



July 13, 2015

**By Electronic Mail to [pubcom@finra.org](mailto:pubcom@finra.org)**

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20549-1090

**Re: FINRA Regulatory Notice 15-19: Proposed Rule to Require Delivery of an Educational Communication to Customers of a Transferring Representative**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association<sup>1</sup> (“SIFMA”) appreciates the opportunity to respond to FINRA’s request for comment on Regulatory Notice 15-19 (“RN 15-19” or the “Proposal”), a proposed rule to require delivery of a FINRA-created educational communication (the “Educational Communication”) to customers of a transferring representative.<sup>2</sup>

SIFMA has a long standing public record of supporting plain English disclosure to investors of material terms and potential material conflicts of interest at pivotal points in the investment process.<sup>3</sup> Without qualifying the foregoing, SIFMA submits the comments below to address various operational challenges that may serve to limit the usefulness and ability to reasonably comply with the Proposal. SIFMA also suggests several other

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<sup>1</sup> SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> See generally RN 15-19, available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory\\_Noteice\\_15-19.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Noteice_15-19.pdf) (last visited July 6, 2015).

<sup>3</sup> See, e.g., SIFMA Comment Letter on Regulatory Notice 13-02, available at <http://www.finra.org/sites/default/files/NoticeComment/p220092.pdf> (last visited July 7, 2015); SIFMA Comment Letter on FINRA Regulatory Notice 10-54, available at: <http://www.sifma.org/issues/item.aspx?id=22482> (last visited July 7, 2015); and SIFMA Comment Letters on SEC Rulemaking under Dodd-Frank Section 913, available at <http://www.sifma.org/issues/item.aspx?id=8589934675> (last visited July 7, 2015).

changes to the Proposal to improve its effectiveness without compromising its underlying goals.

## I. BACKGROUND

SIFMA appreciates FINRA's efforts to obtain input from its member firms regarding the revised proposal in RN 15-19.<sup>4</sup> FINRA's Proposed Rule 2243, initially filed with the Securities and Exchange Commission ("SEC") in March 2014, included two core elements:

- A disclosure obligation to former retail customers who a recruiting firm attempts to induce to follow a transferring registered representative; and
- A reporting obligation to FINRA where a transferring representative receives a significant increase in compensation.

The disclosure obligation would have required a recruiting firm to disclose to former customers ranges of recruitment compensation that the transferring representative has received or will receive in connection with changing firms. The initial proposal included various additional components, including disclosures related to costs incurred to transfer assets and portability of assets.<sup>5</sup>

Commenters raised various issues with Proposed Rule 2243, including concerns about the proposal's competitive implications, operational aspects, and the effectiveness of the proposed recruitment compensation disclosures.<sup>6</sup> In June 2014, FINRA withdrew the

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<sup>4</sup> FINRA previously solicited comment on the proposal in *Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2243*, Securities Exchange Act Rel. No. 71786 (Mar. 24, 2014), 79 FR 17592 (Mar. 28, 2014) (SR-FINRA-2014-010, "Proposed Rule 2243") and FINRA Regulatory Notice 13-02 ("RN 13-02"), available at <http://www.finra.org/Industry/Regulation/Notices/2013/P197600> (last visited July 6, 2015). SIFMA filed a comment letter in response to Proposed FINRA Rule 2243, available at <https://www.sec.gov/comments/sr-finra-2014-010/finra2014010-13.pdf> and a comment letter in response to Regulatory Notice 13-02, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p220092.pdf> (last visited July 6, 2015).

<sup>5</sup> See generally *id.*

<sup>6</sup> See, e.g., Committee of Annuity Insurers, available at <http://www.annuity-insurers.org/wp-content/uploads/2014/05/Comment-Letter2.pdf> (last visited July 8, 2015); Financial Services Institute, available at <http://www.sifma.org/issues/item.aspx?id=8589948662> (last visited July 8, 2015); Financial Services Roundtable, available at <https://www.sec.gov/comments/sr-finra-2014-010/finra2014010-15.pdf> (last visited July 8, 2015); and SIFMA, available at <http://www.sifma.org/issues/item.aspx?id=8589948662> (last visited July 8, 2015). SEC list of comment letters can be found at <https://www.sec.gov/comments/sr-finra-2014-010/finra2014010.shtml> (last visited July 8, 2015). Comments filed on RN 13-02 available at <http://www.finra.org/industry/notices/13-02> (last visited July 8, 2015).

initial proposal.<sup>7</sup>

## II. OVERVIEW OF THE PROPOSAL

The Proposal generally would require delivery of an Educational Communication to certain retail customers by a member firm that associates with a registered representative (“recruiting firm”) who has former customers transfer assets to the recruiting firm. The Educational Communication focuses on certain considerations for a customer who is contemplating transferring assets to the recruiting firm by highlighting the potential implications of transferring assets to the recruiting firm and suggesting questions the customer may want to ask to make an informed decision.

FINRA proposes a complex, multi-tiered structure for delivery of the Educational Communication that is dependent on the mode of initial contact with a customer regarding the transfer of assets to the recruiting firm:

1. If the contact is in writing, then the Educational Communication must accompany the written communication;
2. If the contact is by electronic communication, then the recruiting firm may hyperlink directly to the Educational Communication;
3. If the contact is by oral communication, then the Educational Communication must be sent within three business days or with any other documentation sent by the recruiting firm in connection with a potential transfer of assets, whichever is earlier;
4. If the customer seeks to transfer assets to the recruiting firm on an unsolicited basis (*e.g.*, after learning from a general announcement or other sources his or her registered representative has changed firms), then the Educational Communication must be included with the account transfer approval documentation; and
5. If the customer expressly states that she is not interested in transferring assets to the recruiting firm but, without further individualized contact, subsequently decides to transfer assets to the recruiting firm within the subject time period of the Proposal, then the Educational Communication must accompany the account transfer approval documentation.

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<sup>7</sup> See *Notice of Withdrawal of Proposed Rule Change to Adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices)*, Securities Exchange Act Rel. No. 72459 (June 24, 2014), 79 FR 36855 (June 30, 2014), available at <http://www.finra.org/industry/rule-filings/sr-finra-2014-010> (last visited July 7, 2015).

The requirement to provide the Educational Communication would continue to apply for six months after the registered representative begins employment with the recruiting firm.

### III. EXECUTIVE SUMMARY

In this section of the comment letter, SIFMA summarizes some of its general comments on the Proposal. A detailed discussion of each of these issues is included in the various sections of this comment letter.

- **SIFMA Supports Disclosure of Material Terms:** Consistent with SIFMA's longstanding support of disclosure and investor education, SIFMA supports FINRA's efforts to create simple, plain-English disclosures that permit investors to make informed choices.
  
- **The Proposal Raises Various Operational Issues:** FINRA should address various operational challenges to better align the Proposal's direct and indirect costs with its stated goals. Specifically, FINRA should:
  - Include a uniform delivery obligation in the Proposal and should tie the delivery of the Educational Communication to existing processes;
  - Remove the "attempt to induce"/"inducement" concept from the Proposal; and
  - Apply the delivery obligation for 90 days to maximize effectiveness.
  
- **The Proposal Should Include Exceptions for De Minimis Recruitment Compensation and Non-Recruiting Contexts:** The Proposal's Supplementary Material should include exceptions to properly narrow the scope of the delivery obligation to contexts in which recruitment compensation serves as a significant motivating factor for a registered person to change firms.
  
- **FINRA Should Permit Firms to Alter the Focus of the Educational Communication in Appropriate Contexts:** Financial incentives for representatives changing firms appear to be the primary focus of the Educational Communication. In contexts where such financial incentives are not present the Educational Communication may confuse or mislead former customers. Under these circumstances, firms should be permitted to alter the discussion topics contained in Educational Communication to exclude topics that are not relevant to a particular case.

- **FINRA Should Replace the Use of “Broker” in the Educational Communication with a Term More Commonly Used in the Industry:** SIFMA requests that “broker” be replaced with “registered representative”, “registered person”, or “financial advisor”, as these terms are more commonly used within in the industry, particularly in communications with customers.

#### **IV. SIFMA SUPPORTS DISCLOSURE OF MATERIAL TERMS**

SIFMA supports disclosures that remind customers to think about and ask important questions when contemplating the transfer of assets to a new member firm in connection with a registered representative moving to the new firm. Consistent with SIFMA’s longstanding support of disclosure and investor education, SIFMA supports FINRA’s efforts to create simple, plain-English disclosures that permit investors to make informed choices. Better informed investors benefit everyone by fostering strong and vibrant securities markets.

#### **V. FINRA SHOULD ADDRESS VARIOUS OPERATIONAL CHALLENGES RAISED BY THE PROPOSAL**

SIFMA has long supported the core disclosure principles that underlie the Proposal. SIFMA, however, believes that FINRA needs to address various operational challenges to better align the Proposal’s direct and indirect costs with its stated goals. So that the Proposal may achieve a better balance between its costs and its usefulness to investors, the following issues should be addressed:

##### ***A. FINRA Should Include a Uniform Delivery Obligation in the Proposal and Should Tie the Delivery of the Educational Communication to Existing Processes***

The Proposal’s multi-tiered delivery obligations for the Educational Communication are operationally complex, costly, and inefficient. The multi-tiered delivery obligations are also problematic from a compliance perspective, particularly with respect to monitoring for, and relying on prompt self-reporting of, oral communications with former customers regarding asset transfers to a recruiting firm. The degree of improvement for investor protection between each respective tier does not justify the overall costs of such a complex regulatory structure.

##### ***1. Delivery with Other Account Opening Documentation***

SIFMA acknowledges the important benefits of customers receiving the Educational Communication early in the account transfer process. This important objective, however, must be balanced with the Proposal’s undue operational complexities, costs, and inefficiencies. A uniform delivery requirement that would apply consistently

across the various modes of customer contact regarding the transfer of assets to a recruiting firm would be operationally efficient and less costly.

The Educational Communication, for example, could be delivered with the account transfer documentation. As an existing process with established systems, it would be relatively simple, efficient and inexpensive to tie the Educational Communication to the delivery of account transfer documentation. Indeed, the Proposal already allows for the Educational Communication to be included with “account transfer documentation” if the customer’s asset transfer to the recruiting firm was unsolicited.<sup>8</sup> SIFMA suggests that such treatment be given to all asset transfers under the proposed rule.

Delivery of the Educational Communication with the other account transfer documentation also would be beneficial for and convenient to the customer, who will receive the Educational Communication as part of a single new account package. The Educational Communication would be included with other informational items, such as margin disclosures, that currently are provided at the account opening stage and would permit the customer to have a complete set of disclosures at a single point of time rather than different disclosures at different stages. Importantly, before completing the new account paperwork and committing to open an account with the recruiting firm, former customers would continue to have sufficient time to take appropriate action in connection with the Educational Communication.

## ***2. Remove Unworkable Delivery Requirements Associated with Oral Contacts***

At a minimum, the requirement that the Educational Communication be delivered within three (3) business days of an oral contact should be removed from the Proposal. Such a requirement presents costly implementation and significant compliance challenges that far outweigh any potential benefits. SIFMA believes it is more efficient and effective to deliver the Educational Communication at the same time as other account opening disclosures.

### ***B. FINRA Should Remove the “Attempt to Induce”/“Inducement” Concept***

Under the Proposal, the requirement to provide the Educational Communication is triggered by an “attempt to induce” or by the actual transfer of assets to an account attributed to the transferring representative. Proposed FINRA Rule 2272(a) provides, in relevant part:

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<sup>8</sup> See Proposed FINRA Rule 2271(b)(2) (RN 15-19 at 8-9), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory\\_Notice\\_15-19.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Notice_15-19.pdf) (last visited July 6, 2015).

A member that hires or associates with a registered person shall provide to a former customer ... an educational communication prepared by FINRA when (1) the member, directly or through that registered person, **attempts to induce** the former customer of that registered person to transfer assets or (2) the former customer of that registered person, **absent inducement**, transfers assets to an account assigned, or to be assigned, to the registered person at the member. (emphasis added).<sup>9</sup>

Proposed Rule 2272 and the related Supplementary Materials do not, however, define what it means to “attempt to induce” or what an “inducement” is for purposes of the proposed rule. SIFMA believes that the inducement concept included in the Proposal lacks sufficient specificity to permit firms to create reasonably designed supervisory and compliance controls around the requirement.

SIFMA believes that the operational, compliance and collateral concerns raised by an unclear and imprecise inducement concept can be addressed by replacing the “attempt to induce”/“inducement” concept with a delivery obligation triggered by the delivery of the new account opening documentation.<sup>10</sup> Firms currently provide other written disclosures to customers during the account opening process, including, but not limited to, business continuity plans pursuant to FINRA Rule 4370(e), margin disclosure statements pursuant to FINRA Rule 2264, SIPC information pursuant to FINRA Rule 2266, and the existence of a carrying agreement pursuant to FINRA Rule 4311. The Educational Communication can uniformly be provided at the same time as these other disclosures without compromising investor protection while also providing firms with a more cost effective and reasonable regulatory standard.

SIFMA believes that investors are not served by hazy and imprecise regulatory standards, particularly when those standards relate to disclosure requirements.

### ***C. Delivery Obligation Should Apply for 90 days to Maximize Effectiveness***

SIFMA believes that the usefulness of the Educational Communication will become outweighed by the cost of compliance with the Proposal after a significant period of time has elapsed since the hiring or association of a registered representative with the recruiting firm. When changing firms, registered representatives have a business interest to facilitate customer asset transfers to the recruiting firm soon after.<sup>11</sup> SIFMA believes a

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<sup>9</sup> See Proposed FINRA Rule 2272(a), RN 15-19 at 8, available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory\\_Notice\\_15-19.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Notice_15-19.pdf) (last visited July 7, 2015).

<sup>10</sup> See Section V.A of this comment letter.

<sup>11</sup> In its earlier proposal, FINRA acknowledged that “most customers who transfer assets to the recruiting firm do so soon after the representative changes firms . . . .” Proposed Rule 2243, *supra* note 4, at 52. One

90-day period would be more appropriate in light of registered representatives' incentives, including quarterly fees, to transition former customers to the recruiting firm in a timely fashion.

FINRA did not identify the underlying rationale for its proposed six-month time period in the Proposal. If FINRA has data or other support for the proposed timeframe, SIFMA would be interested in reviewing and commenting on such support. Educational Communications provided to customers six months after a registered representative has been with a new member firm are unlikely to have a material impact on an investor's decision to transfer assets to the "new" member firm. Conversely, as time passes and the value of the Educational Communication for investors decreases, the cost and complexity of complying with the Proposal increases because of the time and resources that firms must dedicate to identifying a decreasing number of potential "former customers."

So that the benefits and costs of the Proposal may be better aligned, SIFMA believes the Proposal should require that the Educational Communication be provided to former customers from the date of hire or association and continue for a period of 90 days.

#### **VI. SUPPLEMENTARY MATERIAL SHOULD INCLUDE EXCEPTIONS FROM THE PROPOSAL'S DELIVERY OBLIGATION FOR DE MINIMIS RECRUITMENT COMPENSATION AND NON-RECRUITING CONTEXTS**

Proposed Rule 2243's focus was to enable a former customer to make an informed decision in connection with transferring assets to a recruiting firm, "taking into account the financial incentives that may motivate a representative to move firms and induce a customer to follow."<sup>12</sup> In the preamble to proposed Rule 2243, FINRA further stated that it attempted to "strike[ ] an appropriate balance to increase transparency with respect to recruitment practices without creating unnecessary costs or burdens on members or their representatives"<sup>13</sup> by, among other things, establishing a de minimis exception for "recruitment compensation" not exceeding \$100,000.<sup>14</sup>

RN 15-19 does not include an exception similar to the de minimis exception included in proposed Rule 2243. SIFMA believes the Proposal should include exceptions to properly narrow the Proposal's scope to contexts in which recruitment compensation serves as a significant motivating factor for a representative to change firms.

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of SIFMA's member firms estimates that 75% of former customer assets transfer within eight to ten weeks after a transferring representative has joined the firm.

<sup>12</sup> Proposed Rule 2243, *supra* note 4, at 16.

<sup>13</sup> *Id.* at 60.

<sup>14</sup> FINRA defined recruitment compensation as including upfront payments, such as cash bonuses or forgivable loans, and potential future payments, such as performance-based bonuses or special commission schedules that are not provided to similarly situated registered persons. *Id.* at 2.



**A. *Exception from Delivery Obligation for Recruitment Compensation Not Exceeding \$100,000***

SIFMA believes the Proposal should include an exception from the delivery obligation for recruitment compensation not exceeding \$100,000. Consistent with FINRA's prior proposal, a \$100,000 threshold "creates a reasonable de minimis exception" at a level where recruitment compensation is a "lesser motivating factor[] for a representative to move."<sup>15</sup>

Many firms, large and small, do not pay significant recruitment compensation beyond reasonable transition assistance that falls well below the previously proposed disclosure thresholds. Accordingly, in many cases recruitment compensation – which serves as the basis of the Proposal – either is not present or does not rise to a level that justifies the Proposal's costs and burdens on firms and their registered representatives.

The focus of the Educational Communication continues to be on recruitment compensation that will not be present under many arrangements, thereby making it confusing, if not misleading, to many transferring customers. Therefore, SIFMA requests that FINRA include in the Supplementary Material an exception from the delivery requirement for arrangements that do not include recruitment compensation in excess of \$100,000.

**B. *Exception from Delivery Obligation for Non-Recruitment Contexts***

SIFMA believes the Proposal should include an exception from the delivery obligation for contexts that do not involve individual representative recruitment, such as bulk transfers in connection with mergers and acquisitions or changes to a bank's networking arrangement. In such circumstances, concerns about recruitment compensation – which appears to be the basis of the Proposal – are less likely to be prevalent (or present at all). FINRA, therefore, should except these situations from the Proposal because the financial incentives contemplated by the Proposal either are not present or are less likely to be prevalent.

**VII. FINRA SHOULD PROVIDE THE OPTION FOR FIRMS TO ALTER THE FOCUS OF THE EDUCATIONAL COMMUNICATION**

SIFMA suggests that the Proposal include an option for firms to alter the Educational Communication to more directly align with the specific situation of each firm.<sup>16</sup> As stated above, many firms do not provide "incentive" compensation to transferring representatives, and various situations that require registered persons to change

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<sup>15</sup> *Id.* at 10.

<sup>16</sup> In its prior proposal, FINRA provided firms with the flexibility to create their own disclosure documents. See Proposed Rule 2243, *supra* note 4, at 12-13.

firms, such as mergers, do not involve recruitment of individual representatives as contemplated in FINRA's original proposal.

The Educational Communication ultimately may confuse former customers if firms are not provided with the option to adjust the focus and content of the document to more directly align with the realities of each firm's situation. For example, former customers might be misdirected or confused by a document that focuses on "incentive" compensation when the particular situation involving a transferring representative does not involve recruitment compensation.

SIFMA believes that the dangers of potential investor confusion can be mitigated by permitting firms to alter the Educational Communication. The Educational Communication should include a free text section in which the recruiting firm or transferring representative may include contextual information. In addition, firms should have the option of removing discussion topics that are inapplicable under the circumstances. For example, when a recruiting firm does not pay recruitment compensation to a transferring representative, the Educational Communication should not be required to include a discussion of potential conflicts associated with the payment of financial incentives. Other applicable disclosures would continue to apply.

**VIII. FINRA SHOULD CLARIFY THAT DELIVERY OF THE EDUCATIONAL COMMUNICATION SHOULD NOT BE USED FOR ANY PURPOSE OTHER THAN TO DETERMINE COMPLIANCE WITH THE PROPOSAL**

SIFMA is concerned that delivery of the Educational Communication could be used in other contexts, such as litigation and arbitration. SIFMA believes that FINRA should address this concern by clarifying that the Proposal only governs disclosure obligations, and delivery of the Educational Communication shall not be used as evidence for any other purpose, including determining when and if a former customer has been solicited.

**IX. TERMINOLOGY USED IN THE EDUCATIONAL COMMUNICATION SHOULD CONFORM WITH TERMS CURRENTLY USED BY THE INDUSTRY**

SIFMA believes that the Educational Communication can be improved if the term "broker" is replaced with "registered representative", "registered person", or "financial advisor". For many SIFMA member firms, "broker" is a dated term that is no longer used in marketing, customer disclosure, customer account and related documents. FINRA's previous proposal (FINRA Rule 2243) referred to "registered person", which SIFMA believes is a better description of the transferring representative.<sup>17</sup>

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<sup>17</sup> See generally RN 13-02 and Proposed Rule 2243, *supra* note 4.

**X. SUPPLEMENTARY MATERIAL SHOULD ADDRESS TRANSFERS OF DUAL HATTED PERSONS**

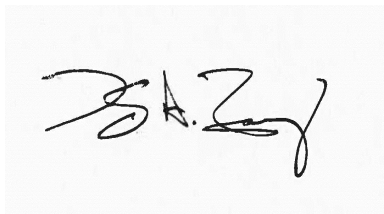
A member firm may, at times, hire or associate with a registered representative that was associated with a member firm that is dually registered as an investment adviser and a broker-dealer. The Supplementary Materials should address scenarios where a registered representative of a firm dually registered as an investment adviser and a broker-dealer transfers to a new firm. Where the registered representative may have served as an investment adviser representative that will be associated in the same capacity with the new firm, or may become associated as a registered representative of a broker-dealer, the Educational Communication may not be applicable. Where the registered representative served as a broker-dealer representative, the disclosure is appropriate as to former customers.

**XI. CONCLUSION**

SIFMA reiterates its support for plain English disclosure to investors of material terms and potential material conflicts of interest at pivotal points in the investment process. SIFMA believes that addressing the comments noted above would further the principals and purpose of the Proposal with greater efficiency and effectiveness. SIFMA looks forward to a continuing dialogue and working together on these important issues.

If you have any questions or require further information, please contact Kevin Zambrowicz, Managing Director & Associate General Counsel, SIFMA, at (202) 962-7386 ([kzambrowicz@sifma.org](mailto:kzambrowicz@sifma.org)), or Stephen Vogt, Assistant Vice President & Assistant General Counsel, SIFMA, at (202) 962-7393 ([svogt@sifma.org](mailto:svogt@sifma.org)).

Very truly yours,



Kevin Zambrowicz  
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Cc: Marlon Paz, Locke Lord