FINRA and the Role of SROs in Enforcing the Securities Laws

_Fiero v. FINRA_

The principal federal regulatory authority for the federal securities laws is the Securities and Exchange Commission. The SEC, however, delegated some of its authority to “self-regulatory organizations” (“SROs”), which are securities industry associations. These SROs formulate and enforce standards for trading and brokerage. In 2007 the enforcement arms of the New York Stock Exchange and the National Association of Securities Dealers merged to form a new SRO, the Financial Industry Regulatory Authority (“FINRA”). FINRA investigates and disciplines members for failing to comply with the federal securities laws and regulations. As a practical matter, all securities firms dealing with the public must be members of FINRA. See _Sacks v. SEC_, 648 F.3d 945, 948 (9th Cir. 2011).

Once a member is fined by FINRA, can FINRA bring a judicial collection action against that member? The Second Circuit held in _Fiero v. FINRA_, No. 09-1556-cv-(L), 2011 WL 4582436 (2d Cir. Oct. 5, 2011), that FINRA lacks authority to bring court actions to collect disciplinary fines that FINRA imposed on its members.

The facts of _Fiero_ are as follows: In 2000 FINRA fined a member broker-dealer firm $1,000,000 for violating the federal securities laws and FINRA Conduct Rules. The firm refused to pay, so FINRA sued in state court. The state court ruled that FINRA could collect its judgment. The firm then sought a declaratory judgment in federal court that FINRA had no authority to collect finds through judicial proceedings; FINRA counterclaimed to enforce the fine. The district court dismissed the firm’s complaint and entered judgment in favor of FINRA.

On appeal, FINRA argued that it had authority to bring judicial collection actions

The court held that the 1934 Act did not provide authority to FINRA. Under Section 15A(b) of the 1934 Act, SROs have statutory authority to “appropriately discipline[]” their members for violating the federal securities laws or their own rules by “expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.” 15 U.S.C. § 78o-3(b)(7). But, the court noted, “there is no express statutory authority for SRO’s to bring judicial actions to enforce the collect of fines.” Further, the court observed that its conclusion was supported by existing sanction-enforcement options available to FINRA, as well as by FINRA’s longstanding practices. The Second Circuit said:

One might argue that an inference of congressional intent to authorize such legal actions by FINRA can be drawn from the seemingly inexplicable nature of a gap in the FINRA enforcement scheme: fines may be levied but not collected. However, the gap does not support an inference of inadvertent omission because significant underenforcement of the securities laws and FINRA rules is hardly the inevitable result of FINRA’s inability to bring fine-enforcement actions. FINRA fines are already enforced by a draconian sanction not involving court action. One cannot deal in securities with the public without being a member of FINRA. When a member fails to pay a fine levied by FINRA, FINRA can revoke the member’s registration, resulting in exclusion from the industry. Moreover, where a fine is based on a violation of the Exchange Act, the violator will also face a panoply of private and SEC remedies. See, e.g., 15 U.S.C. §§ 77k-77l, 78i, 15 78j(b).

Finally, our conclusion is amply supported by NASD’s longstanding practices. It has always relied exclusively upon its powers to revoke the registration of or deny reentry into the industry to punish members who do not comply with sanctions. ... So far as we can tell, it was not until 1990 that the NASD sought to enforce fines or any other sanction through judicial actions in its own right. NASD (or any other SRO) may never even have claimed to have the power to do so until 1990. In that year ... NASD proposed a rule and successfully asked the SEC not to disapprove it. The rule notified the public of a new NASD policy of bringing court actions in its name.
to collect fines. ... And, even after
the change in policy in 1990 ... the
action against the [defendant] is
said to be the first case brought
under that policy. ... Such a
longstanding practice supports an
inference that NASD believed that
it lacked judicial enforcement
power.

The Second Circuit’s decision is available
here.