

High-Risk Brokers

FINRA Requests Comment on FINRA Rule Amendments Relating to High-Risk Brokers and the Firms That Employ Them

Comment Period Expires: June 29, 2018

Summary

FINRA seeks comment on proposed rule amendments that would impose additional restrictions on member firms that employ brokers with a history of significant past misconduct. These brokers, while relatively small in number, may present heightened risk of harm to investors, and any misconduct by them also may undermine confidence in the securities markets as a whole. The rule proposals would strengthen the existing controls, some of which are highlighted below, FINRA has applied to such brokers to further promote investor protection and market integrity.

The new proposals are one part of FINRA's initiatives to confront high-risk brokers. FINRA will continue to evaluate various rules, examination and risk-monitoring programs, and technologies to determine further enhancements that FINRA can make to keep high-risk brokers from potentially harming investors and compromising the integrity of the financial markets.

FINRA is requesting comment on proposed amendments to:

1. the Rule 9200 Series (Disciplinary Proceedings) and the 9300 Series (Review of Disciplinary Proceedings by National Adjudicatory Council and FINRA Board; Application for SEC Review) to allow a Hearing Panel to impose conditions or restrictions on the activities of member firms and brokers while a disciplinary matter is on appeal to the National Adjudicatory Council (NAC), and to require member firms to adopt heightened supervisory procedures for brokers during the period the appeal is pending;
2. the Rule 9520 Series (Eligibility Proceedings) to require member firms to adopt heightened supervisory procedures for brokers during the period a statutory disqualification (SD) eligibility request is under review by FINRA;

April 30, 2018

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

Key Topics

- ▶ BrokerCheck Disclosure
- ▶ Disciplinary Proceedings
- ▶ Eligibility Proceedings
- ▶ Heightened Supervision
- ▶ Statutorily Disqualified Persons
- ▶ Supervision
- ▶ Taping Rule

Referenced Rules & Notices

- ▶ FINRA Rule 3110
- ▶ FINRA Rule 3170
- ▶ FINRA Rule 8312
- ▶ FINRA Rule 9200 Series
- ▶ FINRA Rule 9300 Series
- ▶ FINRA Rule 9520 Series
- ▶ FINRA Rule 9556
- ▶ NASD IM-1011-1
- ▶ NASD IM-1011-2
- ▶ NASD Rule 1010 Series
- ▶ Regulatory Notice 18-15

3. Rule 8312 (FINRA BrokerCheck Disclosure) to disclose the status of a member firm as a “taping firm” under Rule 3170 (Tape Recording of Registered Persons by Certain Firms); and
4. the NASD Rule 1010 Series (Membership Proceedings) (MAP rules) to place additional limitations on member firms by requiring a member firm to first submit a written letter to FINRA’s Department of Member Regulation, through the Membership Application Program Group (MAP Group), seeking a materiality consultation when a natural person that has, in the prior five years, one or more final criminal actions or two or more specified risk events seeks to become an owner, control person, principal or registered person of an existing member firm. Specified risk events (as described in detail below) generally means final, adjudicated disclosure events disclosed on a person’s or firm’s Uniform Registration Forms.¹

The proposed rule text is available in [Attachment A](#). With respect to proposal number 4, FINRA also seeks specific comment on the proposed numeric threshold and criteria that would trigger a materiality consultation. A detailed economic analysis of the proposed rule amendments, including the numeric threshold and criteria used for identifying brokers that would be impacted by the proposed amendments, is discussed below, and the exhibits referenced in this economic impact assessment are available in [Attachment B](#), Exhibits 1, 2, 3 and 4.

In addition, FINRA is focusing attention on high-risk brokers by publishing *Regulatory Notice 18-15* to reiterate the existing obligation of member firms to adopt and implement tailored heightened supervisory procedures under Rule 3110 (Supervision) for high-risk brokers;² and revising FINRA’s qualification examination waiver guidelines and related procedures to more broadly consider past misconduct when considering examination waiver requests.³

Questions concerning this *Notice* should be directed to:

- ▶ Kosha Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-6903.

Questions concerning the Economic Impact Assessment in this *Notice* should be directed to:

- ▶ Jonathan Sokobin, Senior Vice President and Chief Economist, Office of the Chief Economist (OCE), at (202) 728-8248; and
- ▶ Hammad Qureshi, Senior Economist, OCE, at (202) 728-8150.

Action Requested

FINRA encourages all interested parties to comment on the proposal. The comment period ends June 29, 2018.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.⁴

The proposed rule change must be filed with the Securities and Exchange Commission (SEC) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).⁵

Background & Discussion

FINRA uses a combination of tools to reduce misconduct by member firms and the brokers they hire, including SD processes, review of membership applications, disclosure of brokers' regulatory backgrounds,⁶ supervision requirements, focused examinations, risk monitoring and disciplinary actions. These tools, among others, serve to further the Exchange Act goals reflected in FINRA's mission of protecting investors and market integrity, including protecting investors from brokers with a history of significant past misconduct and the firms that choose to employ them.

Formal action to bar or suspend a broker requires FINRA to satisfy procedural safeguards established by federal law and FINRA rules to ensure fair process and to protect the rights of brokers to engage in business unless proven guilty of serious misconduct. Those safeguards include the right to defend oneself before a hearing panel and the right to appeal to the NAC, the SEC, and ultimately the federal courts. In addition, federal law and regulations define the types of misconduct that presumptively disqualify a broker from associating with a firm, and also govern the standards and procedures FINRA must follow when a broker who was found to have engaged in such misconduct applies to remain in or re-enter the industry.⁷

Current Programs

As discussed further below, FINRA strives to prevent and deter misconduct by member firms and the individuals they hire through a number of different measures.

► **Licensing and Registration**

To become a FINRA member, a firm is subject to review through FINRA's membership application program. As part of a new membership application (NMA) or a continuing membership application (CMA) under the Rule 1010 Series, FINRA reviews, among other factors, whether persons associated with an applicant have material disciplinary history, customer complaints, pending and final arbitrations, civil actions or other industry-related matters that could pose a threat to public investors. Where FINRA can show strong cause for concern, we can deny membership or place restrictions on membership to mitigate the risk. The membership application process also provides procedural safeguards for the applicant: applicants have the right to request review by the NAC of an adverse decision or the FINRA Board may call for a discretionary review of a membership proceeding. The applicant also may appeal final FINRA decisions to the SEC and the circuit courts.

► **Statutory Disqualifications – Eligibility Proceedings**

FINRA administers the SD process by assessing applications from member firms that wish to retain or employ an individual who is the subject of an SD. In conducting the assessment, FINRA seeks to exclude individuals who pose a risk of recidivism from continuing in the securities business. As a general framework, the Exchange Act sets out the types of broker misconduct that presumptively exclude brokers from engaging in the securities business. These types of misconduct, entitled "statutory disqualifications," are actions against an individual or member firm taken by a regulator or court based on a finding of serious misconduct that calls into question the integrity of the broker or firm. SDs include any felony and certain misdemeanors for a period of 10 years from the date of conviction; expulsions or bars (and current suspensions) from membership or participation in a self-regulatory organization; bars (and current suspensions) ordered by the SEC, Commodity Futures Trading Commission, or other appropriate regulatory agency or authority; willful violations of the federal securities and commodities laws or MSRB rules; and certain final orders of a state securities commission.

► **Monitoring and Examinations**

FINRA addresses high-risk brokers or high-risk activity through several of its examination programs. First, FINRA executes a High-Risk Registered Representative (HRR) Program that uses various methodologies to identify brokers from across the entire securities industry whose individual risk profiles suggest they are more likely than the general broker population to engage in misconduct. A specialized High-Risk

Registered Representative Examination Unit is responsible for the identification, monitoring and examination activities of high-risk registered representatives with additional examination support provided by examiners located in FINRA's various district offices.

FINRA also reviews individual brokers as part of the firm examination program where every broker-dealer receives an examination at least once every four years. Because our firm examinations are risk-based, the focus on individual brokers varies depending on the specific firm. Also covered during these examinations are assessments of the firms' supervisory and compliance controls over the conduct of brokers.

Further, FINRA examines individual brokers through its cause examination program. These examinations are allegation driven, and triggered by specific and sometimes high-risk events such as a customer complaint, whistleblower tip, arbitration referral or call to the FINRA Securities Helpline for Seniors™.

Lastly, FINRA conducts high-risk branch office examinations that focus on business conduct risks at the point of sale. Branch office examinations look at the core activities conducted from the specific branch location, including customer transactions, money and security movements, customer complaints, communications, account designation changes and credit extensions. The identification of high-risk branch offices is determined in large part by the aggregation of individual registered representative risk assessments.

► **BrokerCheck**

BrokerCheck provides the public with information on the professional background, business practices, and conduct of FINRA member firms and their associated persons, as well as on firms and their associated persons who are registered with national securities exchanges that use the Central Registration Depository (CRD®). BrokerCheck information is derived from the CRD system to, among other things, help investors make informed choices about the individuals and firms with which they conduct business. In addition to BrokerCheck disclosure, FINRA publishes on its website a list of individuals who have been barred by FINRA from association with any member firm in any capacity.⁸ The list is updated on a monthly basis.

► **Supervision Obligations of Member Firms**

FINRA Rule 3110 requires member firms to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and FINRA rules. Further, the rule requires member firms to establish, maintain and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities

laws and regulations and FINRA rules. An effective supervisory system plays an essential role in the prevention of sales abuses, and thus, enhances investor protection and market integrity. As such, FINRA has long emphasized that member firms have a fundamental obligation to implement a supervisory system, including written supervisory procedures, that is tailored specifically to the member firm's business and addresses the activities of all its associated persons.⁹

► **Enforcement and Disciplinary Actions**

An important part of FINRA's supervision of firms and the individuals they employ is our ongoing enforcement of FINRA and MSRB rules, and federal securities laws and rules. We aggressively investigate potential securities violations and, when warranted, bring formal disciplinary actions against member firms and their associated persons.

With respect to problem individuals, FINRA can take a range of formal actions, including barring them from the industry. As previously noted, formal action to bar or suspend a broker requires satisfying procedural safeguards required by the Exchange Act and, with respect to FINRA actions, safeguards include the right to a hearing before a FINRA hearing panel; appeal to the NAC; appeal to the SEC; and ultimately to the circuit courts of appeal.

Proposed Amendments

As part of FINRA's ongoing initiatives to protect investors from high-risk brokers, FINRA is proposing rule amendments that would impose additional obligations on member firms that seek to associate with high-risk brokers. The proposed rule amendments are designed to strengthen oversight of high-risk brokers and the firms that employ them.

1. Proposed Amendments to the Rule 9200 Series (Disciplinary Proceedings) and Rule 9300 Series (Review of Disciplinary Proceedings by National Adjudicatory Council and FINRA Board; Application for SEC Review)

A. Overview of Current Disciplinary Process

FINRA's Department of Enforcement initiates a formal disciplinary action by filing a complaint with FINRA's Office of Hearing Officers (OHO) when it believes that a member firm or associated person of a member firm is violating or has violated any FINRA rule, SEC regulations or federal securities laws, and formal disciplinary action is necessary. Following the filing of the complaint, the Chief Hearing Officer will assign a Hearing Officer to preside over the disciplinary proceeding, and appoint a Hearing Panel, or an Extended Hearing Panel, if applicable, to conduct a hearing and issue a decision.¹⁰

At a hearing, the parties present evidence for the Hearing Panel to determine whether a member firm or broker has engaged in conduct that violates FINRA rules, MSRB rules, SEC regulations or federal securities laws. The Hearing Panel also considers previous court, SEC, NAC and Hearing Panel decisions to determine if violations occurred.

For each case, the Hearing Panel, or the Hearing Officer in the case of default decisions,¹¹ will issue a written decision explaining the reasons for its ruling and consult the FINRA [Sanction Guidelines](#) to determine the appropriate sanctions if violations have occurred. FINRA also, when feasible and appropriate, can order member firms and brokers to make restitution to harmed customers.

Under FINRA's disciplinary procedures, a member firm or broker has the right to appeal a Hearing Panel or Hearing Officer decision to the NAC, or the NAC may on its own initiate a review of a decision. On appeal, the NAC will determine if a Hearing Panel's or Hearing Officer's findings were legally correct, factually supported and consistent with FINRA's Sanction Guidelines. The NAC's decision constitutes a final disciplinary action of FINRA, unless the FINRA Board calls the case for review and issues its own decision. A member firm or broker may appeal a final disciplinary action of FINRA to the SEC, and further to a U.S. Court of Appeals.

Currently, while a Hearing Panel or Hearing Officer decision is on appeal to the NAC, any sanctions imposed by the Hearing Panel or Hearing Officer, including bars or expulsions, are automatically stayed and not enforced against the member firm or broker during the pendency of the appeal.¹²

B. [Proposed Rule 9285 \(Interim Orders While on Appeal\)](#)

FINRA is proposing new FINRA Rule 9285 (Interim Orders While on Appeal) to bolster investor protection during the pendency of an appeal to the NAC of a Hearing Panel or Hearing Officer decision.

► *Conditions and Restrictions*

Proposed 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 the purpose of preventing customer harm.¹³ This approach would be consistent with the rules of several exchanges that have provisions that allow an exchange adjudicator to impose restrictions on the respondent during the exchange's appeal process.¹⁴

Under the proposal, as part of the hearing, FINRA's Department of Enforcement could request that the Hearing Panel or Hearing Officer order conditions and restrictions imposed against the respondent. The Hearing Panel or Hearing Officer would consider the request at the same time it makes findings of violations and imposes sanctions for the misconduct. FINRA believes the Hearing Panel's or Hearing Officer's knowledge about the violations would provide the qualifications to evaluate the potential for customer harm and craft tailored conditions and restrictions to minimize that potential harm. The order would describe the activities that the respondent shall refrain from taking and any conditions imposed.

In considering whether conditions or restrictions should be imposed on the activities of a respondent, the Hearing Panel or Hearing Officer would be guided by the principle of imposing conditions and restrictions reasonably necessary for the purpose of preventing customer harm. These conditions or restrictions could include, for example, prohibiting a member firm or broker from offering private placements in cases of misrepresentations and omissions made to customers, or prohibiting penny stock liquidations in cases involving violations of the penny stock rules. A condition could also include posting a bond to cover harm to customers before the sanction imposed becomes final or precluding a broker from acting in a specified capacity. The conditions and restrictions would be tailored to the specific risks posed by the member firm or broker during the appeal period.

Unlike sanctions imposed in the Hearing Panel or Hearing Officer decision, the proposal would amend FINRA Rule 9311 (Appeal by Any Party; Cross-Appeal) to expressly state that the conditions and restrictions imposed by the Hearing Panel or Hearing Officer would not be stayed during the pendency of the appeal to the NAC. The interim order of conditions and restrictions would remain effective and enforceable until issuance of the NAC's decision in the matter.

FINRA believes authorizing the Hearing Panel or Hearing Officer to order conditions and restrictions during an appeal would allow FINRA to target the demonstrated bad conduct of a respondent during the pendency of the appeal to the NAC. In addition, the proposal would amend FINRA Rule 9556 to grant FINRA staff the authority to start an expedited proceeding in accordance with Rule 9556 if a respondent failed to abide by the conditions and restrictions ordered.¹⁵

► *Expedited Review*

Proposed Rule 9285(b) would establish an expedited review process to allow a respondent that has conditions or restrictions imposed by a Hearing Panel or Hearing Officer to file a motion with the Review Subcommittee of the NAC to modify or remove any or all of the restrictions.

Specifically, proposed Rule 9285(b)(1) would establish an expedited review process available to a respondent that has conditions or restrictions imposed by a Hearing Panel or Hearing Officer to file a motion with the Review Subcommittee of the NAC to modify or remove any or all of the restrictions. Proposed Rule 9285(b)(2) would provide that the respondent has the burden to show that the Hearing Panel or Hearing Officer committed an error by ordering the condition or restrictions imposed. The respondent must show that the conditions or restrictions are not reasonably necessary for the purpose of preventing customer harm. The respondent's motion to modify or remove conditions or restrictions must be filed with FINRA's Office of General Counsel and served simultaneously on OHO and all other parties to the disciplinary proceedings.

Proposed Rule 9285(b)(3) would give FINRA's Department of Enforcement five days from service of the respondent's motion to file an opposition to the motion. As proposed, unless ordered otherwise by the Review Subcommittee, the motion to modify or remove conditions or restrictions would be decided based on the moving and opposition papers and would be decided in an expeditious manner and no later than 30 days after the filing of the opposition.

Proposed Rule 9285(b)(4) would provide that the filing of such an expedited motion to modify or remove a condition or restriction would stay the effectiveness of the ordered conditions and restrictions until the Review Subcommittee issues its ruling.

► *Mandatory Heightened Supervision*

Proposed Rule 9285(c) would require any 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.¹⁶ The proposed amendments would require a firm to adopt a plan of heightened supervision regarding such respondents within ten days of filing an appeal, and this requirement would need to take into account any conditions or restrictions imposed by the Hearing Panel or Hearing Officer.

Specifically, when a Hearing Panel or Hearing Officer issues a decision pursuant to Rule 9268 or Rule 9269 in which the adjudicator finds that an associated person, the respondent, has violated a statute or rule provision, the proposed rule would require any firm with which the respondent is associated to adopt a written plan of heightened supervision that must remain in place until FINRA's final decision takes effect.¹⁷ The member firm would be required to submit the written plan of heightened supervision within ten days of any party filing an appeal or the case being called for review by filing a copy of the plan of heightened supervision with FINRA's Office of General Counsel and serving a copy on the Department of Enforcement. If a respondent becomes associated with another firm while the Hearing Panel's or Hearing Officer's decision is on appeal to the NAC, that member firm must file a copy of a plan of heightened supervision, taking into account any conditions or restrictions imposed by the Hearing Panel or Hearing Officer, with the Office of General Counsel and serve a copy on the Department of Enforcement within ten days of the respondent becoming associated with the firm.

The proposed rule would require a member firm to implement tailored supervisory procedures that are reasonably designed to prevent or detect a reoccurrence of the violations found by the Hearing Panel or Hearing Officer. In addition, the plan of heightened supervision must comply with Rule 3110, which requires firms to establish and maintain supervisory systems for each of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and FINRA rules. The plan of heightened supervision must, at a minimum, include the designation

of an appropriately registered principal who is responsible for carrying out the plan of heightened supervision. The plan of heightened supervision also must be signed by the designated principal, and include an acknowledgement that the principal is responsible for implementing and maintaining the plan of heightened supervision.

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

A. [Overview of Current Statutory Disqualification Eligibility Process](#)

Brokers who have engaged in the types of misconduct specified in the Exchange Act statutory disqualification provisions must undergo special review by FINRA before they are permitted to re-enter or continue working in the securities industry. In conducting its review, FINRA seeks to exclude brokers who pose a risk of recidivism from continuing in the securities business, subject to the limits developed in SEC case law.

As a general framework, the Exchange Act sets out the types of misconduct that presumptively exclude brokers from engaging in the securities business, identified as statutory disqualifications or SDs.¹⁸ These SDs are the result of actions against a broker taken by a regulator or court based on a finding of serious misconduct that calls into question the integrity of the broker, and include any felony and certain misdemeanors for a period of ten years from the date of conviction; expulsions or bars (and current suspensions) from membership or participation in a self-regulatory organization; bars (and current suspensions) ordered by the SEC, Commodity Futures Trading Commission, or other appropriate regulatory agency or authority; willful violations of the federal securities and commodities laws or MSRB rules; and certain final orders of a state securities commission.

The Exchange Act and SEC rules thereunder establish a framework within which FINRA evaluates whether to allow individuals who are the subject of an SD to associate with a member firm.¹⁹ A member firm that seeks to employ or continue the employment of an individual who is the subject of an SD therefore files an application (SD Application) seeking approval from FINRA.²⁰ FINRA Rule 9520 Series sets forth eligibility proceedings under which FINRA may allow a member, person associated with a member, potential member, or potential associated person subject to an SD to enter or remain in the securities industry.²¹ A firm's SD Application is subject to careful scrutiny by FINRA to best ensure that the individual's association with the member firm is subject to heightened supervision and is consistent with the public interest and the protection of investors. To determine whether the SD Application will be approved or denied, FINRA takes into account factors that include the nature and gravity of the disqualifying event; the length of time that has elapsed since the disqualifying event and any intervening misconduct occurring since; the regulatory history of the disqualified individual, the firm and individuals who will act as supervisors; and any proposed plan of supervision.²²

If FINRA recommends approval of the SD Application, the recommendation is submitted either directly to the SEC for its review or to the NAC and ultimately to the SEC for their reviews and approvals. If FINRA recommends disapproval of the SD Application, the member firm has the right to a hearing before a panel of the Statutory Disqualification Committee and the opportunity to demonstrate why the SD Application should be approved.²³ If the NAC denies the SD Application, the member firm can appeal the decision to the SEC and the federal circuit courts.²⁴

As part of an SD Application, a member firm will propose a written plan of heightened supervision to closely monitor the SD individual's securities-related activities. A heightened supervisory plan must be acceptable to FINRA, and FINRA will reject any plan that is not specifically tailored to address the SD individual's prior misconduct and to mitigate the risk of future misconduct. In this regard, FINRA's primary consideration is a heightened supervisory plan carefully constructed to best ensure investor protection.

Despite the requirement of heightened supervision to receive approval of an SD Application, 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.²⁵

B. Proposed Amendments to Require Automatic Heightened Supervision During Review Period

FINRA is proposing to amend Rule 9523 (Acceptance of Member Regulation Recommendations and Supervisory Plans by Consent Pursuant to SEA Rule 19h-1) to require a member firm to immediately place an individual on an interim plan of heightened supervision once an SD Application is filed. The proposed amendments would delineate the circumstances under which an individual who is statutorily disqualified may remain associated with a FINRA member while FINRA is reviewing his or her SD Application.

As with proposed Rule 9285 that would require a plan of heightened supervision during an appeal of a disciplinary action, proposed amendments to Rule 9523 provides flexibility regarding the details of specific interim plans of heightened supervision. However, the proposal would provide that, in order for supervision over a disqualified individual to be reasonable under Rule 3110, the interim plan of heightened supervision must be tailored to the disqualified individual, and must take into account the nature of the disqualification, the nature of the firm's business, the disqualified person's current and proposed activities at the firm, and the qualifications of the supervisor. Every interim plan would be required to identify a qualified principal responsible for carrying out such plan who has evidenced his or her acknowledgement of such responsibility by signing such plan.

The proposed amendments would require that a copy of the interim plan of heightened supervision be submitted with the SD Application, and that the plan be in effect throughout the entire SD Application review process. The proposal would also make clear that an interim plan of heightened supervision may be modified by FINRA through the SD eligibility proceeding, that compliance with the interim plan of heightened supervision will be monitored through FINRA's examination program, and that the firm or individual could be subject to further disciplinary proceedings for failure to comply with the interim plan. The proposed amendments also would provide that an SD Application may be determined to be substantially incomplete if the interim plan is not reasonably designed in compliance with the standards of the proposed amendments. If the applicant fails to timely remedy a substantially incomplete SD Application, FINRA will provide written notice to the member that the SD Application has been rejected, its reasons for so doing, and refund the application fee, less \$1,000 as a FINRA processing fee. Upon such rejection, the SD Application is terminated and the member firm must promptly disassociate with the individual. FINRA would generally cover compliance with interim plans of heightened supervision as part of its examination program.

3. Proposed Amendments to Rule 8312 (FINRA BrokerCheck Disclosure)

Rule 8312 governs the information FINRA releases to the public through its BrokerCheck system.²⁶ BrokerCheck helps investors make informed choices about the brokers and member firms with which they conduct business by providing extensive registration and disciplinary history to investors at no charge. FINRA has required member firms to inform their customers of the availability of BrokerCheck.²⁷

FINRA is proposing to amend Rule 8312 to disclose the status of a member firm as a "taping firm" under Rule 3170 (Tape Recording of Registered Persons by Certain Firms)²⁸ through BrokerCheck. Rule 3170 is designed to ensure that member firms with a significant number of registered persons that previously were employed by "disciplined firms" have specific supervisory procedures in place to prevent fraudulent and improper sales practices or other customer harm.²⁹ Under the rule, a member that hires a specified percentage of registered persons from disciplined firms is designated as a "taping firm" and must establish, maintain, and enforce special written procedures for supervising the telemarketing activities of all its registered persons.³⁰

A taping firm must adopt procedures that include tape-recording all telephone conversations between such firms' registered persons and both existing and potential customers. Such firms also are required to review the tape recordings, maintain appropriate records, and file quarterly reports with FINRA.

To assist member firms in complying with Rule 3170, FINRA publishes on its website a "Disciplined Firms List" identifying those member firms that meet the definition of "disciplined firm."³¹ A member firm that either is notified by FINRA or otherwise has actual knowledge that it is a taping firm is subject to the requirements of the rule.

FINRA believes disclosing the status of a member firm as a taping firm through BrokerCheck will help inform investors of the heightened procedures required of the firm, which may incent the investors to research more carefully the background of a broker associated with the firm.

Currently, Rule 8312 provides that FINRA will release whether a particular member firm is a taping firm subject to Rule 3170 in response to telephonic inquiries via the BrokerCheck toll-free telephone listing. To better inform investors, the proposed amendment would permit FINRA to release information through BrokerCheck, in general, as to whether a particular member is subject to the provisions of Rule 3170.

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

A. Current MAP Process

FINRA also seeks to prevent member firm recidivism by reviewing new member applications or membership changes pursuant to the NASD Rule 1010 Series.

Rule 1014(a) (Standards for Admission) sets forth the 14 standards for admission applied by FINRA's Department of Member Regulation, through the MAP Group (collectively, the Department) in determining whether to approve a New Member Application (NMA) or a Continuing Member Application (CMA). The MAP rules require an applicant to demonstrate its ability to comply with the federal securities laws and FINRA rules, including observing high standards of commercial honor and just and equitable principles of trade applicable to its business. The Department evaluates an applicant's financial, operational, supervisory and compliance systems to ensure that each applicant meets these standards for admission. The Department considers whether persons associated with an applicant have material disciplinary actions taken against them by other industry authorities, customer complaints, adverse arbitrations, pending or unadjudicated matters, civil actions, remedial actions imposed or other industry-related matters that could pose a threat to public investors.

In addition, Rule 1017 provides, among other things, that a member shall file a CMA when there are certain changes in ownership, control or business operations.³² IM-1011-1 creates a safe harbor for specified changes that are presumed not to be a "material change in business operations" and, therefore, do not require a member to file a CMA for approval of the change. One such change is an increase in the number of associated persons involved in sales within the parameters prescribed in the safe harbor. FINRA is concerned about instances where a member may onboard high-risk associated persons without prior consultation or review by FINRA.

Currently the materiality consultation process is used when a member contemplates a change in business operations that may not squarely fall within one of the categories or definitions that would require a CMA under Rule 1017 and the member firm seeks

guidance to determine how best to proceed with the proposed change by voluntarily seeking a materiality consultation from the Department. A request for a materiality consultation is a written request from a member firm for a determination from the Department of whether a proposed change is material. There is no fee associated with submitting this request to the Department. The characterization of a proposed change as material depends on an assessment of all the relevant facts and circumstances. The Department may communicate with the member firm to obtain further information regarding the proposed change and its anticipated impact on the member firm. Where the Department determines that a proposed change is material, the Department will instruct the member to file a CMA if it intends to proceed and will advise that effecting the change without approval would constitute a violation of NASD Rule 1017.

B. Proposed Amendments to MAP Rules

FINRA is proposing amendments to the MAP rules to impose additional obligations on member firms that associate with persons who have, in the prior five years, either one or more final criminal matters, or two or more specified risk events. The proposed amendments to the MAP rules would allow FINRA to review and potentially restrict or deny a member firm from allowing such a person to become an owner, control person, principal or registered person. FINRA believes the proposed MAP rules would further promote investor protection by applying stronger standards for continuing membership with FINRA and for changes to a current member firm's ownership, control or business operations.

▶ *Materiality Consultation*

Proposed IM-1011-2 (Business Expansions and Persons with Specified Risk Events) would require an existing member firm to submit a written letter seeking a materiality consultation to the Department, if the member is not otherwise required to file a CMA, when a natural person that has, in the prior five years, one or more final criminal matters or two or more specified risk events seeks to become an owner, control person, principal or registered person of the member.

In addition, the proposed rule would expressly state that the safe harbor for business expansion in IM-1011-1 (Safe Harbor for Business Expansions) would not be available to member firms in this circumstance.

The proposed rule would provide that the member may not effect the contemplated activity until the member has first submitted a written letter to the Department seeking a materiality consultation for the contemplated activity, and would require that the letter address the issues that are central to the materiality consultation, in a manner prescribed by FINRA. The Department would consider the letter and other information or documents and determine in the public interest and the protection of investors that either (1) the member is not required to file a CMA in accordance with

Rule 1017 and may effect the contemplated activity; or (2) the member is required to file a CMA in accordance with Rule 1017 and the member may not effect the contemplated activity, unless the Department approves the CMA.

In this regard, the materiality consultation would focus on, and the submitting member firm would need to provide information relating to, the conduct underlying the specified risk events, as well as other matters relating to the subject person such as disciplinary actions taken by FINRA or other industry authorities, adverse examination findings, customer complaints, pending or unadjudicated matters, terminations for cause or other incidents that could pose a threat to public investors. The Department's assessment would factor in, among other things, whether the events are customer-related; represent discrete actions or are based on the same underlying conduct; the anticipated activities of the person; the disciplinary history, experience and background of the proposed supervisor, if applicable; the disciplinary history, supervisory practices, standards, systems and internal controls of the member firm and whether they are reasonably designed to achieve compliance with applicable securities laws and regulations, and FINRA rules; whether the member firm employs or intends to employ in any capacity multiple persons with one or more final criminal matters or two or more specified risk events in the prior five years; and any other impact on investor protection raised by seeking to make the person an owner, control person, principal or registered person of the member firm.

► *Definitions*

The proposal would amend Rule 1011 to define a "final criminal matter" as a criminal matter that resulted in a conviction of, or guilty plea or nolo contendere (no contest) by, a person that is disclosed, or was required to be disclosed, on the applicable Uniform Registration Forms.³³

The proposal would further amend Rule 1011 to define a "specified risk event" as any one of the following events that are disclosed, or are or were required to be disclosed, on the applicable Uniform Registration Forms:

- i. a final investment-related,³⁴ consumer-initiated customer arbitration award or civil judgment against the person for a dollar amount at or above \$15,000 in which the person was a named party;
- ii. a final investment-related, consumer-initiated customer arbitration settlement or civil litigation settlement for a dollar amount at or above \$15,000 in which the person was a named party;
- iii. a final investment-related civil action where the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above \$15,000; and

- iv. a final regulatory action where (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above \$15,000; or (B) the sanction against the person was a bar (permanently or temporarily), expulsion, rescission, revocation or suspension from associating with a member.

As noted above, the proposed additional MAP obligations would apply only where the person has, within the prior five years, one or more final criminal matters or two or more specified risk events, and seeks to become an owner, control person, principal or registered person of the member firm.³⁵

Economic Impact Assessment

1. Regulatory Need

As discussed above, FINRA continually strives to strengthen its oversight of the brokers and firms it regulates in order to further its mission of protecting investors and market integrity, including protecting investors from brokers with a history of significant past misconduct and the firms that choose to employ them. Moreover, recent studies provide evidence of the predictability of future regulatory-related events for brokers with a history of past regulatory-related events such as repeated disciplinary actions, arbitrations and customer complaints.³⁶ Therefore, notwithstanding the extensive protections afforded by the federal securities laws and FINRA rules, investors may reasonably continue to be concerned that without additional protections, the risk of potential customer harm may continue where these patterns exist. The proposals discussed in this *Notice* are designed to further promote investor protection by mitigating these concerns while recognizing the need to preserve principles of fairness.

2. Economic Baseline

The following provides the economic baseline for each of the current proposals. These baselines serve as the primary points of comparison for assessing economic impacts, including incremental benefits and costs of the proposed rule amendments. For this proposal, FINRA reviewed and analyzed relevant data over the 2013-2016 period (review period).

A. Proposed Amendments to the Rule 9200 Series and Rule 9300 Series

The economic baseline used to evaluate the economic impacts of the proposed rule changes to the Rule 9200 Series and Rule 9300 Series is the current regulatory framework under these rules. FINRA analyzed disciplinary matters that were appealed to the NAC over the review period that reached a final decision by the NAC.³⁷ During the review period, there were approximately 18 such appeals filed each year, of which approximately 82 percent were filed by brokers, 8 percent were filed by firms, and the remaining 10 percent were filed jointly by brokers and firms.³⁸ FINRA determined that, on average, these disciplinary decisions were on appeal for approximately 14 months.³⁹

B. Proposed Amendments to the Rule 9520 Series

The economic baseline used to evaluate the economic impacts of the proposed rule changes to the Rule 9520 Series is the current regulatory framework under these rules. FINRA analyzed SD Applications filed during the review period and determined that there were 122 SD Applications filed for 119 individuals by 105 firms, or approximately 31 requests that were filed by 26 firms each year.⁴⁰ Approximately 54 percent of these applications were associated with small firms, 17 percent with mid-sized firms and 29 percent with large firms.⁴¹ FINRA also examined the resolution of these applications and determined that approximately 21 percent of the SD Applications were approved, 8 percent were denied, 9 percent were pending during the review period, and the remaining applications (62 percent) did not require a resolution because the SD individual's registration with the filing firm was terminated or the SD Application was subsequently withdrawn.⁴² FINRA determined that, on average, the processing time for an SD Application that reached a final resolution (*i.e.*, an approval or a denial) was approximately 10 months.⁴³

C. Proposed Amendments to the BrokerCheck Rule

The economic baseline used to evaluate the economic impacts of the proposed rule changes to the BrokerCheck Rule is the current regulatory framework under Rules 8312 and 3170. During the review period, FINRA determined that 13 firms hired or retained enough registered persons from previously disciplined firms to be designated as a "taping firm" under Rule 3170 and were notified about their status during this period. All of these firms were small firms with the average size of approximately 40 registered persons. Of these 13 firms, nine firms did not become subject to the rule's tape-recording requirements because they either took advantage of the one-time opportunity to reduce the number of their registered persons from previously disciplined firms below the specified thresholds or terminated their FINRA membership, and one firm was exempted from the requirements of the rule pursuant to Rule 3170(d). As a result, only three of the 13 firms designated as "taping firms" during the review period became subject to the requirements of Rule 3170.

D. Proposed Amendments to the MAP Rules

The economic baseline used to evaluate the economic impacts of the proposed rule changes to the MAP rules is the current regulatory framework under these rules. The proposed rule change would directly impact individuals with one or more final criminal matters or two or more specified risk events within the prior five years, who seek to become owners, control persons, principals or registered persons of a member firm. The criteria used for identifying individuals for this proposal and the number of individuals meeting the proposed criteria are discussed below.

3. Economic Impacts

The following provides the economic impacts, including the anticipated benefits and the anticipated costs for each of the current proposals.

A. Proposed Amendments to the Rule 9200 Series and Rule 9300 Series

The proposed rule amendments would directly impact firms and brokers whose disciplinary matters are on appeal to the NAC. These impacts would vary across appeals and depend on, amongst other factors, the nature and severity of the conditions or restrictions imposed on the activities of respondents and the likely risk that they would continue to harm customers if permitted to remain working during the appeal period without those conditions or restrictions. As discussed above, the scope of these conditions or restrictions would depend on what the Hearing Panel determines to be reasonably necessary for the purpose of mitigating the risk of customer harm. Further, the conditions and restrictions would be tailored to the specific risks posed by the brokers or firms during the appeal period. Accordingly, the conditions and restrictions are not intended to rise to the level of the underlying sanctions and would likely not be economically equivalent to imposing the sanctions during the appeal.

The primary benefit of this proposal accrues from limiting the potential risk of continued harm to customers by respondents during the appeal period by imposing conditions or restrictions on their activities as well as imposing mandatory heightened supervision of brokers while their disciplinary matter is on appeal. In order to evaluate these benefits and assess the potential risk posed by brokers during the appeal period, FINRA examined cases that were appealed to the NAC during the review period and determined whether the brokers associated with an appeal to the NAC had a disclosure event at any time from the filing of the appeal through 2016. Specifically, FINRA identified brokers that were associated with one or more final criminal matters or specified risk events, as defined above, that occurred after they filed their appeals to the NAC.⁴⁴ Based on this analysis, FINRA estimates that 16 of the 65 brokers who appealed to the NAC were associated with a total of 21 disclosure events that occurred subsequent to the filing of their appeal to the NAC.⁴⁵ FINRA anticipates that the proposed heightened supervision requirement and the conditions or restrictions placed on the activities of these brokers would lead to greater oversight of their activities by their firm during the appeal period, thereby reducing the potential risk of future customer harm during this period.

The cost of this proposal would primarily fall upon brokers or firms whose activities during the appeal period would be subject to the specific conditions or restrictions imposed by the Hearing Panel. In addition, firms would incur costs associated with implementing heightened supervision for brokers while their disciplinary matters are under appeal. These costs would likely vary significantly across firms and could escalate if the broker acts in a principal capacity. For example, firms employing

brokers that serve as principals, executive management, owners, or operate in other senior capacities would likely take on more costs in developing and implementing tailored supervisory plans. Such plans may entail re-assignments of responsibilities, restructuring within senior management and leadership, and more complex oversight and governance approaches. These potential costs, in turn, may result in some brokers voluntarily leaving the industry rather than waiting for the resolution of the appeal process.⁴⁶

The costs associated with this proposal would apply to brokers and their employing firms only while the brokers are employed during the pendency of the NAC appeals. While the disciplinary decisions are on appeal for approximately 14 months on average, many brokers filing an appeal to the NAC are not employed at the time the appeal is filed or leave shortly after the appeal is filed. FINRA examined the employment history, including the employment start and end dates, of the 65 brokers associated with NAC appeals during the review period, and estimates that 31 (or 48 percent) of these brokers were not employed by any member firm at any point during the appeal process, 14 (or 21 percent) of the brokers were employed by a member firm only for part of the appeal process, and the remaining 20 (or 31 percent) of the brokers were employed by a member firm throughout the appeal process.

In developing the proposal, FINRA considered the possibility that, in some cases, this proposal may limit activities of brokers and firms, while their disciplinary matter is under appeal, in instances where the restricted activities do not pose a risk to customers. In such cases, these brokers and firms may lose economic opportunities and their customers may lose the benefits associated with the provision of these services. FINRA believes that the proposed rule changes mitigate such risks by requiring the conditions or restrictions imposed to be reasonably necessary for the purpose of reducing the potential risk of future customer harm and by providing a respondent with the right to seek to modify or remove any or all of the conditions and restrictions in an expedited proceeding. Further, as discussed above, only 31 percent of the brokers associated with NAC appeals were employed by a member firm for the full duration of their appeals. Approximately 69 percent of the brokers were not employed by a member firm at any time during the appeal process or were employed by a member firm only for part of the appeal process. Accordingly, these brokers would not be impacted by this proposal or would be subject to the proposed limitations only for a limited period of time.

B. Proposed Amendments to the Rule 9520 Series

The proposed rule amendments would impact SD individuals and their firms while the SD Application goes through an eligibility proceeding. The primary benefit of this proposed rule change would arise from greater oversight by firms of the activities of SD individuals during the pendency of their SD Applications. In order to assess the

potential risk posed by these individuals during the pendency of their SD Applications, FINRA examined whether individuals associated with an SD Application filed during the review period had a disclosure event at any time from the filing of the application through 2016. Based on this analysis, FINRA estimates that 18 (or 15 percent) of the 119 individuals that filed SD Applications during the review period were associated with a total of 20 disclosure events subsequent to the filing of their SD Application.⁴⁷ FINRA anticipates that the proposed heightened supervision requirement would lead to greater oversight by firms of the activities of these individuals during the pendency of their SD Application, thereby reducing the potential risk of customer harm during this period.

Firms may incur costs associated with implementing a tailored heightened supervision program for these individuals while their SD Application is under review. As discussed above, the costs would likely vary significantly across firms and could escalate if the SD individuals also serve as principals, executive management, owners or operate in other senior capacities. Moreover, the heightened supervision requirement may deter some firms from filing an SD Application for these individuals who, as a result, may find it more difficult to remain in the industry.

C. Proposed Amendments to the BrokerCheck Rule

The proposed amendments would impact taping firms and their registered persons. Taping firms have a proportionately significant number of registered persons that were associated with firms that were expelled by a self-regulatory organization or had their registration revoked by the SEC for sales practice violations, and as a result, may pose greater risk to their customers. Disclosing a firm's status as a "taping firm" through BrokerCheck would help investors make more informed choices about the brokers and firms with which they conduct business. This proposal to disclose a firm's status as a "taping firm" would not impose any direct costs on brokers or firms. Nonetheless it may impact their businesses, as investors may also rely on this information in determining whom to engage for financial services and brokerage activities. Disclosing the status of a firm as a "taping firm" through BrokerCheck may also further deter firms from hiring or retaining brokers that previously were employed by disciplined firms in order to avoid the "taping firm" disclosure on BrokerCheck.

D. Proposed Amendments to MAP Rules

The primary benefit of the proposed amendments would be to reduce the potential risk of future customer harm by individuals who meet the proposed criteria and seek to become an owner, control person, principal, or registered person of a member firm. FINRA believes the proposed rule change would further promote investor protection by applying stronger standards for continuing membership with FINRA and for changes to a current member firm's ownership, control or business operations. These benefits would primarily arise from changes in broker and firm behavior and increased scrutiny by FINRA of brokers who meet the proposed criteria during the review of the applications.

The cost of these proposals would fall on the firms that seek to add owners, control persons, principals or registered persons who meet the proposed criteria. These firms would be directly impacted by the proposals through the requirement to seek a materiality consultation with FINRA and potential requirement to file a CMA. While there is no FINRA fee for seeking a materiality consultation, firms may incur internal costs or costs associated with engaging external experts in conjunction with the filing of a CMA if necessary. The requirement of a materiality consultation could result in delays to a firm's ability to add owners, control persons, principals or registered persons who meet the proposed criteria. Based on its review of the materiality consultation, FINRA may require the firm to file a CMA and the firm may not effect the applicable activity until the CMA is approved. FINRA examined the time to process materiality consultations and determined that, on average, these consultations are completed within 8-10 days, although this time period could be longer depending on the complexity of the contemplated expansion or transaction. FINRA recognizes that these anticipated costs may deter some firms from hiring individuals meeting the proposed criteria, who as a result may find it difficult to remain in the industry or bear other labor market related costs.

To provide transparency regarding the application of this proposal, the proposed criteria is based on disclosure events required to be reported on the Uniform Registration Forms. These Uniform Registration Forms are generally available to firms and FINRA.⁴⁸ Accordingly, firms, with a few exceptions, can identify the specific set of disclosure events that would count towards the proposed criteria and replicate the proposed thresholds using available data.⁴⁹ In determining the proposed numeric threshold, FINRA considered three key factors: (1) the different types of reported disclosure events; (2) the counting criteria or number of reported events required to trigger the obligations; and (3) the time period over which the events are counted. In evaluating the proposed numeric threshold versus alternative criteria, significant attention was given to the impact of possible misidentification of individuals; specifically, the economic trade-off between including individuals who are less likely to subsequently pose risk of harm to customers, and *not* including individuals who are more likely to subsequently pose risk of harm to customers but do not meet the proposed numeric threshold. There are costs associated with both types of misidentifications. For example, subjecting individuals who are less likely to pose a risk to customers to the MAP process would impose additional costs on these individuals, their affiliated firms and customers. The proposed numerical threshold aims to appropriately balance these costs in the context of economic impacts associated with the proposed amendments to the MAP rules.

The proposal may create incentives for changes in behavior to avoid meeting the proposed threshold. For example, brokers and firms may be more likely to try to settle customer complaints or arbitrations below \$15,000 so that their settlements do not

count towards the proposed threshold.⁵⁰ To the extent, if any, that customers also would be willing to settle for less, this change may reduce the compensation provided to customers. Brokers and firms also may consider underreporting the disclosure events in an effort to avoid the attendant costs. However, this potential impact is mitigated by the fact that many of the events are reported by FINRA or other regulators and any incorrect or missing reports can trigger regulatory action by FINRA. FINRA rules require firms to take appropriate steps to verify the accuracy and completeness of the information contained in the Uniform Registration Forms before they are filed. FINRA also has the ability to check for unreported events, particularly those that are reported in a separate public notice by a third party, such as the outcome of some civil proceedings.

FINRA recognizes that in some instances, firms may not be able to identify certain individuals with disclosure events that may seek to become owners, control persons, principals or registered persons of the firm. Similarly, firms may have less incentive to conduct appropriate due diligence on those individuals for whom firms may not have readily available disclosure history.⁵¹ Firms, in these instances, would however still be required to seek information on relevant disclosure events from those individuals who seek to become principals or otherwise act as registered persons of the firm as part of their employment and registration process and take reasonable steps (*e.g.*, by conducting background checks) to verify the accuracy and completeness of the information provided by them. Nonetheless, FINRA recognizes that in some cases, even after conducting reasonable due diligence, firms may not have the required information to identify certain individuals that meet the proposed criteria, and these individuals may continue to pose risk of future investor harm to investors. FINRA believes that these risks are mitigated by its own examination risk programs that monitor and examine individuals for which there are concerns of ongoing misconduct or imminent risk of harm to investors. These programs identify high-risk individuals based on the analysis of data available to the firms as well as additional regulatory data available to FINRA.⁵²

In developing this proposal, FINRA analyzed disclosure events reported on the Uniform Registration Forms for all individuals during the review period. For each year, FINRA evaluated the data and determined the approximate number of individuals who would have met the proposed numeric threshold of one or more final criminal matters or two or more specified risk events in the prior five years. Exhibit 1 shows the disclosure categories that FINRA considered and the subcategories that were used for identifying final criminal matters and specified risk events. The exhibit also shows the mapping of these disclosure categories to the underlying questions in the Uniform Registration Form U4.⁵³ Exhibit 2 shows the corresponding mapping between these disclosure categories to the questions in the Uniform Registration Form BD.⁵⁴ Exhibit 3 provides a breakdown of the disclosure categories for all individuals registered with FINRA

in 2016.⁵⁵ The exhibit illustrates the impact of refining subcategories of reported disclosure events and the impact of different numeric thresholds on the number of disclosure events and registered persons associated with these events.⁵⁶ This analysis has led FINRA to initially propose the numeric threshold set forth in the current proposal.

The additional proposed obligations would only apply to individuals with one or more final criminal matters or two or more specified risk events within the prior five years who seek to become owners, control persons, principals or registered persons of a firm. Accordingly, FINRA examined registration information in order to identify all individuals that would have met the proposed criteria during the review period. Those identified serve as a reasonable estimate for the number of individuals who would have been directly impacted by this proposal had it been in place at the time they were seeking to become an owner, control person, principal or registered person of a firm. This analysis indicates that there were approximately 100 – 160 such individuals, per year, as shown in Exhibit 4. These individuals represent 0.09 percent – 0.14 percent of individuals who became owners, control persons, principals, or registered persons with a new member in any year during the review period.⁵⁷

FINRA also analyzed firms that employed individuals who would be directly impacted by this proposal. The analysis shows that in each year over the review period, there were between 115 and 170 firms employing individuals meeting the proposed conditions. Approximately 50 percent of these firms were small, 13 percent were mid-sized and the remaining 37 percent were large firms.⁵⁸ FINRA estimates that approximately 38 percent of the individuals meeting the proposed criteria were employed by small firms, 17 percent by mid-sized firms and 45 percent by large firms.

4. Alternatives Considered

FINRA recognizes that the design and implementation of the rule proposals may impose direct and indirect costs on a variety of stakeholders, including member firms, associated persons, regulators, investors and the public. Accordingly, in developing its rule proposals, FINRA seeks to identify ways to enhance the efficiency and effectiveness of the proposals while maintaining their regulatory objectives. FINRA seeks comment on potential alternatives to the proposed amendments in this *Notice* and why these alternatives may be more efficient or effective at addressing broker misconduct than the proposed amendments.

FINRA considered several alternatives to the numerical and categorical thresholds for identifying individuals that would be subject to the proposed MAP rules amendments. In determining the proposed threshold, FINRA focused significant attention on the economic trade-off between incorrect identification of individuals that may *not* subsequently pose risk of harm their customers, and *not* including individuals that may subsequently pose

risk of harm to customers but do not meet the proposed numeric threshold. FINRA also considered three key factors: (1) the different types of reported disclosure events, (2) the counting criteria or number of reported events, and (3) the time period over which the events are counted. FINRA considered several alternatives for each of these three factors.

A. Alternatives Associated With the Types of Disclosure Events

In determining the different types of disclosure events, FINRA considered all categories of disclosures events reported on the Uniform Registration Forms, including the financial disclosures and the termination disclosures. FINRA decided to exclude financial disclosures because they include personal bankruptcies, civil bonds, or judgments and liens. While these events may be of interest to investors in evaluating whether or not to engage a broker, these types of events by *themselves* are not evidence of customer harm. FINRA also considered whether termination disclosures should be included as specified risk events. Termination disclosures include job separations after allegations against the brokers.⁵⁹ FINRA notes that certain termination disclosures reflect conflicts of interest between the firm and the broker and, as a result, may not necessarily be indicative of misconduct. Further, the underlying allegations in the termination disclosures may result in other disclosure events, such as those associated with customer settlements or awards, regulatory actions or civil actions, which are already included in the proposed criteria. If so, the underlying customer harm conduct would be captured in the proposed criteria. As a result, FINRA did not include termination disclosures as specified risk events. Accordingly, FINRA considered the remaining five categories of disclosure events listed in Exhibit 1.

Within each disclosure category included in the proposed criteria, FINRA considered whether pending matters should be included or if the criteria should be restricted to final matters that have reached a resolution not in favor of the broker. Pending matters include disclosure events that may remain unresolved or subsequently get dismissed because they lack merit or suitable evidence. For example, customers may file complaints that are false or erroneous and such complaints may subsequently be withdrawn by the customers or get dismissed by firms or arbitrators. Accordingly, FINRA excluded pending matters from the proposed criteria because these events may not always be associated with customer harm or misconduct.⁶⁰

Exhibit 1 shows the five categories of disclosure events that were considered and the subcategories that were included in the proposed criteria. For criminal matters, FINRA considered whether criminal charges that do not result in a conviction, or guilty plea or nolo contendere (no contest), should be included in the proposed criteria. These events correspond to criminal matters in which the associated charges were subsequently dismissed or withdrawn, and, as a result, are not necessarily evidence of misconduct. Accordingly, FINRA only included criminal convictions, including guilty plea or nolo contendere (no contest), in the proposed criteria.

For customer settlements and awards, FINRA considered whether settlements and awards in which the broker was **not** “named” should be considered as a specified risk event. These “subject of” customer settlements and awards correspond to events where the customer initiates a claim against the firm and does not specifically name the broker, but the firm identifies the broker as required by the Uniform Registration Forms.⁶¹ In these cases, the broker is not party to the proceedings or settlement. There may be conflicts of interest between the firm and the broker such that the claim may be attributed to the broker without the ability of that broker to directly participate in the resolution. Accordingly, FINRA excluded “subject of” customer settlements and awards from the proposed criteria. FINRA recognizes that excluding these events may also undercount instances where the broker may have been responsible for the alleged customer harm.

For civil actions and regulatory actions, FINRA considered whether all sanctions associated with final matters should be included or certain less severe sanctions be excluded from the proposed criteria. Final regulatory action or civil action disclosures may be associated with a wide variety of activities, ranging from material customer harm to more technical rule violations, such as a failure to file in time or other events not directly related to customer harm. However, due to the way in which such information is currently reported, it is not straightforward to distinguish regulatory or civil actions associated with customer harm from other such actions.⁶² In the absence of a reliable way to identify regulatory and civil actions associated with customer harm, FINRA considered using a proxy of severity of the underlying sanctions as a way to exclude events that are likely not associated with material customer harm. Specifically, FINRA only included regulatory actions or civil actions that are associated with more severe sanctions, such as bars and suspensions or monetary sanctions above a *de minimis* dollar threshold of \$15,000. FINRA notes that relying strictly on a proxy for severity would likely exclude certain regulatory actions or civil actions that are associated with customer harm.

FINRA also considered several alternative *de minimis* dollar thresholds used for identifying disclosure events that are included in the proposed criteria. For example, FINRA considered higher dollar thresholds of \$25,000, \$50,000 and \$100,000 for customer settlements, customer awards, and monetary sanctions associated with regulatory actions and civil actions. A dollar threshold may capture a dimension of severity of the alleged customer harm. FINRA has established a *de minimis* dollar reporting threshold of \$10,000 for complaints filed prior to 2009 and \$15,000 afterwards. The reporting threshold may, however, be low and possibly include instances where the payment was made to end the complaint and minimize litigation costs. However, the dollar threshold does not account for the value of the customers’ account and there are likely cases where even low dollar amounts represent remuneration of a significant portion of customer investments. Accordingly, a dollar

threshold may be both under-inclusive and over-inclusive, and as a result FINRA considered a range of alternative thresholds. Increasing the dollar threshold from \$15,000 to \$25,000, \$50,000 and \$100,000 for identifying individuals that would have met the proposed criteria would decrease the number of individuals impacted by this proposal from 100 – 160 individuals each year to approximately 90 – 155 individuals, 80 – 145 individuals and 65 – 135 individuals each year, respectively, over the review period. Finally, FINRA notes that establishing a *de minimis* dollar threshold that is different from that for the current reporting requirements would likely create incentives for individuals and firms to keep future settlements below the dollar level that would trigger the restrictions.

B. Alternatives Associated With the Counting Criteria

FINRA considered a range of alternative criteria used for counting criminal matters or specified risk events for classifying individuals. For example, FINRA considered whether the counting criteria for final criminal matters should be two or more final criminal matters or one final criminal matter and another specified risk event. This alternative would effectively count final criminal matters the same way as other specified risk events. FINRA believes that final criminal matters are generally more directly tied to serious misconduct than some of the other specified risk events. Accordingly, FINRA believes that one final criminal matter, as defined by this proposal, by itself should be sufficient to trigger the proposed criteria.⁶³ FINRA also considered alternative criteria for counting specified risk events. For example, FINRA considered decreasing the proposed threshold for counting specified risk events from two to one such event during the prior five-year period. This alternative would change the proposed criteria to one or more final criminal matters or one (instead of two) or more specified risk events during the prior five-year period. This approach would increase the number of individuals impacted by this proposal from 100 – 160 individuals to 360 – 620 individuals each year, over the review period. FINRA also considered increasing the proposed threshold for counting specified risk events from two to three such events, thereby changing the proposed criteria to one or more final criminal matter or three (instead of two) or more specified risk events during the prior five year period. This approach would decrease the number of individuals impacted by this proposal from approximately 100 – 160 individuals to 55 – 105 individuals each year, over the review period.

C. Alternatives Associated With the Time Period Over Which the Disclosure Events Are Counted

FINRA also considered alternative criteria for the time period over which final criminal matters and specified risk events are counted for classifying individuals. For example, FINRA considered whether final criminal matters or specified risk events should be counted over the individual's entire reporting period or counted over a more recent period. Based on its experience, FINRA believes that events that are more than ten years ago do not necessarily pose the same level of possible future risk to customers as more

recent events. Further, counting final criminal matters or specified risk events over an individual's entire reporting period would imply that individuals with such events would be subject to the criteria for their entire career, even if they subsequently worked without being associated with any future events. Accordingly, FINRA decided only to include final criminal matters or specified risk events in the more recent period. In addition to the proposed criteria based on a five year period, FINRA considered a criteria that would count two (or more) specified risk events in individuals' reported histories over a ten-year and a five-year period; specifically, the first specified risk event having resolved during the previous ten years and the second specified risk event resolved during the previous five years, or one or more final criminal matters having resolved in the prior five-year period. This approach would increase the number of individuals impacted by this proposal from 100 – 160 individuals to 115 – 200 individuals each year, over the review period.

Request for Comment

FINRA requests comment on all aspects of the proposal, including specifically the proposed amendments to the MAP rules. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following issues.

1. How could current FINRA rules be amended to better address the problem(s) of broker misconduct? To what extent have the original purposes of and need for the rules been affected by subsequent changes to the markets, the delivery of financial services, the applicable regulatory framework, or other considerations?
2. What have been your experiences with current FINRA rules, including specifically Rule 3110 (Supervision), including any ambiguities in the rules or challenges to effectively address the problem(s) of broker misconduct?
3. Are there alternative ways to address broker misconduct that should be considered? What are the alternative approaches, other than the proposal, that FINRA should consider?
4. Are there any material economic impacts, including costs and benefits, to investors, issuers and firms that are associated specifically with the proposal? If so:
 - a. What are these economic impacts and what are their primary sources?
 - b. To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?
 - c. What would be the magnitude of these impacts, including costs and benefits?

5. Are there any expected economic impacts associated with the proposal not discussed in this *Notice*? What are they and what are the estimates of those impacts?
6. As discussed above, FINRA considered several numerical and categorical thresholds for identifying individuals that would be subject to the proposed MAP rules amendments. In determining the proposed threshold, FINRA paid significant attention to the economic trade-offs associated with misidentifications, including both over- and under-identification of individuals. FINRA specifically seeks comments on the proposed numerical threshold, including (1) the different types of reported disclosure events, (2) the counting criteria, and (3) the time period of which the events are counted:
 - a. Are there any other types of disclosure events that FINRA should consider including in the proposed criteria? Which other disclosure events should FINRA consider including and how does including them improve the economic trade-offs associated with misidentifications?
 - i. What counting criteria should FINRA consider for counting these additional disclosure events? What time period should FINRA consider for counting these events?
 - b. Are there any reported disclosure events in Exhibit 1 that FINRA should consider excluding from the proposed criteria? Which events should FINRA consider excluding and how does excluding these events impact the economic trade-offs associated with misidentifications?
 - c. Should FINRA consider alternative counting criteria for the specified risk events or the final criminal matter? What are these alternative counting criteria and why are they a better alternative to the proposed counting criteria of one or more final criminal matters or two or more specified risk events?
 - d. Should FINRA consider alternative time periods over which one or more final criminal matters or two or more specified risk events are counted? Should FINRA consider using different time periods for criminal matters and specified risk events? Should FINRA consider different time periods for the four different types of specified risk events? What are these alternative approaches and why could they be better alternatives to the proposed period of prior five years?
7. As discussed above, the proposed MAP rules amendments would apply to individuals that meet the proposed criteria and seek to become an owner, control person, principal or registered person of a member firm. Should FINRA consider expanding the scope of the MAP requirements to:
 - a. all individuals who meet the proposed criteria and are currently owners, control persons, principals, or registered persons with a firm; or
 - b. all individuals who meet the proposed criteria and are currently associated with a firm, irrespective of their registration type or ownership and control status?

What are the incremental economic impacts, including incremental costs and benefits associated with these alternatives and why are they better than the proposed requirements?

8. Should FINRA consider expanding the scope of the proposed MAP rule amendments to individuals meeting the proposed numerical threshold who are already a principal and seek to add an additional principal registration with their existing firm?
9. FINRA is proposing to disclose information through BrokerCheck on the status of a firm as a “taping firm.” Should FINRA also consider disclosing information of a broker’s association with a “taping firm” through BrokerCheck?

In addition to comments responsive to these questions, FINRA invites comment on any other aspects of the rules that commenters wish to address. FINRA further requests any data or evidence in support of comments. While the purpose of this *Notice* is to obtain input as to whether or not the current rules are effective and efficient, FINRA also welcomes specific suggestions as to how the rules should be changed.

Endnotes

1. The Uniform Registration Forms for firms and brokers are the Uniform Application for Broker-Dealer Registration (Form BD), the Uniform Application for Securities Industry Registration or Transfer (Form U4), the Uniform Termination Notice for Securities Industry Registration (Form U5) and the Uniform Disciplinary Action Reporting Form (Form U6). Firms have access to disclosure events reported on the Form U4, U5, and U6 filings for brokers who were previously registered with the same firms or with other firms. Firms, however, do not readily have available to them disclosure events for persons who were not previously registered, including control affiliates, that are reported on another firm's Form BD. FINRA would expect firms to take reasonable steps to obtain information on the disciplinary history of non-registered individuals that may be disclosed on another firm's Form BD through for example, questionnaires, certifications, and reasonable background checks for those individuals seeking to become an owner, control person, principal or registered person of the firm.
2. See *Regulatory Notice 18-15* (Heightened Supervision, Guidance on Implementing Effective Heightened Supervisory Procedures for Associated Persons With a History of Past Misconduct (April 2018)).
3. FINRA also expects to file a proposed rule change to amend Schedule A to the FINRA By-Laws to increase current application fees for individuals, and impose new application fees for member firms, subject to an SD that are seeking approval by FINRA to enter or remain in the securities industry. In connection with our on-going efforts to address high-risk brokers, FINRA also will be publishing revised Sanction Guidelines shortly.
4. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
5. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
6. See [Individuals Barred by FINRA](#). The list is updated monthly.
7. See [General Information on FINRA's Eligibility Requirements](#).
8. See *supra* note 6.
9. See *supra* note 2.
10. This *Notice* will refer to both a Hearing Panel and Extended Hearing Panel collectively as "Hearing Panel" unless otherwise noted. The Hearing Panel is chaired by the assigned Hearing Officer who is an employee of OHO. The Chief Hearing Officer appoints two industry panelists, drawn primarily from a pool of current and former securities industry members of FINRA's District Committees, as well as its Market Regulation Committee, former members of FINRA's NAC and former FINRA Governors. The NAC is the national committee that reviews initial decisions rendered in FINRA disciplinary and membership proceedings.

11. If a respondent fails to answer the complaint, or a party fails to appear at a pre-hearing conference, or a party fails to appear at any hearing that the party is required to attend, the Hearing Officer may issue a default decision in accordance with Rule 9269.
12. See FINRA Rule 9311(b), which further provides that an appeal will not stay a decision, or part of a decision, that imposes a permanent cease and desist order.
13. As such terms are defined in Rule 9120 (Definitions).
14. See, e.g., CBOE Rule 17.11(b) (“Pending effectiveness of a decision imposing a sanction on the Respondent, the Business Conduct Committee may impose such conditions and restrictions on the activities of the Respondent as the Committee considers reasonably necessary for the protection of investors and the Exchange”); BATS Rule 8.11 (“Pending effectiveness of a decision imposing a penalty on the Respondent, the CRO, Hearing Panel or committee of the Board, as applicable, may impose such conditions and restrictions on the activities of the Respondent as he, she or it considers reasonably necessary for the protection of investors, creditors and the Exchange.”); CHX Article 12, Rule 6 (explaining that sanctions are stayed during appeal process “subject, however, to the power of the Hearing Officer to impose such limitations on the respondent as are necessary or desirable, in the judgment of the Hearing Officer for the protection of the respondent’s customers, creditors or the Exchange or for the maintenance of just and equitable principles of trade”); Nasdaq PHLX Rule 960.10(b) (“Pending effectiveness of a decision imposing sanctions on a Respondent, the Hearing Panel may impose such conditions and restrictions on the activities on such Respondent which it finds to be necessary or appropriate for the protection of the investing public, members, member organizations and the Exchange and its subsidiaries.”)
15. Proposed Rule 9556(a)(2) would permit FINRA staff to issue a notice to a respondent stating that the failure to comply with the conditions or restrictions imposed under Rule 9285 within seven days of service of the notice will result in a suspension or cancellation of membership or a suspension or bar from associating with any member. Proposed Rule 9556(c)(2) would govern the content of the notice similar to current Rule 9556(c).
16. See FINRA Rule 3110. The rule requires member firms to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and FINRA rules. An effective supervisory system plays an essential role in the prevention of sales abuses, and thus, enhances investor protection and market integrity. As such, irrespective of whether a matter is on appeal or under review, a firm should routinely evaluate its supervisory procedures to ensure they are appropriately tailored for each associated person and take into consideration, among other things, the person’s activities and history of industry and regulatory-related incidents. FINRA and the SEC have emphasized the need for heightened supervision when a member firm associates with persons who have a history of industry or regulatory-related incidents.
17. See *supra* note 16.
18. SDs are defined in Section 3(a)(39) of the Exchange Act.

19. See 15 U.S.C. § 78o-3(g)(2) (“A registered securities association may, and in cases in which the Commission, by order, directs as necessary or appropriate in the public interest or for the protection of investors shall, deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification.”); see also Exchange Act Rule 19h-1.
20. See *supra* note 7.
21. The Rule 9520 Series stems from Section 3(a)(39) of the Exchange Act, which sets forth the definition of SD. In 2007, FINRA amended the definition of SD in its By-Laws to incorporate by reference Exchange Act Section 3(a)(39). This change incorporated three additional SD categories, including willful violations of the federal securities or commodities laws, grounds for SD that were enacted by the Sarbanes-Oxley Act of 2002, and associations with certain other persons subject to SD. As a result, there was an increase in the number of individuals subject to SD pursuant to FINRA’s By-Laws, and by derivation, an increase in the number of individuals seeking FINRA’s approval to enter or remain in the securities industry despite their status as a disqualified individual.
22. FINRA’s review of many SD applications is governed by the standards set forth in *Paul Edward Van Dusen*, 47 S.E.C. 668 (1981) and *Arthur H. Ross*, 50 S.E.C. 1082 (1992). These standards provide that in situations where an individual’s misconduct has already been addressed by the SEC or FINRA, and certain sanctions have been imposed for such misconduct, FINRA should not consider the individual’s underlying misconduct when it evaluates an SD application. In *Van Dusen*, the SEC stated that when the period of time specified in the sanction has passed, in the absence of “new information reflecting adversely on [the applicant’s] ability to function in his proposed employment in a manner consonant with the public interest,” it is inconsistent with the remedial purposes of the Exchange Act and unfair to deny an application for re-entry. 47 S.E.C. at 671. The SEC also noted in *Van Dusen*, however, that an applicant’s re-entry is not “to be granted automatically” after the expiration of a given time period. *Id.* Instead, the SEC instructed FINRA to consider other factors, such as: (1) “other misconduct in which the applicant may have engaged”; (2) “the nature and disciplinary history of a prospective employer”; and (3) “the supervision to be accorded the applicant.” *Id.* Further, in *Ross*, the SEC established a narrow exception to the rule that FINRA confine its analysis to “new information.” 50 S.E.C. at 1085. The SEC stated that FINRA could consider the conduct underlying a disqualifying order if an applicant’s later misconduct was so similar that it formed a “significant pattern.” *Id.* n.10.
23. The hearing panel considers evidence and other matters in the record and makes a written recommendation on the SD Application to the Statutory Disqualification Committee. See Rule 9524(a)(10). The Statutory Disqualification Committee, in turn, recommends a decision to the NAC, which issues a written decision to the member firm that filed the SD Application. See Rule 9524(b).
24. Approximately 75 percent of the applications filed in 2016 that have reached a resolution were either denied by FINRA, withdrawn because the applicant expected FINRA would recommend denial of its application or closed as the SD application was not required by operation of law. For the other 25 percent, FINRA approval resulted from legal principles, including those embodied in the Exchange Act and in case law, as noted above, which limits FINRA’s discretion to deny an application.

25. *But see Regulatory Notice 18-15* (reminding member firms of their obligation to tailor the firm's supervisory systems to account for brokers with a history of industry or regulatory-related incidents, including disciplinary actions).
26. See [BrokerCheck](#).
27. See Rules 2210(d)(8) and 2267.
28. Rule 3170(a)(5)(A) defines a "taping firm" to mean:
- (i) A member with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years;
 - (ii) A member with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years;
 - (iii) A member with at least twenty registered persons where 20% or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years.
29. Rule 3170(a)(2) defines a "disciplined firm" to mean:
- (A) a member that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the SEC revoking its registration as a broker-dealer;
 - (B) a futures commission merchant or introducing broker that has been formally charged by either the Commodity Futures Trading Commission or a registered futures association with deceptive telemarketing practices or promotional material relating to security futures, those charges have been resolved, and the futures commission merchant or introducing broker has been closed down and permanently barred from the futures industry as a result of those charges; or
 - (C) a futures commission merchant or introducing broker that, in connection with sales practices involving the offer, purchase, or sale of security futures is subject to an order of the SEC revoking its registration as a broker or dealer.
30. Rule 3170 provides member firms that trigger application of the taping requirement a one-time opportunity to adjust their staffing levels to fall below the prescribed threshold levels and thus avoid application of the rule.
31. There are currently 11 firms identified as "disciplined firms," and one firm is identified as a taping firm under Rule 3170.
32. Specifically, such changes are (1) a merger of the member with another member, unless both are members of the New York Stock Exchange (NYSE) or the surviving entity will continue to be a member of the NYSE; (2) a direct or indirect acquisition by the member of another member, unless the acquiring member is a member of the NYSE; (3) direct or indirect acquisitions or transfers of 25 percent or more in the aggregate of the member's assets or any asset, business or line of operation that generates revenues composing 25 percent or more in the aggregate of the member's earnings measured on a rolling

- 36-month basis, unless both the seller and acquirer are members of the NYSE; (4) a change in the equity ownership or partnership capital of the member that results in one person or entity directly or indirectly owning or controlling 25 percent or more of the equity or partnership capital; or (5) a material change in business operations as defined in Rule 1011(k). The term “material change in business operations” includes, but is not limited to: (1) removing or modifying a membership agreement restriction; (2) market making, underwriting or acting as a dealer for the first time; and (3) adding business activities that require a higher minimum net capital under Rule 15c3-1 of the Exchange Act.
33. Proposed Rule 1011(p) would define the “Uniform Registration Forms,” to mean the Uniform Application for Broker-Dealer Registration (Form BD), the Uniform Application for Securities Industry Registration or Transfer (Form U4), the Uniform Termination Notice for Securities Industry Registration (Form U5) and the Uniform Disciplinary Action Reporting Form (Form U6).
34. Form U4 *Explanation of Terms* defines the term “investment-related” as pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, issuer, investment company, investment adviser, futures sponsor, bank, or savings association).
35. The proposed MAP rules amendments would apply to individuals that meet the proposed criteria and seek to obtain their first principal registration at one of their existing firms or at a new firm. It would not apply to individuals who meet the proposed numerical threshold and are already a principal but seek to add an additional principal registration with one of their existing firms.
36. For example, in 2015 the Office of the Chief Economist (OCE) published a study that examined the predictability of disciplinary and other disclosure events associated with investor harm based on past similar events. The OCE study showed that past disclosure events, including regulatory actions, customer complaints, arbitrations and litigations of brokers have significant power to predict investor harm. In a subsequent research paper by academics at the University of Chicago and the University of Minnesota, the authors present evidence that suggests a higher rate of new disciplinary and other disclosure events is highly correlated with past disciplinary and other disclosure events, as far back as nine years prior. See Qureshi & Sokobin, [Do Investors Have Valuable Information About Brokers?](#) (2015); Mark Egan et al., [The Market for Financial Adviser Misconduct](#) (2016).
37. This analysis included all NAC appeals filed during the review period that reached a final decision by the end of 2017. The analysis includes all NAC decisions, including affirmations, modifications or reversals of the findings in the disciplinary matters. The analysis excludes appeals that were withdrawn prior to the resolution of the appeal process.
38. FINRA further estimates that approximately 94 percent of the appeals filed by brokers involved one broker and the remaining 6 percent involved two brokers. All the appeals filed by firms were associated with one firm.
39. The median processing time was approximately 15 months, while the 25th and the 75th percentiles were approximately 11 months and 18 months, respectively.

40. Three of these 119 individuals were associated with multiple SD Applications over the review period. Approximately 90 percent of the firms filed one request during the review period, and the remaining 10 percent filed two or more requests.
41. FINRA defines a small firm as a member with at least one and no more than 150 registered persons, a mid-size firm as a member with at least 151 and no more than 499 registered persons, and a large firm as a member with 500 or more registered persons. See FINRA By-Laws, Article I.
42. In approximately 12 percent of the SD Applications, the application was withdrawn because the decision leading to the disqualifying event was overturned, thus the individual was no longer subject to an SD or the sanctions were no longer in effect. In one of the 122 SD Applications, the resolution of the application was subsequently reversed.
43. The median processing time was approximately 9 months and the 25th and the 75th percentiles were approximately 3 months and 14 months, respectively.
44. To be consistent with the definitions used for classifying brokers for the proposed MAP requirements, FINRA based its analysis on the occurrence of one or more final criminal matters or specified risk events, as defined in the proposed amendments to the NASD Rule 1010 Series discussed above.
45. These estimates are based on appeals filed by brokers, or jointly filed by brokers and firms, and excludes appeals that were filed only by firms. These estimates likely underrepresent the overall risk of customer harm posed by these brokers because they are based on a specific set of events and outcomes used for classifying brokers for the proposed amendments to the MAP rules. In addition, these brokers had other disclosure events after their appeal was filed and some of these other events may also be associated with risk of customer harm.
46. The proposal may also impose costs on issuers in limited instances where a firm is enjoined from participating in a private placement and the issuer is especially reliant on that firm. The private issuer may incur search costs to find a replacement firm or individual and incur other direct and indirect costs associated with the offering.
47. These estimates are based on the definitions for specified risk events and final criminal matters used for the proposed the MAP requirements, and as result, likely underrepresents the overall risk of customer harm posed by these SD individuals.
48. Firms have access to disclosure events reported on the Form U4, U5 and U6 filings for individuals who were previously registered with the same firms or with other firms. Firms do not, however, readily have available to them disclosure events for individuals where such individuals were not previously registered, including control affiliates, or where information regarding such individuals is reported on another firm's Form BD
49. See *supra* note 48.
50. The proposed \$15,000 threshold for customer settlement corresponds to the reporting threshold for the Uniform Registration Forms and for the settlement information to be displayed through BrokerCheck. As a result, brokers and firms already have incentives to settle below the \$15,000 amount. Accordingly, FINRA does not anticipate that the proposed dollar threshold would result in a material change in customer settlements.

51. For example, FINRA uses disclosure events reported on Form BD across all firms to identify disclosure records of non-registered control affiliates.
52. For example, as discussed above, firms do not have access to disclosure events for non-registered control affiliates at other firms.
53. The Uniform Registration Forms U5 and U6 have questions similar to Form U4 that can also be mapped to the disclosures categories in Exhibit 1.
54. The Uniform Registration Form BD includes information on disclosure events for individual control affiliates, including non-registered control affiliates, that may not have Form U4, U5 or U6 filings. Form BD is the primary source of information on disclosure events for these unregistered control affiliates. Form BD includes information on final criminal matters and certain specified risk events associated with regulatory actions and civil actions, but does not include information on customer awards or settlements.
55. Exhibit 3 does not include information on individuals that were not registered with FINRA in 2016. These non-registered individuals may include non-registered associated persons, including non-registered control affiliates.
56. Exhibit 3 shows the number of criminal disclosures and disclosures considered in developing specified risk events (regulatory action disclosures, civil judicial disclosures, and customer complaint, arbitration and civil litigation disclosures), including pending and final disclosures, over the entire reporting history of brokers who were registered with FINRA in 2016. The exhibit also reports the number of brokers associated with these disclosure events and the impact of refining the disclosure categories and the period over which these events are counted. For example, the exhibit shows that there are a total of approximately 20,900 criminal disclosures and 140,200 disclosures considered in developing specified risk events over the entire reporting history of these brokers. Refining the disclosure categories to include final criminal matters and specified risk events, as defined in this proposal, would result in approximately 155 final criminal matters and 3,425 specified risk events. Exhibit 3 also shows that there were approximately 490 brokers who were registered with FINRA in 2016 and met the proposed numeric threshold of one or more final criminal matters or two or more specified risk events in the prior five years.
57. These percentages are calculated by dividing FINRA's estimate of the number of individuals who met the proposed criteria each year during the review period (approximately 100 – 160 individuals per year), by the number of individuals who became owners, control persons, principals, or registered persons with a new member each year during the review period (approximately 105,500 – 112,800 individuals per year).
58. *See supra* note 41.
59. Termination disclosures involve situations where the individual voluntarily resigned, was discharged, or was permitted to resign after allegations.
60. More than 50 percent of the pending matters during the review period remain unresolved or were subsequently dismissed. For example, Exhibit 3 shows that approximately 69,000 (or 49 percent) of the 140,000 disclosures considered in developing specified risk events resulted in final matters. Accordingly, more than 50 percent of the pending matters remain unresolved or were subsequently dismissed or did not reach a resolution that was unfavorable to the broker.

61. For example, the Instructions to Form U4, Questions 14I(4) or 14I(5) provide that the answer should be “yes” if the broker was not named as a respondent/defendant but (1) the Statement of Claim or Complaint specifically mentions the individual by name and alleges the broker was involved in one or more sales practice violations or (2) the Statement of Claim or Complaint does not mention the broker by name, but the firm has made a good faith determination that the sales practice violation(s) alleged involves one or more particular brokers.
62. For example, the Uniform Registration Forms contain a description on the allegation, which could be useful in identifying regulatory actions or civil actions associated with customer harm, but this information is stored as “free-text” and, therefore, cannot be reliably compared across disclosures.
63. FINRA recognizes that final criminal matters include felony convictions that may not be investment related (*e.g.*, a conviction associated with multiple DUIs).