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LEGAL ALERT

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Annual Sutherland FINRA Sanctions Survey Shows a 51% Jump in Fines in 2011

Sutherland Asbill & Brennan LLP has completed its annual FINRA Sanctions Survey, a review of the disciplinary actions reported by the Financial Industry Regulatory Authority (FINRA). By reviewing FINRA's notices and releases, Sutherland Partners Deborah G. Heilizer and Brian L. Rubin and Associate Andrew M. McCormick found that in 2011 FINRA reported a significant increase in the number of disciplinary actions filed and the total fines imposed. These increases followed a substantial increase in the number of cases reported in 2010. Sutherland also identified the top enforcement issues for FINRA in 2011, as well as emerging trends.

The Results

Fines and Disciplinary Actions

FINRA reported filing 1,488 disciplinary actions in 2011, a considerable increase from the 1,310 cases the regulator initiated in 2010.[1] 2011 was the third straight year of growth in the number of FINRA disciplinary actions. While the growth in 2009 was relatively modest (an 8% increase), FINRA posted double-digit increases for both 2010 and 2011, approximately 13% each year. The number of individuals barred by FINRA also increased significantly—from 288 in 2010 to 329 in 2011, an increase of more than 14%. Similarly, the 97 formal complaints filed by FINRA to the Office of Hearing Officers in 2011 nearly matched the 98 filed in 2005 and rose for the fourth straight year after significant slowdowns in 2006 and 2007. (Prior to the filing of a formal complaint, an enforcement action can be settled through a Letter of Acceptance, Waiver and Consent.)

The rate of growth in fines last year surpasses the rate of growth in the number of actions, with fines in 2011 jumping 51% to $68 million from 2010's $45 million. This is a significant reversal from 2010, when there was a $5 million drop in the total amount of fines notwithstanding a 13% increase in the number of actions filed. While the $68 million reported in 2011 is still a far cry from the $184 million and $111 million that FINRA fined firms and representatives in 2005 and 2006, respectively, it may signal continued enforcement efforts for the near future.

The chart below shows the fines and the number of disciplinary actions that FINRA has reported during each of the past seven years.[2]

[1] FINRA defines disciplinary actions to include Letters of Acceptance, Waivers and Consents, Complaints, Rule 9522 suspensions, and Minor Rule Violations.

[2] The number of cases reported and the amount of corresponding fines come from the *Disciplinary and Other FINRA Actions* report that FINRA publishes each month.

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FINRA's Sanctions Statistics, 2005 - 2011

	Fines Reported	Percentage Change	Disciplinary Action	Percentage Change
2005	$184 million	n/a	1,412	n/a
2006	$111 million	<40>	1,204	<15>
2007	$ 77 million	<31>	1,177	<2>
2008	$ 28 million	<64>	1,073	<9>
2009	$ 50 million	79	1,158	8
2010	$ 45 million	<10>	1,310	13
2011	$ 68 million	51	1,488	13.6

Top Enforcement Issues

#1 **Advertising** sanctions jumped from $4.75 million in 2010 (when it was also ranked first on Sutherland's *Top Enforcement Issues* list) to $21.1 million in 2011. The number of cases involving alleged advertising violations doubled in number to 45 in 2011. As in 2009 and 2010, a significant amount of the 2011 advertising fines ($9.5 million) related to the sale of auction rate securities. In addition, nearly $8 million in fines stemmed from nine cases involving the use of allegedly misleading advertising materials on firm websites available to investors. This included advertisements for complex products, such as Auction Rate Securities, and for more traditional investments like annuities.

For the Sutherland Focus Report on Advertising, click here.

#2 **Short selling** cases were the second biggest enforcement issue reported by FINRA in 2011, generating $16.8 million in fines. In contrast, short selling was fifth on Sutherland's 2010 *Top Enforcement Issues* list. The 2011 fines for short selling represent a more than fourfold increase compared with the fines reported in 2010. This substantial increase was largely driven by a single $12 million fine imposed on a firm that allegedly violated Regulation SHO by failing to properly supervise millions of short sale orders that were mismarked and placed to the market without reasonable grounds to believe that the securities could be borrowed.

For the Sutherland Focus Report on Short Selling, click here.

#3 **Auction Rate Securities (ARS)** continued to be an important focus for FINRA in 2011, as seven ARS cases resulted in nearly $10 million in fines. This was a substantial increase from 2010 when two ARS cases were reported that resulted in $1.75 million in total fines. Most of the 2011 cases concerned the alleged failure to disclose material facts to investors, often in advertising materials.

For the Sutherland Focus Report on Auction Rate Securities, click here.

#4 **Suitability** cases resulted in $7.7 million in reported fines in 2011. The 106 cases that involved suitability allegations in 2011 doubled the 53 cases reported in both 2009 and 2010. Similarly, the fines reported in suitability cases jumped from $3.75 million in 2010 to $7.7 million in 2011, a

105% increase. Suitability has repeatedly landed on Sutherland's *Top Enforcement Issues* list, placing fourth in 2010 and 2011 and second in 2008 and 2009.

For the Sutherland Focus Report on Suitability, click here.

#5 **Improper Form U4, U5, and Rule 3070** filings resulted in 91 FINRA disciplinary actions and more than $6.6 million in reported fines in 2011 (compared to 67 cases and fines of $1.45 million in 2010). Although allegations concerning isolated problems with these regulatory filings often led to fines of $5,000 to $10,000, there were four 2011 cases where each firm was fined more than $600,000 for failing to report material information on Forms U4 and U5, including SEC investigations and customer settlements.

Trends

- **Advertising.** Advertising made its debut on Sutherland's *Top Enforcement Issues* list in 2009, ranking fifth with $5.5 million in total fines. In 2010, advertising cases ranked first, although fines dropped to $4.75 million. In last year's analysis, Sutherland predicted that FINRA would continue placing greater emphasis on advertising materials. This prediction proved to be correct in 2011, as advertising cases resulted in fines totaling $21.1 million, an increase of 344% compared with 2010.

- **Municipal Securities.** In FINRA's February 8, 2011 Regulatory and Examination Priorities Letter, FINRA emphasized that member firms need to understand the municipal securities they sell and corresponding regulatory requirements. FINRA's January 31, 2012 edition of this letter reminded firms that they must ensure that any municipal securities sold are suitable for the purchasing customers. FINRA's 2011 enforcement activity reflected a growing regulatory concern for municipal securities, as the number of cases reported jumped 81% in 2011 (32 cases reported in 2010 compared to 58 in 2011). Similarly, the amount of fines reported in 2011 ($3.7 million) more than doubled the $1.5 million imposed in cases involving municipal securities in 2010.

- **The Return of "Supersized" Fines.** The number of FINRA's "supersized" fines ($1 million or more) has dwindled in recent years, from 19 reported in both 2006 and 2007, to 10 in 2009, and only six in 2010. Although the number of these large fines grew only to 10 in 2011, the total amount of these fines exploded from $14.2 million in 2010 to more than $35 million in 2011. This includes five fines of at least $3 million and a short selling case that resulted in a $12 million fine.

- **The Mutual Fund Comeback.** After yielding the most fines in both 2008 and 2009, fines stemming from disciplinary actions involving mutual funds dropped dramatically in 2010. In fact, there were only 12 mutual fund cases in 2010, totaling only $1.3 million in fines. In comparison, mutual fund cases generated more than $12 million and $10.3 million in fines in 2008 and 2009 and $104 million and $95 million in fines in 2005 and 2006. Although the $5.1 million in 2011 fines is only a small percentage of these earlier numbers, it is a substantial increase from 2010's figures. With the number of mutual fund cases (55) and the total amount of corresponding fines more than quadrupling during the past year compared to 2010, it seems likely that these products will once again become an area of emphasis for FINRA.

- **Electronic Communications.** The total amount of fines stemming from alleged violations concerning electronic communications has now decreased for three consecutive years. After yielding approximately $4 million in fines in both 2009 and 2010, these cases resulted in only $3.6 million in fines in 2011. Despite this drop in fines, the number of cases actually grew from 34 reported in 2010 to 57 in 2011.

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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.

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