July 1, 2019

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I am writing regarding proposed Rule 4111 in response to Notice to Members 19-17. Proposed Rule 4111 should not be enacted because it will have a disparate impact on small firms, for the reasons set forth herein. While material changes to the Rule are also suggested herein, even if FINRA adopted all of the suggested changes, the Rule should still not be enacted.

The number of broker-dealers has declined from 5,892 in March 2007 to 3,989 in March 2017. This should cause policymakers grave concern. Proposed Rule 4111 will only exacerbate this downward trend. FINRA's true priority, as reflected in, among other things, this proposed Rule, is to force small firms out of the business.

In general, small firms and small businesses are the driving force of new employment and innovation in the United States. Congress has demonstrated that easing regulation, not increasing regulation, to encourage funding of small businesses, is a legislative priority. For instance, in 2012, Congress enacted the Jumpstart Our Business Startups Act with bipartisan support, to ease regulation and encourage the formation of small business.

FINRA, which purports to operate as a "not-for-profit" corporation, acts with unresolvable financial conflicts of interest in its regulatory activities. FINRA wants to put small firms out of business because it cannot make a profit regulating small firms. FINRA can only pay its executive management and employees the outsize salaries and bonuses it pays them if it collects significant fines and controls regulatory costs. The cost of regulating small firms exceeds the fines that FINRA can collect from small firms. As a result, FINRA is seeking to enact a rule that disparately impacts small firms and greatly enhances FINRA's ability to put them out of business.

To determine the true impact on small firms of the proposed rule, the FINRA Chief Economist should do an economic analysis of the true effect on small firms if the proposed rule is enacted. The FINRA Chief Economist should do an analysis of how many brokers who are licensed with FINRA and in good standing would become unemployable under proposed Rule 4111. For example, the FINRA Chief Economist should do an analysis of how many of the 66,477 registered representatives who worked at small firm in 2017 have worked at a firm that has been expelled at any time in their careers, which would render such representative virtually unemployable under the proposed Rule.

FINRA's Testing of the Metrics From 2013 to 2018 is Flawed

The back-testing of the impact of proposed Rule 4111 on FINRA Firms in Attachment D is flawed since it only includes the time period for a bull market (it does not consider the effect of a market correction, such as what occurred in 1987, 2001 or 2008) Historically, a significant number of "events," (as defined in the Notice) occur within a couple of years after a market correction, yet the analysis contained in Attachment D only goes back to 2013, which is five years after the 2008 correction. FINRA should review their customer complaints, terminations for cause, arbitration, etc. statistics for this period, which no doubt will bear out this concern.

Proposed Rule 4111 Should Be Abandoned Because It Lacks Transparency

While FINRA claims that proposed Rule 4111 has transparency, it in fact does not. For instance, proposed Rule 4111 encompasses a "flow chart" filtering process that permits FINRA to simply decline to enforce the Rule against some firms and to enforce the Rule against other firms. The flow chart filtering process gives FINRA unconstrained discretion to enforce, or not to enforce, proposed Rule 4111. The Rule also gives FINRA complete discretion to exempt a Firm from the restrictions after its Consultation. There should be specific, enumerated criteria that restricts and constrains FINRA.

FINRA also has unfettered ability to place "conditions or restrictions on the member's operations." This power again entirely lacks transparency. There are no guidelines or parameters on what "conditions or restrictions" FINRA can place on a firm in the event that FINRA decides to enforce proposed Rule 4111 against it. FINRA would be free to raise compliance costs at a small firm to a level that would exhaust a small firm's resources and force that firm to close its doors.

There is also no transparency in FINRA's ability to set the amount of the Restricted Deposit. The Restricted Deposit is a backdoor way of allowing FINRA to randomly increase the Net Capital requirements on firms it selects to do so or increase the amount of cash required to run a firm. There are no parameters or guidelines for how much the Restricted Deposit can be. Proposed Rule 4111(i)(15) states that a Restricted Deposit Amount "would not significantly undermine the continued financial stability and operational capability of the firm as an ongoing enterprise…." This is just not true and as any CEO or CFO knows, taking away a significant amount of cash from the operations results in cashflow problems, increased borrowing, and layoffs. However, there is no maximum or cap on what FINRA could set as a Restricted Deposit Amount and FINRA has complete discretion over this that is not reviewable outside of FINRA.

Thus, FINRA can easily set a Restricted Deposit amount that would be far outside the reach of a small firm. However, large firms would undoubtedly not be subjected to Restricted Deposit Amounts that would threaten the existence of the firm.

For these reasons, among others, proposed Rule 4111 lacks transparency and should be abandoned.

Proposed Rule 4111 Is Too Subjective and Gives FINRA Too Much Discretion to Apply the Rule in a Manner That is Arbitrary and Capricious

Proposed Rule 4111 empowers FINRA to act in a manner that is arbitrary and capricious in numerous material ways. Rules of a self-regulatory organization cannot be "arbitrary and capricious." *See, e.g., Susquehanna International Group, LLP, et al., v. SEC*, 866 F. 3d 442 (D.C. Cir. 2017) (reviewing SEC Order approving rule of self-regulatory organization under the "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" standard of the Administrative Procedures Act).

For example, the proposed Rule gives FINRA unfettered ability to place "conditions or restrictions on the member's operations," to set the amount of the Restricted Deposit, and to exempt a firm from the Restricted Deposit requirement. There are no parameters as to what conditions or restrictions could be set.

Proposed Rule 4111(i)(15) states that a Restricted Deposit Amount "would not significantly undermine the continued financial stability and operational capability of the firm as an ongoing enterprise…." However, there is no maximum or cap on what FINRA could set as a Restricted Deposit Amount and there is no safeguard preventing FINRA from setting a deposit that actually seriously impacts the viability of the firm. For example, at the very minimum, there should be a restriction in place that prevents a Restricted Deposit Amount from being greater than a certain percentage of required Net Cap or a percentage of average Net Income over the last three years. The use of the word "significantly" is vague and ambiguous and permits FINRA to apply the proposed Rule in a manner that is arbitrary and capricious.

Proposed Rule 4111 also gives FINRA arbitrary authority to set deadlines for things that could be different for different firms. For instance, proposed Rule 4111(e)(1)(B)(i) states that a Restricted Firm must "promptly establish a Restricted Deposit Account…." The use of the word "promptly" is vague and ambiguous and permits FINRA to apply the proposed Rule in a manner that is arbitrary and capricious. FINRA would have the discretion to set a timeline for the establishment of a Restricted Deposit that does not provide a small firm with enough time to raise the capital.

These are just three examples of why proposed Rule 4111 cannot be enacted because it gives FINRA too much discretion to apply it in a manner that is arbitrary and capricious.

Proposed Rule 4111 Exceeds FINRA's Authority Under the Securities and Exchange Act of 1934

Proposed Rule 4111 violates the Exchange Act and exceeds FINRA's authority under the Exchange Act and thus cannot be approved by the United States Securities and Exchange Commission (the "Commission"). A FINRA rule that violates the Securities and Exchange Act of 1934 (the "Exchange Act") is unenforceable. *See* 15 U.S.C. § 78s(b)(3)(C) (SRO rule "may be enforced … to the extent it is not inconsistent with the provisions of this title [15 U.S.C. §§ 78a *et seq.*], the rules and regulations thereunder, and applicable Federal and State law.").

The Exchange Act constricts FINRA's authority. FINRA only has authority to have rules that are "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, […] to remove impediments to and perfect the mechanism of a free and open market […], and are *not* designed to permit unfair discrimination between customers, issuers, brokers or dealers …." 15 U.S.C. § 78o-3(b)(6) (emphasis added). Here, proposed Rule

4111 exceeds FINRA's authority under the Exchange Act because it is designed and intended to permit unfair discrimination between brokers and dealers and otherwise serves no purpose.

The Rule will have, and is intended to have, a disparate impact on small and large broker-dealers. The draconian requirements that this proposed rule seeks to impose will essentially put many more small firms out of business by raising compliance costs, effectively raising the net capital requirement, and limiting and restricting firm operations that provide sources of revenue for small firms. And as FINRA's own analysis points out in Attachment D, discussed below, the proposed Rule will have an impact on small firms and almost no impact on large firms.

Congress has shown over and over again that the growth and development of small business in the United States is a public policy priority. The Exchange Act itself reflects this public policy. The Exchange Act does not authorize the Commission to approve any rule of a self-regulatory organization that imposes an undue burden on competition. *See*, *e.g.*, 15 U.S.C. § 78o-3(b)(9) ("An association of brokers and dealers shall not be registered as a national securities association unless the Commission determines that […] (9) The rules of the association do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.").

Moreover, under 15 U.S.C. § 78o-3(b)(5), "[a]n association of brokers and dealers shall not be registered as a national securities association unless the Commission determines that – […] [t]he rules of the association provide for the equitable allocation of reasonable dues, fees, and other charges among members …." Effectively raising the net capital and cash requirements on certain firms on an arbitrary basis violates this law.

FINRA rules must "remove impediments to and perfect the mechanism of a free and open market […], and are not designed to permit unfair discrimination between […] brokers[] or dealers …." 15 U.S.C. § 78o-3(b)(6). Rather than "remove impediments to and perfect the mechanism of a free and open market," proposed Rule 4111 *is* an impediment to a free and open market.

Proposed Rule 4111 burdens small firms only. This is proven beyond any doubt by Attachment D-2, Distribution of Firms Meeting the Preliminary Criteria for Identification by Firm Size. Attachment D-2 identifies the percentage of firms meeting the Preliminary Criteria for Identification by Firm Size. During the sample period of 2013 to 2018, 94% to 90% of the firms meeting the Preliminary Criteria for Identification were small firms. During this time, the percentage of the total of large firms meeting the Preliminary Criteria for Identification ranged from 0% to 2% of the firms.

In addition to being a result of the factors discussed herein, the fact that 90% of the firms meeting the criteria are small firms and 0% of the firms meeting the criteria are large firms is a direct result of, among other things, the bias in the Preliminary Identification Metric Thresholds. The thresholds are purposely set to punish small firms and to allow for wrongdoing at large firms with no consequences under the rule.

Proposed Rule 4111 also violates the Exchange Act and cannot be enacted because it is an end-run around the Exchange Act's requirement that there be a fair process for imposing discipline on a member firm or a representative. *See* 15 U.S.C. §780-3(b)(8). Rule 4111 allows FINRA to far exceed its disciplinary abilities, by monetarily sanctioning firms and by restricting their operations at FINRA's discretion with no protections for the firms or the representatives that the Rule would impact.

In the Notice to Members on page 4, FINRA explains its true basis for the rule. FINRA states that "examiners are not empowered to require a firm to change or limit its business operations" and that "these constraints on the examination process protect firms from potentially arbitrary or overly onerous examination findings" and that "enforcement actions can only be brought after a rule has been violated."

In the next paragraph, FINRA admits that with the proposed Rule it is trying to circumvent the laws, regulations, and rules that limit and restrict FINRA's ability to impose discipline. FINRA admits that enforcement actions can only be brought when a rule is violated and that firms and representatives are entitled to hearings and appeals. FINRA wants to enact a rule that simply circumvents the due process and fair procedure requirements that provide what limited restriction there is on FINRA's behavior and allow it to sanction firms with impunity. *See* 15 U.S.C. §78o-3(b)(8).

The true basis for proposed Rule 4111 is for FINRA to circumvent the due process guarantees for member firms and registered representatives in the Exchange Act and the Constitution. The true purpose to is to remove the "constraints" on the examination process that protect firms from potentially arbitrary or overly onerous examination findings and replace those constraints with unfettered and arbitrary discretion. It has nothing to do with "investor protection," "market integrity," or "arbitration awards."

Proposed Rule 4111 Cannot Be Enacted Because It Violates the United States Constitution

Proposed Rule 4111 cannot be enacted because it is unconstitutional. *See* 15 U.S.C. § 78s(b)(3)(C) (SRO rule "may be enforced … to the extent it is not inconsistent with the provisions of this title [15 U.S.C. §§ 78a *et seq.*], the rules and regulations thereunder, and applicable Federal and State law."). Proposed Rule 4111 would be unenforceable because it violates the Constitution and the Exchange does not permit it. Moreover, the Commission cannot issue an Order approving a rule of a self-regulatory organization such as FINRA that violates due process because all activities of the Commission are subject to the constraints of the Constitution. In addition, the constraints of the Constitution apply to FINRA's activities and its rules, because FINRA does not have rule-making authority and can only enact a rule with an order of the Commission,[1] to which the Constitution applies. Thus, all FINRA rules must be constitutional. Proposed Rule 4111 is not.

Because interested FINRA staff would rule on exemption requests, there is no meaningful appeals process of the Restricted Deposit Amount, there is no meaningful appeals process at all because, among other things, there is no stay during the appeals process, and two of the Preliminary Identification Metrics subject firms to the Restricted Deposit and conditions and limitations on their operations prior to any adjudication of fault, the rule is unconstitutional. It is also unconstitutional because it has no rational basis, is impermissibly vague and ambiguous, and is arbitrary and capricious.

While the limitation or restriction of a member firm's operations is appealable to the Commission, there is no stay during the appeal, meaning the firm could be forced out of business before the appeal is even heard. In addition, the amount of the Restricted Deposit is only appealable, also without a stay, within FINRA. Thus, interested FINRA staff would be free to set a firm's Restricted Deposit at such a level that a firm would be unable to pay it and would force the firm out of business. Such a firm would have no recourse outside of FINRA. The FINRA process for hearings and appeals favors FINRA nearly 100% of the time and does not provide for or protect due process. Indeed, reviewing five years of decisions of the National

[1] See 15 U.S.C. § 78s(b).

Adjudicatory Council shows that FINRA wins 99% of the time, *per se* evidence of bias. The Rule 9600 Series is subject to collateral attack because it is unconstitutional.

Two of the Preliminary Identification Metrics would subject firms to punitive deposit requirements and restrictions on their operations prior to any adjudication of fault. "Registered Person Pending Events," as defined in proposed Rule 4111(i)(4)(B), would permit FINRA to require firms to maintain deposits and enable FINRA to limit or restrict a firm's operations prior to any finding that the broker at issue violated any law, rule, or regulation. "Member Firm Pending Events," as defined in proposed Rule 4111(i)(4)(E), would have the same effect. In effect, it is "guilty until proven innocent."

Permitting FINRA to count pending events in the Preliminary Identification Metric makes a mockery of due process. "Pending" events by definition exclusively consist of allegations that have not been proven. Counting "Pending Events" in the Preliminary Identification Metric allows FINRA to circumvent the established enforcement procedures entirely without due process.

Proposed Rule 4111 has no rational basis. FINRA claims that the basis for the proposed rule is to "promote investor protection and market integrity and give FINRA another tool to incentivize member firms to comply with regulatory requirements and to pay arbitration awards." The proposed Rule does not accomplish this purpose and the stated purpose is a sham.

FINRA's own enforcement behavior belies any claim that a Restricted Deposit is necessary for the protection of investors or to encourage member firms to pay arbitration awards, as FINRA settles with representatives and supervisors and allows them to stay in the business while expelling the whole firm, causing the very problems they claim now to be seeking to fix.

If FINRA believes a representative is not suitable for the business, the regulator should revoke the representative's license and not punish a whole firm.

Moreover, a firm that does not pay an arbitration award or an arbitration settlement gets suspended. It is hard to imagine how a rule that permits FINRA to arbitrarily raise a small firm's capital requirements and limit a firm's operations would enhance a firm's ability to pay arbitration awards or "encourage" them to do so. There is no rational basis.

"Investor protection" and "market integrity" are completely meaningless generic terms that that this rule claims to support but does not. The real basis for proposed Rule 4111 is to enhance the ability to discriminate against small firms in favor of large firms and to use the backdoor to expel small firms and bar representatives that it otherwise cannot or will not under existing FINRA rules and the Constitution's and the Exchange Act's guarantees of due process and fair procedure protections.

As stated above, in the Notice to Members on page 4, FINRA explains its actual basis for the rule. FINRA states that "examiners are not empowered to require a firm to change or limit its business operations" and that "these constraints on the examination process protect firms from potentially arbitrary or overly onerous examination findings" and that "enforcement actions can only be brought after a rule has been violated."

There is no rational basis for proposed Rule 4111 because what it really does is allow FINRA to circumvent the due process and fair procedure guarantees for member firms and registered representatives in the Constitution and the Exchange Act. The true purpose to is to remove the "constraints" on the examination process that protect firms from potentially arbitrary or overly onerous examination findings and replace those constraints with unfettered and arbitrary discretion. It has nothing to do with "investor protection," "market integrity," or "arbitration awards."

In addition to the requirement that the proposed Rule be constitutional, FINRA's enforcement of the rule must also be constitutional. FINRA claims both to have "governmental immunity" exempting it from civil suits and to be a "private actor," exempting it from the application of the United States Constitution to its rules and actions. This leaves firms in the untenable position of having no recourse. It is an untenable position that is subject to attack. There is no such thing as a "private actor with sovereign immunity."

As a result, proposed Rule 4111 cannot be enacted because it is so vague and ambiguous that it gives FINRA free range to enforce the rule in an arbitrary and discriminatory fashion. There are no guidelines or constraints on how FINRA could limit or restrict a member firm's business. The language of the rule violates due process because it is impermissibly vague.

For instance, proposed Rule 4111(a) provides that a member "shall be subject to such conditions or restrictions on the members operations as determined by the Department to be necessary or appropriate for protection of investors and in the public interest." This language is irreparably vague, ambiguous, contentless, and meaningless. The rule is so standardless that it authorizes and encourages seriously discriminatory enforcement.

Proposed Rule 4111 Is Biased Against Small Firms

According to NTM 19-17, "as of year-end 2018, there were 20 small firms (i.e., firms with no more than 150 registered persons) with 30 or more disclosure events over the prior five years, 10 mid-size firms (i.e., firms with between 151 and 499 registered persons) with 45 or more disclosure events over the prior five years, and five large firms (i.e., firms with 500 or more registered persons) with 750 or more disclosure events over the prior five years." NTM 19-17, p.

4. The impact on a small firm of one disclosure event is enormous, while the impact on a large firm of any disclosure event has literally no impact. If a firm with 100 representatives is allowed to have 30 disclosures, how is a firm with 500 representatives allowed to have 750 disclosures?

FINRA is purposely insulating large firms with hundreds of disclosure events from proposed Rule 4111 while subjecting small firms with a tiny fraction of the disclosure events to draconian financial burdens. Permitting large firms to have 750 disclosure events while only permitting small firms to have 30 disclosure events reflects evident bias against small firms. The alleged wrongdoing of one representative at a small firm puts that small firm over the limit and has no impact on a large firm.

FINRA's Attachment D-2 chart shows that 0% of the large firms met the Preliminary Criteria for Identification in the last two years of the review period.

To demonstrate the flaws in the proposed Rule, one only has to compare the BrokerCheck reports of the small firms with the BrokerCheck reports of the large firms. Large Firm 1 has 1,174 Disclosures on its BrokerCheck Report, including 531 Regulatory Events, 4 Civil Events, and 639 Arbitrations. In 2018 alone, Large Firm 1 had at least 6 regulatory disclosure events, including making misstatements and omissions (resulting in a $6,500,000 fine), failure to supervise, failure to establish and maintain a supervisory system, and failure to supervise traders who were mismarking trades and engaging in unauthorized trading (resulting in a $5,750,000 fine). These violations include such systemic violations as, for example, the failure to establish and maintain a reasonable system to review for the accuracy of content in the firm's customer trade confirmations over 11 years pertaining to errors in 9.3 million of the firm's 12.5 million trade confirmations ($550,000 fine).

Large Firm 2 was sanctioned for having systems that allowed five representatives to steal more than $1 million out of customer accounts. Large Firm 2 paid a $4.5 million dollar fine to the SEC. Small firms have been expelled for far less egregious conduct.

Yet, somehow, according to FINRA's proposed metrics and thresholds, 0% of large firms met the test for a restricted firm.

On the other hand, one "disclosure event" regarding alleged "supervisory" violations relating to one representative where there are no customer complaints and no losses would count as the exact same thing at a small firm.

Attachment D-2, Distribution of Firms Meeting the Preliminary Criteria for Identification by Firm Size, is *per se* evidence of the bias in proposed Rule 4111 against small firms. For the years 2013 through 2018, small firms accounted for more than 90% of all firms meeting the "Preliminary Criteria for Identification." Yet these small firms have a small number of disclosures relative to the enormous number of disclosures at large firms.

The Preliminary Identification Metric Exponentially Magnifies the Existing Regulatory Bias

FINRA does not enforce the rules against small and large firms, or the representatives who work in those respective firms, in the same way. FINRA also does not enforce the rules against firms in an evenhanded manner. There is no uniformity in FINRA sanctions for similar conduct across firm sizes. There is also no uniformity in the charges that FINRA brings.

The Preliminary Identification Metric Is Subject to Manipulation

The Preliminary Identification Metric is also subject to manipulation due to the bias in FINRA's process for expelling firms. With exceedingly rare example, FINRA does not expel large firms. However, FINRA expels small firms.

For example, FINRA never expelled Lehman Brothers, Bear Stearns, or Brookstreet Securities Corporation. Therefore, none of the representatives who worked at the two largest broker-dealers responsible for the near collapse of the U.S. economy in 2008 or a large firm that blew up when its dangerously leveraged collateralized mortgage obligation activities imploded have had their records marked with "being from an expelled firm." As a result, even if a representative worked at Lehman Brothers, Bear Sterns, or Brookstreet, that representative would not have a mark on his or her license. So, when those representatives go to work for other firms, also likely large firms, the hiring firms will avoid triggering the Preliminary Identification Metric.

Rather than be subject to FINRA sanctions and expulsion, Congress paid hundreds of billions of dollars to bail out the very entities that created the 2008 crisis. For example, AIG and its Chief Executive Officer were never sanctioned or expelled.

Brookstreet, a large firm that sold derivative securities that were over-leveraged and thus risky to its customers without proper disclosures, was never expelled. Its membership was "cancelled" by FINRA on September 3, 2008.

By contrast, FINRA expels small firms that are already out of business, exceeding its authority. For instance, FINRA expelled Small Firm 1 in July 2017. Small Firm 1 had 18 regulatory events on its BrokerCheck Report and had been in business since 1978 (compared to the hundreds if not thousands at large firms). Small Firm 1 filed Form BDW on December 9, 2016. FINRA did not expel the firm until July 2017, after the firm had already filed Form BDW and gone out of business. According to BrokerCheck, FINRA "expelled" Small Firm 1 for "failure to pay fines and costs" on July 31, 2017. As a result, every representative who ever worked at Small Firm 1 now bears the mark on his or her license as being from an expelled firm.

In 2017, there were more than half a million registered representatives working at large firms. By contrast, in 2017, there were only 66,477 representatives working at more than 3,000 small firms. According to FINRA's 2018 FINRA Industry Snapshot, 81% of the registered representatives worked at large firms. Yet, because FINRA does not expel large firms, with extremely rare exception, these representatives do not have a mark on their license as being from an expelled firm. Because FINRA expels small firms, the metrics disparately impact the representatives who work at small firms.

Proposed Rule 4111 Is a Backdoor Way of Expelling Firms and Barring Representatives from the Industry

Proposed Rule 4111 gives FINRA the discretion to put restrictions and limitations on firms and to require firms to put up a Restricted Deposit that will undoubtedly be out of reach for at least some small firms. Proposed Rule 4111 is intended to provide FINRA with a mechanism to force small firms out of business that it otherwise cannot with the bare minimum of protections that small firms have against FINRA as it is.

Proposed Rule 4111 is also intended to make it financially untenable for small firms to employ brokers with certain levels of disclosures, essentially making such brokers unemployable. This is a backdoor way of removing from the industry brokers whom FINRA has no grounds to bar. It permits FINRA to essentially bar from the industry brokers who have not violated any rule while further denying them any due process or appeals procedures. FINRA would not have to prove any violation of a rule, regulation, or law that could support the sanction of a bar from the industry, yet such brokers will be rendered unemployable. This is a backdoor way around the Exchange Act's requirements that FINRA cannot take away the license of a representative without a violation that is proven through a fair procedure and due process, as guaranteed by the Exchange Act and the Constitution. *See* 15 U.S.C. §780-3(b)(8).

Firms should be entitled to employ any broker who has a FINRA license. If FINRA believes that any certain broker has engaged in conduct that would warrant a bar from the industry, FINRA should be required to proceed under the established disciplinary rules and requirements to revoke his or her license.

There is an enormous range of disclosure items that would count towards a Registered Representative's Adjudicated and Pending Event Metrics. For example, many customers file arbitration complaints anytime they lose money and make allegations that are not true. Many customer arbitrations are entirely without merit. Nonetheless, a small award from an arbitration panel or the settlement of a meritless claim to reduce the cost of litigation would count towards a firm's Preliminary Identification Metric. On the other hand, a large meritorious claim against another representative with a million dollar award would count as the exact same thing. There is no method for a representative to have an opportunity to be heard regarding what is essentially a disciplinary mark on his/her license under Proposed Rule 4111. Moreover, if a claimant names every officer of the firm, which is common practice, each officer named in the arbitration would count towards the metric even if they were never involved with the customer.

This is also true as to a representative who once worked at a firm that was later expelled, even if they worked there years or decades before the expulsion. Such a representative would be unemployable. There is no method for a representative to have an opportunity to be heard regarding what is essentially a disciplinary mark on his or her license under Proposed Rule 4111.

The Proposed Ways That a Firm Can Affect the Outcome Are Unlikely to Work

FINRA is unlikely to exempt any firms from the Restricted Deposit Requirement based on a member's explanation of why it should not be subject to the Restricted Deposit Requirement. Member firms that are designated as Restricted Firms are also unlikely to get relief from a Hearing Officer from the FINRA Office of Hearing Officers. Member firms are also unlikely to get relief from the FINRA National Adjudicatory Council. The track record of the OHO and the NAC speaks for itself. This would subject firms to a long and expensive appeal, during which time the firm's resources are tied up in the Restricted Deposit Account and during which time there is no stay of the restrictions FINRA decides to impose. With regard to the amount of the Restricted Deposit, there is no appeal outside of FINRA and the internal FINRA appeals process is unconstitutional.

PROPOSED RULE 4111 SHOULD BE MATERIALLY CHANGED

The Formula for Computing the Preliminary Identification Metrics is Overinclusive

Persons registered with the firm for one day should not be counted towards the metric. There should be a minimum employment period of 180 days before the representative counts towards the metric.

The Preliminary Identification Metrics Should be Materially Changed

Adjudicated Events

"Registered Person Adjudicated Events," defined in proposed Rule 4111(i)(4)(A), should not include subsection (ii) regarding settlements of customer claims because representatives settle cases with false and unsupportable allegations to avoid legal fees, the distraction of arbitrations, and arbitration risk. The allegations are never proven and should not be counted against the representative or the firm.

Subsections (i) and (ii) should be narrowed because Claimants' lawyers often reflexively name all officers and directors as control persons or for failure to supervise regardless of the fact that such officers and directors never even had supervisory responsibilities or customer contact. Thus, one settlement implicating one representative could count as five or more events even when there is no fault.

Subsections (iii) and (iv) should not include "findings" because such findings are the result of settlements and are not the result of proven allegations. Representatives settle false accusations for many reasons, including the expense of litigating claims, the distraction of a proceeding, and the general risk attendant to a contested proceeding. In addition, events that do not involve any customer harm should not be included.

Subsection (v) should not include criminal matters in which the registered person pled nolo contendere (no contest) because there was no admission or proof of guilt.

"Member Firm Adjudicated Events," defined in proposed Rule 4111(i)(4)(D), should not include "findings" because firms settle for many reasons even if there has not been a violation of the laws, rules, or regulations, including the decision to stop paying substantial legal fees, to put the matter behind the firm because it is distracting to management, and to avoid the FINRA disciplinary proceeding and appeal process, which is entirely biased in favor of FINRA. These "findings" in an AWC have not gone through a judicial process and there has not been any determination of factual or legal violations. A firm does not admit it engaged in any wrongdoing.

If findings are included it is highly likely that this compromise process will end as individuals and small firms will need to fight to the end to avoid the devastating consequences of Rule 4111. Such "findings" remain unproven allegations that were never subjected to the judicial process. Including "findings" in the Preliminary Identification Metric elevates "findings," in which the member firm does not admit the "findings," to the same level as what has been proven at a hearing. In addition, events that do not involve any customer harm should not be included.

Pending Events

"Registered Person Pending Events," as defined in proposed Rule 4111(i)(4)(B), and "Member Pending Events," as defined in proposed Rule 4111(i)(4)(E), should not be included in any final rule. Including "pending events" in the Preliminary Identification Metric is unfair and violates due process. Allegations are not proven and are often false. This allows FINRA to open an investigation into a member firm and, in conjunction with the biased metric thresholds for the other categories, automatically put a small firm over the Preliminary Identification Metric Threshold.

Including pending investigations in the Preliminary Identification Metric allows FINRA to simply sidestep its obligation to fairly conduct investigations. FINRA would be able to financially sanction a firm and restrict its activities without proving anything. According to FINRA in every 8210 letter, mere investigations "should not be construed as an indication that the Enforcement Department or its staff has determined that any violations of federal securities laws or FINRA, NASD, NYSE, or MSRB rules have occurred." However, under Proposed Rule 4111, FINRA would be able to immediately sanction a firm.

Criminal defendants are entitled to due process of law and are innocent until proven guilty. Sanctioning a firm because it or a representative had a pending criminal matter would deny such firm or person due process of law.

In addition, events that do not involve any customer harm should not be included.

Registered Person Termination and Internal Review Events

"Registered Person and Internal Review Events," as defined in proposed Rule 4111(i)(4)(C), should not be included in the Preliminary Identification Metric. Including any pending or closed internal review would have the obvious and perverse effect of discouraging firms from conducting internal reviews and lessening, not enhancing, internal compliance procedures. It is another example of the true basis for the Rule, to circumvent the disciplinary process and punish small firms. The proposed Rule has nothing to do with investor protection or market integrity.

Registered Persons Associated with Previously Expelled Firms

"Registered Persons Associated with Previously Expelled Firms," (also referred to as the Expelled Firm Association category), as defined in proposed Rule 4111(i)(4)(F), should be entirely removed as a category. In the alternative, representatives should not be counted who worked at an expelled firm "at any time in his/her career."

A high-ranking FINRA official admitted to the Wall Street Journal that "the fact that someone has worked for a high-risk or expelled firm 'doesn't mean they're necessarily a bad actor or guilty of anything."[2]

Representatives should not be counted who worked at an expelled firm "at any time in his/her career." There are representatives who worked at firms that were expelled years later. The representatives who once worked at a firm that was later expelled were not implicated in the enforcement actions in any way should not be counted. There should also be a time limit on when such representative worked at a firm that was expelled.

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[2] "*FINRA program hasn't barred any brokers who worked at "Wolf of Wall Street" firm*," The Wall Street Journal, March 5, 2012, available at http://www.marketwatch.com/story/watchdogs-hunt-is-short-on-wolves-2015-03-05

In addition, representatives hired by a member firm before the prior firm was expelled should not be counted towards the threshold. Firms that hire representatives from firms that have not been expelled at the time of the hiring decision should not be counted towards the threshold. A FINRA rule should not be allowed to contain a "gotcha" provision.

However, the category should be entirely removed because if FINRA expels a firm, it would automatically make all of its representatives, even the ones who were completely uninvolved in the events leading to the expulsion, unemployable.

The "One-Time Staff Reduction" should be revisited due to this discrepancy. If a representative is currently employed at a firm during an "Evaluation" period and none of his former employer member firms was an "Expelled Firm," but during the next "Evaluation Period" one or more of his prior employers are so labelled, the Firm is arbitrarily penalized for something that was completely out of both the current firm's and the representative's control in a "gotcha."

The metric Registered Persons Associated with Previously Expelled Firms is biased against small firms. It is unfair and overbroad. FINRA's method for marking the licenses of representatives who once worked at a firm that was later expelled itself violates due process as there is no notice and opportunity to be heard for a representative whose license is being marked with what is at its essence a disciplinary item.

FINRA has virtually only expelled small firms. When a firm is "expelled," every representative who ever worked at the firm, no matter when or for how long, is branded with the mark of being from an expelled firm. There are instances of a representative working at a firm for 7 days, years before the firm was ever expelled, who now bears the mark on their BrokerCheck as being from an expelled firm and other representatives who worked at a firm 20 years before it was expelled and who, if they worked for a member firm for one day during the Evaluation Period, would count towards the firm's threshold.

Almost all of the representatives from "expelled" firms in the current time had nothing to do with whatever disciplinary proceeding got the firm expelled, yet they are tarnished with being from an expelled firm. However, there are instances of FINRA settling with the representatives and supervisors who were involved and allowing them to stay in the business while expelling the entire firm and marking the licenses of all of the innocent representatives.

Proposed Rule 4111 threatens the ability of representatives who work at small firms to obtain and retain continued employment because, even though they are entirely innocent, the mark on their license of having worked at an expelled firm will discourage firms from hiring them due to the financial penalties and threat of the imposition of conditions and restrictions on their operations. Such innocent representatives will be rendered unemployable.

On the other hand, no matter the conduct, large firms with significant financial resources are permitted to simply pay fines. When a small firm cannot pay a fine, the firm is expelled.

As even further evidence of the uneven application of the rules and the potential for abuse, as demonstrated above, FINRA does not expel large firms that engage in rampant wrongdoing, such as Brookstreet, Lehman Brothers, and Bear Stearns, leaving those representatives free to go to other large firms without the scarlet letter of having worked at a firm that was expelled, and leaving large firms free to hire these representatives without having to count anything towards their thresholds.

Depending on the length of time that an expelled firm was registered, this metric could count thousands of representatives as having been from an expelled firm. This is an example of

FINRA’s disproportionate enforcement activities against small firms having an even more magnified effect here.

The Preliminary Identification Metric Thresholds Discriminate Against Small Firms

The Preliminary Identification Event Metric Thresholds are also strongly biased against small firms. For Member Firm Pending Events, for a firm up to 100 representatives, one pending event puts the firm at the threshold. For firms over 100 representatives, the thresholds are skewed in their favors. A firm with 500 representatives can have up to 4 pending events without triggering the threshold. In other words, under the proposed rule, a large firm with four pending criminal investigations would not have its activities restricted or have to put up a Restricted Deposit, but a small firm with one FINRA investigation that may have no merit would have its operations restricted or limited and their capital requirement arbitrarily raised with no due process protections, no fair procedure, and no meaningful appeal.

In addition, there is no provision made for actual harm to investors of the event. An event with no customer losses with a nominal fine would count the same as an event impacting millions of customers with a fine in the millions. FINRA disciplines member firms and individual representatives even when there is no harm to customers and such regulatory events should not be counted.

The One-Time Opportunity to Reduce Staffing Should Renew After Three Years

Proposed Rule 4111(c)(2) permits a firm that has triggered the Preliminary Identification Metric for the first time to reduce headcount to go below the threshold. The opportunity to reduce staffing should renew every three years. A lifetime bar on the opportunity to reduce staffing ignores, for instance, the reality of the cyclical nature of the financial markets.

The Five-Year Lookback is Too Long

The Evaluation Period of five years is too long. *See* Proposed Rule 4111(i)(6). For the adjudicated disclosure-event categories, under Proposed Rule 4111, the counts would include disclosure events that reached a resolution during the prior five years from the date of the calculation. The lookback period should be three years, as that would give a firm ample opportunity to resolve any issues.

Pending Arbitrations Should Not Impact the Size of a Restricted Deposit

No deposit should be required for pending arbitrations. On page 6 of the Notice, FINRA states that "pending arbitration claims" could impact the size of the required deposit. *See* NTM 19-17, at p. 6. Pending arbitration claims involve allegations that have not been proven. The proposed rule would give claimants' lawyers a gun to point at small firms in that the claimants' lawyers could simply inflate the damages claim, for instance, to force a firm to put up an enormous restricted deposit, essentially forcing a small firm to settle meritless cases prior to every Evaluation Period.

Small firms would also be forced to settle meritless cases before the Evaluation Period, regardless of when they were filed during the year, to get the case off the firm's books prior to any meaningful opportunity for discovery and disclosure and prior to any opportunity to make a motion to dismiss, to engage in legitimate settlement discussions, or to defend itself at a hearing. Proposed Rule 4111 eviscerates the Code of Arbitration Procedure and provides the claimant's securities bar with a potent weapon that will result in unfair results and violate firms' and representatives' due process rights, among other things.

There is Literally No Way For a Small Firm To Get Its Restricted Deposit Amount Back

At the next Evaluation Period after a firm is no longer determined to be a Restricted Firm, FINRA can still keep the Restricted Deposit for as long as it wants under the terms of proposed Rule 4111(f)(3). To get the Deposit back, a Firm must make an "application" to FINRA, who has complete discretion under the Rule to force the Firm to maintain the Deposit. FINRA will makes its determination "After such review as it considers necessary or appropriate…." This is another instance of the Rule being vague and ambiguous and allowing FINRA to apply the Rule in a manner that is arbitrary and capricious.

The proposed Rule also has a "presumption that the Department shall require the member or the Former Member to continue to maintain its Restricted Deposit Requirement if the member or the Former Member has any 'covered pending arbitration claims,' unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding." Rule 4111(f)(3)(D).

This allows FINRA to financially punish small firms against whom a claimant's lawyer has filed a meritless arbitration. It also punishes a small firm that is making settlement payments on a payment plan, even if that firm is paying as agreed. It also punishes small firms that have absolutely no history whatsoever of not paying arbitration awards in customer arbitrations.

It also materially alters a small firm's ability to settle an arbitration, because the claimants' bar will seek to obtain a settlement in the maximum amount of the funds available, just like they do with an insurance policy, not an amount that is actually reflective of the settlement value of the case.

The Proposed Rule Does Not Provide Firms With Adequate Time to Prepare For a Consultation or Implement Any Requirements

Proposed Rule 4111(d)(2) provides no protections to firms or restrictions on FINRA regarding the length of time between the written letter informing the firm that it is subject to a Consultation and the date and place of a Consultation. Proposed Rule 4111(e)(1)(B)(ii) also provides no timetable for firms to implement any conditions or restrictions that FINRA imposes or to fund a Restricted Deposit Account. Small firms do not have large amounts of extra capital and FINRA could suspend a firm if it cannot fund the Restricted Deposit Account in whatever time frame FINRA arbitrarily imposes.

There is No Meaningful Appeals Process

Proposed Rule 4111(e)(2) provides that there is no stay during the pendency of an appeal. This renders the appeals process, which is already largely meaningless, even more meaningless.

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In conclusion, Proposed Rule 4111 should not be enacted for all of the reasons set forth herein. Even if FINRA adopted all of the changes suggested herein, the Rule should still not be enacted for all of the reasons set forth above.