



# FINRA Firm Grouping Member Forum: **Retail**

December 9, 2021 | Virtual

---

## **Restricted Firm Obligations: What You Need to Know**

**Thursday, December 9**

**1:30 p.m. – 2:15 p.m.**

Join FINRA staff as they discuss Rule 4111 (Restricted Firm Obligations) which takes effect January 2022. During the session, panelists review the new obligation and criteria for identification.

**Moderator:** Lance Burkett  
Senior Director, Risk Monitoring – Denver Office  
FINRA Member Supervision

**Panelists:** Kosha Dalal  
Vice President and Associate General Counsel, Legal Policy  
FINRA Office of General Counsel

Michael Garawski  
Associate General Counsel, Regulatory  
FINRA Office of General Counsel

AnnMarie McGarrigle  
Director, Risk Monitoring – Philadelphia Office  
FINRA Member Supervision

## Restricted Firm Obligations: What You Need to Know Panelist Bios:

### Moderator:



**Lance Burkett** is Senior Director of Risk Monitoring in the FINRA Denver Office. He began his securities industry career in 1993 as a Securities Fraud Investigator for the State of Arizona Securities Division, working exclusively on fraud cases involving broker-dealers. Later, at a FINRA member firm, he was responsible for supervising Producing Branch Managers and Field Representatives as the Field Compliance Director. Throughout his tenure with FINRA, Mr. Burkett has held positions ranging from Compliance Examiner, District Director and now Senior Director - Risk Monitoring, responsible in overseeing the Risk Monitoring team and coordinating with the Examination Program Management on the execution of examinations of Member firms in the retail space. Mr. Burkett earned his Certified Regulatory and Compliance Professional™ designation through the FINRA Institute at Wharton and has developed content and presented at several FINRA Institute class offerings.

### Panelists:



**Kosha Dalal** is Vice President and Associate General Counsel for Legal Policy with FINRA's Office of General Counsel. In this role, she provides legal guidance on various policy initiatives and rule changes/interpretations including, supervision, firms and brokers with a history of misconduct, branch office/OSJ, remote inspections, customer account statements, membership application rules, ACATs, payments to unregistered persons and corporate actions. She has been with FINRA's Office of General Counsel since 2000. Prior to coming to FINRA, she was an associate with the law firm of Venable in Baltimore, MD, Kalkines Zall in New York, NY and Skadden Arps in New York, NY. Ms. Dalal holds a BA in Political Science and Economics from Barnard University and a JD from Brooklyn Law School. Ms. Dalal also serves on FINRA's Diversity Leadership Council, which is tasked with recommending steps and initiatives to help FINRA develop and implement a robust diversity and inclusion strategy.



**Michael Garawski** is Associate General Counsel, Regulatory Practice & Policy, with FINRA's Office of General Counsel. In this role, Mr. Garawski directs and manages the complete life cycle of the adoption of new regulatory requirements, and he advises the FINRA Board of Governors, FINRA advisory committees, and senior FINRA management on regulatory initiatives and rule changes. Previously, he served as Associate General Counsel in FINRA's Appellate Group and as Assistant General Counsel with the Commodity Futures Trading Commission. He is a graduate of Boston College and the George Washington University Law School.



Institute.

**AnnMarie McGarrigle** is Risk Monitoring Director for FINRA's Retail – Independent Contractor firms. In her role, she actively manages the regulatory risk-monitoring program and leads a team of six Risk Monitoring Analysts who oversee and monitor retail – independent contractor member firms for compliance with applicable securities rules and regulations. As the Director, Ms. McGarrigle is also responsible for FINRA's efforts to identify and address current and emerging industry risks through the analysis and assessment of a firms' finances, operations, controls and systems. Ms. McGarrigle has a Bachelor of Science degree in Accountancy from Villanova University and is designated as a Certified Regulatory and Compliance Professional™ (CRCP™) through the FINRA

# Restricted Firm Obligations: What You Need to Know

# Panelists

## ○ Moderator

- Lance Burkett, Senior Director, Risk Monitoring – Denver Office, FINRA Member Supervision

## ○ Panelists

- Kosha Dalal, Vice President and Associate General Counsel, Legal Policy, FINRA Office of General Counsel
- Michael Garawski, Associate General Counsel, Regulatory, FINRA Office of General Counsel
- AnnMarie McGarrigle, Director, Risk Monitoring – Philadelphia Office, FINRA Member Supervision

# Regulatory Notice

21-34

## Protecting Investors from Misconduct

### FINRA Adopts Rules to Address Firms With a Significant History of Misconduct

Effective Date: January 1, 2022

#### Summary

FINRA has adopted new rules to address firms with a significant history of misconduct.<sup>1</sup> New Rule 4111 (Restricted Firm Obligations) requires member firms that are identified as “Restricted Firms” to deposit cash or qualified securities in a segregated, restricted account; adhere to specified conditions or restrictions; or comply with a combination of such obligations. New Rule 9561 (Procedures for Regulating Activities Under Rule 4111) and amendments to Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series) establish a new expedited proceeding to implement Rule 4111.

The new rules and rule amendments become effective on January 1, 2022.

The rule text is available in Attachment A. A flow chart of the Rule 4111 process is available in Attachment B.

Questions concerning this *Notice* should be directed to:

- ▶ Kosha Dalal, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903 or [Kosha.Dalal@finra.org](mailto:Kosha.Dalal@finra.org); or
- ▶ Michael Garawski, Associate General Counsel, OGC, at (202) 728-8835 or [Michael.Garawski@finra.org](mailto:Michael.Garawski@finra.org).

#### Background and Discussion

FINRA uses a combination of tools to reduce the risk of harm to investors from member firms and the brokers they hire that have a history of misconduct. These tools include assessments of applications member firms file to retain or employ an individual subject to a statutory disqualification, reviews of membership and continuing membership applications, disclosure of brokers’ regulatory backgrounds, supervision requirements, focused examinations, risk monitoring and disciplinary actions.

September 28, 2021

#### Notice Type

- ▶ New Rule
- ▶ Rule Amendment

#### Suggested Routing

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

#### Key Topics

- ▶ Firms With a Significant History of Misconduct

#### Referenced Rules & Notices

- ▶ Regulatory Notice 18-15
- ▶ Regulatory Notice 18-16
- ▶ Regulatory Notice 18-17
- ▶ Regulatory Notice 20-15
- ▶ Regulatory Notice 21-09
- ▶ FINRA Rule 3110
- ▶ FINRA Rule 4111
- ▶ FINRA Rule 8312
- ▶ FINRA Rule 8313
- ▶ FINRA Rule 9559
- ▶ FINRA Rule 9561

For several years, FINRA has been enhancing its programs to address the risks that can be posed to investors and the broader market by individual brokers and member firms that have a history of misconduct. As part of this initiative, FINRA has:

- ▶ published *Regulatory Notice 18-15* (Heightened Supervision), which reiterates the existing obligation of member firms to implement for such individuals tailored heightened supervisory procedures under Rule 3110 (Supervision);
- ▶ published *Regulatory Notice 18-17* (FINRA Revises the Sanction Guidelines), which announced revisions to the FINRA Sanction Guidelines;
- ▶ raised fees for statutory disqualification applications;<sup>2</sup>
- ▶ revised the qualification examination waiver guidelines to permit FINRA to more broadly consider past misconduct when considering examination waiver requests;<sup>3</sup> and
- ▶ adopted rules concerning brokers with a significant history of misconduct.<sup>4</sup>

## New Rule 4111

Rule 4111 addresses risks from broker-dealers with a significant history of misconduct, including firms with a high concentration of individuals with a significant history of misconduct. The rule allows FINRA to impose new obligations on broker-dealers with significantly higher levels of risk-related disclosures than other similarly sized peers, based on numeric, threshold-based criteria. The obligations that can be imposed include a requirement to deposit cash or qualified securities in a segregated, restricted account, and other conditions and restrictions that are necessary or appropriate for the protection of investors and in the public interest. FINRA believes that the direct financial impact of a restricted deposit is likely to change such member firms' behavior—and therefore protect investors.

As explained in detail below, Rule 4111 establishes a multi-step, annual process through which FINRA will determine whether a member firm raises investor protection concerns substantial enough to require that it be designated (or re-designated) as a "Restricted Firm" and subject to additional obligations, including a "Restricted Deposit Requirement." The multi-step process includes numerous features designed to narrowly focus the new obligations on the firms most of concern. Each year's process will begin with a calculation of which firms meet numeric thresholds based on firm-level and individual-level disclosure events to identify member firms with a significantly higher level of risk-related disclosures as compared to similarly sized peers. The process also gives each member firm that is preliminarily identified by these numeric criteria several ways to affect outcomes during subsequent steps in the process. These include a one-time opportunity to avoid the imposition of obligations by voluntarily reducing its workforce; an opportunity to explain

to the Department of Member Supervision (Department) why the firm should not be designated as a Restricted Firm or be subject to a Restricted Deposit Requirement or to propose alternatives that would still accomplish FINRA's goal of protecting investors; and the opportunity to request a hearing before a FINRA Hearing Officer in an expedited proceeding to challenge a Department determination.

As the attached flow chart reflects (Attachment B), the Rule 4111 process is akin to a "funnel." The top of the funnel applies to the range of member firms with the most disclosures, with a narrowing in the middle of the potential member firms that may be subject to additional obligations, and the bottom of the funnel reflecting the smaller number of member firms that are determined to present high risks to the investing public.

An added benefit of Rule 4111 will be important ancillary effects in addressing unpaid arbitration awards. The rule is intended to incentivize firms to improve their practices to avoid being deemed a Restricted Firm in the first place. In addition, the new rule will consider, among other factors, "Covered Pending Arbitration Claims"<sup>5</sup> and unpaid arbitration awards<sup>6</sup> in determining the size of a Restricted Firm's Restricted Deposit Requirement.<sup>7</sup> The new rule also includes a number of presumptions that apply in the Department's assessment of an application by a previously designated Restricted Firm to make a withdrawal from its Restricted Deposit that would further incentivize the payment of arbitration awards.<sup>8</sup>

Explanations of the specific provisions in Rule 4111 are provided below.

### **General (Rule 4111(a))**

Rule 4111(a) requires a member designated as a Restricted Firm to establish a "Restricted Deposit Account"<sup>9</sup> and deposit in that account cash or qualified securities with an aggregate value that is not less than the member firm's Restricted Deposit Requirement, except in certain identified situations. Restricted Firms also could be subject to conditions or restrictions on the member firm's operations as determined by the Department to be necessary or appropriate for the protection of investors and in the public interest, in addition or in alternative to a Restricted Deposit Requirement.

### **Annual Calculation by FINRA of the Preliminary Criteria for Identification (Rule 4111(b))**

The annual multi-step Rule 4111 process will begin with a calculation. As explained below, Rule 4111(b) requires the Department to calculate annually a member firm's "Preliminary Identification Metrics"<sup>10</sup> to determine whether the firm meets the "Preliminary Criteria for Identification."<sup>11</sup> A key driver of that is whether a member firm's Preliminary Identification Metrics meet quantitative, risk-based "Preliminary Identification Metrics Thresholds."<sup>12</sup>

Several principles guided FINRA's development of the Preliminary Criteria for Identification and the Preliminary Identification Metrics Thresholds. The criteria and thresholds are intended to be replicable and transparent to FINRA and affected member firms, employ the most complete and accurate data available to FINRA, be objective, account for different firm sizes and business profiles and target the sales-practice concerns that motivated the new rule. These criteria are intended to identify member firms that present a high risk, but avoid imposing obligations on member firms whose risk profile and activities do not warrant such obligations.

To calculate whether a member firm meets the Preliminary Criteria for Identification, the Department will first compute the Preliminary Identification Metrics for each of six categories of events or conditions, collectively defined as the "Disclosure Event and Expelled Firm Association Categories."<sup>13</sup> These six categories are all based on events or conditions disclosed through the Uniform Registration Forms,<sup>14</sup> with the exception of one event category (Member Firm Adjudicated Events), which also includes events that are derived from customer arbitrations filed with FINRA's dispute resolution forum. The six categories are:

1. Registered Person Adjudicated Events;<sup>15</sup>
2. Registered Person Pending Events;<sup>16</sup>
3. Registered Person Termination and Internal Review Events;<sup>17</sup>
4. Member Firm Adjudicated Events;<sup>18</sup>
5. Member Firm Pending Events;<sup>19</sup> and
6. Registered Persons Associated with Previously Expelled Firms (also referred to as the Expelled Firm Association category).<sup>20</sup>

To calculate each of the six categories' Preliminary Identification Metrics, FINRA first will add the number of pertinent disclosure events or, for the Expelled Firm Association category, the number of the Registered Persons Associated with Previously Expelled Firms. For the adjudicated-events categories, the counts will include disclosure events that were resolved during the prior five years from the Evaluation Date.<sup>21</sup> For the pending-events categories and pending internal reviews, the counts will include disclosure events that are pending as of the Evaluation Date.<sup>22</sup> In addition, for the three Registered Person disclosure-event based categories, the counts will include disclosure events across all "Registered Persons In-Scope," which is defined to include persons registered with the member firm for one or more days within the one year prior to the Evaluation Date.<sup>23</sup>



Each of those six sums will then be standardized to determine the member firm's six Preliminary Identification Metrics. For the five "Registered Person and Member Firm Events" categories (Categories 1-5 above),<sup>24</sup> the Preliminary Identification Metrics are in the form of an average number of events per Registered Persons In-Scope, calculated by taking each category's sum and dividing it by the number of Registered Persons In-Scope.<sup>25</sup> The sixth Preliminary Identification Metric—the Expelled Firm Association Metric—is in the form of a percentage concentration at the member firm of Registered Persons Associated with Previously Expelled Firms. This concentration is calculated by taking the number of Registered Persons Associated with Previously Expelled Firms and dividing it by the number of Registered Persons In-Scope.<sup>26</sup>

A firm's six Preliminary Identification Metrics will then be used to determine if the member firm meets the Preliminary Criteria for Identification. This involves analyzing the extent to which the member firm's Preliminary Identification Metrics meet the specified numeric Preliminary Identification Metrics Thresholds in Rule 4111(i)(11) and meet additional conditions intended to prevent a member firm from becoming potentially subject to additional obligations solely as a result of pending matters or a single event or condition.<sup>27</sup> Each specific numeric threshold in the Preliminary Identification Metrics Thresholds grid in Rule 4111(i)(11) is a number which represents outliers with respect to similarly sized peers for the type of events or conditions in the category (i.e., the firm is at the far tail of the respective category's distribution), which is intended to preliminarily identify member firms that present significantly higher risk than a large percentage of the membership. There are numeric thresholds for seven different firm sizes (ranging from firms with 1-4 Registered Persons In-Scope to 500 or more Registered Persons In-Scope) to ensure that each member firm is compared only to its similarly sized peers.

Specifically, a member firm will meet the Preliminary Criteria for Identification if:

- ▶ two or more of the member firm's Preliminary Identification Metrics are equal to or more than the corresponding Preliminary Identification Metrics Thresholds for the member firm's size, and at least one of those Preliminary Identification Metrics is the Registered Person Adjudicated Event Metric, the Member Firm Adjudicated Event Metric, or the Expelled Firm Association Metric;<sup>28</sup> and
- ▶ the member firm has two or more Registered Person or Member Firm Events (*i.e.*, two or more events from Categories 1-5 above) during the Evaluation Period.<sup>29</sup>

The following three examples demonstrate—in practical terms—the point at which a member firm’s Preliminary Identification Metrics for different categories will meet the Preliminary Identification Metrics Thresholds:

	Preliminary Identification Metrics Thresholds	Practical Equivalent
Example 1 (member firm size between 1-4 Registered Persons In-Scope)	The Preliminary Identification Metrics Threshold for the Registered Person Adjudicated Event Metric, for a member firm that has between one and four Registered Persons In-Scope as of the Evaluation Date, is 0.50 (or 0.50 events per Registered Broker In-Scope).	For a member firm with four Registered Persons In-Scope as of the Evaluation Date, the member will meet the Preliminary Identification Metrics Threshold for the Registered Person Adjudicated Event Metric if the sum of its four Registered Persons In-Scope’s Adjudicated Events, which reached a resolution over the five years before the Evaluation Date, was <i>two or more</i> .  (4 Registered Persons In-Scope) * (0.50 Preliminary Identification Metrics Threshold for the Registered Person Adjudicated Event Metric) = (2 Adjudicated Events)
Example 2 (member firm size between 20-50 Registered Persons In-Scope)	The Preliminary Identification Metrics Threshold for the Member Firm Adjudicated Event Metric, for a member firm that has between 20-50 Registered Persons In-Scope as of the Evaluation Date, is 0.20 (or 0.20 events per Registered Broker In-Scope).	For a member firm with 50 Registered Persons In-Scope as of the Evaluation Date, the member firm will meet the Preliminary Identification Metrics Threshold for the Member Firm Adjudicated Event Metric if the sum of the member firm’s Adjudicated Events, which reached a resolution over the five years before the Evaluation Date, was <i>ten or more</i> .  (50 Registered Persons In-Scope) * (0.20 Preliminary Identification Metrics Threshold for the Member Firm Adjudicated Event Metric) = (10 Adjudicated Events)
Example 3 (member firm size between 51-150 Registered Persons In-Scope)	The Preliminary Identification Metrics Threshold for the Expelled Firm Association Metric, for a member firm that has between 51-150 Registered Persons In-Scope as of the Evaluation Date, is 0.03 (or a 3 percent concentration level).	For a member firm with 100 Registered Persons In-Scope as of the Evaluation Date, the member firm will meet the Preliminary Identification Metrics Threshold for the Expelled Firm Association Metric if the sum of its Registered Persons Associated with Previously Expelled Firms was <i>three or more</i> .  (100 Registered Persons In-Scope) * (0.03 Preliminary Identification Metrics Threshold for the Expelled Firm Association Metric) = (Three Registered Persons Associated with Previously Expelled Firms)

The annual “Evaluation Date” will establish the date as of which all specified events that are reportable on the Uniform Registration Forms, or otherwise included in Rule 4111, would be included in the annual calculation of the Preliminary Criteria for Identification, not the date as of when the events that are reported would be counted. For example, if a relevant final regulatory action against a registered person occurs just prior to the Evaluation Date but is reported on Form U4 after the Evaluation Date, the annual Preliminary Criteria for Identification calculation would include that disclosure event. Furthermore, the Evaluation Date is not the date when FINRA would actually perform the annual calculation of the Preliminary Criteria for Identification. Rather, FINRA plans to actually perform the annual calculation at least 30 days after the Evaluation Date, to account for the time between when relevant disclosure events occurred and when firms must report those events on the Uniform Registration Forms.

In a separate *Regulatory Notice*, FINRA will announce the first Evaluation Date no less than 120 calendar days before the first Evaluation Date. FINRA expects that the first Evaluation Date will be mid-year 2022. FINRA further expects that subsequent Evaluation Dates will be on the same month and day each year, whether that date certain falls on a business day, weekend or a holiday. However, FINRA will evaluate whether future adjustments of the annual Evaluation Date are warranted and would announce any changes in such date sufficiently in advance.

Before the first Evaluation Date and FINRA’s first performing of the annual calculation, FINRA will need to develop new systems and processes to implement Rule 4111. These systems and processes will include, for example, internal systems for FINRA’s annual calculations of the Preliminary Criteria for Identification (and the underlying Preliminary Identification Metrics) and systems that facilitate FINRA’s Rule 4111 operations. While the development of such technology will require time and resources, FINRA expects that these new systems and processes will add significant value long term by allowing the large volumes of data required to run the annual calculations to be evaluated and analyzed efficiently.

In addition, FINRA will provide several external resources to assist firms. FINRA will maintain on its website a chart that maps the Registered Person and Member Firm Events categories (Categories 1-5 above) to the relevant disclosure questions and fields on the Uniform Registration Forms. FINRA also plans to publish on its website, and keep updated, a list of firms that have been expelled.

Based on feedback from member firms, FINRA also expects to provide a non-determinative calculation (an “early indicator calculation”) of the Preliminary Criteria for Identification that will give firms an indication of where they stand as of a specific date in advance of the Evaluation Date. This early indicator calculation would be for informational purposes only to provide firms a signal, and a firm’s status as of the Evaluation Date could change significantly based on subsequent activities at the firm. The early indicator calculations

will indicate only whether a firm would meet the Preliminary Criteria for Identification and what a firm's six Preliminary Identification Metrics would be were the annual Rule 4111 calculation to be run as of the specific date used in the early indicator calculation. The results of the early indicator calculations could be used by member firms to monitor their status in relation to the Preliminary Criteria for Identification, including how close a firm's Preliminary Identification Metrics are in relation to the relevant Preliminary Identification Metrics Thresholds, at that specific point in time. As the necessary technology systems are built and tested, FINRA will announce in advance the date it will make available to firms the early indicator calculation and the process and manner by which firms can gain access to their own early indicator calculation.

#### **Initial Department Evaluation (Rule 4111(c)(1))**

Following the annual calculation, for each member firm that meets the Preliminary Criteria for Identification as of the Evaluation Date, the Department will conduct, pursuant to Rule 4111(c)(1), an initial internal evaluation to determine whether the member firm does not warrant further review under Rule 4111. In doing so, the Department will review whether the computation of the member firm's Preliminary Identification Metrics included disclosure events or other conditions that are not consistent with the purpose of the Preliminary Criteria for Identification and are not reflective of a firm posing a high degree of risk. For example, the Department may have information that the computation included disclosure events that were not sales-practice related, were duplicative (involving the same customer and the same matter), or mostly involved compliance concerns best addressed by a different regulatory response by FINRA (*e.g.*, enforcement actions, more frequent examination cycles, temporary cease and desist orders). The Department will evaluate the events to determine, among other things, whether they indicated risks to investors or market integrity, rather than, for instance, repeated violations of procedural rules.

The Department will also consider whether the member firm has addressed the concerns signaled by the disclosure events or conditions, or altered its business operations such that the threshold calculation no longer reflects the member firm's current risk profile. Essentially, the purpose of the Department's initial evaluation is to determine whether it is aware of information that would show that the member firm—despite having met the Preliminary Criteria for Identification—does not pose a high degree of risk.

Pursuant to Rule 4111(c)(3), if the Department determines, after this initial evaluation, that the member firm does not warrant further review, the Department will conclude that year's Rule 4111 process for the member firm and would not seek that year to impose any obligations on it. If, however, the Department determines that the member firm does warrant further review, the Rule 4111 process would continue.

**One-Time Opportunity to Reduce Staffing Levels (Rule 4111(c)(2))**

If the Department determines, after its initial evaluation, that a member firm warrants further review under Rule 4111, such member firm—if it has met the Preliminary Criteria for Identification for the first time—will have a one-time opportunity to reduce its staffing levels to no longer meet these criteria, within 30 business days after being informed by the Department that it met the Preliminary Criteria for Identification. The member firm will be required to demonstrate the staff reduction to the Department by identifying the terminated individuals. Rule 4111(c)(2) will prohibit the member firm from rehiring any persons terminated pursuant to this option, in any capacity, for one year.

If the member reduces its staffing levels, and the Department determines that the member firm no longer meets the Preliminary Criteria for Identification, the Department will close out that year's Rule 4111 process for the member firm. If, on the other hand, the Department determines that the member firm still meets the Preliminary Criteria for Identification even after its staff reductions, the Department will proceed to determine the firm's maximum Restricted Deposit Requirement, and the member firm will proceed to a "Consultation" with the Department.

**FINRA's Determination of a Maximum Restricted Deposit Requirement (Rule 4111(i)(15))**

The Department would tailor the member firm's maximum Restricted Deposit Requirement amount to its size, operations and financial conditions. As provided in Rule 4111(i)(15), the Department will consider the nature of the member firm's operations and activities, revenues, commissions, assets, liabilities, expenses, net capital, the number of offices and registered persons, the nature of the disclosure events counted in the numeric thresholds, insurance coverage for customer arbitration awards or settlements, concerns raised during FINRA exams and the amount of any of the firm's or its Associated Persons' "Covered Pending Arbitration Claims" or unpaid arbitration awards.<sup>30</sup> Based on a consideration of these factors, the Department will determine a maximum Restricted Deposit Requirement for the member firm that is consistent with the objectives of the rule, but that does not significantly undermine the continued financial stability and operational capability of the member firm as an ongoing enterprise over the next 12 months. FINRA's intent is that the maximum Restricted Deposit Requirement should be significant enough to change the member firm's behavior but not force the member firm out of business solely by virtue of the imposed deposit requirement.<sup>31</sup>

**Consultation (Rule 4111(d))**

During the Consultation, the member firm will have an opportunity to demonstrate why it does not meet the Preliminary Criteria for Identification, why it should not be designated as a Restricted Firm and why it should not be subject to the maximum Restricted Deposit Requirement. There will be two rebuttable presumptions in a Consultation: That the member firm should be designated as a Restricted Firm; and that it should be subject to the maximum Restricted Deposit Requirement. The member firm will bear the burden of overcoming those presumptions.

Rule 4111(d)(1) governs how a member firm may overcome these two presumptions. First, a member firm may overcome the presumption that it should be designated as a Restricted Firm by clearly demonstrating that the Department's calculation that the member meets the Preliminary Criteria for Identification is inaccurate because, among other things, it included events, in the six categories described above, that should not have been included because, for example, they are duplicative, involving the same customer and the same matter, or are not sales-practice related. Second, a member firm may overcome the presumption that it should be subject to the maximum Restricted Deposit Requirement by clearly demonstrating that the member firm would face significant undue financial hardship if it were subject to the maximum Restricted Deposit Requirement and that a lesser deposit requirement would satisfy the objectives of Rule 4111 and be consistent with the protection of investors and the public interest; or that other conditions and restrictions on the operations and activities of the member firm and its associated persons would address the concerns indicated by the thresholds and protect investors and the public interest.

Rule 4111(d)(2) governs how the Department will schedule and provide notice of the Consultation, and also governs requests for postponements of the Consultation.

Rule 4111(d)(3) provides guidance on what the Department will consider during the Consultation when evaluating whether a member firm should be designated as a Restricted Firm and subject to a Restricted Deposit Requirement. This provision also provides member firms with guidance on how to attempt to overcome the two rebuttable presumptions. Specifically, Rule 4111(d)(3) requires that the Department consider:

- ▶ information provided by the member firm during any meetings as part of the Consultation;
- ▶ relevant information or documents, if any, submitted by the member firm, in the manner and form prescribed by the Department, as shall be necessary or appropriate for the Department to review the computation of the Preliminary Criteria for Identification;
- ▶ any plan submitted by the member firm, in the manner and form prescribed by the Department, proposing in detail the specific conditions or restrictions that the member firm seeks to have the Department consider;

- ▶ such other information or documents as the Department may reasonably request from the member firm related to the evaluation; and
- ▶ any other information the Department deems necessary or appropriate to evaluate the matter.

To the extent a member firm seeks to claim undue financial hardship, it is the member firm's burden to support that with documents and information.

#### **Department Decision and Notice (Rule 4111(e)); No Stays**

Rule 4111(e) requires that, after the Consultation, the Department render a Department decision. Under Rule 4111(e)(1), there are three paths that decision might take:

- ▶ If the Department determines that the member firm has rebutted the presumption that it should be designated as a Restricted Firm, the Department's decision will state that the member firm will not be designated that year as a Restricted Firm.
- ▶ If the Department determines that the member firm has not rebutted the presumption that it should be designated as a Restricted Firm or the presumption that it must be subject to the maximum Restricted Deposit Requirement, the Department's decision will:
  - ▶ designate the member firm as a Restricted Firm; and
  - ▶ require the member firm to promptly establish a Restricted Deposit Account and deposit in that account the maximum Restricted Deposit Requirement; and
  - ▶ require the member firm to implement and maintain specified conditions or restrictions, as necessary or appropriate, on the operations and activities of the member firm and its associated persons that relate to, and are designed to address the concerns indicated by, the Preliminary Criteria for Identification and protect investors and the public interest.
- ▶ If the Department determines that the member firm has not rebutted the presumption that it should be designated as a Restricted Firm but has rebutted the presumption that it shall be subject to the maximum Restricted Deposit Requirement, the Department's decision will:
  - ▶ designate the member firm as a Restricted Firm;
  - ▶ impose no Restricted Deposit Requirement on the member firm, or will require the member firm to promptly establish a Restricted Deposit Account, deposit in that account a Restricted Deposit Requirement in such dollar amount less than the maximum Restricted Deposit Requirement as the Department deems necessary or appropriate; and

- require the member firm to implement and maintain specified conditions or restrictions, as necessary or appropriate, on the operations and activities of the member firm and its associated persons that relate to, and are designed to address the concerns indicated by, the Preliminary Criteria for Identification and protect investors and the public interest.<sup>32</sup>

Rule 4111(e)(2) provides that the Department will issue a written notice of its decision to the member firm, pursuant to new Rule 9561 and no later than 30 days from the latest letter provided to the member firm under Rule 4111(d)(2), that states the obligations to be imposed on the member firm, if any, and the ability of the member firm to request a hearing with the Office of Hearing Officers in an expedited proceeding.<sup>33</sup>

Rule 4111(e)(2) provides that a request for a hearing will not stay the effectiveness of the Department's decision. However, upon requesting a hearing of a Department decision that imposes a Restricted Deposit Requirement, the member firm will only be required to deposit in a Restricted Deposit Account the lesser of 25 percent of its Restricted Deposit Requirement or 25 percent of its average excess net capital during the prior calendar year, until the Office of Hearing Officers or the National Adjudicatory Council (NAC) issues its final written decision in the expedited proceeding. This has one exception: A member firm that is re-designated as a Restricted Firm and is already subject to a previously imposed Restricted Deposit Requirement will be required to keep in the Restricted Deposit Account the assets then on deposit therein until the Office of Hearing Officers or the NAC issues a written decision in the expedited proceeding.

#### **Continuation or Termination of Restricted Firm Obligations (Rule 4111(f))**

Rule 4111(f) contains provisions that set forth how any obligations that were imposed during the Rule 4111 process in one year are continued or terminated in that same year and in subsequent years.

Rule 4111(f)(1), titled "Currently Designated Restricted Firms," establishes constraints on a member firm's ability to seek to modify or terminate, directly or indirectly, any obligations imposed pursuant to Rule 4111. Because Rule 4111 will entail annual reviews by the Department to determine whether a member firm is a Restricted Firm that should be subject to obligations, a Restricted Firm will be able to seek each year to terminate or modify any obligations that continue to be imposed. For this reason, Rule 4111 does not authorize a Restricted Firm to seek, outside of the Consultation process and any ensuing expedited proceedings after a Department decision, a separate interim termination or modification of any obligations imposed. Rather, Rule 4111(f)(1) provides that a currently designated Restricted Firm will not be permitted to withdraw all or any portion of its Restricted Deposit Requirement, or seek to terminate or modify any deposit requirement, conditions or restrictions that have been imposed on it, without the prior written consent of the Department. Rule 4111(f)(1) also provides that there shall be a presumption that the Department shall deny an application by a currently designated Restricted Firm to withdraw all or any portion of its Restricted Deposit Requirement.



Rule 4111(f)(2), titled “Re-Designation as a Restricted Firm,” addresses the scenario when the Department determines in one year that a member firm is a Restricted Firm, and in the following year determines that the member firm still meets the Preliminary Criteria for Identification. In that instance, the Department will provide a written letter to the member firm stating that it shall be re-designated as a Restricted Firm, and that the obligations previously imposed on the member firm shall remain effective and unchanged, unless either the member firm or the Department requests a Consultation in writing within seven days of the Department’s letter. If a Consultation is requested, the obligations previously imposed will continue unchanged unless and until the Department modifies or terminates them after the Consultation. In addition, in the Consultation process, a presumption will apply that any previously imposed Restricted Deposit Requirement, conditions or restrictions will remain effective and unchanged absent a showing by the party seeking changes that they are no longer necessary or appropriate for the protection of investors or in the public interest. If a Consultation is not requested, the firm shall be subject to Rule 4111(f)(1) (the provision that governs “currently designated Restricted Firms”).

Rule 4111(f)(2) further provides that when FINRA re-designates a member as a Restricted Firm and the member is subject to a Restricted Deposit Requirement, the member shall promptly after such re-designation (or, in the case where a hearing is requested pursuant to Rule 9561, promptly after the Office of Hearing Officers or the NAC issues a written decision under Rule 9559) deposit additional cash or qualified securities in the member’s Restricted Deposit Account to the extent necessary to cause the aggregate value of the cash and qualified securities in the member’s Restricted Deposit Account to be not less than its re-designated Restricted Deposit Requirement.

Rule 4111(f)(3), titled “Previously Designated Restricted Firms,” addresses the scenario where the Department determines in one year that a member firm is a Restricted Firm, but in the following year(s) determines that the member firm or former member firm<sup>34</sup> either does not meet the Preliminary Criteria for Identification or should not be designated as a Restricted Firm. In that case, the member firm or former member firm will no longer be subject to any obligations previously imposed under Rule 4111.

There is one exception: A former Restricted Firm will not be permitted to withdraw any portion of its Restricted Deposit Requirement without submitting an application and obtaining the Department’s prior written consent for the withdrawal. Such an application will be required to include, among other things set forth in Rule 4111(f)(3)(A), evidence as to whether the firm, its Associated Persons, or the former member firm have Covered Pending Arbitration Claims or any unpaid arbitration awards outstanding. The Department will determine whether to authorize a withdrawal, in part or in whole, and several presumptions will apply. Rule 4111(f)(3)(B)(i) establishes a presumption that the Department shall approve an application for withdrawal if the member firm, its Associated Persons, or the former member firm have no Covered Pending Arbitration Claims or unpaid arbitration awards. Rule 4111(f)(3)(B)(ii) establishes presumptions that the Department

shall: (a) Deny an application for withdrawal if the member firm, the member firm's Associated Persons who are owners or control persons, or the former member have any Covered Pending Arbitration Claims or unpaid arbitration awards, or if the member's Associated Persons have any Covered Pending Arbitration Claims or unpaid arbitration awards relating to arbitrations that involved conduct or alleged conduct that occurred while associated with the member; but (b) approve an application by a former member for withdrawal if the former member commits in the manner specified by the Department to use the amount it seeks to withdraw from its Restricted Deposit to pay the former member's specified unpaid arbitration awards. The Department will be required to issue, pursuant to Rule 9561, a notice of its decision on an application to withdraw from the Restricted Deposit Account within 30 days from the date the application is received by the Department.<sup>35</sup>

#### **Restricted Deposit Account (Rule 4111(i)(14))**

If a Department decision requires a member firm to establish a Restricted Deposit Account, Rule 4111(i)(14) will govern this account. The underlying policy for the account requirements is that, to make a deposit requirement effective in creating appropriate incentives to member firms that pose higher risks to change their behavior, the member firm must be restricted from withdrawing any of the required deposit amount, even if it terminates its FINRA membership.

Rule 4111(i)(14) requires that the Restricted Deposit Account be established in the name of the member firm, at a bank or the member firm's clearing firm. The account must be subject to an agreement in which the bank or the clearing firm agrees:

- ▶ not to permit withdrawals from the account absent FINRA's prior written consent;
- ▶ to keep the account separate from any other accounts maintained by the member firm with the bank or clearing firm;
- ▶ that the cash or qualified securities on deposit will not be used directly or indirectly as security for a loan to the member firm by the bank or the clearing firm, and will not be subject to any set-off, right, charge, security interest, lien, or claim of any kind in favor of the bank, clearing firm or any person claiming through the bank or clearing firm;
- ▶ that if the member firm becomes a former member, the assets deposited in the Restricted Deposit Account to satisfy the Restricted Deposit Requirement shall be kept in the Restricted Deposit Account, and withdrawals will not be permitted without FINRA's prior written consent;
- ▶ that FINRA is a third-party beneficiary to the agreement; and
- ▶ that the agreement may not be amended without FINRA's prior written consent.

In addition, the Restricted Deposit Account may not be subject to any right, charge, security interest, lien, or claim of any kind granted by the member.<sup>36</sup>

**Books and Records (Rule 4111(g))**

Rule 4111(g) establishes requirements to maintain books and records that evidence the member firm's compliance with Rule 4111 and any Restricted Deposit Requirement or other conditions or restrictions imposed under that rule. In addition, the books and records provision specifically requires a member firm subject to a Restricted Deposit Requirement to provide to the Department, upon its request, records that demonstrate the member firm's compliance with that requirement.

**Notice of Failure to Comply (Rule 4111(h))**

Under Rule 4111(h), FINRA will be authorized to issue a notice pursuant to Rule 9561(b) directing a member firm that is not in compliance with its Restricted Deposit Requirement, or with any conditions or restrictions imposed under Rule 4111, to suspend all or a portion of its business.

**Net Capital Treatment of the Deposits in the Restricted Deposit Account (Rule 4111.01)**

Supplementary Material .01 provides that, because of the restrictions on withdrawals from a Restricted Deposit Account, deposits in such an account cannot be readily converted to cash and therefore shall be deducted in determining the member's net capital under Exchange Act Rule 15c3-1<sup>37</sup> and FINRA Rule 4110.

**Compliance With Continuing Membership Application Rule (Rule 4111.02—Compliance with Rule 1017)**

Supplementary Material .02 provides that nothing in Rule 4111 shall be construed as altering a member firm's obligations under Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations). A member firm subject to Rule 4111 will need to continue complying with the requirements of Rule 1017 and submit continuing membership applications as necessary.

**Examples of Conditions and Restrictions (Rule 4111.03)**

Supplementary Material .03 provides a non-exhaustive list of examples of conditions and restrictions that the Department could impose on Restricted Firms. This non-exhaustive list is intended to provide clarity about the Department's authority to impose conditions and restrictions without restricting the Department's flexibility to react and respond to different sources of risk.

## New Rule 9561 and Amendments to Rule 9559

Rule 9561 establishes a new expedited proceeding that will: (1) allow member firms to request a prompt review of the Department's determinations under Rule 4111 and challenge any of the "Rule 4111 Requirements"<sup>38</sup> imposed, including any Restricted Deposit Requirements; and (2) address a member firm's failure to comply with any requirements imposed under Rule 4111.

### Notices Under Rule 4111 (Rule 9561(a))

Rule 9561(a) establishes an expedited proceeding for the Department's determinations under Rule 4111 to designate a member firm as a Restricted Firm and impose obligations on the member; and to deny a member's request to access all or part of its Restricted Deposit Requirement. Rule 9561(a) requires the Department to serve a notice that provides its determination and the specific grounds and factual basis for the Department's action; states when the action will take effect; informs the member firm that it may file, pursuant to Rule 9559, a request for a hearing in an expedited proceeding within seven days after service of the notice; and explains the Hearing Officer's authority.<sup>39</sup> The rule also provides that, if a member firm does not request a hearing, the notice of the Department's determination will constitute final FINRA action.<sup>40</sup>

In general, a request for a hearing will not stay any of the Rule 4111 Requirements imposed in the Department's decision, which would be immediately effective.<sup>41</sup> There would be one exception: When a member firm requests review of a Department determination under Rule 4111 that imposes a Restricted Deposit Requirement on the member for the first time, the member firm will be required to deposit, while the expedited proceeding is pending, the lesser of 25 percent of its Restricted Deposit Requirement or 25 percent of its average excess net capital over the prior year.<sup>42</sup> As explained above, however, this exception would not be available for a member firm that has been re-designated as a Restricted Firm, and is already subject to a previously imposed Restricted Deposit Requirement; in that instance, the firm would need to keep the assets on deposit in the Restricted Deposit Account until the Office of Hearing Officers or NAC issues a written decision.<sup>43</sup>

### Notice for Failure to Comply with the Rule 4111 Requirements (Rule 9561(b))

Rule 9561(b) authorizes the Department, after receiving authorization from FINRA's chief executive officer (CEO), or such other executive officer as the CEO may designate, to serve a notice stating that the member firm's failure to comply with the Rule 4111 Requirements, within seven days of service of the notice, will result in a suspension or cancellation of membership.<sup>44</sup> The rule requires that the notice identify the requirements with which the member firm is alleged to have not complied; include a statement of facts specifying the alleged failure; state when the action will take effect; explain what the member firm must do to avoid the suspension or cancellation; inform the member firm that it may file,

pursuant to Rule 9559, a request for a hearing in an expedited proceeding within seven days after service of the notice; and explain the Hearing Officer's authority.<sup>45</sup> The rule provides that the suspension or cancellation referenced in a notice shall become effective seven days after service of the notice unless stayed by a request for a hearing.<sup>46</sup> The rule also provides that a member firm may file a request seeking termination of a suspension imposed pursuant to the rule, on the ground of full compliance with the notice or decision, and authorizes the head of the Department to grant relief for good cause shown.<sup>47</sup>

### Hearings (Amendments to Rule 9559)

If a member firm requests a hearing under Rule 9561, the hearing will be subject to Rule 9559. Several amendments to Rule 9559 have been approved that are specific to hearings requested pursuant to Rule 9561. These include, among others, amendments to Rule 9559(d) and (n) to establish the authority of the Hearing Officer; amendments to Rule 9559(f) to set out timing requirements for hearings conducted under Rule 9561(a) and (b); and amendments to Rule 9559(p)(6) to account for the obligations that may be imposed under Rule 4111 within the content requirements of any decision issued by a Hearing Officer under the Rule 9550 Series.<sup>48</sup>

## Endnotes

1. See Securities Exchange Act Release No. 92525 (July 30, 2021), 86 FR 42925 (August 5, 2021) (Order Approving File No. SR-FINRA-2020-041, as Modified by Amendment Nos. 1 and 2) (Approval Order).
2. See Securities Exchange Act Release No. 83181 (May 7, 2018), 83 FR 22107 (May 11, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2018-018).
3. See *Regulatory Notice 18-16* (April 2018).
4. See *Regulatory Notice 21-09* (March 2021).
5. The term “Covered Pending Arbitration Claim” is defined in Rule 4111(i)(2) to mean, for purposes of Rule 4111, an investment-related, consumer initiated claim filed against the member or its associated persons in any arbitration forum that is unresolved; and whose claim amount (individually or, if there is more than one claim, in the aggregate) exceeds the member’s excess net capital. The claim amount includes claimed compensatory loss amounts only, not requests for pain and suffering, punitive damages or attorney’s fees, and shall be the maximum amount for which the member or associated person, as applicable, is potentially liable regardless of whether the claim was brought against additional persons or the associated person reasonably expects to be indemnified, share liability or otherwise lawfully avoid being held responsible for all or part of such maximum amount. This term conforms, in relevant part, to the definition of Covered Pending Arbitration Claim in Rule 1011(c).
6. For purposes of this *Regulatory Notice*, “unpaid arbitration awards” also includes unpaid settlements related to arbitrations.
7. “Restricted Deposit Requirement” is defined in Rule 4111(i)(15) and is further described below.
8. FINRA also has recently amended its Membership Application Program rules to create further incentives for the timely payment of arbitration awards by preventing an individual from switching firms, or a firm from using asset transfers or similar transactions, to avoid payment of arbitration awards. See *Regulatory Notice 20-15* (May 2020).
9. “Restricted Deposit Account” is defined in Rule 4111(i)(14) and is further described below.
10. See Rule 4111(i)(10) (definition of “Preliminary Identification Metrics”).
11. See Rule 4111(i)(9) (definition of “Preliminary Criteria for Identification”).
12. See Rule 4111(i)(11) (definition of “Preliminary Identification Metrics Thresholds”).
13. See Rule 4111(i)(4) (defining “Disclosure Event and Expelled Firm Association Categories”).
14. See Rule 4111(i)(17) (defining “Uniform Registration Forms”).
15. “Registered Person Adjudicated Events,” defined in Rule 4111(i)(4)(A), means any one of the following events that are reportable on the registered person’s Uniform Registration Forms: (i) A final investment-related, consumer-initiated customer arbitration award or civil judgment against the registered person in which the registered person was a named party, or was a “subject of” the customer arbitration award or civil judgment; (ii) a final investment-related, consumer-initiated customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation for a dollar amount at or above \$15,000 in which the registered person was a named party or was a “subject of” the customer arbitration settlement, civil

litigation settlement or a settlement prior to a customer arbitration or civil litigation; (iii) a final investment-related civil judicial matter that resulted in a finding, sanction or order; (iv) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or Commodity Futures Trading Commission (CFTC), other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (v) a criminal matter in which the registered person was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign or military court to any felony or any reportable misdemeanor.

16. "Registered Person Pending Events," defined in Rule 4111(i)(4)(B), means any one of the following events associated with the registered person that are reportable on the registered person's Uniform Registration Forms: (i) A pending investment-related civil judicial matter; (ii) a pending investigation by a regulatory authority; (iii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (iv) a pending criminal charge associated with any felony or any reportable misdemeanor. Registered Person Pending Events does not include pending arbitrations, pending civil litigations or consumer-initiated complaints that are reportable on the registered person's Uniform Registration Forms.
17. "Registered Person Termination and Internal Review Events," defined in Rule 4111(i)(4)(C), means any one of the following events associated with the registered person at a previous member firm that are reportable on the registered person's Uniform Registration Forms: (i) A termination in which the registered person voluntarily resigned,

was discharged or was permitted to resign from a previous member after allegations; or (ii) a pending or closed internal review by a previous member. Under this definition, the included termination and internal review disclosures concerning a person whom a member firm terminated will not impact that member firm's own Registered Person Termination and Internal Review Event Metric; rather, they will impact only the metrics of member firms that subsequently register the terminated individual.

18. "Member Firm Adjudicated Events," defined in Rule 4111(i)(4)(D), means any one of the following events that are reportable on the member firm's Uniform Registration Forms or based on customer arbitrations filed with FINRA's dispute resolution forum: (i) A final investment-related, consumer-initiated customer arbitration award in which the member was a named party; (ii) a final investment-related civil judicial matter that resulted in a finding, sanction or order; (iii) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (iv) a criminal matter in which the member was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign or military court to any felony or any reportable misdemeanor. As FINRA previously explained, Rule 4111(i)(4)(D)(i) is intended to capture all BrokerCheck disclosures of arbitration awards against firms. See FINRA Response to Comments, at p. 8, SR-FINRA-2020-041 (March 4, 2021), available at <https://www.finra.org/sites/default/files/2021-03/sr-finra-2020-041-response-to-comments.pdf>.

19. “Member Firm Pending Events,” defined in Rule 4111(i)(4)(E), means any one of the following events that are reportable on the member firm’s Uniform Registration Forms: (i) a pending investment-related civil judicial matter; (ii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority or a self-regulatory organization; or (iii) a pending criminal charge associated with any felony or any reportable misdemeanor.
20. “Registered Persons Associated with Previously Expelled Firms,” defined in Rule 4111(i)(4)(F), means any “Registered Person In-Scope” who was registered for at least one year with a previously expelled firm and whose registration with the previously expelled firm terminated during the “Evaluation Period” (*i.e.*, the prior five years from the “Evaluation Date,” which is the annual date as of which the Department calculates the Preliminary Identification Metrics to determine if the member firm meets the Preliminary Criteria for Identification). *See* Rule 4111(i)(5), (6), and (13) (definitions of “Evaluation Date,” “Evaluation Period,” and “Registered Persons In-Scope”).
21. *See* Rule 4111(i)(10)(A), (C) and (D); Rule 4111(i)(6) (definition of “Evaluation Period”).
22. *See* Rule 4111(i)(10)(B), (C) and (E); Rule 4111(i)(6) (definition of “Evaluation Period”).
23. *See* Rule 4111(i)(10)(A), (B) and (C); Rule 4111(i)(13) (definition of “Registered Persons In-Scope”).
24. *See* Rule 4111(i)(12) (definition of “Registered Person and Member Firm Events”).
25. *See* Rule 4111(i)(10)(A)-(E).
26. *See* Rule 4111(i)(10)(F).
27. The purpose of ensuring that a firm does not meet the Preliminary Criteria for Identification solely because of pending matters is because FINRA recognizes that pending matters include disclosure events that may remain unresolved or that may subsequently be dismissed or concluded with no adverse action.
28. *See* Rule 4111(b) and (i)(9)(A).
29. *See* Rule 4111(b) and (i)(9)(B).
30. The Department’s consideration of claims and awards against the firm’s Associated Persons would focus on claims and awards against Associated Persons who are owners or control persons and on claims and awards relating to arbitrations that involved conduct or alleged conduct that occurred while associated with the member firm. *See* Securities Exchange Act Release No. 90527 (November 27, 2020), 85 FR 78540, 78545 n.33 (December 4, 2020) (Notice of Filing of File No. SR-FINRA-2020-041) (Filing).
31. The term “maximum” is used to indicate that a firm’s maximum Restricted Deposit Requirement will be the figure FINRA declares to the firm is the highest deposit requirement to which it may be subject during that year’s Rule 4111 process. *See* Approval Order, 86 FR 42925, 42930 n.88.
32. A Restricted Deposit Requirement will require the member firm to promptly deposit in a Restricted Deposit Account cash or qualified securities with an aggregate value that is not less than the firm’s Restricted Deposit Requirement, but will not require the firm to make additional deposits in order to maintain continuously the original value of the qualified securities in its Restricted Deposit Account, if such qualified securities have declined in value. Likewise, if the aggregate value of the assets deposited by a member firm to comply with its Restricted Deposit Requirement



increases above the firm's Restricted Deposit Requirement, that would not be a basis for the firm to request a withdrawal from its Restricted Deposit Account. *See* Partial Amendment No. 2, at p. 4, SR-FINRA-2020-041 (July 20, 2021) (Partial Amendment No. 2). As described below, there are additional requirements in Rule 4111(f)(2) that apply when FINRA re-designates a member firm as a Restricted Firm and the member is subject to a Restricted Deposit Requirement.

33. As FINRA has previously explained, FINRA plans to file with the SEC a proposed amendment to Rule 8312 (FINRA BrokerCheck Disclosure) to release on BrokerCheck information as to whether a particular member firm or former member firm is designated as a Restricted Firm pursuant to Rules 4111 and 9561. *See* FINRA Response to Comments, at p. 3, SR-FINRA-2020-041 (July 20, 2021), available at <https://www.finra.org/sites/default/files/2021-07/SR-FINRA-2020-041-response-to-comments.pdf>. In addition, in Rule 9561 expedited proceedings, FINRA shall release to the public a copy of, and information with respect to, any decision issued pursuant to Rule 9559 that constitutes final FINRA action. *See* Rule 8313(a)(3).
34. *See* Rule 4111(i)(7) (definition of "Former Member").
35. *See* Rule 4111(f)(3)(B).
36. As FINRA has explained, funds or securities on deposit in a Restricted Firm's Restricted Deposit Account are not held with respect to any particular claim, or class of claimants, against the Restricted Firm. In the event of a liquidation of a Restricted Firm, funds or securities on deposit in the Restricted Deposit Account would be additional financial resources available to satisfy claims against the Restricted Firm. *See* Partial Amendment No. 2, at 4 n.6.
37. *See* 17 CFR 240.15c3-1.
38. *See* Rule 9561(a)(1) (defining the "Rule 4111 Requirements" to mean the requirements, conditions, or restrictions imposed by a Department determination under Rule 4111).
39. *See* Rule 9561(a)(1), (2), (3) and (5).
40. *See* Rule 9561(a)(6).
41. *See* Rule 9561(a)(4).
42. *See* Rule 9561(a)(4).
43. *See* Rule 4111(e)(2).
44. *See* Rule 9561(b)(1), (2).
45. *See* Rule 9561(b)(3) and (5).
46. *See* Rule 9561(b)(4) and (6).
47. *See* Rule 9561(b)(7).
48. Amendments also have been approved to Rule 9559(b) (computation of time), (c) (stays), (e) (consolidation of severance of proceedings), (g) (notice of hearing), (h) (transmission of documents) and (o) (timing of decision). Additionally, in expedited proceedings pursuant to Rule 9561(a) to review a Department determination under Rule 4111, a member firm may sometimes seek to demonstrate that the Department included incorrectly disclosure events when calculating whether the member firm meets the Preliminary Criteria for Identification. When the member firm does so, however, it will not be permitted to collaterally attack the underlying merits of those final actions. *See* Filing, 85 FR 78540, 78550 & n.45; *see also* Approval Order, 86 FR 42925, 42932 n.115.

## Attachment A

### New and Amended Rule Text

New language is underlined; deletions are in brackets.]

\*\*\*\*\*

#### FINRA Rules

\*\*\*\*\*

#### 4000. FINANCIAL AND OPERATIONAL RULES

\*\*\*\*\*

##### 4111. Restricted Firm Obligations

###### (a) General

A member designated as a Restricted Firm shall be required, except as provided in paragraphs (e) and (f) of this Rule, to establish a Restricted Deposit Account and deposit in that account cash or qualified securities with an aggregate value that is not less than the member's Restricted Deposit Requirement, and shall be subject to such conditions or restrictions on the member's operations as determined by the Department to be necessary or appropriate for the protection of investors and in the public interest.

###### (b) Annual Calculation by FINRA of Preliminary Criteria for Identification

For each member, the Department will compute annually (on a calendar-year basis) the Preliminary Identification Metrics to determine if the member meets the Preliminary Criteria for Identification.

###### (c) Initial Department Evaluation and One-Time Staff Reduction

###### (1) Initial Department Evaluation

If the member is deemed to meet the Preliminary Criteria for Identification, the Department shall conduct an internal evaluation to determine whether (A) the member does not warrant further review under this Rule because the Department has information to conclude that the computation of the member's Preliminary Identification Metrics included disclosure events (and other conditions) that should not have been included because they are not consistent with the purpose of the Preliminary Criteria for Identification and are not reflective of a firm posing

a high degree of risk. The Department shall also consider whether the member has addressed the concerns signaled by the disclosure events or conditions or altered its business operations such that the Preliminary Criteria for Identification calculation no longer reflects the member's current risk profile, or (B) except as provided in paragraph (c)(2) of this Rule, the member should proceed to a Consultation.

**(2) One-Time Staff Reduction**

If the Department determines that the member meets the Preliminary Criteria for Identification and such member has met such criteria for the first time, such member may reduce its staffing levels to no longer meet the Preliminary Criteria for Identification within 30 business days after being informed by the Department. The member shall provide evidence of the staff reduction to the Department identifying the terminated individuals. Once the member has reduced staffing levels to no longer meet the Preliminary Criteria for Identification, it shall not rehire in any capacity a person terminated to accomplish the staff reduction for a period of one year.

**(3) Close-Out Review**

If the Department determines that the member no longer warrants further review in accordance with paragraph (c)(1)(A) or (c)(2) of this Rule, the Department shall close out the review of the member for such year.

**(d) Consultation**

**(1) General**

If the Department determines that the member meets the Preliminary Criteria for Identification and should proceed to a Consultation, the Department shall conduct the Consultation to allow the member to demonstrate why it does not meet the Preliminary Criteria for Identification and should not be designated as a Restricted Firm. If the member is designated as a Restricted Firm, the Department may require it to be subject to a Restricted Deposit Requirement or to such conditions or restrictions as the Department in its discretion shall deem necessary or appropriate for the protection of investors or in the public interest, or both. The member bears the burden of demonstrating that it should not be designated as a Restricted Firm and should not be subject to the maximum Restricted Deposit Requirement.

(A) A member may overcome the presumption that it should be designated as a Restricted Firm by clearly demonstrating that the Department's calculation that the member meets the Preliminary Criteria for Identification included events in the Disclosure Event and Expelled Firm Association Categories that should not have been included because for example, they are duplicative, involving the same customer and the same matter, or are not sales practice related; and

(B) A member may overcome the presumption that it should be subject to the maximum Restricted Deposit Requirement by clearly demonstrating to the Department that the member would face significant undue financial hardship if it were subject to the maximum Restricted Deposit Requirement and that a lesser deposit requirement would satisfy the objectives of this Rule and be consistent with the protection of investors and the public interest; or that conditions and restrictions on the operations and activities of the member and its associated persons would address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.

### **(2) Scheduling Consultation**

The Department shall provide a written letter to each member it determines should proceed to a Consultation or that will proceed to a Consultation pursuant to paragraph (f)(2) of this Rule at least seven days prior to the Consultation, of the date, time and place of the Consultation and shall coordinate with the member to schedule further meetings as necessary. A Consultation shall begin at the time scheduled, unless the Department, for good cause shown by the member, provides a written letter that postpones the commencement of the Consultation. Postponements shall not exceed 30 days unless the member establishes the reasons a longer postponement is necessary.

### **(3) Consultation Process**

In conducting its evaluation of whether a member should be designated as a Restricted Firm and subject to a Restricted Deposit Requirement, the Department shall consider:

(A) information provided by the member during any meetings as part of the Consultation;

(B) relevant information or documents, if any, submitted by the member, in the manner and form prescribed by the Department, as shall be necessary or appropriate for the Department to review the computation of the Preliminary Criteria for Identification;

(C) a plan, if any, submitted by the member, in the manner and form prescribed by the Department, proposing in detail the specific conditions or restrictions that the member seeks to have the Department consider;

(D) such other information or documents as the Department may reasonably request in its discretion from the member related to the evaluation; and

(E) any other information the Department deems necessary or appropriate to evaluate the matter.

**(e) Department Decision and Notice**

**(1) Department Decision**

Following the Consultation, but no later than 30 days from the date of the latest letter provided to the member under paragraph (d)(2) of this Rule, the Department shall render a Department Decision as follows:

(A) If the Department determines that the member has rebutted the presumption set forth in paragraph (d)(1)(A) of this Rule that it should be designated as a Restricted Firm, the Department's decision shall state that the firm shall not be designated as a Restricted Firm.

(B) If the Department determines that the member has failed to rebut the presumption set forth in paragraphs (d)(1)(A) and (d)(1)(B) of this Rule that it should be designated as a Restricted Firm that shall be subject to the maximum Restricted Deposit Requirement, the Department's decision shall designate the member as a Restricted Firm and require the member to: (i) promptly establish a Restricted Deposit Account and deposit in that account the maximum Restricted Deposit Requirement; and (ii) implement and maintain specified conditions or restrictions, as the Department deems necessary or appropriate, on the operations and activities of the member and its associated persons to address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.

(C) If the Department determines that the member has failed to rebut the presumption in paragraph (d)(1)(A) of this Rule that it should be designated as a Restricted Firm but that it has rebutted the presumption in paragraph (d)(1)(B) of this Rule that it shall be subject to the maximum Restricted Deposit Requirement, the Department shall designate the member as a Restricted Firm and shall: (i) impose no Restricted Deposit Requirement on the member or require the member to promptly establish a Restricted Deposit Account and deposit in that account a Restricted Deposit Requirement in such dollar amount less than the maximum Restricted Deposit Requirement as the Department deems necessary or appropriate; and (ii) require the member to implement and maintain specified conditions or restrictions, as the Department deems necessary or appropriate, on the operations and activities of the member and its associated persons to address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.

**(2) Notice of Department Decision, No Stays**

No later than 30 days following the latest letter provided to the member under paragraph (d)(2) of this Rule, the Department shall issue a notice of the Department's decision pursuant to Rule 9561(a) that states the obligations to be imposed on the member, if any, under this Rule 4111 and the ability of the member under Rule 9561 to request a hearing with the Office of Hearing Officers. A timely request for a hearing shall not stay the effectiveness of the notice issued under Rule 9561(a), except that for a notice under Rule 9561(a) a member subject to a Restricted Deposit Requirement shall be required to deposit in a Restricted Deposit Account the lesser of 25 percent of its Restricted Deposit Requirement or 25 percent of its average excess net capital during the prior calendar year, until the Office of Hearing Officers or the NAC issues a written decision under Rule 9559; provided, however, that a member that has been re-designated as a Restricted Firm as set forth in paragraph (f)(2) of this Rule and is already subject to a previously imposed Restricted Deposit Requirement shall be required to keep in the Restricted Deposit Account the assets then on deposit therein until the Office of Hearing Officers or NAC issues a written decision under Rule 9559.

**(f) Continuation or Termination of Restricted Firm Obligations**

**(1) Currently Designated Restricted Firms**

A member or Former Member that is currently designated as a Restricted Firm subject to the requirements of this Rule shall not be permitted to withdraw all or any portion of its Restricted Deposit Requirement, or seek to terminate or modify any deposit requirement, conditions, or restrictions that have been imposed pursuant to this Rule, without the prior written consent of the Department. There shall be a presumption that the Department shall deny an application by a member or Former Member that is currently designated as a Restricted Firm to withdraw all or any portion of its Restricted Deposit Requirement. An application under this paragraph for a withdrawal from a Restricted Deposit Requirement shall comply with the content requirements in paragraph (f)(3)(A)(i) through (iv) of this Rule.

**(2) Re-Designation as a Restricted Firm**

Where a member has been designated as a Restricted Firm in one year and is determined to meet the Preliminary Criteria for Identification the following year in accordance with paragraph (b) of this Rule, the Department shall provide a written letter to the member stating that it shall be re-designated as a Restricted Firm, and that the obligations previously imposed on the member in accordance with this Rule shall remain effective and unchanged, unless either the member or the Department requests a Consultation in writing within seven days of the date of the letter, in which case the obligations previously imposed shall remain effective and unchanged unless and until the Department modifies or terminates them after the Consultation. If a Consultation is conducted, there shall be a presumption that the Restricted Deposit Requirement and conditions or restrictions, if any, previously imposed on the member shall remain effective and unchanged absent a showing by the party seeking changes that the previously imposed obligations are no longer necessary or appropriate for the protection of investors or in the public interest. If a Consultation is not timely requested, the member shall be subject to paragraph (f)(1) of this Rule. When FINRA re-designates a member as a Restricted Firm and the member is subject to a Restricted Deposit Requirement, the member shall promptly after such re-designation (or, in the case where a hearing is requested pursuant to Rule 9561, promptly after the Office of Hearing Officers or the NAC issues a written decision under Rule 9559) deposit additional cash or qualified securities in the member's Restricted Deposit Account to the extent necessary to

cause the aggregate value of the cash and qualified securities in the member's Restricted Deposit Account to be not less than its re-designated Restricted Deposit Requirement.

**(3) Previously Designated Restricted Firms**

(A) A member or Former Member that is a Restricted Firm in one year, but does not meet the Preliminary Criteria for Identification or is not designated as a Restricted Firm the following year(s), shall no longer be subject to any deposit requirement, conditions, or restrictions previously imposed on it under this Rule; provided, however, the member or Former Member shall not be permitted to withdraw any portion of its Restricted Deposit Requirement without submitting an application and obtaining the prior written consent of the Department. Such application shall:

(i) be made in such form and manner as FINRA may prescribe;

(ii) be accompanied by a copy of a current account statement for the member or Former Member's Restricted Deposit Account;

(iii) include a certification by the member's or Former Member's chief executive officer (or equivalent officer) stating the member's or Former Member's Restricted Deposit Requirement; the value of the cash or qualified securities on deposit in the member's or Former Member's Restricted Deposit Account; the value of cash or qualified securities on deposit in the member's or Former Member's Restricted Deposit Account that the member or Former Member is seeking the Department's consent to withdraw; and

(iv) include evidence that there are no "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding against the member, the member's Associated Persons or the Former Member, or if there are any "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding, provide a detailed description of such.

(B) After such review and investigation as it considers necessary or appropriate, the Department shall determine whether to authorize a withdrawal, in part or whole, of cash or qualified securities from the member's or Former Member's Restricted Deposit Account. There shall be presumptions



that the Department shall: (i) approve an application for withdrawal if the member, the member's Associated Persons, or the Former Member have no "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding; and (ii) (a) deny an application for withdrawal if the member, the member's Associated Persons who are owners or control persons, or the Former Member have any "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding, or if the member's Associated Persons have any "Covered Pending Arbitration Claims," unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding that involved conduct or alleged conduct that occurred while associated with the member; but (b) approve an application by a Former Member for withdrawal if the Former Member commits in the manner specified by the Department to use the amount it seeks to withdraw from its Restricted Deposit to pay the Former Member's specified unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding. Within 30 days from the date the application is received by the Department, the Department shall issue a notice of the Department's decision pursuant to Rule 9561(a).

**(g) Books and Records**

Each member shall maintain records evidencing the member's compliance with this Rule and any Restricted Deposit Requirement or conditions or restrictions imposed in accordance with this Rule, including without limitation, records relating to the calculation of the Preliminary Criteria for Identification, Consultation, the Restricted Deposit Account, conditions or restrictions imposed, and agreements with bank(s) or clearing firm(s), for a period of six years from the date the member is no longer subject to the requirements of this Rule. In addition, a firm that is subject to a Restricted Deposit Requirement shall provide to the Department, upon its request, records, agreements and account statements that demonstrate the firm's compliance with the Restricted Deposit Requirement.

**(h) Notice of Failure to Comply**

FINRA may issue a notice pursuant to Rule 9561(b) directing a member that is not in compliance with the Restricted Deposit Requirement or the conditions or restrictions imposed by this Rule to suspend all or a portion of its business.

**(i) Definitions**

For purposes of this Rule, the following terms shall have the following meanings:

(1) The term “Consultation” means one or more meetings or consultations between the Department and a member that meets the Preliminary Criteria for Identification.

(2) The term “Covered Pending Arbitration Claim,” for purposes of this Rule 4111, means an investment-related, consumer initiated claim filed against the member or its Associated Persons in any arbitration forum that is unresolved; and whose claim amount (individually or, if there is more than one claim, in the aggregate) exceeds the member’s excess net capital. For purposes of this definition, the claim amount includes claimed compensatory loss amounts only, not requests for pain and suffering, punitive damages or attorney’s fees, and shall be the maximum amount for which the member or Associated Person, as applicable, is potentially liable regardless of whether the claim was brought against additional persons or the Associated Person reasonably expects to be indemnified, share liability or otherwise lawfully avoid being held responsible for all or part of such maximum amount.

(3) The term “Department” means FINRA’s Department of Member Regulation.

(4) The term “Disclosure Event and Expelled Firm Association Categories” means the following categories of disclosure events and other information:

(A) “Registered Person Adjudicated Events” means any one of the following events that are reportable on the registered person’s Uniform Registration Forms:

(i) a final investment-related, consumer-initiated customer arbitration award or civil judgment against the registered person in which the registered person was a named party or was a “subject of” the customer arbitration award or civil judgment;

(ii) a final investment-related, consumer-initiated customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation for a dollar amount at or above \$15,000 in which the registered person was a named party or was a “subject of” the customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation;

(iii) a final investment-related civil judicial matter that resulted in a finding, sanction or order;

(iv) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or Commodity Futures Trading Commission (CFTC), other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(v) a criminal matter in which the registered person was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign, or military court to any felony or any reportable misdemeanor.

(B) “Registered Person Pending Events” means any one of the following events associated with the registered person that are reportable on the registered person’s Uniform Registration Forms:

(i) a pending investment-related civil judicial matter;

(ii) a pending investigation by a regulatory authority;

(iii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(iv) a pending criminal charge associated with any felony or any reportable misdemeanor.

(C) “Registered Person Termination and Internal Review Events” means any one of the following events associated with the registered person at a previous member that are reportable on the registered person’s Uniform Registration Forms:

(i) a termination in which the registered person voluntarily resigned, was discharged or was permitted to resign from a previous member after allegations; or

(ii) a pending or closed internal review by a previous member.

(D) “Member Firm Adjudicated Events” means any one of the following events that are reportable on the member’s Uniform Registration Forms, or are based on customer arbitrations filed with FINRA’s dispute resolution forum:

(i) a final investment-related, consumer-initiated customer arbitration award in which the member was a named party;

(ii) a final investment-related civil judicial matter that resulted in a finding, sanction or order;

(iii) a final regulatory action that resulted in a finding, sanction or order, and was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(iv) a criminal matter in which the member was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign, or military court to any felony or any reportable misdemeanor.

(E) “Member Firm Pending Events” means any one of the following events that are reportable on the member’s Uniform Registration Forms:

(i) a pending investment-related civil judicial matter;

(ii) a pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or

(iii) a pending criminal charge associated with any felony or any reportable misdemeanor.

(F) “Registered Persons Associated with Previously Expelled Firms” means any Registered Person In-Scope who was registered for at least one year with a previously expelled firm and whose registration with the previously expelled firm terminated during the Evaluation Period.

(5) The term “Evaluation Date” means the date, each calendar year, as of which the Department calculates the Preliminary Identification Metrics to determine if the member meets the Preliminary Criteria for Identification.

(6) The term “Evaluation Period” means the prior five years from the Evaluation Date, provided that for the Registered Person Pending Events and Member Firm Pending Events categories and pending internal reviews in the Registered Person Termination and Internal Review Events category, it would correspond to the Evaluation Date (and include all events that are pending as of the Evaluation Date).

(7) The term “Former Member” means an entity that has withdrawn or resigned its FINRA membership, or that has had its membership cancelled or revoked.

(8) The term “qualified security” has the meaning given it in SEA Rule 15c3-3(a)(6).

(9) The term “Preliminary Criteria for Identification” means meeting the following conditions:

(A) Two or more of the member’s Preliminary Identification Metrics are equal to or more than the corresponding Preliminary Identification Metrics Thresholds, and at least one of these metrics is among the following metrics:

- (i) Registered Person Adjudicated Event Metric;
- (ii) Member Firm Adjudicated Event Metric; and
- (iii) Expelled Firm Association Metric; and

(B) The member has two or more Registered Person and Member Firm Events during the Evaluation Period.

(10) The term “Preliminary Identification Metrics” means the following six metrics that are based on the number of disclosure events (defined above) per Registered Persons In-Scope or percent of Registered Persons In-Scope associated with previously expelled firms:

(A) “Registered Person Adjudicated Event Metric” would be computed as the sum of Registered Person Adjudicated Events that reached a resolution during the Evaluation Period, across all Registered Persons In-Scope and divided by the number of Registered Persons In-Scope.

(B) “Registered Person Pending Event Metric” would be computed as the sum of Registered Person Pending Events as of the Evaluation Date, across all Registered Persons In-Scope and divided by the number of Registered Persons In-Scope.

(C) “Registered Person Termination and Internal Review Event Metric” would be computed as the sum of Registered Person Termination and Internal Review Events that reached a resolution during the Evaluation Period and pending internal reviews by a previous member as of the Evaluation Date, across all Registered Persons In-Scope and divided by the number of Registered Persons In-Scope.

(D) “Member Firm Adjudicated Event Metric” would be computed as the sum of Member Firm Adjudicated Events that reached a resolution during the Evaluation Period, divided by the number of Registered Persons In-Scope.

(E) “Member Firm Pending Event Metric” would be computed as the sum of Member Firm Pending Events as of the Evaluation Date, divided by the number of Registered Persons In-Scope.

(F) “Expelled Firm Association Metric” would be computed as the sum of Registered Persons Associated with Previously Expelled Firms, divided by the number of Registered Persons In-Scope.

(11) The term “Preliminary Identification Metrics Thresholds” means the following thresholds corresponding to each of the six Preliminary Identification Metrics.

Preliminary Identification Metrics Thresholds							
Firm Size Category	Number of Registered Persons In-Scope in Firm Size Category	Thresholds for Registered Person Event Metrics:			Thresholds for Member Firm Event Metrics:		Threshold for Expelled Firm Association Metric:
		Registered Person Adjudicated Event Metric	Registered Person Pending Event Metric	Registered Person Termination and Internal Review Event Metric	Member Firm Adjudicated Event Metric	Member Firm Pending Event Metric	Expelled Firm Association Metric
		(1)	(2)	(3)	(4)	(5)	(6)
1	1-4	0.50	0.20	0.10	0.75	0.25	0.30
2	5-9	0.30	0.20	0.10	0.30	0.10	0.25
3	10-19	0.20	0.10	0.10	0.30	0.05	0.20
4	20-50	0.20	0.10	0.10	0.20	0.02	0.15
5	51-150	0.20	0.05	0.10	0.15	0.01	0.03
6	151-499	0.15	0.05	0.10	0.10	0.01	0.01
7	500+	0.10	0.05	0.10	0.05	0.01	0.01

(12) The term “Registered Person and Member Firm Events” means the sum of the following categories of defined events during the Evaluation Period:

- (A) Registered Person Adjudicated Events;
- (B) Registered Person Pending Events;
- (C) Registered Person Termination and Internal Review Events;
- (D) Member Firm Adjudicated Events; and
- (E) Member Firm Pending Events.

(13) The term “Registered Persons In-Scope” means all persons registered with the firm for one or more days within the one year prior to the Evaluation Date.

(14) The term “Restricted Deposit Account” means an account in the name of the member:

- (A) at a bank (as defined in Section 3(a)(6) of the Exchange Act) or the member’s clearing firm;
- (B) subject to an agreement in which the bank or the member’s clearing firm, as applicable, agrees:
  - (i) not to permit withdrawals (other than withdrawals of interest or the withdrawal of qualified securities or cash after and on the same day as the deposit of cash or qualified securities of equal value) from the Restricted Deposit Account without the prior written consent of FINRA;
  - (ii) to keep the account separate from any other accounts maintained by the member with the bank or clearing firm;
  - (iii) that the cash or securities on deposit in the account will at no time be used directly or indirectly as security for a loan to the member by the bank or clearing firm and will not be subject to any set-off, right, charge, security interest, lien, or claim of any kind in favor of the bank, clearing firm or any person claiming through the bank or clearing firm;
  - (iv) that if the member becomes a Former Member, the assets deposited in the Restricted Deposit Account to satisfy the Restricted Deposit Requirement shall be kept in the Restricted Deposit Account, and the bank or clearing firm will not permit withdrawals from the Restricted Deposit Account without the prior written consent of FINRA as set forth in paragraphs (f)(1) and (f)(3) of this Rule; and

(v) that FINRA is a third-party beneficiary to such agreement and that such agreement may not be amended without the prior written consent of FINRA; and

(C) not subject to any right, charge, security interest, lien or claim of any kind granted by the member.

(15) The term “Restricted Deposit Requirement” means one of the following amounts:

(A) the specific maximum Restricted Deposit Requirement for a member, determined by the Department taking into consideration the nature of the firm’s operations and activities, revenues, commissions, assets, liabilities, expenses, net capital, the number of offices and registered persons, the nature of the disclosure events counted in the numeric thresholds, insurance coverage for customer arbitration awards or settlements, concerns raised during FINRA exams, and the amount of any of the firm’s or its Associated Persons’ Covered Pending Arbitration Claims, unpaid arbitration awards or unpaid settlements related to arbitrations. Based on a review of these factors, the Department would determine a maximum Restricted Deposit Requirement for the member that would be consistent with the objectives of this Rule, but would not significantly undermine the continued financial stability and operational capability of the firm as an ongoing enterprise over the next 12 months; or

(B) the amount, adjusted after the Consultation, determined by the Department; and

(C) with respect to a Former Member, the Restricted Deposit Requirement last calculated pursuant to paragraph (i)(15)(A) or (15)(B) of this Rule when the firm was a member.

(16) The term “Restricted Firm” means each member that is designated as such in accordance with paragraphs (e)(1)(B) and (e)(1)(C) of this Rule.

(17) The term “Uniform Registration Forms” means the Forms BD, U4, U5 and U6, as applicable.



• • • Supplementary Material: -----

.01 Net Capital Treatment of the Deposits in the Restricted Deposit Account. Because of the restrictions on withdrawals from a Restricted Deposit Account, deposits in such an account cannot be readily converted into cash and therefore shall be deducted in determining the member's net capital under SEA Rule 15c3-1 and FINRA Rule 4110.

.02 Compliance with Rule 1017. Nothing in this Rule shall be construed as altering in any manner a member's obligations under Rule 1017.

.03 Examples of Conditions and Restrictions. For purposes of this Rule, the conditions or restrictions that the Department may impose include, but are not limited to, the following:

- (a) limitations on business expansions, mergers, consolidations or changes in control;
- (b) filing all advertising with FINRA's Department of Advertising Regulation;
- (c) imposing requirements on establishing and supervising offices;
- (d) requiring a compliance audit by a qualified, independent third party;
- (e) limiting business lines or product types offered;
- (f) limiting the opening of new customer accounts;
- (g) limiting approvals of registered persons entering into borrowing or lending arrangements with their customers;
- (h) requiring the member to impose specific conditions or limitations on, or to prohibit, registered persons' outside business activities of which the member has received notice pursuant to Rule 3270; and
- (i) requiring the member to prohibit or, as part of its supervision of approved private securities transactions for compensation under Rule 3280 or otherwise, impose specific conditions on associated persons' participation in private securities transactions of which the member has received notice pursuant to Rule 3280.

\* \* \* \* \*

**9500. OTHER PROCEEDINGS**

\*\*\*\*\*

**9550. Expedited Proceedings**

\*\*\*\*\*

**9559. Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series**

(a) No Change.

**(b) Computation of Time**

Rule 9138 shall govern the computation of time in proceedings brought under the Rule 9550 Series, except that intermediate Saturdays, Sundays and Federal holidays shall be included in the computation in proceedings brought under Rules 9556 through 9558 and 9561, unless otherwise specified.

**(c) Stays**

(1) Unless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown, a timely request for a hearing shall stay the effectiveness of a notice issued under Rules 9551 through 9556 and 9561(b), except that: (A) the effectiveness of a notice of a limitation or prohibition on access to services offered by FINRA or a member thereof under Rule 9555 with respect to services to which the member or person does not have access shall not be stayed by a request for a hearing; and (B) this paragraph has no applicability to a petition instituting an expedited proceeding under Rule 9556(h).

(2) A timely request for a hearing shall stay the effectiveness of a notice issued under Rule 9557 for 10[ten] business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4) (A) (whichever period is less), unless FINRA's Chief Executive Officer (or such other executive officer as the Chief Executive Officer may designate) determines that a notice under Rule 9557 shall not be stayed. Where a notice under Rule 9557 is stayed by a request for a hearing, such stay shall remain in effect only for 10[ten] business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less) and shall not be extended.

(3) No Change.

(4) A timely request for a hearing shall not stay the effectiveness of a notice issued under Rule 9561(a).

**(d) Appointment and Authority of Hearing Officer and[/or] Hearing Panel**

(1) For proceedings initiated under Rules 9553, 9554, [and] 9556(h) and 9561, the Chief Hearing Officer shall appoint a Hearing Officer to preside over and act as the sole adjudicator for the matter.

(2) through (6) No Change.

**(e) Consolidation or Severance of Proceedings**

Rule 9214 shall govern the consolidation or severance of proceedings, except that, where one of the notices that are the subject of consolidation under this Rule requires that a hearing be held before a Hearing Panel, the hearing of the consolidated matters shall be held before a Hearing Panel. Where two consolidated matters contain different timelines under this Rule, the Chief Hearing Officer or Hearing Officer assigned to the matter has discretion to determine which timeline is appropriate under the facts and circumstances of the case. Where one of the consolidated matters includes an action brought under a Rule that does not permit a stay of the effectiveness of the notice or where FINRA's Chief Executive Officer (or such other executive officer as the Chief Executive Officer may designate), in the case of Rule 9557, or Hearing Officer, in the case of Rule 9558(d), determines that a request for a hearing shall not stay the effectiveness of the notice, the limitation, prohibition, condition, requirement, restriction, obligation or suspension specified in the notice, or the partial deposit requirement specified in Rule 9561(a)(4), shall not be stayed pending resolution of the case. Where one of the consolidated matters includes an action brought under Rule 9557 that is stayed for up to 10[ten] business days, the requirement [and/]or restriction specified in the notice shall not be further stayed.

**(f) Time of Hearing**

(1) No Change.

(2) A hearing shall be held within 10[ten] days after a respondent is served a petition seeking an expedited proceeding issued under Rules 9556(h).

(3) A hearing shall be held within 14 days after a respondent subject to a notice issued under Rules 9556 (except Rule 9556(h)), [and] 9558 or 9561(b) files a written request for a hearing with the Office of Hearing Officers.

(4) No Change.

(5) A hearing shall be held within 30 days after a respondent subject to a notice issued under Rule 9561(a) files a written request for a hearing with the Office of Hearing Officers.

([5]6) The timelines established by paragraphs (f)(1) through (f)(5[4]) of this Rule confer no substantive rights on the parties.

**(g) Notice of Hearing**

The Hearing Officer shall issue a notice stating the date, time, and place of the hearing as follows:

(1) through (2) No Change.

(3) At least seven days prior to the hearing in the case of an action brought pursuant to Rules 9556 (except Rule 9556(h)), [and] 9558 or 9561(b); and

(4) At least 21 days prior to the hearing in the case of an action brought pursuant to Rules 9551 through 9555 or 9561(a).

**(h) Transmission of Documents**

(1) Not less than two business days before the hearing in an action brought under Rule 9557, not less than six days before the hearing in an action brought under Rule 9556(h), not less than seven days before the hearing in an action brought under Rules 9556 (except Rule 9556(h)), [and] 9558 or 9561(b), and not less than 14 days before the hearing in an action brought under Rules 9551 through 9555 or 9561(a), FINRA staff shall provide to the respondent who requested the hearing or the respondent who has received a petition pursuant to Rule 9556(h), by facsimile, email, overnight courier or personal delivery, all documents that were considered in issuing the notice unless a document meets the criteria of Rule 9251(b)(1)(A), (B), (C) or (b)(2). Documents served by facsimile or email shall also be served by either overnight courier or personal delivery. A document that meets the criteria in this paragraph shall not constitute part of the record, but shall be retained by FINRA until the date upon which FINRA serves a final decision or, if applicable, upon the conclusion of any review by the SEC or the federal courts.

(2) Not less than two business days before the hearing in an action brought under Rule 9557, not less than three days before the hearing in an action brought under Rules 9556, [and] 9558 or 9561(b), and not less than seven days before the hearing in an action brought under Rules 9551 through 9555 or 9561(a), the parties shall exchange proposed exhibit and witness lists. The exhibit and witness lists shall be served by facsimile, email, overnight courier or personal delivery. Documents served by facsimile or email shall also be served by either overnight courier or personal delivery.

(i) through (m) No Change.

**(n) Sanctions, Requirements, Costs and Remands**

(1) In any action brought under the Rule 9550 Series, other than an action brought under Rule 9556(h), [or] Rule 9557 or Rule 9561, the Hearing Officer or, if applicable, the Hearing Panel may approve, modify or withdraw any and all sanctions, requirements, restrictions or limitations imposed by the notice and, pursuant to Rule 8310(a), may also impose any other fitting sanction.

(2) No Change.

(3) In an action brought under Rule 9557, the Hearing Panel shall approve or withdraw the requirements [and/]or restrictions imposed by the notice. If the Hearing Panel approves the requirements [and/]or restrictions and finds that the respondent has not complied with all of them, the Hearing Panel shall impose an immediate suspension on the respondent that shall remain in effect unless FINRA staff issues a letter of withdrawal of all requirements [and/]or restrictions pursuant to Rule 9557(g)(2).

(4) through (5) No Change.

(6) In any action brought under Rule 9561(a), the Hearing Officer may approve or withdraw any and all of the Rule 4111 Requirements, or remand the matter to the department that issued the notice for further consideration of specified matters, but may not modify any of the Rule 4111 Requirements imposed by the notice or impose any other requirements, obligations or restrictions available under Rule 4111. In any action brought under Rule 9561(b), the Hearing Officer may approve or withdraw the suspension or cancellation of membership, and may impose any other fitting sanction.

**(o) Timing of Decision****(1) Proceedings initiated under Rules 9553, [and] 9554 and 9561**

Within 60 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision and provide it to the National Adjudicatory Council's Review Subcommittee.

(2) through (4) No Change.

(5) If not timely called for review by the National Adjudicatory Council's Review Subcommittee pursuant to paragraph (q) of this Rule, the Hearing Officer's or, if applicable, the Hearing Panel's written decision shall constitute final FINRA action. For decisions issued under Rules 9551 through 9556, [and] 9558 or 9561, the Office of Hearing Officers shall promptly serve the decision of the Hearing Officer or, if applicable, the Hearing Panel on the Parties and provide a copy to each FINRA member with which the respondent is associated.

(6) No Change.

**(p) Contents of Decision**

The decision, which for purposes of Rule 9557 means the written decision issued under paragraph (o)(4)(B) of this Rule, shall include:

(1) through (5) No Change.

(6) a statement describing any sanction, requirement, obligation, restriction or limitation imposed, the reasons therefore, and the date upon which such sanction, requirement, obligation, restriction or limitation shall become effective, if they are not already effective.

(q) through (r) No Change.

**9561. Procedures for Regulating Activities Under Rule 4111****(a) Notices Under Rule 4111****(1) Notice of Requirements or Restrictions**

FINRA's Department of Member Regulation ("Department") shall issue a notice of its determination under Rule 4111 that a firm is a Restricted Firm and the requirements, conditions or restrictions to which the Restricted Firm is subject (hereinafter, collectively referred to as the "Rule 4111 Requirements").

**(2) Service of Notice**

FINRA staff shall serve the member subject to a notice issued under this Rule (or upon counsel representing the member, or other person authorized to represent others under Rule 9141, when counsel or other person authorized to represent others under Rule 9141 agrees to accept service for the member) by facsimile, email, overnight courier or personal delivery. Papers served on a member, counsel for such member, or other person authorized to represent others under Rule 9141 by overnight courier or personal delivery shall conform to paragraphs (a)(1) and (3) and, with respect to a member, (b)(2) of Rule 9134. Papers served on a member by facsimile shall be sent to the member's facsimile number listed in the FINRA Contact System submitted to FINRA pursuant to Article 4, Section III of the FINRA By-Laws, except that, if FINRA staff has actual knowledge that a member's FINRA Contact System facsimile number is out of date, duplicate copies shall be sent to the member by overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) and (b)(2) of Rule 9134. Papers served on a member by email shall be sent to the member's email address listed in the FINRA Contact System submitted to FINRA pursuant to Article 4, Section III of the FINRA By-Laws and shall also be served by either overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) and (b)(2) of Rule 9134. Papers served on counsel for a member, or other person authorized to represent others under Rule 9141 by facsimile or email shall be sent to the facsimile number or email address that counsel or other person authorized to represent others under Rule 9141 provides and shall also be served by either overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) of Rule 9134. Service is complete upon sending the notice by facsimile or email, sending the notice by overnight courier or delivering it in person, except that, where duplicate service is required, service is complete upon sending the duplicate service.

**(3) Contents of Notice**

A notice issued under this Rule shall include the Department's determinations under Rule 4111 and state the specific grounds and include the factual basis for the FINRA action. The notice shall state when the FINRA action will take effect. The notice shall state that the respondent may file a written request for a hearing with the Office of Hearing Officers pursuant to Rule 9559. The notice also shall inform the respondent of the applicable deadline for filing a request for a hearing and shall state that a request for a hearing must set forth with specificity the basis for

eliminating any Rule 4111 Requirements. In addition, the notice shall explain that, pursuant to Rule 9559(n), a Hearing Officer may approve or withdraw any and all of the Rule 4111 Requirements, or remand the matter to the Department that issued the notice for further consideration of specified matters, but may not modify any of the Rule 4111 Requirements imposed by the notice or impose any other obligations or restrictions available under Rule 4111.

**(4) Effectiveness of the Rule 4111 Requirements**

The Rule 4111 Requirements imposed by a notice issued and served under paragraph (a) of this Rule are immediately effective; provided, however, that when a firm requests review of a Department determination under Rule 4111 that imposes a deposit requirement on the firm for the first time, the firm shall be required to deposit only 25 percent of its restricted deposit requirement or 25 percent of its average excess net capital over the prior year, whichever is less, while the hearing is pending. The Rule 4111 Requirements, and the partial deposit requirement required by Rule 4111 and this paragraph, shall remain in effect while the hearing is pending.

**(5) Request for Hearing**

A member served with a notice under paragraph (a) of this Rule may file with the Office of Hearing Officers a written request for a hearing pursuant to Rule 9559. A request for a hearing shall be made within seven days after service of the notice issued under this Rule. A request for a hearing must set forth with specificity the basis for eliminating any Rule 4111 Requirements.

**(6) Failure to Request Hearing**

If a member does not timely request a hearing, the notice under paragraph (a) of this Rule shall constitute final FINRA action.

**(b) Notice for Failure to Comply with the Rule 4111 Requirements**

**(1) Notice of Suspension or Cancellation**

If a member fails to comply with any Rule 4111 Requirements imposed under this Rule, the Department, after receiving authorization from FINRA's Chief Executive Officer or such other executive officer as the Chief Executive Officer may designate, may issue a suspension or cancellation notice to such member stating that the failure to comply with the Rule 4111 Requirements within seven days of service of the notice will result in a suspension or cancellation of membership.



**(2) Service of Notice**

FINRA staff shall serve the member subject to a notice issued under this paragraph (b) in accordance with the service provisions in paragraph (a)(2) of this Rule.

**(3) Contents of Notice**

The notice shall explicitly identify the Rule 4111 Requirements with which the firm is alleged to have not complied and shall contain a statement of facts specifying the alleged failure. The notice shall state when the suspension will take effect and explain what the respondent must do to avoid such suspension. The notice shall state that the respondent may file a written request for a hearing with the Office of Hearing Officers pursuant to Rule 9559. The notice also shall inform the respondent of the applicable deadline for filing a request for a hearing and shall state that a request for a hearing must set forth with specificity any and all defenses to the FINRA action. In addition, the notice shall explain that, pursuant to Rules 8310(a) and 9559(n), a Hearing Officer may approve or withdraw the suspension or cancellation of membership, and may impose any other fitting sanction.

**(4) Effective Date of Suspension or Cancellation**

The suspension or cancellation referenced in a notice issued and served under paragraphs (b)(1) and (b)(2) of this Rule shall become effective seven days after service of the notice, unless stayed by a request for hearing pursuant to Rule 9559.

**(5) Request for a Hearing**

A member served with a notice under paragraphs (b)(1) and (b)(2) of this Rule may file with the Office of Hearing Officers a written request for a hearing pursuant to Rule 9559. A request for a hearing shall be made before the effective date of the notice, as indicated in paragraph (b)(4) of this Rule. A request for a hearing must set forth with specificity any and all defenses to the FINRA action.

**(6) Failure to Request Hearing**

If a member does not timely request a hearing, the suspension or cancellation specified in the notice shall become effective seven days after the service of the notice and the notice shall constitute final FINRA action.

**(7) Request for Termination of the Suspension**

A member subject to a suspension imposed after the process described in paragraphs (b)(1) through (6) of this Rule may file a written request for termination of the suspension on the ground of full compliance with the notice or decision. Such request shall be filed with the head of the Department. The head of the Department may grant relief for good cause shown.

**• • • Supplementary Material: -----**

.01 Application to Former Members Under Rule 4111. For purposes of this Rule, the term member also shall include a “Former Member” as defined in Rule 4111(i) as applicable.

\*\*\*\*\*

**Capital Acquisition Broker Rules**

\*\*\*\*\*

**400. FINANCIAL AND OPERATIONAL RULES**

\*\*\*\*\*

**412. Restricted Firm Obligations**

All capital acquisition brokers are subject to FINRA Rule 4111.

\*\*\*\*\*

**Funding Portal Rules**

\*\*\*\*\*

**900. Code of Procedure.****(a) Application of FINRA Rule 9000 Series (Code of Procedure) to Funding Portals**

Except for the FINRA Rule 9520 Series, FINRA Rule 9557, FINRA Rule 9561, and the FINRA Rule 9700 Series, all funding portal members shall be subject to the FINRA Rule 9000 Series, unless the context requires otherwise, provided, however, that:

(1) through (9) No Change.

(b) No Change.

\*\*\*\*\*

# Rule 4111 (Restricted Firm Obligations)

