SECURITIES LAW SERIES

FINRA Disciplinary Proceedings

FINRA's Complaint & Hearing Process

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DISCLAIMER

This e-Book is for general informational purposes only and is neither intended as, nor should it be considered, legal advice. Every fact situation is different and there is no substitute for qualified legal counsel which you should seek at the earliest possible moment as there are strict timelines in all areas of Securities Law. Your reading or downloading of this e-Book does not create and attorney-client relationship with our firm which can only be done after speaking with a Herskovits PLLC attorney and both parties signing a written engagement letter. For more information on working with Herskovits PLLC visit: www.HerskovitsLaw.com or Call Us 212.897.5410

Introduction

FINRA's enforcement program is big business.

In 2008, FINRA levied fines totaling $28 million. By 2016, that number jumped to $176 million. In 2008, FINRA ordered restitution payments to investors totaling $6 million. By 2015, that number jumped to $96 million.

Each year, FINRA initiates approximately 1,500 disciplinary actions against member firms and employees. FINRA's Office of Hearing Officers resolves approximately 400 proceedings per year.

Although FINRA's enforcement program is expansive, insufficient guidance is given to industry participants who choose to contest FINRA's charges. This entry in the e-book series sheds light on the nuts and bolts of FINRA's disciplinary hearing process. Obviously, many enforcement matters involve complex issues of fact and law and require the assistance of a lawyer.

This e-book is designed to provide basic information and is no substitute for legal advice. It is imperative to consult with an experienced FINRA-defense attorney to assess any exposure you may have and decide upon a strategy which best serves your interests.

Questions concerning FINRA's disciplinary process should be directed to:

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Overview

The lifecycle of a FINRA disciplinary proceeding follows a predictable path:

Pre-Complaint Investigation

This topic was covered in Volume I of the e-book series.

Complaint

A disciplinary proceeding officially begins when FINRA serves the Complaint. FINRA's complaint is supposed to specify "in reasonable detail" the conduct which caused the rule violation. Once the Complaint is issued, the respondent has 25 days to file an Answer, which must admit, deny, or disclaim knowledge responsive to, each allegation in the Complaint (FINRA Rule 9215).

Common Issues

- **Hearing Request**

When filing the Answer, the responding party has the right to a demand a hearing (FINRA Rule 9221). Failing to request a hearing when filing your Answer may waive your right to demand a hearing.

- **Insufficient Details in the Complaint**

You are permitted to file a "motion for a more definite statement." A motion is simply a written request to obtain a ruling from the Hearing Officer. A motion of this type may be appropriate if the Complaint fails to provide enough detail for you to understand the charge against you and plan your defense.

- **Default**

Failing to answer the complaint permits the Hearing Officer to issue a default decision.

Hearing Panel is Appointed

Soon after the Complaint is filed, FINRA's Chief Hearing Officer appoints the Hearing Officer who will preside over your case. The Hearing Officer is employed by FINRA but strives to be impartial and conflict-free.

Hearing Officers play no role in the pre-complaint investigation and maintain independence from FINRA's enforcement program. Biographies of FINRA's Hearing Officers are available at http://www.finra.org/industry/hearing-officer-biographies. The function of the Hearing Officer is to resolve all motions and ensure that the proceeding is conducted fairly and efficiently.

Hearings are typically heard before a 3-person Hearing Panel. The panel is chaired by the Hearing Officer and includes 2 industry panelists who typically are drawn from FINRA's District Committees.

Settlement

The settlement process shifts once a Complaint has been issued. Prior to the issuance of a Complaint, settlement is documented with a Letter of Acceptance, Waiver and Consent. After the Complaint has been issued, settlement occurs only through a written Offer of Settlement (FINRA Rule 9270).

An Offer of Settlement is presented to the Hearing Officer and must contain the following:

- A signature by the respondent
- Identification of the origin the disciplinary action

- Specification of the rules which were allegedly violated
- Specification of the facts or practices that the respondent engaged in to cause the rule violation
- A statement consenting to findings of fact and violations consistent with the terms of the Offer of Settlement
- A proposed sanction

The decision to submit an Offer of Settlement is a difficult one. If the Offer of Settlement is rejected, the Hearing Panel may assume that the person who submitted the Offer is guilty of the rule violation.

Offers of Settlement can be contested or uncontested. It is uncontested if Enforcement or Market Regulation agrees in advance to the terms of the Offer and is contested if they do not. Clearly, the odds of acceptance of the settlement offer increase greatly if the Offer is uncontested.

Settlement terms may also be reached by mediation through FINRA's Office of Hearing Officers mediation program. If mediation is agreed to, the Chief Hearing Officer appoints a Hearing Officer (other than the Hearing Officer assigned to the case) to conduct the mediation.

Mediation is confidential, voluntary and non-binding, meaning that any party can choose to discontinue the mediation at any time. The mediation is typically conducted by telephone.

Initial Pre-Hearing Conference

At various points during the pre-hearing phase, the Hearing Officer may order the parties to attend a pre-hearing conference by telephone.

The initial pre-hearing conference is important because it sets a case management and scheduling order. Generally, the Hearing Officer will expect the parties to strictly adhere to each deadline in the

scheduling order. Deadlines typically set during the initial pre-hearing would include:

- Dates and location of the final hearing
- Deadline for parties to file motions for leave to permit expert testimony
- Deadline for parties to file motions for summary disposition pursuant to FINRA Rule 9264
- Deadline for the respondent to file a motion related to Enforcement's production of documents under FINRA Rules 9251 and 9253
- Deadline for respondent to file a motion seeking to compel Enforcement to invoke FINRA Rule 8210 to obtain documents or hearing testimony from non-parties
- Deadline for parties to exchange proposed stipulations concerning relevant undisputed facts
- Deadline for parties to file pre-hearing submissions, including briefs, witness lists, exhibits lists, and proposed exhibits
- Deadline for parties to file objections to proposed witnesses or exhibits

Discovery

Discovery is the term used to describe the exchange of documents or information before trial. Litigants use discovery as a means to obtain documents or information needed to support their claims or defenses.

Discovery in the context of a FINRA disciplinary proceeding will likely feel decidedly one-sided. Enforcement has vast powers to conduct an expansive investigation. In so doing, Enforcement obtains all the discovery it deems necessary before starting the disciplinary proceeding. They can obtain documents and testimony from any

member firm or employee without your knowledge and without any practical limitation.

Once Enforcement or Market Regulation deems its investigation complete (meaning, once they obtain the documents and information they deem necessary to support its charges), the Complaint is filed.

Nevertheless, when defending a disciplinary action, you are not afforded anywhere near the same latitude to obtain documents or information which may support your defenses.

FINRA's rules do require automatic disclosure by Enforcement or Market Regulation of the following categories of documents, provided the documents "relate to" the investigation which led to the disciplinary proceeding:

- Requests for documents or information issued pursuant to FINRA Rule 8210 and all responses
- Requests for documents or testimony not issued pursuant to FINRA Rule 8210 and all responses
- All transcripts and transcript exhibits
- Documents obtained from non-parties
- Documents containing "material exculpatory evidence," meaning documents which may rebut FINRA's charges of wrongdoing

Common Discovery Issues

- **Absence of Subpoena Power**

In traditional litigation, you have the ability to subpoena documents or testimony from third-parties which may be critical to support your defense. However, in a FINRA disciplinary proceeding, you have no right to issue subpoenas for documents or testimony. You can file a

motion asking the Hearing Officer to order Enforcement to issue a Rule 8210 request to a member firm or its employees, but you should not assume the Hearing Officer will grant the request.

The motion must describe the documents, state why these documents are material, identify the efforts made to obtain the documents by other means, and state whether FINRA has jurisdiction over the custodian of the documents (FINRA Rule 9252).

Generally, the Hearing Officer will need to be convinced that (1) the information sought is relevant, material, and noncumulative; (2) the requesting Party has previously attempted in good faith to obtain the desired documents and testimony through other means but has been unsuccessful in such efforts; and (3) each of the persons from whom the documents and testimony are sought is subject to FINRA's jurisdiction.

- **Disputes Concerning Whether a Document "Relates to" Your Proceeding**

Enforcement or Market Regulation is only required to produce documents obtained by FINRA "in connection with the investigation that led to the institution of proceedings." This standard may invite abuse on the part of Enforcement because it is easy to claim that documents in FINRA's possession were not obtained "in connection with" your investigation.

Generally, you will need something more than assumption to convince a Hearing Officer that documents withheld by Enforcement or Market Regulation were obtained "in connection with" your investigation.

- **Disputes Concerning Witness Interview Notes**

A respondent is entitled to file a motion seeking "witness statements"

(generally, a transcript of an "on-the-record" interview) for each witness that Enforcement or Market Regulation may call to testify. A respondent may also file a motion seeking witness interview notes transcribed by a FINRA investigator.

For technical reasons, it is uncommon to obtain witness interview notes taken by a FINRA investigator.

Pre-Hearing Motions

Pre-hearing motions will generally concern:

- Motions for summary disposition (FINRA Rule 9264)
- Motions to obtain documents or testimony from members firm or employees (FINRA Rule 9252)
- Motions concerning the use of expert witnesses
- Motions concerning proposed witnesses, exhibits or areas of testimony

Pre-Hearing Submissions

- Witness List

The parties are required to exchange witness lists. The list must disclose the name, address, telephone number, and current occupation of each prospective witness. The list must also briefly describe the substance and scope of the anticipated testimony.

Once the witness list is exchanged, either side can object to witnesses proposed by the opposing party.

- Exhibit List

The parties are required to exchange proposed exhibits. The list must include a description of each exhibit and a brief statement indicating the purpose for which the document will be offered at the hearing. The determination of which documents to use is labor intensive because Enforcement often produces thousands of pages of documents during discovery.

Once the exhibit list is exchanged, either side can object to exhibits proposed by the opposing party.

- Pre-Hearing Briefs

Pre-hearing briefs are critically important. You are expected to provide a cogent narrative of the facts and apply the facts to the rules at issue. This is often the first opportunity for the respondent to educate the Hearing Panel on your "view of the world." Prior to this point, the Hearing Panel has only seen a one-sided presentation – the Complaint.

Drafting a persuasive pre-hearing brief requires skill and a great deal of effort. It is difficult to extract nuggets of information from thousands of pages of documents and weave that information into a persuasive fact pattern.

The Hearing

The hearing is conducted in a manner very similar to traditional litigation. The parties can make opening remarks. Then Enforcement or Market Regulation has its witnesses testify. Then the respondent has his witnesses testify. The hearing will conclude with closing statements by the parties.

Trial strategy is well beyond the scope of this e-book. Suffice it to say, it requires a highly skilled lawyer to effectively question witnesses and elicit favorable testimony at a disciplinary hearing.

Post-Hearing Submissions

Hearing Officers may direct the parties to file proposed findings of fact and conclusions of law, or post-hearing briefs, or both. These, too, are labor intensive endeavors. A persuasive post-hearing brief provides a cogent narrative of the record (the record is comprised of witness testimony and documents received in evidence).

Conclusion

After the hearing concludes, the Hearing Panel typically issues the decision within 60-days. The parties do have certain rights to appeal an adverse decision, first to the National Adjudicatory Council, then to the SEC, and finally to a federal court of appeals.

ABOUT THE AUTHOR

Since he began practicing law in 1996, Robert Herskovits has represented securities industry participants in a variety of litigation, arbitration and enforcement actions, first as associate general counsel to an NYSE broker-dealer firm, and later as an attorney and partner at various law firms.

Rob is a certified arbitrator for FINRA, AAA, and the NFA, and has participated in an estimated 200 arbitration proceedings before FINRA.

At the end of 2011, Robert formed Herskovits PLLC to provide legal representation to broker-dealers, investment advisors, securities industry professionals, and investors in securities litigation, securities arbitration and securities industry regulatory defense for matters appearing before FINRA and other self-regulatory bodies, as well as before the SEC, state securities authorities, and state and federal courts. In addition to dealing with regulatory matters, Robert provides representation in employment, contract, and general commercial litigation for these same financial services clients.

The impetus for founding his own firm was Robert's recognition that securities and financial services industry clients were not always being well-served by some of the larger law firms, particularly with regard to billing inefficiencies. He recognized that, sometimes, their large size and broad practice structure actually hindered them from constructing the hands-on, personal relationships necessary to truly understand their client's priorities and goals in representative matters.

He formed Herskovits PLLC to fill a void in the marketplace by offering clients involved in the securities profession experienced legal services while still recognizing and appreciating the budgetary limitations imposed on these businesses by a weak economy and a constrained market.

Robert's insight is to provide a broad range of business-related services in a small-firm atmosphere, so that his clients do not have to deal with multiple firms or, alternatively, work with multiple attorneys at a single large firm who are unfamiliar with the particular concerns that securities industry participants face. Herskovits PLLC knows its clients, understands its clients' business, and provides its clients with offer cost-effective representation.

Robert is dedicated to providing legal expertise and advocacy that will empower his securities and financial services clients to operate their businesses and pursue their professions with as little disruption and cost as possible when faced with problems, whether they are customer or employee disputes, enforcement actions, or regulatory investigations.

Prior to forming Herskovits PLLC, Robert was a partner with Gusrae Kaplan Nusbaum PLLC, for more than five years.

Robert is the Co-Chair of the Committee for Securities and Exchanges of the New York County Lawyers' Association, and is admitted to practice in the States of New York and Mississippi and before various federal courts throughout the country, including the U.S. Supreme Court.