

Two Steps Forward, One Step Back: FINRA's Push for More Disclosure through BrokerCheck

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INTRODUCTION

FINRA has been busy in the first quarter of 2014. In particular, FINRA has devoted substantial time to issues involving BrokerCheck. FINRA was initially successful in having two proposed rules sent to the S.E.C. for consideration: one involving permanent disclosure of settled regulatory actions and one involving mandatory reference to a firm's BrokerCheck on websites and social media. The first proposal has been approved and will become effective June 23, 2014. The second proposal was recently withdrawn after intense scrutiny.

BACKGROUND

FINRA prides itself as being dedicated to protecting investors. BrokerCheck is one of the tools FINRA utilizes to disseminate information to investors about FINRA members and associated persons to help investors make informed decisions about who to conduct business with.

In the last twelve months, the Wall Street Journal ("WSJ"), in particular, has taken exception with FINRA's BrokerCheck system. Starting with an October 4, 2013 article, the WSJ cited its own study, which found that more than 5,000 stockbrokers from expelled firms are still selling securities.¹ An October 16, 2013 article cited the same study, finding that stockbrokers

are routinely allowed to scrub customer complaints from their public records, leaving investors in the dark about potentially troubled advisers.² On March 5, 2014, the WSJ issued a third article claiming that more than 1,600 stockbrokers had bankruptcies or criminal charges that were not disclosed on FINRA's BrokerCheck.³ One day later, the WSJ authored yet another article, citing a study by the Public Investors Arbitration Bar Association, a well-known conglomeration of plaintiff securities lawyers, finding that FINRA routinely strips out possible red flags on brokers from its database in the information it makes available to investors.⁴

As public criticism grew and garnered the attention of Congress, FINRA responded by, among other things, proposing the following two changes to the BrokerCheck system.

A. Changes to FINRA Rule 8312 Will Require Permanent Disclosure of Regulatory Settlements

In February 2014, the S.E.C. approved a change to FINRA Rule 8312, which will expand the categories of information permanently included in BrokerCheck. Under the current rule, BrokerCheck makes certain information about former associated persons permanently available on BrokerCheck. Specifically, BrokerCheck permanently discloses information about associated persons

who have not been associated with a member firm within the preceding 10 years, and (a) were ever the subject of a final regulatory action, or (b) were registered on or after August 16, 1999, and were:

- (i) convicted of or pled guilty or nolo contendere to a crime;
- (ii) the subject of a civil injunction in connection with investment related activity or a civil court finding of involvement in a violation of any investment related statute or regulation (Civil Judicial Disclosures); or
- (iii) named as a respondent or defendant in an investment-related arbitration or civil litigation which alleged that the person was involved in a sales practice violation and which resulted in an arbitration award or civil judgment against the person.

FINRA's amendment to Rule 8312 will add an additional category of what leads to permanent disclosure. BrokerCheck will now permanently make available information about former associated persons of a FINRA member firm who have been the subject of an investment-related civil action brought by a state or foreign financial regulatory authority that was dismissed pursuant to a settlement agreement.

Although consistent with FINRA's push

¹ See <http://online.wsj.com/news/articles/SB10001424052702303643304579107442831410708?KEYWORDS=FINRA&mg=reno64-wsj>, last visited on 4/29/14.

² See <http://online.wsj.com/news/articles/SB10001424052702303680404579139520100083360>, last visited 4/29/2014.

³ See <http://online.wsj.com/news/articles/SB10001424052702304026804579411171593358690>, last visited 4/29/2014.

⁴ See <http://online.wsj.com/news/articles/SB10001424052702304554004579423270046013550?KEYWORDS=FINRA&mg=reno64-wsj>, last visited 4/29/2014.

for more transparency and disclosure, this change may have unintended consequence for members of the industry. Securities professionals and firms can no longer take solace in the concept that time heals all wounds—that is, that disclosure of a settled regulatory action will be removed from their record with time. Now settlements, not just a civil court finding, will be permanently disclosed on BrokerCheck.

B. FINRA’s Attempt to Require Reference to BrokerCheck on Websites and Social Media Fails (For Now)

In February 2014, FINRA approved and sent to the S.E.C. a proposed rule that would have required FINRA firms to include a “readily apparent” reference and link to BrokerCheck on any member firm’s website. In addition, the proposal would have required a firm to include a “readily apparent” reference and link to BrokerCheck in any online retail communication that includes a professional profile of, or contact information for, an associated person, subject to specified conditions.

After the rule was sent to the S.E.C. for comment, brokerage firms expressed overwhelming concern over the rule's implementation. Many expressed concern over how the rule would be implemented in social media. “There is simply no way in many cases for a link to BrokerCheck to be prominently displayed on social media sites and, therefore, the rule is impossible to implement,” said David Bellaire, general counsel of the Financial Services Institute, in a recent Reuters article.⁵ Advocates for investors, however,

pushed for this type of disclosure to increase the likelihood that investors actually see the BrokerCheck report before entering into relationships with brokerage firms or individuals. On April 18, 2014, FINRA withdrew the filing, but representatives from FINRA say they plan to refile. It remains to be seen what modifications FINRA will make to any subsequently proposed rule on this topic. Stay tuned.

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⁵See <http://www.reuters.com/article/2013/04/24/finra-brokercheck-idUSL2N0DB1L820130424>, last visited 4/29/2014.