become operative prior to 30 days after the date of the filing. However, pursuant to Rule 19b–4(f)(6)(iii),[33] the Commission may designate a shorter time if such action is consistent with protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposed rule change may become operative upon filing. The Exchange's proposal does not raise any new or novel issues. Therefore, the Commission believes that waving the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission designates the proposed rule change to be operative on upon filing.[34]

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number SR–NASDAQ–2021–059 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–NASDAQ–2021–059. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NASDAQ–2021–059 and should be submitted on or before August 26, 2021.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[35]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2021–16676 Filed 8–4–21; 8:45 am]

BILLING CODE 8011–01–P

[33] 17 CFR 240.19b–4(f)(6).

[34] For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[35] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–92525; File No. SR–FINRA–2020–04]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1 and Amendment No. 2, To Adopt FINRA Rule 4111 (Restricted Firm Obligations) and FINRA Rule 9561 (Procedures for Regulating Activities Under Rule 4111)

July 30, 2021.

I. Introduction

On November 16, 2020, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend FINRA's rules to help further address the issue of associated persons with a significant history of misconduct and the broker-dealers that employ them. The proposed rule change was published for comment in the **Federal Register** on December 4, 2020.[3] On January 12, 2021, FINRA consented to extend until March 4, 2021, the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.[4] On March 4, 2021, FINRA responded to the comment letters received in response to the Notice.[5] On March 4, 2021, the Commission filed an order instituting proceedings to determine whether to approve or disapprove the proposed rule change.[6] On May 7, 2021, FINRA consented to an extension of the time period in which the Commission must approve or disapprove the proposed rule change to July 30, 2021.[7] On May 14, 2021, FINRA filed an amendment to the proposed rule change (''Amendment No. 1'').[8] On July 20, 2021, FINRA filed

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Exchange Act Release No. 90527 (Nov. 27, 2020), 85 FR 78540 (Dec. 4, 2020) (File No. SR–FINRA–2020–041) (''Notice'').

[4] *See* letter from Michael Garawski, Associate General Counsel, OGC Regulatory Practice and Policy, FINRA, to Daniel Fisher, Branch Chief, Division of Trading and Markets, Commission, dated January 12, 2021. This letter is available at *https://www.finra.org/sites/default/files/2021-01/SR-FINRA-2020-041-Extension1.pdf.*

[5] *See* letter from Michael Garawski, Associate General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated March 4, 2021 (''FINRA March 4 Letter''). The FINRA March 4 Letter is available at *https://www.sec.gov/comments/sr-finra-2020-041/srfinra2020041-8445557-229759.pdf.*

[6] *See* Exchange Act Release No. 91258 (Mar. 4, 2021), 86 FR 13780 (Mar. 10, 2021) (File No. SR–FINRA–2020–041) (''Order Instituting Proceedings''). The Order Instituting Proceedings is available at *https://www.sec.gov/rules/sro/finra/2021/34-91258.pdf.*

[7] *See* letter from Michael Garawski, Associate General Counsel, Office of General Counsel, FINRA, to Daniel Fisher, Branch Chief, Division of Trading and Markets, Commission, dated May 7, 2021. This letter is available at *https://www.finra.org/sites/default/files/2021-05/sr-finra-2020-041-extension2.pdf.*

[8] Amendment No. 1 is available at *https://www.finra.org/sites/default/files/2021-05/sr-finra-2020-041-amendment1.pdf.* FINRA has made a technical correction to the definition of ''Member Firm Pending Events'' in proposed Rule 4111(i)(4)(E). In the initial filing of the proposed rule change, proposed Rule 4111(i)(4)(E)(ii) included ''a pending investigation by a regulatory authority'' reportable on the member's Uniform Registration Forms as among the Member Firm Pending Events. The Uniform Registration Forms, however, do not contain disclosure questions or

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a second amendment to the proposed rule change (''Amendment No. 2''),[9] as well as a second response to the comment letters received in response to the Notice.[10] This order approves the proposed rule change, as modified by Amendment No. 1 and Amendment No. 2.

II. Description of the Proposed Rule Change

Background

FINRA's proposed rule change would adopt a new Rule 4111 to address the risks that can be posed to investors by broker-dealers and their associated persons with a history of misconduct.[11] The proposal would impose new obligations on broker-dealers with significantly higher levels of risk-related disclosures (including, notably, sales-practice related disclosure events) than other similarly sized peers based on numeric, threshold-based criteria.[12]

Specifically, FINRA is proposing to adopt FINRA Rule 4111 (Restricted Firm Obligations) to require member firms that are identified as ''Restricted Firms'' [13] to deposit cash or qualified securities in a segregated account, adhere to specified conditions or restrictions, or comply with a combination of such obligations.[14] FINRA is also proposing to adopt FINRA Rule 9561 (Procedures for Regulating Activities) and amend FINRA Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series), to create a new expedited proceeding to implement proposed Rule 4111.[15] In particular, the proposed rule change would establish a process to give a Restricted Firm an opportunity to challenge the designation and the resulting obligations of that designation, as well as give the firm a one-time opportunity to avoid the imposition of obligations by voluntarily reducing its workforce.[16]

The proposed rule change is designed to protect investors and the public interest by strengthening tools available to FINRA to address the risks posed by member firms with a significant history of misconduct, including firms with a high concentration of individuals with a significant history of misconduct.[17] The proposed rule should create incentives for firms to change behaviors and activities, either to avoid being designated as a Restricted Firm or lose an existing Restricted Firm designation, to mitigate FINRA's concerns.[18]

This proposal is designed to address persistent compliance issues that arise at some FINRA member firms that generally do not carry out their supervisory obligations to achieve compliance with applicable securities laws and regulations and FINRA rules, and act in ways that could harm their customers and erode confidence in the brokerage industry.[19] According to FINRA, recent academic studies have found that some firms persistently employ registered representatives who engage in misconduct, and that misconduct can be concentrated at these firms.[20] FINRA states that these studies also provide evidence that the past disciplinary history and other regulatory events associated with a firm or individual can be predictive of future events.[21] While these firms may eventually be forced out of the industry through FINRA action or otherwise, FINRA observed that these compliance issues include a persistent, if limited, population of firms with a history of misconduct that may not be acting appropriately as a first line of defense to prevent customer harm.[22]

FINRA states that such firms expose investors to real risk.[23] For example, FINRA states that it 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.[24] FINRA has found that these firms generally have a retail business engaging in cold calling investors to make recommendations of securities, often to vulnerable customers.[25] FINRA has also identified groups of individual representatives who move from one firm of concern to another firm of concern.[26]

Disclosure Reporting Pages (''DRP'') fields about pending investigations by a regulatory authority concerning firms. Amendment No. 1 proposes deleting ''a pending investigation by a regulatory authority'' from the proposed definition of Member Firm Pending Events. Because Amendment No. 1 to the proposed rule change is technical in nature and does not materially alter the substance of the proposed rule change or raise any novel regulatory issues, it is not subject to notice and comment.

[9] Amendment No. 2 is available at *https://www.finra.org/sites/default/files/2021-07/SR-FINRA-2020-041-Amendment2.pdf.* In the initial filing of the proposed rule change, proposed Rule 4111 included several references to the requirement that a Restricted Firm (defined below) ''maintain'' a deposit in a segregated account. Amendment No. 2 proposes several changes to, among other things, eliminate the word ''maintain'' from proposed Rule 4111 and clarify that a firm is not required to deposit additional funds or qualified securities where the initial deposit consists of qualified securities that have declined in value, nor is it permitted to withdraw any such funds or securities merely because the value of such qualified securities increased in value. It further clarifies that if FINRA thereafter re-designates a firm as a Restricted Firm in the following year, such firm would be required to deposit additional cash or qualified securities if necessary, at the appropriate time during that process, to meet the required deposit amount. Because Amendment No. 2 to the proposed rule change is technical in nature and does not materially alter the substance of the proposed rule change or raise any novel regulatory issues, it is not subject to notice and comment.

[10] *See* letter from Michael Garawski, Associate General Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission, dated July 20, 2021 (''FINRA July 20 Letter''). The FINRA July 20 Letter is available at *https://www.sec.gov/comments/sr-finra-2020-041/srfinra2020041-9083092-246591.pdf.*

[11] As discussed more fully below, the proposed rule change would apply to firms who, based on statistical analysis of their prior disclosure events, including regulatory actions, customer arbitrations and litigations of brokers, are substantially more likely than similarly-sized peers to subsequently have a range of additional events indicating various types of harm or potential harm to investors. *See* Notice at 78565.

[12] As described below, such ''risk-related disclosures'' encompass those items included within the ''Preliminary Identification Metrics'' found in proposed Rule 4111(i)(10). Higher levels of risk-related disclosures are hereinafter referred to as ''outlier-level disclosure events'' or ''outlier-level risks.''

[13] As described more fully below, a ''Restricted Firm'' is a firm identified through the proposed multi-step process to have a significantly higher level of risk-related disclosures than similarly sized peers and determined by FINRA to pose a high degree of risk to the investing public. *See* discussion *infra* Proposed Rule 4111 (Restricted Firm Obligations).

[14] *See* Notice at 78540.

[15] *See* Notice at 78542–78550. The proposed rule change would cover Capital Acquisition Brokers (''CABs''). FINRA is proposing to adopt CAB Rule 412 (Restricted Firm Obligations), to clarify that the member firms that have elected to be treated as CABs would be subject to proposed FINRA Rule 4111. The proposed rule change would not cover funding portals. According to FINRA, given its limited regulatory experience with funding portals, it is not clear that funding portals present the corresponding risks that FINRA is seeking to address with respect to broker-dealers. *See* Notice at 78550 note 46. Moreover, developing relevant metrics and thresholds for funding portals would require a separate effort and analysis because, unlike broker-dealers, the Uniform Registration Forms do not apply to funding portals and their associated persons. Accordingly, FINRA is proposing to amend Funding Portal Rule 900(a) (Application of FINRA Rule 9000 Series (Code of Procedure) to Funding Portals), to clarify that funding portals would not be subject to proposed FINRA Rule 9561. *See* Notice at 78550 note 46.

[16] *See* Notice at 78542.

[17] *Id.* at 78540.

[18] *Id.* at 78550.

[19] *Id.* at 78550–51.

[20] *See* Notice at 78540 note 5 (In particular, FINRA cited to Hammad Qureshi & Jonathan Sokobin, Do Investors Have Valuable Information About Brokers? (OCE Working Paper, Aug. 2015) (a study showing that past disclosure events, including regulatory actions, customer arbitrations and litigations of registered representatives, have significant power to predict future investor harm) and Mark Egan, Gregor Matvos & Amit Seru, The Market for Financial Adviser Misconduct, J. Pol. Econ. 127, no. 1 (Feb. 2019), 233–295 (presenting evidence suggesting a higher rate of new disciplinary and other disclosure events is highly correlated with past disciplinary and other disclosure events that occurred in the previous nine years)).

[21] *Id.* at 78540.

[22] *Id.* at 78540–41.

[23] *Id.* at 78541.

[24] *Id.*

[25] *Id.*

[26] *Id.*

FINRA observed that such firms and their associated persons often have substantial numbers of reportable events on their Uniform Registration Forms.[27] In such situations, FINRA closely examines the firms' and registered representatives' conduct, and where appropriate, FINRA will bring enforcement actions to bar or suspend the firms and individuals involved.[28]

However, FINRA states that individuals and firms with a history of misconduct can pose a particular challenge for FINRA's existing examination and enforcement programs.[29] Specifically, examinations can identify compliance failures—or imminent failures—and prescribe remedies to be taken, but examiners are not empowered to require a firm to change or limit its business operations in a particular manner without an enforcement action.[30] While these constraints on the examination process protect firms from potentially arbitrary or overly onerous examination findings, an individual or firm with a history of misconduct can take advantage of these limits to continue activities that pose risk of harm to investors until they result in an enforcement action.[31]

FINRA states that enforcement actions in turn can only be brought after a rule has been violated and any resulting customer harm has already occurred.[32] In addition, these proceedings can take significant time to develop, prosecute and conclude, during which time the individual or firm is able to continue misconduct, with significant risks of additional harm to investors.[33] Parties with serious compliance issues often will litigate enforcement actions brought by FINRA, which may involve a hearing and multiple rounds of appeals, forestalling the imposition of disciplinary sanctions for an extended period.[34] For example, an enforcement proceeding could involve a hearing before a Hearing Panel, numerous motions, an appeal to the National Adjudicatory Council (''NAC''), and a further appeal to the Commission.[35] Moreover, even when a FINRA Hearing Panel imposes a significant sanction, the sanction is stayed during appeal to the NAC.[36] Many sanctions are also automatically stayed on appeal to the Commission, and can be stayed during an appeal to the courts.[37] And when all appeals are exhausted, the firm may have withdrawn its FINRA membership and shifted its business to another member or other type of financial firm, limiting FINRA's jurisdiction and avoiding the sanction, including making restitution to customers.[38] In such circumstances, the firm may also fail to pay arbitration awards owed to claimants, leaving investors uncompensated and diminishing confidence in the securities markets.[39]

Proposed Rule 4111 (Restricted Firm Obligations)

Proposed Rule 4111 would establish numeric thresholds based on firm-level and individual-level disclosure events to identify member firms with a significantly higher level of risk-related disclosures as compared to similarly sized peers.[40] Following a multi-step process of evaluating a member firm, FINRA's Department of Member Regulation (''Department'') would be permitted to impose on member firms it determines pose a high risk to the investing public (*i.e.,* a ''Restricted Firm'') a ''Restricted Deposit Requirement,'' [41] conditions or restrictions on the member firm's operations that are necessary or appropriate to protect investors and the public interest, or both.[42]

According to FINRA, the proposed multi-step process includes features that narrowly focus the proposed obligations on the firms of most concern.[43] FINRA describes this process as a ''funnel.'' [44] The top of the funnel applies to the range of member firms with the most disclosures, with a narrowing in the middle of the potential member firms that may be subject to additional obligations, and the bottom of the funnel reflecting the smaller number of member firms that FINRA determines present high risks to the investing public.[45]

FINRA would conduct the process annually for each member firm, determining whether it should be designated (or re-designated) as a Restricted Firm and whether any such Restricted Firm should be subject to any obligations.[46] Each member firm that is preliminarily identified based on its firm-level and individual-level disclosure events would have several ways to affect outcomes during subsequent steps in the evaluative process, including a one-time opportunity to terminate registered representatives with relevant disclosure events so as to no longer trigger the numeric thresholds.[47] The member firm would also be able to explain to the Department why it should not be subject to a Restricted Deposit Requirement, or propose alternatives that would still accomplish FINRA's goal of protecting investors, and could request a hearing before a FINRA Hearing Officer in an expedited proceeding to challenge a Department determination.[48]

The rule would subject the Department to certain presumptions when it assesses a previously designated Restricted Firm's application for withdrawal from its Restricted Deposit Account.[49] Specifically, the Department would be required to: (1) Deny an application for withdrawal if the member firm, the member firm's associated persons who are owners or control persons, or the former member firm have any Covered Pending Arbitration Claims [50] or unpaid arbitration awards, or if the member firm's associated persons have any Covered Pending Arbitration Claims or unpaid arbitration awards relating to arbitrations that involved conduct or alleged conduct that occurred while the person was associated with the member firm; but (2) approve the application of a Former Member [51] when that Former

[27] *Id.*
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] *Id.* FINRA also states that temporary cease and desist proceedings can, but do not always, provide an effective remedy for potential ongoing harm to investors during the enforcement process. FINRA explains that it does not always permit rapid intervention because FINRA must be prepared to file the underlying disciplinary complaint at the same time it seeks a cease and desist order. *See* Notice at 78541. Moreover, temporary cease and desist proceedings are available only in narrowly defined circumstances. *See* FINRA Rule 9800 Series (Temporary and Permanent Cease and Desist Orders).
[39] *See* Notice at 78541.
[40] *Id.*
[41] *See* proposed Rule 4111(i)(15) (defining ''Restricted Deposit Requirement'').
[42] *See* Notice at 78542.
[43] *Id.*
[44] *Id.*
[45] *See* Exhibit 2d to the text of FINRA's proposed rule change for a diagram of the ''funnel,'' available at *https://www.finra.org/sites/default/files/2020-11/SR-FINRA-2020-041.pdf* at p. 553.
[46] *See* Notice at 78542.
[47] *Id.*
[48] *Id.*
[49] *See* proposed Rule 4111(i)(14) (defining ''Restricted Deposit Account'').
[50] *See* proposed Rule 4111(i)(2) (defining Covered Pending Arbitration Claim as an investment-related, consumer-initiated claim filed against the member or its associated persons in any arbitration forum that is unresolved; and whose claim amount (individually or, if there is more than one claim, in the aggregate) exceeds the member's excess net capital).
[51] *See* proposed Rule 4111(i)(7) would define ''Former Member'' as an entity that has withdrawn or resigned its FINRA membership, or that has had

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Member commits in the manner specified by the Department to use the amount it withdraws to pay down its specified unpaid arbitration awards.[52]

General (Proposed Rule 4111(a))

Under the proposal, any member firm that is designated by the Department as a Restricted Firm would be required to establish a Restricted Deposit Account[53] and deposit cash or qualified securities with an aggregate value that is not less than the member firm's Restricted Deposit Requirement, except in certain identified situations.[54] Restricted Firms could also be subject to conditions or restrictions on their operations,[55] as determined by the Department to be necessary or appropriate to protect investors and the public interest in addition or in the alternative to a Restricted Deposit Requirement.[56]

Annual Calculation by FINRA of the Preliminary Criteria for Identification (Proposed Rule 4111(b))

FINRA will announce for all member firms the date of the first annual evaluation (''Evaluation Date'') no less than 120 calendar days prior to the first Evaluation Date.[57] Subsequent Evaluation Dates would be on the same month and day each year, whether that date certain falls on a business day, a weekend day, or a holiday.[58]

The Department would begin each member firm's annual Rule 4111 review process by calculating specified ''Preliminary Identification Metrics'' for each firm for each of six categories of events or conditions, collectively defined as the ''Disclosure Event and Expelled Firm Association Categories.'' [59] FINRA would use a formula to identify whether a firm has exceeded certain established thresholds,[60] based on the firm's size,[61] for each of these six categories of events or conditions.[62] The six categories are: (1) Registered Person Adjudicated Events; [63] (2) Registered Person Pending Events; [64] (3) Registered Person Termination and Internal Review Events; [65] (4) Member Firm Adjudicated Events; [66] (5) Member Firm Pending

its membership cancelled or revoked. However, proposed rule 9561.01 would include former members as members for purposes of the proposed rule changes. To the extent a Restricted Member withdraws its membership applications with specified unpaid arbitration awards, the conditions for releasing funds from the restricted deposit would encourage the firm to use the released funds to pay those awards. *See also* Notice at 78542.

[52] *See* Notice at 78547.

[53] *See* proposed Rule 4111(i)(14) (defining ''Restricted Deposit Account''). Proposed Rule 4111(i)(14) would require that any Restricted Deposit Account be in the name of the member firm at a bank or at the member firm's clearing firm. The account would need to 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 firm 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 firm 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 firm becomes a Former Member, the assets deposited in the Restricted Deposit Account to satisfy the Restricted Deposit Requirement shall be kept in the Restricted Deposit Account, 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. *See* Notice at 78547–8. In the event of a liquidation of a Restricted Firm, funds or securities on deposit in the Restricted Deposit Account would be additional financial resources available for the Restricted Firm's trustee to distribute to those with claims against the Restricted Firm. However, such funds and securities on deposit in the Restricted Deposit Account would not be held with respect to any particular claim, or class of claimants, against such firm. *See* Notice at 78548 note 39.

[54] *See* Notice at 78542.

[55] FINRA has also proposed adopting Supplementary Material .03 to proposed Rule 4111 to provide member firms with a non-exhaustive list of examples of conditions and restrictions that the Department could impose on Restricted Firms. *See* Notice at 78458.

[56] *Id.*

[57] *Id.*

[58] *See* FINRA March 4 Letter at 5–6.

[59] *See* proposed Rule 4111(i)(4) (defining ''Disclosure Event and Expelled Firm Association Categories''). The Disclosure Event and Expelled Firm Association Categories are all based on events or conditions disclosed through the Uniform Registration Forms with the exception of one event category (Member Firm Adjudicated Events), which includes events that are derived from customer arbitrations filed with FINRA's dispute resolution forum. *See* Notice at 78542 note 17.

[60] *See* proposed Rule 4111(i)(11) (defining ''Preliminary Identification Metrics Thresholds'').

[61] Specifically, member firms will be divided into seven size categories, ranging from firms with 1–4 Registered Persons In-Scope to 500 or more Registered Persons In-Scope. *See* Notice at 78544. The term ''Registered Persons In-Scope'' means all persons registered with the firm for one or more days within the one year prior to the Evaluation Date. *See* proposed Rule 4111(i)(13).

[62] *See* Notice at 78543. As detailed further below, in each of these six categories, FINRA would identify all of the firm's events or conditions within that category. The total number of these events or conditions in each category will then be divided by the number of Registered Persons In-Scope to identify the per capita number of events or conditions that the firm has, to enable comparison against similarly sized firms. This per capita number of events or conditions in each category will then be used to determine whether or not the firm has met or exceeded the threshold for that category, as set out below. *Id.*

[63] ''Registered Person Adjudicated Events,'' defined in proposed Rule 4111(i)(4)(A), means any one of the following events that are reportable on the registered person's Uniform Registration Forms: (1) A final investment-related, consumer-initiated customer arbitration award or civil judgment against the registered person in which the registered person was a named party, or was a subject of the customer arbitration award or civil judgment; (2) a final investment-related, consumer-initiated customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation for a dollar amount at or above $15,000 in which the registered person was a named party or was a subject of the customer arbitration settlement, civil litigation settlement or a settlement prior to a customer arbitration or civil litigation; (3) a final investment-related civil judicial matter that resulted in a finding, sanction or order; (4) a final regulatory action that resulted in a finding, sanction or order, and was brought by the Commission or Commodity Futures Trading Commission (''CFTC''), other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or (5) a criminal matter in which the registered person was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign, or military court to any felony or any reportable misdemeanor.

[64] ''Registered Person Pending Events,'' defined in proposed Rule 4111(i)(4)(B), means any one of the following events associated with the registered person that are reportable on the registered person's Uniform Registration Forms: (1) A pending investment-related civil judicial matter; (2) a pending investigation by a regulatory authority; (3) a pending regulatory action that was brought by the Commission or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or (4) a pending criminal charge associated with any felony or any reportable misdemeanor. Registered Person Pending Events does not include pending arbitrations, pending civil litigations, or consumer-initiated complaints that are reportable on the registered person's Uniform Registration Forms.

[65] ''Registered Person Termination and Internal Review Events,'' defined in proposed Rule 4111(i)(4)(C), means any one of the following events associated with the registered person at a previous member firm that are reportable on the registered person's Uniform Registration Forms: (1) A termination in which the registered person voluntarily resigned, was discharged or was permitted to resign from a previous member after allegations; or (2) a pending or closed internal review by a previous member. FINRA has revised this definition, from the version proposed in Regulatory Notice 19–17 (May 2019), to clarify that termination and internal review disclosures concerning a person whom a member firm terminated would not impact that member firm's own Registered Person Termination and Internal Review Metric; rather, they would only impact the metrics of member firms that subsequently register the terminated individual.

[66] ''Member Firm Adjudicated Events,'' defined in proposed Rule 4111(i)(4)(D), means any one of the following events that are reportable on the member firm's Uniform Registration Forms or based on customer arbitrations filed with FINRA's dispute resolution forum: (1) A final investment-related, consumer-initiated customer arbitration award in which the member was a named party; (2) a final investment-related civil judicial matter that resulted in a finding, sanction or order; (3) a final regulatory action that resulted in a finding, sanction or order, and was brought by the Commission or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization; or (4) a criminal matter in which the member was convicted of or pled guilty or nolo contendere (no contest) in a domestic, foreign, or military court to any felony or any reportable misdemeanor.

Events; [67] and (6) Registered Persons Associated with Previously Expelled Firms (also referred to as the Expelled Firm Association category).[68] Based on this calculation, the Department would determine whether the particular member firm meets the ''Preliminary Criteria for Identification.'' [69]

Several principles guided FINRA's development of the proposed Preliminary Criteria for Identification and the proposed Preliminary Identification Metrics Thresholds.[70] The criteria and thresholds are intended to be replicable and transparent to FINRA and affected member firms; employ the most complete and accurate data available to FINRA; be objective; account for different firm sizes and business profiles; and target the sales practice concerns that arise when firms appear to systemically perpetuate harm on investors leading up to and at the point-of-sale of securities products, that are motivating the proposal.[71] These criteria are intended to identify member firms that present a high risk but avoid imposing obligations on member firms whose risk profile and activities do not warrant such obligations.[72]

To calculate each of the six categories' Preliminary Identification Metrics, FINRA would first add the number of pertinent disclosure events.[73] To calculate the Expelled Firm Association category, FINRA would count the number of Registered Persons Associated with Previously Expelled Firms.[74] For purposes of these calculations: (1) Adjudicated disclosure events would include only those that were resolved during the prior five years from the date of the calculation; (2) pending events and pending internal reviews would include disclosure events that are pending as of the date of the calculation; and (3) Registered Person disclosure events (*i.e.,* disclosure events of all persons registered with the member firm for one or more days within the one year prior to the calculation date, that is, Registered Persons In-Scope).[75] The sum for each of the six categories would then be run through a standardization process to determine the member's six Preliminary Identification Metrics, wherein the raw numbers of a firm's relevant events in each category would be divided by the number of Registered Persons In-Scope at the firm, to enable more accurate, per person comparisons with other member firms.[76]

A firm's six Preliminary Identification Metrics would be used to determine if the member firm meets the Preliminary Criteria for Identification. FINRA believes that the Preliminary Identification Metrics Thresholds in proposed Rule 4111(i)(11) represent member firms that present significantly higher risk than a large percentage of their similarly sized peers for the type of events in the category. There are numeric thresholds for seven different firm sizes, to provide that each member firm would be compared only to its similarly sized peers.[77]

To meet the Preliminary Criteria for Identification, a member firm would need to meet: (1) Two or more of the Preliminary Identification Metrics Thresholds set forth in proposed Rule 4111(i)(11), at least one of which must be the Registered Person Adjudicated Event Metric, the Member Firm Adjudicated Event Metric, or the Expelled Firm Association Metric, and (2) two or more Registered Person and Member Firm Events (*i.e.,* two or more events from Categories 1–5 above).[78] If these conditions are met, the member firm would meet the Preliminary Criteria for Identification.[79]

Initial Department Evaluation (Proposed Rule 4111(c)(1))

The Department would then evaluate whether a member firm that has met the Preliminary Criteria for Identification warrants further review under Rule 4111.[80] FINRA's evaluation would include consideration of: Whether non-high-risk disclosure events or other conditions should not have been included within the initial calculation of the firm's Preliminary Identification Metric computations (*e.g.,* events that were not sales-practice related, duplicative events involving the same customer and the same matter, or events involving compliance concerns best addressed by a different regulatory response by FINRA (*e.g.,* enforcement actions; more frequent examination cycles; temporary cease and desist orders)); [81] whether the disclosure events pose risks to investors or market integrity, as opposed to violations of procedural rules; [82] and whether the member firm has already addressed the concerns signaled by the disclosure events or conditions, or has altered its business operations such that the threshold calculation no longer reflects the firm's current risk profile.[83] The Department would then either determine that further review would be necessary and continue the Rule 4111 process, or, if the Department concluded that no further review would be warranted, close out that member firm's Rule 4111 process for the year without imposing any restrictions or obligations.[84]

One-Time Opportunity To Reduce Staffing Levels (Proposed Rule 4111(c)(2))

If the Department determines that a member firm warrants further review under Rule 4111, and such member firm would be meeting the Preliminary Criteria for Identification for the first time, the member firm would have a

[67] ''Member Firm Pending Events,'' defined in proposed Rule 4111(i)(4)(E), means any one of the same kinds of events as the ''Registered Person Pending Events,'' but that are reportable on the member firm's Uniform Registration Forms.

[68] ''Registered Persons Associated with Previously Expelled Firms,'' defined in proposed Rule 4111(i)(4)(F), means any ''Registered Person In-Scope'' who was registered for at least one year with a previously expelled firm and whose registration with the previously expelled firm terminated during the ''Evaluation Period'' (*i.e.,* the prior five years from the ''Evaluation Date,'' which would be the annual date as of which the Department calculates the Preliminary Identification Metrics). See proposed Rule 4111(i)(5), (6), and (13) (proposed definitions of ''Evaluation Date,'' ''Evaluation Period,'' and ''Registered Persons In-Scope''). This proposed definition is narrower than the definition proposed in Regulatory Notice 19–17, which would have captured any registered person registered for one or more days within the year prior to the Evaluation Date with the firm, and who was associated with one or more previously expelled firms at any time in his/her career. Including an Expelled Firm Association Metric in the Preliminary Criteria for Identification is similar to how FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms) imposes recording requirements on firms with specific percentages of registered persons who were previously associated with disciplined firms.

[69] *See* proposed Rule 4111(i)(9) (defining ''Preliminary Criteria for Identification'').

[70] *See* Notice at 78542.

[71] *Id.*

[72] *Id.*

[73] *Id.* at 78543.

[74] *Id.*

[75] *See* proposed Rule 4111(i)(13).

[76] *See* Notice at 78543. For the five ''Registered Person and Member Firm Events'' categories (Categories 1–5 above),[76] the proposed standardized Preliminary Identification Metrics would be derived by dividing the sum of events from each category by the number of Registered Persons In-Scope to identify the average number of events per registered representative. For the Expelled Firm Association category (Category 6 above), the proposed Preliminary Identification Metric would be standardized by taking the number of Registered Persons Associated with Previously Expelled Firms and dividing it by the number of Registered Persons In-Scope to determine the percentage of the member firm's registered representatives who meet the Registered Persons Associated with Previously Expelled Firms definition. *See also* proposed Rule 4111(i)(12) (defining ''Registered Person'' and ''Member Firm Events'').

[77] Because FINRA has narrowed the definition of Registered Persons Associated with Previously Expelled Firms from the version that was originally proposed in Regulatory Notice 19–17, FINRA also has revised the Expelled Firm Association Metric Thresholds. *See* Notice at 78544 note 29.

[78] *See* Notice at 78543.

[79] *Id.*

[80] *See* Notice at 78544.

[81] *Id.*

[82] *Id.* at 78544–45.

[83] *Id.* at 78545.

[84] *Id.*

one-time opportunity to reduce its staffing levels to avoid meeting the Preliminary Criteria for Identification, within 30 business days after being informed by the Department that it met the Preliminary Criteria for Identification.[85] The member firm would need to identify the terminated individuals to the Department and would be prohibited from rehiring any of those terminated persons, in any capacity, for one year.[86]

If the member firm reduces its staffing levels, and the Department then determines that the member firm no longer meets the Preliminary Criteria for Identification, the Department would close out the firm's Rule 4111 process for the year without seeking to impose any restrictions or obligations on the firm. However, if the Department determines that the member firm still meets the Preliminary Criteria for Identification (or if the member firm did not opt to reduce staffing levels) the Department would determine the firm's maximum Restricted Deposit Requirement, and the member firm would proceed to a ''Consultation'' with the Department.[87]

Determination of a Maximum Restricted Deposit Requirement (Proposed Rule 4111(i)(15))

For firms still meeting the Preliminary Criteria for Identification, the Department would then determine the firm's maximum Restricted Deposit Requirement,[88] and the member firm would then proceed to a ''Consultation'' with the Department.[89] The Department would seek to tailor a firm's maximum Restricted Deposit Requirement amount to its size, operations and financial conditions, and determine the member firm's maximum Restricted Deposit Requirement consistent with the objectives of the rule, while not significantly undermining the firm's continued financial stability and operational capability as an ongoing enterprise over the next 12 months.[90]

Consultation (Proposed Rule 4111(d))

During the Consultation, the Department would give the member firm an opportunity to demonstrate why it does not meet the Preliminary Criteria for Identification, why it should not be designated as a Restricted Firm, and why it should not be subject to the maximum Restricted Deposit Requirement.[91] A member firm may overcome the presumption that it should be designated as a Restricted Firm by ''clearly demonstrating that the Department's calculation is inaccurate'' because, among other things, it considered events that should not have been included.[92] A member firm also may overcome the presumption that it should be subject to the maximum Restricted Deposit Requirement by clearly demonstrating that such an amount would cause significant undue financial hardship, and that a lesser deposit requirement would satisfy the objectives of Rule 4111; or that other operational conditions and restrictions on the member and its associated persons would sufficiently protect investors and the public interest.[93] To the extent a member firm seeks to claim undue financial hardship, it would bear the burden of supporting that claim with documents and information.[94]

Department Decision and Notice (Proposed Rule 4111(e)); No Stays

After the Consultation, the Department would be required to render a decision, pursuant to one of three paths: (1) If the Department determines that the member firm has rebutted the presumption that it should be designated a Restricted Firm, the Department would not designate the firm as a Restricted Firm that year; (2) if the Department determines that the member firm has not rebutted the presumption that it should be designated as a Restricted Firm, but has rebutted the presumption that it shall be subject to the maximum Restricted Deposit Requirement, the Department would designate the member firm as a Restricted Firm, but would: (a) Either impose no Restricted Deposit Requirement on the member firm, or require it to promptly establish a Restricted Deposit Account, and deposit in that account a lower Restricted Deposit Requirement in such dollar amount as the Department deems necessary or appropriate; and (b) require the member firm to implement and maintain specified conditions or restrictions on the operations and activities of the member firm and its associated persons, as necessary or appropriate, to address the concerns identified by the Department, and protect investors and the public interest; or (3) if the Department determines that the member firm has rebutted neither presumption, the Department would designate the member firm as a Restricted Firm, require it to promptly establish a Restricted Deposit Account, deposit in that account the maximum Restricted Deposit Requirement, and implement and maintain specified conditions or restrictions on the firm's operations and activities, and those of its associated persons, as necessary or appropriate to address the concerns identified by the Department, and protect investors and the public interest.[95] Pursuant to proposed Rule 4111(e)(2), the Department would provide the member firm with written notice of its decision no later than 30 days from the date of FINRA's letter scheduling the Consultation, stating any conditions or restrictions to be imposed, and the ability of the member firm to request a hearing with the Office of Hearing Officers in an expedited proceeding.[96]

Continuation or Termination of Restricted Firm Obligations (Proposed Rule 4111(f))

Proposed Rule 4111(f) would set forth the circumstances under which any obligations (including any Restricted Deposit Requirement, conditions, or

[85] *Id.* at 78544.

[86] *Id.*

[87] *Id.* at 78545.

[88] The term ''maximum'' is used to indicate that a firm's maximum Restricted Deposit Requirement will be the figure FINRA declares to the firm is the highest deposit requirement it may be subject to during that year's Rule 4111 process. As discussed below, firms could then seek to demonstrate to FINRA why a lower deposit requirement would be more appropriate during the Consultation. *See* FINRA March 4 Letter *supra* note 5.

[89] *See* Notice at 78545.

[90] *Id.* The proposed factors that the Department would consider when determining a maximum Restricted Deposit Requirement include revenues, net capital, assets, expenses, and liabilities, the firm's operations and activities, number of registered persons, the nature of the disclosure events included in the numeric thresholds, insurance coverage for customer arbitration awards or settlements concerns raised during FINRA exams, and the amount of any of the firm's or its associated persons' ''Covered Pending Arbitration Claims'' or unpaid arbitration awards. *See* proposed FINRA Rule 4111(i)(15)(A).

[91] *See* Notice at 78545.

[92] *Id.* These would include, for example, events that are duplicative, involving the same customer and the same matter, or are not sales-practice related. *Id.*

[93] *Id.* Proposed Rule 4111(d)(3) provides guidance to member firms on what information the Department would consider during the Consultation, and guidance on how to attempt to overcome the two rebuttable presumptions (that the member firm should be designated as a Restricted Firm, and that it should be subject to the maximum Restricted Deposit Requirement). *See* Notice at 78546.

[94] *See* Notice at 78545.

[95] *See* Notice at 78546.

[96] *Id.* As noted below, any request for a hearing would not stay the effectiveness of the Department's decision, but, unless that firm was already operating as a Restricted Firm based on a prior year's Department decision, it would temporarily lower the necessary Required Deposit Requirement for that member firm until the Office of Hearing Officers, or the NAC issues a final written decision. *See* proposed FINRA Rule 4111(e)(2). If the firm was already operating as a Restricted Firm based on a prior year's Department decision, it would be required to keep in the Restricted Deposit Account the assets then on deposit therein until the Office of Hearing Officers or the NAC issues its final written decision in the expedited proceeding. *Id.*

restrictions) that were imposed during the Rule 4111 process in one year are continued or terminated in that same year and in subsequent years. Pursuant to proposed Rule 4111(f)(1), a currently designated Restricted Firm would not be able to withdraw all or any portion of its Restricted Deposit Requirement, or seek to terminate or modify any Restricted Deposit Requirement, conditions, or restrictions that have been imposed pursuant to this Rule, without the prior written consent of the Department. Restricted Firms would only be permitted to seek to withdraw a portion of its Restricted Deposit Requirement, or terminate or modify any required deposit, conditions, or restrictions that have been imposed, during their annual Consultation, and any ensuing expedited proceedings after a Department decision; no interim termination or modification of any obligations would be permitted.[97]

Where the Department determines in one year that a member firm is a Restricted Firm, but in the following year(s) determines that the member firm or former member firm [98] either does not meet the Preliminary Criteria for Identification or should not be designated as a Restricted Firm, the member firm or former member firm would no longer be subject to any obligations previously imposed under proposed Rule 4111.[99] There would be one exception from this removal of previously imposed obligations in the case of the Restricted Deposit Requirement: A former Restricted Firm would not be permitted to withdraw any portion of its Restricted Deposit Requirement without submitting an application in the manner specified under Rule 4111(f)(3)(A), and obtaining the Department's prior written consent for the withdrawal.[100] The rule would establish presumptions for the Department's approval, or disapproval, of a withdrawal application. Specifically, the Department would approve an application for withdrawal if the member firm, its associated persons, or the former member firm have no Covered Pending Arbitration Claims or unpaid arbitration awards.[101] In addition, the Department would approve an application by a former member for withdrawal if the former member commits in the manner specified by the Department to use the amount it seeks to withdraw from its Restricted Deposit to pay the former member's specified unpaid arbitration awards.[102] By contrast, the Department would deny an application for withdrawal if: (1) The member firm, the member firm's associated persons who are owners or control persons, or the former member have any Covered Pending Arbitration Claims or unpaid arbitration awards, or (2) any of the member's associated persons have any Covered Pending Arbitration Claims or unpaid arbitration awards relating to arbitrations that involved conduct or alleged conduct that occurred while associated with the member.[103]

Books and Records (Proposed Rule 4111(g))

Member firms would also be obligated to maintain books and records that evidence their compliance with Rule 4111 and any Restricted Deposit Requirement or other conditions or restrictions imposed under that rule, which the member firm would also need to provide to the Department upon request.[104]

Proposed Rule 9561 (Procedures for Regulating Activities Under Rule 4111) and Amendments to Rule 9559 To Implement the Requirements of Proposed Rule 4111

Rule 9561 would establish new expedited proceedings that would: (1) Provide an opportunity to challenge any requirements the Department has imposed, including any Restricted Deposit Requirements, by requesting a prompt review of the Department's decision in the Rule 4111 process; [105] and (2) address a member firm's failure to comply with any requirements imposed under Rule 4111.[106]

Notices Under Proposed Rule 4111 (Proposed Rule 9561(a))

Under new Rule 9561(a)(1), the Department would serve to the member firm a notice of the Department's decision following the Rule 4111 process that: (1) Provides the specific grounds and factual basis for the Department's action; (2) states when the action would take effect; (3) informs the member firm that it may, within seven days after service of the notice, request a hearing in an expedited proceeding; and (4) explains the Hearing Officer's authority.[107] The proposed rule change would also provide that, if a member firm does not request a hearing, the decision would constitute final FINRA action.[108]

In general, a request for a hearing would not stay any of the Rule 4111 Requirements imposed in the Department's decision, which would be immediately effective.[109] There is one exception: When a member firm requests review of a Department determination to impose a Restricted Deposit Requirement on the member, the firm would be required to deposit the lesser of 25% of its Restricted Deposit Requirement or 25% of its average excess net capital over the prior year, while the expedited proceeding is pending.[110] This exception would not be available for a member firm that has been re-designated as a Restricted Firm, and is already subject to a previously imposed Restricted Deposit Requirement, which it would need to keep the assets on deposit in the Restricted Deposit account until the Office of Hearing Officers or NAC issues a written decision.[111]

Notice for Failure To Comply With the Proposed Rule 4111 Requirements (Proposed Rule 9561(b))

If a member firm fails to comply with any of the requirements imposed on it under Rule 4111, the Department would be authorized to serve a notice pursuant to proposed Rule 9561 stating that the member firm's continued failure to

[97] *See* Notice at 78547. FINRA has indicated that there will be a presumption that the Department shall deny an application by a member firm or former member firm that is currently designated as a Restricted Firm to withdraw all or any portion of its Restricted Deposit Requirement.; *see also* FINRA proposed Rule 4111(f)(3).

[98] *See* Notice at 78547; *see also* definition of ''Former Member'' in proposed Rule 4111(i)(7).

[99] *See* Notice at 78547.

[100] *Id.* Proposed Rule 4111(f)(3) would require a member's application requesting permission to withdraw any portion of its Restricted Deposit Requirement to include, among other things: (1) Evidence that there are no Covered Pending Arbitration Claims, unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding against the member, the member's Associated Persons or the Former Member, or (2) a detailed description of any existing Covered Pending Arbitration Claims, unpaid arbitration awards or unpaid settlements relating to arbitrations outstanding. The Department would be required to issue a notice of its decision within 30 days from the date it receives the relevant application.; *see also* FINRA proposed Rule 9561.

[101] *See* Notice at 78547.

[102] *Id.; see also* proposed Rule 4111(f)(3) provides that the Covered Pending Arbitration Claims and unpaid arbitration awards of a member firm's associated persons are pertinent to an application for a withdrawal from the Restricted Deposit Requirement. In particular, the conditions for releasing funds from the restricted deposit include the former member having no specified unpaid arbitration awards. *See supra* note 51 and accompanying text.

[103] *See* Notice at 78547; *see also* FINRA proposed Rule 4111(f)(3)(B).

[104] *See* Notice at 78547.

[105] Proposed Rule 9561(a)(1) would define the ''Rule 4111 Requirements'' to mean the requirements, conditions, or restrictions imposed by a Department determination under proposed Rule 4111. *See* Notice at 78548.

[106] *See* Notice at 78549.

[107] *Id.*

[108] *Id.* at 78548–49.

[109] *Id.* at 78549.

[110] *Id.*

[111] *See* FINRA Rule 4111(e)(2), as modified by Amendment No. 2.

comply within seven days of service of the notice would result in a suspension or cancellation of membership.[112] The notice would need to: (1) Identify the requirements with which the member firm is alleged to have not complied; (2) specify the facts involved in the alleged failure; state when the action will take effect; (3) explain what the member firm would be required to do to avoid the suspension or cancellation; (4) inform the member firm that it may file a request for a hearing in an expedited proceeding within seven days after service of the notice under Rule 9559; and (5) explain the Hearing Officer's authority.[113] If a member firm does not request a hearing, the suspension or cancellation would become effective seven days after service of the notice.[114]

Hearings (Proposed Amendments to the Hearing Procedures Rule)

If a member firm requests a hearing under proposed Rule 9561, the hearing would be subject to Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series). FINRA is also adopting several amendments to Rule 9559 specific to hearings requested pursuant to new Rule 9561.[115]

Effective Date

The effective date will be 180 days after the Regulatory Notice announcing this Commission approval.[116]

[112] *See* FINRA Rule 4111(b)(1)–(2).

[113] *See* FINRA Rule 4111(b)(3).

[114] *See* FINRA Rule 4111(b)(6). After a suspension has been imposed, a member firm may file a request under Rule 9561(b) to terminate the suspension on the ground of full compliance with the notice or decision, and the head of the Department will be permitted to grant relief for good cause shown. *See* Notice at 78549.

[115] *See* Notice at 78549. Specifically, FINRA is: (1) Amending Rule 9559(d) and (n) to establish the authority of a Hearing Officer in expedited proceedings under Rule 9561; (2) amending Rule 9559(f) to set out timing requirements for hearings conducted under Rule 9561(a) and (b); and (3) amending Rule 9559(p)(6) to account for the obligations that may be imposed under new Rule 4111 within the content requirements of any decision issued by a Hearing Officer under the Rule 9550 Series. *See* amended Rules 9559(d), (f), (n), and (p)(6). Additionally, during expedited proceedings conducted under new Rule 9561(a) to review a Department determination under proposed Rule 4111, a member firm would be permitted to seek to demonstrate that the Department incorrectly included disclosure events when calculating whether the member firm meets the Preliminary Criteria for Identification. However, the member firm would not be permitted to argue the underlying merits of the final actions underlying the disclosure events. *See* Notice at 78550.

[116] *See* FINRA March 4 Letter at 4. FINRA set a 180-day timeline for the effective date based on comments requesting that FINRA provide additional resources to facilitate member firms' compliance with proposed Rule 4111. FINRA stated, however, that while it intends to develop and provide additional tools to member firms, such tools may not be determinative, because ''whether a member firm will meet the Preliminary Criteria for Identification could only be definitely established as of the annual Evaluation Date.'' *Id.*

III. Discussion and Commission Findings

After careful review of the proposed rule change, as modified by Amendment No. 1 and Amendment No. 2, the comment letters, and FINRA's responses to the comments, the Commission finds that the proposed rule change, as modified by Amendment No. 1 and Amendment No. 2, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.[117] Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act, which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.[118]

Proposed Rule 4111 (Restricted Firm Obligations)

The proposal to establish a process in new Rule 4111 to identify member firms that present a high degree of risk to the investing public, based on numeric thresholds of firm-level and individual-level disclosure events, and then impose a Restricted Deposit Requirement, conditions or restrictions on the member firm's operations, or both, will help protect investors and encourage such member firms to change their behavior. FINRA has designed the proposed rule change to establish an annual, multi-step process to determine whether a member firm raises investor protection concerns substantial enough to require the imposition of additional obligations,[119] while allowing identified firms several means of challenging FINRA's decisions and affecting the ultimate outcome.[120] The annual review process, and the ability to impose added obligations on firms presenting a significantly higher degree of risk to investors, should encourage firms to alter their behavior, ultimately to the benefit and protection of investors.

One commenter expressed general support for the proposal, without calling for any amendments.[121] Three commenters expressed general support for the proposal, while also suggesting changes to the proposal to ease firms' compliance burdens, and to help achieve the intended purpose of both incentivizing improved behavior from member firms and better protecting investors.[122] Finally, three other commenters expressed general opposition to the proposal.[123]

Disclosure of Restricted Firms

Three commenters advocated for some form of public disclosure of Restricted Firms identified by FINRA during the Rule 4111 process.[124] Two of those commenters expressed concerns that withholding publication of this information would limit investors'

[117] In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[118] 15 U.S.C. 78o–3(b)(6).

[119] FINRA believes that the proposal contains numerous steps that are objective and do not involve the use of discretion or that limit or focus FINRA's discretion. For example, the annual calculation that identifies member firms that are subject to the proposed rule would use objective, transparent criteria to identify outlier firms with the most significant history of misconduct relative to their peers. *See* Notice at 78559.

[120] For example, during the Consultation, the Department would evaluate whether the member firm has demonstrated that the annual calculation included disclosure events that should not have been included (because they are duplicative or not sales-practice related). *Id.*

[121] *See* Letter from Ruben Huertero, Legal Intern, and Christine Lazaro, Director of the Securities Arbitration Clinic and Professor of Clinical Legal Education, St. John's University School of Law, dated December 28, 2020 (The Clinic indicating its support for the adoption of Rule 4111 requiring member firms with a high degree of risk towards the investing public to be subject to a deposit from which withdrawals would be restricted).

[122] *See* Letter from Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated December 28, 2020 (''SIFMA Letter'') (SIFMA was supportive of the proposal ''to the extent it has the ancillary effect of incentivizing firms and their associated persons to comply with their regulatory obligations and to pay their arbitration awards.''); Letter from David P. Meyer, President, Public Investors Advocate Bar Association, dated December 28, 2020 (''PIABA Letter'') (PIABA indicated it supports the proposal ''in general'' and is ''a firm supporter of FINRA's efforts to enhance its programs to address the risks posed to investors by individual brokers and member firms that have a history of misconduct.''); letter from Lisa Hopkins, President, General Counsel and Senior Deputy Commissioner of Securities, West Virginia, North American Securities Administrators Association, Inc., dated December 28, 2020 (''NASAA Letter'') (NASAA ''commends the Commission and FINRA for expanding controls over high-risk firms'' and indicated the proposal has the potential to ''better protect investors from high-risk firms, which is a goal that NASAA supports.'').

[123] *See* Letter from Lev Bagramian, Senior Securities Policy Advisor, and Michael J, Hughes, Program & Research Assistant, Better Markets, dated December 28, 2020 (''Better Markets Letter'') (Better Markets indicated that the proposal is ''better than doing nothing, [but] it is nonetheless grossly insufficient.''); Letter from Andrew R. Harvin, Doyle, Restrepo, Harvin & Robbins, L.L.P., dated December 21, 2020 (''Harvin Letter'') (Harvin indicated that the proposal is a ''rule proposal looking for a problem.''); Letter from Richard J. Carlesco Jr., CEO, IBN Financial Services, Inc., dated December 15, 2020 (''IBN Letter'') (IBN indicated that the proposal is just one of a ''throng of new regulations that are burying small firms.'').

[124] *See* PIABA Letter; Better Markets Letter; and NASAA Letter.

ability to make informed decisions when selecting a brokerage firm.[125] One argued that ''at a minimum, FINRA must prominently publicize the names of the firms that have been twice-designated as high-risk'' and those of newly formed firms where at least 20% of the associated persons were affiliated previously with twice-designated high-risk firms.[126] One commenter also criticized the lack of required disclosure on Form BD or Form CRS, noting that firms are unlikely to make such disclosures voluntarily.[127] The other commenter asserted that, ''at a minimum, the names of Restricted Firms should be provided to state securities regulators'' to assist such authorities with regulatory oversight and risk analyses of the firms.[128] This commenter stated that the lack of disclosure to state securities regulators was particularly concerning, because it could ''skew an examiner's review of the firm's compliance with net capital requirements due to the restricted funds not being readily available to meet creditor's calls or liquidity requirements.'' [129]

In its initial response, FINRA pointed out that the purpose of proposed Rule 4111 is to address the risks posed by Restricted Firms through appropriate operational restrictions, while giving them opportunities and an incentive to remedy those risks, but that it intends to explore how it can appropriately share identified risks presented by certain firms with both the public and state securities regulators, while remaining consistent with the purpose of proposed Rule 4111.[130] FINRA stated that the proposed rule change is designed to incentivize members that pose outlier-level risks, when compared to all similarly sized firms by headcount, to change behavior and could have an ancillary benefits for addressing unpaid arbitration awards.[131] FINRA expressed concern that publicly disclosing a firm's Restricted Firm status may potentially interfere with those purposes.[132] However, FINRA recognized the potential value to investors of public disclosure of a member's status as a Restricted Firm and intends to consider employing it and other approaches during its planned review of Rule 4111 after it has gained ''sufficient experience with the rule.'' [133]

In further consideration of the matter, FINRA filed a second response to comments, wherein it indicated that the FINRA Board of Governors has authorized the filing of proposed amendments to Rule 8312 (FINRA BrokerCheck Disclosure) that would require FINRA to identify on BrokerCheck those member firms or former member firms that are designated as Restricted Firms pursuant to proposed Rules 4111 and 9561.[134] FINRA indicated that public disclosure on BrokerCheck of those firms that it designates as a Restricted Firm should ''help investors make informed choices about the member firms with which they do business.'' [135] FINRA stated that if the Commission approves the proposed rule change, FINRA would promptly thereafter file with the Commission the proposed amendments to Rule 8312.[136] Additionally, FINRA committed to working with individual state securities regulators to share relevant information concerning whether firms that operate within their jurisdictions have been designated as Restricted Firms, along with information pertaining to the obligations that it has imposed on such firms pursuant to proposed Rules 4111 and 9561.[137]

The Commission finds that the incentives it provides to encourage firms' remediation of high-risk behaviors would be an important step in furtherance of the protection of investors from broker-dealers with risk profiles indicative of potential future harm. The Commission finds that the proposed rule change is reasonable and is designed to enhance investor protection by incentivizing broker-dealers and brokers that pose higher risks to investors to change their behavior. For these reasons, the Commission finds the proposed rule change as presented is consistent with Section 15A(b)(6) of the Act in that it is in the public interest. The Commission further supports FINRA's commitment to working with individual state securities regulators to share relevant information and observes its commitment to further consider public disclosure of a firm's designation as a Restricted Firm by filing proposed amendments to Rule 8312 that would require FINRA to identify on BrokerCheck those member firms or former member firms that are designated as Restricted Firms pursuant to proposed Rules 4111 and 9561.

Resources To Assist Member Firms With Compliance

Two commenters advocated for greater clarity on how firms can independently replicate FINRA's calculation of the Preliminary Identification Metrics, due to the burdens firms may face in complying with proposed Rule 4111.[138] One suggested that FINRA commit to: (1) Providing resources that ''map the Disclosure Event and Expelled Firm Association Categories to the relevant questions on Uniform Registration Forms''; (2) giving firms a worksheet to track their status based on disclosure events and previous firm associations of their Registered Persons In-Scope; and (3) providing firms with a list of all expelled firms.[139] The other commenter suggested FINRA should advise each member firm ''in writing annually what its six Preliminary Identification Metrics are,'' and pointed out that without further assistance from FINRA, firms would need to review each of their registered representative's BrokerCheck reports to track the Registered Persons Associated With Previously Expelled Firms metric.[140] FINRA indicated that it appreciates the potential compliance burdens, and understands the need and expressed its commitment to provide more guidance and resources.[141] Further, FINRA indicated it will explore the feasibility of providing each member firm with notice of its status with respect to the Preliminary Criteria for Identification, including whether such notice would be useful for firms if calculated at any point other than on their annual Evaluation Date.[142] As noted above, due to these concerns and the need to develop resources to assist firms with compliance, FINRA has extended the effective date for the proposed rule change to no later than 180 days after publication of a

[125] *See* PIABA Letter at 3–4; Better Markets Letter at 17–18.

[126] *See* Better Markets Letter at 18. The Commission finds that this suggestion is also beyond the scope of the proposed rule change.

[127] *See* NASAA Letter at 5.

[128] *Id.* at 4.

[129] *Id.*

[130] *See* FINRA March 4 Letter at 16–17 (listing the one-time staff reduction as an example of a means to get removed from the Restricted Firms list).

[131] *Id.* at 12.

[132] *Id.* at 16.

[133] *Id.* at 17. FINRA believes that information about a firm's status as a Restricted Firm, and any restricted deposit it is subject to, could become publicly available through existing sources or processes, such as 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. *See* Notice at 78567 note 159.

[134] *See* FINRA July 20 Letter.

[135] *Id.* at 3.

[136] *See* FINRA July 20 Letter.

[137] *Id.*

[138] *See* SIFMA Letter; Harvin Letter.

[139] *See* SIFMA Letter at 2.

[140] *See* Harvin Letter at 1–3.

[141] *See* FINRA March 4 Letter at 4.

[142] *Id.*

Regulatory Notice announcing this Commission approval.[143]

Providing firms with increased clarity as to how the Preliminary Identification Metrics apply to their own situation would further assist in FINRA's goal to incentivize better behaviors from firms. The Commission thus supports FINRA's decision to extend the effective date of proposed Rule 4111 to develop certain compliance tools, and would encourage FINRA to provide resources and guidance for firms as is feasible.

Preliminary Criteria for Identification

Three commenters expressed various concerns regarding the scope of events included in the proposed Preliminary Criteria for Identification.[144]

One commenter urged FINRA to amend the Preliminary Identification Metrics to use ''more stringent criteria in identifying high risk firms,'' including (1) expanding the look-back review period for disclosure events from five to ten years; (2) decreasing the settlement size threshold for investment-related, consumer-initiated customer arbitration awards and civil judgments from $15,000 to $5,000; and (3) expanding the scope of disclosure events to cover events that are harmful to investors, even where not consumer-initiated.[145]

FINRA responded that it already considered these alternative definitions and criteria among many others. For instance, FINRA stated that it considered whether adjudicated events should be counted over the individual's or firm's entire reporting period or counted over a more recent period. Based on its experience, FINRA believes that more recent events (*i.e.,* events occurring in the last five years) generally pose a higher level of possible future risk to customers than other events. Further, FINRA believes that counting events over an individual's or firm's entire reporting period would imply that associated persons and firms would always be included in the Preliminary Identification Metrics for adjudicated events, even if they subsequently worked without being associated with any future adjudicated events.[146]

Similarly, FINRA's use of the $15,000 settlement threshold is consistent with its approach in the High Risk Broker Approval Order. In that filing, FINRA established metrics based, in part, on complaints that led to an award against a broker or settled above a de minimis threshold of $15,000 because it wanted to ''focus its analysis on outcomes that are more likely associated with material customer harm.'' [147] FINRA also stated that the $15,000 mark represents the current CRD settlement threshold for reporting customer complaints on Uniform Registration Forms.[148] Thus, by lowering the threshold to $5,000, FINRA ''would not have useful information . . . from which to make its objective analysis,'' because the additional events that would be captured by this change from the proposed rule would not be reportable.[149]

Finally, FINRA also disputed the assessment that the proposed rule is ''limited to only events that are 'consumer-initiated,' '' as disclosure events are only qualified by the term ''consumer-initiated'' in the proposal where that distinction is made in disclosure questions in the Uniform Registration Forms.[150]

The Commission finds that the standards proposed by FINRA are reasonable and are designed to better enable FINRA to initially identify firms for potential designation as a Restricted Firm through objective criteria—one of FINRA's stated goals in initially proposing the rule.[151] Further, this approach conforms to another of FINRA's ''guiding principles'' in developing the proposal, to provide member firms with transparency regarding how proposed Rule 4111 would operate, such that firms ''could largely identify with available data the specific set of disclosure events that would count towards the proposed criteria and whether the firm had the potential to be designated as a Restricted Firm.'' [152] In addition, the proposed disclosure events covered by the proposed rule would not be limited to customer initiated events but would include, among other things, criminal matters, regulatory actions, and terminations.[153] FINRA's proposed definition of disclosure events would capture the types of activities FINRA believes are indicative of future investor protection concerns. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

With respect to expanding the five-year lookback, the same commenter objected to FINRA's proposed rule change establishing a maximum look-back period for the Registered Persons Associated with Previously Expelled Firms metric at five years, asserting it was based on ''overblown'' concerns that an unlimited look-back period would discourage firms from hiring registered representatives who may not themselves have violated any rules, thus resulting in unfair punishment.[154] Alternatively, the commenter suggested that this lookback period be extended to ten years.[155]

In response, FINRA explained that it avoided proposing an unlimited lookback period over a registered person's entire career and added a five-year look back to be consistent with the lookback periods for the other proposed metrics.[156] FINRA further reasoned that it added the requirement that the individual was registered at the now-expelled firm for a year or more because, in its experience, registered persons with more recent associations and longer tenures with expelled firms ''generally pose higher risk than other individuals.'' [157] Finally, FINRA stated that it believes the Expelled Firm Association Metric and Expelled Firm Association Metrics Thresholds ''appropriately serve[] the goal of preliminarily identifying firms that present a higher risk.'' [158] To help ensure the Expelled Firm Association Metric continues to serve its intended purposes, FINRA indicated it examined the Expelled Firm Association Metric and related thresholds and validated that they continue to serve the intended purpose of identifying firms posing a greater risk to customers.[159]

The Commission finds that FINRA has reasonably tailored its proposal and its related thresholds to identify those firms that present such a risk. In

[143] *Id.*

[144] *See* Harvin Letter; Better Markets Letter; and PIABA Letter.

[145] *See* Better Markets Letter at 16.

[146] *See* Notice at 78556.

[147] *See* High Risk Broker Approval Order at 81547.

[148] *Id.*

[149] *Id.*

[150] *See* FINRA March 4 Letter at 10; *see also* proposed Rule 4111(i)(4), including, among other things, criminal matters, regulatory actions, and terminations as disclosure events.

[151] *See* Notice at 78542.

[152] *Id.* at 78561. FINRA also stated that this desire to provide transparency is why it based proposed Rule 4111 on ''events disclosed on the Uniform Registration Forms, which are generally available to firms and FINRA.'' As noted above, FINRA remains aware that even though these data would be available to firms by accessing the BrokerCheck reports of each of their registered representatives, FINRA could ease firms' compliance burdens by providing additional tools. With this in mind, FINRA has committed to providing firms with additional guidance and resources to help facilitate member firms' independent calculations, and has extended the effective date following the Commission's approval in order to have sufficient time for development of such resources. *See* FINRA March 4 Letter at 4.

[153] *See* FINRA March 4 Letter at 10.

[154] *See* Better Markets Letter at 10.

[155] *Id.* at 16.

[156] *See* FINRA March 4 Letter at 11; *see also* Notice at 78560.

[157] *See* FINRA March 4 Letter at 11.

[158] *Id.* at 10.

[159] *Id.* at 11–12.

particular, the Commission finds FINRA's conclusion reasonable that a registered representative's association with an expelled firm that is more recent, and/or longer-term is more likely to pose a higher risk than those relationships that are further removed, or of a shorter-duration. The Commission encourages FINRA to regularly reassess the appropriateness of the related metrics and thresholds for identifying firms to help ensure these definitions accurately identify the highest risk firms.[160] For these reasons, the Commission finds FINRA's approach to identify firms that may pose a higher risk to investors is designed to protect investors and the public interest.

Finally, one commenter suggested that the proposed Preliminary Criteria for Identification Metrics could be improved by considering the nature and extent to which certain securities are sold by firms. In particular, this commenter expressed concern that ''high-risk firms will often focus a large percentage of their business on selling, for example, non-publicly traded investment products.'' [161] In the event that such a product fails, these firms' investors can be left without recourse if a firm collapses.[162] FINRA responded that the proposed Preliminary Criteria for Identification are intended to be ''replicable, objective and transparent,'' and are thus ''almost entirely based on disclosures on the Uniform Registration Forms'' that do not distinguish disclosures associated with product failures from any other disclosures made by the firm.[163] However, FINRA indicated it could account for the types of securities sold by a firm (including ''product failures'') when making its initial determination in the Rule 4111 process, or through the Consultation.[164] Further, FINRA stated that proposed Rule 4111(i)(15) requires that any determination of a Restricted Firm's Restricted Deposit Requirement would be required to consider, among other items, ''the nature of the firm's operations and activities.'' [165]

As previously noted, the Commission supports FINRA setting Preliminary Criteria for Identification in as transparent, replicable, and objective a manner as possible by reference to the Uniform Registration Forms. While the comment focuses on securities that may be riskier for investors, such as non-publicly traded securities, FINRA has demonstrated that the proposed ''funnel'' process affords the opportunity for FINRA to account for the types of securities sold by a firm. While not included in the Preliminary Criteria for Identification Metrics that serve as the threshold analysis, FINRA can identify and consider a firm's propensity to offer riskier securities during the Consultation process and in setting a Restricted Deposit Requirement and imposing appropriate conditions and restrictions on such a firm. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

One commenter suggested that proposed Rule 4111 should directly reference the ''specific disclosure questions or items'' in the Uniform Registration Forms that align to the Preliminary Criteria for Identification, rather than using alternative language for the definitions of each of the rule's categories.[166] FINRA responded that the definitions of the six categories of the Preliminary Criteria for Identification capture disclosures from multiple Uniform Registration Forms.[167] As such, FINRA believes that listing each of the questions from each such relevant form would ''be more confusing in the rule text and could lead to ongoing amendments to the definition as the [Uniform Registration Forms] are amended.'' [168] Instead, FINRA has elected to use substantive descriptions of the included disclosure events in proposed Rule 4111 with a ''plain-English approach'' that summarizes and describes disclosure events from the Uniform Registration Forms to make the definitions easier to read, understand, and use.[169] FINRA also stated that this approach is consistent with a related filing that was recently approved by the Commission (SR–FINRA–2020–011), where it elected not to include questions from the Uniform Registration Forms to avoid confusion and the need for ongoing amendments to the proposed rule change when these forms are revised in the future.[170] Although FINRA did not take this commenter's suggestion, it stated it is considering providing guidance that would map the Registered Person and Member Firm events to the relevant disclosure questions on the Uniform Registration Forms to help firms self-monitor their metrics.[171]

The same commenter stated that while the proposed definition of ''Member Firm Adjudicated Events'' includes ''[a] final investment-related, consumer-initiated customer arbitration award in which the member was a named party,'' [172] publicly available summary information on arbitration awards found on BrokerCheck and Arbitration Awards Online do not identify awards as ''investment-related'' or ''consumer-initiated.'' [173] FINRA agreed that additional clarity is warranted, and confirmed that this prong of the Member Firm Adjudicated Events definition is ''intended to capture all BrokerCheck disclosures of arbitration awards against firms,'' but stopped short of amending the rule text to make direct references to BrokerCheck. Due to the concerns over the potential for added confusion noted above, FINRA stated it was not appropriate to make such amendment in light of its plain-English approach.[174]

The Commission finds that FINRA's choice to provide a ''plain-English'' approach is reasonable and designed to provide clarity regarding what events would and would not be included in the Preliminary Identification Metrics. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

The same commenter also raised a question about the definition of Member Firm Pending Events, and whether there is a distinction between a ''pending investigation by a regulatory authority'' and a ''pending regulatory action that was brought by the SEC or CFTC, other federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization.'' While Forms U4 and U5 require disclosure of pending ''investigations,'' the commenter observed that Form U6 refers to a matter as an action and does not mention ''investigation.'' [175] FINRA stated that the proposed inclusion of ''pending investigations by a regulatory authority''

[160] If FINRA proposes to amend these rules in the future, FINRA would be required to file the proposed rule change with the Commission along with a concise general statement of the basis and purpose of the proposed rule change. The Commission would then publish a notice in connection with the proposed rule change in the **Federal Register** and post it on its public website to give interested persons an opportunity to comment on the proposed rule change. *See* Exchange Act Section 19(b)(1) and Rule 19b-4 promulgated thereunder.

[161] *See* PIABA Letter at 6.

[162] *Id.*

[163] *See* FINRA March 4 Letter at 9; *see also supra* note 66 (noting that one of the event categories, Member Firm Adjudicated Events, includes events that are derived from customer arbitrations filed with FINRA's dispute resolution forum).

[164] *Id.*

[165] *Id.; see also* 4111(i)(15).

[166] *See* Harvin Letter at 2.

[167] *See* FINRA March 4 Letter at 7.

[168] *Id.*

[169] *Id.* at 8.

[170] *Id.* at 7–8.

[171] *Id.* at 8.

[172] *See* proposed Rule 4111(i)(4)(D)(i).

[173] *See* Harvin Letter at 2.

[174] *See* FINRA March 4 Letter at 8.

[175] *See* Harvin Letter at 2; *see also* proposed Rule 4111(i)(4)(E)(ii) and (iii).

within the Member Firm Pending Events definition was intended to parallel a similar provision in the proposed Registered Person Pending Events definition.[176] However, FINRA stated that, from a technical perspective, ''Form BD contains no disclosure questions or DRP fields about pending investigations by a regulatory authority concerning firms.'' [177] As a result, FINRA filed Amendment No. 1 to make a technical correction to the definition of Member Firm Pending Events in proposed Rule 4111(i)(4)(E) by deleting ''a pending investigation by a regulatory authority'' reportable on the member's Uniform Registration Forms, as the relevant forms contain no such disclosure question or DRP fields.

One-Time Opportunity To Reduce Staffing Levels

Two commenters urged FINRA to add further conditions to the one-time staff reduction option afforded to those firms identified the first time the Rule 4111 process is used.[178] One commenter asked FINRA to require that any terminations would need to begin with those persons with the highest number of disclosure events or those that ''pose the greatest risk to investors,'' and that in all circumstances, firms should be prohibited from retaining certain persons ''due to their position within the firm or the amount of revenue they generate.'' [179] The other commenter criticized the allowance of a one-time staff reduction as incentivizing member firms to merely ''discharge 'low hanging fruit' and continue business as usual,'' rather than effectively monitor and supervise their registered representatives.[180]

FINRA responded that it agrees with the investor protection objectives of these two comments, but that the proposed rule change achieves these objectives.[181] For instance, FINRA believes that firms would have a strong incentive to use the staff-reduction option to avoid being subject to a Restricted Deposit Requirement or other conditions and restrictions for a significant period of time, and to use this option they would need to terminate representatives who have the kinds of disclosures captured by the rule and in sufficient numbers that cause the firm to fall below the stated thresholds.[182] FINRA also stated that prohibiting the firm from rehiring any terminated employees for one-year prevents a firm from evading the objectives of the proposed rule change since any member firm that seeks to hire such persons would need to also consider and comply with FINRA Rule 9522 (Initiation of Eligibility Proceeding; Member Regulation Consideration) to the extent that any such persons are subject to a ''statutory disqualification'' as defined in Section 3(a)(39) of the Exchange Act.[183] Additionally, FINRA stated that since a firm would not be able to use the staff-reduction option a second time, it would deter firms from thereafter hiring individuals with a record of disciplinary issues after a staff reduction and incentivize those firms to improve compliance going forward to avoid a Restricted Firm designation in the future.[184]

The Commission finds that the one-time staff reduction option, along with a one-year restriction on rehiring by the firm from which those employees were terminated, as proposed, is a reasonable means to materially reduce the current risk to investors and to incentivize firms to improve compliance over a longer-term period to avoid both a Restricted Firm designation the first time they meet the Preliminary Criteria for Identification, and also being re-identified in a subsequent Rule 4111 evaluation. For these reasons, the Commission finds that FINRA's approach is designed to protect investors and the public interest.

One of the commenters also called on FINRA to amend the proposal to prohibit those employees who are laid off during the Consultation process from being ''hired by other firms for at least one year, and never by another high-risk firm.'' [185] While FINRA stated that a separate rulemaking (amending FINRA Rule 1017), recently approved by the Commission, may also help deter firms from hiring recidivist registered representatives recently fired by other firms,[186] the commenter argued this rule change is insufficient, as it ''does not prohibit the hiring [of such terminated employees], but merely requires that the hiring firm impose an additional supervisory regime over troublesome brokers.'' [187]

FINRA disagreed, noting that under the approved changes to Rule 1017(a)(7), member firms must submit a written request to FINRA seeking a materiality consultation whenever a person ''seeks to become an owner, control person, principal or registered person of the member'' who has one ''final criminal matter'' or two ''specified risk events'' within the past five years.[188] During this materiality assessment, the Department may then require the firm make a Form CMA filing [189]—and obtain FINRA's approval thereafter—before such person may be hired.[190] Further, FINRA stated that one of the examples provided in proposed Rule 4111.03 of the conditions and restrictions the Department may impose on a Restricted Firm is ''limitations on business expansions,'' which FINRA has indicated ''could include limitations on the kinds of persons that a Restricted Firm may hire.'' [191] Separately, FINRA also stated that the Commission recently approved rule changes that will potentially impact employees terminated under proposed Rule 4111(c)(2) when seeking to join another firm.[192]

The Commission finds that the incentives created by the one-time staff reduction option, as proposed, reasonably align with FINRA's stated purpose to incentivize firms to reduce their risk profile and improve their compliance. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest. While the Commission recognizes that FINRA's recent amendments to the materiality

[176] *See* FINRA March 4 Letter at 9; *see also* proposed Rule 4111(i)(4)(B)(ii).

[177] *See* FINRA March 4 Letter at 9.

[178] *See* Better Markets Letter; PIABA Letter.

[179] *See* Better Markets Letter at 17.

[180] *See* PIABA Letter at 7.

[181] *See* FINRA March 4 Letter at 21.

[182] *Id.* at 21–22.

[183] *Id.* at 22 note 60.

[184] *Id.* at 22; *see also* Notice at 78562.

[185] *See* Better Markets Letter at 16–17. In its letter, Better Markets also suggested—as an alternative to their suggestion that FINRA adopt an order for the employees to be terminated—that FINRA could require would be that firms ''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.'' Better Markets Letter at 16.

[186] *See* Exchange Act Release No. 90635 (Dec. 10, 2020), 85 FR 81540 (Dec. 16, 2020) (File No. FINRA–2020–011) (''High Risk Broker Approval Order''). Pursuant to FINRA Rule 1017, any broker-dealer seeking to add a natural person who: (1) Has, in the prior five years, one or more final criminal matters or two or more specified risk events and (2) seeks to become an owner, control person, principal, or registered person of the member must submit a written request seeking a materiality consultation for the contemplated activity so that FINRA can determine whether a the firm must file a continuing member application.

[187] *See* Better Markets Letter at 17.

[188] *See* FINRA March 4 Letter at 22–23.

[189] Prior to making certain changes to its ownership, control, or business operations, a FINRA member firm must file a Form Continuing Membership Application or ''Form CMA,'' and obtain FINRA's pre-approval to do so. *See* FINRA Rule 1017(a) (Application for Approval of Change in Ownership, Control, or Business Operations).

[190] *See* FINRA March 4 Letter at 22–23.

[191] *Id.* at 23; *see* proposed Rule 4111.03(1), which sets out that FINRA may impose ''limitations on business expansions, mergers, consolidations, or changes in control,'' among the examples of potential conditions or restrictions that may be placed on Restricted Firms.

[192] *See* FINRA March 4 Letter at 22; *see also* High Risk Broker Approval Order at 81544–45.

consultation process noted above, could provide an additional layer of deterrence to firms' hiring of recidivist representatives terminated by other firms, it finds that the critique of previously approved Rule 1017(a)(7) is beyond the subject matter of this proposed rule change and therefore is beyond the scope of this filing.

Calls To Expel Restricted Firms That Fail To Improve

One commenter argued that proposed Rule 4111 should be amended so that if a firm is designated a Restricted Firm in one year, and does not improve to avoid re-designation in either of the next two years, FINRA should ''expel the firm, and de-license and bar all current brokers who were employed by the firm at the time of initial designation.'' [193] Further, this commenter argued the expulsion order ''should not be appealable and should take immediate effect.'' [194] FINRA responded that this request would essentially broaden the statutory definition of ''disqualified persons,'' ''which is not within FINRA's jurisdiction to do.'' [195] Additionally, FINRA asserted that the call for expulsion without a right to appeal would be ''inconsistent with the fair procedure requirements in Section 15A(b)(8) of the Securities Exchange Act of 1934.'' [196]

The Commission agrees with FINRA that the expulsion of a firm without right to appeal the decision would be inconsistent with the fair disciplinary procedures that member firms are to be afforded pursuant to Section 15A(b)(8). Moreover, the Commission finds that proposed Rule 4111 adopts a reasonable set of conditions and restrictions on firms with outlier-level disclosure events, and incentivizes such firms to improve their behavior for the protection of the investing public. Still, the Commission encourages FINRA to, after gaining sufficient experience post-effectiveness, to review whether proposed Rule 4111 is adequately meeting its intended goals or if further amendments would be appropriate.[197] For these reasons, the Commission does not believe that it is necessary to address whether, as FINRA states, the commenter's proposal would impermissibly broaden the definition of ''statutory disqualification'' under the Exchange Act.

Concerns About the Definition of ''Covered Pending Arbitration Claim'' and the Restricted Deposit Account

Two commenters expressed concerns regarding the proposed definition of a ''Covered Pending Arbitration Claim.'' [198] One commenter argued that adopting a definition to only cover claims if they exceed a firm's excess net capital ''improperly excludes claims that are less than a firm's excess net capital yet may still remain unpaid by the firm.'' [199] In response, FINRA stated that the term ''Covered Pending Arbitration Claim'' excludes final arbitration matters that have resulted in either an award or settlement, and that ''regardless of a firm's excess net capital, if a final arbitration award or settlement is unpaid, that would be a factor for FINRA to consider when determining a Restricted Deposit Requirement and reviewing a firm's request for a withdrawal from a Restricted Deposit.'' [200] The same commenter also argued that because FINRA will assess each firm based on a fixed point in time, this definition will enable firms to ''manipulate whether an arbitration claim is covered simply by adjusting its excess net capital while FINRA is determining the Restricted Deposit Requirement.'' [201] FINRA responded that although its assessment of a firm will occur on a fixed date, proposed Rule 4111(i)(15) would require the Department to review a firm's financial factors, including its net capital levels ''for relevant periods,'' enabling the Department to detect material changes in a firm's net capital levels during or in anticipation of a possible review under Rule 4111 and to ''take into account attempts by a firm to manipulate financial-related factors.'' [202]

The Commission finds that it is reasonable to exclude final arbitration matters that have resulted in an award or settlement from a definition designed to capture only pending claims. Further, the Commission agrees that proposed Rule 4111 has provided a mechanism for FINRA to account for such unpaid arbitration awards or settlements resulting from a final arbitration in crafting a Restricted Firm's Restricted Deposit Requirement, and in evaluating any request to withdraw funds from its Restricted Deposit Account. The Commission also finds that the design of proposed Rule 4111, which would require FINRA to evaluate each firm's financial factors across ''relevant periods,'' should be allow FINRA to detect potential manipulation of a firm's net capital amounts. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Another commenter asserted that the term ''claim amount'' should be removed from the definition of a ''Covered Pending Arbitration Claim,'' arguing there is no support for the proposition that the ''claim amount'' stated in an arbitration claim has ''any basis in reality.'' [203] Instead, this commenter suggested that the definition of ''Covered Pending Arbitration Claim'' be revised to refer to the accounting standards pertaining to loss contingencies as adopted by the Financial Accounting Standards Board, so as to account for the probability that a pending arbitration claim results in a loss, and whether that potential loss can be reasonably estimated.[204]

[193] *See* Better Markets Letter at 19.

[194] *Id.* Better Markets argued that the rationale for this remedy is that firms that have been twice-designated, but not significantly improved their compliance culture have ''prove[d] that they are irredeemable, and they do not deserve to be permitted to serve, or more likely, harm any additional investors.'' *Id.*

[195] *See* FINRA March 4 Letter at 26.

[196] *Id.* at 26–27; *see also* Exchange Act Section 15A(b)(8) (Requiring that FINRA's rules, in general, ''provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the association of any person with respect to access to services offered by the association or a member thereof.'').

[197] FINRA plans to conduct a review of the effectiveness of proposed Rule 4111 after gaining sufficient experience with its operation. *See* Notice at 78548. Among other things, FINRA would review whether the Preliminary Identification Metrics Thresholds are sufficiently targeted and effective at identifying member firms that pose higher risks. *Id.*

[198] *See* PIABA Letter; Harvin Letter. As noted above, proposed Rule 4111(i)(2) defines Covered Pending Arbitration Claim as an investment-related, consumer-initiated claim filed against the member or its associated persons in any arbitration forum that is unresolved; and whose claim amount (individually or, if there is more than one claim, in the aggregate) exceeds the member's excess net capital.

[199] *See* PIABA Letter at 7.

[200] *See* FINRA March 4 Letter at 23. FINRA also stated that other of its rules ''currently prohibit member firms or registered representatives who do not pay arbitration awards in a timely manner from continuing to engage in the securities business under FINRA's jurisdiction.'' *Id.* at 23 note 65; *see also* proposed Rule 4111(f) and (i)(15).

[201] *See* PIABA Letter at 7.

[202] *See* FINRA March 4 Letter at 24.

[203] *See* Harvin Letter at 3; *see also* Notice at 78541 note 10 (FINRA has stated that the ''claim amount'' only includes claimed compensatory loss amounts and not those for pain and suffering, punitive damages or attorney's fees. The claim amount shall be the maximum amount that the member or associated person is potentially liable regardless of whether the claim was brought against additional persons or the associated person reasonably expects to be indemnified, share liability or otherwise lawfully avoid being held responsible for all or part of such maximum amount.).

[204] *Id.* at 5. Specifically, Harvin pointed to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 450–20 (Loss Contingencies), ASC 450–20–25 (Recognition), ASC 450–20–25–2, ASC–450–20 (Glossary), and ASC 450–20–55–13. *Id.* at 3–5.

FINRA responded that it is necessary that all Covered Pending Arbitration Claims be considered within the requirements, because based on its experience, firms do not necessarily recognize a ''loss contingency'' for such a claim before concluding a proceeding.[205] FINRA also indicated it believes that proposed Rule 4111(i)(15) ''is already flexible enough to address'' the commenter's concerns regarding loss contingencies.[206] Finally, FINRA clarified that while the commenter seemed to ''presume [ ] that the Restricted Deposit Requirement amount would establish a floor based on the amount of the firm's Covered Pending Arbitration Claims,'' the amount of such claims will serve merely as one factor, among many others, considered when FINRA crafts a firm's Restricted Deposit Requirement.[207]

The Commission finds it is reasonable for FINRA to retain the term ''claim amount'' within the proposed definition of a Covered Pending Arbitration Claim. To operationalize Rule 4111, FINRA will need to be able to utilize consistent metrics that provide for comparable data across firms of similar sizes. The Commission agrees that the lack of consistency in firms recognizing ''loss contingencies'' for pending claims would undermine the usefulness of such figures in making initial identifications of those firms with outlier-level disclosure events relative to similarly sized peers. Further, the Commission agrees that proposed Rule 4111, and specifically the proposed definition of a Restricted Deposit Requirement, provides flexibility to enable FINRA to account for loss contingencies when thereafter determining an appropriate deposit requirement for Restricted Firms. Finally, pursuant to proposed Rule 4111(d), a firm would have an opportunity to demonstrate that it should not be required to be subject to the maximum Restricted Deposit Requirement by arguing that that certain Covered Pending Arbitration Claims were improperly considered in determining its restricted status.[208] For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Concerns About the Calculation of a Firm's Maximum Restricted Deposit Requirement

One commenter stated that as one of the purposes of proposed Rule 4111 is to ''give FINRA another tool to incentivize member firms to . . . pay arbitration awards,'' imposing a Restricted Deposit Requirement on any firm that lacks Covered Pending Arbitration Claims or other unpaid arbitration awards would be unnecessary and that calculation of the Restricted Deposit in these circumstances would be arbitrary.[209] FINRA disagreed, asserting that the primary purpose of proposed Rule 4111 is to incentivize member firms with outlier-level risks to change their behavior, and therefore confirmed that under the proposal the Department could impose a Restricted Deposit Requirement on a Restricted Firm regardless of whether it has any unpaid arbitration awards or Covered Pending Arbitration Claims.[210]

The same commenter criticized FINRA's failure to include in proposed Rule 4111(i)(15) the ''average total revenue paid out in the past five years in arbitration and customer settlements and litigation'' as a factor for determining a firm's maximum Restricted Deposit Requirement.[211] According to the commenter, the ''average total revenue paid'' would represent a more accurate metric than the average amount of arbitration and customer settlements paid because the latter is not indicative of a firm having difficulty paying arbitration awards. FINRA questioned the commenter's assumption, stating that even if a Restricted Firm has a recent history of paying arbitration awards and settlements, it does not mean that a Restricted Deposit Requirement would not be an appropriate step to address the risks such firm poses to investors.[212] FINRA responded that in general, it believes the factors included in the rule are both specific enough to be relevant for the Department in determining a firm's maximum Restricted Deposit Requirement, and also flexible enough to allow the Department to weigh those factors against all relevant facts and circumstances for a given firm.[213] Moreover, the Consultation process would provide an opportunity for a firm to present why the maximum Restricted Deposit Requirement amount does not properly account for any particular factor in the rule, including by presenting the firm's average total revenue paid out in the past five years in arbitration and customer settlements and litigation.[214]

The Commission finds that the proposed rule change to enable FINRA to impose a Restricted Deposit Requirement on Restricted Firms is a reasonable component of proposed Rule 4111 and is reasonably designed to address the proposed rule's goal of improving member firm behavior for the protection of the investing public. Even where a firm lacks Covered Pending Arbitration Claims or other unpaid arbitration awards, the imposition of a Restricted Deposit Requirement is a reasonable means of accomplishing the proposal's primary purpose. Moreover, the Commission agrees that the flexibility afforded by proposed Rule 4111(i)(15) should enable FINRA to account for such factors as the ''average total revenue paid out in the past five years in arbitration and customer settlements and litigation'' when determining the appropriate deposit requirement for a firm.

Further, the Commission disagrees with the assertion that the calculation of a firm's Restricted Deposit Requirement would be arbitrary. FINRA has laid out numerous factors in proposed Rule 4111(i)(15) to discern an appropriate maximum Restricted Deposit Requirement for Restricted Firms that will incentivize improved behavior without undermining that firm's financial stability. Moreover, the proposed rule's Consultation process provides firms an opportunity to discuss the imposition of a lower Restricted Deposit Requirement.[215] As FINRA has stated, the Consultation process is designed to specifically account for the disparities in risk presented by each firm initially identified through the Preliminary Identification Criteria, and to thereafter enable the Department to craft a Restricted Firm's Restricted Deposit Requirement in light of discussions with that firm, and to account for that firm's ''unique characteristics.'' Further, FINRA stated it will ''tailor the member firm's maximum Restricted Deposit Requirement amount to its size, operations and financial conditions . . .

[205] *See* FINRA March 4 Letter at 24.

[206] *Id.* FINRA also stated that, in this regard, firms would not be precluded during the Consultation from asserting that the Covered Pending Arbitration Claims factor should be evaluated by the Department ''in relation to the probability that those pending claims would evolve into actual liabilities and that the size of such actual liabilities would be less than the stated amount of the claims.''

[207] *Id. See supra* note 90 (detailing a series of proposed factors the Department would consider when determining a Restricted Firm's maximum Restricted Deposit Requirement).

[208] *See* Notice at 78545.

[209] *See* Harvin Letter at 5–7.

[210] *See* FINRA March 4 Letter at 13; *see also* Notice at 78541 (stating FINRA believes that the ''direct financial impact of a restricted deposit is most likely to change [a] member firms' behavior—and therefore protect investors.'').

[211] *See* Harvin Letter at 7.

[212] *See* FINRA March 4 Letter at 14.

[213] *Id.* at 13.

[214] *Id.* at 13–14; *see also* Notice at 78545–46.

[215] *See* Notice at 78545.

[to] be consistent with the objectives of the rule, but [without] significantly undermin[ing] the continued financial stability and operational capability of the member firm as an ongoing enterprise over the next 12 months'' [216] The Commission finds this process is a reasonable means of establishing an appropriate Restricted Deposit Requirement for individual Restricted Firms that affords those firms with sufficient opportunity to affect the outcome of FINRA's determination. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Unpaid Arbitration Awards and Settlements

One commenter asserted that proposed Rule 4111 does not explicitly address unpaid arbitration awards and settlements.[217] In particular, this commenter criticized proposed Rule 4111's failure to require or incentivize Restricted Firms to pay unpaid arbitration awards and settlements in connection with imposing a Restricted Deposit Requirement.[218]

FINRA responded that firms are already required to pay unpaid arbitration awards and settlements, and that any Restricted Deposit Requirement will serve only as an additional, mandatory obligation—with each requirement serving an ''important, but different, regulatory purpose.'' [219] FINRA also stated it currently suspends member firms and their registered representatives from membership or association where they do not timely pay arbitration awards, and that proposed Rule 4111 is designed to address investor protection concerns beyond unpaid awards.[220] Further, FINRA stated it believes that proposed Rule 4111 ''may have important ancillary effects in addressing unpaid customer arbitration awards.'' [221]

The same commenter asserted that as unpaid and anticipated arbitration awards are part of the proposed criteria used to determine whether a firm should be designated as a Restricted Firm, and thereafter, to determine its maximum Restricted Deposit Requirement, it is ''axiomatic'' that the maximum deposit FINRA ultimately imposes should ''at the very least'' cover such awards.[222] However, the commenter also stated that proposed Rule 4111, in limiting what FINRA may require in the way of a restricted deposit to avoid ''significantly undermin[ing] the continued financial stability and operational capability of the member as an ongoing enterprise over the next 12 months,'' may result in more thinly capitalized firms not being subject to a Restricted Deposit Requirement sufficient to cover all outstanding arbitration awards and settlements, ''let alone 'Covered Pending Arbitration Claims.''' [223]

In response, FINRA stated that a key reason why FINRA proposed a factor-based approach to determining a Restricted Deposit Requirement rather than a formulaic one is because it is less susceptible manipulation by firms.[224] Accordingly, nothing in proposed Rule 4111 would establish a floor for the amount of a Restricted Deposit Requirement.[225] Nevertheless, FINRA reiterated that proposed Rule 4111 would ''not absolve firms from paying unpaid arbitration awards,'' and that a member's ''thin capitalization at the time of the Consultation would be only one factor'' that the Department considers during that firm's Consultation process, and would ''not necessarily result in a lower'' Restricted Deposit Requirement.[226]

Finally, this commenter also suggested that proposed Rule 4111 should be amended to address how those investors owed unpaid arbitration awards might access funds from a Restricted Firm's restricted deposits to pay themselves.[227] FINRA responded that although it understands the purpose of the request, proposed Rule 4111 is intended to ''address the risks posed to investors by individual brokers and member firms that have a history of misconduct,'' and while the rule has features to incentivize payment of unpaid arbitration awards, ''it is not intended to alter how aggrieved investors currently may collect on an arbitration award.'' [228]

The Commission finds it is reasonable for FINRA to adopt the Restricted Deposit Requirement as a separate obligation, distinct from a Restricted Firm's existing obligations on member firms to satisfy unpaid arbitration awards. As FINRA stated, its rules already include comprehensive obligations on member firms that owe unpaid arbitration awards, and impose significant penalties on those firms that fail to do so.[229] The Commission thus finds that structuring proposed Rule 4111's Restricted Deposit Requirement to instead primarily address investor protection concerns more broadly, with the possibility of reducing the number of unpaid customer arbitration awards as a potential ancillary benefit, is reasonable. Moreover, the Commission finds that FINRA's proposed use of the Consultation process—taking a fulsome view of a firm's capitalization, including the potential effect of any unpaid arbitration awards—when determining its Restricted Deposit Requirement, provides a reasonable safeguard for evaluating the application of the proposed rule to thinly capitalized firms. This approach should enable FINRA to both further the intended goal of proposed Rule 4111 to incentivize better behavior from firms without undermining their financial stability, while also taking into account their pre-existing obligations to satisfy unpaid arbitration awards. Finally, as the Restricted Deposit Requirement is intended to provide an obligation on Restricted Firms distinct from their pre-existing obligations to satisfy unpaid arbitration awards, the Commission finds the issue of collecting unpaid arbitration awards by investors is beyond the subject matter of this proposed rule change and therefore, is beyond the scope of this filing.

Another commenter stated that FINRA's data on unpaid arbitration awards do not justify its establishment of ''an elaborate system of additional

[216] *Id.*

[217] *See* PIABA Letter at 3.

[218] *Id.* at 4.

[219] *See* FINRA March 4 Letter at 18.

[220] *Id.* Specifically, FINRA indicated that proposed Rule 4111 would cover those firms that, ''based on statistical analysis of their prior disclosure events, are substantially more likely than their peers to subsequently have a range of additional events indicating various types of harm or potential harm to investors.'' *See* Notice at 78565.

[221] *Id.* In particular, FINRA thinks that proposed Rule 4111 may incentivize firms to reduce their risk profile and scope of violative conduct to avoid being deemed a Restricted Firm in the first place. FINRA further believes that proposed Rule 4111 may also incentivize firms to obtain insurance for potential arbitration awards because the proposed rule would account for this type of insurance coverage in determining any firm's Restricted Deposit Requirement. *See* Rule 4111(i)(15)(A) and the discussion about FINRA's determination of a Maximum Restricted Deposit Requirement, *supra* note 90. Finally, FINRA argued that proposed Rule 4111 includes a number of presumptions as to the Department's assessment of any previously designated Restricted Firm's application to withdraw from its Restricted Deposit, ''that would further incentivize the payment of arbitration awards.''

[222] *See* PIABA Letter at 3.

[223] *Id.*

[224] *See* FINRA March 4 Letter at 19.

[225] *Id.*

[226] *Id.*

[227] *See* PIABA Letter at 4. In particular, PIABA indicated that proposed Rule 4111 should address how an investor may access funds from a firm's restricted deposit in the case of Former Members ''if the former firm refuses to apply for a withdrawal, or if no one from the former firm is available to make such a request on behalf of the investor.'' *Id.*

[228] *See* FINRA March 4 Letter at 19–20.

[229] *See* Notice at 78565 note 151 and accompanying text; *see also* FINRA March 4 Letter at 7 note 15 and accompanying text.

regulation to address the issue.'' [230] In response, FINRA stated that addressing the issue of unpaid arbitration awards was not the primary purpose of the proposed rule change. Specifically, FINRA stated that the proposed rule change's primary purpose is ''to create incentives for members that pose outlier-level risks to change behavior.'' [231] At the same time, FINRA believes that the proposed rule change ''may have important ancillary effects in addressing unpaid customer arbitration awards [including deterring] behavior that could otherwise result in unpaid arbitration awards by incentivizing firms to reduce their risk profile and violative conduct to avoid being deemed a Restricted Firm and becoming subject to a Restricted Deposit Requirement or other conditions or restrictions for a year or more.'' [232] FINRA stated that it has ''long been concerned about non-payment of arbitration awards'' [233] and hopes to continue the dialogue about ''addressing the challenges of customer recovery across the financial services industry.'' [234]

FINRA has clarified that the primary purpose of the proposed rule change is to incentivize better behavior from firms without undermining their financial stability. While the Restricted Deposit Requirement may also reduce the number of unpaid customer arbitration awards as a potential ancillary benefit, the Commission finds that the issue of collecting unpaid arbitration awards by investors is beyond the subject matter of this proposed rule change and therefore, is beyond the scope of this filing.

Expungement Concerns and Undercounting Arbitrations

One commenter expressed concern about the ''pervasive nature of expungement of customer disputes'' and how that might undermine FINRA's ability to determine whether a firm should be deemed a Restricted Firm under proposed Rule 4111.[235] This commenter asserted that FINRA's inability to review the ''full breadth of relevant disclosures'' due to certain events being expunged from the record will likely lead to it overlooking recidivist firms and registered representatives that should be designated as Restricted Firms.[236] As a result, the commenter argued that proposed Rule 4111 incentivizes member firms and registered representatives to ''sanitize their records'' by pursuing expungement of customer complaints.[237]

FINRA responded that its rules require accurate disclosures of member firms and individuals, who are ''subject to disciplinary action and possible disqualification if they fail to do so.'' [238] Further, FINRA stated that even if expungement requests rise due to proposed Rule 4111, that does not mean that there will be a corresponding increase in expungements that are granted, as such approvals may only be provided ''after a court of competent jurisdiction has entered an order directing expungement or confirming an arbitration award containing expungement relief.'' [239] FINRA also explained in its Response that its Office of the Chief Economist has tested the proposed thresholds under proposed Rule 4111 based on existing CRD data,[240] and believes that the existing CRD data and proposed criteria using these data are ''effective at identifying firms that pose greater risks to customers.'' [241] Finally, FINRA also pointed out that although proposed Rule 4111 is not intended to address the expungement process, it has undertaken a prior separate rulemaking to ''substantially strengthen'' this process.[242]

Given that the proposed rule change does not affect FINRA's expungement process, the Commission finds recommendations to amend it are outside the scope of the proposed rule change.

The Restricted Deposit Requirement and a Member Firm's Net Capital Requirement

One commenter argued that, although proposed Rule 4111 requires deposits in the Restricted Deposit Account to be deducted when determining a member firm's net capital under Exchange Act Rule 15c3–1 and FINRA Rule 4110 (Capital Compliance), the actual effect of the rule is to require additional net capital of the firm.[243] This commenter argued that, under Rule 4110(a), FINRA may already prescribe greater net capital or net worth requirements on carrying or clearing members, which the commenter stated would appear to provide FINRA ''ample authority'' to address the issue of unpaid customer arbitration awards.[244] FINRA responded by noting that proposed Rule 4111's primary purpose is incentivizing member firms to engage in less risky behaviors, and the extent to which the rule change addresses unpaid arbitration awards, this is merely an ancillary benefit.[245] Further, FINRA stated that it had considered the alternative of applying increased capital requirements on Restricted Firms, but determined this approach would be accompanied by ''several drawbacks with respect to economic incentives and anticipated impacts.'' [246]

The Commission finds the use of a separate and distinct deposit requirement is reasonable and designed to accomplish the separate purpose of incentivizing Restricted Firms to engage in less risky behaviors. The Commission anticipates that FINRA members will include in their decision-making the possibility of having their funds held in an account with significant withdrawal restrictions when making certain business determinations, which should reduce their propensity to engage in

[230] *See* Harvin Letter at 5.

[231] *See* FINRA March 4 Letter at 12.

[232] *Id.*

[233] *See* FINRA March 4 Letter at 18 note 52 (citing FINRA, Discussion Paper—FINRA Perspectives on Customer Recovery, at pp. 1, 19 (Feb. 8, 2018), available at *https://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf*).

[234] *Id.*

[235] *See* PIABA Letter at 4–5.

[236] *Id.* at 4.

[237] *Id.*

[238] *See* FINRA March 4 Letter at 20. FINRA also stated that the source of disclosures on Form U6 are regulators, and that FINRA's Department of Credentialing, Registration, Education and Disclosure ''conducts a public records review to verify the completeness and accuracy of criminal disclosure reporting.'' *Id.* (citing Notice at 79561).

[239] *Id.*

[240] Specifically, FINRA asserted it believes the use of existing CRD data in conjunction with the criteria proposed under the proposed rule effectively identifies higher risk firms. FINRA bases this assertion on its comparison of firms captured by the proposed thresholds to the firms that had recently been expelled, that had unpaid arbitration awards, that Department staff had identified as high risk for sales practice and fraud based on its own risk-based analysis, and that subsequently had additional disclosures after FINRA had made these preliminary identifications. *See* FINRA March 4 Letter at 20–21.

[241] *Id.*

[242] *Id.; see* Exchange Act Release No. 90000 (Sep. 25, 2020), 85 FR 62142 (Oct. 1, 2020) (FINRA No. SR–FINRA–2020–030). FINRA temporarily withdrew this rule filing from Commission consideration so that they can further consider whether modifications to the filing are appropriate. *See* FINRA Statement on Temporary Withdrawal of Specialized Arbitrator Roster Rule Filing (May 28, 2021).

[243] *See* Harvin Letter at 7.

[244] *Id.*

[245] *See* FINRA March 4 Letter at 12.

[246] *Id.; see also* Notice at 78556–57. FINRA stated that maintaining the firm's assets under an increased net capital requirement would not be isolated to a restricted account and thus ''may be fungible with other firm assets,'' potentially resulting in such assets being withdrawn and used by the firm during the restricted period. Thus, FINRA determined that such an approach would likely provide a much lower deterrent effect on firms than the Restricted Deposit Requirement under proposed Rule 4111. Similarly, FINRA believes that using an increased net capital requirement, rather than the Restricted Deposit Requirement, may not sufficiently incentivize behavioral changes from those Restricted Firms that already were carrying substantial excess net capital.). *See* Notice at 78557.

risky behaviors that are not in their customers' interests. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Potential Harm to Small Firms

One commenter asserted that proposed Rule 4111 will have unintended consequences for small firms including ''increased costs to defend and reporting.'' [247] FINRA responded that, although some reporting and defense costs may increase for a limited number of firms, this will impact firms of all sizes, and it does not believe proposed Rule 4111 imposes either disproportionate costs or impacts on small firms.[248] These costs could include, for example, when a firm seeks to rebut the presumption that it is a Restricted Firm, which would involve added costs to collect and provide information to FINRA, and when a firm seeks review through the expedited proceeding proposed in Rule 9561.[249] FINRA further indicated that proposed Rule 4111 is designed to impact a limited number of firms that pose significantly higher risk compared to similarly sized peers—across all firm sizes.[250] The proposed ''funnel'' process proposed by FINRA includes subsequent review and a Consultation process provides safeguards designed to protect firms of all sizes against misidentification.[251] Finally, FINRA reiterated that the rule requires FINRA to consider a firm's size, among other things, when it determines to impose a Restricted Deposit Requirement or other conditions or restrictions, and thus should not have a disproportionate impact on small firms.[252]

In raising concerns about the impact on small firms, this commenter also provided a partial list of purported disclosure events applicable to the commenter's firm, including that seven of the firm's 70 representatives were previously at now-expelled firms ''during their career.'' [253] FINRA stated that the list of disclosure events included in this commenter's letter were broader than those covered by the Preliminary Criteria for Identification, and could not determine whether they would be captured by the proposed criteria without more information.[254] For example, in reference to the individuals who had been at an expelled firm ''during their careers,'' FINRA stated that the Registered Persons Associated with Previously Expelled Firms category only covers a narrow scope of those registered representatives who were registered with an expelled firm for at least one year and whose registration with the previously expelled firm terminated during the Evaluation Period.[255]

The Commission finds that the proposal, which is designed to identify a limited number of firms with a significantly higher level of risk related disclosures than similarly situated peers with thresholds tailored to seven different firm sizes, takes a reasonable approach to identifying firms that pose the greatest risk to investors, without being unduly burdensome towards smaller firms. Further, FINRA's commitment to tailoring any Restricted Deposit Requirement or other conditions or restrictions it imposes on any firm it designates as a Restricted Firm in a manner that accounts for the firm's size and financial condition should help tailor the application of proposed Rule 4111 to the unique risks presented by particular firms. Finally, pursuant to proposed Rule 4111(d), a firm would have an opportunity to demonstrate that it should not be required to be subject to the maximum Restricted Deposit Requirement by arguing that that certain disclosures were improperly considered in determining its restricted status. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Restricted Deposit Subject to Swings in Value

One commenter asserted that proposed Rule 4111 fails to address fluctuations in the valuation of ''qualified securities'' that a Restricted Firm may deposit into its Restricted Deposit Account as opposed to depositing cash.[256] The commenter argued that as there is no guarantee that securities used for this purpose will retain sufficient value until they are redeemed to pay the firm's outstanding debt, and proposed Rule 4111 lacks a ''mechanism . . . to ensure the Restricted Deposit Account maintains sufficient value between FINRA reviews,'' the proposal should be amended to require account replenishment as necessary.[257]

FINRA has stated that proposed Rule 4111(a) only permits a Restricted Firm to satisfy its Restricted Deposit Requirement with ''a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States.'' [258] FINRA believes such securities possess a sufficiently stable value such that any post-deposit price fluctuation would not affect the financial impact of their use to satisfy the Restricted Deposit Requirement, nor the resulting incentive for the Restricted Firm to reform.[259] Nevertheless, FINRA filed Amendment No. 2 to clarify that the proposed rule change would not require a Restricted Firm to make additional deposits in order to maintain continuously the original value of qualified securities in its Restricted Deposit Account, if such qualified securities have declined in value.[260] Likewise, FINRA clarified that, if the aggregate value of the assets deposited by a member firm increases above the firm's Restricted Deposit Requirement, that would not be a basis for the firm to request a withdrawal from its Restricted Deposit Account. Rather, if a firm is re-designated as Restricted Firm in the following year, it would need to deposit additional cash or qualified securities if needed to meet the Restricted Deposit Requirement at that time.[261]

The Commission finds that FINRA's determination to not require a Restricted Firm to replenish a Restricted Deposit Account to address fluctuations in the value of qualified securities is reasonable. Securities included within the ''qualified securities'' definition,

[247] *See* IBN Letter.

[248] *See* FINRA March 4 Letter at 5.

[249] *Id.*

[250] *Id.*

[251] *Id.*

[252] *Id.*

[253] *See* IBN Letter.

[254] *See* FINRA March 4 Letter at 6.

[255] *Id.* The Registered Persons Associated with Previously Expelled Firms category only includes any Registered Person In-Scope who was registered with the previously expelled firm (1) for at least one year; and (2) ''whose registration with the previously expelled firm terminated during the Evaluation Period'' (limiting this to the prior five years from the current firm's Evaluation Date). *See* FINRA Rule 4111(i)(4)(F). The same commenter also referenced a registered representative with a ''financial disclosure'' related to ''medical losses'' and expressed concerns about pending arbitrations. *See* IBN Letter. FINRA reiterated that neither a registered person's ''financial disclosures'' (*e.g.,* the compromises with creditors, bankruptcy petitions, bond-related questions, unsatisfied judgments, and unsatisfied liens found in Form U4, Questions 14K, 14L, and 14M), nor pending arbitrations and written consumer-initiated complaints like those disclosed under Form U4 Question 14I are counted in the Preliminary Criteria for Identification. *See* FINRA March 4 Letter at 6–7. Only those ''awards and settlements in specified investment-related, consumer initiated arbitrations and complaints'' are counted within the Preliminary Criteria for Identification. *See* FINRA March 4 Letter at 7.

[256] *See* PIABA Letter at 7.

[257] *Id.*

[258] *See* FINRA March 4 Letter at 15.

[259] *Id.*

[260] *See* Amendment No. 2 at 4.

[261] *Id. See also* Rule 4111(f)(2), as modified by Amendment No. 2. The firm would be required to make any necessary additional deposit promptly at the time of re-designation, or where a hearing is requested pursuant to Proposed Rule 9561, promptly after the Office of Hearing Officers or the NAC issues a written decision under Rule 9559. *Id.*

including U.S. Treasury Securities, serve as a benchmark for stability and liquidity within U.S. securities markets. Thus, the Commission expects that any change in value of these securities should be relatively minimal during the year between any Restricted Firm designation made by FINRA, and a firm's next annual Rule 4111 evaluation—wherein any re-designation of the firm as a Restricted Firm would require the firm to again satisfy any Restricted Deposit Requirement then imposed by FINRA. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Additional Conditions and Restrictions Imposed on Restricted Firms

One commenter stated that proposed Rule 4111.03 would unnecessarily limit FINRA's options for conditioning or restricting the operation high-risk firms.[262] Specifically, the commenter stated that by promulgating an illustrative list of conditions and restrictions that could be imposed on Restricted Firms proposed Rule 4111 would not give FINRA the necessary flexibility to impose obligations on such firms.[263] Instead, this commenter proposed that FINRA should explicitly amend its proposal to make clear that it does not cede any authority to take ''punitive'' action against firms that violate FINRA's rules and the rights of their customers.[264]

FINRA does not take the view that proposed Rule 4111 provides either an express or implied limit on the scope of conditions and restrictions that FINRA could impose on Restricted Firms.[265] Further, FINRA disagrees with the suggestion that ''punitive'' conditions and restrictions would be imposed, and in fact has pointed to proposed Rule 4111(e) as allowing the Department to impose those conditions and restrictions on the ''operations and activities of the member and its associated persons that are necessary or appropriate to address the concerns indicated by the Preliminary Criteria for Identification and protect investors and the public interest.'' [266] However, FINRA acknowledged the concerns raised by the commenter of the need to act, when appropriate, to protect investors from predatory firms, and indicated it ''fully intends to continue using its existing authority to take action against predatory firms that violate FINRA's rules and the rights of customers.'' [267] Further, FINRA does not view anything in proposed Rule 4111 to limit FINRA's authority to bring disciplinary action against firms and registered representatives for violations and ''impose remedial sanctions for violations, including expulsions and bars where appropriate.'' [268]

The Commission agrees with FINRA's assessment that proposed Rule 4111 provides no express or implied limitation on the scope of conditions or restrictions that it may impose as necessary or appropriate to protect investors and the public interest, or both, without seeking to undermine the viability of such firms' ongoing operations. Additionally, the Commission agrees with FINRA's assessment that nothing in proposed Rule 4111 limits its authority to impose remedial sanctions—including expulsions and bars where appropriate—through separate disciplinary actions against firms and registered representatives for violations of FINRA rules. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

FINRA Should Impose Specific ''Terms and Conditions'' on Restricted Firms That Circumvent Conditions and Restrictions Imposed by FINRA Under Proposed Rule 4111, or Fail to Significantly Improve Compliance

One commenter argued that FINRA should add to proposed Rule 4111 the general authority to impose ''terms and conditions'' on firms that demonstrate ''significant compliance failures'' to prevent any ''gaming'' of the Preliminary Identification Metric Thresholds.[269] In particular, this commenter expressed support for FINRA using this authority regarding those firms that ''either circumvent the obligations and restrictions placed upon them by proposed Rule 4111 . . . or otherwise refuse to significantly improve their compliance culture.'' [270] FINRA responded that although it is not adopting a ''terms and conditions'' approach currently, it will explore doing so in the future to address any compliance issues.[271] While FINRA recognized that a terms and conditions rule would make it more difficult for firms to evade the identification criteria, FINRA believed that proposed Rule 4111 may offer a better deterrent effect for firms to change their behavior, particularly those firms that may be close to meeting such criteria.[272] For Restricted Firms that evade compliance with the conditions and restrictions imposed on them, FINRA stated that proposed Rule 9561(b) would permit it to ''bring an expedited proceeding against a member that fails to comply with any Rule 4111 Requirements'' that could result in the suspension or cancellation of the firm's membership.[273] Further, FINRA asserted that proposed Rule 4111 already has been designed with features that will make it more difficult to manipulate their Preliminary Identification Metrics, but that it appreciates the support for any further efforts it adopts to curtail such behavior.[274]

The Commission finds the proposal provides for reasonable measures to

[262] *See* Better Markets Letter at 20.

[263] *Id. See* Notice at 78548, providing in Supplementary Material .03 to proposed Rule 4111, Examples of Conditions and Restrictions that FINRA may impose on Restricted Firms other than a Restricted Deposit Requirement.

[264] *See* Better Markets Letter at 20.

[265] *See* FINRA March 4 Letter at 15.

[266] *Id.* at 15–16.

[267] *Id.* at 16.

[268] *Id.* FINRA also stated that it is separately proposing the adoption of Rule 9561(b) to permit it to bring expedited proceedings against any firm that fails to comply with any of the Rule 4111 requirements—and also to seek the imposition of a suspension or cancellation of that firm's membership. *Id.*

[269] *See* Better Markets Letter at 19–20. Better Markets further indicated that, to prevent the gaming of Preliminary Identification Metric Thresholds, it will support ''any reasonable and appropriate amendments or future proposals that will allow FINRA to address firms with substantial compliance issues that cannot be captured by the proposed numerical framework.'' *See* Better Markets Letter at 19–20. As part of the proposal, FINRA considered an approach similar to the Investment Industry Regulatory Organization of Canada's (''IIROC'') ''terms and conditions'' rule to identify a limited number of firms with significant compliance failures using non-public information from FINRA's examination and monitoring process and impose appropriate terms and conditions to encourage these firms' increased compliance. However, it elected not to propose a terms and conditions rule at this time. *See* Notice at 78554–55 (referencing IIROC Consolidated Rule 9208).

[270] *See* Better Markets Letter at 5.

[271] *See* FINRA March 4 Letter at 27. FINRA stated that it had already explained one possible alternative approach it has considered is to adopt an approach similar to the ''terms and conditions'' rule used by IIROC, under IIROC Consolidated Rule 9208. *See* Notice at 78554.

[272] *See* Notice at 78554–55.

[273] *Id.*

[274] *See* FINRA March 4 Letter at 27–28. FINRA stated that particular aspects of proposed Rule 4111 that are designed to curtail efforts by firms to game their Preliminary Identification Metrics include: (1) Defining ''Registered Persons In-Scope'' under proposed Rule 4111(i)(13) to cover all persons registered with the firm for one or more days within the year prior to the Evaluation Date, undercutting any effort to manipulate the outcome by reducing staff immediately before FINRA's annual calculation of that firm's Preliminary Criteria for Identification; and (2) performing the annual calculation of a firm's Preliminary Criteria for Identification at least 30–45 days after the Evaluation Date, ''to account for the lag time between when relevant disclosure events occurred and when they are required to be reported on the Uniform Registration Forms'' to prevent any attempt by a firm to delay Uniform Registration Form submissions to manipulate annual metrics. *Id.*

prevent firms from manipulating their Preliminary Identification Metrics, particularly by adopting checks within proposed Rule 4111 to impede any efforts to distort FINRA's initial calculations of a firm's metrics as of the Evaluation Date. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

Economic Impact Analysis

One commenter suggested that although proposed Rule 4111 may increase investor protection above the status quo, FINRA should conduct a ''full economic assessment'' that not only compares proposed Rule 4111 against the ''baseline scenario where FINRA takes no action to monitor or control predatory wolf-pack firms,'' but also compares proposed Rule 4111 against an alternative scenario that ''assumes the improvements offered'' by the commenter.[275] FINRA rejected the suggestion, as it believes that its current economic impact analysis ''thoroughly addresses'' how proposed Rule 4111 addresses the current regulatory need better than reasonable alternatives,[276] and is also ''consistent with the framework for FINRA's approach to economic impact assessments in proposed rulemakings.'' [277] FINRA asserted that the appropriate economic baseline, and the one that it used to evaluate the economic impacts of proposed Rule 4111, is the ''current regulatory framework,'' which includes numerous provisions related to FINRA's current supervision and oversight of member firms.[278] FINRA argued that it has already conducted a thorough economic impact analysis of proposed Rule 4111, and assessed the potential impacts by examining the number of firms that would have met the Preliminary Criteria for Identification between 2013–2017, and the number of ''new'' Registered Person and Member Firm Events in the 2014–2019 period.[279] FINRA believes this assessment provided the ''appropriate information about the economic baseline and effectiveness of the proposed rule in identifying firms that may be associated with additional events after identification.'' [280]

The Commission finds it is both reasonable and appropriate for FINRA to assess the hypothetical results of proposed Rule 4111 using the current regulatory framework as its economic baseline. Doing so enables FINRA to determine the potential impact of the proposal based on existing, recent market data. As any modification of the existing regulatory framework will lead to a response in the market and changes in firm behavior, it is appropriate for FINRA to compare the hypothetical impacts of proposed Rule 4111 against this pre-existing, recent market data.

In sum, the Commission finds that proposed Rule 4111 would provide an important new tool to FINRA in identifying and imposing conditions or restrictions on those member firms with outlier-level disclosure events relative to their similarly sized peers. In addition, the Commission finds that proposed Rule 4111 takes a reasonable and appropriate approach to incentivizing better behavior from such firms for the protection of investors and the public interest. Further, the Commission finds that the proposed Rule 4111 process provides firms with ample opportunity to affect the ultimate outcome of FINRA's decisions, including an extensive Consultation process—that will provide member firms who would be initially identified by FINRA with opportunities to demonstrate why they should not actually be designated as a Restricted Firm, or thereafter why they should not be subject to the maximum Restricted Deposit Requirement or other operational conditions or restrictions—along with avenues to seek further review if necessary. Moreover, by establishing different thresholds for identification across seven different firm sizes, proposed Rule 4111 should help reduce the possibility that the rule becomes overly burdensome on any group of firms based solely on their size or resources.

Accordingly, the Commission finds proposed Rule 4111 is reasonably designed to protect investors by helping incentivize compliant behavior from those firms exhibiting higher levels of disclosure events, while effectively tailoring the review process to mitigate the burdens on member firms throughout that process. The Commission further supports FINRA's commitment to working with individual state securities regulators to share relevant information and observes its commitment to further consider public disclosure of a firm's designation as a Restricted Firm by filing proposed amendments to Rule 8312 that would require FINRA to identify on BrokerCheck those member firms or former member firms that are designated as Restricted Firms pursuant to proposed Rules 4111 and 9561.

Proposed Rule 9561 (Procedures for Regulating Activities Under Rule 4111) and Amendments to Rule 9559 To Implement the Requirements of Proposed Rule 4111

The proposal to adopt new Rule 9561 and to amend Rule 9559 to establish new, expedited proceedings to enable firms to challenge any requirements imposed by the Department under the Rule 4111 process will help provide for both the fair administration of Rule 4111, and faster remediation of instances of non-compliance. Proposed new Rule 9561 is designed to afford firms with an opportunity to address such matters through timely notice of FINRA's decision to impose obligations, or determination that a firm is failing to comply with such obligations, and the ability to thereafter request a hearing regarding such a decision or determination. Correspondingly, the proposed amendments to Rule 9559 would assist in the administration of such requested hearings.

One commenter suggested that the expedited proceeding rule be amended to include a requirement ''that each member firm be given notice of the Preliminary Identification Metrics.'' [281] FINRA declined this suggestion, asserting that the purpose of the proposed rule, ''is to establish procedures for when the Department determines, after the Rule 4111 process,

[275] *See* Better Markets Letter at 13. As discussed more fully above, the Commission considered this commenter's recommended alternatives and has concluded that the proposed rule change represents a reasonable approach to identifying firms that pose the greatest risk to investors and imposing obligations on those firms to encourage them to change their behavior.

[276] *See* FINRA March 4 Letter at 26. For example, FINRA indicated that it ''considered several alternative specifications to the numeric threshold based-approach, including alternative categories of reported disclosure events and metrics, alternative counting criteria for the number of reported events or conditions, and alternative time periods over which the events or conditions are counted.'' *See* FINRA March 4 Letter at 26 note 70.

[277] *Id. See* Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking (Sept. 2013), available at *https://www.finra.org/sites/default/files/Economic%20Impact%20Assessment_0_0.pdf.*

[278] *See* FINRA March 4 Letter at 25. Specifically, FINRA highlighted its rules pertaining to FINRA supervision, the membership application process, proceedings for statutory disqualification and other disciplinary proceedings as to firms and registered representatives, along with FINRA's current ''risk monitoring and focused examination programs . . . designed to monitor and address the risks posed by high-risk firms and high-risk brokers.'' *Id.*

[279] *Id.* FINRA indicated that economic analysis ''demonstrated that for firms that would have met the Preliminary Criteria for Identification in the years 2013–2017, those firms were associated with 2,995 'new' Registered Person and Member Firm Events in the Post-Identification Period . . . [and] also demonstrated that such firms had between 6.1 and 19.9 times more ''new'' disclosure events (per registered person) in the years after identification than other firms registered during the 2013–2017 period.'' *See* FINRA March 4 Letter at 25–26.

[280] *See* FINRA March 4 Letter at 26.

[281] *See* Harvin Letter at 1.

that a firm is a Restricted Firm and seeks to impose requirements, conditions, or restrictions on the Restricted Firm.'' [282] Further, FINRA asserted that the proposed expedited proceeding rule is not intended to provide any notice of the Preliminary Identification Metrics to firms other than those few that are deemed to be Restricted Firms.[283] FINRA believes that the commenter may have instead been suggesting that it provide each firm with notice of its own Preliminary Identification Metrics under proposed Rule 4111, and indicated that if this is the case, FINRA reiterates its commitment to providing firms with compliance tools for the Rule 4111 process.[284]

The expedited proceedings process proposed by FINRA will help afford firms with fair procedures to contest such decisions and determinations. The Commission also agrees with FINRA that disclosure of the Preliminary Identification Metrics to member firms does not fall within the purpose of the expedited proceedings rule.[285] Accordingly, the Commission finds that the proposed new Rule 9561 and proposed amendments to existing Rule 9559 will help facilitate the effective administration of proposed new Rule 4111, while providing a fair appeal and review process for firms seeking to challenge FINRA's decisions and determinations thereunder. For these reasons, the Commission finds FINRA's approach is designed to protect investors and the public interest.

However, the Commission also supports and encourages FINRA's willingness to regularly reassess the performance of the Rule 4111 process in practice to continue to identify what further measures, if any, are necessary and appropriate to guard against such manipulation by firms.

IV. Conclusion

It is therefore ordered pursuant to Section 19(b)(2) of the Exchange Act [286] that the proposed rule change (SR–FINRA–2020–041), as modified by Amendment No. 1 and Amendment No. 2, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[287]

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2021–16671 Filed 8–4–21; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 34346]

Notice of Applications for Deregistration Under Section 8(f) of the Investment Company Act of 1940

July 30, 2021.

The following is a notice of applications for deregistration under section 8(f) of the Investment Company Act of 1940 for the month of July 2021. A copy of each application may be obtained via the Commission's website by searching for the file number, or for an applicant using the Company name box, at *http://www.sec.gov/search/search.htm* or by calling (202) 551–8090. An order granting each application will be issued unless the SEC orders a hearing. Interested persons may request a hearing on any application by emailing the SEC's Secretary at *Secretarys-Office@sec.gov* and serving the relevant applicant with a copy of the request by email, if an email address is listed for the relevant applicant below, or personally or by mail, if a physical address is listed for the relevant applicant below. Hearing requests should be received by the SEC by 5:30 p.m. on August 24, 2021, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Pursuant to Rule 0–5 under the Act, hearing requests should state the nature of the writer's interest, any facts bearing upon the desirability of a hearing on the matter, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary at *Secretarys-Office@sec.gov*.

ADDRESSES: The Commission: *Secretarys-Office@sec.gov*.

FOR FURTHER INFORMATION CONTACT: Shawn Davis, Assistant Director, at (202) 551–6413 or Chief Counsel's Office at (202) 551–6821; SEC, Division of Investment Management, Chief Counsel's Office, 100 F Street NE, Washington, DC 20549–8010.

AIP Macro Registered Fund A [File No. 811–22682]

Summary: Applicant, a closed-end investment company, seeks an order declaring that it has ceased to be an investment company. On May 17, 2019, August 28, 2019, December 20, 2019, April 2, 2020, and July 1, 2020, applicant made liquidating distributions to its shareholders based on net asset value. Expenses of $67,000 incurred in connection with the liquidation were paid by the applicant. Applicant also has retained $67,000 for the purpose of paying outstanding accrued liabilities.

Filing Dates: The application was filed on October 14, 2020 and amended on July 27, 2021.

Applicant's Address: Jonathan.Gaines@dechert.com.

BNY Mellon Growth and Income Fund, Inc. [File No. 811–06474]

Summary: Applicant seeks an order declaring that it has ceased to be an investment company. The applicant has transferred its assets to Nationwide Dynamic U.S. Growth Fund, a series of Nationwide Mutual Funds, and on December 11, 2019 made a final distribution to its shareholders. Expenses of $199,671.76 incurred in connection with the reorganization were paid by the applicant's investment adviser and the acquiring fund's investment adviser.

Filing Dates: The application was filed on April 5, 2021 and amended on June 9, 2021, July 16, 2021, and July 22, 2021.

Applicant's Address: peter.sullivan@bnymellon.com.

FSI Low Beta Absolute Return Fund [811–22595]

Summary: Applicant, a closed-end investment company, seeks an order declaring that it has ceased to be an investment company. Applicant currently has six beneficial owners and will continue to operate as a private investment fund in reliance on Section 3(c)(1) of the Act.

Filing Dates: The application was filed on May 14, 2021 and amended on July 27, 2021.

Applicant's Address: tsheehan@bernsteinshur.com.

Variable Account J of Lincoln Life Assurance Co of Boston [File No. 811–08269]

Summary: Summary: Applicant, a unit investment trust, seeks an order declaring that it has ceased to be an investment company. The applicant is not making and does not presently propose to make a public offering of its securities, and will continue to operate

[282] *See* FINRA March 4 Letter at 25.

[283] *Id.*

[284] *Id. See supra* note 152 (addressing FINRA's commitment to providing additional guidance and resources to member firms to assist in satisfying their compliance burdens under the proposed rule).

[285] Separate comments addressing whether FINRA should otherwise disclose to firms their Preliminary Identification Metrics across all six categories is discussed above in ''Resources to assist Member Firms with Compliance.''

[286] 15 U.S.C. 78s(b)(2).

[287] 17 CFR 200.30–3(a)(12).