

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the

Continuing Membership Application of

Firm A

DECISION

Application No.

Dated: September 21, 2023

FINRA’s Department of Member Supervision denied firm’s application for membership. Held, denial affirmed.

Appearances

For Firm A: Firm A Attorneys

For the Department of Member Supervision: Attorneys

Decision

Pursuant to FINRA Rule 1015(a), Firm A (“Firm A” or the “Firm”) appeals a February 24, 2023 Department of Member Supervision (“Member Supervision”) decision denying the Firm’s continuing membership application (“CMA”). After reviewing the record and the parties’ briefs, and considering the parties’ arguments, we affirm Member Supervision’s denial of Firm A’s CMA.

I. Background and Procedural History

The FINRA Membership Rule 1010 Series sets out the substantive standards and procedural guidelines for the membership application and registration process. FINRA Rule 1017 governs continuing membership applications and incorporates the standards for approval set forth in FINRA Rule 1014. Once a prospective firm files a substantially complete application with FINRA, Member Supervision conducts a review to determine whether it requires any additional information from the applicant firm to conduct a meaningful review of the application.

Member Supervision’s decision is governed by the membership standards articulated in FINRA Rule 1014, and the applicant firm bears the burden of demonstrating that it meets each of the rule’s standards. If the applicant firm fails to demonstrate that it satisfies each of the 14 standards of FINRA Rule 1014(a), the application may be denied.

A. Firm A's Background

Firm A has been a FINRA member since 2003 and is based in City, State. Firm A is owned and controlled by Individual A, the Firm's president; Individual B, who serves as the Firm's Chief Compliance Officer ("CCO") and Financial and Operations Principal ("FINOP"); and Individual C, the Firm's Anti-Money Laundering Compliance Officer ("AMLCO").¹ Firm A's primary business is accepting for deposit, liquidating, and making a market in microcap and low-priced over-the-counter securities.

B. Firm A's Continuing Membership Application

Firm A filed its CMA on August 12, 2022. Pursuant to the CMA, Firm A proposed engaging in additional lines of business, including (1) acting as an underwriting or selling group participant for corporate securities other than mutual funds; (2) private placements of securities; and (3) mergers and acquisitions.² The CMA proposed that the Firm's CCO, Individual B, would supervise the new business lines. On August 31, 2022, Firm A filed an amended CMA that Member Supervision deemed substantially complete.³

C. Member Supervision's Review of Firm A's CMA

In September 2022, Member Supervision staff met with Firm A representatives. During that meeting, Member Supervision staff explained that Firm A's disciplinary history resulted in a rebuttable presumption of denial under FINRA Rules 1017(i) and 1014(a) and that the burden of rebutting the presumption rested with the Firm. Member Supervision staff also explained that Firm A had the option of withdrawing its application within 30 days and would be reimbursed part of its filing fees. Staff also communicated that it had concerns given the Firm's disciplinary history about whether Firm A would be able to provide sufficient assurance that it would not circumvent, evade, or otherwise avoid compliance with the federal securities laws, regulations, and rules, as required by FINRA Rule 1014(a)(13). Firm A decided to proceed with the application.

As part of its review, Member Supervision issued two requests for documents and information about the Firm's proposed new lines of business and whether it could rebut the presumption of denial that arose due to its disciplinary history. Member Supervision staff also met with Firm A representatives on February 2 and 10, 2023.

¹ Firm A also has three other shareholder owners.

² Firm A initially requested approval to sell real estate securities as well, but subsequently withdrew this request.

³ Firm A amended its CMA five more times after filing the August 31, 2022 amended CMA.

1. The First Request for Information

On September 30, 2022, Member Supervision issued a request for documents and information (the “First Request”). The First Request asked for information about the Firm’s proposed business lines, as well as information concerning whether the Firm could rebut the presumption of denial triggered by its disciplinary history. Specifically, the First Request asked Firm A to “provide a detailed explanation as to how the Firm believes that it overcomes the presumption for denial.” The First Request further directed Firm A to “reference any controls or systems put in place and refer to any specific pages or sections in the Firm’s written supervisory procedures that address such controls and any heightened supervisory requirements.”

Firm A responded to the First Request on October 28, 2022 (the “First Response”), by filing an amended CMA with additional information and submitting written responses. With respect to a Letter of Acceptance, Waiver and Consent (“AWC”) issued in 2010, Firm A responded that it had: (1) updated its written supervisory procedures (“WSPs”) to “contain significant procedures relating to customer due diligence performed in connection with legal entity customers and their beneficial owners”; (2) hired an additional registered principal to act as an anti-money laundering (“AML”) officer (a role held by the Firm’s president at the time of the AWC); and (3) “adopted significant procedures to prevent the sale of unregistered securities.” With respect to a National Adjudicatory Council (“NAC”) decision issued in 2021, Firm A stated that it had, in relevant part: (1) updated its AML procedures, “particularly with regard to red flag identification”; (2) hired a new AMLCO, Individual C; (3) hired Individual D, who speaks and reads Chinese, as a full-time compliance principal to assist Individual C in supervising a Chinese speaking registered representative, Representative A, and implemented Chinese “keyword” searches on Representative A’s email; and (4) “implemented more robust [customer identification] procedures in connection with account opening” by using third-party verification systems and by requiring foreign customers to provide a “selfie” photograph to confirm identity. Finally, with respect to an AWC issued in 2022, Firm A stated that it had updated various portions of its WSPs related to its AML program and retained an independent consultant who issued a generally favorable report about the Firm’s compliance program.

2. The Second Request for Information

On November 28, 2022, Member Supervision issued an additional request for documents and information (the “Second Request”). The Second Request asked Firm A to provide the procedures in effect at the time of the 2022 AWC and 2021 NAC decision, as well as the underlying April 5, 2019 Extended Hearing Panel decision. The Second Request also asked Firm A to “highlight the changes made to the Firm’s WSPs and AML Program” since the events in the 2021 NAC decision and 2022 AWC, and to describe “any other corrective measures the Firm has taken” since those events. The Second Request further included additional questions that asked how the Firm believed it overcame the presumption of denial with respect to the 2010 AWC, 2021 NAC decision, and 2022 AWC.

Firm A submitted responses on December 28 and 29, 2022, and January 4, 2023 (the “Second Response”). As part of its Second Response, Firm A provided redlined copies of various versions of its WSPs and provided written responses.

D. Member Supervision Denies Firm A's CMA

Member Supervision issued a decision letter on February 24, 2023 (the "Denial") denying Firm A's CMA based on findings that the Firm failed to satisfy the standards in FINRA Rules 1014(a)(3), (10), and (13).

1. Firm A's Relevant Disciplinary History

Firm A's record in FINRA's Central Registration Depository reflects, and Member Supervision's denial of the CMA cites, three disciplinary matters relevant to the CMA.

a. The 2010 AWC

On November 23, 2010, FINRA issued an AWC in which Firm A consented to findings that the Firm violated FINRA rules by failing to adequately implement its AML compliance program and by failing to establish and maintain an adequate supervisory system and written procedures that were reasonably designed to prevent participation in unregistered distributions of securities (the "2010 AWC"). Specifically, Firm A consented to findings that while "[f]rom at least January 2005 through March 2008, [Firm A's] AML program required it to monitor for potentially suspicious activity and AML 'red flags,' investigate potentially suspicious activity, and report suspicious activity," the Firm "failed to adequately implement and enforce its AML program and to otherwise comply with its AML obligations." As a result, Firm A "did not identify and analyze numerous transactions to determine if they were in fact suspicious and were required to be reported," and allowed approximately 51 foreign corporate accounts controlled by a single individual to deposit and promptly liquidate a total of approximately 279 million shares of low-priced securities. After these securities were deposited and liquidated, all the proceeds were disbursed by wire to bank accounts maintained at a foreign bank. The 2010 AWC found that, because of this misconduct, Firm A violated NASD Rules 3011 and 2110.

The 2010 AWC further found that between at least April 2007 and April 2009, while transactions in low-priced over-the-counter securities were Firm A's primary source of revenue, the Firm had no written procedures to detect and prevent participation in unregistered distributions of securities. Rather, Firm A relied primarily on transfer agents to determine whether securities were free trading. By failing to have an adequate supervisory system and procedures designed to avoid participating in unregistered distributions of securities, Firm A violated NASD Rules 3010 and 2110 for the period of April 2007 through December 14, 2008, and NASD Rule 3010 and FINRA Rule 2010 for the period of December 15, 2008, through April 2009.

Firm A agreed to a censure and \$45,000 fine pursuant to the 2010 AWC.

b. The 2021 NAC Decision

On October 6, 2021, FINRA's NAC issued a decision finding, in relevant part, that Firm A, its former AMLCO, Individual E, and its CCO, Individual B, violated FINRA rules related to its AML program and supervision during the period of 2014 to 2016 (the "2021 NAC Decision"). The NAC found that Firm A, through Individual E, violated FINRA Rules 3310 and 2010 by: (1) failing to tailor Firm A's AML procedures to the Firm's primary business of

accepting for deposit and liquidating low-priced and thinly-traded stocks and thus failing to detect and investigate red flags of suspicious activity related to three penny stocks; (2) failing to implement the Firm's customer identification procedures to verify the identities of foreign customers; and (3) failing to conduct risk-based AML due diligence on accounts opened through a foreign bank.

The NAC also found that Firm A, through Individual B and Individual E, failed to supervise reasonably the activities of a Firm A registered representative, Representative A, in violation of FINRA Rules 3110 and 2010. Representative A was based in New York City and his clients included many Chinese speaking individuals. Representative A translated portions of Firm documents into Chinese and communicated by email and text with customers in Chinese. Individual B and Individual E knew that Representative A communicated with customers in a language other than English but failed to properly supervise these communications. Neither Individual B nor Individual E asked Representative A how he was communicating with these customers or whether the customers understood English language documents and communications. The NAC also found that Individual B and Individual E took no steps to ensure the accuracy of Representative A's translations of Firm documents and that the supervision of Representative A's Chinese language communications, which was limited to occasional use of Google's translation program, was inadequate.

For these violations, Firm A was fined a total of \$155,000; Individual E was suspended for more than 18 months and fined \$30,000; and Individual B was suspended for 30 business days and fined \$30,000.⁴ The NAC also ordered Firm A to "retain a consultant to review and revise its AML-related procedures to appropriately tailor them to its microcap stock liquidation business model."

c. The 2022 AWC

On September 9, 2022, FINRA issued an AWC in which Firm A consented to findings that "[b]etween June 2018 and April 2019, [it] failed to develop and implement an AML compliance program reasonably designed to detect and report suspicious transactions" and, "[a]s a result, the [F]irm failed to investigate red flags of potentially suspicious trading activity in the account of one of its corporate customers" (the "2022 AWC"). Specifically, Firm A consented to findings that its procedures failed to identify the need to monitor for sustained customer trading activity representing a significant portion of the daily trading volume in thinly-traded or low-priced securities, or customer trading with no discernible purpose or which lacked business sense. The procedures also did not specify how or with what frequency supervisors should monitor trading and did not contain information about documenting the investigation of potentially suspicious activity. Additionally, Firm A's procedures directed supervisors to monitor suspicious trading using exception reports that the Firm no longer made available.

Firm A also consented to findings that it unreasonably relied primarily on a manual review of the daily trade blotter to monitor for suspicious trading. Manual review was inadequate because the daily trade blotter "did not reflect patterns of trading across accounts or

⁴ Individual B appealed the NAC's decision to the SEC. The appeal is pending.

across multiple days,” and did not reflect “coordinated trading between firm accounts, sustained customer trading activity representing a significant proportion of the daily trading volume in a thinly-traded or low-priced security, or trading resulting in losses that might indicate a lack of discernable purpose and business sense or an intent to artificially support the price of a security.” The 2022 AWC also included findings that the exception reports Firm A implemented in June 2018, which were not mentioned in its written procedures, were inadequate because “these reports only alerted the [F]irm to evidence of marking the open, marking the close, and suspicious order cancellations.” Firm A “had no exception reports to alert it to evidence of other forms of suspicious and potentially manipulative trading.”

The 2022 AWC found that through this conduct, Firm A violated FINRA Rules 3310 and 2010. Firm A consented to a censure and a \$50,000 fine. Additionally, Firm A agreed to retain an independent consultant “to conduct a comprehensive review of the reasonableness of [its] policies, systems, procedures (written and otherwise), and training related to compliance with FINRA Rule 3310 and the requirements of the [Bank Secrecy Act] and regulations promulgated thereunder for monitoring, identifying, investigating, documenting, and responding to red flags of suspicious trading activity and potential market manipulation.”

2. Member Supervision’s Findings Under the Prong for Complying with Applicable Securities Laws and FINRA Rules, FINRA Rule 1014(a)(3)

Member Supervision determined that the 2010 AWC, the 2021 NAC Decision, and the 2022 AWC each triggered a presumption of denial and that Firm A failed to rebut the presumption by demonstrating that it meets the membership standards in FINRA Rule 1014(a) notwithstanding the existence of the disciplinary events. *See* FINRA Rule 1017(i).

Member Supervision found that Firm A failed to demonstrate how the Firm’s WSP revisions addressed the issues in the 2010 AWC because Staff “could not reasonably discern from [Firm A’s] response which policies and procedures were in place during the time of the violations as cited in the AWC and which ones were implemented thereafter” and, as a result, “Staff was unable to determine whether [Firm A] made changes to address the deficiencies FINRA identified in the [2010] AWC.” Member Supervision explained that Firm A’s responses “did not contain any specificity and did not reference exactly how the policies were improved upon [] so that it directly addressed the deficiencies cited in [the 2010 AWC].” Member Supervision also noted that Firm A was sanctioned two more times after the 2010 AWC for violations of FINRA Rules 3110 and 3310—in the 2021 NAC Decision and 2022 AWC—and that these “repeat violations evidence that the iterative changes made to the Firm’s policies are ineffective.” Accordingly, Member Supervision found that Firm A failed to rebut the presumption of denial with respect to the 2010 AWC.

Member Supervision also found that Firm A failed to rebut the presumption of denial with respect to the 2021 NAC Decision. Member Supervision explained that while Individual D was hired to address the Firm’s failure to properly supervise Representative A, Individual D left Firm A on January 31, 2020, and Firm A did not replace him with another Chinese speaking supervisor. Instead, Individual B resumed supervising him. Member Supervision also noted that Firm A’s WSPs revised on December 28, 2022, “did not disclose any procedures related to the maintenance and upkeep of the Chinese character word searches or policies related to

supervision of foreign language communications.” The 2021 NAC Decision was the second time Firm A was sanctioned for supervisory and AML violations, and Member Supervision explained that the “recurring violations evidence that the changes the Firm made and is relying on to rebut the presumption continue to be ineffective, including the measures implemented to address supervision of [Representative A].”

Member Supervision also found that Firm A’s responses with respect to the 2022 AWC were insufficient to rebut the presumption of denial. Firm A stated that it replaced its manual review for AML red flags with a computer program that conducts an automated review and produced the user manual for that computer program. Member Supervision found, however, that Firm A’s responses failed to explain how the information in the manual “supports the rebuttal or what specific parts of the manual Staff should consider,” and “also failed to address how the Firm analyzes the exception reports . . . , how information from different reports is connected to establish patterns across multiple accounts or over multiple days, and how the reports are customized to ensure that they are tailored to the Firm’s business activities.” Member Supervision concluded that “[t]his lack of information did not allow Staff to consider how the exception reports correspond to the AML red flags included in the Firm’s WSPs and are used in the context of the overall AML program.”

Member Supervision further found that Firm A’s WSPs revised after the 2022 AWC “do not specify the actual process and workflow to be followed regarding the transactions review pertaining to the AML program,” and while several reports are listed in the procedures, the WSPs do not contain “adequate and clear policies and procedures defining ‘how’ supervision is supposed to be conducted”—an issue that “was identified as one of the deficiencies in the disciplinary action that the Firm was cited for in the [2022 AWC] and an issue that continues to persist.” Accordingly, Member Supervision concluded that after “thoroughly reviewing the information . . . and taking into consideration the Firm’s repeated and recent supervisory and AML violations, Staff concluded that the Firm did not successfully rebut the presumption to deny the [CMA].”

Membership Supervision also noted that the proposed supervisor for the new lines of business, Individual B, had been sanctioned by the NAC for failure to supervise and stated that, “[t]he history of the Firm and [Individual B] demonstrates a clear pattern of violations of applicable rules and standards and raises significant concerns about the Firm’s ability to comply with rules and regulations. A further expansion of firm activities, and one that directly involves [Individual B]—in a role with additional supervisory responsibilities—only aggravates these significant concerns. As such, the Firm has failed to overcome the rebuttable presumption of denial and therefore satisfy the requirements of Rule 1014(a)(3).”

3. Member Supervision’s Findings Under the Prong for Supervisory, Operating, and Compliance Procedures, FINRA Rule 1014(a)(10)

Member Supervision determined that Firm A failed to meet the criteria in Rule 1014(a)(10). In determining whether Firm A had an adequate supervisory program, Member Supervision considered Firm A’s and its associated persons’ “multiple and repeated regulatory actions related to the same rule infractions.” Member Supervision noted that Firm A failed to implement an adequate AML program “despite the opportunities after the repeated infractions.”

Member Supervision cited Firm A and Individual B's failure to supervise Representative A and Individual B's decision to resume supervision of Representative A after Individual D left Firm A, explaining that this decision "exhibits a continued disregard to the temporary measures [i.e., hiring Individual D] implemented to address the regulatory failures as described in [the 2021 NAC Decision]." Thus, Member Supervision found that Firm A "has still failed to provide evidence of an adequate supervisory system that would give consideration for a heightened supervisory plan for [Representative A], who currently continues to be registered with the Firm, and a communications surveillance system using a lexicon of Chinese keywords that is evaluated for effectiveness on a periodic basis."

Member Supervision concluded that "[t]he aforementioned illustrates the Firm's overall and enduring lack of a culture of compliance and does not provide confidence that the Firm currently has an adequate supervisory system, let alone one that will be adequate to accommodate the expansion of business activities and responsibilities generated by this CMA proposal." Member Supervision explained that "[t]he information presented in the CMA never effectively resolved existing concerns, and moreover, consistently raised new regulatory concerns germane to the adequacy of the supervisory structure of the Applicant."

4. Member Supervision's Findings Under FINRA Rule 1014(a)(13)

Member Supervision's final basis for denial arose out of its conclusion that Firm A may circumvent, evade, or otherwise avoid compliance with applicable securities laws and FINRA rules. Member Supervision cited Firm A's "pattern of non-compliance" as demonstrated by the 2010 AWC, 2021 NAC Decision, and 2022 AWC. Member Supervision also noted that Firm A had not "adequately explained the steps the Firm has taken to ensure these violations do not occur again." Instead, Member Supervision found that "[t]he recurring nature (and recency) of the violations clearly indicate that the Firm's proffered plans and rationale as to successful mitigation are wholly insufficient; the Firm's regulatory history serves as evidence that they have failed to resolve these issues in a continuous, adequate, and sustainable manner."

E. Firm A Appeals Member Supervision's Denial

Pursuant to FINRA Rule 1015(a), Firm A appealed Member Supervision's decision on March 21, 2022. In its notice of appeal, Firm A states that it appeals Member Supervision's denial on three bases. Firm A argues that: (1) Member Supervision failed to comply with FINRA Rule 1017(i) because it did not conduct a membership interview and failed to consider the Firm's CMA, interviews, and other documents and information provided by the Firm; (2) Member Supervision failed to provide Firm A with notice of the reasons for the denial and an opportunity to respond to its concerns; and (3) Firm A met all the standards under FINRA Rule 1014. Firm A stated in its notice of appeal that it did not request a hearing on appeal and thus this appeal was decided based on the record and the parties' briefs.⁵

⁵ On May 5, 2023, Member Supervision filed an unopposed motion for leave to supplement the record with copies of the 2010 AWC, 2021 NAC Decision, and 2022 AWC. The motion is granted.

II. Discussion

FINRA Rule 1014(a) sets forth 14 standards that an applicant firm must meet before FINRA may approve an application. In general, the standards in FINRA Rule 1014(a) are intended to ensure that members can satisfy all relevant regulatory requirements for the protection of the investing public, the securities markets, the applicant, and other member firms. *Membership Continuance Application of Member Firm*, Application No. 20060058633, 2007 FINRA Discip. LEXIS 31, at *44-45 (FINRA NAC July 2007). When assessing whether an applicant for membership meets these standards, FINRA Rule 1014(a) requires FINRA to consider, among other things, “the public interest and the protection of investors.” *Asensio & Co., Inc.*, Exchange Act Release No. 68505, 2012 SEC LEXIS 3954, at *9 (Dec. 20, 2012). The applicant firm bears the burden of demonstrating that it meets each of the rule’s standards for approval. *New Membership Application of Firm A*, Application No. 20090182345, 2010 FINRA Discip. LEXIS 24, at *22 (FINRA NAC Sept. 28, 2010); *see also* FINRA Rules 1014(a), (b).

We affirm Member Supervision’s findings that Firm A failed to carry its burden to rebut the presumption that its application should be denied by demonstrating that it satisfies the standards set forth in FINRA Rules 1014(a)(3), (10), and (13) notwithstanding its disciplinary history.

A. Firm A Failed to Rebut the Presumption of Denial Based on Its Disciplinary History

FINRA Rule 1014(a)(3) provides that in deciding whether to approve an application, Member Supervision must consider whether “[t]he [a]pplicant and its [a]ssociated [p]ersons are capable of complying with applicable securities laws and regulations, and with applicable FINRA rules, including observing high standards of commercial honor and just and equitable principles of trade.” The rule further lists eight specific matters Member Supervision must consider, including the applicant’s and its associated persons’ disciplinary history. The applicant firm bears the burden of demonstrating that it meets each of the standards for approval, including those in FINRA Rule 1014(a)(3). *See Membership Continuance Application of Member Firm*, 2007 FINRA Discip. LEXIS 31, at *44 (stating that the “firm filing a membership continuance application bears the burden of establishing the merits of its application and, in particular, that it meets, and will continue to meet, each of the 14 standards for membership approval contained in . . . Rule 1014(a)”).

FINRA Rule 1017 applies when a firm requests approval for a change in its business operations. *See* FINRA Rule 1017(a)(5). In rendering a decision on an application, FINRA Rule 1017(i)(1) requires Member Supervision to “consider whether the [a]pplicant and its [a]ssociated [p]ersons meet each of the standards in Rule 1014(a).” Moreover, when “the [a]pplicant or its [a]ssociated [p]erson are the subject of any of the events set forth in Rule 1014(a)(3)(A), (C), (D), (F) and (G), a presumption exists that the application should be denied.” FINRA Rule 1017(i)(1). An applicant may overcome the presumption of denial “by demonstrating that it can meet each of the standards in Rule 1014(a), notwithstanding the existence of any of the events.” *Id.* The events triggering the rebuttable presumption of denial include, in relevant part, whether the applicant or an associated person “is the subject of a pending, adjudicated, or settled regulatory action or investigation by the SEC, the Commodity Futures Trading Commission, a

federal or state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization.” FINRA Rule 1014(a)(3)(C). In considering whether an applicant has overcome the presumption of denial, Member Supervision is directed to “consider the applicant’s submission in light of the specific standards of Rule 1014(a), the public interest, protection of investors, and [FINRA]’s responsibility to provide a fair procedure in accordance with membership rules.” *NASD Notice to Members 04-10*, 2004 NASD LEXIS 13, at * 11 (Feb. 23, 2004).

A rebuttable presumption of denial was triggered by the 2010 AWC, 2021 NAC Decision, and 2022 AWC. Member Supervision found that Firm A did not satisfy FINRA Rule 1014(a)(3) because it did not overcome the presumption of denial with respect to all three matters by demonstrating that it nonetheless met the standards for approval. We agree.

1. The 2010 AWC

Firm A argues that Member Supervision “ignores numerous changes” made to Firm A’s AML procedures after the 2010 AWC and “fundamentally misapplies” the standards of FINRA Rule 1014(a)(3). Firm A further states that its procedures “have been updated since 2007, including sections relating to customer due diligence and legal entity customers, customer identification, and monitoring of AML issues.” In support of these claims, Firm A provided redlined copies of its WSPs reflecting changes in them and points to procedures implemented in 2014. Firm A also cites as other measures rebutting the presumption of denial with respect to the 2010 AWC: (1) its use of daily automated monitoring of red flags of suspicious activity; (2) its hiring of a new AML officer; (3) its implementation of a “selfie” requirement in its customer identification program; and (4) its use of USinfosearch.com.

We find that Firm A’s responses are insufficient to rebut the presumption of denial with respect to the 2010 AWC. The redlined WSPs Firm A provided compare versions of its WSPs in effect years after the 2010 AWC and reflect myriad changes without explaining why the changes were made or how the changes relate to the findings in the 2010 AWC. The same is true of the other procedures Firm A cites. Moreover, all the measures Firm A cites appear to have been implemented years after the 2010 AWC. Significantly, Firm A has not provided the procedures that were in place at the time of the violations in the 2010 AWC and has not explained what changes, if any, it made immediately afterwards in response to the 2010 AWC. To rebut the presumption of denial, Firm A is required to specify the steps it took to ensure the violations do not recur. *See Membership Continuance Application of Member Firm*, 2007 FINRA Discip. LEXIS 31, at *56. It did not do so.

Firm A relies largely on its current WSPs to argue that it has rebutted the presumption of denial. But these procedures were implemented years after the 2010 AWC and thus the Firm has not explained the remedial actions Firm A took immediately following and in response to the violations found in the 2010 AWC. Firm A cannot rebut the presumption of denial with actions it took years later and after it was cited twice for similar misconduct.⁶ Indeed, the fact that

⁶ Firm A argues the violations in the 2010 AWC, 2021 NAC Decision, and 2022 AWC are not the same. We find that all these violations reflected a pattern of similar misconduct. All
[Footnote continued on next page]

Firm A's AML program continued to remain deficient until at least 2019, as reflected in the 2021 NAC Decision and 2022 AWC, demonstrates that if the Firm did take any corrective action after the 2010 AWC, it was insufficient or ineffective. Accordingly, we find that Firm A failed to rebut the presumption of denial triggered by the 2010 AWC.

2. The 2021 NAC Decision

In rebutting the presumption of denial raised by the 2021 NAC decision, Firm A relies on the report of the consultant it was required to retain in connection with the 2022 AWC and claims that it adequately responded to deficiencies in its supervision of Representative A. Firm A again points to changes in its WSPs, as well as the use of USinfosearch and third-party identification verification services, the "selfie system," and its hiring of a new AMLCO and other additional staff. With respect to the supervision of Representative A, Firm A states that it hired a Chinese-speaking supervisor "uniquely poised" to improve supervision at [Representative A's] branch, implemented Chinese "key word" searches, and uses "computerized translation services."

As with its attempt to rebut the presumption of denial arising out of the 2010 AWC, Firm A fails to explain the specific steps it took in response to the 2021 NAC Decision. Again, Firm A points generally to changes in its redlined WSPs but does not explain which changes were made because of the 2021 NAC Decision and how any changes specifically addressed the NAC's findings. As Member Supervision points out, the changes Firm A relies on were made in the WSPs revised as of October 26, 2022, more than a year after the 2021 NAC decision was issued and after Firm A filed the CMA and Member Supervision raised with the Firm the rebuttable presumption triggered by the 2021 NAC Decision and other disciplinary matters.

Similarly, the December 2, 2022 consultant's report on which Firm A relies states that it was prepared pursuant to the terms of the 2022 AWC and does not reference the 2021 NAC Decision or the procedures relevant to addressing the specific violations in that decision. Indeed, as Member Supervision states, there is no evidence in the record that Firm A complied with the 2021 NAC Decision's order that it retain a consultant to review and revise its AML-related procedures to appropriately tailor them to its microcap stock liquidation business model.⁷

[cont'd]

three disciplinary actions involved Firm A's supervisory and AML procedures and violations of FINRA supervisory and AML rules (FINRA Rules 3110 and 3310, and their predecessor rules, NASD Rules 3010 and 3011). Further, the 2010 AWC, 2021 NAC Decision, and 2022 AWC all contained findings related to Firm A's failures to properly supervise its primary line of business of accepting for deposit and liquidating low-priced securities by failing to tailor its AML procedures and failing to adequately implement those procedures.

⁷ In its reply brief, Firm A claims that there was an agreement with FINRA staff to address the order in the 2021 NAC Decision and the 2022 AWC deficiencies with a single consultant. Firm A, however, elected not to request a hearing to present evidence on this and other claims it makes in its briefing. Thus, there is no evidence in the record on which we can evaluate Firm A's claims.

Firm A's apparent lack of timely compliance with the NAC's order in the 2021 NAC Decision further highlights its failure to rebut the presumption of denial and underscores its failure to demonstrate that it is capable of complying with applicable laws and rules as required by FINRA Rule 1014(a)(3).

Firm A has also failed to rebut the presumption of denial with respect to its failure to supervise Representative A. While Firm A hired a Chinese-speaking supervisor to review Representative A's Chinese communications with customers, when that supervisor left the Firm in early 2020, Firm A did not replace him and Individual B resumed supervision of Representative A. Further, while Firm A claims it has implemented Chinese keyword searches, as the Denial notes, its WSPs still do not contain procedures for the "maintenance and upkeep" of these searches or policies related to the supervision of foreign language communications. Additionally, Firm A has not explained how its use of electronic translation programs differs from that used by Individual E at the time of the violations in the 2021 NAC Decision.

Finally, any steps Firm A took to correct the AML deficiencies identified in the 2021 NAC Decision were ineffective. For example, as the 2022 AWC reflects, the deficiencies in Firm A's AML procedures continued for years. For all these reasons, we find that Firm A has failed to rebut the presumption of denial based on the 2021 NAC Decision by showing it can comply with securities laws and rules, as required by FINRA Rule 1014(a)(3).

3. The 2022 AWC

Finally, we agree that Firm A failed to rebut the presumption of denial based on the 2022 AWC. Firm A provided the user manual for FIS, the compliance program it began using to monitor for red flags but did not specify which parts of the manual were relevant to addressing the violations in the 2022 AWC. The Firm's responses did not explain how it analyzes the exception reports available to it or how it uses those reports to monitor trading over multiple accounts or over multiple days—the very deficiency found in the 2022 AWC. The procedures also do not include a description of the process for its AML review, do not specify who will conduct testing or how often the criteria used for AML review will be tested for effectiveness, and do not provide for documentation of that review. In short, Firm A's responses do not contain the specificity required to rebut the presumption of denial.

In addition to finding that Firm A failed to rebut the presumption of denial with respect to each of the 2010 AWC, 2021 NAC Decision, and 2022 AWC, we have considered Firm A's application as a whole and are not persuaded that Firm A has demonstrated that it can comply with securities laws and FINRA rules moving forward. The presumption of denial supports investor protection and market integrity by requiring a greater showing by firms with disciplinary events because such events indicate a greater risk of future violations. Firm A's history reflects repeated failures by its supervisors to identify and respond properly to red flags of potentially suspicious activity related to its primary business line. To the extent the Firm made iterative changes to its WSPs, its repeated violations demonstrate a failure to implement changes and maintain operations and supervisory systems that meet the standards expected of FINRA members. Under these circumstances, we are unconvinced that Firm A can conduct an entirely new line of business, which itself presents numerous risks, in a compliant manner.

B. Firm A Failed to Demonstrate that It Satisfied FINRA Rule 1014(a)(10)

FINRA Rule 1014(a)(10) requires the applicant firm to establish that it has a “supervisory system, including written supervisory procedures, internal operating procedures (including operational and internal controls), and compliance procedures designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and [FINRA] Rules.” The applicant firm must establish the adequacy of the supervisory system based on, among other things, the nature of the proposed business; the number, experience (direct and indirect), and qualifications of supervisory personnel; and any other factors that “will have a material impact on the [Firm’s] ability to detect and prevent violations.” FINRA Rule 1014(a)(10)(J); *see also Ramcon Fin. LLC*, Exchange Act Release No. 77062, 2016 SEC LEXIS 429 at *19-21 (Feb. 4, 2016).

The 2010 AWC, 2021 NAC Decision, and 2022 AWC demonstrate Firm A’s inability to implement both an effective supervisory system and a compliant AML program over a period of approximately 14 years. Over that period, FINRA has repeatedly cited Firm A for failure to identify and investigate red flags of suspicious activity connected to its primary business line. To the extent Firm A made iterative changes to its supervisory program after each disciplinary event, those changes were ineffective. Thus, while Firm A emphasizes the changes in its most recent WSPs—which were adopted after the CMA was filed and after Member Supervision articulated its concerns about the application—because of its repeated past violations over an extended period of time, we are unconvinced at this time that those procedures will ensure an adequate supervisory program going forward in Firm A’s current business, much less a new line of business.

We also find that Firm A’s current WSPs contain several continuing deficiencies. With respect to the supervision of Representative A’s Chinese language communications with customers, Firm A has no procedures related to the maintenance of Chinese character word searches and no policies concerning the supervision of foreign language communications. With respect to monitoring for red flags of suspicious activity for AML purposes, Firm A’s procedures do not describe the actual process to be followed when reviewing transactions for red flags. Moreover, while Firm A’s procedures refer to various reports, the procedures do not provide for testing the effectiveness of the criteria used to generate those reports, including the person responsible for testing, its frequency, and documentation of that process.

We are also troubled by the proposal that Individual B supervise the new line of business. During each of the disciplinary events, Individual B was the Firm’s CCO. Moreover, he recently was found to have failed to supervise Representative A in the 2021 NAC Decision. We are not persuaded that the concerns of recurring violations are alleviated, as Firm A argues, simply because Individual B would be supervising a new line of business.

C. Firm A Failed to Demonstrate that It Satisfied FINRA Rule 1014(a)(13)

FINRA Rule 1014(a)(13) prohibits approving a firm’s membership application if there is evidence that the firm “may circumvent, evade, or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, or FINRA rules.” Member Supervision found that Firm A’s relevant and recent regulatory history demonstrates a pattern of repeated

non-compliance with securities rules and regulations—specifically violations of FINRA’s AML and supervision rules—and reflects that the Firm may circumvent compliance with these rules in the future. Firm A argues that its disciplinary history is not a proper basis for finding that it did not meet the standards of FINRA Rule 1014(a)(13) and complains that Member Supervision relies on its disciplinary history in finding its failure to meet multiple standards.

We find that there is no reason a single factor may not be relevant to more than one of the standards of FINRA Rule 1014(a). To the contrary, disciplinary history is relevant to FINRA Rule 1014(a)(3) because it raises a presumption of denial and should be relevant to Rule 1014(a)(13) because it evidences the risk of future violations. Indeed, in the analogous context of disciplinary cases, the NAC has long recognized the relevance of disciplinary history and recidivism in fashioning appropriate sanctions because disciplinary history evidences a disregard for fundamental regulatory requirements and because recidivists pose increased risks of future violations. *See, e.g., Dep’t of Enf’t v. N. Woodward Fin. Corp.*, Complaint No. 2011028502101, 2016 FINRA Discip. LEXIS 35, at *41-42 (FINRA NAC July 19, 2016) (finding that respondent’s disciplinary history demonstrates a disregard for regulatory requirements); *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 SEC LEXIS 1699, at *48 (June 14, 2013) (finding that considering disciplinary history when imposing a disciplinary sanction is proper because that history evidenced that the respondent posed a risk to the investing public).

These principles apply with equal force to determining whether FINRA has evidence that Firm A may “circumvent, evade, or otherwise avoid compliance” with rules and regulations based on its disciplinary history. Firm A’s repeated violations over the course of many years, and its repeated failures to implement effective changes to its policies and procedures, raise these precise concerns of future violations.⁸

For these reasons, we find that Firm A has failed to establish that FINRA does not have evidence that the Firm may avoid compliance with applicable laws, regulations, and rules, as provided under FINRA Rule 1014(a)(13).

⁸ In arguing that its disciplinary history does not demonstrate that it may violate rules in the future, Firm A cites two cases in which the NAC found that an applicant failed to meet the standards in FINRA Rule 1014(a)(13) based on misconduct during the CMA process, including failures to disclose relevant information during the process. *See Membership Continuance Application of Member Firm*, 2007 FINRA Discip. LEXIS 31; *New Member Application of Applicant Firm*, 2021 FINRA Discip. LEXIS 6 (FINRA NAC June 2, 2021). Relying on these cases, Firm A suggests that something more than its disciplinary history is necessary under FINRA Rule 1014(a)(13). We do not view FINRA Rule 1014(a)(13) so narrowly. Nothing in the language of the rule or in the cases Firm A cites requires misconduct during the CMA process for FINRA Rule 1014(a)(13) to apply as a basis for denial.

D. Firm A's Other Arguments on Appeal Fail

Firm A makes several procedural arguments, related to both the underlying application process and Member Supervision's decision. For the reasons discussed below, we find that Firm A's arguments fail.⁹

1. Member Supervision Did Not Violate FINRA Rule 1017(i)

Firm A argues that Member Supervision did not act in accordance with FINRA Rule 1017(i) by failing to conduct a membership interview with the Firm, and by deciding to deny the application early in the process before it had requested or received any information from the Firm. We find that both arguments lack merit.

FINRA Rule 1017 applies to applications for changes in ownership, control, or business operations and Rule 1017(g)(1) provides that Membership Supervision “*may* require the [a]pplicant to participate in a membership interview” for such a continuing membership application. (Emphasis added); *compare* FINRA Rule 1013(b)(1) (which provides that in the case of “an application for *new membership in FINRA*, [Member Supervision] *shall* conduct a membership interview with a representative or representatives of the [a]pplicant”) (emphasis added); *see also* FINRA Rule 1017(i)(2) (explaining the timing of issuance of the decision “[i]f [Member Supervision] does not require the [a]pplicant to participate in a membership interview”). Nothing in the language of FINRA Rule 1017 requires a membership interview, and Firm A points to no authority providing otherwise.

The record also does not support Firm A's claim that Member Supervision prejudged its application before requesting and receiving any information. To the contrary, Member Supervision requested a plethora of relevant information from Firm A and, when its initial responses were insufficient, issued a second lengthy and detailed request. The Denial reflects

⁹ Firm A states that it filed a prior CMA on June 18, 2021, requesting approval for an investment banking line of business, but withdrew that CMA after staff advised it that it would deny the application based on pending disciplinary actions. Firm A also states that FINRA staff advised that “if the [f]irm resolved the issue[s] speedily, the [f]irm could reapply and the action would not hinder approval of the new application.” Firm A claims that based on this representation, it entered into the 2022 AWC rather than litigating those claims. Thus, Firm A argues, Member Supervision unfairly relied on the 2022 AWC as one of the reasons for denying the CMA. The record, however, contains no evidence related to this application or the conversations Firm A claims it had with staff. We therefore find that Firm A has offered no evidence to support its claim that it withdrew the earlier CMA and consented to the 2022 AWC based on staff's representations that settling those claims would not be an obstacle to approval of a future CMA. To the contrary, the only relevant record evidence is the terms of the 2022 AWC itself, in which Firm A “certifies” that it “agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in [the] AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.”

that Member Supervision considered Firm A's responses and explained the specific reasons for the denial. Nothing in the record contradicts that Member Supervision considered the information provided by Firm A in considering the application.

In its Notice of Appeal, Firm A describes alleged discussions with unnamed Member Supervision staff that it claims supports its argument that Member Supervision prejudged its application without considering the information the Firm provided. This argument fails for several reasons. First, Firm A elected to proceed with this appeal without a hearing and the record contains no evidence of any such conversations. Second, the email communications in the record between Member Supervision and Firm A's counsel indicate that staff described the rebuttable presumption of denial to Firm A, explained its concerns about the Firm's disciplinary history, and explained the Firm's options going forward. Moreover, when Firm A elected to continue with the application, the record supports that Member Supervision requested and considered relevant information. Accordingly, Firm A has not established that Member Supervision failed to consider properly its application.

2. Member Supervision Notified Firm A of the Reasons for Its Denial and Provided Firm A with an Opportunity to Respond

Firm A further argues that Member Supervision failed to provide it with the reasons for denying the CMA and did not give the Firm an opportunity to respond to its concerns about the CMA. Neither claim is persuasive.

FINRA Rule 1017(i)(2) requires that Member Supervision "shall serve a written decision on the application" that "provide[s] a rationale" for its decision, including references to the applicable standards in FINRA Rule 1014. We have previously held that Member Supervision's "decision is the primary way for [it] to provide notice of its concerns." *Membership Continuance Application of Member Firm*, 2007 FINRA Discip. LEXIS 31, at *20. The decision must "reasonably apprise the applicant of the grounds of the decision." *Id.* (internal quotations omitted). We find that the Denial here complied with the applicable rules by explaining the reasons for the decision and referencing the applicable standards.

Firm A's argument focuses not on the Denial, but rather on the claim that it was not given adequate notice of Member Supervision's concerns during the application process. The record reflects, however, that throughout the process Member Supervision advised the Firm about its concerns with its disciplinary history, the applicability of the rebuttable presumption of denial, and Firm A's burden to overcome it—the primary basis for the denial of Firm A's CMA.

Firm A's Notice of Appeal acknowledges that at its first September 2022 meeting with Member Supervision, staff described the presumption of denial based on the Firm's disciplinary history. In a September 29, 2022 email to Firm A's counsel, staff referenced two telephone calls with Individual B and Firm A's counsel, and explained that it was reiterating that Firm A and Individual B:

have disciplinary history, which history, based on FINRA Rule 1017(i)(1) in connection with FINRA Rule 1014(a)(3)(C), triggers

a presumption of denial of the current CMA. The presumption is rebuttable and the onerous [sic] is on the Firm to provide information [to show] how the Firm is capable of complying with industry rules, regulations, laws, and observing high standards of commercial honor and just and equitable principles of trade, and to attempt to rebut the presumption.

The email also noted that, on an earlier call, staff

mentioned [that] . . . due to the overall Firm's regulatory history, Staff is concerned, based on FINRA Rule 1014(a)(13) how the Firm will assure that going forward it will not circumvent, evade, or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, or FINRA rules.

Member Supervision's subsequent information requests further put Firm A on notice of staff's concerns with the application. The First and Second Requests referenced the presumption of denial, the applicable standards of FINRA Rule 1014, and explicitly asked how the Firm "overcomes the presumption of denial" created by each disciplinary matter. The record demonstrates that Firm A had notice of Member Supervision's concerns about the application from the start of the proceedings and was given an opportunity to respond to those concerns in its First and Second Responses.

The cases Firm A cites in arguing it had insufficient notice are inapposite. In those cases, the NAC found that Member Supervision's *denial decision* did not include bases for the denial of the application that Member Supervision later raised in an appeal hearing. *See In the Matter of the New Membership Application of Firm A*, 2010 FINRA Discip. LEXIS 24, at *23-26 (finding that Member Supervision's denial decision did not provide adequate notice because it did not explain the factual underpinning of a Wells Notice and examination report that Member Supervision later cited as a basis for its denial during the appeal hearing); *Membership Continuance Application of Member Firm*, 2007 FINRA Discip. LEXIS 31, at *17, 22-23 (finding notice was inadequate because at the appeal hearing, Member Supervision offered a "variety of factual contentions that were not expressly stated in its decision letter" and the firm had inadequate notice of several new grounds for the denial raised at the hearing because "[e]ven read liberally, neither Member Regulation's decision nor its prehearing filing, reasonably apprised the Member Firm that these were grounds of the decision"). Here, the Denial apprised Firm A of the reasons for denying the application and Member Supervision has not raised any new facts or new bases for a denial in its briefs on appeal.

As Firm A concedes, the rules do not require Member Supervision to act in a "consultative role" or to assist the Firm in resolving the issues preventing approval of the application. *See New Member Application of Applicant Firm*, 2021 FINRA Discip. LEXIS 6, at *37 (rejecting argument that Member Supervision failed to keep the firm adequately apprised of the purported deficiencies in the application, and finding that Member Supervision is not required to help resolve problems with the application); *New Membership Application of*

Applicant Firm, Application No. 20090196759, at *12-13 (FINRA NAC Dec. 2010).¹⁰ Rather, it is the Firm's burden to demonstrate that its application meets the standards for approval.

For these reasons, we find that the Denial reasonably apprised Firm A of the reasons its CMA was denied, and that it also had notice of these reasons throughout the membership process.

III. Conclusion

Firm A failed to demonstrate that it meets the standards of membership contained in FINRA Rules 1014(a)(3), (10), and (13). Accordingly, Member Supervision's decision to deny the Firm's continuing membership application is affirmed.

On Behalf of the National Adjudicatory Council,

Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

¹⁰ Available at https://www.finra.org/sites/default/files/NACDecision/p125380_0_0_0.pdf.