



NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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August 1, 2018

By electronic mail to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 18-16 – High-Risk Brokers

Dear Ms. Piorko Mitchell:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),¹ I am submitting the following comments and recommendations in response to FINRA Regulatory Notice 18-16 (the “Proposal”) regarding member firms’ responsibilities when employing brokers with a history of significant past misconduct (*i.e.*, “high risk” brokers).² This comment letter is organized into four parts corresponding to the four parts of the Proposal.

High risk brokers are a perennial problem for investors. NASAA members continue to bring a large number of enforcement actions against bad actors in the brokerage industry.³ Our capital markets function and grow in large part due to the trust investors place in securities market participants. Maintaining that trust is essential to the continued primacy of our markets in an ever-competitive global marketplace. Expelling bad actors from the industry and reining in the activities of negligent or irresponsible brokers serves the interests of investors and the law abiding businesses and securities professionals that endeavor to comply with applicable securities laws and regulations.

¹ NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as a forum for these regulators to work with each other to protect investors at the grassroots level and promote fair and open capital markets.

² See FINRA Regulatory Notice 18-16, *High-Risk Brokers – FINRA Requests Comment on FINRA Rule Amendments Relating to High-Risk Brokers and the Firms that Employ Them* (Apr. 30, 2018), available at <http://www.finra.org/industry/notices/18-16>.

³ See NASAA 2017 Enforcement Report Based on 2016 Data (Sept. 27, 2017), available at <http://www.nasaa.org/43311/nasaa-releases-annual-enforcement-report-3/>.

1. Proposed Amendments to Rule 9200 Series (Disciplinary Proceedings) and Rule 9300 Series (Review of Disciplinary Proceedings)

The first part of the Proposal would amend FINRA rules to allow for the imposition of temporary conditions or restrictions on practice during the internal FINRA disciplinary appeals process. Currently, if a hearing panel or hearing officer finds a respondent liable in a FINRA disciplinary action and orders sanctions, the actual imposition of those sanctions – including suspensions, bars, expulsions, monetary fines or practice limitations – will be stayed if the action is appealed to (or called for review by) the National Adjudicatory Council (“NAC”). The NAC then reviews the disciplinary decision, including the sanctions assessed, and issues its own opinion affirming, rejecting or modifying the hearing panel’s decision. The NAC’s order is considered the final decision of FINRA, and any sanctions the NAC assesses will become enforceable (unless a respondent appeals to the U.S. Securities and Exchange Commission and, potentially further, to a United States Court of Appeals, in which case all or part of the sanctions may be stayed during the pendency of these actions).⁴ Under current practice, therefore, respondents in FINRA enforcement actions can stay the imposition of sanctions, including orders of expulsion or suspension, through at least the NAC appeals process.⁵ NAC appeals take on average 14 months to complete.⁶

NASAA supports the proposed changes to allow for temporary conditions or restrictions on practice during the pendency of NAC appeals. FINRA’s current practice of delaying the imposition of sanctions without an opportunity for temporary remedies during the NAC appeals process is contrary to standards under federal and state law, whereby civil and criminal awards or penalties generally become effective automatically after trial.⁷ And although defendants in civil and criminal court proceedings may be able to stay trial remedies by filing timely appeals, unlike FINRA practice, courts usually impose temporary remedies on parties that lose at trial (such as by requiring the posting of supersedeas bonds).⁸ It is entirely appropriate, therefore, for FINRA to revise its disciplinary procedures to bring them more into line with federal and state law.

⁴ See, e.g., In re Thaddeus J. North, SEC Release No. 34-80490 (Apr. 19, 2017); In re William Scholander and Talman Harris, SEC Release No. 34-74437 (Mar. 4, 2015). See also Section 25(c)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y(c)(2).

⁵ The Proposal would not affect current FINRA rules governing customer or industry arbitrations, though. Arbitration awards thus would continue to be final and non-appealable (though there are limited grounds upon which federal courts can modify or vacate arbitration awards). See Awards FAQ, <https://www.finra.org/arbitration-and-mediation/faq-awards-faq>; Fitzgerald v. H&R Block Fin. Advisors, No. 08-cv-10784, 2008 WL 2397636 (E.D. Mich. June 11, 2008).

⁶ See Proposal p.16 & fn.39.

⁷ See, e.g., Fed. R. Civ. Pro. 62; Fed. R. Crim. Pro. 38.

⁸ See, e.g., Athridge v. Iglesias, 464 F. Supp. 2d 19 (D.D.C. 2006); Segal v. Goodman, 851 P.2d 471 (N.M. 1993). Supersedeas bonds act like escrow accounts, protecting appellees by preventing appellants from potentially dissipating their assets during the appeals process and thereby rendering a trial court’s monetary award unrecoverable.

We recommend one change to this part of the Proposal, though. Proposed Rule 9285(b)(4) would stay the effectiveness of temporary conditions or restrictions if a respondent appealed the imposition of those conditions or restrictions. This subparagraph should be deleted from the proposed rule. To ensure investor protection and prevent customer harm, temporary conditions or restrictions imposed by a hearing panel or hearing officer should not be stayed if a respondent objects to them (which respondents likely always will do). Furthermore, subparagraph (b)(4) is inconsistent with proposed Rule 9285(c), which would require mandatory heightened supervision of individuals whose disciplinary cases are appealed to (or called for review by) the NAC. Allowing individuals to stay the imposition of temporary conditions or restrictions ordered by a hearing panel merely by appealing them runs counter the basic purpose of mandating heightened supervision for all persons under proposed Rule 9285(c).

2. Proposed Amendments to Rule 9520 Series (Eligibility Proceedings)

The second part of the Proposal would amend FINRA Rule 9523 to require interim plans of heightened supervision whenever a member firm seeks to associate with someone who is the subject of a statutory disqualification (“SD”). As explained in the Proposal, “there is currently no explicit rule requirement that these SD individuals be placed on heightened supervision by their employing member firm during the pendency of the SD Application review.”⁹ We agree this is a regulatory gap that should be closed and, for the reasons outlined in the Proposal, we support the proposed amendments to Rule 9523 as presented.

3. Proposed Amendments to Rule 8312 (BrokerCheck Disclosure) to Disclose the Status of “Taping Firms”

We agree with the third part of the Proposal to identify on BrokerCheck those “taping firms” subject to FINRA Rule 3170. This change would advance investor protection. The Proposal does not indicate precisely how this change would be implemented, though. How this disclosure is actually made on BrokerCheck is important, and we offer the following suggestions.

According to FINRA statistics, there are currently *eleven* firms subject to the taping rule.¹⁰ Given the extreme rarity of taping firms, the BrokerCheck disclosures of the 99.7% of FINRA member firms not subject to the taping rule should stay unchanged.¹¹ Taping rule disclosures should only appear on the reports of those few firms actually subject to the rule. For these firms,

⁹ Proposal p.11.

¹⁰ See Disciplined Firms Under FINRA Taping Rule (FINRA Rule 3170), <http://www.finra.org/industry/disciplined-firms-under-finra-taping-rule-finra-rule-3170>.

¹¹ As an aside, NASAA encourages FINRA to reopen Rule 3170 for potential revision. NASAA members have witnessed broker-dealers purposefully avoiding the disclosure of disciplinary events in order to evade the taping rule. We believe consideration should be given to ways the rule might be revised so as to prevent noncompliance.

BrokerCheck should identify them as subject to the rule and explain in plain English what this means. We suggest a standardized BrokerCheck disclosure for taping firms such as the following:

This broker-dealer is a disciplined firm within the meaning of the FINRA “Taping Rule” (FINRA Rule 3170). The Taping Rule identifies FINRA member firms that employ comparatively high percentages of registered persons who previously were associated with firms disciplined for violations of applicable laws and regulations. As a FINRA member subject to the Taping Rule, this broker-dealer must tape record all telephone conversations between its registered persons and customers and review these conversations for compliance with applicable laws and regulations (in addition to meeting all its other regulatory obligations).

4. Proposed Amendments to NASD Rule 1010 Series (MAP Rules)

The final part of the Proposal would impose additional obligations on member firms that seek to “onboard high-risk associated persons without prior consultation or review by FINRA.”¹² Specifically, the Proposal would amend the NASD Rule 1010 Series to require that FINRA members request materiality consultations with the Department of Member Regulation (the “Department”) before associating with any owner, control person, principal or registered person that, within the past five years, has been the subject of one or more “final criminal matters” or two or more “specified risk events.” These two terms are defined in the Proposal and capture most disclosable events on the uniform registration forms (*e.g.*, the questions in section 14 of the Form U4). Upon the Department’s receipt of a notice of such requested association, the Department would either permit the association or require the member to submit a continuing membership application (“CMA”) under FINRA Rule 1017, thereby subjecting the request to more formal Department review.

We agree with the objective of getting the Department more involved in FINRA members’ decisions to associate with individuals who have significant disciplinary histories. We believe the Proposal presents a reasonable means of achieving this objective, although we recommend some revisions to this part of the Proposal.

First, we agree with the proposed definition of “final criminal matters.” This definition appropriately captures the scope of criminal disclosable events on the uniform forms. We believe the definition of “specified risk events” should not be limited solely to individuals “named” in customer arbitrations, though. Instead, the definition of specified risk events should apply to all individuals who are the subject of customer settlements or awards and we note that this approach is also consistent with the approach taken on the Form U4. NASAA members have observed situations in which broker-dealer representatives are not named in customer arbitrations but clearly

¹² Proposal p.13.

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bear significant personal responsibility for the broker-dealer's offending conduct. The mere fact that a plaintiff has not chosen to name a registered representative as a party in an arbitration proceeding in what may be a litigation strategy should not provide that person with a free pass under the Proposal.

In addition, we believe the lookback period for disclosures under the Proposal should be adjusted. IM-1011-2 as drafted contemplates a five-year lookback requirement for disclosure of final criminal matters or specified risk events. We believe this lookback period should be increased to ten years. This would bring IM-1011-2 closer into line with the uniform forms (Form U4 is not time-limited, while Form BD calls for a ten-year criminal lookback period).¹³ IM-1011-2 should mirror the uniform forms for consistency and to better safeguard customers from potential harm.

* * *

In conclusion, for the reasons discussed herein, we broadly support the Proposal and encourage its adoption. If you have any questions about this letter or would like to discuss these issues, please contact NASAA's Broker-Dealer Section Chair, Frank Borger-Gilligan (frank.borger-gilligan@tn.gov or 615-532-2375), or General Counsel, A. Valerie Mirko (vm@nasaa.org or 202-737-0900).

Sincerely,



Joseph P. Borg
NASAA President
Director, Alabama Securities Commission

¹³ See Form U4 Questions 14A-14B and Form BD Question 11A.