



**NASAA**

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**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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December 28, 2020

**By email to:** [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

J. Matthew DeLesDernier  
Assistant Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2020-041: 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 Mr. DeLesDernier:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),<sup>1</sup> I am writing in response to U.S. Securities and Exchange Commission (“SEC” or the “Commission”) Release No. 34-90527, *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)* (the “Proposal”).<sup>2</sup> The Proposal has the potential to better protect investors from high-risk firms, which is a goal that NASAA supports.

NASAA commends the Commission and the Financial Industry Regulatory Authority, Inc. (“FINRA”) for expanding controls over high-risk firms. The market relies on the combined expertise and cooperative oversight provided by state, federal, and self-regulatory enforcement of the securities laws.<sup>3</sup> State enforcement in this area is vigorous; NASAA’s members issued more

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<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> The Proposal is available at <https://www.sec.gov/rules/sro/finra/2020/34-90527.pdf>.

<sup>3</sup> See Commissioner Elisse B. Walter, *Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional (CRCP) Program* (Nov. 8, 2011), available at <https://www.sec.gov/news/speech/2011/spch110811ebw.htm>.

than 1,000 licensing and registration sanctions, including actions against 200 broker dealer firms and 391 broker dealer agents in 2019.<sup>4</sup> NASAA recognizes that the Proposal could help to address the need for stronger controls to protect investors from concerns such as unpaid arbitration awards and bad actors in the industry. Investor protection is the core of NASAA's mission, and we took the opportunity to comment previously on Proposed Rule 4111 when it was introduced by FINRA.<sup>5</sup> However, the current version of the Proposal does not incorporate certain of our comments which we believe are essential to investor protection and regulatory cooperation, and which we believe warrant consideration by the Commission.

In brief, NASAA maintains that a firm's restricted status as determined under Proposed Rule 4111 should be included in the Central Registration Depository ("CRD") and disclosed publicly on BrokerCheck. Requiring public disclosure of this information would be consistent with other disclosure rules discussed below and would allow investors to make informed decisions regarding the individuals and firms with whom they do business. However, should the Commission decide to accept FINRA's proposal to keep a firm's restricted status private, it should nevertheless require FINRA to disclose the information to other regulators through CRD. Allowing FINRA to withhold a firm's restricted status from other regulators would lead to regulatory confusion and wasted resources and could leave investors inadequately protected.

## **I. Public Disclosure of a Firm's Restricted Status Should Be Mandated Under Proposed Rule 4111.**

Proposed Rule 4111 would create a category of "Restricted Firms" that FINRA deems to be high risk based on criteria enumerated in the Proposal and a demonstrated pattern of prior misconduct. In our comment letter on FINRA Regulatory Notice 19-17, NASAA called for public disclosure of a firm's restricted status.<sup>6</sup> In our view, such disclosure is consistent with FINRA's general standards for public disclosure of disciplinary complaints, decisions, and other information under FINRA Rule 8312,<sup>7</sup> and analogous to the public disclosure of firms subject to the "Taping

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<sup>4</sup> NASAA Enforcement Report, 2020 Report on 2019 Data (Sept. 2020) at 5, available at <https://www.nasaa.org/wp-content/uploads/2020/09/2020-Enforcement-Report-Based-on-2019-Data-FINAL.pdf>.

<sup>5</sup> See Regulatory Notice 19-17, *Protecting Investors from Misconduct* (May 2, 2019), available at <https://www.finra.org/sites/default/files/2019-05/Regulatory-Notice-19-17.pdf>; Letter from Michael Pieciak, NASAA President, to Jennifer Piorko Michelle, FINRA Office of the Corporate Secretary, *Re: Regulatory Notice 19-17: Protecting Investors from Misconduct* (July 1, 2020), available at <https://www.nasaa.org/wp-content/uploads/2019/07/NASAA-Reg.-Notice-19-17-Comment-Letter-7-1-19.pdf> ("NASAA 19-17 Comment Letter").

<sup>6</sup> NASAA 19-17 Comment Letter at 2.

<sup>7</sup> See FINRA Rule 8312, *FINRA BrokerCheck Disclosure* (stating that FINRA shall release "(A) any information reported on the most recently filed Form U4, Form U5, Form U6, Form BD, and Form BDW (collectively "Registration Forms"); [and] (B) currently approved registrations..."). A firm's conditional or limited status and approval are statuses currently listed on BrokerCheck.

Rule” under FINRA Rule 3170.<sup>8</sup> However, like Regulatory Notice 19-17, the Proposal does not require public disclosure.

FINRA’s discussion of NASAA’s 19-17 Comment Letter states that public disclosure of a firm’s restricted status would interfere with Proposed Rule 4111’s goal to incentivize firms to fix the underlying concerns,<sup>9</sup> but FINRA does not explain how that requirement would interfere with the goal. Instead, FINRA asks the SEC to allow it to postpone that decision so that it can “gain meaningful experience with the proposed rule to evaluate the impact of creating an affirmative disclosure program.”<sup>10</sup> That is not necessary or warranted. FINRA already has such experience; firms are required to publicly disclose restrictions on their behavior under the Taping Rule, and investors are already able to find that information by reviewing a firm’s disclosures on BrokerCheck. FINRA does not explain in the Proposal why public disclosure is appropriate in one context but not another. In NASAA’s view, public disclosure is appropriate here for the same reason it is appropriate under the Taping Rule; namely, investors should be able to know whether and how the firms they deal with are restricted by regulators in order to decide whether to transact with them.

Moreover, requiring public disclosure of restricted status could facilitate remediation by compelling firms to undertake remedial measures – such as one-time staff reductions – quickly in order to avoid being designated as restricted by FINRA. Better still, the prospect of public disclosure would encourage firms to avoid behaviors that would cause them to become restricted in the first place. As proposed by FINRA, a restricted status designation does not serve as a sufficient deterrent to bad behavior.

NASAA understands that the Proposal is designed in part to incentivize good behavior. By defining the criteria under which a firm could become restricted, and a process for making restriction determinations, the Proposal lays the groundwork for encouraging compliance. The best outcome would be one in which the existence of the restricted firm framework compelled firms to avoid trouble. The Proposal falls short because it does not marry its incentives for good behavior with sufficient consequences for bad behavior. That shortcoming puts investors at risk. The goals of compliance, deterrence and protection would best be met if, after FINRA determines to place a firm on restricted status, and the firm foregoes or exhausts any administrative remedies or opportunities to contest or avoid the designation, the disclosure of such status is made available to existing and potential new customers.

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<sup>8</sup> See FINRA Rule 8312(b)(2)(F), requiring disclosure of a taping firm’s status in response to telephonic inquiry via the BrokerCheck telephone listing. A relatively recent FINRA proposal would also require this information be provided proactively on BrokerCheck, and NASAAA supported this proposal. See Letter from Joseph Borg, NASAA President, to Jennifer Piorko Mitchell, *Re: FINRA Regulatory Notice 18-16: High Risk Brokers* (Aug. 1, 2018), available at [https://www.finra.org/sites/default/files/18-16\\_NASAA\\_Comment.pdf](https://www.finra.org/sites/default/files/18-16_NASAA_Comment.pdf).

<sup>9</sup> Proposal at 113.

<sup>10</sup> *Id.*

## **II. A Firm's Restricted Status Must Be Shared with Regulators.**

In our comment letter on Regulatory Notice 19-17, NASAA stated that “at a minimum, the names of Restricted Firms should be provided to state securities regulators so NASAA members can include this information in their own regulatory oversight and risk analyses.”<sup>11</sup> In the Proposal, FINRA declined to disclose a firm’s restricted status publicly, but it did not respond to our comment that the information should be made available to state regulators. NASAA maintains that Proposed Rule 4111 should be revised to require FINRA to provide disclosure of a firm’s restricted status to regulators. Such non-public disclosure can be made by adding regulatory notes to each restricted firm’s record in CRD.

If FINRA places a firm on restricted status, state regulators need to know. Any restriction on a firm’s ability to do business – particularly because a firm has demonstrated high-risk behavior – is material to state regulatory risk evaluation and examination planning. High-risk firms may require different and enhanced examination procedures. Conversely, if a state is unaware that a firm deemed by FINRA as high risk is operating within its borders, it may not extend the level of regulatory scrutiny appropriate for such a firm.

Further, and of particular concern, is FINRA’s proposal to be able to impose access limitations on a restricted firm’s bank account. Withholding that fact from regulators could skew an examiner’s review of the firm’s compliance with net capital requirements because the restricted funds would not be readily available to meet creditors’ calls or liquidity requirements. NASAA believes that disclosure to regulators would enhance risk assessments, simplify examinations, and alleviate potential misunderstandings and wasted effort during examinations. To avoid the wasted expenditure of resources and regulatory confusion, state agencies must be made aware of a firm’s status to better monitor and examine the firm’s practices and processes. The mechanism for signaling a firm’s restricted status to all regulators exists within CRD in the form of regulatory notes. The current system allows for intrastate notices, all state notices, or all regulator notices, including to the SEC and FINRA. Failure to utilize this system to share information among regulators would undermine the effectiveness of regulation over high-risk firms generally.

It is worth noting that in addressing disclosure of a firm’s restricted status, FINRA stated that:

... information about a firm’s status as a Restricted Firm, and any restricted deposit it must maintain, could become publicly available through existing sources or processes. Such disclosures could occur, for example, through Form BD, Form CRS, or financial statements, or when a Hearing Officer’s decision in an expedited proceeding is published pursuant to FINRA’s publicity rule.<sup>12</sup>

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<sup>11</sup> NASAA 19-17 Comment Letter at 2.

<sup>12</sup> Proposal at n.158.

FINRA's observation that this information "could" become public is of little value because it has nothing to do with the Proposed Rule's requirements. With the exception of the circumstance where a hearing officer's determination mandates disclosure,<sup>13</sup> NASAA does not believe that firms would disclose their restricted status in Forms BD or CRS without being required to do so through changes to the forms' existing requirements. The Proposal would effectively leave regulators and investors blind to firms that FINRA deems high risk and in need of additional safeguards. FINRA has not provided a good reason to find such concealment to be regulatorily prudent.

### **III. Conclusion.**

NASAA supports the work of the Commission and FINRA in protecting investors and appreciates the opportunity to comment on the Proposal. In sum, NASAA believes that a restricted firm's status should be publicly disclosed. Doing so is in keeping with investor expectations and the disclosure-based system on which we rely. Should the Commission, however, decide to accept the Proposal without requiring public disclosure, it should nevertheless require FINRA to notify regulators of a firm's restricted status. By making restricted status designations available to all regulators, the Commission, FINRA, and state securities regulators can continue to work together to protect the market and serve the best interests of investors.

Thank you for considering these views. Should you have questions, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (██████████)

Sincerely,



Lisa Hopkins  
NASAA President  
General Counsel and Senior Deputy  
Commissioner of Securities, West Virginia

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<sup>13</sup> See FINRA Rule 8313.