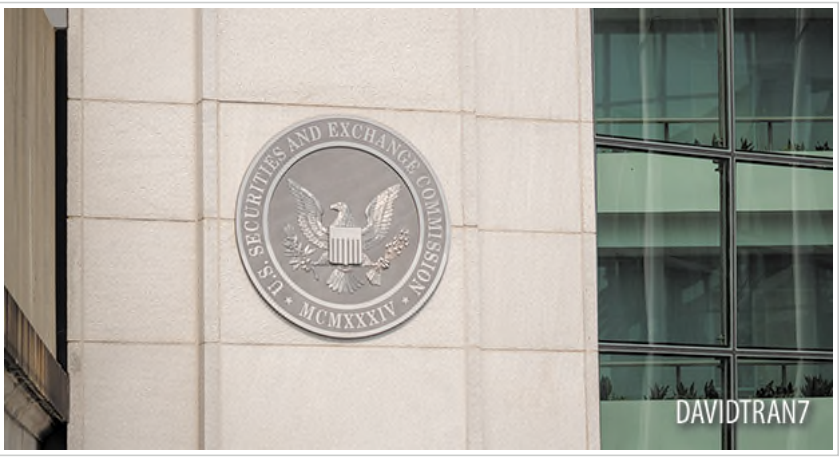
MASSACHUSETTS Lawyers Weekly

SEC: actual notice is needed to bar broker

FINRA reconsiders its harsh penalty for failing to respond

By: Kris Olson September 24, 2020



Before barring a broker for life, the Financial Industry Regulatory Authority needed to show that the broker had actual notice of its request for investigatory information, the Securities and Exchange Commission ruled recently.

Lacking subpoena power, FINRA instead relies on its Rule 8210 to compel cooperation with its investigations into alleged misdeeds by financial services professionals.

In the last two years, FINRA has barred more than 730 people, and violations of Rule 8210 were the leading cause, according to a recent blog post by Jessica Hopper, FINRA's executive vice president of enforcement. In that regard, bans stemmed more often from ignoring Rule 8210 requests than misuse of customer funds or making fraudulent representations.

While that might seem harsh to the uninitiated, serious wrongdoing often underlies Rule 8210 requests, Hopper added.

But that was not the case with respondent Brendan D. Feitelberg, whose original sin was not reporting to his employer a state tax lien on his home, prompting the referral to FINRA. However, Feitelberg had reported a federal tax lien, suggesting that he had not intended to hide the ball.

Feitelberg then suffered a serious illness, which seemed to explain his failure to respond to the Rule 8210 request or file a timely appeal, the SEC found.

The SEC decided it would be appropriate to remand the proceedings so that FINRA could address the circumstances that led to the bar before determining whether Feitelberg failed to exhaust his administrative remedies.

The SEC has regularly decided to remand cases when it believes the applicant did not have actual notice of FINRA's requests, the SEC noted in a previous case, *Destina M. Mantar*.

Like Mantar, Feitelberg had responded to FINRA's requests once he learned of the bar and before he filed his application for review, while FINRA had provided no explanation for why a bar was nonetheless appropriate, the SEC noted.

FINRA has since decided to abandon its pursuit of barring Feitelberg, his attorneys report.

> *"Clearly, the dam is starting to break a little bit."*
>
> *— Robert A. Fisher, Boston*

But whether the SEC's decision in Feitelberg's case signifies a broader softening of what has been an unforgiving process is a matter of some debate.

Contact is key

It at least used to be the case that once FINRA barred a broker, that was it — there was no getting back in, said one of Feitelberg's attorneys, Robert A. Fisher of Nixon Peabody in Boston.

"Clearly, the dam is starting to break a little bit," he said.

As former senior litigation counsel at FINRA, Fisher would know.

Fisher and his co-counsel, R. Scott Seitz, said the crucial step they took after being retained was first to reach out to FINRA and then respond to its underlying Rule 8210 request for information before taking their appeal to the SEC.

Fisher said many attorneys in such circumstances might be inclined to ignore FINRA and go straight to the SEC, especially when time is of the essence.

Wellesley attorney Steven N. Fuller agreed that starting a conversation with FINRA is key. Often, what can be negotiated — at least when such a request is timely made — is a bar that includes curative language. The bar would then be lifted once the Rule 8210 request for information is fulfilled.

Fuller said the decision in *Feitelberg* highlights the importance of being responsive to all regulatory organizations.

"If you ignore them, you're going to have to defend that if you want to get back into the business, and you better have a good reason," he said.

Boston attorney William A. Haddad said a lesson for attorneys representing brokers is that they need to consider all the factors around why a client has been non-responsive to FINRA and what can be done to try to comply, even if delinquently.

But to Providence attorney Geoffrey W. Millsom, Feitelberg's case is yet another example of the old adage that "bad facts make bad law."

Indeed, FINRA may have had the better argument on the law, which might have carried the day if Feitelberg's underlying transgression had been more severe and a bar not such an inequitable result, Millsom said.

"This decision by the SEC clearly is a wake-up call to FINRA to not be so heavy handed," he said.

In hindsight, FINRA could have stopped at suspending Feitelberg indefinitely until he applied for reinstatement, Millsom suggested.

But FINRA seemingly felt compelled to make a point about the importance of responding to Rule 8210 request, Millsom said.

Such overkill may be unnecessary in an industry in which practitioners are already living in fear of negative information appearing on their pages in FINRA's public BrokerCheck database, he said. Indeed, appeals by brokers to expunge negative "disclosure events" from the database comprise 60 to 70 percent of FINRA's arbitration proceedings, Millsom said.

As part of their response to FINRA, Fisher and Seitz also explained the reason why Feitelberg had not responded — he was recuperating in the hospital — which further laid the foundation and created a record for the SEC appeal.

Historically, FINRA argued — often successfully — that it had provided a broker "actual notice" by referencing the requirement that a broker keep his information current in its Central Registration Depository, or CRD.

Now, Feitelberg's case stands as another example that FINRA cannot meet its obligation to provide notice by simply sending a letter to a broker's last known address.

To be sure, there are instances in which a broker will not open mail from FINRA for less innocent reasons, such as being under a criminal investigation. In such circumstances, a ban from FINRA is the least of the broker's concerns, Fisher said.

Seitz said he was actually more worried that FINRA could prevail with its argument that Feitelberg had failed to exhaust his administrative remedies due to a "mountain of precedent" disposing of appeals on that basis.

However, Seitz noted that those cases generally involve a broker who had committed serious misconduct and ignored FINRA intentionally before deciding to take a shot on getting reinstated years down the road.

While "FINRA can be stubborn," Fisher said, there have been some signs that it is getting the message that barring brokers from the industry without being able to prove the broker was notified of the looming ban will only set the agency up for additional losses in front of the SEC.

Wellesley attorney Michael B. Cosentino concurred that FINRA will become more careful to "check the box" of providing actual notice to brokers of a pending ban in light of *Feitelberg*.

The essence of the SEC's decision is that, because Rule 8210 is such a powerful weapon, FINRA needs to wield it more carefully, Haddad said.

Excusable silence

Feitelberg had been associated with United Planners Financial Services for a little under a year — from May 4, 2017, to April 11, 2018 — when United Planners used the standard Form U5 to notify FINRA that it had terminated Feitelberg for his failure to disclose a state tax lien.

That prompted FINRA to launch an investigation; it sent Feitelberg its first request pursuant to Rule 8210 on April 26, 2018. In that request, FINRA asked Feitelberg to provide a signed statement responding to the allegations and copies of all documents related to the matter. It also asked him to state whether there were any additional reportable financial events that he had failed to disclose in a timely manner.

If Feitelberg failed to respond "fully, promptly and without qualification" by May 10, 2018, he risked sanctions, including a permanent bar from the securities industry, FINRA warned.

Before sending the Rule 8210 request by certified and first-class mail, FINRA conducted a public records database search to confirm Feitelberg's address. The U.S. Postal Service returned the certified mailing as "unclaimed" but did not return the first-class mailing.

On May 9, 2018, Feitelberg emailed FINRA, acknowledging he had received the request. He was subsequently granted two requests for an extension of time to file a response.

But when the second extended deadline passed without a response, FINRA sent Feitelberg a second Rule 8210 request by regular and certified mail and email.

Once again, the certified mailing was not delivered, but neither the first-class mailing nor the email was returned. Feitelberg did not respond in any way.

FINRA then commenced an expedited proceeding against Feitelberg pursuant to FINRA Rule 9552(a) based on his failure to respond to FINRA's request for information.

On Aug. 20, 2018, FINRA sent Feitelberg a notice informing him that he would be suspended from associating with any FINRA member on Sept. 13, 2018, if he failed to provide the information requested by that date. An automatic bar would kick in two months later if he failed to respond, FINRA added.

Once again, the notice went out to Feitelberg's registered address by certified and first-class mail. The certified mailing was returned as "unclaimed," but the first-class mailing was not returned.

Two more notices followed, one on Sept. 13, 2018, notifying Feitelberg of the suspension, and another on Nov. 23, 2018, alerting him that he had been barred and notifying him of his right to appeal the decision within 30 days. But FINRA heard nothing back for over five months.

In May 2019, Feitelberg, after retaining counsel, provided a written response to FINRA's requests, explaining that he had suffered a serious illness that required hospitalization, surgery and an extended recovery period, which he documented in a sworn affidavit.

FINRA declined to reconsider the bar, saying that Feitelberg had "failed to exhaust his administrative remedies."

On June 21, 2019, Feitelberg filed an application for review of his bar with the SEC. He argued that he never received actual notice of the suspension or possibility of a bar and had only learned that FINRA had barred him after he recovered from surgery and returned to work in February 2019.

In its motion to dismiss, FINRA argued that Feitelberg's appeal was untimely, and there were no extraordinary circumstances that would warrant extending the 30-day appeal deadline.

FINRA also argued that its service of Feitelberg by mailing its information requests and notices to his registered address was proper.

Extraordinary circumstance

Fisher and Seitz attempted to argue that Feitelberg's appeal was not in fact tardy because the 30-day period did not begin to run until May 24, 2019, when FINRA sent him a letter stating that it would not reconsider the bar it had imposed.

But Feitelberg cited no authority to support that proposition, "and we are aware of none," the SEC wrote.

Nonetheless, Feitelberg had made a sufficient showing of "extraordinary circumstances" to allow for the consideration of an otherwise untimely application for review, the SEC concluded.

The SEC noted that in its previous decision in *PennMont Securities*, it had identified as a valid "extraordinary circumstance" a "serious illness" that caused the delay in filing.

In *PennMont*, the SEC had also stressed the importance of an applicant demonstrating that he or she "promptly arranged for the filing of the appeal as soon as reasonably practicable thereafter."

By indicating that he was suffering from a serious illness and filing an appeal as soon as reasonably practicable after he recovered, Feitelberg had met the *PennMont* standard, the SEC concluded.

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