Center for Clinical Programs

Mailing Address:
PO BOX 4037
Atlanta, GA 30302-4037
Phone: (404) 413-9270
Fax : (404) 413-9229

In Person:
85 Park Place
Atlanta, GA 30303

Georgia State University | COLLEGE OF LAW
Investor Advocacy Clinic

April 9, 2018

VIA EMAIL to pubcom@finra.org

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

Re: Comments Concerning FINRA Regulatory Notice 18-06
Membership Application Program

To whom it may concern:

Thank you for the opportunity to comment on Regulatory Notice 18-06 and its proposed changes to the Membership Application Process. We work in the Georgia State College of Law's Investor Advocacy Clinic where we represent small investors who cannot afford legal representation. Because we work closely with investors, we understand the hard work it takes to reach a settlement or award and the value of funds to those investors. For these reasons, we support changes that improve the likelihood that settlements or awards are paid. We support stringent guidelines for new and continuing membership applications from firms with pending or unpaid awards. We also support the proposals to incentivize payments because investors need additional protections from those who have wronged them. Claimants in arbitration with new member applicants may be at a greater risk for nonpayment of awards or settlements and are therefore in need of greater protection.

Thus, we believe that firms should show that they can pay a pending arbitration claim before being approved as a new member. FINRA should have the final decision in approving a member's decision to hire problematic brokers with pending or unpaid awards or settlement. A firm should not be able to actively avoid its obligations to investors by shifting assets and resurfacing under a new entity identity. We also recommend carrying out the alternative suggestion in the notice by reducing the 25% threshold to file a Continuing Membership Application (CMA) for asset acquisitions and transfers to 10%. We also support including the presumption of denial for CMAs as well as new members.

A. A Firm Should Show Its Ability to Pay a Pending Arbitration Claim Before Being Approved as a New Member.

FINRA should deny new applications for applicants or their associated persons who have pending arbitration claims until the applicant shows how those claims would be paid should they go to award.[1] Showing an ability and intent to pay pending claims is an important factor to the public. If the claims go to award, the firms or associated persons will need to pay them. Requiring members to show their ability to do so engenders trust. As the notice itself states, this new requirement would "shine a spotlight on the individuals with the pending arbitration claims and the firm's supervision of such individuals."[2]

Additionally, we recommend that this presumptive denial also apply to CMAs for members who have pending arbitration or unpaid settlement claims for amounts greater than $15,000. Investors with existing brokers should have at least the same amount of protection as those with new brokers. Limiting the required showing to claims over $15,000 will provide some balance to this rule, only requiring a presumption of denial for claims that would be reported.

B. FINRA Should Have the Final Decision, Using A Materiality Consultation, to Approve a Member's Decision to Hire Problematic Brokers With Pending or Unpaid Awards or Settlements.

We support the second proposed amendment that would require members, who do not otherwise have to file a CMA, to apply for a materiality consultation to approve or deny a business expansion when taking on new associated members with pending or unpaid arbitration claims or settlements.[3] Currently, hiring brokers with pending or unpaid arbitration claims is not considered a material change. However, this is a material business change since these persons could affect future claims and liability owed by the member firm. In accordance with the proposed requirement, firms would have to abide by FINRA's determination in the materiality consultation and file a CMA if they intend to proceed with the hiring of problematic brokers. This change prevents firms from taking advantage of the business expansion safe harbor when adding new members. Not only would FINRA be able to assess the impact these persons would have on firms, it would also incentivize firms' scrutiny of brokers with a bad record of paying claims, adding an additional layer of supervision. Additionally, brokers would know that having claims against them would be problematic when trying to move to a different firm, which would

---

[1] *See* FINRA, REGULATORY NOTICE 18-06, MEMBERSHIP APPLICATION PROGRAM 4–5 (2018) ("One factor [already] considered in [existing] Rule 1014(a)(3)(C) to be considered by [FINRA's Department of Member Regulation], and that creates a presumption of denial, is whether the applicant . . . is subject to unpaid arbitration awards . . . or unpaid arbitration settlements. The rebuttable presumption does not apply, however, to pending arbitration claims." Therefore, "FINRA is proposing to amend Rules 1014(a) and (b) to specify that a presumption of denial exists if the new member applicant or its associated persons are subject to pending arbitration claims.")

[2] *Id.* at 4.

[3] *See id.* at 5 ("FINRA is proposing not to permit a member to effect a business expansion that would involve adding one or more associated persons with a 'covered pending arbitration claim,' unpaid arbitration award or unpaid settlement related to an arbitration, and the member is not otherwise required to file a CMA, unless the member first seeks a materiality consultation for the contemplated expansion with the Department and the Department determines that the member may effect the contemplated business expansion without a CMA.")

hopefully deter bad actions. If such claims exist, this proposal incentivizes brokers to resolve and pay them.

We recommend that the proposed amendment be applicable to the hiring of anyone who is involved in direct customer sales, and also to principals, control persons, or officers. Occasionally, associated persons from problematic firms go on to become officers at larger firms, taking their poor business practices with them. FINRA should use these amendments as an opportunity to prevent these individuals from moving to firms where they can create a culture of misconduct.

Additionally, we believe that the applicability of a presumptive denial in a CMA for those with pending or unpaid arbitration awards or settlements is crucial. A firm should be aware that taking on a problematic broker would impose stricter membership approval standards. If they take on such a risk, they should take steps to ensure the public is protected.

C. A Firm Should Not Be Able to Actively Avoid Its Obligations to Investors by Shifting Assets.

We support preventing acquisitions or transfers without a materiality consultation where the member or any of its associated persons have pending or unpaid awards.[4] Large transfers should be prevented until the firm files a CMA while some smaller transfers could still be permitted. A 10% safe harbor would still be small enough to allow the occasional transfer of customer accounts from one firm to another. However, it would not allow an associated person to move a meaningful percentage of his accounts to another firm. While we understand that this would overall result in more CMAs, adding costs to member firms, the added rigor of CMAs will help prevent problematic transfers.

We agree with this change because it would allow FINRA's Department of Member Regulation to determine how the claims will be paid before approving the transfer or acquisition. This will prevent firms with unpaid or pending claims from closing down and opening back up under a different name, or shifting their assets to other firms. This change would protect investors by preventing firms from actively avoiding their obligation to pay settlements or claims. By ensuring that firms are not engaging in business expansions or asset acquisitions as a means of avoiding payment of claims, investors would be better protected against these practices.

CONCLUSION

In conclusion, new members or brokers with pending or unpaid arbitration claims should bear the burden of showing how they will resolve these issues before having their application accepted. These changes would help contribute to FINRA's integrity, and hopefully ensure that more claims are paid. The costs incurred by firms are outweighed by the benefits of protecting

[4] *See id.* at 7 ("FINRA believes that member firms engaging in asset acquisitions or transfers that have covered pending arbitration claims, unpaid arbitration awards or unpaid settlement agreements related to an arbitration should be required to seek a materiality consultation for the contemplated acquisition or transfer.")

investors and maintaining industry integrity. The changes would serve as an incentive to treat investors fairly.

Thank you for this opportunity to share our comments.

Best regards,

/s/ Benjamin Dell'Orto	*/s/ Esmat Hanano*	*/s/ Alisa Radut*
Benjamin Dell'Orto	Esmat Hanano	Alisa Radut
Student Intern	Student Intern	Student Intern
Student Reg. No. SP001565*	Student Reg. No. SP001567*	Student Reg. No. SP001351*

/s/ Nicole G. Iannarone
Nicole G. Iannarone
Assistant Clinical Professor

* All student interns in the Investor Advocacy Clinic, including this signatory, perform all work under the Georgia Student Practice Rule contained in Rules 91-95 of the Rules of the Supreme Court of Georgia as registered law students under the supervision of a licensed Georgia attorney.