



**FINANCIAL  
SERVICES  
INSTITUTE**

VOICE OF INDEPENDENT  
FINANCIAL SERVICES  
FIRMS AND INDEPENDENT  
FINANCIAL ADVISORS

## VIA ELECTRONIC MAIL

June 29, 2018

Ms. Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
The Financial Industry Regulatory Authority, Inc.  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: Regulatory Notice 18-16 | FINRA Requests Comment on FINRA Rule Amendments Relating to High-Risk Brokers and the Firms That Employ Them (Notice)**

Dear Ms. Mitchell:

On April 30, 2018, the Financial Industry Regulatory Authority, Inc. (FINRA) published its request for public comment on proposed amendments to FINRA Rule 8312 (FINRA BrokerCheck Disclosure), as well as to FINRA rule series 9200 (Disciplinary Proceedings); 9300 (Review of Disciplinary Proceeding By National Adjudicatory Council and FINRA Board; Application for SEC Review); 9520 (Eligibility Proceedings); and to NASD Rule 1010 (Membership Proceedings) (collectively, Proposed Amendments and, each individually, a Proposed Amendment).<sup>1</sup>

In addition to the Notice, FINRA also filed with the Securities and Exchange Commission (SEC) a proposal to increase filing fees for individual statutory disqualification (SD) applications and imposing a first time filing fee on firm SD applications.<sup>2</sup> On April 30, 2018, FINRA published guidance to help firms implement effective plans of heightened supervision for advisors with a disciplinary history warranting such supervision.<sup>3</sup> Thereafter, on May 2, 2018, FINRA published Regulatory Notice 18-17 revising its sanction guidelines by encouraging adjudicators to consider stricter sanctions where the member's disciplinary history, prior arbitration awards, or prior settled arbitrations indicate a pattern.<sup>4</sup> These collective measures are part and parcel of FINRA's efforts to address high risk advisors and the firms that associate with those advisors.

The Financial Services Institute<sup>5</sup> (FSI) appreciates the opportunity to comment on this important proposal. FSI supports regulatory proposals addressing high risk advisors, and firms

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<sup>1</sup> See FINRA Regulatory Notice 18-16 at p. 2 (April 30, 2018) (Notice).

<sup>2</sup> See S.E.C. Release No 34-83181; File No. SR-FINRA-2018-018 (May 7, 2018) at pp. 3-4.

<sup>3</sup> See FINRA Regulatory Notice 18-15 (April 30, 2018).

<sup>4</sup> See FINRA Regulatory Notice 18-17 (May 2, 2018).

<sup>5</sup> The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

that choose to associate with those advisors, so long as the proposal: (a) is reasonable; (b) is narrowly tailored to address the intended class of advisors or firms and to discourage the targeted misconduct; (c) is not overly broad such that it has the unintended consequences of adversely impacting compliant advisors or firms or posing an impediment on firms' legitimate business activities; and (d) fosters investor protection. Applying that criteria to the present proposal, FSI supports the Proposed Amendments, subject to the suggested modifications discussed below.<sup>6</sup>

### **Background on FSI Members**

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.<sup>7</sup> These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).<sup>8</sup>

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.<sup>9</sup>

### **Discussion**

FSI appreciates the opportunity to comment on FINRA's proposal. As noted above, FSI supports the proposal. In particular, the numeric parameters and proposed criteria for Materiality Consultation (MatCon) filings is sound and reasonable. There are, nonetheless, certain aspects of the proposal that FSI is concerned may be interpreted too broadly. The basis for FSI's support of the MatCon filing parameters and criteria, as well as the basis for FSI's concerns regarding the

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<sup>6</sup> For the avoidance of doubt, FSI's support, subject to the modification discussed herein, of the Proposed Amendments should not be construed to infer that FSI supports (or does not support) the guidance and other proposals referenced in the first paragraph of this letter.

<sup>7</sup> Cerulli Associates, Advisor Headcount 2016, on file with author.

<sup>8</sup> The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

<sup>9</sup> Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

scope of certain other aspects of the proposal, are set forth more fully below for your consideration.

## **I. FSI Supports FINRA's Rule Proposal, Subject to Certain Modifications**

### **A. Interim Orders by Adjudicators Should be Narrowly Tailored to Address the Violation**

FINRA rules stay sanctions imposed by Hearing Panels while the matter is on appeal to the National Adjudicatory Council.<sup>10</sup> This includes sanctions to expel or bar a member from FINRA membership.<sup>11</sup> To heighten investor protection, FINRA proposes to adopt FINRA Rule 9285(a), which provides, in pertinent part, that:

“The Hearing Panel or, if applicable, the Extended Hearing Panel (“Hearing Panel”), or Hearing Officer may impose such conditions or restrictions on the activities of a Respondent as the Hearing Panel or Hearing Officer considers reasonably necessary for the purpose of preventing customer harm.”<sup>12</sup>

That proposal would, in sum, allow Hearing Panels who have found that a FINRA member violated a rule or statute, to impose restrictions on the member while the matter is under appeal. FSI supports this proposal because there has been an affirmative finding, by an adjudicator, that the respondent has engaged in wrongdoing. Under these circumstances, the firm's and advisor's fair process is not compromised by, for example, basing specialized requirements on pending proceedings that have not yet resulted in a determination by an adjudicator. Additionally, investor protection is heightened by placing restrictions on the firm's or advisor's activities while the appeal is pending. This proposal, therefore, appears to strike the appropriate balance between the FINRA member's rights and investor protection considerations.

However, while the Notice explains that the Hearing Panel would be qualified to “... craft tailored conditions and restrictions to minimize ... potential harm,”<sup>13</sup> proposed rule 9285(a) does not require that the conditions or restrictions imposed be appropriately tailored. Rather, proposed rule 9285(a) only requires that the Hearing Panel believe the restriction or condition is “reasonably necessary for the purpose of preventing customer harm.”<sup>14</sup> That language could be interpreted to grant Hearing Panels extensive power, resulting in Hearing Panels imposing restrictions or conditions that are overly broad. Overly broad restrictions or conditions, i.e., ones that are not substantially related to the violation, may not be fair to the advisor or firm. More importantly, however, they have little investor protection value because the restriction or condition is not tailored to address, prevent, or deter future instances of the violation. FSI suggests a solution below.

### **B. Interim Orders by Adjudicators Placing Restrictions or Conditions on Advisors Should Consider Firm Size and Resources**

As noted above, the Hearing Panel may have the qualifications, based on their knowledge of the violation, to determine what restrictions or conditions may be necessary to prevent customer harm. However, in the case of an advisor that is associated with a FINRA member firm at the time

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<sup>10</sup> See FINRA Rule 9311(b).

<sup>11</sup> See Notice at p. 7.

<sup>12</sup> See Proposed FINRA Rule 9285(a).

<sup>13</sup> *Id.*

<sup>14</sup> See Proposed FINRA Rule 9285(a).

the Hearing Panel renders its adverse determination, that firm would have to be able to supervise the advisor to ensure that she complies with the restriction or condition. This may be problematic because the Hearing Panel would not have sufficient knowledge of the firm's supervisory structure to determine the nature of supervision that is feasible for the firm. Thus, the Hearing Panel should give due consideration to the firm's size and resources and the firm should be permitted to propose conditions or restrictions for the Hearing Panel's consideration.

Thus, FSI suggests that proposed rule 9285(a) be amended in the following regard:

"The Hearing Panel or, if applicable, the Extended Hearing Panel ("Hearing Panel"), or Hearing Officer may impose such conditions or restrictions on the activities of a Respondent as the Hearing Panel or Hearing Officer considers reasonably necessary for the purpose of preventing customer harm and that are reasonably designed to prevent further violations of the rule or rules the Hearing Panel or Hearing Officer has found to have been violated.

In imposing conditions or restrictions in respect to a registered representative in accordance with this Rule, the Hearing Panel or Hearing Panel Officer shall:

- i. Provide the firm the registered representative is associated with at the time the conditions or restrictions are imposed, with the opportunity to propose conditions or restrictions reasonably designed to prevent further violations of the rule or rules the Hearing Panel or Hearing Officer has found to have been violated; and
- ii. Consider the firm's size, resources and overall ability to supervise the registered representative's compliance with the condition or restriction."

This additional language will prevent the Hearing Panel from imposing restrictions or conditions unrelated to underlying misconduct and from imposing restrictions that may be unduly burdensome to supervise, due to the firm's size or its limited resources.

C. Respondents' Burden of Proof in Expedited Review Proceedings of Interim Orders by Adjudicators Should be Narrowly Tailored to Prevent Reoccurrences of The Underlying Misconduct

A respondent may seek an expedited review of the conditions and restrictions imposed by a Hearing Panel.<sup>15</sup> The respondent's burden of proof in that proceeding is to demonstrate that the Hearing Panel committed an error and that the conditions or restrictions are not necessary to prevent customer harm.<sup>16</sup> To correspond with FSI's suggested amendments to proposed rule 9285(a), the respondent's burden of proof should be whether: a) the Hearing Panel committed an

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<sup>15</sup> See Proposed FINRA Rule 9285 (b)(1).

<sup>16</sup> See Proposed FINRA Rule 9285(b)(2).

error; and b) the conditions or restrictions are overly broad; or c) the restrictions or conditions are not narrowly tailored to prevent future occurrences of the underlying violations.

D. Proposed Rule 9285(c) Should Be Amended to Provide Firms with Additional Time to Impose a Well-Crafted Plan of Heightened Supervision

Pursuant to proposed rule 9285(c), where an adjudicator finds that the respondent violated a rule or statute, and the respondent decides to appeal that finding, the firm the respondent is associated with would have ten days to adopt a plan of heightened supervision with respect to that person. Regulatory Notice 18-15, published at nearly the same time as the Proposed Amendments, provides firms with guidance on adopting and implementing effective plans of heightened supervision.

That Notice suggests that, for a plan to be effective, at the very minimum, the firm should consider designating a qualified principal to implement and enforce the plan, requiring the respondent engage in additional training to address the violation and requiring that the respondent and the designated principal both acknowledge the plan, in writing.<sup>17</sup> In addition to these minimum requirements, Regulatory Notice 18-15 also includes a number of best practices that firms should consider and makes it clear that the guidance is not exhaustive.<sup>18</sup> Thus, in certain cases, for a plan to be effective, a firm would have to go beyond what is set forth in the guidance.

Thus, it is clear that an effective plan takes time and substantial internal collaboration to construct. Ten days may, simply, not be enough time for many firms to internally collaborate and craft a heightened supervisory plan in that requisite level of detail. Therefore, FSI suggest that FINRA require that firms implement a plan of heightened supervision as soon as possible, but no later than 30 days.

E. Comment on Numeric Parameters and Defined Criteria for MatCon Filings

FINRA has, specifically, requested that stakeholders provide feedback on the “proposed numeric threshold and criteria” that would trigger a MatCon filing.<sup>19</sup> The Proposed Amendments would require firms to file a MatCon where a proposed “owner, control person, principal, or a registered person of a member” has one or more “final criminal matter” (as defined in the proposal) or two or more “specified risk events” (as defined in the proposal) in the prior five-year period.<sup>20</sup>

FSI supports this proposal in terms of both the threshold and the proposed criteria because the specified risk events are: a) final; and b) investment or regulatory related. Also, to trigger the filing requirement, the criminal matter must not only be final, but also must be a matter that was either disclosed, or that the person should have disclosed, on their U4 or U5.<sup>21</sup> Therefore, Proposed FINRA Rule 1011(g) does not impose additional disclosure requirements on advisors and would only apply to final matters and not pending matters.<sup>22</sup> Further, due to the limited time-period of five years,<sup>23</sup> one criminal matter and two specified risk events, in that limited time, may

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<sup>17</sup> See FINRA Regulatory Notice 18-15 at p. 5 (April 30, 2018).

<sup>18</sup> *Id.*

<sup>19</sup> See Notice at p. 2.

<sup>20</sup> See Proposed FINRA Rule IM-1011-2.

<sup>21</sup> See Proposed FINRA Rule 1011 (g).

<sup>22</sup> *Id.*

<sup>23</sup> See Proposed FINRA Rule IM-1011-2.

be meaningful and FINRA should have the ability to assess the impact, if any, to the investing public or to marketplace integrity.

However, FSI notes that in addition to the present proposal, FINRA has published other proposals that would change the MatCon process from a voluntary process to a mandatory process.<sup>24</sup> Thus, prior to adopting any of these proposals, FSI suggests that FINRA consider placing rule based parameters around the MatCon process. These parameters may include remedies for firms should they not agree with the MatCon decision, timeframes around FINRA issuing a MatCon decision, limitations on FINRA's time to either issue a decision or ask additional questions, a requirement that FINRA provide written explanations regarding any determination that a change is material such that a membership application must be filed, etc..<sup>25</sup> Absent these parameters, firm's may end up in the MatCon process, for indefinite periods of time, for changes that are, arguably, not material to their business.

### **Conclusion**

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,



Vice President, Regulatory Affairs & Associate General Counsel

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<sup>24</sup> See, e.g., FINRA Regulatory Notice 18-06 (February 8, 2018).

<sup>25</sup> FSI understands that FINRA has published guidance on the MatCon process. See, e.g., Overview of Materiality Consultation Process, available at <http://www.finra.org/industry/overview-materiality-consultation-process>. However, guidance and rules are different and if the MatCon process becomes a rule-based requirement; rather than a voluntary process, rules regarding the process are seemingly also appropriate.