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Via email (pubcom@finra.org)

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

Re: Request for Comments – Retrospective Review of FINRA Rule 4530 (Reporting Requirements)

Dear Ms. Piorko Mitchell,

We submit this letter on behalf of Shearman & Sterling LLP in response to FINRA Regulatory Notice 20-02 requesting comment in connection with a retrospective review of FINRA Rule 4530 (Reporting Requirements) ("Rule 4530").[1] Shearman & Sterling LLP is an international law firm that, for over a century, has had an opportunity to serve members of FINRA and its predecessors. We appreciate the opportunity to provide comments to FINRA with respect to this review.

We are regularly called upon by member firms, and by financial institutions around the world, to discuss self-reporting obligations in the context of matters that arise in their day-to-day business. As an initial matter, we generally support self-reporting, and in the US-registered broker-dealer context, the self-reporting obligations found at Rule 4530. Our overarching view is that the self-reporting principles espoused by FINRA, NASD, and NYSE Regulations, and by member firms, have served the industry well for decades; have fostered cooperation between member firms and FINRA; and have produced good results for investors.

However, in respect of modernization of Rule 4530, we propose certain updates and amendments—as set forth in further detail below—that would: (a) promote self-reporting among member firms, (b) improve the efficacy and efficiency of the rule, (c) encourage greater transparency between FINRA and its members, and (d) lead to the faster resolution of internal issues identified by members.

[1] FINRA Regulatory Notice 20-02 (Jan. 9, 2020).

We note that the self-reporting obligations set forth in Rule 4530 consist of two distinct forms of reporting: (i) firms are required to report the existence of certain enumerated events about which they "know or should have known" pursuant to Rule 4530(a); and (ii) firms are required to report certain self-identified issues that meet the standards laid out in Rule 4530(b) and Supplementary Material .01 thereto. Below, we comment on each of these self-reporting obligations in turn.

I. REDUCING REDUNDANCIES WITH RESPECT TO RULE 4530(a)

As noted above, Rule 4530(a) requires member firms to "promptly" report to FINRA after a firm "knows or should have known" of the existence of an enumerated series of events. For instance, Rule 4530(a) mandates self-reporting when a member firm or associated person, *inter alia*, (i) "ha[s] violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct" of regulatory bodies or other relevant authorities; (ii) is denied registration or expelled by various regulatory bodies; or (iii) is indicted or convicted of a felony.

In addition to these Rule 4530(a) self-reporting requirements, firms must simultaneously comply with a dizzying array of other reporting requirements under Forms BD, U4, and U5, as well as the reporting requirements of other regulators, while also assessing consequences under various contractual arrangements—for example, default or other contractual provisions—associated with a Rule 4530(a) event. The details of each regulatory reporting requirement and other contractual consequences take time and resources to address. Furthermore, firms that are subsidiaries of international financial institutions may also have separate home-country reporting requirements and collateral issues that arise and are centered on that jurisdiction. This web of consequences and overlapping reporting requirements creates duplication in reporting requirements with firms being required to report matters already subject to FINRA or public reporting.

Accordingly, we recommend that the enumerated events triggering a self-reporting obligation set forth in Rule 4530(a) be pared back—or alternatively the exceptions listed in the second part of Rule 4530(e)(3) be expanded—for items which are: (a) otherwise reported or subject to disclosure through public order of any governmental or self-regulatory body; or (b) otherwise disclosed to FINRA through an alternate reporting requirement, such as Form U4 or Form BD.

Our recommendation seeks only to avoid unnecessary redundancies in terms of reporting obligations. It would not diminish investor protection because the public would otherwise obtain relevant information related to an event enumerated in Rule 4530(a) through alternate means, such as Forms BD, U4, or U5 (which are publicly available on BrokerCheck) or other public notice. In every case, FINRA would be notified.

II. THE THRESHOLD DOLLAR AMOUNT IN RULE 4530(A)(2) SHOULD BE RAISED

Rule 4530(a)(2) requires a member firm to submit a report to FINRA for situations in which "an associated person . . . is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of $2,500 [or] the imposition of fines in excess of $2,500."

FINRA has failed to update this $2,500 amount since at least 1994. As such, the figure should be significantly higher as it currently casts too wide a net in terms of member firm self-reporting. FINRA should critically assess an appropriate amount adjusted for inflation. It should further consider whether too low a monetary threshold might also discourage firms from disciplining associated persons for minor, but still meaningful, infractions for fear of triggering a self-reporting requirement under Rule 4530(a)(2). We recommend that the dollar threshold under this provision be not less than $20,000.

III. UPDATES TO RULE 4530(B) AND SUPPLEMENTARY MATERIAL .01

Unlike Rule 4530(a), which contains a series of enumerated events triggering self-reporting, Rule 4530(b) consists of an inherently vague standard for self-reporting. Specifically, Rule 4530(b) mandates the reporting of events that member firms "[have] concluded ***or should have concluded***" (emphasis added) resulted in the violation of "any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct" of regulatory bodies or other relevant authorities. The section also mandates "prompt" reporting. Further, Supplementary Material .01 requires firms to report "only conduct that has widespread or potential widespread impact to the member, its customers or the markets, or conduct that arises from a material failure of the member's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts."

We believe that the inherent vagueness, and complexity, of this standard causes significant confusion among member firms that can only be satisfied with certainty through reporting. As a result, many events are reported notwithstanding incomplete analysis or absence of customer harm.

Given this complex phenomenon of early reporting and over-reporting, we believe that the self-reporting standard under Rule 4530(b)—"concluded or reasonably should have concluded," combined with the standards set in the Supplementary Material—is overly broad and serves only to complicate the principles of self-reporting. Furthermore, the multiple, disjunctive clauses of Rule 4530(b) and the Supplementary Material can easily lead reasonable individuals to adopt different views as to what must be reported to FINRA. This lack of clarity seems counterproductive for both the industry and FINRA itself.

Against this backdrop, we therefore recommend that FINRA update Rule 4530(b) to only capture self-reporting of violations that are (a) known or reasonably should have been known to member firms, and that (b) cause actual harm to the firm's customers or to the markets. In our view, in the absence of such harm, the proper way that FINRA should engage with member firms with respect to prospective rule violations is through ordinary-course examinations, and/or enforcement actions. For the reasons noted above, firms should not be incentivized to self-report other violations.

In addition, certain regulators do not permit member firms to share confidential information related to their supervisory activities with other regulatory entities, including FINRA, while a matter is pending.[2] Accordingly, Rule 4530(b) should further contain a safe harbor from the self-reporting obligation for events that are pending and confidential based on the rules, regulations, or practices of other regulatory authorities.

Finally, we recommend that FINRA generally provide insulation from suspension or other disciplinary actions, either against a firm or against a firm-associated person, for failure to detect violations where the member firm self-identifies and reports the issue in question.

IV. RULE 4530(D) AND SUPPLEMENTARY MATERIAL .08 SHOULD BE MOVED OUT OF RULE 4530

Rule 4530(d), requiring firms to report "statistical or summary information regarding written customer complaints" to FINRA, appears incongruous with the general purpose of Rule 4530. While Rule 4530(d) addresses customer complaints, which can range from inconsequential to serious, the remaining provisions of Rule 4530 aim to ensure that member firms report significant actual or potential violations of relevant laws, regulations, or rules by the firm itself and its associated persons.

FINRA should thus fashion Rule 4530(d) as a separate rule or alternatively transfer it to a different—and more suitable—existing rule, such as Rule 4513 (Records of Written Customer Complaints). Such redrafting would help to streamline the contents of Rule 4530 and better coordinate regulation of complaint handling.

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We thank FINRA for their efforts and the opportunity to provide comments. If you have any questions regarding the views expressed herein or require additional information, please do not hesitate to contact the undersigned at (212) 848-7585.

Best Regards,

Russell D. Sacks
Partner
Shearman & Sterling LLP

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[2] Consider, *e.g.*, the restrictions of the Federal Reserve Board or the New York Department of Financial Service on the disclosure of confidential supervisory information under 12 C.F.R § 261.20 and New York Banking Law § 36.10 respectively.