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Via E-mail: *pubcom@finra.org*
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, D.C. 20006-1506

RE: Comment on Regulatory Notice 19-17
Proposed New Rule 4111 (Restricted Firm Obligations)

Dear Ms. Piorko Mitchell:

The University of Miami School of Law Investor Rights Clinic ("the IRC")[1] appreciates the opportunity to comment on proposed new Rule 4111 (Restricted Firm Obligations) imposing additional obligations on firms with a significant history of misconduct. The IRC supports FINRA's ongoing regulatory efforts to enhance scrutiny of high-risk firms and brokers, including proposed Rule 4111. At the same time, the IRC advocates for modification and clarification of certain features of the proposed rule in order to increase investor protection.

The proposed rule draws on studies and data that suggest that member firms with a history of misconduct pose a far greater risk of ongoing and future harm to investors. The proposed new rule seeks to set objective criteria to identify firms that raise "investor-protection concerns substantial enough to require that it be subject to additional obligations."[2] FINRA may impose obligations that include a requirement to maintain a deposit of cash or qualified securities or conditions or restrictions on a firm's operations, subject to the firm's opportunity to consult with FINRA and to request a hearing on the imposed obligations in an expedited proceeding.

For more than seven years, the IRC has assisted unsophisticated investors who have suffered financial losses due to unscrupulous broker practices, often at firms that pose an unusually high-risk to the investing public. High-risk firms and their brokers harm investors represented by the IRC on a routine and disproportionate basis. The IRC addresses the implementation of Rule 4111, including its benefits and potential shortcomings, through discussion of IRC clients and potential impacts of the proposed rule.

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[1] Launched in 2012, the IRC provides *pro bono* representation to investors of modest means who have suffered investment losses as a result of broker misconduct but, due to the size of their claims, cannot find legal representation. The IRC is the only *pro bono* organization in Florida available to investors asserting claims in FINRA arbitration. To date, the IRC has recovered more than $1,100,000 on behalf of investors.

[2] *FINRA Regulatory Notice 19-17*, p. 7.

Restricted Firms and the Restricted Deposit Requirement

As one example of the potential impact of the proposed rule, the IRC represented a husband and wife in their 80s in connection with losses of almost $200,000 of their life savings resulting from their broker's recommendation of illiquid private placements and direct participation programs. At the time the clients retained the IRC, FINRA had expelled the small member firm that employed the broker (among other brokers with numerous disclosures) for its failure to pay a regulatory sanction. Because the expelled firm had insufficient assets, the senior clients had little choice other than to pursue their claim against the individual broker and to accept a settlement that represented around five percent of their losses. In this instance, the Preliminary Criteria for Identification (had proposed Rule 4111 been effective) may have resulted in Restricted Firm Obligations that may have prevented the investor harm in the first place or provided means for a greater recovery for the harmed investors.

However, it is unclear whether the Restricted Deposit Requirement would be available to aggrieved investors who obtain an award or a settlement against a Restricted Firm, including when the firm is no longer registered with FINRA. Indeed, Regulatory Notice 19-17 and proposed Rule 4111 provide little or no guidance on the relationship between the Restricted Deposit Requirement and the amount of pending arbitration claims or unpaid arbitration awards that FINRA would consider in determining the Restricted Deposit Requirement. At a minimum, the IRC urges FINRA to include as factors in this determination all pending claims (not limited to pending arbitration claims) and all unpaid settlements in addition to unpaid arbitration awards. The IRC also suggests that the proposed rule should provide clarity on the availability of funds from the Restricted Deposit Requirement to recover for pending claims, unpaid settlements, or arbitration awards, including when the firm is no longer a FINRA member.

Preliminary Criteria for Identification: Expungement and Product Lines

In other cases, it is less likely that the Preliminary Criteria for Identification would provide any enhanced protection against investor harm by high-risk member firms. For example, the IRC has recently represented different clients in two separate claims against the same member firm for investment losses related to unsuitable recommendations of non-traded REITs and BDCs, including two of the exact same securities in both claims. The brokers that recommended these high-commission products to the separate clients worked in different offices in different states. The clients in each claim also had different investment profiles. Yet, the separate brokers portrayed the same high-commission, illiquid securities as suitable for each of the clients. After the firm settled one of the IRC client's claims, the broker sought and obtained expungement of the claim.

The above example illustrates potential shortcomings in the Preliminary Identification Criteria in the proposed rule. First, the routine expungement of settlement disclosures from brokers' CRD records complicates implementation of proposed Rule 4111 and frustrates its stated purpose "to change firms' behavior – and therefore protect investors – through its direct financial impact."[3] Due to the expungement obtained in the above example, the settlement would not factor into the Registered Person Adjudicated Event category, despite the fact that it

[3] *FINRA Regulatory Notice 19-17*, p. 6.

evidences a history of misconduct in the form of investor harm and relates to a type of product that has also harmed other investors of the same firm. The IRC expresses concern that reliance on CRD disclosures in the threshold for Registered Person Event Metrics under the proposed rule will incentivize firms to increase pursuit of expungement of broker disclosures, which continues to be granted with far greater frequency than the "extraordinary" relief it is intended to be.

Second, as the member firm in this example has more than 600 brokers, at least 30 to 60 registered person events (depending on the category) would be necessary under the metrics in the proposed rule for FINRA to consider identifying the member firm as a Restricted Firm. While this may reflect an appropriate balance for general identification of high-risk firms, it may be less effective to address the increased risk of harm posed by a specific product or type of product. Moreover, due to the nature of non-traded securities in particular, investors may not observe harm for several years after investing and may or may not assert a claim for various reasons. One approach may be to include in the threshold criteria a category for measurement of disclosures related to specific products or types or products. In addition to the proposed Restricted Firm Obligations, FINRA may also consider imposing Restricted Firm Obligations tailored to the dangers of the products or types of products meeting the product-specific metric, including a Restricted Deposit Requirement sufficient to meet all unpaid awards and pending claims related to the products or product types, as well as other conditions and restrictions targeted to reform member firm behavior related to that product line. Given the difficulties posed by expungement of disclosures and accurate identification of products as reported in disclosures, a more effective approach may be to include consideration of the risk posed by specific products and the extent of the sales of those products relative to the member firm's overall business.

Support for Further Consideration of "Terms and Conditions" Rule

In Regulatory Notice 19-17, FINRA states that it considered, but rejected, a "terms and conditions" rule similar to Investment Industry Regulatory Organization of Canada ("IIROC") Consolidated Rule 9208, which permits the IIROC to impose terms and conditions on recidivist firms when it considers those terms and conditions appropriate to ensure the firm's compliance with IIROC requirements. The IRC supports further consideration of a "terms and conditions" rule because of the greater flexibility such a rule would provide in circumstances under which a firm does not the numerical metric for threshold identification as a Restricted Firm, especially when firms may seek to avoid meeting threshold metrics through expungement of disclosures that would otherwise impact threshold categories.

The IRC is committed to protecting investors and supports FINRA's efforts to impose more rigorous requirements on member firms that pose an increased risk of harm to investors. We thank FINRA for the opportunity to comment on this proposal.

Respectfully submitted,

Scott A. Eichhorn
Associate Director