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July 2, 2020

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-FINRA-2020-011 (Proposed Rule Change to Address Brokers with a Significant History of Misconduct)

Dear Ms. Countryman:

This letter is being submitted by Financial Industry Regulatory Authority ("FINRA") in response to comments received by the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing. The proposed rule change would:

(1) amend the FINRA Rule 9200 Series (Disciplinary Proceedings) and the 9300 Series (Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review) to allow a Hearing Officer to impose conditions or restrictions on the activities of a respondent member firm or respondent broker, and require a respondent broker's member firm to adopt heightened supervisory procedures for such broker, when a disciplinary matter is appealed to the National Adjudicatory Council ("NAC") or called for NAC review;

(2) amend the FINRA Rule 9520 Series (Eligibility Proceedings) to require member firms to adopt heightened supervisory procedures for statutorily disqualified brokers during the period a statutory disqualification eligibility request is under review by FINRA;

(3) amend FINRA Rule 8312 (FINRA BrokerCheck Disclosure) to allow the disclosure through FINRA BrokerCheck of the status of a member firm as a "taping firm" under FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms); and

(4) 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") (collectively, the "Department"), seeking a materiality consultation and approval of a continuing membership application ("CMA"), 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.

The Commission published the proposed rule change for public comment in the Federal Register on April 14, 2020.[1] The Commission received five comment letters directed to the rule filing.[2] Two commenters supported the proposal.[3] One commenter had a concern that the proposal ensure due process.[4] One commenter raised several questions about, and suggested revisions to, the proposed rule changes to the Rule 1000 Series.[5] One commenter filed a copy of the June 29, 2018 comment letter that it filed with FINRA concerning Regulatory Notice 18-16 (April 2018).[6]

The following are FINRA's responses to the commenters' material concerns.

Process Concerns

Miller raised a general concern that the proposal should "ensure due process, both appearance and actual." FINRA agrees that fair process is vital and believes the proposed processes are fair ones. Proposed Rule 9285 would establish a process for seeking the imposition of conditions or restrictions on a respondent in a disciplinary proceeding during an appeal or a call for review. That process would require each of the following steps: a

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1 See Securities Exchange Act Release No. 88600 (April 8, 2020), 85 FR 20745 (April 14, 2020) (Notice of Filing of File No. SR-FINRA-2020-011).

2 See Letter from Andrew R. Harvin, Partner, Doyle, Restrepo, Harvin & Robbins, LLP, to Jill M. Petersen, Assistant Secretary, SEC, dated April 28, 2020 ("Harvin"); Letter from Lisa Miller, dated April 30, 2020 ("Miller"); Letter from William A. Jacobson & Ayomikun Loye, Cornell Law School and Cornell Securities Law Clinic, to Vanessa Countryman, Secretary, SEC, dated May 5, 2020 ("Cornell Clinic"); Letter from Samuel B. Edwards, President, Public Investors Advocate Bar Association, to Brent J. Fields, Secretary, SEC, dated May 5, 2020 ("PIABA"); and Letter from Lev Bagramian, Senior Securities Policy Advisor, Better Markets, Inc. to Vanessa A. Countryman, Secretary, SEC, dated June 19, 2020 ("Better Markets").

3 See Cornell Clinic, PIABA.

4 See Miller.

5 See Harvin.

6 See Better Markets. In the proposed rule change that FINRA has filed with the Commission, FINRA addressed the substance of Better Markets' June 29, 2018 comment letter. See generally Securities Exchange Act Release No. 88600 (April 8, 2020), 85 FR 20745, 20762-68 (April 14, 2020) (Notice of Filing of File No. SR-FINRA-2020-011).

motion to be filed with a Hearing Officer, an opportunity for the respondent to file a written opposition or other response, a written order by the Hearing Officer, the right for a respondent to seek expedited review before the NAC's Review Subcommittee of an order that imposes conditions or restrictions, and an automatic stay when a respondent requests such an expedited review.[7] All motions for the imposition of conditions or restrictions would be required to comply with existing Rule 9146, which governs motions in FINRA disciplinary proceedings.

The materiality consultation process required by proposed Rule 1017(a)(7) would be similar to FINRA's existing materiality consultation process and would provide the member firm an opportunity to be heard on whether the contemplated change is material. Specifically, proposed Rule 1017(a)(7) would provide that a member firm must submit a written request that seeks a materiality consultation and addresses the issues that are central to the materiality consultation; and that, as part of the materiality consultation, the Department must consider the written request and other information or documents provided by the member. If the Department determines that a CMA is required, the CMA would be governed by the existing process set forth in FINRA Rule 1017 and the Rule 1010 Series, including its appeal rights.[8] FINRA believes these procedures are fair.

Proposed Rule 9285(b)

Proposed Rule 9285(b) would provide that a respondent subject to a Hearing Officer's order imposing conditions or restrictions may file a motion with the Review Subcommittee to modify or remove any or all of the conditions or restrictions. Proposed Rule 9285(b)(2) would provide that "[t]he Respondent has the burden to show that the conditions or restrictions imposed are not reasonably necessary for the purpose of preventing customer harm."

PIABA commented that "members should be required to provide clear and convincing evidence of a manifest error by the trier of fact and show the likelihood of success of the underlying appeal before any restrictions are removed." FINRA previously considered, but declined, PIABA's comment to establish a higher burden to remove conditions and restrictions. As FINRA explained in the initial rule filing, the burden in proposed Rule 9285(b)(2) is consistent with the standard in proposed Rule 9285(a) for establishing conditions and restrictions in the first place. FINRA's intent is that the Review

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[7] The proposed rules also would give the Hearing Officer and the Review Subcommittee the discretion to allow replies and oral arguments.

[8] Miller's comment generally referred to the "appellate processes." To the extent that was directed to the process involving materiality consultations, the proposed rule does not provide for a direct appeal from a Department determination in a materiality consultation.

Subcommittee would essentially conduct a de novo review when considering a respondent's motion to modify or remove conditions or restrictions.[9]

Proposed Changes to the Member Application and Associated Person Registration Rules

- Definitions of "Final Criminal Matter" and "Specified Risk Event"

    - Uniform Registration Forms and Disclosures

Harvin commented that the definitions of "final criminal matter" and "specified risk event" in proposed Rule 1011(h) and (p) are "subject to speculation as to the disclosures and events to which they refer" and should "refer to the actual . . . questions or use the actual . . . language" from the Uniform Application for Securities Industry Registration or Transfer (Form U4). While FINRA understands the need for clarity, we believe the proposed definitions should not list specific questions for several reasons. The definitions include disclosures from multiple Uniform Registration Forms, and FINRA believes listing questions from each relevant form will be more confusing and could lead to ongoing amendments to the definitions as the forms are amended. Defining "final criminal matter" and "specified risk event" with substantive descriptions of the included disclosure events—instead of references to specific disclosure questions and fields on the Uniform Registration Forms—is a plain-English approach that will make the definitions easier for firms and individuals to read, understand, and use.

Nonetheless, FINRA appreciates and shares Harvin's concern about the transparency of the "final criminal matter" and "specified risk event" definitions. FINRA plans to publish tools that map these definitions to the relevant questions and fields on Forms U4, the Uniform Termination Notice for Securities Industry Registration (Form U5), the Uniform Disciplinary Action Reporting Form (Form U6), and the Uniform Application for Broker-Dealer Registration (Form BD), including the Disclosure Reporting Pages ("DRPs") on these forms. Although FINRA believes that Exhibits 3a and 3b provided useful mapping examples, it will consider ways to make the mapping clearer, including specific references to relevant disclosure questions.

Harvin also contended that the proposed definitions of "final criminal matter" and "specified risk event" should include disclosures only on Form U4, and not disclosures on other Uniform Registration Forms. Specifically, Harvin suggested the proposed definitions should not include events disclosed or required to be disclosed on Form U6, because Form U6 is "submitted by the SEC, FINRA, or a state regulatory authority" and "[i]s not available to members in its native format," and that "it is impossible for a member to know if an event should or should not have been or be reported on a Form U6." Harvin further commented

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[9] As FINRA also explained in the initial rule filing, an exception would be for a Hearing Officer's credibility determinations, which are entitled to considerable weight and deference, and can be overturned only where the record contains substantial evidence for doing so.

that the definitions should not include Form BD disclosures, because proposed Rule 1017(a)(7) would apply only to natural persons, and "it is not possible for a natural person to register as a broker/dealer or become a member of FINRA."[10]

FINRA generally disagrees with these comments. The proposed definitions of "final criminal matter" and "specified risk event" describe disclosures that are made on Forms U4, U5, U6, and BD. Form BD has relevant disclosure questions and DRP fields about natural persons who are "control affiliates."[11] The Form U6 DRPs allow regulators and jurisdictions to disclose the same information as would be disclosed on the related DRPs on Forms U4 and U5. Member firms know what can be disclosed on Form U6, because the Form U6 template is publicly available.[12] Member firms can learn what was disclosed on Form U6 because the relevant disclosure information is disclosed on BrokerCheck (to the extent required by the FINRA BrokerCheck Disclosure rule[13]), and they can request individual Central Registration Depository snapshots that include Form U6 disclosures for persons who are current or former associated persons of the member firm and persons whom the firm is considering for registration or association.

Nevertheless, a clarification is warranted with respect to the extent to which the "required to be disclosed" language in the "final criminal matter" and "specified risk event" definitions pertains to Form U6. Form U6 allows regulators and jurisdictions to submit Form U6 DRPs, but they are not required to make Form U6 submissions. For this reason, the "required to be disclosed" language in the proposed definitions of "final criminal matter" and "specified risk event" applies to Form U4, U5 and BD, but it does not apply to Form U6.

Harvin also raised a question concerning whether the "final criminal matter" definition includes Form U4 disclosures of convictions of an organization over which a natural person exercised control. Exhibit 3a mapped the "final criminal matter" definition to questions on Form U4, including, in pertinent part, Questions 14A(2)(a) and 14B(2)(a). Those Form U4 questions ask the applicant to disclose certain criminal matters against an organization, based upon activities that occurred while the applicant exercised control over it. FINRA's intent is that the "final criminal matter" definition includes these kinds of convictions, because exercise of control by an individual of an organization that was subject

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10 Proposed Rule 1017(a)(7) will require the member to seek a materiality consultation when a natural person seeks to become an owner, control person, principal or registered person and has, in the prior five years, one or more final criminal matters or two or more specified risk events.

11 See Form BD Instructions, at 2, available at https://www.sec.gov/files/formbd.pdf (defining "control affiliate" and "person").

12 See Form U6, https://www.finra.org/sites/default/files/AppSupportDoc/p116975.pdf.

13 See Rule 8312.

to a final criminal matter can be indicative of risk. Through the materiality consultation process, FINRA believes the specific nature of the individual's involvement can be evaluated.

- "Required to be disclosed"

In a more general comment about the "was required to be disclosed" language in the proposed definition of "final criminal matter," Harvin questioned how a firm could know if a conviction was required to be disclosed if the firm has no knowledge of the matter. He assumed the "required to be disclosed" language was "intended to address the circumstance where a natural person is not registered but wishes to be an owner or control person of a member," and suggested that the language be replaced with "or would result in a 'Yes' answer [on the pertinent Form U4 disclosure questions] by a person if the person completed Uniform Registration Form U4."

FINRA believes, however, that the "was required to be disclosed" and "were required to be disclosed" language is a material aspect of the proposed definitions of "final criminal matter" and "specified risk event," respectively. This language will ensure that a firm cannot avoid the materiality consultation process (and any CMA that is required upon a determination of materiality) simply because an event that was required to be disclosed on Forms U4, U5 or BD was not disclosed, and, moreover, not create an incentive for firms or individuals to intentionally underreport events. When a firm completes Form U4, it is required to take appropriate steps to verify the accuracy and completeness of the information contained therein.[14] A firm will have to take similar steps to review whether there are any relevant criminal actions, civil judicial actions, regulatory actions, and civil litigation/arbitration matters for the previous five years that should have been disclosed on Forms U4, U5 or BD but were not disclosed.

Contrary to Harvin's assumption, the circumstance where a natural person is not registered but wishes to be an owner or control person is not the only circumstance the "was required to be disclosed" language is intended to address. Persons who seek to become an owner, control person, principal or registered person may have previously worked in registered capacities or been a "control affiliate" at a member firm. The "was required to be disclosed" language will include any disclosure about that person that was required to be disclosed on Forms U4, U5 and BD but was not disclosed. Similarly, the language is intended to include events that were required to be disclosed on Uniform Registration Forms

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[14] See Form U4, Section 15B (Firm/Appropriate Signatory Representations); FINRA Rule 3110(e) (providing that each member shall establish and implement written procedures reasonably designed to verify the accuracy and completeness of the information contained in an applicant's initial or transfer Form U4); see also Form U5, Section 8A (Firm Acknowledgment) (requiring acknowledgement of the accuracy and completeness of the information contained in and with Form U5); Form BD, at 1 (requiring acknowledgment that the information on Form BD is "current, true, and complete").

that the firm has already submitted in connection with the contemplated addition of a person who seeks to become an owner, control person, principal or registered person.

FINRA believes that Harvin's comment, however, has the effect of highlighting how the "*was* required to be disclosed" language in the proposed "final criminal matter" definition differs in substance from the "*are or were* required to be disclosed" language in the proposed "specified risk event" definition. As such, FINRA believes that this difference should be eliminated, and that both definitions should include disclosures that are required if the member firm and person proceed with the contemplated change, including disclosures that are required on Uniform Registration Forms that have not yet been executed. For this reason, as stated in Partial Amendment No. 1, FINRA is modifying proposed Rule 1011(h) so that the definition of "final criminal matter" includes a relevant criminal event that "is or was" required to be disclosed on a Uniform Registration Form.

- Grammar and Syntax

Harvin also proposed revisions to the definition of "final criminal matter" to improve its grammar and syntax.[15] FINRA agrees with these suggestions and, as stated in Partial Amendment No. 1, is modifying the definition of "final criminal matter" to incorporate them.

- Proposed IM-1011-3

In addition, Harvin raised concerns about proposed IM-1011-3, which would provide as follows:

> The safe harbor for business expansions in IM-1011-1 is not available to any member that is seeking to add a natural person who has, in the prior five years, one or more final criminal matters or two or more specified risk events and seeks to become an owner, control person, principal, or registered person of the member; in such circumstances, if the member is not otherwise required to file a Form CMA in accordance with Rule 1017, the member must comply with the requirements of Rule 1017(a)(7).

In turn, IM-1011-1 provides that, for those firms to which the IM-1011-1 safe harbor is available, specific increases of three types—increases in Associated Persons involved in sales, offices (registered or unregistered), and markets made—within a one-year period will

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15 Specifically, Harvin recommended that in proposed Rule 1011(h): (1) the "means a final criminal matter" language be revised to "means a criminal matter"; and that (2) the "or guilty plea or nolo contendre" language be revised to "or plea of guilty or nolo contendre."

be presumed not to be a "material change in business operations" that requires a CMA under Rule 1017.

Harvin questioned the need for, and scope of, proposed IM-1011-3. He commented that the IM-1011-1 safe harbor does not relate 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." He deemed it unlikely that adding one person would be a material change in business operations, at any firm. He further commented that adding a new owner or control person would not be a "change in business operations, material or otherwise," because ownership changes are not addressed in Rule 1017(a)(5) but in other subparagraphs of Rule 1017(a). To address these issues, Harvin proposed revisions that would: (1) narrow IM-1011-3 to address only that aspect of the IM-1011-1 safe harbor that applies to increases in "Associated Persons involved in sales"; and (2) narrow the "not otherwise required to file a Form CMA in accordance with Rule 1017" clause in proposed IM-1011-3 to "not otherwise required to file an application for approval in accordance with Rule 1017(a)(5)."

FINRA disagrees with these comments and suggestions. As proposed, IM-1011-3 is intended to ensure that a member firm cannot rely on any aspect of the IM-1011-1 safe harbor to avoid a materiality consultation—and any CMA that is subsequently required—when a member firm is seeking to add a natural person who has, in the prior five years, one or more final criminal matters or two or more specified risk events and seeks to become an owner, control person, principal or registered person of the member. Adding such persons will sometimes, but not always, amount to a material change in business operations that requires a CMA. In addition, an ownership change *can* be a "material change in business operations." In this regard, the term "material change in business operations" is defined in Rule 1011 with only illustrative examples. It does not exclude ownership changes or preclude FINRA from determining that an ownership change not covered by Rule 1017(a)(1)-(4) may nonetheless involve a "material change in business operations" under Rule 1017(a)(5).

FINRA also disagrees with Harvin's proposed change to narrow the "not otherwise required to file a Form CMA in accordance with Rule 1017" clause in proposed IM-1011-3. This proposed clause conveys that a firm need not seek a materiality consultation under Rule 1017(a)(7) if the firm is already required to file a CMA under any other provision of Rule 1017. Harvin's proposed revision could potentially lead to situations where the firm would be required to seek a materiality consultation under Rule 1017(a)(7) (and possibly file a CMA) despite the fact that a CMA may already be required by another subparagraph of Rule 1017(a). To avoid these kinds of situations, FINRA has retained IM-1011-3 as originally proposed.

- Proposed Rule 1017(a)(7)

  - Introductory Clause

Harvin questioned why proposed Rule 1017(a)(7) begins with "notwithstanding subparagraphs (3), (4), (5) and (6) of Rule 1017(a)," contending that each of those subparagraphs "would appear to cover any such change in which a person proposed to be covered by subparagraph (7) would be a party." Harvin suggests—presumably as a substitute for proposed Rule 1017(a)(7)—that a disclosure be added to Form CMA that requests 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, or a direct owner, indirect owner, or control person disclosed on Form BD, Schedule A (Direct Owners and Executive Officers) and Schedule B (Indirect Owners).

FINRA disagrees with Harvin's suggestion. The "notwithstanding subparagraphs (3), (4), (5) and (6) of Rule 1017(a) and IM-1011-1" language that introduces proposed Rule 1017(a)(7) will ensure that changes that do not or may not require a CMA under those other provisions are not, for that reason, exempt from proposed Rule 1017(a)(7).[16] Likewise, the changes for which Rule 1017(a)(7) will require materiality consultations are not already fully covered by existing provisions of Rule 1017(a). Rather, Rule 1017(a)(7) is intended to expand the scope of Rule 1017(a) by defining a new category of changes—beyond those already covered by Rule 1017(a)(1)-(6)—that could require FINRA approval.

  - "Owner" and "Control Person"

Harvin raised concerns about the meanings of "owner" and "control person" in proposed Rule 1017(a)(7) (and, by extension, proposed IM-1011-3). He noted that the proposal defines neither term for purposes of proposed Rule 1017(a)(7). He also commented that proposed Rule 1017(a)(7) "appears to apply to every proposed acquisition

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[16] For example, there are changes in ownership, control or business operations that could result in adding an owner, control person, principal or registered person but do not require a CMA pursuant to Rule 1017(a)(3), (4), and (6) (e.g., direct or indirect acquisitions or transfers of *less than* 25 percent or more in the aggregate of the member's assets or any asset, business or line of operation that generates revenues composing 25 percent or more in the aggregate of the member's earnings; a change in the equity ownership or partnership capital of the member that results in one person directly or indirectly owning or controlling *less than* 25% of the member's equity or partnership capital; a direct or indirect acquisition or transfer of a member's assets or any asset, business or line of operation where the transferring member or an Associated Person of the transferring member *does not* have a Covered Pending Arbitration Claim, unpaid arbitration award or unpaid settlement related to an arbitration), may not require a CMA pursuant to Rule 1017(a)(5) (i.e., a change that is not a material change in business operations), or are described by the IM-1011-1 safe harbor.

of an ownership interest in a member" no matter how small, questioned whether that is FINRA's intent, and commented that it is unclear whether the "owner" and "control person" terms include "being a non-voting owner, partner, or member." With respect to the term "control person," Harvin further commented that it is unclear what direct and indirect ownership level are required. Harvin proposed this substitute for Rule 1017(a)(7):

> (a)(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. . . .[17]

Some of Harvin's proposed revisions would *narrow* Rule 1017(a)(7), and thereby *decrease* the situations that would require materiality consultations. In this regard, instead of the term "owner," Harvin's proposed definition would essentially include "direct owners" identified on Form BD Schedule A. Some of Harvin's proposed changes would *broaden* Rule 1017(a)(7), and thereby *increase* the situations that would require materiality consultations. Specifically, using "Associated Person," instead of "principal" or "registered person" would broaden Rule 1017(a)(7). This is because Rule 1011(b) defines "Associated Person" to include not just "a natural person registered under FINRA rules," but also "a sole proprietor, or any partner, officer, director, branch manager of the Applicant, or any person occupying a similar status or performing similar functions,[18] "any employee of the Applicant, except any person whose functions are solely clerical or ministerial,"[19] "any person engaged in investment banking or securities business controlled directly or indirectly by the Applicant whether such person is registered or exempt from registration under the FINRA By-Laws or FINRA rules";[20] and "any person who will be or is anticipated to be a person described . . . above," among other persons.[21] Finally, and notwithstanding his comment about whether the "control person" definition would require any ownership levels,

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17 See Harvin, at pp. 8-9.

18 Rule 1011(b)(2).

19 Rule 1011(b)(4).

20 Rule 1011(b)(6).

21 Rule 1011(b)(7).

Harvin's proposed text revisions would not limit the application of Rule 1017(a)(7) to control persons who have specified ownership levels.[22]

In light of these comments, FINRA is modifying proposed Rule 1017(a)(7) to define "owner" and "control person" for purposes of proposed Rule 1017(a)(7) (and, by extension, proposed IM-1011-3). Specifically, FINRA is modifying proposed Rule 1017(a)(7) to provide that, for purposes of Rule 1017(a)(7): (i) the term "owner" has the same meaning as

[22] Harvin's proposed Rule 1017(a)(7) would not use the term "control person," but it would use the term "Associated Person." FINRA Rule 1011(b) defines "Associated Person" to include, in pertinent part, "any person directly or indirectly controlling the Applicant whether or not such person is registered or exempt from registration under the FINRA By-Laws or FINRA rules." *See* Rule 1011(b)(5).

"direct owner" on Form BD Schedule A[23] and "indirect owner" on Form BD Schedule B;[24] and (ii) that "control person" means a person who would have "control" as defined on Form

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[23] Form BD, Schedule A provides that the following persons must be disclosed as a "direct owner":

> (b) in the case of an applicant that is a corporation, each shareholder that directly owns 5% or more of a class of a voting security of the applicant, unless the applicant is a public reporting company (a company subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934);
>
> Direct owners include any person that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 5% or more of a class of a voting security of the applicant. For purposes of this Schedule, a person beneficially owns any securities (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant or right to purchase the security;
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> (c) in the case of an applicant that is a partnership, all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the partnership's capital; and
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> (d) in the case of a trust that directly owns 5% or more of a class of a voting security of the applicant, or that has the right to receive upon dissolution, or has contributed, 5% or more of the applicant's capital, the trust and each trustee.
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> (e) in the case of an applicant that is a Limited Liability Company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

[24] Form BD, Schedule B, provides that the following persons are to be listed as "indirect owners":

> With respect to each owner listed on [Form BD] Schedule A, (except individual owners), list below:
>
> (a) in the case of an owner that is a corporation, each of its shareholders that 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 corporation;

BD.[25] Defining "control person" by reference to Form BD means that the term would not be defined with reference to the term "controlling" as defined in the FINRA By-Laws, Art. I(h).[26] Furthermore, the modification described in Partial Amendment No. 1 does not incorporate Harvin's incorrect implication that being a "control person" requires a level of ownership interest. Although there is a presumption of control based on certain ownership levels, "control" does not require a specific ownership level. Rather, Form BD defines

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> For purposes of this Schedule, a person beneficially owns any securities (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant or right to purchase the security;
>
> (b) in the case of an owner that is a partnership, all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 25% or more of the partnership's capital; and
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> (c) in the case of an owner that is a trust, the trust and each trustee.
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> (d) in the case of an owner that is a Limited Liability Company ("LCC"), (i) those members that have the right to receive upon dissolution, or have contributed, 25% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

Schedule B further requires the applicant to "[c]ontinue up the chain of ownership listing all 25% owners at each level. Once a public reporting company (a company subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934) is reached, no ownership information further up the chain of ownership need be given."

[25] Form BD defines "control" as follows:

> 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 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."

[26] The Form BD definition of "control" is similar to the FINRA By-Laws definition of "controlling," albeit with somewhat different presumptions.

"control" as "the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise."

Finally, to the extent Harvin suggested that Rule 1017(a)(7) be broadened, FINRA appreciates that suggestion but has maintained Rule 1017(a)(7) as proposed. Proposed Rule 1017(a)(7) focuses on persons who seek to become an owner, control person, principal or registered person because FINRA believes that persons serving in these roles (and who have one or more final criminal matters or two or more specified risk events in the prior five years) may pose greater risks to customers than other associated persons. Moreover, in developing the threshold criteria, FINRA gave significant attention to the impact of possible misidentification of individuals; specifically, the economic trade-off between including individuals who are less likely to subsequently pose risk of harm to customers, and not including individuals who are more likely to subsequently pose risk of harm to customers. There are costs associated with both types of misidentifications. For example, subjecting individuals who are less likely to pose a risk to customers to mandatory materiality consultations, and potentially CMAs, would impose additional costs on these individuals, their affiliated firms and customers. As FINRA gains experience with Rule 1017(a)(7), it can continue to evaluate whether there are ways to further strengthen the rule without increasing the costs associated with misidentification. FINRA will also monitor potential changes in broker and firm behavior as a result of the proposed rule, and continue to assess the effectiveness of the proposed threshold in identifying individuals who are more likely to subsequently pose risk of harm to customers. FINRA expects, however, that broadening Rule 1017(a)(7) to include any "Associated Person" as Harvin suggested—which broadly includes "any employee of the Applicant"—could result in the kinds of misidentifications that FINRA seeks to avoid.

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FINRA believes that the foregoing responds to the material issues raised by the commenters to the rule filing. If you have any questions, please contact me at (202) 728-8835, email: michael.garawski@finra.org.

Best regards,

/s/ Michael Garawski

Michael Garawski
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FINRA Office of General Counsel