

# **Bond Case Briefs**

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## **Frequently Asked Questions on FINRA's Eligibility Proceedings for Firms Participating in the MCDC Initiative.**

To guide firms participating in the SEC's Municipalities Continuing Disclosure Cooperation Initiative (MCDC Initiative), FINRA is issuing the following questions and answers regarding the statutory disqualification process. The questions and answers address topics that firms participating in the MCDC Initiative have recently raised with FINRA. As a result, information contained in this guidance applies only to firms that become statutorily disqualified based on an SEC order issued under the MCDC Initiative. For general information relating to FINRA's statutory disqualification process, please review FINRA's [Statutory Disqualification page](#). More information regarding the SEC's MCDC Initiative is available on the SEC's website.

### **1. What causes a broker-dealer that participates in the MCDC Initiative to be subject to a statutory disqualification?**

Based on discussions with SEC staff as well as publicly available information, FINRA understands that a broker-dealer participating in the SEC's MCDC Initiative (a "Participating Firm") may be subject to findings by the SEC that it willfully violated the federal securities laws. A willful violation of the federal securities laws results in a statutory disqualification, as described in Section 15(b)(4)(D) of the Securities Exchange Act of 1934 ("Exchange Act"), incorporated by reference in 3(a)(39)(F) of the Exchange Act.

### **2. At what point in the process does a Participating Firm become statutorily disqualified?**

A Participating Firm will become statutorily disqualified only if the Participating Firm is subject to a Commission order under the MCDC Initiative. A Participating Firm does not become statutorily disqualified merely upon submitting an offer of settlement to the SEC.

### **3. What happens when a Participating Firm becomes subject to a Commission order and, therefore, is subject to a statutory disqualification?**

Article III, Section 3(a) of FINRA's By-Laws states that no firm can continue in membership with FINRA if it is subject to a statutory disqualification. Article III, Section 3(d) of the By-Laws, however, allows a disqualified firm to file an application to seek FINRA's approval to continue its membership notwithstanding a statutory disqualification.

Accordingly, after the SEC accepts an offer of settlement and issues an order, FINRA's Registration & Disclosure Department ("RAD") will send a letter, known as the SD Notification Letter, to the Participating Firm. The letter will notify the Participating Firm that it is subject to a statutory disqualification and that it must file a Membership Continuance Application (Form MC-400A) within ten business days after receipt of the SD Notification Letter if it wishes to continue in FINRA membership. The filing of a Form MC-400A application begins a process known as FINRA's Eligibility Proceedings. The SD Notification Letter will provide specific instructions regarding how to initiate an Eligibility Proceeding.

In order for a Participating Firm to continue in membership, it must submit a timely Form MC-400A application to FINRA to initiate the Eligibility Proceeding. As part of the Eligibility Proceeding, a Participating Firm will be required to provide FINRA with specified information, and importantly, a Participating Firm should expect that FINRA will require it to consent to a plan of heightened supervision.

#### **4. What information and/or documents are required to initiate an Eligibility Proceeding?**

In general, a Participating Firm will be required to answer designated questions on the Form MC-400A application and to provide a copy of the SEC's order as well as a statement explaining why it should be permitted to continue in membership notwithstanding a statutory disqualification. In addition, the Participating Firm should expect that it will be required to submit a plan of heightened supervision with its application. The Participating Firm will need to immediately implement the plan of heightened supervision should its application be approved.

#### **5. What conditions should Participating Firms expect FINRA to require in a plan of heightened supervision?**

A definitive answer to this question will depend on any conditions that are contained within the SEC's order involving the Participating Firm. FINRA anticipates, however, that at a minimum the conditions of the plan will align with any undertakings that the SEC imposes on the Participating Firm. FINRA also anticipates that the plan will include an obligation on the part of the Participating Firm to notify FINRA, in addition to the SEC, when the firm has completed its obligations pursuant to the SEC order and to forward confirming documents to FINRA.

#### **6. What parts of the Form MC-400A application must a Participating Firm complete?**

Participating Firms will receive instructions in the SD Notification Letter on how to complete the Form MC-400A application. That letter will detail the questions that must be completed on the application and those that can be omitted. FINRA has the right to request the omitted information or other information as needed during its review process.

#### **7. Where can I obtain a copy of the Form MC-400A application?**

FINRA encourages Participating Firms to review the application in advance. An electronic copy is available on FINRA's website at the following link: [Form MC-400-A](#). The application cannot be submitted until the Participating Firm receives the SD Notification Letter from FINRA that will provide specific instructions for the completion of the application.

#### **8. What is the cost of the Eligibility Proceeding?**

There is no fee associated with the Form MC-400A application or the Eligibility Proceeding for a Participating Firm.

#### **9. What happens once a Participating Firm submits the Form MC-400A application?**

FINRA is required by rule to evaluate a Participating Firm's application and determine whether such firm should be approved to continue in FINRA membership notwithstanding a statutory disqualification. If FINRA determines that approval of the application is warranted, FINRA is required by Exchange Act Rule 19h-1 to provide the SEC with notice of the approval of the firm's application for continued membership. Should FINRA deny the application, FINRA is required by Exchange Act Rule 19d-1 to file a notice with the SEC of such denial.

**10. Will FINRA preclude a Participating Firm from conducting a securities business during the pendency of the Eligibility Proceeding?**

No. A Participating Firm will be permitted to continue business operations as normal during the pendency of the Eligibility Proceeding. However, it is critical that any statutorily disqualified firm timely file a Form MC-400A application with FINRA. Failure to timely file an application could result in cancellation of a firm's membership with FINRA.

**11. Can a Participating Firm's Form MC-400A application be denied by FINRA?**

Approval of a Participating Firm's Form MC-400A application is not automatic. FINRA's Eligibility Proceedings are designed to ensure that the continued membership of a statutorily disqualified member is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors.

**12. What happens after FINRA files a notice with the SEC approving the Participating Firm's continued membership?**

The SEC will conduct a review of the notice and issue a written communication to FINRA regarding the continued membership of the Participating Firm. Upon receipt of the SEC's communication, FINRA will forward a copy to the Participating Firm.

FINRA cannot speak to the time it will take the SEC to conduct its review or to the SEC's processes for considering FINRA's notice filing; however, a Participating Firm's business operations may continue without interruption during this time.

**13. What happens after the SEC issues its written communication to FINRA?**

The Participating Firm must implement any plan of heightened supervision as agreed upon during the Eligibility Proceeding and will be required to comply with the provisions of the plan for the time period it is in place.

**14. Does a Participating Firm have to disclose that it participated in the SEC's MCDC Initiative in response to any of the disclosure questions on the Form BD?**

Yes. A Participating Firm must disclose on Form BD the settlement with, and findings made by, the SEC in connection with the MCDC Initiative (see Question 11C of the Form BD).

**15. Does a Participating Firm have to disclose that it is undergoing FINRA's Eligibility Proceeding in response to any of the disclosure questions on the Form BD?**

No. A Participating Firm is not required to disclose on the Form BD that it is subject to FINRA's Eligibility Proceedings.

**16. Is the reporting requirement provided for in FINRA Rule 4530(a)(1)(H) triggered as a result of a Participating Firm's settlement with the SEC?**

A Participating Firm will need to report to FINRA that it is subject to statutory disqualification pursuant to FINRA Rule 4530(a)(1)(H). In addition, the rule requires, among other things, that a member report to FINRA whenever it is involved in the sale of any financial instrument, the provision of any investment advice or the financing of any such activities ("financial dealings") with any person that it knows or should have known is statutorily disqualified.

However, a recent amendment to FINRA Rule 4530(a)(1)(H) provides that a firm will not need to report financial dealings with another firm that is subject to statutory disqualification, if the statutorily disqualified firm has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to be a member. Subject to some exceptions, FINRA's current practice permits a FINRA member firm that becomes statutorily disqualified to continue in membership without interruption to its business activities, provided that a timely Form MC-400A application is filed in accordance with FINRA Rule 9522(a)(2). Based on this practice, for the purpose of any statutory disqualification that arises from the MCDC Initiative, FINRA will not require a firm, including a Participating Firm, to report to it that it engaged in any financial dealings with a Participating Firm during the period that the application is pending, provided that the Participating Firm that is the subject of reporting has filed a timely application with FINRA pursuant to Rule 9522(a)(2). This deferment period is only available if the reporting firm knows or should have known that the Participating Firm that is the subject of reporting has filed a timely application pursuant to Rule 9522(a)(2). If FINRA approves the Participating Firm's application, the reporting firm has no reporting obligation under FINRA Rule 4530(a)(1)(H). If FINRA denies the application, the reporting firm has an obligation to retroactively report financial dealings that occurred with the Participating Firm during the deferment period as well as any future financial dealings with such Participating Firm.

FINRA intends to work with Participating Firms to obtain their consent to publish the fact that they have filed an MC-400A Application as a result of the MCDC Initiative. FINRA will publish to its website a list of Participating Firms that have given FINRA their consent to this publication.

#### **17. Does the scope of the MCDC Initiative include registered representatives?**

According to the SEC's website, the "...MCDC Initiative covers only eligible issuers and underwriters."

#### **18. Will FINRA contact other self-regulatory organizations ("SROs") of which a Participating Firm is a member regarding the Form MC-400A application?**

In the notice that FINRA is required to file with the SEC pursuant to Exchange Act Rule 19h-1, it must identify any other SRO of which the Participating Firm is a member and whether such SRO is in agreement with the terms and conditions of the proposed continuance. FINRA will, therefore, contact any applicable SRO so that it can identify in its filing with the SEC, whether such SRO agrees that the Participating Firm should be permitted to continue in membership.

#### **19. If I have questions regarding the Eligibility Proceedings or a Participating Firm's Form MC-400A application, whom should I contact?**

All questions regarding FINRA's Statutory Disqualification Program may be directed to Lorraine Lee-Stepney, Manager, at (202) 728-8442 or by email at [Lorraine.Lee@finra.org](mailto:Lorraine.Lee@finra.org).

For questions relating to FINRA Rule 4530 reporting, please contact Dave Troutner at (240) 386-6404 or [dave.troutner@finra.org](mailto:dave.troutner@finra.org).