american securities association
America's Voice for Main Street's Investors

May 2, 2022

Ms. Marcia E. Asquith, Executive Vice President
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1500

Re: **FINRA Regulatory Notice 22-08**

Dear Ms. Asquith:

The American Securities Association (ASA)[1] appreciates the opportunity to comment on the Notice. ASA is concerned that the Financial Industry Regulatory Authority ("FINRA") is considering a series of measures that could undermine the core principle of our financial regulatory system – the right of investors to choose based on full and fair disclosures.

I. <u>FINRA should not seek to upend the federal securities laws.</u>

The foundation of the federal securities laws is full and fair disclosure paired with investor choice. As Securities and Exchange Commission (SEC) Chair Gary Gensler said recently, "Our core bargain from the 1930s is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures."[2] As the Chair rightly notes, our robust and resilient financial markets rely on investors – not regulators – making investment choices based on full and fair disclosure of material facts.

We are concerned the questions FINRA posed in the Notice reflect a fundamental shift away from the current disclosure-based regime and toward a merit-based one. Specifically, the questions FINRA has asked about imposing restrictions or limits on investors suggests an approach that is contrary to the disclosure-based system that Congress has maintained for more than 80 years.

FINRA's role in our disclosure-based system is well established. FINRA is the self-regulatory organization for brokers and dealers and its authority to regulate is limited to those areas delegated to it under the Securities Exchange Act of 1934 (the "Act"). The measures FINRA is considering are in direct contravention of the organization's regulatory mandate under the Act.[3]

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[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.
[2] SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors [Press Release]. https://www.sec.gov/news/press-release/2022-46.
[3] For example, the rules of an SRO authorized under Section 15A of the Act are required to be designed to "remove impediments to and perfect the mechanism of a free and open market and a national market system." They must not be "designed to permit

Moreover, while FINRA's history and expertise is grounded in regulating broker-dealers, the measures under consideration extend beyond supervising broker-dealer behavior to supervising investor access to the public markets. FINRA was never intended to be – and it does not have the institutional capacity to be – a regulator of investor choice.

As the SEC has articulated:

> "The federal securities laws…are based on a simple and straightforward concept: everyone should be treated fairly and have access to certain facts about investments and those who sell them. We require public companies, fund and asset managers, investment professionals and other market participants to regularly disclose significant financial and other information so investors have the timely, accurate and complete information they need to make confident and informed decisions about when or where to invest."[4]

FINRA should not seek to rewrite that concept by imposing restrictions on investors.

II. <u>Limiting Investor Choice Harms Investors.</u>

FINRA acknowledges in the Notice that the investment products it is seeking to restrict can provide benefits to investors including "enhancing returns, limiting losses or improving diversification."[5] However, in discussing certain products – in particular options – the Notice seems to portray these products as inherently "risky." The Notice only makes a passing reference to the fact that certain options strategies can *reduce* overall risk in a portfolio or help investors generate income.

We are concerned FINRA is considering multiple mechanisms that would undermine investor access and strip investors of these important benefits. In particular, subjective tests of investor understanding with cooling off periods, limitations based on net worth, and potentially time-consuming training courses, would, at a minimum, deter investors from selecting investments that could reduce their risk or enhance their returns.

This could also have the effect of reserving the benefits FINRA acknowledges only to the wealthiest of investors and restrict access for investors who may have modest assets yet retain the ability to make sophisticated investment decisions.

Measures that introduce subjectivity, testing bias, and net worth requirements have the potential to disadvantage underserved communities that have historically been denied access to the financial services sector. FINRA should not regulatorily mandate measures that would entrench bias in the public securities markets.

Net worth requirements, in particular, would most obviously exacerbate wealth inequality, but each of these restrictions are more likely to disproportionately impact members of underserved

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unfair discrimination between customers, issuers, broker, or dealers…" Section 15A(b)(6). The measures under consideration would violate both of these mandates.

[4] What We Do. SEC Website. https://www.sec.gov/about/what-we-do.

[5] FINRA, Regulatory Notice 22-08, at 1.

communities. Furthermore, new requirements being contemplated by the Proposal would go beyond what has already been established by Regulation Best Interest (Reg BI) in terms of documentation and obligations for firms when making recommendations to retail investors.

The Notice outlines a host of potential new requirements that firms would have to follow for customers who wish to trade options. These potential new rules could include:

- A requirement that a firm determine and document whether an investor has a "certain number of years of trading experience or [has] a specific amount of equity in their account";
- A requirement that firms have a "conversation" with each customer (regardless of whether an account is self-directed) prior to options trading approval;
- A requirement that firms provide customers with specific educational material *beyond* what is already required under current SEC and FINRA rules;
- A requirement that customers demonstrate their understanding of options to firms;
- A requirement that firms display "total position risk" to customers that takes into account both an options position as well as any security underlying that option;
- A requirement that a firm suspend a customer from trading options if that customer (presumably self-directed) enters into a transaction that cannot earn a profit.

All of these represent new and potentially restrictive requirements that would be costly to implement and which FINRA has not demonstrated a need for. As the Notice acknowledges, a host of existing SEC/FINRA rules as well as previous notices have established a robust framework for overseeing options trading by customers which has worked effectively in practice. Treating every options trade as an outlandish risk will not benefit customers and will make it less likely that firms allow certain clients to trade even the safest types of options.

Finally, placing these onerous restrictions between investors and the public markets for only a subset of investments may give investors a false sense of security that products without those restrictions are simple or safe. All investments have risks. Investors can and should understand those risks before investing but placing restrictions on an arbitrarily selected group of investments that have previously been approved by the SEC for trading does not forward the goal of investor understanding.

III. <u>FINRA Provides No Basis for New Regulation</u>

The Notice does not identify a problem that the proposed measures are intended to resolve. FINRA flatly states that "important regulatory concerns arise when investors trade complex products without understanding their unique characteristics and risks,"[6] but provides no evidence that investors do not understand the instruments in which they invest.

Instead, the notice cites as evidence enforcement cases brought against brokers for inappropriate *recommendations*.[7] FINRA's unsupported belief that investors do not understand their

[6] FINRA, Regulatory Notice 22-08, at 1.
[7] FINRA, Regulatory Notice 22-08, at 5.

investments cannot form the basis for new regulation and certainly cannot form the basis for imposing sweeping changes to our disclosure-based regulatory system.

Once again, we appreciate the opportunity to comment on the proposal and we look forward to working with you.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association