FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT BROKER-DEALERS
AND INDEPENDENT FINANCIAL ADVISORS

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VIA ELECTRONIC MAIL

July 29, 2009

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

RE: File Number SR-FINRA-2009-042 – Outside Business Activities of Registered Persons

Dear Ms. Murphy:

On June 8, 2009, the Financial Industry Regulatory Authority (FINRA) filed with the Securities and Exchange Commission (SEC) a proposed rule change to adopt a modified version of NASD Rule 3030[1] as FINRA Rule 3270 in the Consolidated Rulebook (Proposed Rule).[2] The Proposed Rule would require registered persons to give written notice to their broker-dealer prior to engaging in an outside business activity.[3] Broker-dealers would be required to review the registered person's participation in the outside activity to determine whether it "raises investor protection concerns."[4] If the firm determines that the activity does raise such concerns, the broker-dealer would be required to restrict the financial advisor's participation in the activity, implement procedures over the activity to protect investors, or outright prohibit the registered person's participation in the activity.[5]

The Financial Services Institute[6] (FSI) welcomes this opportunity to comment on the Proposed Rule. Independent financial advisors have long focused on providing comprehensive and cohesive financial planning advice and implementation services designed to address all of their client's major financial needs. These efforts often involve outside business activities including sales of fixed insurance products, financial planning or other investment advisory services, and the offering of other related products and services. As a result, many independent broker-dealers (IBDs) have adopted procedures and practices that go beyond the existing requirements of NASD Conduct Rule 3030. In fact, the typical IBD already requires their affiliated financial advisors to disclose in writing any and all outside business activities prior to engaging in them.[7] Nevertheless, we have significant concerns with the Proposed Rule because it seeks to unreasonably expand FINRA's jurisdiction, creates an unintended regulatory trap for broker-

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[1] See NASD Rule 3030 at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4404&element_id=3726&highlight=3030#r4404.
[2] See the proposing release at http://sec.gov/rules/sro/finra/2009/34-60199.pdf.
[3] 74 FR 32668.
[4] 74 FR 32669.
[5] Id.
[6] 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 10,000 Financial Advisor members.
[7] For more information on IBD firm's efforts to supervise the outside business activities of their affiliated financial advisors, please see *Independent Broker-Dealers: Building a Culture of Compliance* at http://www.financialservices.org/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=704.

dealer firms, and needs further clarification of its terms and requirements. A detailed discussion of these concerns is provided below.

Background on FSI Members

The 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.[8] 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.[9] 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 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

FSI has significant concerns with the Proposed Rule. These concerns are discussed in detail below:

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[8] 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.

[9] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

- **Proposed Rule Unreasonably Expands Firm's Supervisory Requirements to Activities Beyond their Control or Expertise and Beyond FINRA's Jurisdiction** – Supplementary Material to the Proposed Rule would require a broker-dealer firm who has received written notice of a financial advisor's intent to engage in an outside business activity to "make a determination whether the proposed activity raises investor protections concerns…"[10] If the firm determines that the activity does raise these concerns, it is obligated to "implement procedures or restrictions on the activity to protect investors, or prohibit the activity."[11] We believe that this represents an impractical enforcement requirement for firms and an unwarranted and unauthorized attempt by FINRA to expand its jurisdiction beyond securities activities. Specifically, we are concerned that the Supplementary Material:

    - **Fails to define the term "investor."** Under the rule, who is an "investor"? Is an investor anyone who is a client of the broker-dealer? Is an investor anyone purchasing or holding an "investment" product, even if that person purchased the investment as part of the financial advisor's outside business activity? Is an investor any person who has a business relationship with the financial advisor's outside business activity? As written, the term "investor" could even be read to mean any person, whether or not the person has any relationship with the particular representative or outside business activity.
    - **Fails to define the term "protect investors."** What does it mean to protect investors? For example, will broker-dealers be expected to supervise a financial advisor's fixed insurance activities in an effort to insure that a financial advisor is not misappropriating client funds through his insurance agency? How about reviewing the suitability of life insurance recommendations or limits on homeowner's insurance policies? Is the rule obligating the broker-dealer to protect its own clients or all of the clients of the financial advisor's outside business activity?
    - **Requires broker-dealers to supervise activities beyond their area of expertise.** Broker-dealers have neither the experience, expertise, nor practical ability to directly supervise the wide variety of outside business activities in which their financial advisors may engage. Are broker-dealers expected to hire experts in the outside business activities so that they can be supervised effectively?
    - **Requires broker-dealers to supervise activities that are subject to other regulatory schemes.** As written, the Supplementary Material could be read to require broker-dealers to place restrictions on such businesses as insurance sales and providing investment advisory services. These activities are already subject to other regulatory requirements. Requiring broker-dealers to impose broker-dealer related restrictions on these activities which are not otherwise subject to broker-dealer rules and regulations would result in unwarranted, duplicative and potentially conflicting regulation.
    - **Distracts broker-dealers from their core supervisory functions.** Supervising the securities activities of the broker-dealer is and should be the sole focus of supervising principals. However, the Proposed Rule would detract from this focus by involving supervising principals in the supervision of unrelated outside activities beyond the purview or practical control of the broker-dealer.

[10] See proposed Supplementary Material 3270.01.
[11] Id.

We believe these questions and concerns demonstrate the unreasonable nature of the first sentence of the Supplementary Material to the Proposed Rule. We believe the net effect of these requirements will be to make the broker-dealer a guarantor for "investor" losses through the outside business activity. This is unfair in the extreme. Therefore, we urge FINRA to eliminate the requirement by striking the first sentence of Supplementary Material .01 to the Proposed Rule.

We have no objection to the remaining provisions of the Supplementary Material.

- **Proposed Rule Should Require an Affirmative Response from the Firm Before a Financial Advisor Can Engage in the Activity** –FSI believes the Proposed Rule should require financial advisors to obtain a written response from the firm before engaging in the outside business activity. As currently written, the Proposed Rule would prohibit "a registered person from being an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member."[12] As stated previously, this would codify existing requirements already in place at many IBD firms. Firms, however, need time to review requests for outside business activities. As written, the Proposed Rule would appear to allow the financial advisor to engage in the outside business activity during the period following written notice to the broker-dealer but prior to the completion of the firm's analysis. As a result, we believe the Proposed Rule creates an unintended regulatory trap for broker-dealer firms by exposing them to risk during this interim period. Therefore, we urge FINRA to amend the Proposed Rule to require financial advisors to refrain from engaging in outside business activities until they receive a written response from their broker-dealer of any objections or restrictions. We believe this would greatly clarify the Proposed Rule.

- **Proposed Rule Should Impose an Ongoing Duty to Inform Broker-Dealers of Material Changes to Outside Business Activities** – We believe the Proposed Rule should impose an ongoing obligation on financial advisors to inform their broker-dealer of material changes to the nature of their outside business activity. This will insure that the broker-dealer has the necessary information to make informed decisions about the financial advisor's continued involvement in the activity or the need to impose new conditions or restrictions with respect to the activity. Absent such a requirement, broker-dealers will be unfairly exposed to regulatory scrutiny and legal exposure beyond their ability to control.

- **Proposed Rule's Terms Should Be Clarified** – In an effort to combine the language of NASD Rule 3030 and NYSE Rule 346, FINRA has introduced unnecessary ambiguity into the Proposed Rule. For example, the Proposed Rule would prohibit any registered person from being "an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be[ing] compensated, or ha[ving] the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship" with his or her broker-dealer firm. Since an individual is either an employee, officer or director in a business entity or not, it does not make sense to connect these relationships to the phrase "as a result of any business

[12] See text of the Proposed Rule at http://www.finra.org/Industry/Regulation/RuleFilings/2009/P118899.

activity" as the current draft does. We would recommend that the section be rewritten as follows:

> **3270. Outside Business Activities of [an Associated Person] Registered Persons**
> No registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person ~~as a result of any business activity~~ in conjunction with an established business enterprise outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member. Passive investments and activities subject to the requirements of NASD Rule 3040 shall be exempted from this requirement.

In addition, we note that the Proposed Rule and Supplementary Material fail to define the term "compensation." This term is fundamental to an understanding of the Proposed Rule. The failure to define the term introduces unnecessary ambiguity into the Proposed Rule's meaning and application. For example, does the term include non-cash compensation? Therefore, we urge FINRA to define the term in the Supplementary Material to the Proposed Rule.

- **FINRA Should Provide Guidance on Implementation of the Final Rule** – Independent financial advisors have complied with their existing obligations under NASD Rule 3030 by providing their broker-dealers with prompt written notice of their outside business activities. Some of these businesses have been in operation for many years, provide much needed products and services to investors, and employ thousands of individuals who depend on a steady paycheck. However, the Proposed Rule is silent as to its application to these pre-existing business relationships. It will be an enormous undertaking for IBD firms to analyze each of these established outside business activities and adopt policies and procedures for each of them. We also believe it is unreasonable for FINRA to expect these businesses to accept broker-dealer efforts to control their longstanding business practices based upon vague potential investor protection concerns. Therefore, we believe it would be unfair to apply the Proposed Rules requirements retroactively to such activities. We urge FINRA to adopt this policy, and state so clearly, when it implements the final rule.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to enhance investor protection.

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