing wrong.*²⁶
- *What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin.*²⁷

- **FINRA sanctioned a representative for failing to disclose a tax lien and outside business activities (OBAs)**²⁸

On November 30, 2021, through an AWC, FINRA sanctioned a representative, who was also a principal, for a failure to timely disclose a tax lien and an OBA.²⁹ FINRA suspended the respondent from associating with a FINRA member for two months and fined him \$10,000.

FINRA found that he failed to timely amend his Form U4 to disclose a federal tax lien totaling almost \$60,000 despite becoming aware of it for over six months. In addition, for two months, the respondent made capital contributions to a medical marijuana company through an entity he owned in the form of a promissory note, in exchange for a partial ownership interest in the marijuana company. He also formed and became the managing member of a new limited liability company to engage in operational activity for the marijuana company and planned to serve as its CFO. The respondent failed to disclose any of this to his firm.

Takeaways:

- First, this case is a reminder that FINRA takes seriously disclosures like tax liens and OBAs.
- Second, be careful about OBAs dealing with marijuana businesses. Sometimes, those plans go up in smoke. (Sorry, we couldn't resist.)

26. <https://www.azquotes.com/quote/1131754>.

27. <http://www.twainquotes.com/Tax.html>.

28. We could not find any quotes from Mark Twain about OBAs. However, he did say, "When everyone is looking for gold, it's a good time to be in the pick and shovel business."

https://www.azquotes.com/author/14883-Mark_Twain/tag/business.

29. AWC NO. 2019061329901.

- Finally, times were different when Mark Twain lived. As far as we know, he didn't touch marijuana, however, he had a lot to say about his cigars, including the following:
 - If smoking is not allowed in heaven, I shall not go.
 - I smoke in moderation. Only one cigar at a time.
 - It has always been my rule never to smoke when asleep, and never to refrain when awake.
 - It's easy to quit smoking. I've done it hundreds of times.³⁰

Rules to Live By

Despite being on the wrong side of history about cigars (and perhaps not as progressive as we would like in some other areas), Mark Twain said many things that should help us weather this pandemic (the way the pilot of a steamboat or a raft traverses the Mississippi River) and ride the waves of regulatory change sure to come with the new administration. (How's that for connecting themes?)

• Advice for children

- *Always obey your parents when they are present. Most parents think they know more than you do; and you can generally make more by humoring that superstition than you can by acting on your own better judgement. (sic)*³¹
- *When I was a boy of 14, my father was so ignorant I could hardly stand to have the old man around. But when I got to be 21, I was astonished at how much the old man had learned in seven years.*
- *Franklin said once in one of his inspired flights of malignity--Early to bed and early to rise make a man healthy and wealthy and wise. As if it were any object to a boy to be healthy and wealthy and wise on such terms.*

• Advice on investing

- *There are two times in a man's life when he should not speculate: when he can't afford it, and when he can.*
- *October: this is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February.*³²

• Advice for success

- *The secret of getting ahead is getting started.*
- *To succeed in life, you need two things: ignorance and confidence.*
- *I am an old man and have known a great many troubles, but most of them never happened.*
- *It's not the size of the dog in the fight, it's the size of the fight in the dog.*
- *Never put off till tomorrow what may be done day after tomorrow just as well.*
- *Never argue with stupid people, they will drag you down to their level and then beat you with experience.*
- *Let us be thankful for the fools. But for them the rest of us could not succeed.*

30. <https://nottinghamcigaretteandcigar.com/cigars-edmonton/cigar-quotes/>

31. <http://www.twainquotes.com/Obedience.html#:~:text=Always%20obey%20your%20parents%2C%20when,on%20your%20own%20better%20judgement>

32. https://en.wikipedia.org/wiki/Mark_Twain_effect#:~:text=In%20some%20stock%20markets%2C%20the,months%20to%20speculate%20in%20stocks

- **Advice for others**

- *Nothing so needs reforming as other people's habits.*

- **Do not be afraid of aging**

- *I do not fear death. I had been dead for billions and billions of years before I was born, and had not suffered the slightest inconvenience from it.*
- *Wrinkles should merely indicate where the smiles have been.*
- *Age is an issue of mind over matter. If you don't mind, it doesn't matter.*

- **Do not fear politicians**

- *Politicians and diapers must be changed often, and for the same reason.*

- **And finally, the ultimate advice:**

- *All generalizations are false, including this one. ■*