

VIA ELECTRONIC MAIL

April 17, 2009

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

RE: File Number SR-FINRA-2009-008: Proposed Changes to Forms U4 and U5

Dear Ms. Murphy:

On March 6, the Financial Industry Regulatory Authority, Inc. (FINRA) filed with the Securities and Exchange Commission (SEC) a proposal to make certain changes to Forms U4 and U5 (Forms) as well as amend FINRA Rule 8312 (Proposed Rule).¹ If adopted, the Proposed Rule would:

- Revise questions on the Forms to enable FINRA and other regulators to identify more readily individuals and firms subject to statutory disqualification pursuant to Section 15(b)(4)(D) or (E) of the Exchange Act (referred to as "willful violations");
- Revise questions on the Forms regarding disclosure of arbitrations or civil litigation to elicit reporting of allegations of sales practice violations made against a registered person in arbitration or litigation in which that person is not named as a party;
- Revise questions on the Forms regarding customer complaints, arbitrations or civil litigation to clarify the manner in which individuals and firms must report sales practice violations alleged against registered persons;
- Raise the monetary threshold for reporting of settlements of customer complaints, arbitrations or civil litigation on the Forms from \$10,000 to \$15,000, and make a conforming change to reflect this revised monetary threshold in the description of "Historic Complaints" in FINRA Rule 8312;
- Revise the definition of "Date of Termination" in Form U5, and enable firms to amend the "Date of Termination" and "Reason for Termination" sections of the Form U5, subject to certain conditions and notifications; and
- Make certain technical and conforming changes to the Forms intended to clarify the information being elicited by regulators and to facilitate accurate reporting by firms on the Forms.

The Financial Services Institute² (FSI) is very concerned about the potential unintended

¹ See the proposing release at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p118319.pdf>.

² 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 118 Broker-Dealer member firms that

consequences of requiring firms to report, as customer complaints, allegations of sales practice violations made in arbitration claims and civil lawsuits against registered persons who are not named as parties in those proceedings. While we understand the concerns FINRA raises in the proposing release, we believe the proposed solution will have significant unintended consequences and, therefore, we strongly oppose this portion of the Proposed Rule. In addition, we suggest certain modifications to the Proposed Rule that we believe will enhance broker-dealer firms' ability to comply with its terms.

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. 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.

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.³ 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.⁴ 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

have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 10,000 Financial Advisor members.

³ 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.

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

committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission 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 on the Proposed Rule

The Proposed Rule is of particular interest to FSI. While we support some of the proposed changes to Form U4 and U5, and offer modifications to others, we strenuously oppose efforts to require the reporting of allegations of sales practices violations against persons not named as parties in arbitration or litigation matters. Our specific comments are provided in full below:

- Proposed Revisions Regarding Willful Violations – The Proposed Rule would revise Forms U4 and U5 to enable FINRA and other regulators to more readily identify persons subject to statutory disqualification as a result of willful violations. Specifically, the Proposed Rule would amend Form U4 to include new Questions 14C(6), (7) and (8) and 14E(5), (6) and (7). Broker-dealers would be given 120 days to obtain the necessary information, amend their financial advisors' Form U4, obtain the advisor's signature on the amended form, and update the CRD with the new information. While FINRA states that it "appreciates that adding new disclosure questions to Form U4 will require firms to amend (or refile) such forms for their registered persons, and that this requirement may place an administrative burden on firms..."⁵, we believe they greatly underestimate the size and scope of this burden. At the very least, the process will require the updating of the forms, printing hard copies, delivering them to financial advisors with an explanation of the requirement to update the U4, responding to questions from confused financial advisors, obtaining their signatures on the updated forms and then updating the CRD with the new information.⁶ We believe it is clear that the U4 update process will likely prove extremely time consuming for all but the smallest of broker-dealer firms.

As a result, we urge the adoption of a longer timeframe in which to complete the process and other modifications to the implementation requirements. Specifically, we recommend the following:

1. Broker-dealers be allowed a period of 180 days in which to amend the Form U4 filings of their financial advisors;
2. Require broker-dealer firms to only file forms that include "yes" responses to the new questions within the implementation period;
3. Allow broker-dealer firms to file forms that include "no" responses to the new questions the next time that a disclosure amendment is required, during the annual attestation process or through a batch filing process to be developed by FINRA;

⁵ See 74 FR 13493.

⁶ The Form U4 instructions state that "A copy, with original signatures, of the initial Form U4 and amendments to DRPs U4 must be retained by the *filing firm* and must be made available for inspection upon regulatory request." (Emphasis is included in the original text)

4. Eliminate the need for financial advisor signatures on U4 amendments that include “no” answers to new Questions 14C(6), (7) and (8) and 14E(5), (6) and (7);
5. Eliminate the requirement that, should a registrant need to file a non-disclosure amendment unrelated to the Proposed Rule within the implementation period, they would be obligated to respond to the new Form U4 questions; and
6. Insure that the resulting high volume of required “no” answer disclosure amendments to the Forms would not result in greater scrutiny of broker-dealer firms, especially larger firms who will have a correspondingly large number of amendments.

In addition, we note that implementing these proposed amendments will be costly for broker-dealer firms. In addition to the considerable resources necessary to complete the update process, FINRA assesses fees for disclosure amendments. Since the Proposed Rule is designed to benefit FINRA and other regulators, we urge FINRA to waive any such fees and limit the financial burden on broker-dealer firms to the substantial administrative effort necessary to process the required updates.

- Proposed Revisions to Elicit Reporting of Allegations of Sales Practice Violations Against Registered Persons Made in Arbitrations or Litigation in Which the Registered Person Is Not a Named Party – The Proposed Rule would revise the Forms to require firms to report, as customer complaints, allegations of sales practice violations made in arbitration claims and civil lawsuits against financial advisors who are not named as parties in those proceedings. Specifically, the Proposed Rule would add Questions 14I(4) and (5) to Form U4 and Questions 7E(4) and (5) to Form U5. A “yes” answer to the proposed Questions would indicate that the financial advisor, though not named as a respondent or defendant in a customer-initiated arbitration or civil lawsuit, was either named in or could be reasonably identified from the body of the arbitration claim or civil litigation as a registered person who was involved in one or more of the alleged sales practice violations.

FSI strongly opposes these proposed amendments to Form U4 and U5 because they have the potential to deny due process to financial advisors. A review of question 14I(2) will demonstrate the point. The proposed language of question 14I(2) appears to require a financial advisor who has not been named in the Statement of Claim to disclose on his or her Form U-4 that the named respondents in an arbitration matter agreed to a settlement of \$10,000 or more.⁷ The question does not require a finding that the settlement related to the unnamed financial advisor’s conduct. As a result, a financial advisor’s Form U4 can be stained with the black mark of a settlement even though the financial advisor had no opportunity to participate in settlement negotiations between the parties. Likewise, a financial advisor’s Form U4 must be amended if an arbitration award or civil judgment is issued against the named respondents, regardless of the dollar amount. Since Statements of Claim often allege multiple claims for recovery, an arbitration panel could base an award of damages upon a claim for recovery unrelated to the activities of the unnamed financial advisor. Nevertheless, the matter would still be disclosed on the financial advisor’s Form U4 by virtue of the panel granting claimants an award and despite the financial advisor being denied the opportunity to mount a defense.

⁷ The Proposed Rule include proposal to raise this dollar threshold from \$10,000 to \$15,000. FSI supports this proposal.

Similar due process concerns arise in the context of Proposed Rule to Form U4 questions 14I(3) and Form U5 7E(2) and 7E(3).

FSI also opposes these proposed amendments to the Forms because we believe they will create evidentiary problems that disadvantage broker-dealers in arbitration and civil litigation matters. The Proposed Rule would provide financial advisors an opportunity to respond on Form U4 to the required disclosures or, if they are no longer registered with a FINRA member firm, through a Broker Comment.⁸ This process can create substantial difficulties for named respondents in arbitration matters, as claimant's counsel will certainly obtain copies of the unnamed financial advisor's Form U4 or Broker Comment responses through the subpoena process or otherwise. Promoting these means of responding to substantive claims away from the litigation forum is troubling because of its potential to disadvantage broker-dealers in such cases. For example, if the financial advisor's position is adverse to the firm or other respondents, there is a real risk that the unnamed financial advisor's statements will be used by the plaintiff in arbitration or litigation without the benefit of cross-examination, thereby disadvantaging the broker-dealer firm.

In its proposing release, FINRA states that while it "appreciates the concerns raised regarding the potential harm to a registered person's reputation based on allegations of sales practice violations made in an arbitration claim, FINRA believes that such allegations, which are made in writing and filed in a formal proceeding, are not appreciably different than those made in written customer complaints, and *may have even more substance*. Accordingly, such allegations should be treated in the same manner that customer complaints are currently treated in the Uniform Forms."⁹ This statement itself suggests that unsubstantiated allegations concerning a financial advisor contained in a statement of claim are likely to be given more credence by regulators and the public merely simply because they are memorialized in a statement of claim. While this may be true, it is not because the allegation has been subject to a vetting process or quantum of proof higher than a statement included in a written customer complaint. It is for this very reason that we believe the standard for reporting this information on Forms U4 and U5 should remain unchanged. We believe requiring that the financial advisor be named as a party in the litigation or arbitration is the appropriate standard.

- Proposed Revisions to Clarify the Manner in Which Individuals and Firms Must Report Sales Practice Violations Alleged Against Registered Persons – The Proposed Rule would make additional revisions to Questions 14I on Form U4 and 7E on Form U5 to further clarify the manner in which individuals and firms must report allegations of sales practice violations against registered persons made through arbitration or civil litigation or through consumer-initiated complaints. Of concern to us is that question 14I(2) in Form U4 and Question 7E(2) in Form U5 would also add the words "written or oral" to describe an investment-related, consumer-initiated complaint, "to reflect FINRA's longstanding interpretation that, for purposes of this question, a consumer-initiated complaint can be in either written or oral format."¹⁰ We note that this vital information is included in a

⁸ A Broker Comment can be filed by individuals who are currently not registered with FINRA, but who have been registered within the last two years.

⁹ Emphasis added. See at 74 FR 13497.

¹⁰ See at 74 FR 13494.

footnote to the proposing release, was not included in FINRA Regulatory Notice 08-20, and that no citation is provided to the previous public announcement of this "longstanding interpretation."¹¹ We are, therefore, concerned that FINRA is effectively extending the general definition of complaint to include oral complaints. This expansion represents a significant change to the scope of the reporting requirements and represents a departure from NASD Rule 3070(c)'s definition of complaint. Momentary outbursts of aggravation or frustration stated in the heat of the moment should not be the basis of a Form U4 or U5 amendment. Requiring a client to take the time to draft a brief letter of complaint seems eminently reasonable when a financial advisor's hard earned reputation and livelihood are at risk. In addition, FINRA's proposal to require the reporting of oral complaints presents evidentiary challenges for broker-dealers in that it relies upon an individual's memory of the sum and substance of a conversation. These challenges could result in the inaccurate reporting of complaint matters on the records of financial advisors and/or liability exposure to broker-dealers attempting to comply in good faith. Therefore, we urge that the changes to Question 14I(2) in Form U4 and Question 7E(2) in Form U5 be removed from the Proposed Rule.

- Proposed Revisions to Raise the Monetary Threshold for Reporting Customer Complaints, Arbitrations or Litigation From \$10,000 to \$15,000 on the Forms and Conforming Change to FINRA Rule 8312 – The Proposed Rule would raise the existing reporting threshold for settlement amounts from \$10,000 to \$15,000 to more accurately reflect the current business climate. This change would be reflected in the Forms through changes to Question 14I on Form U4 and Question 7E on Form U5. We believe this change is appropriate since the monetary threshold for settlements of customer complaints, arbitrations or litigation was set in 1998 and does not reflect the impact of inflation since that time.¹² We note that this change also has the benefit of aligning the Proposed Rule with the current reporting requirements contained in NASD Rule 3070.¹³ For these reasons, FSI supports raising the reporting threshold in Question 14I on Form U4 and Question 7E on Form U5 to \$15,000.
- Proposed Revisions To Clarify the Definition of "Date of Termination" in Form U5 and To Allow Firms To Amend the "Date of Termination" and "Reason for Termination" – The Proposed Rule would amend Form U5 to clarify that the date to be provided by a firm in the "Date of Termination" field is the "date that the firm terminated the individual's association with the firm in a capacity for which registration is required." In addition, the Proposed Rule would allow broker-dealer firms the ability to amend the date of, or

¹¹ See FINRA Regulatory Notice 08-20: Proposed Changes to Forms U4 and U5 at

<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038384.pdf>.

¹² See, e.g., Securities Exchange Act Release No. 39562 (January 20, 1998), 63 FR 3942 (January 27, 1998); Special NASD Notice to Members 98- 27, "Interim Forms U-4 and U-5 Go Into Effect; Interim Form BD Also Approved" (March 1998).

¹³ In a January 16, 2008 comment letter concerning a proposal by FINRA to replace NASD Rule 3070 and NYSE Rule 351, with a single reporting rule to be known as FINRA Rule 4530 (see at <http://www.finra.org/Industry/Regulation/Notices/Comments/P117738>), FSI argued for a reporting threshold of \$30,000 for financial advisors under proposed rule 4530(a)(1)(9). We argued for a significantly higher reporting threshold in that context because the proposal would include attorney's fee in the calculation of the dollar value of any judgment, award, or settlement. If FINRA insists on including attorney's fees in the reporting threshold calculation under proposed rule 4530(a)(1)(9), we would support sacrificing alignment of the reporting thresholds in order to achieve the more reasonable threshold of \$30,000 under proposed rule 4530.

reason for, termination on Form U5 in order to correct clerical errors. Broker-dealers would be required to provide a reason for any such amendment. FSI supports this proposal as an important improvement over the current system that requires financial advisors to obtain an arbitration award or court order directing the expungement or change of an inaccurate date or reason for termination. It is eminently reasonable for member firms to have the ability to correct clerical errors to protect the financial advisor's record from inaccuracies and to limit the broker-dealer firm's exposure to liability arising from such errors.

- Proposed Technical and Conforming Changes to the Forms – The Proposed Rule would make various technical and conforming changes to the Forms. The changes are intended to clarify the information requested by regulators and to facilitate reporting by broker-dealer firms. FSI supports these proposed technical and conforming changes to Forms U4 and U5.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to enhance investor protection through candid and accurate disclosure on Forms U4 and U5.

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

Respectfully submitted,



Dale E. Brown, CAE
President & CEO