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Ms. Jill M. Petersen  
Assistant Secretary  
SECURITIES AND EXCHANGE COMMISSION  
100 F Street NE  
Washington, D.C. 20519-1090

By Electronic Mail – [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Re: File Number SR-FINRA-2020-011

Dear Ms. Peterson

The following comment is submitted with respect to the proposal (the “Proposal”) by the Financial Industry Regulatory Authority, Inc. (“FINRA”) to amend the FINRA Rule 1000 Series (Member Application and Associated Person Registration) to require a member firm to submit a written request to FINRA’s Department of Member Regulation (“Member Regulation”), through the Membership Application Group (“MAP Group”), seeking a materiality consultation and approval of a continuing membership application, if required, when a natural person that has, in the prior five years, one or more “final criminal matters” or two or more “specified risk events” seeks to become an owner, control person, principal, or registered person of the member firm.

I note at the outset that the wording of FINRA’s proposed definitions of “final criminal matter” and “specified risk event” is inartfully drafted, subject to speculation as to the disclosures and events to which they refer, and contradicted by the Exhibits that FINRA submitted indicating the “subcategories included.”

Definition of final criminal matter

FINRA’s proposed definition of “final criminal matter” in Rule 1011(h) is

The term “final criminal matter” means a final criminal matter that resulted in a conviction of, or guilty plea or nolo contendere (“no contest”) by, a person that is disclosed, or was required to be disclosed, on the applicable Uniform Registration Forms.<sup>1</sup>

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<sup>1</sup> The correct syntax and grammar for the definition probably is “The term “final criminal matter” means a criminal matter that resulted in a conviction of, or plea of guilty or nolo contendere (“no contest”) by, a person that is disclosed, or was required to be disclosed, on the applicable Uniform Registration Forms.”

While FINRA’s proposed definition of Uniform Registration Forms refers to Forms BD, U4, U5, and U6, Exhibits 3a and 3b submitted by FINRA refer only to Form U4 and Form BD.

It is difficult to understand why Form BD and Exhibit 3b<sup>2</sup> have any application whatsoever as the proposed addition of IM-1011-3 and Rule 1017(a)(7) apply only to natural persons. As far as the author knows it is not possible for a natural person to register as a broker/dealer or become a member of FINRA. Moreover, Form U6 is generally submitted by the SEC, FINRA, or a state regulatory authority to report a regulatory matter and is not available to members in its native format. It is impossible for a member to know if an event should or should not have been or be reported on a Form U6.

In Exhibit 3a FINRA indicates that its definition of final criminal matter includes convictions referenced in Form U4 Questions 14A(1)(a) and (2)(a) and 14B(1)(a) and (2)(a).

Criminal Disclosure	Yes	No
14A (1) Have you ever:  (a) been convicted of or plead guilty or nolo contendere (“no contest”) in a domestic, foreign, or military court to any <i>felony</i> ?	<input type="checkbox"/>	<input type="checkbox"/>
(2) Based upon activities that occurred while you exercised control over it has an organization ever:  (a) been convicted of or plead guilty or nolo contendere (“no contest”) in a domestic, foreign, or military court to any <i>felony</i> ?	<input type="checkbox"/>	<input type="checkbox"/>
14B (1) Have you ever:  (a) been convicted of or plead guilty or nolo contendere (“no contest”) in a domestic, foreign, or military court to any <i>misdemeanor</i> involving: investment-related business or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?	<input type="checkbox"/>	<input type="checkbox"/>
(2) Based upon activities that occurred while you exercised control over it has an organization ever:  (a) been convicted of or plead guilty or nolo contendere (“no contest”) in a domestic or foreign court to any <i>misdemeanor</i> specified in 14B(1)(a)?	<input type="checkbox"/>	<input type="checkbox"/>

So, while it is not apparent from the proposed definition of final criminal matter and the Proposal in general, FINRA’s interpretation of the Proposal is that it not only encompasses a

<sup>2</sup> Exhibit 3b is referred to three times in FINRA’s filing and purports to show the mapping of the disclosure categories to the questions on Form BD.

criminal matter that resulted in a conviction of a natural person, but a conviction of an organization over which the natural person exercised control.

One wonders exactly why FINRA cannot either use the actual language set forth in Form U4 or refer to the Form U4 Question numbers or state specifically what is covered by the definition of “final criminal matter.” All criminal matters with a “yes” answer to Form U4 Questions 14A(1)(a) and (2)(a) and 14B(1)(a) and (2)(a) are final by definition.

Proposed revised definition of final criminal matter

(h) “final criminal matter”

The term “final criminal matter” means a criminal matter that resulted in a “Yes” answer by a person to Questions 14A(1)(a) or (b) or 14B(1)(a) or (b) on Uniform Registration Form U4 or would result in a “Yes” answer by a person if the person completed Uniform Registration Form U4.

This presumes that FINRA intends the definition to in fact extend to convictions of controlled organizations.

Moreover, one wonders how a firm is supposed to know if an individual was convicted of a matter that is “required to be disclosed,” but is not disclosed, if the firm has no knowledge of the matter. Assuming this language is intended to address the circumstance where a natural person is not registered but wishes to be an owner or control person of a member, the language should be revised to address that scenario. The above proposed definition addresses the issue. Another alternative would be to change the clause “or was required to be disclosed,” to “or would be required to be disclosed.”

If the reluctance to actually refer to the Questions in Form U4 is the possibility that the question numbers or letters could change, history reflects that has not happened to date.

Definition of specified risk event

The definition of specified risk event suffers from the same issues as the definition of final criminal matter. Rather than referring to the individual questions in Questions 14C, D, E, F, G, and H of Form U4, FINRA attempts to condense language and defined terms within the questions. FINRA’s Exhibit 3a is no help as it does not even refer to the particular Form U4 Questions but rather subcategories within the individual Disclosure Reporting Pages (DRPs) as to the disposition of a reported event.

Here, there is merit in trying to condense the definition as Regulatory Action Disclosures encompass some 20 plus questions. However FINRA misses the mark with its proposed definition.

FINRA’s proposed definition

(p) “specified risk event”

The term “specified risk event” means any one of the following events that are disclosed, or are or were required to be disclosed, on an applicable Uniform Registration Form:

(1) a final investment-related, consumer-initiated customer arbitration award or civil judgment against the person for a dollar amount at or above \$15,000<sup>3</sup> in which the person was a named party;

(2) a final investment-related, consumer-initiated customer arbitration settlement or civil litigation settlement for a dollar amount at or above \$15,000 in which the person was a named party;

(3) a final investment-related civil action<sup>4</sup> where: (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above \$15,000; or (B) the sanction against the person was a bar, expulsion, revocation, or suspension; and

(4) a final regulatory action where (A) the total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for a dollar amount at or above \$15,000; or (B) the sanction against the person was a bar (permanently or temporarily), expulsion, rescission, revocation, or suspension from associating with a member.

Proposed revised definition of specified risk event

The term “specified risk event” means any one of the following events that resulted in a “Yes” answer by a person to the referenced Questions on Uniform Registration Form U4 or would result in a “Yes” answer by a person if the person completed Uniform Registration Form U4:

(1) Questions 14I(1)(b) and the arbitration award or civil judgment against the person was for \$15,000 or more;

(2) Question 14I(1)(d);

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<sup>3</sup> When referring to dollar amounts all Uniform Registration Forms use the phrasing of “\$X,000 or more.”

<sup>4</sup> This event refers to “civil actions” whereas Question 14H of Form U4 refers to “Civil Judicial Actions,” which would generally be when the SEC, FINRA, or any other federal or state regulatory authority brings an action or proceeding in court against a person. Civil Judicial Actions differ from Civil Litigation, which is consumer-initiated.

(3) Questions 14H(1)(a) or (b) and the sanctions included a monetary sanction (including a civil and administrative penalty or fine, disgorgement, monetary penalty other than fines, or restitution) of \$15,000 or more<sup>5</sup>; or

(4) Questions 14C(1) through (8), 14D(1)(a) through (3), 14D2(a) or (b), 14E(1) through (7), 14F, or 14G(1)<sup>6</sup> and the sanctions ordered against the person included (A) total monetary sanctions (including civil and administrative penalties or fines, disgorgement, monetary penalties other than fines, or restitution) were ordered for \$15,000 or more or (B) a bar (permanently or temporarily/time limited), expulsion, rescission, revocation, or suspension<sup>7</sup>.

Since the language in the Uniform Registration Application Forms U4, U5, and U6 is determined through a collaboration among FINRA, the SEC, and the NASAA, there does not seem to be a reason to redefine what already exists particularly since the events reported are reported in the forms adopted by FINRA and at the end of the day Schedule 3a tracks back to Form U4.

In order for any firm to be able to identify what events are a “final criminal event” or “specified risk event” it must refer to Form U-4 and the specific questions. Not referring to the specific questions in the definitions requires a firm to in effect guess or interpret whether or not a specific event is covered. Referring to the specific question eliminates this problem.

#### IM-1011-3 Business Expansions and Persons with Specified Risk Events

The proposed IM-1011-3 relates solely to IM-1011-1. Since that is the case, an initial thought is why not just amend IM-1011-1 instead of adding a new IM?

Be that as it may, IM-1011-1 provides a safe harbor that permits a member to: (a) increase the number of “Associated Persons involved in sales,” (b) the number of offices (registered or unregistered), and (c) the number of markets made without submitting a Rule 1017 application and nothing more.

IM-1011-1 does not apply or relate in any way to a request by a natural person to become an owner, control person, principal, or registered person of a member unless the person is an Associated Person involved in sales.

The fact is that IM-1011-1 has nothing whatsoever to do with what FINRA wishes to accomplish by adding IM-1011-3 (or IM-1011-2). Moreover, the concept that FINRA believes

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<sup>5</sup> Exhibit 3a submitted by FINRA does not include as a “Subcategories Included” “the sanction against the person was a bar, expulsion, revocation, or suspension” as that is not a Sanction Detail set forth in Question 12A of the Civil Judicial DRP. Nor does Exhibit 3a include the category of “Other Sanction,” which is a subcategory in Question 12A, as an “Subcategories Included.”

<sup>6</sup> As the U4- Regulatory Action DRP includes all of these Questions, an alternative is to refer to “a Yes” answer to any Questions reported on U4 - Regulatory Action DRP.”

<sup>7</sup> The Sanction Detail in Question 13 of the Regulatory Action DRP has a box for Suspension. It does not include the language “from associating with a member.”

that it is addressing by limiting the use of the safe harbor in IM-1011-1 is illusory at best since (a) if a natural person is not involved in sales, he or she may be associated without reliance on IM-1011-1 even if the person is an owner, control person, principal, or in a position not involving sales and (b) IM-1011-1 applies only to increases in the number of Associated Persons involved in sales not to replacements.

The purpose of IM-1011-1 was to create a safe harbor in three areas where a limited number of increases in those areas would be presumed not to be a material change in business operations under Rule 1017(a)(5).

The term “material change in business operations” is defined in Rule 1011(k) to include, but is not limited to: (1) removing or modifying a membership agreement restriction; (2) market making, underwriting, or acting as a dealer for the first time; and (3) adding business activities that require a higher minimum net capital under SEA Rule 15c3-1.

It is unlikely that for a member of any size that the association of one person would be considered a material change in business operations. And adding a new owner or control person would not be a change in business operations, material or otherwise.

Changes in ownership of a member are addressed in subparagraphs (1), (2), (3), and (4) of Rule 1017(a), not subparagraph 5.

While, as noted, the proposed IM-1011-3 does not address the issue for which it is proposed, a suggested wording is

**IM-1011-3. Business Expansions and Persons with Specified Risk Events**

The safe harbor for business expansions in IM-1011-1 is not available to any member that is seeking to add a natural person as an Associated Person involved in sales who has, in the prior five years, one or more final criminal matters or two or more specified risk events. If the member is not otherwise required to file an application for approval in accordance with Rule 1017(a)(5), the member must comply with the requirements of Rule 1017(a)(7).

Or, with the changes accepted,

The safe harbor for business expansions in IM-1011-1 is not available to any member that is seeking to add a natural person as an Associated Person involved in sales who has, in the prior five years, one or more final criminal matters or two or more specified risk events. If the member is not otherwise required to file an application for approval in accordance with Rule 1017(a)(5), the member must comply with the requirements of Rule 1017(a)(7).

As written proposed IM-1011-3 reinterprets the safe harbor of IM-1011 and converts it into a new rule that is properly done through the addition of Rule 1017(a)(7) if at all.

Proposed Rule 1017(a)(7)

(7) notwithstanding subparagraphs (3), (4), (5) and (6) of Rule 1017(a) and IM-1011-1,<sup>8</sup> whenever a natural person seeking to become an owner, control person, principal or registered person of a member has, in the prior five years, one or more final criminal matters or two or more specified risk events, and the member is not otherwise required to file a Form CMA in accordance with Rule 1017, unless the member has submitted a written request to the Department, in a manner prescribed by FINRA, seeking a materiality consultation for the contemplated activity; provided, however, this subparagraph (7) shall not apply when the member is required to file an application or written request for relief pursuant to Rule 9522 for approval of the same contemplated association. The written request must address the issues that are central to the materiality consultation. As part of the materiality consultation, the Department shall consider the written request and other information or documents provided by the member to determine in the public interest and the protection of investors that either (A) the member is not required to file a Form CMA in accordance with Rule 1017 and may effect the contemplated activity; or (B) the member is required to file a Form CMA in accordance with Rule 1017 and the member may not effect the contemplated activity unless the Department approves the Form CMA. The safe harbor for business expansions under IM-1011-1 shall not be available to the member when a materiality consultation is required under this paragraph (a)(7).

While it may be in the purview of FINRA to review the character of natural persons who associate with its members, as written Rule 1017(a)(7) on its face appears to apply to every proposed acquisition of an ownership interest in a member. It does not indicate that it is limited to acquisitions that are otherwise subject to Rule 1017(a)(1), (2), (3) and (4).

A person who is an owner of a member is not an “Associated Person” as defined in Rule 1011(b) unless the person directly or indirectly controls the member. The term “control” is defined in SEC Rule 12b-2 as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

Control is defined in Form BD as:

The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any person that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% or more of a class

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<sup>8</sup> It is unclear why subparagraphs (3), (4), (5), and (6) are referenced since each requires that an application for approval be submitted for each of the identified changes, which would appear to cover any such change in which a person proposed to be covered by subparagraph (7) would be a party. An appropriate manner to address this question would be to add a disclosure to the Continuing Membership Application (CMA) Form to request information as to any natural person with one or more final criminal matters or two or more specified risk events within the past five years, who is an Associated Person of the member or is a direct owner or indirect owner or Control Person disclosed on Schedule A or B to Form BD.

of a voting security or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that company. (This definition is used solely for the purpose of Form BD.)

On Schedule A to Form BD a broker/dealer (applicant) that is a corporation must list each shareholder that directly owns 5% or more of a class of a voting security. A similar 5% threshold applies to partnerships, trusts, and limited liability companies. If a direct owner is an entity, a broker/dealer (applicant) must disclose any shareholders of that entity the beneficially owns, has the right to vote, or has the power to sell or direct the sale of 25% or more of a class of a voting security of that entity. A broker/dealer (applicant) must continue up the chain listing all 25% owners at each level.

Form BD provides on Schedule A and B that in the “Control Person” column, enter “Yes” if person has “control” as defined in the instructions to this form, and enter “No” if the person does not have control. And it is noted that under this definition most executive officers and all 25% owners, general partners, and trustees would be “control persons”.

Rule 1017(a)(4) adopts a change in a member’s equity ownership or capital that results in one person or entity acquiring 25% or more of a member’s equity or capital as a change requiring submission of an application for approval.

As the terms “owner” and “control person” used in proposed subparagraph 1017(a)(7) are not defined in either FINRA Rule 160 or 1011, it is unclear if being a non-voting owner, partner, or member is intended to be covered by proposed subparagraph 1017(a)(7) or if the ownership of any amount of shares no matter how small a percentage is included.<sup>9</sup> And, as to the term “control person,” it is unclear what direct ownership level is required and if the indirect level is 25% or more of a class of voting securities or some lesser amount.

A suggested wording for subparagraph 1017(a)(7) that comports with FINRA’s current rules and Form BD is as follows:

(7) whenever a natural person seeking to become (A) an Associated Person of a member or (B) a shareholder, general or limited partner, trustee, member, or manager of a member required to be listed on Schedule A to Form BD has, in the prior five years, one or more final criminal matters or two or more specified risk events, and the member is not otherwise required to file an application for approval of the change in accordance with Rule 1017(a), -unless the member has submitted a written request to the Department, in a manner prescribed by FINRA, seeking a materiality consultation for the contemplated association or filed an application or written request for relief pursuant to Rule 9522 for approval of the contemplated association. The materiality consultation submission must address the issues that are central to the matter. The Department shall consider the materiality

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<sup>9</sup> It is unclear how the Proposal applies to members that have a significant number of shareholders. Or, if in the future a member will be required to have each shareholder complete a questionnaire prior to their purchase of shares or acquisition of an ownership interest in order to determine if they are subject to Rule 1017(a)(7).

consultation submission and other information or documents provided by the member to determine in the public interest and the protection of investors and advise the member within 30 days that either (A) the member is not required to file an application for approval in accordance with Rule 1017(a) and may affect the contemplated association; or (B) the member is required to file an application for approval in accordance with Rule 1017(a) and the member may not affect the contemplated association unless the application is approved. The safe harbor for business expansions under IM-1011-1 to the extent applicable to the contemplated association shall not be available to the member when a materiality consultation is required under this subparagraph (a)(7).

Or, with the changes accepted:

(7) whenever a natural person seeking to become (A) an Associated Person of a member or (B) a shareholder, general or limited partner, trustee, member, or manager of a member required to be listed on Schedule A to Form BD has, in the prior five years, one or more final criminal matters or two or more specified risk events, and the member is not otherwise required to file an application for approval of the change in accordance with Rule 1017(a), unless the member has submitted a written request to the Department, in a manner prescribed by FINRA, seeking a materiality consultation for the contemplated association or filed an application or written request for relief pursuant to Rule 9522 for approval of the contemplated association. The materiality consultation submission must address the issues that are central to the matter. The Department shall consider the materiality consultation submission and other information or documents provided by the member to determine in the public interest and the protection of investors, and advise the member within 30 days, that either (A) the member is not required to file an application for approval in accordance with Rule 1017(a) and may effect the contemplated association or (B) the member is required to file an application for approval in accordance with Rule 1017(a) and the member may not effect the contemplated association unless the application is approved. The safe harbor for business expansions under IM-1011-1 to the extent applicable to the contemplated association shall not be available to the member when a materiality consultation is required under this subparagraph (a)(7).

If the intention or desire of FINRA is to prohibit any natural person who has in the prior five years, one or more final criminal matters or two or more specified risk events from associating with a member as a principal or registered person), or becoming an owner or control person of a member, it would be easy enough to write such a rule. Relying on innocuous amendments to IM-1011-1 and Rule 1017(a) is not the appropriate method.

As there is no formal time period set out in FINRA's guidance on materiality consultations, it would be reasonable to impose a 30-day limitation on FINRA's review.

#### Summary

The proposed definitions of "final criminal matter" and "significant risk event" are general when they should be specific. There is no way that a member or a person intended to be covered

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by the definitions can easily tie the proposed definitions to Form U4, which is the only applicable Uniform Application Form. Why not refer to the actual Form U4 questions or use the actual Form U4 language.

The proposed materiality consultation envisioned by proposed Rule 1017(a)(7), while addressing a valid concern, also suffers from the prospect of trying to put a square peg in a round hole. That is, trying to address an issue by amending a rule that was never intended to cover the issue. Again, the proposed Rule 1017(a)(7) fails to follow existing language and concepts in existing forms. Does the proposed Rule 1017(a)(7) require that every member review every proposed acquisition of an ownership interest, no matter how small, to determine if the acquiror has reportable events in the past 5 years? On its face that is what the proposed addition of Rule 1017(a)(7) requires. I assume that is not the intent.

I ask that the Commission and FINRA consider the points contained herein. I appreciate your time and attention to this correspondence.

Very truly yours,



Andrew R. Harvin

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