BETTER MARKETS

December 28, 2020

Mrs. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 4111 (Restricted Firm Obligations) and FINRA Rule 9561 (Procedures for Regulating Activities Under Rule 4111).

Dear Secretary Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule Change ("Notice" or "Rule" or "Proposal") filed with the Securities and Exchange Commission ("SEC" or "Commission") by the Financial Industry Regulatory Authority ("FINRA").[2] The Notice is a re-proposal of a convoluted, Rube Goldberg-type process[3] to identify and place new obligations on predator wolf-pack firms—the so called high-risk firms—first released for comment by FINRA in 2019.[4] In spite of comments from Better Markets[5] and many others, FINRA has chosen to submit the rule to the SEC largely unchanged. What few alterations have been made since the initial notice will serve primarily to benefit predatory firms and constrain FINRA's ability to protect investors.

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 *See* Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 4111 (Restricted Firm Obligations) and FINRA Rule 9561 (Procedures for Regulating Activities Under Rule 4111), *available* at https://www.govinfo.gov/content/pkg/FR-2020-12-04/pdf/2020-26594.pdf.

3 *See infra*, "Description of the Proposal." According to his entry in Wikipedia, Rube Goldberg "is best known for his popular cartoons depicting complicated gadgets performing simple tasks in indirect, convoluted ways." https://en.wikipedia.org/wiki/Rube_Goldberg.

4 *See* FINRA Notice 19-17, "Proposed New Rule 4111 (Restricted Firm Obligations) Imposing Additional Obligations on Firms with a Significant History of Misconduct" (May 2, 2019) *available* at finra.org/sites/default/files/2019-05/Regulatory-Notice-19-17.pdf

5 Better Markets Comment on Regulatory Notice 19-17 *available* at https://www.finra.org/sites/default/files/2019-07/19-17_Better-Markets_comment.pdf

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FINRA has done a disservice to investors by failing to adequately respond to comments on the original notice. We urge the Commission to correct FINRA's failure by fixing the glaring infirmities of the Proposal. FINRA has rejected well-reasoned and evidenced calls to broaden the Primary Identification Criteria and expand investor protections in ways that would allow the Rule to better accomplish its stated goals. All the improvements we offer below logically grow from the Proposal. But if the Commission feels that the improvements offered in this letter require FINRA to re-file the Rule for the Commission's consideration, then the Commission must either reject this Proposal or ask FINRA to re-file an amended proposal that incorporates the significantly important changes we proffer in this letter. To put it succinctly, without improving the Proposal in the logical and reasonable ways we suggest in this letter, this Proposal is not worth approving. While the Proposal—trying to minimally regulate firms that specialize in recidivist brokers by making it a little costlier for them to operate—is arguably better than doing nothing, it is nonetheless grossly insufficient and doomed to fail to achieve the purported objectives of the Notice.

We also urge the Commission to reject the needless and harmful incrementalism that FINRA has adopted as a regulatory approach in dealing with these predator wolf-packs. Regulatory incrementalism and a slow, cautious approach in policymaking can be prudent when matters under consideration are complex, nuanced, and the impact of the suggested solutions unclear. But the harm caused by recidivist wolf-pack firms is crystal clear, and the solution is elegantly simple: de-licensing, baring, and cleaning up the ranks of the brokerage industry of members that **choose** to sell obviously unsuitable products, cheat, defraud, and harm countless victims and rob them off of their future financial security. FINRA has the indispensable mission to protect investors and promote market integrity; it must do more to stop firms that specialize in recidivist brokers. Rather than, at best, half measures, FINRA must revoke the licenses and expel these firms that are based on a predator wolf-pack business model that specializes in harming investors.

Making matters worse, these predator firms are not just going after any investors; they are specifically targeting and harming the most vulnerable kinds of investors, including seniors, those with language barriers, and those who lack basic financial literacy.[6] By defrauding consumers and tainting the good names of honest brokers, these firms harm not only the consumers that FINRA is meant to be protecting, but the industry as a whole.[7]

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6 Broker misconduct, particularly among the recidivists, is more prevalent in counties and cities with a large proportion of retirees and a lower educated population. Said differently, bad brokers and the firms that employ and reward them specifically target and flourish in areas where there are unsophisticated investors and vulnerable adults who can more easily be preyed upon. *See* Mark Egan, Gregor Matvos &Amit Seru, *The Market for Financial Adviser Misconduct* at 27, J. OF POL. ECON. (forthcoming) (Sept. 1, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2739170. .

7 Trust is a crucially important factor in shaping investor behavior. A strong consumer preference for trust can help explain why money managers are able to attract new clients while underperforming passive investment strategies. Empirical studies of investor behavior show that after a 'trust shock' such as the collapse of a Ponzi scheme or the revelation of large-scale fraud many investors choose to devest partially or entirely from the market and keep their wealth in liquid assets. *See e.g.* Nicola Gennaioli, Andrei Shleifer, and Robert Vishny, *Money Doctors,* 70 JOURNAL OF FINANCE 91 (Feb. 2015) available at https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12188, establishing a theoretical framework for the

What possible service or good do predator firms provide to investors that cannot be offered by thousands of other FINRA members that actually follow FINRA and SEC rules? What is the public interest, market integrity, and pro-investor rationale for permitting these predatory firms to use FINRA's seal-of-approval to continue to harm investors? This Notice once again fails to answer these threshold questions, which, in our view, is a disservice to millions of American investors who must rely upon FINRA as the cop on the beat and the front-line regulator of the broker-dealer profession. It is now up to the Commission to hold FINRA accountable in failing to pass this fundamental test and correct FINRA's failure. But if the Commission chooses to ignore these reasonable calls for improvement, then it will become complicit in harm that will befall investors by these predator wolf-pack firms that could have been stopped with more forceful rules and effective enforcement.

While it is tempting to say that the policies proposed in this Notice are steps in the right direction, we cannot say that in this comment letter. Investors, and particularly those harmed by such unscrupulous brokers and firms who retain them, deserve concrete, effective, swift, and far-reaching consequences from FINRA for brokers that repeatedly violate FINRA's rules, and the firms that employ them, not convoluted and weak attempts at regulation. We do not believe FINRA is lacking authority under its current rules to more forcefully and effectively punish and expel predators, or to prevent predator wolf-packs from ever forming. However, if FINRA feels it lacks the authority to properly reduce investor harm by effectively punishing and deterring high-risk firms, then it should have proposed a rule that would have authorized FINRA to become a more effective regulator.

Instead, FINRA chooses to do the bare minimum by proposing to make it marginally more expensive for the worst-of-the-worst broker-dealer firms, that have already proven that they will brazenly disregard FINRA rules, to continue hiring and rewarding brokers that give self-serving advice and sell unsuitable products that are harmful to investors' and their families' financial health. These are not close calls; these are not brokers with a blemish or violation here or there; these are not firms hiring a broker or two with isolated violations. These are predatory wolf-pack firms whose business model is to maximize profits by breaking rules and ripping off unsuspecting and vulnerable investors. They need to be put out of business and barred from the industry. Investors need to be protected from the harmful practices of the wolf-packs and be better served by other, law-abiding FINRA members.

Investors need and deserve honest, qualified, and competent brokers and firms who respect and follow the rules when offering their services and financial products. Americans need these honest and rule-abiding brokerage firms and their brokers to help them meet their life goals, including saving for their children's college education, preparing for retirement, and enjoying a decent standard of living. As the front-line regulator of brokers and brokerage firms, FINRA has a paramount responsibility to ensure that all investors—especially the financially unsophisticated,

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role of trust and personal relationships in determining individual investor behavior. *See also* Umit G. Gurun, Noah Stoffman , and Scott E. Yonker, *Trust Busting: The Effect of Fraud on Investor Behavior*, 31 REVIEW OF FINANCIAL STUDIES 1341 (Apr. 2018) available at https://academic.oup.com/rfs/article-abstract/31/4/1341/3958335 documenting systemic changes in investing behavior in communities affected by the Madoff Ponzi scheme.

elderly, and less educated—are protected from predatory and unscrupulous brokerage firms who employ brokers who repeatedly break the law with impunity.

FINRA can and must do more to address and extinguish the predatory wolf-pack business model, and our comment letter will focus on ways FINRA must significantly improve this Notice and its oversight of the broker-dealer firms.

SUMMARY OF COMMENTS

- FINRA is falling far short of its regulatory duties by seemingly caring more about the career prospects of recidivist brokers and the economic viability of recidivist firms more than about the investors they harm.

- The Proposal risks perpetuating the recidivist mills' business model and increasing moral hazard when permitting firms with a long history of investor harm to remain operational by depositing some funds into a segregated account.

- The Proposal should not be approved unless significantly improved by applying more stringent criteria in identifying high-risk firms, including at a minimum:

    - Look-back or review period of 10 years, and not just 5;
    - The disclosure events should include all settlements, penalties, arbitration claims, etc., that are at or above $5,000, and not $15,000 as proposed;
    - The disclosure events should include all events that are harmful to investors, not just those that are discovered through consumer complaints (so called, "consumer-initiated events"). FINRA should count with equal weights events that are discovered through, for example, whistleblower tips or regulatory examinations. The Proposal seems to be limited to only events that are consumer-initiated events.

- FINRA must not permit those who have been laid-off or terminated as part of the consultation process to be hired by other firms for at least one year, and never by another high-risk firm. The Proposal only inadequately prohibits the firm who has laid off the broker from rehiring the same person within a year. Additionally, during the consultation period, FINRA must require the termination or lay-off of brokers, starting with those with the most disclosure events regardless of their role within the organization or the revenue they generate.

- FINRA must prominently publicize the names of high-risk firms. At a minimum, FINRA must prominently publicize the names of the firms that have been designated high-risk **twice**. FINRA must also publicize the names of newly formed firms that are made up of 20% or more brokers who were affiliated with previously twice-designated high-risk firms.

- FINRA must require brokers who are affiliated with twice-designated high-risk firms to disclose to their former, current, and prospective clients the fact that they are employed by such a firm.

- At the end of the second year, if the firm is still a high-risk firm, FINRA must expel the firm, and de-license and bar all current brokers who were employed by the firm at the time of initial designation.

- We support FINRA obtaining authority to impose specific "terms and conditions" on certain firms who either circumvent the obligations and restrictions placed upon them by the Proposed Rule 4111 (as amended by our comments herein) or otherwise refuse to significantly improve their compliance culture.

- FINRA must not artificially limit its options to deal with non-compliant or exceptionally high-risk firms.

DESCRIPTION OF THE PROPOSAL

FINRA's proposed Rule 4111[8] creates an extraordinarily lengthy and complex process that would, eventually, impose financial obligations and other requirements on certain high-risk member firms that are identified through a complicated process and application of various criteria and metrics. The proposed Rule 4111 would annually evaluate FINRA's entire 3,580-plus broker-dealer membership through the following six different metrics (using information obtained from Uniform Registration Forms):

1. Registered Person Adjudicated Events;[9]
2. Registered Person Pending Events;[10]
3. Registered Person Termination and Internal Review Events;[11]
4. Member Firm Adjudicated Events;[12]
5. Member Firm Pending Events;[13] and
6. Registered Persons Associated with Previously Expelled Firms (also Referred to as the Expelled Firm Association category).[14]

For each of these "Preliminary Identification Metrics" categories, FINRA proposes to apply different thresholds, depending on the firm's size (as measured by the number of registered persons in the firm). Only once above these thresholds would a firm be designated as having met the "Preliminary Criteria for Identification."[15] The table below shows the different Preliminary Identification Metrics Thresholds that FINRA would apply as part of its annual computation and evaluation of disclosure events:

8 Proposed Rule text is *available* at https://www.finra.org/sites/default/files/2020-11/SR-FINRA-2020-041.pdf
9 "Registered Person Adjudicated Events," defined in Proposed Rule 4111(i)(4)(A).
10 "Registered Person Pending Events," defined in Proposed Rule 4111(i)(4)(B).
11 "Registered Person Termination and Internal Review Events," defined in Proposed Rule 4111(i)(4)(C).
12 "Member Firm Adjudicated Events," defined in Proposed Rule 4111(i)(4)(D).
13 "Member Firm Pending Events," defined in Proposed Rule 4111(i)(4)(E).
14 "Registered Persons Associated with Previously Expelled Firms," defined in Proposed Rule 4111(i)(4)(F).
15 *See* Proposed Rule 4111(i)(11).

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

Source: SR-2020-041, Proposed Rule Change to Address Firms with a Significant History of Misconduct, exhibit 5, FINRA Proposed Rule 4111(i)11. Available at https://www.finra.org/sites/default/files/2020-11/SR-FINRA-2020-041.pdf

For example, a firm with 10 registered persons would need to have more than two "Adjudicated Events" and more than one "Pending Event" to pass the thresholds of these categories. Additionally, a smaller firm would need to have, on average, more "Adjudicated Events" per capita compared to its peers than larger firms (again, compared to its peers). Or, smaller firms need to have a higher concentration of "Persons Associated with Previously Expelled Firms" among their brokers' ranks than larger firms to qualify.[16] Finally, a firm needs to pass the thresholds of at least two categories to be designated as having met the Preliminary Criteria for Identification.[17]

To assess the impact of the proposed Rule, FINRA evaluated its entire membership between the 2013-2018 period to analyze categories of events that would have caused firms to meet the Preliminary Criteria for Identification. According to this analysis, "there were 45-80 such firms at the end of each year during the review period" or 1.3-2.0% of all firms registered with FINRA in any year during the review period.[18] Furthermore, "approximately 88-94% percent of these firms were small, 4-12% percent were mid-sized and 0-3% percent were large at the end of each year during the review period."[19] The below table shows this analysis, separated by firm size (according to the number of registered representatives).

16 Within categories one-five, FINRA would calculate using simple averages: dividing the number of events over number of registered representatives. For the sixth category, the metric would show the percentage concentration of the firm with employees who were associated with previously expelled firms at any point in their career.

17 A firm can be flagged Preliminarily for meeting just two or more of the set forth thresholds as compared to other firms their size. If a firm were to meet the threshold for two metrics (metrics one-five), one would have to be for adjudicated events, and the firm must have at least two events.

18 *See* Notice at 78551.

19 *Ibid*.

Exhibit 3b: Distribution of Firms Meeting the Preliminary Criteria for Identification by Firm Size*

Identification Year	Number of FINRA Registered Member Firms	Firms Meeting the Preliminary Criteria for Identification						
		Small	Mid-Size	Large	Total	Small	Mid-Size	Large
		Number of Firms				Percent of Total		
2013	4,140	72	3	2	77	94%	4%	3%
2014	4,070	75	4	1	80	94%	5%	1%
2015	3,942	67	4	1	72	93%	6%	1%
2016	3,837	57	4	1	62	92%	6%	2%
2017	3,721	53	6	0	59	90%	10%	0%
2018	3,606	52	7	0	59	88%	12%	0%
2019	3,477	40	5	0	45	89%	11%	0%

* Firm sizes are computed using the number of registered persons at the end of each identification year, e.g. December 31st.
FINRA defines a small firm as a member with at least one and no more than 150 registered persons, a mid-size firm as a member with at least 151 and no more than 499 registered persons, and a large firm as a member with 500 or more registered persons. *See* FINRA By-Laws, Article I.

Source: SR-FINRA-2020-41, Proposed Rule Change to Address Firms with a Significant History of Misconduct, exhibit 3b. Available at https://www.finra.org/sites/default/files/2020-11/SR-FINRA-2020-041.pdf.

Once a firm meets the Preliminary Criteria for Identification, there are several more steps before it is designated as a "Restricted Firm" and thus become subject to the new financial and other obligations. After the Criteria are met, FINRA will conduct a focused analysis of the firm's disclosure events to reduce the likelihood of misidentification. Once this analysis is complete, FINRA will preliminarily designate the firm as "Restricted Firm" and propose a "Restricted Fund" amount. After these preliminary decisions, FINRA will invite the firm to engage in consultations. During this consultation process, the firm will have the opportunity to rebut two presumptions: the presumption that it must be designated as a "Restricted Firm" and the presumption that the firm must maintain a "Restricted Fund" in the amount proposed by FINRA.[20]

If a firm successfully rebuts both presumptions, no further obligations are imposed. However, if FINRA decides that the firm has not rebutted the presumption that the firm should be a Restricted Firm but has rebutted the presumption of maintaining the maximum amount in the Restricted Fund, it will be designated as Restricted Firm but will have either no Restricted Fund or will have appropriately reduced Restricted Fund. However, the firm would have to implement and maintain specific conditions or restrictions on operations at FINRA's discretion with the aim of addressing the Preliminary Criteria for Identification metrics.[21] Finally, if the firm has not rebutted either presumption, then the firm will be designated as a Restricted Firm for that year, be required to establish a Restricted Deposit Account, deposit and maintain in that account the maximum Restricted Deposit Requirement, and implement specific conditions identified by FINRA to address the metrics indicating the firm meeting the Preliminary Criteria for

20 *See* Proposed Rule 4111(e)(1).
21 *Ibid.*

Identification.[22]

Once a firm is designated as a "Restricted Firm," and after it fails to rebut the presumptions, **the firm would be permitted to reduce its staffing levels** so as to fall below the thresholds that had triggered the firm's identification.[23] If a firm satisfactorily reduces staffing, then the firm is no longer designated as a Restricted Firm for that year.

If a firm **declines** to adequately reduce staff—therefore **choosing to become a designated high-risk firm**—FINRA will finalize its designation of the firm as a Restricted Firm, and require the firm to establish a bankruptcy-remote, segregated account Restricted Fund, and FINRA will determine a Maximum Restricted Deposit Requirement to be deposited into this fund.[24] This 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 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 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 becomes a former member, the Restricted Deposit Requirement in the account must be maintained, 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 account could not be subject to any right, charge, security interest, lien, or claim of any kind granted by the member."[25]

In setting the Restricted Deposit Requirement, FINRA will "tailor the member's maximum … amount to its size, operations and financial conditions" and consider the nature of "member's operations and activities, annual revenues, commissions, net capital requirements, the number of offices and registered persons, the nature of the disclosure events counted in the numeric thresholds, the amount of any "covered pending arbitration claims" or unpaid arbitration awards, and concerns raised during FINRA exams.[26] The Notice explains that this Maximum Restricted Deposit is intended to be high enough to change the firm's behavior **but "not so burdensome that it would force the member out of business solely by virtue of the imposed deposit requirement."**[27]

After FINRA designates the firm as Restricted Firm and requires the establishment of a "Restricted Fund," the firm can request a hearing with the Office of Hearing Officers in an expedited proceeding.[28] The proposed Rule would not permit any stay during the hearing proceedings.

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22 *Ibid.*
23 *See* Proposed Rule 4111(d).
24 *See* Proposed Rule 4111(i)(15).
25 *See* Notice at 78548.
26 *See* Notice at 78554.
27 *See* Notice at 78545, emphasis added.
28 *See* Notice at 78546.

In a significant change from the initial proposal, and in response to complaints FINRA received from its members, FINRA has included a non-exhaustive list of terms and conditions that could be imposed on Restricted Firms[29] including:

(1) Limitations on business expansions, mergers, consolidations or changes in control;

(2) Filing all advertising with FINRA's Department of Advertising Regulation;

(3) Imposing requirements on establishing and supervising offices;

(4) Requiring a compliance audit by a qualified, independent third party;

(5) Limiting business lines or product types offered;

(6) Limiting the opening of new customer accounts;

(7) Limiting approvals of registered persons entering into borrowing or lending arrangements with their customers;

(8) 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;

(9) 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.

Finally, FINRA discusses but **does not** propose in the Notice a general authority to impose specific "terms and conditions" upon firms that either game the proposed Rule 4111 by staying just below the thresholds that would trigger their identification or otherwise do not change their behavior and fail to "demonstrate commitment to the development of strong compliance culture."[30] Unfortunately, other than a brief reference and discussion of a similar "terms and conditions" authority that a Canadian SRO has implemented, there is no further discussion regarding the contours and possible uses of such authority. In our comments below, we will support in concept granting such authority to FINRA to empower it with appropriate regulatory tools to stop and deter firms that have substantial and unaddressed compliance failures and seem impervious to obligations and restrictions envisioned by Rule 4111 (as amended by our comments herein).

COMMENTS

29 *See* Notice at 78560
30 *See* Notice at 78554.

FINRA's Primary Mission is to Protect Investors And The Integrity of The Securities Markets, Not Serve The Interests of Its Worst Members Who Repeatedly Violate The Law. The Proposal Risks Perpetuating The Recidivist Wolf-Packs Business Model.

As we stated in our initial comment letter, FINRA's first and foremost concern in drafting and enforcing this Rule should be the protection of investors, particularly the vulnerable population of retail and financially unsophisticated investors. These investors—and the advocates who fight for their interests—are disappointed that FINRA has decided to move forward with the Proposal without taking steps to ensure that it provides a robust deterrent against predatory recidivist behavior. In fact, FINRA has made alterations that will make it significantly easier for recidivist brokers to be hired by other wolf-pack firms, once again putting investors at risk.

For example, in response to comments on the original notice FINRA is now proposing to set a maximum lookback period of five years for the Registered Persons Associated with Previously Expelled Firms metric, and to specify that a registered person must have been associated with a previously expelled firm for at least one year within that five-year period to be counted towards the metric. Commenters who objected to the Registered Persons Associated with Previously Expelled Firms metric's original specification, including an unlimited lookback period, did so on the grounds that it would discourage firms from hiring brokers who had merely worked for expelled firms, unfairly punishing brokers who may not themselves have violated any rules.[31]

These concerns are overblown, especially when compared to the other significant deficiencies that were not addressed by FINRA. Even with an unlimited lookback period, a firm could be reasonably discouraged from hiring a broker who was previously associated with an expelled firm only if;

(1) Doing so would put them over the generous Expelled Person Metric Threshold;

(2) They had already exceeded the threshold for a second primary identification metric.

The benefits of this change are therefore unlikely to outweigh the costs of limiting FINRA's ability to properly identify high-risk firms. As briefly described in the Notice, FINRA currently has several regulatory tools that aim to deter or punish misconduct by firms and brokers. These include the ability to not renew or deny membership applications, conduct firm-focused examinations and other monitoring for risks, and bring enforcement cases. But, as the Notice itself admits, "persistent compliance issues continue to arise in some FINRA member firms."[32]

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31 *See e.g.* Cambridge Investment Research Comment on Regulatory Notice 19-17 (July 1, 2019) *available* at https://www.finra.org/sites/default/files/2019-07/19-17_Cambridge-Investment_comment.pdf, Cetera Financial Group Comment on Regulatory Notice 19-17 (July 1, 2019) *available* at https://www.finra.org/sites/default/files/2019-07/19-17_Cetera_comment.pdf,

32 *See* Notice at 78540.

There are multiple, peer-reviewed studies showing the disproportionate harm that firms that specialize in bad brokers inflict on investors.[33] As released, the Proposal fails to solve this fundamental challenge.

Instead of appropriately working to rid its membership ranks of firms that attract and pay brokers who have indisputable records of repeat misconduct and investor abuses, this Notice tinkers on the margins by essentially making it slightly costlier for firms to hire or retain brokers with checkered pasts by slightly raising the firm's regulatory costs. While some firms may indeed decide to fire or not hire a broker with a long rap-sheet in order not to tie funds into the Restricted Fund and assume costs associated with heightened supervision (as proposed in the Notice) and potential liability, it would still permit firms that self-elect into the category of high-risk brokers (since they refuse to offload their most troublesome brokers, discussed below) to repeatedly and systematically harm investors.

The Notice fails to make any persuasive public policy rationale for keeping these recidivist wolf-packs in business. Indeed, every FINRA member shares the reputational stain caused by such recidivist wolf-packs and should, in their own self-interest if not in the public interest, demand that such firms be shut down.

As FINRA detailed in the Notice, there is no dispute about these firms and brokers and the business practices:

> "Such firms expose investors to real risk. For example, FINRA has identified certain firms that have a concentration of associated persons with a history of misconduct, and some of these firms consistently hire such individuals and fail to reasonably supervise their activities. These firms generally have a retail business engaging in cold calling to make recommendations of securities, often to vulnerable customers. FINRA has also identified groups of individual brokers who move from one firm of concern to another firm of concern. Such firms and their associated persons often have substantial numbers of disclosures on their records."[34]

Others have exposed the prevalence of these recidivist wolf-pack firms more starkly. A Wall Street Journal investigation exposed a deeply troubling fact: There are **over 100 FINRA regulated firms**—

33 *See, e.g.*, Mark Egan, Gregor Matvos &Amit Seru, *The Market for Financial Adviser Misconduct*, J. OF POL. ECON. (forthcoming) (Sept. 1, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2739170. *See also* Benjamin Lesser & Elizaeth Dilts, *Wall Street's Self-Regulator Blocks Public Scrutiny of Firms with Tainted Brokers*, REUTERS INVESTIGATES (June 12, 2017), *available* at https://www.reuters.com/investigates/specialreport/usa-finra-brokers/.

34 *See* Notice at 78541.

> "where 10% to 60% of the in-house brokers had three or more investor complaints, regulatory actions, criminal charges or other red flags on their records… These brokerages helped sell to investors more than $60 billion of stakes in private companies."[35]

The Journal report gave an example of a seemingly flourishing broker-dealer, Newbridge Securities Corp., in Boca Raton, FL, employing over 100 brokers, showing that—

> "Investors have a one in four chance of getting a broker there with at least three red flags. Regulators sanctioned the firm 20 times—an average of twice a year—over the past decade, with fines of $1.75 million."

These are the firms that FINRA licenses and is legally mandated to police. And yet, the Notice fails to show what, if anything, these firms do to deserve the privilege of carrying a FINRA license and engaging investors. What services or products do they provide to investors and the public that cannot be provided by other law-abiding firms and brokers? The Notice offers no description or explanation.

The pernicious practices described above cry out for a fundamental re-thinking of how brokerage firms that are designed for and specialize in investor harm are regulated by FINRA—a rethinking that should include expelling these firms so they cannot continue to cause investor harm.

But, inexcusably, FINRA seems to be more concerned about the economic viability of these firms. In fact, several times in the Notice, FINRA argues that it does **not** want to drive-out these firms that seek and embrace recidivist brokers and engage in profitable yet harmful investor conduct. Because the Restricted Fund will be set—by the designs of this proposed Rule—at levels to ensure that the firm will continue to be economically viable and make profits despite the obligation to segregate some funds into the Restricted Fund, the proposal will perpetuate the recidivist mill business models. Whatever funds/revenue will need to be deposited in the segregated Restricted Fund, the firm would likely offset these by doubling-down on its predatory practices, all the while using FINRA's membership as an imprimatur to attract and victimize investors.

This Restricted Fund will increase moral hazard by allowing firms with a lax culture of compliance to essentially insure their business practices through the Restricted Fund. Instead of discouraging and reducing the number of recidivist wolf-pack firms that profit through investor harm and violation of FINRA rules, the Proposal runs the risk of actually increasing their numbers. If the Rule is approved as proposed, FINRA would signal to firms that have a culture of non-compliance but are below the thresholds that would trigger their designation, that they can in fact become much more profitable, even if they go beyond the thresholds, so long as they are willing to set aside some funds and slightly increase their cost of doing business. This Rule, if approved as proposed, could serve as an acceptable on-ramp for firms that have a culture of non-compliance and are seeking to maximize profits to join the ranks of wolf-pack firms.

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[35] *See* Jean Eaglesham & Coulter Jones, *Firms with Troubled Brokers Are Often Behind Sales of Private Stakes*, WALL ST. J. (June 24, 2018), *available at* https://www.wsj.com/articles/firms-with-troubled-brokers-are-often-behindsales-of-private-stakes-1529838000.

Allowing high risk firms to remain operational is also unfair to the vast majority of FINRA's members who want to serve their clients honestly and well. High-risk firms sully the reputation of the industry and erode the confidence of the entire investing public and the public at large, who also lose faith in the regulators who are supposed to be vigilant against fraudsters. Investors who have been hurt by a recidivist wolf-pack are further demoralized and victimized when they see that the same fraudsters are still holding a license—a public privilege—and continue to work in the industry. Investors are the constituency FINRA must serve, and all its regulatory actions and initiatives should be designed for the maximal benefit of investors—and, by extension, the brokers who serve those investors honestly—and **not** the recidivist wolf-pack firms that have decided to cheat time and time again.

The Notice also fails to quantify the harm to investors caused by brokers who peddle unsuitable investments that generate high commissions for themselves and profits for their brokerage firms. FINRA has stated in the release that:

> "FINRA anticipates that the proposed rule will reduce the risk and associated costs of possible future customer harm and lead to improvements in the compliance culture, relative to the economic baseline of the current regulatory framework. The proposed rule is intended to create incentives for firms and brokers to limit or end practices that result in customer harm and provide increasing restrictions on those that choose not to alter their activities. Nonetheless, it is difficult to predict or quantify, before the proposed rule is implemented, the extent to which firms may continue to engage in harmful activities despite any additional restrictions imposed. However, FINRA plans to review the proposed rule after gaining sufficient experience with it, at which time FINRA will assess the rule's ongoing effectiveness and efficiency."[36]

We agree with FINRA's assessment that the proposed rule may likely reduce investor harm compared to the baseline scenario where FINRA takes no action to monitor or control predatory wolf-pack firms. However, neither FINRA nor the Commission should be satisfied with merely improving on the worst-case scenario. Conducting a full economic assessment that takes into account consumer harm in the baseline scenario and one that assumes the improvements offered by this letter would allow FINRA to more effectively and sustainably fulfill its mission of investor protection and promotion of market integrity, and augment the Commission's statutory responsibilities of investor protection. Finally, neither FINRA nor the Commission have the luxury of waiting—and the harmed and soon-to-be-victimized investors certainly cannot afford—to experiment in regulatory half-measures when the obvious solutions are staring down the faces of FINRA and the Commission.

To get to where we are, it took FINRA nearly three years. FINRA now suggest another three to five years to gain experience with the proposed Rule. It is clear to anyone who cares that in the next few years, there will be thousands of more victimized savers, retirees, and hard-working Americans at the hands of wolf-pack firms. It will be the height of regulatory malpractice to

[36] *See* Notice at 78567.

experiment with the financial well-being of thousands of American families, especially when the regulators responsible for the financial well-being of these families have all the authorities, tools, and solutions necessary to prevent the predictable and significant harm.

FINRA has not been charged by Congress to ensure that recidivist brokers have gainful employment in the financial industry or that firms that specialize in hiring and unleashing them on unsuspecting and vulnerable investors maximize their profits. In fact a growing body of research suggest that in order to accomplish its statutory mission to protect investors and promote market integrity, FINRA should be actively working to expel these recidivist brokers from the industry.

It is well documented that the behavior of both firms and individuals is shaped by the decisions of their peers.[37] Empirical examinations have shown that amongst financial professionals a propensity for misconduct is contagious.[38] By permitting recidivist brokers to re-enter the labor force, FINRA is enabling the spread of a culture of criminality and impunity that will put more vulnerable and financially unsophisticated investors at risk.

FINRA exists to protect investors and promote market integrity.[39] If FINRA indeed has investors' best interest in mind, it should not compromise that interest for the benefit of broker-dealer firms who are either unable or unwilling to comply with the letter and spirit of the law. Neither the employment prospects of recidivist brokers nor FINRA's concern for decreasing the number of small broker-dealers among its membership should outweigh what is best for the investing public.

<u>The Measures in The Proposal Are Inexcusably Weak And Should Not be Approved Without Overhaul.</u>

<u>FINRA Should Identify Firms Using More Stringent Criteria to Capture More High-Risk Firms. FINRA's Proposed Criteria and Metrics Risk Under-Identifying Many High-Risk Firms.</u>

Commenters on the original notice called on FINRA to broaden the Preliminary Identification Criteria to ensure that FINRA was able to properly identify the firms and brokers

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37 *See e.g.* Leonardo Bursztyn, Florian Ederer, Bruno Ferman and Noam Yuchtman, *Understanding Mechanisms Underlying Peer Effects: Evidence From a Field Experiment on Financial Decisions*, 82 ECONOMETRICA 1273 (July 2014), available at http://eprints.lse.ac.uk/91509/1/Yuchtman_Understanding-mechanisms.pdf, showing that investors significantly alter their valuations of assets based on the valuations of other investors, particualry those that are perceived as sophisticated or knowledgeable. *See also*, Mark T. Leary and Michael R. Roberts, *Do Peer Firms Affect Corporate Financial Policy?* 69 JOURNAL OF FINANCE 139 (Feb. 2014) available at https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12094, showing that firms significantly alter their capital structure based on the financing decisions of more successful peer firms.

38 *See* Stephen G. Dimmock William C. Gerken and Nathaniel P. Graham, *Is Fraud Contagious? Co-Worker Influence on Misconduct by Financial Advisors*, 73 JOURNAL OF FINANCE 1417 (June 2018) available at https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12613, which documents financial advisor misconduct after firm mergers, and finds that the likelihood that an individual advisor will commits misconduct increase if their new coworkers have a history of misconduct.

39 *See* About FINRA (last visited on June 21, 2019), *available at* http://www.finra.org/about.

that posed the highest risk of serious investor harm.[40] Six then-sitting Senators responsible for FINRA and SEC oversight wrote to FINRA raising serious concerns about the Proposal and called for significant improvements of it before approval.[41] In part, the Senators wrote: "FINRA's failure to publicize the names of high-risk brokers and firms that have repeatedly broken the rules needlessly leaves investors vulnerable to potential future harm," and,

> "The proposed Rule also seems to under-count the number of these high-risk firms by setting the threshold for "disclosure events" at $15,000 and limiting it to events that are "consumer-initiated." With the average broker account in the U.S. totaling $6,200, we have concerns that the proposed Rule will leave behind many investors who have lost the entirety of their account due to the predatory actions of a broker but will not have these pernicious acts count towards the "disclosure event" count since they do not meet the monetary threshold of $15,000. Additionally, we have concerns that counting only "consumer-initiated" events will unduly let recidivist high-risk brokers off the hook since harmful practices that are discovered through FINRA' s own examinations and inspections, or through whistleblower tips, would not count towards the threshold number." (citations omitted).[42]

The Notice acknowledges but declines to act on these comments, stating:

> "Many of the commenters' other proposed alternative definitions and criteria comments concern issues that FINRA already considered and addressed in the economic assessment in Regulatory Notice 19–17, and the comments have not persuaded FINRA that any changes would be more efficient or effective at addressing the potential for future customer harm presented."[43]

We do not believe that FINRA has adequately addressed the concerns raised by these commenters, and that it is the responsibility of the Commission to cure FINRA's shortcomings. As previously noted, the economic analysis is seriously deficient in its quantification of consumer harm. More importantly there is empirical evidence to suggest that simple modifications to the proposed Rule would allow FINRA to better protect the investors who are most vulnerable to predatory tactics.

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40 *See e.g.* Commonwealth of Massachusetts Comment on Regulatory Notice 19-17 (June 28, 2019) *available* at https://www.finra.org/sites/default/files/2019-07/19-17_Commonwealth-Massachusetts_comment.pdf, North American Securities Administrators Association Comment on Regulatory Notice 19-17 (July 1, 2019) *available* at https://www.finra.org/sites/default/files/2019-07/19-17_NASAA_comment.pdf.

41 *See* Senator Cortez Masto, Senator Warren, Senator Brown, Senator Reed, Senator Smith, and Senator Baldwin Comment on Regulatory Notice 19-17 (Nov. 22, 2019) *available* at https://www.cortezmasto.senate.gov/imo/media/doc/2019%2011%2022%20Cortez%20Masto%20et%20al%20FINRA%20Rule%204111.pdf ("Senators Letter").

42 *See* Senators Letter at 2.

43 *See* Notice at 78560.

First, the Notice proposes to count towards the "disclosure event" any "final investment-related, consumer-initiated customer arbitration award or civil judgement against the person for a dollar amount at or above $15,000 in which the person [e.g., broker] was a named party."[44] FINRA must lower this monetary threshold to $5,000. With the median brokerage account balance of U.S. investors at only $6,200, setting the "disclosure event" threshold at $5,000 would better serve the investing public.[45] Moreover, lowering the threshold from the proposed $15,000 threshold to $5,000 would enable FINRA to capture more misconduct, and this lowered threshold could serve as a more sensitive gauge for FINRA to assess the quality of the service and the level of integrity among brokers and the firms that employ them.

Second, FINRA should not exclude "disclosure events" that are harmful to investors but are not "consumer-initiated." There is no public interest, market integrity, or investor protection rationale for FINRA to overlook or discount harmful conduct simply based on who initiated the complaint. FINRA should include events that it has discovered through its regulatory activities (examinations and inspections, whistleblower tips, enforcement, sweeps, etc.). There is no reason—unless FINRA's goal is to deliberately undercount disclosure-worthy events—why FINRA should exclude a "disclosure event" discovered at a broker-dealer firm that is training its recidivist brokers ways to churn, peddle unsuitable products, or engage in any other predatory conduct upon especially vulnerable investors who are either too intimidated or unsophisticated to lodge a complaint. These discovered, non-consumer-initiated events should count with equal weight as those that are consumer-initiated.

Third, FINRA should expand the review period to include the previous 10 years, instead of five as proposed in the Notice, but credit firms that have demonstrated a record of improved compliance during the previous five years. A look-back period of five years risks under-identifying medium and large firms whose disclosure events (even if they are many) would still need to be divided by the large number of affiliated registered representatives for them to breach the proposed Preliminary Identification Metrics Thresholds. Expanding the look-back period to 10 years would mitigate the risk of under-identification. To alleviate concerns that a 10-year lookback period is unduly harsh, and to incentivize firms to actually reform, FINRA could consider crediting firms that have demonstrated improved compliance in the most recent 5-year period.

Fourth, FINRA must not permit those who have been laid-off or terminated as part of the consultation process to be hired by other firms for at least one year, and never by another high-risk firm. The Proposal only prohibits the firm who has laid off the broker from rehiring the same person within a year. But this leaves open the scenario where a recidivist broker who has been laid-off simply joins another recidivist wolf-pack that is either more brazen and unwilling to comply with FINRA rules or is just below the threshold to be identified as a high-risk firm. FINRA should not permit this unhealthy turnover. In the Proposal, FINRA claims that a separate rulemaking initiative[46] may work to effectively deter the hiring of newly fired recidivist brokers by other firms. But we remain unpersuaded because the regulatory initiative referred to by FINRA

44 *See* Proposed Rule 4111(i)(A)(i-ii).

45 *See* Brokerage Accounts in the United States, Advanced Analytical Consulting Group and Deloitte, (November 30, 2015), *available* at https://www.dol.gov/sites/default/files/ebsa/researchers/analysis/retirement/brokerage-accountsin-the-us.pdf.

46 *See* FINRA Regulatory Notice 18-16, *available* at https://www.finra.org/rules-guidance/notices/18-16.

does not prohibit the hiring but merely requires that the hiring firm **impose an additional supervisory regime** over troublesome brokers. Furthermore, in this very Notice, FINRA reports—referring to a myriad of FINRA regulatory obligations—that "Some firms [referring to high-risk firms] do not effectively carry out these supervisory obligations to ensure compliance and they act in ways that could harm their customers—sometimes substantially."[47] This makes sense; the entire premise of the Notice is that these high-risk firms do not have a culture of compliance, and more rules and restrictions on them will have marginal to no benefit.

Finally, as firms engage in consultations with FINRA to take advantage of the one-time opportunity to reduce the number of brokers to fall below the designation thresholds, FINRA must require that the firms begin their termination or laying-off process with those brokers who have the highest number of disclosure events or pose the greatest risk to investors. Alternatively, FINRA could require that the firm terminate or lay-off those brokers who would have had a harmful combination of frequent and severe violations of FINRA and SEC rules that have a direct impact on investors. **In all circumstances, FINRA should prohibit firms from retaining recidivist brokers due to their position within the firm or the amount of revenue they generate.**

<u>FINRA Should Prominently Publicize The Names of The High-Risk Firms So Investors Are Maximally Empowered to Make More Informed Broker-Dealer Choice.</u>

In the Notice FINRA rejects recommendations that they disclose the name of Restricted Firms or share information on Restricted Firms with regulators, stating:

> "FINRA believes the aim of the proposal is to address the risks posed by Restricted Firms by imposing appropriate restrictions on them and, at the same time, providing them with opportunities and incentives to remedy the underlying concerns. Because requiring FINRA to publicly disclose a firm's Restricted Firm status may potentially interfere with those purposes, FINRA is not proposing to require the public disclosure of a firm's status as a Restricted Firm at this time. FINRA believes that it is necessary to gain meaningful experience with the proposed rule to evaluate the impact of creating an affirmative disclosure program."[48]

It is not at all clear how providing investors with more information about high-risk firms would interfere with FINRA's ability to administer any of the measures proposed in the Notice. Nor is it clear how publicly naming Restricted Firms would reduce or weaken incentives for those firms to change their behavior. The exact opposite may be true: if firms face the real prospects of getting designated and they know that their name will be publicized, they are likely to offload their most high-risk brokers and possibly avoid designation, therefore "change their behavior," as FINRA expects. Said differently, **not** disclosing the names of the firms may incentivize the firms to **not** change their behavior and remain a designated firm for longer, and therefore prolong investor harm.

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47 *See* Notice at 78550.
48 *See* Notice at 78567.

We believe that investors should be able to make an informed choice when selecting a brokerage firm. As FINRA itself has noted, financial misconduct is concentrated at a small number of firms. In 2019, just 45 of the 3,477 firms registered with FINRA would even meet the proposed Preliminary Identification Criteria.[49] Similarly, empirical analysis of financial misconduct shows that if investors simply avoid the highest risk firms, investors could massively decrease their likelihood of being victimized and their expected loses in the case of fraud or misconduct.[50] By taking the following steps, FINRA could protect investors from these high-risk firms while simultaneously empowering other investors to decide if the returns generated by these firms are worth the clear risk that they present.

First, FINRA must prominently publicize the names of the high-risk firms. If FINRA refuses to do what is right and necessary and expel firms who specialize in harming investors, then it must at least provide bold and unmistakable warnings that would empower investors to make more informed broker-dealer choices. FINRA's use of robust disclosures would help investors to better protect themselves. Blunt and prominent warnings have long been an effective technique for informing consumers of dangerous products, such as cigarettes or toxins.

At a minimum, FINRA must prominently publicize the names of the firms that have been **twice-designated** as high-risk. Similarly, FINRA must also publicize the names of newly formed firms that are made-up of 20% or more of brokers who were affiliated with previously twice-designated high-risk firm.

Second, FINRA must require brokers who are affiliated with twice-designated high-risk firms to disclose to their former, current, and prospective clients the fact that they are employed by such a firm. These registered representatives either clearly know or are willfully ignorant of the fact that they are affiliated with and paid by a broker-dealer that essentially has been running a multi-year boiler room. All investors who have been or are about to be solicited by these brokers deserve to know the fact that whichever firm is employing the broker has been twice-designated as a high-risk firm by the front-line SRO.

Finally, FINRA should engage in more investor education on the topic, clearly explaining the methods these recidivist wolf-packs employ and why they pose a threat to investors. FINRA should also design and implement a disclosure system, either on BrokerCheck or through a separate user-friendly database, that clearly identifies those brokers with a demonstrable pattern of violating the law. Such an enhanced education and disclosure regime will prove more effective at warning investors (and incentivizing good behavior) that the use of these brokers and brokerage firms will be harmful to the investor's financial health. But this financial education campaign should not come at the expense of robust rules and forceful enforcement of those rules. Financial

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49 *See* SR-FINRA-2020-41, Proposed Rule Change to Address Firms with a Significant History of Misconduct, exhibit 3b. Available at https://www.finra.org/sites/default/files/2020-11/SR-FINRA-2020-041.pdf.

50 *See* Stephen G. Dimmocka and William C. Gerken, *Predicting Fraud by Investment Managers,*105 JOURNAL OF FINANCIAL ECONOMICS 153 (July 2012) available at https://www.sciencedirect.com/science/article/abs/pii/S0304405X12000037, showing that by avoiding the 5% of firms with the highest probability of misconduct an investor could avoid 29% of fraud cases and 40% of the total dollar loses from fraud.

education campaigns can only augment a regulator's effectiveness in policing fraud and rule-violation, but they cannot supplant that regulator's responsibility.

FINRA Must Expel Firms at The End of The Second Year of Designation.

FINRA has stated in the Notice that the suggestions about the expulsion or suspension of Restricted Funds or Restricted Brokers supplied in our original comment letter would require FINRA to "broaden the statutory definition of disqualified persons, which is not within FINRA's jurisdiction to do." We disagree. While Congress has set its own standard for disqualification, FINRA is well within its authority to establish its own rules and standards for its members. FINRA should wield that authority to ensure that the Rule provides high-risk brokers with strict incentives to change their behavior.

The Notice must be amended to authorize FINRA to expel firms that have not significantly changed their behavior at the end of the second year of designation, **and de-license and bar all current brokers of the firm who were affiliated with the firm at the time of the initial designation**. This expulsion order should not be appealable and should take immediate effect. The rationale for this swift and effective remedy is elegantly simple: firms that have been twice-designated and have not significantly improved their compliance culture prove that they are irredeemable, and they do not deserve to be permitted to serve, or more likely, harm **any** additional investors. It would be a disgrace for FINRA to continue to lend its imprimatur and the privilege of being a firm regulated by FINRA to twice-designated firms that specialize in fraud and misconduct. At the end of the second year of designation, FINRA should be mandated to solve this issue and send a strong signal to the brokerage industry that it will no longer tolerate boiler-rooms, predator wolf-packs, and fraud-houses.

FINRA Must Obtain Authority to Impose Specific and Effective Terms and Conditions on Firms That Game FINRA's Rules.

The Notice briefly discusses but does not proposes an alternative to the numerical threshold-based approach presented in the notice which would grant FINRA a general authority to impose specific "terms and conditions" that demonstrate "significant compliance failures."[51] As FINRA notes, this alternative approach would allow FINRA to use non-public information to more accurately identify and reprimand the highest risk firms, and would prevent firms from gaming the regulatory regime by staying just below the Preliminary Identification Metric Thresholds.

In spite of these benefits, FINRA has again declined to actually propose such a general authority on the grounds that it would provide a less effective deterrent than the proposed numerical thresholds approach. We disagree with FINRA's assessment, and believe that developing broader, more flexible, and more efficient enforcement mechanisms is an effective way for FINRA to deter firms from violating FINRA and SEC rules.

Regardless of FINRA's beliefs about the specific authority discussed in the Notice, FINRA must prevent firms from gaming the Preliminary Identification Metric Thresholds. We support any reasonable and appropriate amendments or future proposals that would allow FINRA to

51 *See* Notice at 78554.

address firms with substantial compliance issues that cannot be captured by the proposed numerical framework.

FINRA Must Not Artificially Limit Its Authority to Take Action Against Non-Compliant or Exceptionally High-Risk Firms

In the Notice FINRA has elected to supply a non-exhaustive list of terms and conditions that could be imposed on Restricted Firms. We appreciate that FINRA is demonstrating at least a theoretical willingness to impose serious consequences on predatory firms. However, we are concerned that by setting out this list FINRA may be limiting its options in dealing with non-complaint and exceptionally high-risk firms.

The Notice should be amended to make clear that FINRA does not cede its authority to take punitive against predatory firms that violate FINRA's rule and the rights of their customers.

CONCLUSION

We hope these comments are helpful. We support fair and appropriate measures designed to ensure that all brokers receive all the process to which they are due. But none of the procedural or fairness arguments advanced to date can justify the excessive leniency that FINRA has displayed toward bad brokers and brokerage firms. The priority must be to protect investors and to eject recidivist brokers and brokerage firms from the industry. It should be done in the interest of investors, to promote fairness in the capital markets, and to protect the good reputations of FINRA's law-abiding members.

FINRA has the authority, duty, and competency to do what is in the best interest of investors: reduce the prevalence of recidivism and expel firms specializing in investor harm. Now FINRA must apply its resolve to achieve this goal. FINRA must go beyond the specifics of this Notice and fundamentally change its treatment of and tolerance for firms that specialize in harming investors.

Sincerely,

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