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FINRA Facts and Trends: November 2022

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Welcome to the latest issue of Bracewell's FINRA Facts and Trends, a monthly newsletter devoted to condensing and digesting recent FINRA developments in the areas of enforcement, regulation and dispute resolution. This month, we report on FINRA's targeted sweep of crypto-related communications, further proposed amendments to the expungement rule, and FINRA's crack down on small-cap IPOs, Read about these issues, along with notable enforcement actions and arbitration decisions, below.

FINRA Announces Targeted Sweep of Crypto Purveyors

Earlier this month, FINRA launched a ***targeted examination*** into cryptocurrency-related communications made by broker-dealers and their affiliates. Whether this examination was triggered by the stunning collapse of crypto exchange FTX or whether the timing was purely coincidental, FINRA has clearly signaled that it is ready to take a harder line on transactions involving digital currency.

FINRA's sweep focuses on retail communications made by brokers or their affiliates in the third quarter of 2022 that involved a crypto asset or a service involving the transaction or holding of a crypto asset. The examination letter defines "crypto asset" as any asset "issued or transferred using distributed ledger or blockchain technology," whether described as a currency, coin or token. And "communications" include not just written and electronic messages, but also video, social media posts, websites and private messages posted on mobile applications like WhatsApp (another issue being ***followed closely by FINRA***).

Firms receiving FINRA's exam letter must disclose details about the communications themselves, including internal approval processes as well as whether the communications were filed with FINRA's Advertising Regulation Department. FINRA is also seeking to review each target firm's supervisory procedures, compliance policies, manuals or other guidance regarding such communications. Finally, FINRA seeks information on how broker-dealers use affiliates to offer crypto assets.

Generally speaking, FINRA uses targeted exams to gather information and carry out investigations, especially in response to emerging issues. ***According to FINRA***, the firms included in a sweep are selected based on a variety of factors, including level and nature of business activity in a particular area, customer complaints and regulatory history, and prior examination findings.

This month's action on cryptocurrency communications presents the latest step in FINRA's attempts to monitor digital asset sales. ***Since 2018***, FINRA has been issuing yearly notices encouraging firms to notify FINRA if they engage in activities related to digital assets. In October 2021, FINRA released a ***regulatory notice*** concerning FinCEN's anti-money laundering priorities that highlighted "virtual currency considerations." And this past January, as ***reported by Barron's***, FINRA CEO Robert Cook announced potential changes to cryptocurrency advertising and disclosure requirements at a Securities Industry and Financial Markets Association (SIFMA) event.

Proposed Expungement Rule Delayed Again

As we reported ***previously***, FINRA proposed an overhaul of the customer complaint expungement process back in July 2022. On November 10, 2022, after receiving dozens of comments from industry advocates, and one day before the Securities and Exchange Commission was set to rule on the proposal, FINRA filed an ***amendment*** that would further tighten the expungement process. The proposed amendment contains three modifications that are designed to meet the concerns of certain investor advocates. First, the amendment would forbid brokers from seeking expungement if that broker had previously been found liable for that same matter by a panel or court of competent jurisdiction. Second, the amendment would clarify that customers whose complaints are the subject of an expungement request are entitled to participate in "all aspects" of the expungement process. Third, the amendment makes clear that arbitrators should not "give any evidentiary weight" if a customer elects not to participate or attend an expungement hearing. Assuming these latest amendments do not generate further concerns by industry or investor advocates, the new expungement rules could go live in early 2023.

Notable Enforcement Matters and Disciplinary Actions

- **Falsifying Client Statements.** On November 4, 2022, Wedbush Securities agreed to pay $850,000 in fines to settle allegations that it falsified monthly account statements for five years from 2013 to 2018.

  In its ***Letter of Acceptance, Waiver and Consent***, FINRA said that the Los Angeles-based wealth management, brokerage and clearing firm "negligently misrepresented on monthly account statements that it sent to approximately 610 customers that certain corporate and municipal bonds were making interest or principal payments when, in fact, the bonds were in default." Although Wedbush allegedly received notifications that the bonds were in default, it failed to pass along that information to customers. The AWC also alleges that Wedbush did not reasonably review the accuracy of account statements even after being notified by a vendor that it was misreporting information.

Notable FINRA Arbitration Awards

- **Options trading.** In our previous several issues, we have reported on a series of customer arbitration proceedings related to investments in a securities broker-dealer's managed account options trading strategy. Recent decisions have skewed toward victories for the broker-dealer, with a new award issued this month continuing that trend.

- ***FINRA Case No. 19-02173*** – A three-arbitrator panel conducted a six-day hearing in New York on claims of unsuitability and misrepresentations related to an individual Claimant's investments in the options trading strategy, seeking $700,000 in compensatory damages, and more than $2 million in punitive damages. Following the hearing, the panel dismissed the claims and recommended expungement of the claims from an associated person's CRD records. In recommending expungement, the panel noted that the claims of unsuitability were withdrawn at the hearing, while the facts at the hearing established that no misrepresentations had been made in connection with the Claimant's participation in the options strategy.

- **Investment Banking Fees.** Two awards were issued this month in cases brought by Intellivest Securities, Inc., a Georgia-based investment banking company, on claims that counterparties to its investment banking agreements failed to pay one or more fees for Intellivest's investment banking services.

  - ***FINRA Case No. 20-04131*** – Following a three-day hearing, a three-arbitrator panel dismissed in their entirety claims brought by Intellivest against Rethink Community, LP and Rethink Management, LLC, seeking $300,000 for alleged breach of an investment banking agreement.

  - ***FINRA CASE No. 20-03652*** – After conducting a four-day hearing in Wilmington, Delaware, the parties apparently reached a settlement in the principal amount of $24,000. The three-arbitrator panel in the proceeding nevertheless issued an award, granting Intellivest pre-judgment interest on the settlement amount, plus $10,500 in expert costs. The panel further assessed the entirety of the forum fees to Respondents Gratitute Management LLC and The Builders Fund, LP, based on the Panel's finding that Respondents were "inattentive" to their obligations under contract and law.

- **Individual Retirement Accounts (IRAs).** Two awards were issued this month that granted damages and equitable relief to Claimants in connection with claims of improper tampering with their IRAs.

  - ***FINRA Case No. 21-02340*** – Claimants in this arbitration alleged that Respondent Lincoln Financial Advisors Corporation conducted an unauthorized liquidation of Claimants' IRAs, which the Statement of Claim described as "unauthorized panic selling." A three-arbitrator panel, following a four-day hearing, dismissed the claims for violation of the securities laws, but granted the Claimants $100,000 on their claims for failure to supervise, and further directed that one of the two IRAs in question be reinstated "as if it had remained invested as of March 11, 2020."

FINRA Notices

- ***Regulatory Notice 22-23*** – FINRA provided guidance to member firms and? registered representatives on developing succession plans for their customers. Such succession plans often come into play when a firm or representative leaves the brokerage industry, such as in retirement, due to disability or illness, or, primarily in the case of small firms, upon the sale of a brokerage firm.

  The Notice discusses the background and emerging trends with respect to succession plans, and provides member firms and representatives with an overview of the governing FINRA rules and important considerations surrounding succession planning. While this Regulatory Notice creates no new rules or regulatory framework for succession plans, the guidance it provides can be used by member firms to review and modify their WSPs and business practices to achieve compliance with their regulatory obligations.

- ***Regulatory Notice 22-24*** – FINRA amended Rule 11880, concerning the settlement of syndicate accounts in connection with offerings of corporate debt securities. While the current rule requires only that syndicate accounts be settled within 90 days from the date on which the corporate securities are delivered by the issuer, the new rule will require 70% of the gross amount due to each syndicate member to be remitted within 30 days, with final settlement of the remainder to occur within 90 days.

  In its ***filing*** approving the rule change, the SEC explained that the amendment seeks to reduce the risks associated with syndicate debt issuance, including most notably the exposure of syndicate members to the potential deterioration of the credit of syndicate managers during the pendency of account settlement.

- ***Regulatory Notice 22-25*** – FINRA issued an alert concerning a recent trend in initial public offerings (IPOs) for certain small-cap issuers, pointing to a heightened threat of fraud. Specifically, FINRA has observed unusual price increases occurring the day of or shortly following small-cap IPOs, especially those involving issuers with operations in other countries. FINRA notes its concerns that these issuers may be the subject of "pump-and-dump-like schemes," and encourages members to immediately report potential fraud.