

VIA ELECTRONIC MAIL

January 6, 2009

Elizabeth Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

RE: File Number SR-FINRA-2008-055: Recommendations to Customers in OTC Securities

Dear Ms. Murphy:

On December 10, 2008, the Financial Industry Regulatory Authority, Inc. (FINRA) filed a proposal to adopt FINRA Rule 2114 (Proposed Rule) concerning recommendations to customers in certain over-the-counter equity securities (OTC Equity Securities).<sup>1</sup> If adopted, the Proposed Rule would make certain amendments to NASD Rule 2315 (NASD Rule) which currently requires members to conduct a due diligence review of an issuer's current financial and business information before recommending an OTC Security. The Proposed Rule would greatly expand the scope of these due diligence requirements by covering the recommendation of any non-exempt OTC Equity Security. The Proposed Rule would also specifically define and clarify certain aspects of the rule while eliminating other exemptions from its requirements. The Financial Services Institute<sup>2</sup> (FSI) appreciates FINRA's desire to protect investors from abuses in the trading of thinly traded and capitalized securities. However, we are concerned that the Proposed Rule will have certain unintended consequences that will serve to deny investors access to and reduce competition in these markets. As a result, we recommend that FINRA adopt the provisions of the NASD Rule into the consolidated FINRA rulebook.

#### Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. While OTC Equity Securities make up a small fraction of firm revenues, IBD firms pride themselves on providing access to a wide range of securities. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

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<sup>1</sup> See the proposing release at <http://www.sec.gov/rules/sro/finra/2008/34-59075.pdf>.

<sup>2</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 116 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 12,000 Financial Advisor members.

In the U.S., approximately 98,000 independent financial advisors – or approximately 42.3% percent of all practicing registered representatives – operate in the IBD channel.<sup>3</sup> These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>4</sup> Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI’s primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI’s advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

### Comments

Existing NASD Rule 2315 (NASD Rule) supplements broker-dealers’ suitability obligations by generally requiring firms to review current financial statements and material business information before recommending transactions in low-priced over-the-counter equity securities. The NASD Rule applies to those securities that are published in a “quotation medium” and are either (1) not listed on NASDAQ or a national securities exchange, or (2) are listed on a regional securities exchange and do not qualify for dissemination of transaction reports via the Consolidated Tape. The NASD Rule defines “quotation medium” as (1) any system of general circulation to brokers or dealers that regularly disseminates quotation or indications of interest of identified brokers or dealers, or (2) any publication, alternative trading system, or other device that is used by brokers or dealers to disseminate quotations or indication of interest to others.<sup>5</sup>

The Proposed Rule would substantially expand the scope of the NASD Rule by applying it to any non-exempt OTC Equity Security, irrespective of whether the security is published on a quotation medium. The Proposed Rule would also eliminate the exemption from the rule for a security with a worldwide average daily trading volume value of at least \$100,000 during each of the six

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<sup>3</sup> Cerulli Associates Quantitative Update: Advisor Metrics 2007, Exhibit 2.04. Please note that this figure represents a subset of independent contractor financial advisors. In fact, more than 138,000 financial advisors are affiliated with FSI member firms. Cerulli Associates categorizes the majority of these additional advisors as part of the bank or insurance channel.

<sup>4</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

<sup>5</sup> See NASD Rule 2315 at [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=4319&element\\_id=3642&highlight=2315#r4319](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4319&element_id=3642&highlight=2315#r4319) and NASD Notice to Members 02-66 at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003455.pdf>.

calendar months preceding the recommendation, as well as a related exemption for a convertible security where the underlying security satisfies the trading volume exemption requirements. In addition, the Proposed Rule would add a requirement that, in the event the person designated to perform the review is not registered as a Series 24 principal, the member must document the name of the Series 24 principal who supervised the designated person. Additionally, the Proposed Rule would amend the current definition of "current material business information" to include "information that is ascertainable through the reasonable exercise of professional diligence and that a reasonable person would take into account in reaching an investment decision."

FSI supports FINRA's goal of protecting investors from fraud and abuse in transactions involving OTC Equity Securities. We commend FINRA for clarifying the principal review requirements and the definition of "current business information." We believe these changes will provide broker-dealer firms with greater clarity as they adopt procedures to implement the Proposed Rule's requirements. However, we have significant concerns about the expansion of the scope of the Proposed Rule. These concerns are described below:

- Investors Denied Reasonable Access to OTC Equity Securities – Imposing the burdensome requirements of the Proposed Rule on all OTC Equity Security transactions will result in reduced investor access to these securities by increasing barriers to entry in this marketplace. In addition, the Proposed Rule will impose a delay in processing the purchase of all OTC Equity Securities. Such a delay may preclude a customer from capturing a particular market opportunity and may result in the customer reducing his return in a particular OTC Equity Security transaction. The time it takes to locate and review financial statements on a company will also greatly limit a broker-dealer firm's choice of stocks to recommend. Therefore, the Proposed Rule will have the unfortunate unintended consequence of denying many investors reasonable access to OTC Equity Securities through the financial advisor of their choice.
- Reduction of Competition in the OTC Equity Security Market – We expect that many firms will simply decide that the compliance burdens involved in OTC Equity Security transactions are simply too great and, therefore, decide to leave the market. Those firms who choose to remain in the market will face the increased cost and compliance burdens associated with all OTC Equity Security transactions. This will certainly limit small companies ability to raise capital, but will also harm investors by imposing higher commission costs without the counterbalance of a competitive marketplace to reduce these costs. The Proposed Rule will, therefore, have the unfortunate unintended consequence of reducing competition and increasing investor costs in the OTC Equity Security market.
- Requirements are Overly Burdensome – Applying the Proposed Rule's requirements to all OTC Equity Securities will be extremely burdensome for IBD firms. The recordkeeping and compliance burdens associated with the NASD Rule are already significant. These burdens will become overwhelming by expanding the scope of the Proposed Rule from certain over-the-counter equity securities that are published in a quotation medium to all non-exempt OTC Equity Securities. In fact, some FSI member firms have indicated that they would react to the adoption of Proposed Rule by simply eliminating their financial advisors' and clients' ability to engage in OTC Equity Security transactions. We believe this would be an unfortunate result.

We urge FINRA to reconsider their amendments to the NASD Rule. If, however, you should choose to proceed, we recommend that you include an exemption from the Proposed Rule's requirements for firms that: (1) generate less than 5% of their commission revenue from OTC

Equity Security transactions, and (2) do not make a market in such securities. We believe this would allow FINRA to meet its investor protection goals without the unintended consequences described above.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to achieve investor protection while preserving investor access to a competitive OTC Equity Security marketplace.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dale Brown", written in a cursive style.

Dale E. Brown, CAE  
President & CEO