Securities Regulation Daily Wrap Up, TOP STORY—DCCir: SEC Erred by Upholding Life Bar in FINRA Action; Personal Stress As Mitigating Factor, (Jun. 11, 2013)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

The SEC abused its discretion by failing to consider all potentially mitigating factors in its review of a FINRA disciplinary action in which an employee of a registered broker-dealer was barred for life, according to the D.C. Circuit. The court found that while the SEC had considered and rejected some mitigating factors, it had not weighed the broker-dealer's personal and professional stress or the fact that he had been terminated before FINRA filed a complaint against him. The SEC's errors required the case to be remanded (*Saad v. SEC*, June 11, 2013, Edwards, H.).

Background. John M.E. Saad was one of Penn Mutual Life Insurance Company's (Penn's) regional directors in Atlanta, Georgia. He also was registered with Hornor, Townsend & Kent, Inc., Penn's broker-dealer affiliate. According to recitations from Saad's disciplinary hearing, he allegedly submitted false travel expense reports to his employer and attempted to fraudulently get reimbursed for the purchase of a cell phone. Mr. Saad had claimed that during this time he was influenced by extreme personal and professional stress arising from his employer's admonition to up his sales and due to his caring for a sick child.

Sanction standard upheld. FINRA had alleged that Mr. Saad violated NASD Conduct Rule 2110, under which members must "observe high standards of commercial honor and just and equitable principles of trade." Mr. Saad argued on appeal that the SEC applied the wrong sanction guideline. Specifically, he said the SEC wrongly likened his alleged "misappropriation" to "conversion" (counseling a bar) but should have instead treated his acts as forgery or falsification, which counsels regulators to consider a bar only for egregious acts. The court found that the SEC did not act arbitrarily in using the conversion standard because the FINRA sanction guidelines do not specify a sanction for misappropriation.

The court similarly rejected Mr. Saad's argument that NASD Conduct Rule 2010 (or its predecessor Rule 2110) impliedly distinguishes between improper use of customer funds and other improper uses. The court observed that the standard cited by the SEC and the improper use one both allow for lifetime bars. The court, thus, deferred to the SEC's interpretation of the sanction guidelines.

Lifetime bar flawed. Although the court upheld the SEC's view of the relevant sanctions standards, the court said the SEC erred in its approval of Mr. Saad's lifetime bar. Specifically, Mr. Saad had argued that under the SEC's statutory review standard, it failed to consider, among other things, whether the lifetime bar was "excessive or oppressive" and penal instead of remedial. The court observed that its prior decisions in this area caution that the SEC must take care to review any potentially mitigating factors in cases that involve lifetime bars.

Here, the court found that the SEC failed to consider two potentially mitigating factors. First, the SEC did not consider the fact that Mr. Saad's employer fired him before FINRA took action. FINRA's guidelines require consideration of whether an accused's employer disciplined him prior to the regulator finding the wrongdoing. Moreover, the SEC's counsel had erroneously stated at oral argument that Mr. Saad's firing took place after the violation and was thus "irrelevant."

The court also found that the SEC failed to consider that Mr. Saad had experienced severe stress during the period in which he allegedly committed the wrongful acts. The court reached this conclusion even though FINRA's guidelines do not specifically mention stress as a mitigating factor. The court explained that in this

respect FINRA's guidelines are "illustrative" but not "exhaustive" of the types of mitigating factors that may be considered when a lifetime bar is at stake. The guidelines, thus, permit an adjudicator to review unlisted "case-specific factors."

As a result, the court remanded the case for further consideration. The court, however, did not rule on whether Mr. Saad should get a lifetime bar because the SEC must first review all potentially mitigating factors.

The case is No. 10-1195.

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Companies: Financial Industry Regulatory Authority, Inc.; Penn Mutual Life Insurance Company; Hornor, Townsend & Kent, Inc.

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