June 19, 2020

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

Re: Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Address Brokers with a Significant History of Misconduct (Release No. 34-88600; File No. SR-FINRA-2020-011)

Dear Secretary Countryman:

Better Markets[1] appreciates the opportunity to submit the enclosed comment letter which we filed with Financial Industry Regulatory Authority (FINRA) when it first noticed essentially the same rule change as captioned above. We now file the attached comment letter to be incorporated herein and be made a part hereof as if set out in full herein. Our June 2018 comment letter (enclosed) remains highly relevant as the Commission considers FINRA's proposal.

Sincerely,

Lev Bagramian

Lev Bagramian
Senior Securities Policy Advisor

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006

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

[redacted]

[redacted]
www.bettermarkets.com

BETTER MARKETS

June 29, 2018

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: High-Risk Brokers, Regulatory Notice 18-16

Dear Mrs. Mitchell:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Regulatory Notice ("Notice" or "Release") released for comment by the Financial Industry Regulatory Authority ("FINRA").

SUMMARY

As FINRA knows and has been well-documented (as we detail below), there are too many investors who are victims of predatory brokers[2] who willfully, knowingly, and repeatedly break the law. These are not close calls. These are not one-time offenders. These are not technical, victimless crimes. These are the worst-of-the-worst and give all brokers and law-abiding brokerag firms a bad name and ruined reputation. It is long past time to put a stop to this and prioritize protecting investors.

FINRA's Release, therefore, gestures in the right direction, but FINRA must do significantly more to reduce the number of bad brokers and the prevalence of recidivism. This

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[2] In our comment letter, we use the term "broker" to refer to individuals and "brokerage firms" to refer to registered broker-dealer firms.

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Release falls far short. While we urge FINRA to adopt some specific changes to the Release, FINRA must go far beyond this proposal to credibly claim that it is serious in its intention not just to hold brokers accountable but also to protect investors from brokers who have demonstrated a proclivity to violate the law. As a Congressionally mandated regulatory body with its mission of investor protection and market integrity, FINRA should impose a lifetime ban on brokers with two criminal convictions, and impose a lifetime ban on brokers who have three specified risk events (a "Three Strikes Rule"). FINRA should immediately and permanently expel firms where more than 20% of the brokers have 3 or more misconduct records.

BACKGROUND

As documented by a recent rigorous, peer-reviewed study, misconduct in the broker-dealer profession is widespread.[3] Over 12% of active brokers' records contain misconduct events.[4] Over 15% percent of brokers at some of the largest brokerage firms have misconduct records.[5] For example, at Oppenheimer & Co, Inc., as of May 2015, over 28% percent of its "client facing" brokers had a misconduct record.[6] Oppenheimer is not an outlier: in at least 8 other firms, employing tens of thousands of brokers, over 18% of brokers had misconduct records.[7]

Not only is misconduct prevalent, but recidivism among those engaged in misconduct is also high. About one-third of brokers who have engaged in misconduct are repeat offenders: recidivists.[8] Over 50% of those who have been reprimanded for misconduct remain with the firm, and another 20% simply switch to another firm.[9] The study also found that some firms indeed specialize in hiring recidivists, and those firms that are controlled by officers who themselves have had disclosure events are much more likely to hire recidivists.[10]

Another study put the number of brokers with misconduct records even higher: At least 30% of brokers at 48 firms registered with FINRA had misconduct records.[11] The same study also found that at least 14 firms employ brokers over 50% of whom have misconduct records, and at some firms the percentage of brokers with misconduct records is as high as 70%.[12] These 14 firms collectively employ over 826 brokers, which means tens of thousands of investors are being needlessly exposed to a heightened risk of fraud and abuse, and in many cases, are undoubtedly

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3 *See* Mark Egan, Gregor Matvos, Amit Seru, *The Market for Financial Adviser Misconduct*, JOURNAL OF POLITICAL ECONOMY, Forthcoming (Sept. 1, 2017), *available at* https://ssrn.com/abstract=2739170.

4 *Id.* at 7-8.

5 *Id.* at 1.

6 *Id.* at 73.

7 *Id.* at 73, Table A16.

8 *Id.* at 1.

9 *Id.* at 34.

10 *Id.* at 23.

11 *See Wall Street's Self-Regulator Blocks Public Scrutiny of Firms with Tainted Brokers*, REUTERS INVESTIGATES (June 12, 2017), *available at* https://www.reuters.com/investigates/special-report/usa-finra-brokers/.

12 *See* Reuters Table, available at https://www.reuters.com/investigates/special-report/usa-finra-brokers/#interactive-brokers-link.

suffering financial harm. This is the price that investors have been paying for too long, as firms seek the revenues that come with hiring, retaining, and rewarding bad brokers.

Broker misconduct, particularly among the recidivists, is more prevalent in counties and cities with a large proportion of retirees and a lower educated population.[13] Said differently, bad brokers and the firms that employ and reward them specifically target and flourish in areas where there are unsophisticated investors and vulnerable adults who can more easily be preyed upon. This is despicable and FINRA simply must make it a priority to end this practice.

While unscrupulous brokers do indeed target unsophisticated and vulnerable investors, they also do not ignore those who are deemed "accredited investors." Within the last week, a study by the Wall Street Journal[14] showed that brokers with three or more misconduct records are also adept at peddling private placements to investors who are ostensibly sophisticated and have the financial means to withstand significant losses. An investor is considered an "accredited investor" if he or she "earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year, OR has a net worth over $1 million, either alone or together with a spouse (excluding the value of the person's primary residence and any loans secured by the residence (up to the value of the residence))."[15]

The Journal exposed a deeply troubling fact: There are over 100 firms—

> "where 10% to 60% of the in-house brokers had three or more investor complaints, regulatory actions, criminal charges or other red flags on their records… These brokerages helped sell to investors more than $60 billion of stakes in private companies."[16]

The Journal gave an example of one still operating and seemingly flourishing broker-dealer, Newbridge Securities Corp., in Boca Raton, FL,[17] employing over 100 brokers, showing that—

> "Investors have a one in four chance of getting a broker there with at least three red flags. Regulators sanctioned the firm 20 times—an average of twice a year—over the past decade, with fines of $1.75 million."[18]

The pernicious practices described above cry out for a fundamental re-thinking of how brokers with misconduct records are regulated by both the self-regulatory organizations, FINRA

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13 *See* Egan, *supra* note 3, at 27.

14 *See Firms with Troubled Brokers Are Often Behind Sales of Private Stakes*, WALL ST. J. (June 24, 2018), *available at* https://www.wsj.com/articles/firms-with-troubled-brokers-are-often-behind-sales-of-private-stakes-1529838000.

15 *See Investor Bulletin: Private Placements Under Regulation D*, SEC (last visited June 25, 2018), *available at* https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html.

16 *See* article, *supra* note 14.

17 *See* "Join Us" webpage of Newbridge Securities. (last visited on June 25, 2018), *available at* http://www.newbridgesecurities.com/join-us.html.

18 *See* article, *supra* note 14.

and the Municipal Securities Rulemaking Board (MSRB), and by the Securities and Exchange Commission.

We are not alone in holding this view. Over two years ago, Senators Elizabeth Warren and Tom Cotton wrote[19] to then-FINRA Chairman Rick Ketchum expressing their deep concern about recidivism, and FINRA's apparent inaction to rid the ranks of brokers of recidivists. FINRA's current President, Mr. Robert Cook, in a 2017 speech, agreed with SEC Chairman Jay Clayton that there is "zero room for bad actors in our capital markets."[20] In stark contrast to "zero room," however, this Release tinkers on the margins by, essentially, making it a little bit costlier for firms to hire bad brokers, and by making them jump through an additional hoop before they can hire brokers with checkered pasts. This is a significant missed opportunity and will continue FINRA's failure to protect investors. Half-measures as proposed in the Release, and as sensible as they may be, will not solve this well-documented, long-known, pervasive problem of bad brokers.

While we will offer comments to improve the Release, we urge FINRA to address the issue of bad brokers more boldly and fundamentally. The Release is primarily focused on a few new measures to contain the damage that a bad broker may inflict on investors, without taking steps to actually rid the industry of those brokers altogether.

Investors need and deserve more: honest, qualified, and competent brokers, with clean records, who have the best interest of the investor in mind when offering their services and financial products. Americans need those brokers to help them meet their life goals, including saving for their children's college education, preparing for retirement, and enjoying a decent standard of living. As the front-line regulator of brokers and brokerage firms, FINRA has a paramount responsibility to ensure that all investors—from the unsophisticated, elderly, and less-educated to the putatively "accredited"—are protected and not preyed upon by unscrupulous brokers who repeatedly break the law with impunity with little or nothing to fear from FINRA.

BRIEF DESCRIPTION OF THE PROPOSAL

FINRA proposes to amend its rules to:

1. Allow (but not require) hearing officers, after an enforcement case is complete and a disciplinary decision is reached, to impose unspecified restrictions upon individual brokers or brokerage firms while these firms or individuals appeal the enforcement decision to FINRA's National Adjudicatory Council (NAC);

2. Require firms to adopt heightened supervision of individuals who are appealing a disciplinary matter to the NAC;

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19 *See* Letter from Senators Elizabeth Warren and Tom Cotton to Rick Ketchum (May 11, 2016), *available at* https://www.warren.senate.gov/files/documents/2016-5-11_Warren-Cotton_Letter_to_FINRA.pdf.

20 *See* Robert Cook, Remarks delivered at the Georgetown University McDonough School of Business, "Protecting Investors From Bad Actors" (June 12, 2017), *available at* https://www.finra.org/newsroom/speeches/061217-protecting-investors-bad-actors.

3. Require firms to place individuals fighting a Statutory Disqualification (SD) decision under heightened supervision while FINRA is reviewing the SD decision;

4. Flag on BrokerCheck's website any firms that tape the interactions (e.g., phone calls, emails, etc.) between the firm's brokers and customers; and

5. Require firms that hire individuals who, in the past five years, have one (or more) criminal record or two (or more) "risk events" to seek further consultation with FINRA's Membership Committee.

COMMENTS

FINRA's Primary Mission Is to Protect Investors and the Integrity of the Securities Markets, Not Serve the Interests of Brokers Who Violate the Law.

As the front-line regulator of broker-dealers, FINRA has a paramount responsibility to ensure that investors—particularly the vulnerable population of retail and unsophisticated investors—are protected and not preyed upon by unscrupulous brokers. Yet, this Notice fails to adequately address the issue of recidivist brokers. Instead of boldly and fundamentally working to rid the ranks of brokers of those who have indisputable records of repeat misconduct, this Notice tinkers on the margins by essentially making it slightly costlier for firms to hire or retain brokers with checkered pasts by raising the firm's regulatory costs. While some firms may indeed decide to fire or not hire a broker with a rap-sheet due to the costs associated with heightened supervision (as proposed in the Release) and potential liability, it would still leave untouched those firms that, as documented in multiple studies,[21] actually seek out and embrace recidivist brokers because these firms will stand to profit, on a net basis, by employing unscrupulous brokers who are especially skilled at preying on investors. These brokers often peddle unsuitable investments that generate high commissions for themselves and profits for their brokerage firms.

FINRA has not been charged by Congress to ensure that brokers have gainful employment in the financial industry. FINRA exists to protect investors and promote market integrity.[22] If FINRA indeed has investors' best interest in mind, it should not compromise that interest for the benefit of brokers who are either unable or unwilling to abide by the law. Nor can the hiring challenges facing brokerage firms outweigh what is best for the investing public.

The Measures in the Proposal Are Beneficial, but they Should Be Stronger in Specific Respects.

All of the proposed FINRA rule changes and additions are an improvement over the status quo, but they are simply not enough to address the harm investors are facing daily at the hands of brokers with bad records. They should be strengthened in several key respects.

1. The imposition of restrictions pending appeal should be mandatory, not merely authorized.

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[21] *See* studies cited *supra*, notes 3 and 14.

[22] *See* FINRA "About" webpage (last visited on June 25, 2018), *available at* http://www.finra.org/about.

We support granting FINRA hearing officers the authority to impose temporary restrictions on brokers who have been found to have violated FINRA rules, SEC rules, MSRB rules, or the federal securities laws, pending any appeal of a hearing officer's decision to the NAC. This is an obviously appropriate and necessary measure, and as the Release notes, it is already the practice at some exchanges.[23] However, this step only goes halfway: Hearing officers should be **required** to impose any restrictions that are necessary to protect investors pending appeal.

This too is an obviously appropriate measure for the protection of investors, and it is hardly unfair to the broker. If a broker has had his or her "day in court," the evidence has been weighed, and an impartial hearing officer has found against the broker, then restrictions on the broker's conduct, at the very least, are warranted and reasonable to protect investors pending the outcome of the appeal. This is especially important, given the multiple layers of appeal that a broker's case may wind through: the NAC, FINRA itself, the SEC, and the federal appellate courts.

This mandatory approach to restrictions pending appeal also aligns with analogous procedures under federal law. For example, a losing party in a case involving injunctive and declaratory relief faces a heavy burden if they seek a stay pending appeal. And those who have lost their case at trial and are subject to a monetary judgment are typically required to post a bond pending appeal to ensure they have the wherewithal to pay if they ultimately lose on appeal—the most likely outcome as a statistical matter. The proposal is in fact comparatively modest, in that it only authorizes for the imposition of tailored restrictions pending appeal for the protection of investors, and does nothing to effectuate the remedies or penalties that the hearing officer has found appropriate pending the appeal process. Making such restrictions mandatory simply ensures that the necessary prophylactic measures are in place.

2. FINRA should not allow expedited review of restrictions that have been imposed pending appeal, nor should it allow expedited review to stay the effectiveness of those restrictions.

We also believe brokers should not be afforded an opportunity to request an expedited review of these temporary and customized restrictions. It is enough that a broker may seek review of any such restrictions; expediting the process has no justification, and the Release offers none. Even more objectionable is the proposal to stay the effectiveness of any restrictions immediately upon the filing of a motion seeking expedited review of the restrictions. Here too, the Release appears to favor the rights of brokers already found to have violated the law over the rights of innocent investors.

These measures are unwarranted from a practical standpoint as well. If the NAC has the bandwidth and ability to conduct any hearing on an expedited schedule, it should perhaps consider devoting additional bandwidth to shortening the appeals processes itself. The Release states that the NAC takes an average of 14 months to reach a decision on an appeal. If the NAC is repeatedly burdened with requests to expeditiously review temporary restrictions imposed by hearing officers (as proposed in the Release), the NAC would take even longer to actually dispense with the underlying appeal, and the successful and timely completion of NAC's other duties.

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[23] *See* Release at 7.

3. The monetary thresholds should be lowered.

The Release establishes monetary thresholds that trigger "specified risk events." Under the proposal, FINRA Rule 1011 would define "specified risk event" as, among other events, any: "final investment-related, consumer-initiated customer arbitration award or civil judgement against the person for a dollar amount at or above $15,000 in which the person [*e.g.*, broker] was a named party."[24] The Notice includes other provisions that use the $15,000 threshold.

We recommend that these monetary thresholds be lowered to $5,000 as the threshold for **all** "specified risk event." With the median brokerage account balance of US investors at only $6,200, setting the "risk event" threshold at $5,000 would better serve the investing public.[25] Moreover, lowering the threshold from the proposed $15,000 threshold to $5,000, would enable FINRA to capture more misconduct, and this lowered threshold could serve as a more sensitive gauge for FINRA to assess the quality of the service and the level of integrity among brokers and the firms that employ them.

4. It is appropriate to impose heightened supervision of brokers pending their appeals.

We support requiring firms to immediately impose heightened supervision on brokers who appeal either a disciplinary matter to the NAC or a Statutory Disqualification (SD) decision to FINRA, other regulatory organizations, or the courts. As we argued above, individuals who have been sanctioned by FINRA have already gone through FINRA's fair enforcement proceedings and the firms who employ these brokers have a reasonable basis to assume that the decisions will be upheld at the end of the appeals process and that heightened supervision pending review is necessary and appropriate. We further support the immediate imposition of heightened supervision on brokers who have been found to have committed such acts that Congress itself has deemed grounds for disqualification from offering financial advice, services, or products to investors. Firms can easily reassign the clients of any broker who is appealing a FINRA or SD decision to other brokers within the firm who are not involved in any appeals, and therefore investors would continue being served, perhaps served by an even more qualified broker.

5. Additional disclosure regarding "taping" firms is appropriate, but additional requirements are necessary to ensure that this is a meaningful measure.

We support flagging "taping" firms on BrokerCheck. Unfortunately, the Release offers scant information about the taping process and what it signifies. In general, taping the interactions between brokers and their clients by a firm is required when a firm has an unusually high number

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24 *See* Proposed Rule Text at 1, *available at* http://www.finra.org/sites/default/files/Attachment-A_RN-18-16.pdf.

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

of brokers with misconduct records.[26] We understand there are very few firms that are required to tape the interactions of the brokers associated with the firm and their clients, since the bar is set so high. Nevertheless, we support flagging these firms on BrokerCheck with the expectation that the disclosure of taping status is accompanied by clear and complete information, comprehensible to investors, explaining what it means to be such a firm. This reddest of red flags ought to be clearly explained to investors.

We also believe individual brokers associated with taping firms should also be flagged under their BrokerCheck profile. This latter disclosure might actually be more useful to an investor as it would cause an appropriate pause and prompt the investor to raise questions with his or her broker about the disciplinary history of the firm that caused regulators to impose the requirement that it record its own brokers.

6. Requiring MAP consultations before hiring is an important regulatory innovation and must be maintained, but the triggering "risk event" must be $5,000 or more.

We strongly support the new proposal to require firms that associate with brokers "who have, in the prior five years, either one or more final criminal matters, or two or more specified risk events"[27] to seek consultation with FINRA's Membership Application Program group (under FINRA's Membership Proceedings rules). Under the proposal, FINRA would have the authority to restrict or outright "deny a member firm from allowing such a person to become an owner, control person, principal or registered person."[28] This would essentially mean firms would need to pre-clear with FINRA before they can hire and onboard bad brokers. We support this proposal with the caveat that it also change the definition of "specified risk event" from the proposed $15,000 level to $5,000.

Half Measures Will Not Solve the Serious Problem of Recidivist Brokers or Reduce the Number of Brokers with Misconduct Records, and therefore Stronger Remedies are Essential to Protect Investors from Bad Brokers.

As detailed above, the proposals in the Release are beneficial and can be made even more effective with the changes we have suggested. However, even when fortified, they will not fully address the chronic problem of bad brokers allowed to remain in the industry. To more effectively address this issue, FINRA should take a number of additional steps, set forth below.

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26 The Release, in endnote 28, describes "taping firm" to mean: "(i) A member with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years; (ii) A member with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years; (iii) A member with at least twenty registered persons where 20% or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years."

27 *See* Release at 14.

28 *Id.*

Adopt Three Strikes Rule: FINRA should make it impossible for brokers with a rap-sheet containing three or more specified risk events (at the $5,000 threshold level we proposed above) over the preceding 10 years to remain in the industry. FINRA should adopt a simple, clearly defined "Three Strikes" rule. There is no public policy justification to allow bad brokers to continually harm investors.

Allowing them to remain operational is also unfair to the vast majority of brokers who want to serve their clients honestly and well. These bad brokers sully the reputation of an entire industry, and erode the confidence of the entire investing public and the public at large who also lose faith in the regulators who are supposed to be vigilant against fraudsters.

Finally, investors who have been hurt by an unscrupulous broker are further demoralized and victimized when they see that the same fraudsters are still holding a license— a public privilege—and continue to work in the industry. Investors are the constituency to whom FINRA must cater, and all of its regulatory actions and proposals should be designed for the maximal benefit of investors and *not* the brokers who have decided to cheat time and time again.

Bold and Unmistakable Warnings About Bad Brokers: If FINRA refuses to do what is right and necessary and ban bad brokers with multiple misconduct records (as we argued above), and expel firms who specialize in hiring bad brokers (as we argue below), FINRA must at least use much more robust disclosures to empower investors to better protect themselves. Regulators that protect the public from harmful substances such as cigarettes have long deployed such techniques. FINRA should engage in more investor education on the topic, clearly explaining what a recidivist broker is and why they pose a threat to investors. In addition, FINRA should design and implement a disclosure system, either on BrokerCheck or through a separate user-friendly database, that clearly identifies those brokers with a demonstrable pattern of violating the law. Such an enhanced education and disclosure regime will prove more effective at warning investors that the use of these brokers and brokerage firms will be harmful to the investor's financial health.

Repeal Rule 9311: FINRA should repeal its Rule 9311 that allows a stay to be in-place while a party appeals a disciplinary matter to either the NAC, FINRA's board, the SEC, or any courts. There should be a blanket prohibition on stays while appeals are underway. Assuming FINRA reaches its disciplinary decisions through appropriate due process, there is no justification to allow a broker or firm to continue potentially harming investors while they file appeal after appeal.

Expel Bad-Broker Specialized Firms: FINRA should expel member-firms whose brokers' roster is 20% or more composed of brokers who have three or more specified risk events on their records. As documented by the studies noted above, having firms that enjoy the privilege and the imprimatur of being a firm regulated by FINRA and yet specialize in fraud and misconduct is a disgrace that needs immediate resolution. FINRA has the authority and the capability to solve this issue and send a strong signal to the brokerage industry that it will no longer tolerate boiler-rooms and fraud-houses, even in the guise of legitimate firms.

We support fair and appropriate measures designed to ensure that all brokers receive all the process to which they are due. But none of the procedural or fairness arguments advanced to date can justify the excessive leniency that FINRA has displayed toward bad brokers and brokerage firms. The priority must be to protect investors and to eject recidivist brokers and brokerage firms from the industry.

CONCLUSION

We hope these comments are helpful. FINRA has the authority, duty, and competency to do what is in the best interest of investors: reduce the prevalence of recidivism and the number of bad brokers. Now FINRA must apply its resolve to achieve this goal. FINRA must go beyond the specifics of this Release and fundamentally change its treatment of and tolerance for bad brokers and the firms who hire them.

Sincerely,

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