sifma

Invested in America

June 24, 2018

By Electronic Mail (pubcom@finra.org)

Jennifer Piorko Mitchell
Vice President and Deputy Corporate Secretary
Office of Corporate Secretary
FINRA
1735 K Street NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 18-16:
SIFMA Comment on FINRA Rule Amendments Relating to High-Risk Brokers and the Firms That Employ Them

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") Regulatory Notice 18-16 ("RN 18-16"), which seeks comment on proposed rule amendments that would impose additional restrictions on member firms that employ brokers with a history of significant past misconduct.[2]

SIFMA is supportive of the proposed amendments because we are committed to protecting investors and ensuring confidence in our markets through effective supervision. For that reason, our comments below concern mainly procedural issues, with one exception where we believe that the costs outweigh the benefits to FINRA, investors, and firms alike. SIFMA also seeks FINRA's assistance to better enable us to comply with certain amendments.

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] FINRA Regulatory Notice 18-16 (Apr. 30, 2018), http://www.finra.org/industry/notices/18-16.

Comments on New FINRA Rule 9285(a)

FINRA Rule 9285(a) would provide that the Hearing Panel or, if applicable, the Extended Hearing Panel, or Hearing Officer may impose such conditions or restrictions on the activities of a respondent as the Hearing Panel or Hearing Officer considers *reasonably necessary* for preventing customer harm during an appeal.

SIFMA supports this provision but suggests that a respondent or a respondent's firm be given the opportunity to propose conditions or restrictions for consideration by the Hearing Panel or Hearing Officer, similar to what firms do when negotiating the approval of state registrations for their registered persons. As currently proposed, a Hearing Panel or Hearing Officer unilaterally chooses conditions that he or she deems "reasonably necessary" for preventing customer harm. Accordingly, there is the potential that they could impose conditions or restrictions that are not tailored to a firm's business model. It is also possible that they could extrapolate from the actions of one or a small number of individuals changes onto firms that have the effect of firm-wide changes in policies and procedures or broad restrictions on activities – e.g., a finding that there were deficiencies in supervision of a product that results in the imposition of additional requirements for all sales. Certainly, conditions and restrictions on firm activities and products may be appropriate if the conduct is found to be widespread at the firm, but not in the instance where an individual or small number of individuals violated existing firm policies and procedures.

Allowing a respondent or a respondent's firm the opportunity to propose conditions or restrictions ensures that they will be "reasonably necessary" to address the conduct and prevent investor harm. And while Rule 9285(b) would allow for expedited review of the conditions or restrictions imposed by the Hearing Panel or Hearing Officer, it would reduce motions for review if a respondent or respondent's firm could propose conditions or restrictions for consideration by the Hearing Panel or Hearing Officer. Rule 9285(b) could still be utilized for modifying or removing conditions or restrictions if warranted by the circumstances.

Comments on New FINRA Rule 9285(c)

FINRA Rule 9285(c) would require, *within 10 days*, a firm with which a respondent is associated to adopt a written plan of heightened supervision if any party appeals a Hearing Panel or Hearing Officer decision to the NAC, or if the NAC calls the case for review.

SIFMA suggests that that firms have 30 days to submit a written plan of heightened supervision. A 10-day period is insufficient for firms to do everything necessary to implement a heightened supervisory plan. This may include analyzing the conduct at issue to be able to identify supervisory conditions reasonably designed to address the conduct, coordinating with several internal stakeholders, and making policy and procedure and system changes. This may also include consulting with counsel and/or FINRA staff. On top of this, a firm already must implement conditions or restrictions imposed under 9285(a). SIFMA does not believe that providing a slightly longer period for firms to adopt a plan

would be detrimental to investors; rather, it would ultimately benefit them because firms would have sufficient time to adopt a well-thought-out plan.

Comments on Amended IM-1011-2

Amended IM-1011-2 would require an existing member firm to submit a written letter seeking a materiality consultation to FINRA's Department of Member Regulation, if the member is not otherwise required to file a Continuing Membership Application (CMA), when a natural person that has, in the prior five years, one or more final criminal matter or two or more specified risk events, defined in proposed Rule 1011(g) and (o), respectively, seeks to become an owner, control person, *principal, or registered person of the member firm*.

At the outset, this proposal is contrary to the spirit of the materiality consultation guidance, which focuses on changes to a firm's business model, not the activity of individuals.[3] That being said, SIFMA is more concerned about the potentially significant impact this rule has on many of its members, despite FINRA's backward-looking assessment that the impact would be low.[4] The broad scope of this rule to include registered persons and principals who do not own or control a firm and set its policies, as well as the thresholds set for specified risk events in amended FINRA Rule 1011(o), would drain both FINRA and firm resources unnecessarily and not provide any benefits to investors.

First, the likelihood that the association of a registered person or a principal who is not an owner or control person would be material to a medium or large firm's business such that a CMA would be required is negligible. The time, costs, and resources devoted to materiality consultations, which are not supposed to be lengthy and laborious events but in practice are, when the chances are low that a CMA would be required is a waste of both FINRA and firm resources. Second, because of the low thresholds set for specified risk events, a medium to large-sized firm could be significantly impacted if it sought to associate with several or more registered persons or principals with specified risk events resulting from a product failure, for example. In this example, these individuals are not a risk to investors arguably, but the firm would nevertheless be required to file materiality consultations that more likely than not result in no CMA being required. Again, this would be a fruitless effort by FINRA and the firm.

To address our concerns and still retain the benefits to investors of this proposed amendment, SIFMA suggests narrowing the scope of amended IM-1011-2 to only require materiality consultations for owners or control persons with specified risk events seeking to become associated with a firm. We believe this tailoring to be more appropriate because they would exercise authority over a firm and its policies. Their association would therefore be material to the firm's business. Alternatively, SIFMA suggests excluding as

[3] *See* Overview of Materiality Consultation Process, http://www.finra.org/industry/overview-materiality-consultation-process.

[4] *See* Exhibit 4 to RN 18-16, *supra* note 2.

non-material per se registered persons and principals seeking to associate with a firm over a certain size (as established by FINRA).

Request for Assistance in Complying with Amended Rule 1011

SIFMA is concerned that specified risk events may not be properly identified and disclosed by the individual to the firm in a timely manner. To facilitate compliance with the rule, SIFMA respectfully requests that FINRA provide a notification, through appropriate means such as CRD, to firms for individuals with specified risk events. This would be in the same helpful vein as FINRA's announced enhancements to its disclosure review process wherein, beginning July 9, 2018, FINRA will conduct a public records search within fifteen calendar days from the date of an applicant's Form U4 and provide member firms any information resulting from such a search if such information is different from what was reported in the applicant's Form U4.[5]

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We appreciate your time and consideration of our comments. If you have any questions about them or would like additional information, please contact me at (202) 962-7300 or bcanepa@sifma.org.

Sincerely,

Bernard V. Canepa
Vice-President &
Assistant General Counsel

[5] FINRA Information Notice (May 18, 2018), http://www.finra.org/sites/default/files/notice_doc_file_ref/Information-Notice-051818.pdf.