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June 29, 2018

Via e-mail: pubcom@finra.org
Jennifer Piroko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 18-16
Comment Letter of Janney Montgomery Scott LLC on FINRA Rule Amendments Relating to High Risk Brokers and the Firms That Employ Them

Dear Ms. Mitchell:

Thank you for this opportunity to comment on the proposed rule amendments ("Proposal") to Financial Industry Regulatory Authority ("FINRA") rules 9200, 9250, 8312 and, in particular, legacy NASD rule 1010. Janney traces its roots in Philadelphia to 1832 and is one of the oldest full service financial services firms in the country with 116 offices and 779 Financial Advisors. As Janney has been actively shaping its roster of Financial Advisors over the course of the last decade, the firm is well positioned to offer feedback regarding the Proposal.

Janney shares the goal of protecting investors and understands that imposing additional restrictions on both Financial Advisors with a material history of misconduct and the firms that employ them is a reasonable approach. Consequently, the firm is generally supportive of three of the proposed amendments. However, Janney has significant reservations related to the proposed amendments to NASD Rule Series 1010, which as drafted would require submission of a Membership Application for registered persons who are the subject of "specified risk events," as detailed below.

I. Comments on Amended IM-1011

Amended Rule 1011 would require that an existing member firm submit a Materiality Consultation ("MAP") to FINRA in the event a natural person seeks to become an owner, control person, principal or registered person of the member firm who, in the prior five years, has one or more final criminal matter disclosure or two or more "specified risk" events. The Proposal as drafted further requires that the hire not be completed until FINRA responds with guidance as to whether a full Continuing Membership Application ("CMA") is required.

a) The Proposal Exceeds the Stated Purpose of MAP Consultation

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As noted in the June 24, 2018 comment letter submitted by the Securities Industry and Financial Markets Association ("SIFMA"), the Proposal appears contrary to the purpose of the MAP process. While acting as gatekeeper to the community of Broker Dealers is clearly within the MAP group's mission, the process, as pertains to existing firms, is designed to review material changes in business operations, not the "employability" of individuals. FINRA has previously articulated the appropriate tests to determine "material changes":

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

This guidance appears centered on business operations rather than review of transitions, for which a separate and distinct process already exists. FINRA should employ the existing tools associated with registration and examination to achieve the stated purpose.

b) Covered Persons are Interpreted Unnecessarily Broadly

To the extent that an individual's employment may be deemed a "material change in business operations," that status should be reserved for owners and control persons rather than *all registered persons and principals*. It is unlikely that the hire of a registered person in a non-control role would be considered a material event at a firm of significant scale. In contrast, for Broker Dealers employing hundreds of registered persons, it is predictable that the creation and evaluation of request letters will consume significant resources more effectively engaged elsewhere at both the employer and FINRA.

FINRA should eliminate registered persons generally from the definition of Covered Persons. In the alternative, FINRA should restore the materiality safe harbor from the existing MAP process to recognize that firms of sufficient scale will have the supervisory resources in place to monitor its registered persons.

c) The Specified Risk Event Definition Thresholds are too Low

As drafted, the Proposal treats any arbitration award or settlement in excess of $15,000 as a specified event. This threshold is far too low. As a threshold issue, it is crucial to appreciate that the CRD system mandates reporting of a mere sales practice *allegation*, without any regard for underlying *merit.*

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Regardless of the size or merit of a single arbitration claim, defense costs are significant. Prior to hearing, filing fees are assed against member firms in addition to conferences, drafting an answer, discovery, witness preparation and hiring of experts. These unavoidable elements typically consume between *$50,000 and $100,000*. If a matter reaches hearing, it is typical for the combined costs of representation, FIRNA session fees, travel and experts to consume an additional $10,000 *per day.*

Thus any arbitration claim, regardless of merit, will cost between $100,000 and $150,000 *to win* even if the Award to Claimant is zero. Firms often respond to this arithmetic by rapidly resolving claims where possible because a $15,000 settlement represents a bottom line savings of at least $85,000.

Claimant's counsel know this calculus and the resulting business pressures and are therefore unlikely to settle any case for less than $15,000. This means two things. First, the Proposal will encompass thousands of meritless "cost of business" settlements each year and second, ironically, Broker Dealers will be incented *not to resolve client issues* with lower settlements and instead fight them to conclusion, where a zero Award is often the result.

FINRA should raise the threshold for a risk event to at least the de facto minimum cost of successful litigation, currently approximately $100,000.

d) The Logistical and Timing Issues are Unworkable

The recruitment of Financial Advisors is a competitive marketplace already rife with litigation. As background, note recent withdrawals from the broker hire "protocol" and the sheer volume of promissory note, defamation and retaliation claims already filling the arbitration docket. It is foreseeable that the introduction of additional hurdles and delays in the hiring process with engender new litigation risks.

By design, the Proposal requires potential hiring firms to submit consultations prior to a registered person leaving their existing firms. Indeed, the request pragmatically must be made prior to departure in order to avoid making an employment offer the new Broker Dealer may not be permitted to honor by FINRA. It is predictable that existing employers will learn of the requests. When this inevitably occurs, terminations and claims for breach of protocol, duty of loyalty, which will likely involve FINRA, are sure to follow.

The Proposal states that a member firm "may not effect the contemplated activity until the member has first submitted a written letter to the Department.." In essence, the firm must file and await a response prior to completing a hire. However, while FINRA observes that "on average" consultations are completed "within 8-10 days," it is acknowledged that some could be "longer" and no service level agreement is proposed by FINRA. Further, this already uncertain

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timeframe is based on the flow of requests under the existing rule. It is reasonable to anticipate the timeframe would lengthen if the number of requests grows under the Proposal. Each day of delay under this proposed process introduces another layer of litigation risk to both firms, the registered person and FINRA itself.

If the Proposal goes forward, FINRA should establish a clear response deadline to permit firms to responsibly conduct their hiring practices to minimize litigation risks.

e) FIRNA Already Has Access to the Information at Issue

FINRA appears to already be in possession of all of the information that would be collected under the Proposal. Note that every occurrence covered under the definition of "specified event" is already required to be reported under the existing form U4 and form U5. This is demonstrated by the very document presented in FINRA's impact analysis. Intuitively, the analysis could not have been prepared without the data already in hand. Similarly, member firms are required to register all new hires and registered representatives must update their form U4s when they change firms. Further, all firms are subject to continuous examination and nearly all "specified events" result in issuance of an 8210 inquiry by FINRA today.

In the instance where FINRA might hypothetically conclude that a Registered Representative presents a risk sufficient to justify preventing transition pursuant to a MAP review, but was already in possession of this information, it must be questioned why moving from one firm to another constitutes the triggering event for FINRA to take action. The investing public and markets appear better protected by taking contemporaneous action rather than disrupting the hiring practices of an unrelated firm as many as five years later.

g) It is Unclear How FINRA Intends to Use the Information Requested

If FINRA is already in possession of the information requested, it necessary to understand how the Proposal may differ from the existing reporting and examination requirements. It appears the issue is timing and that FINRA would like to review transitions specifically in the context of an affiliation change and that is it FINRA's intention to create the ability to prevent transition of a Registered Representative without taking enforcement action otherwise.

If so, this suggests FINRA might conclude an existing employer has the supervisory resources to oversight the individual in question. However, this is counter intuitive given the existing employer is likely where the specified events occurred in the first instance. Conversely, it also suggests FINRA might conclude the hiring firm lacks the supervisory resources required to oversight the new employee. This is troubling as it suggests FINRA might have evidence that the new employer is unable to supervise staff, but without taking enforcement action otherwise.

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As suggested above, it appears FINRAs has both the tools and information necessary to prevent both contemplated scenarios.

In short, While Janney shares FINRA's investor protection mandate it is Janney's recommendation that the Proposal as relates superficially to changes in NASD rule series 1011 not be implemented. As contemplated, it appears to unnecessarily impact hiring practices by creating new process outside the designed scope of MAP that request information FINRA is already in possession of. If the Proposal does go forward, the thresholds for both Covered Individuals and specified events should be more narrowly tailored to minimize the disruptive impact.

Best Regards,

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