

January 29, 2016

Via Electronic Mail (rule-comments@sec.gov)

Securities and Exchange Commission

Robert W. Errett

Deputy Secretary

100 F Street NE

Washington, D.C. 20549-1090

Re: SR-FINRA-2015-057: Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2273 (Educational Communication Related to Recruitment Practices and Account Transfers)

Dear Mr. Errett:

HD Vest Investment Services (“HD Vest”) appreciates the opportunity to comment on the above-referenced rulemaking (“Proposal”), which the Financial Industry Regulatory Authority (“FINRA”) has filed with the Securities and Exchange Commission (“Commission”). Proposed FINRA Rule 2273 (“Proposed Rule”) would require member firms to provide customers an educational communication prepared by FINRA under specified circumstances after their registered representative transfers to a new firm.¹ HD Vest believes that the Proposed Rule should not be approved because it unnecessarily imposes very significant costs on firms without concomitant benefits, and would be difficult if not impossible to comply with as currently drafted.

I. INTRODUCTION

A. Background

HD Vest is a registered broker-dealer and FINRA member with approximately 4,600 registered representatives nationwide. HD Vest actively recruits new registered representatives into the securities business (*i.e.*, individuals who have not previously been registered), and also recruits representatives from other firms. Hundreds of representatives join HD Vest each year, some of whom have existing clients.

¹ See generally Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2273 (Educational Communication Related to Recruitment Practices and Account Transfers), Exchange Act Rel. No.76757 (Dec. 23, 2015), 80 FR 81590 (Dec. 30, 2015) (SR-FINRA-2015-057), available at <http://www.finra.org/industry/rule-filings/sr-finra-2015-057>.

FINRA's recruiting compensation proposals have evolved significantly over the past three years.² FINRA's various proposals have elicited mixed comments from member firms. While firms are not opposed to additional disclosures in this area, they have raised legitimate concerns regarding the content of the proposed Educational Communication, and the convoluted requirements around the required timing and method of delivery. HD Vest submitted a comment letter in response to Regulatory Notice 13-02, which initially proposed the recruiting compensation practices rules in 2013,³ and more recently submitted a comment letter in response to FINRA Regulatory Notice 15-19 ("RN 15-19").⁴ These letters pointed out problems with the proposed content of the Educational Communication, and the substantial costs and practical problems associated with the disclosure requirements as proposed.

HD Vest opposes the current proposal because all firms should not be forced to provide general disclosures that in all or nearly all instances are not relevant to their circumstances. Moreover, even if the Educational Communication was marginally relevant, clients already receive comprehensive and specific information about fees, and the transfer-related issues addressed in the Educational Communication rarely occur for most firms. The Educational Communication disclosure does not implicate important systemic problems that warrant an entirely new and expensive disclosure regime. The Proposed Rule is far too complex and impractical, and firms will experience significant operational challenges trying to comply with it. On the other hand, it will not significantly enhance consumer protection.

As more thoroughly explained herein, the Commission should decline to approve the Proposed Rule. However, in the event the Commission believes that it should be approved, it should be substantially modified to address the practical compliance considerations that make it unworkable in its current form. HD Vest and other commenters have proposed practical and reasonable solutions that would allow firms to incorporate delivery of the Educational Communication into existing processes, which would significantly reduce the operational burdens and compliance costs without materially impacting any investor protection concerns.

² See FINRA Regulatory Notice 15-19 (May 2015) ("RN 15-19"), available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Noteice_15-19.pdf; FINRA Regulatory Notice 13-02 (Jan. 2013) at 5 ("RN 13-02"), available at <https://www.finra.org/sites/default/files/NoticeDocument/p197599.pdf>; SEC, *Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2243*, Release No. 34-71786, at 47 (March 24, 2014) ("Proposed Rule 2243"), available at <https://www.sec.gov/rules/sro/finra/2014/34-71786.pdf>; see also SIFMA Comment Letter to FINRA re: the Proposed Rule at 2-3. (Jan. 20, 2016) ("SIFMA Comment Letter re: the Proposed Rule") (summary of FINRA's various recruitment compensation rule proposals).

³ See HD Vest Investment Services Comment Letter re Regulatory Notice 13-02 (Recruitment Compensation Practices) (Mar. 5, 2013) ("HD Vest Comment Letter re: RN 13-02"), available at <http://www.finra.org/sites/default/files/NoticeComment/p220093.pdf>

⁴ See HD Vest Investment Services Comment Letter re Regulatory Notice 15-19 (July 24, 2015) ("HD Vest Comment Letter re: RN 15-19") available at https://www.finra.org/sites/default/files/notice_comment_file_ref/15-19_HDvest_comment.pdf

B. The Proposed Educational Communication Requirements

Under the Proposed Rule, firms would be required to deliver an Educational Communication created by FINRA (which could not be modified).⁵ The Educational Communication contains general disclosure about recruiting compensation, which is intended to highlight potential conflicts of interest that may arise if recruiting firms compensate representatives when they transfer firms. The other disclosures raise general considerations for investors who are transferring an account between firms. The Educational Communication does not actually provide customers information they need to make a decision, but rather “is intended to prompt a former customer to make further inquiries of the transferring representative (and, if necessary, the customer’s current firm), to the extent that the customer considers the information important to his or her decision-making.”⁶ The five considerations are presented as follows:

1. Could financial incentives create a conflict of interest for your broker?
2. Can you transfer all of your holdings to the new firm? What are the implications and costs if you can’t?
3. What costs will you pay—both in the short term and ongoing—if you change firms?
4. How do the products at the new firm compare with your current firm?
5. What level of service will you have?

The trigger for having to deliver the Educational Communication depends on whether the recruiting firm or transferring representative has “individualized contact” with the former customer.⁷ The member would be required to deliver the Educational Communication when either: (1) the member or representative individually contacts a former customer to transfer assets; or (2) a former customer, absent individualized contact, transfers assets to an account assigned, or to be assigned, to the representative at the member.⁸

The delivery requirement would apply for a period of three months following the date that the representative begins employment or associates with the member.⁹

In terms of the timing and method of delivery, those depend on how the firm or representative contacts the customer:

- If the firm or representative has individualized contact with the former customer in writing, then the Educational Communication must be delivered at the time of the

⁵ See FINRA 19b-4 Filing with the SEC, Exhibit 3 (Dec. 16, 2015), available at http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-057.pdf

⁶ Proposal, 80 FR 81591.

⁷ See generally Proposed Rule 2273.

⁸ See Proposed Rule 2273(a).

⁹ See Proposed Rule 2273(b)(3).

“first individualized contact with a former customer.”¹⁰ For example, if the recruiting firm or the transferring representative contacts the former customer by sending a letter, then the Educational Communication must accompany the first written communication.¹¹

- If the recruiting firm or the representative contacts the former customer by electronic communication then the first contact may hyperlink directly to the Educational Communication. FINRA should clarify whether a recruiting firm or the representative may attach the Educational Communication to an electronic communication, i.e., as a PDF attached to an email. This approach seems to comport with the spirit of the Proposed Rule, and clarification regarding this approach would be beneficial for firms and representatives.
- If the recruiting firm or transferring representative has individualized contact with the former customer orally, the former customer must be told during the conversation that he or she will receive an Educational Communication which includes considerations about deciding whether to transfer their assets to the member firm, and the Educational Communication must be sent by the member firm within three business days.¹² If, however, the transferring representative or firm sends other correspondence to the former customer related to transferring assets before this three business day period expires, the Educational Communication must accompany that correspondence.
- Absent any individualized contact with the former customer before he or she seeks to transfer assets, firms would be still required to deliver the Educational Communication to the former customer with the account transfer approval documentation when the account transfers to the new firm.¹³

This Rube Goldberg approach to disclosure is ambiguous, complicated, costly, inefficient, and unworkable.¹⁴ There is simply no reasonable way to implement a supervisory system to meet these requirements.

¹⁰ See Proposed Rule 2273(b)(1).

¹¹ See Proposed Rule 2273(b)(1)(A).

¹² See Proposed Rule 2273(b)(1)(B).

¹³ See Proposed Rule 2273(b)(2).

¹⁴ See also SIFMA Comment Letter re: the Proposed Rule, *supra* note 2, at 6.

II. WITHOUT SIGNIFICANT CHANGES, COMPLIANCE WITH THE PROPOSED RULE WILL BE BURDENSOME AND COSTLY, IF NOT IMPOSSIBLE

Twenty-seven comment letters were submitted to FINRA in response to RN 15-19. The comments contained reasonable suggestions to reduce the compliance burdens, most of which were rejected in the Proposal.¹⁵ It is not clear whether FINRA conducted a meaningful cost-benefit analysis consistent with its *Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking*.¹⁶ What is clear is that the Proposal significantly underestimates the operational burdens and costs firms will incur to comply with the Proposed Rule.¹⁷

A. Transferring Representatives and Recruiting Firms May Not Have Access to Former Customers' Information

In order to send the Educational Communication, recruiting firms would need information about the transferring representatives' former clients, including a client list and addresses. The Proposed Rule seems to assume that this information is readily available to recruiting firms as a matter of course before the former customer actually becomes a client of the new firm. However, the exact opposite is true. Due to Regulation S-P and contractual limitations, representatives may not even be permitted to retain former customers' information, or share that information with their new firm.

1. Regulation S-P May Prevent Firms From Obtaining Information Necessary to Comply with the Proposed Rule

The Proposal does not clarify how firms are supposed to comply with the Educational Communication delivery requirements consistent with Regulation S-P ("Reg. S-P"). Reg. S-P restricts firms' ability to share nonpublic personal information ("NPPI") about customers with unaffiliated third-parties unless customers have been notified and given the opportunity to opt-out of this disclosure. It is not clear that Reg. S-P permits a transferring representative routinely to share former customers' NPPI with recruiting firms. Without this information, however, it would be impossible to comply with the Proposed Rule.

Reg. S-P defines NPPI to include (i) personally identifiable financial information (PIFI); and (ii) any list, description, or other grouping of consumers (and publicly available information

¹⁵ Improvements that were made in the Proposed Rule include: (1) reducing the time period for which the proposed rule's delivery obligation would apply from six months to three months; (2) excluding from the delivery obligation bulk transfer and change of broker-dealer of record situations; and (3) providing clarity with respect to treatment of dual-hatted persons. See Proposal, 80 FR at 81592, 81596, 81601.

¹⁶ See FINRA Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking (Sept. 2013), available at http://www.finra.org/sites/default/files/Economic%20Impact%20Assessment_0_0.pdf.

¹⁷ Proposal, 80 FR at 81592. ("FINRA does not believe that the proposed rule change will impose undue operational costs on members to comply with the educational communication.").

pertaining to them) that is derived using any PIFI that is not publicly available information.¹⁸ The fact that an individual is or has been a firm's customer or has obtained a financial product or service from a firm is PIFI.¹⁹ Under certain circumstances, transferring representatives could violate Reg. S-P if they inform the recruiting firm that an individual is a customer of the representatives' former firm and share the customer's address or account information. Without this information, however, the recruiting firm will not be able to determine who must get the Educational Communication, and will not be able to deliver it within the time frames of the Proposed Rule.

The Proposed Rule does not (nor could it) provide transferring representatives and recruiting firms a safe harbor from Reg. S-P. Although the Protocol for Broker Recruiting ("Protocol") allows representatives to retain limited NPPI under certain circumstances,²⁰ the SEC has indicated that the "information may be used at the representative's new firm *only by the representative*, and only for the purpose of soliciting the representative's new clients."²¹ In any event, not all firms have joined the Protocol so it cannot be relied upon globally to facilitate compliance with the mailing requirements.

This conundrum is similar to the issues FINRA itself addressed in Regulatory Notice ("RN 07-36"). In RN 07-36, FINRA stated that, "in establishing due diligence procedures [to supervise representatives who transfer firms], *NTM 07-06* does not recommend, nor does it suggest, that a firm obtain nonpublic personal information about any customers the prospective registered representative may seek to bring to the new firm."²² Similarly, in Regulatory Notice 15-22, FINRA specified that, in facilitating bulk account transfers, "no personal confidential customer information (e.g., social security numbers) may be provided to the receiving introducing or clearing firm, as applicable, unless the sharing of such information is in compliance with SEC

¹⁸ 17 C.F.R. § 248.3(t).

¹⁹ 17 C.F.R. § 248.3(t)(3)(u)(2)(C).

²⁰ See Proposal, 80 FR at 81591 n.5. ("The Protocol was created in 2004 and permits departing representatives to take certain limited customer information with them to a new firm, and solicit those customers at the new firm, without the fear of legal action by their former employer. The Protocol provides that representatives of firms that have signed the Protocol can take client names, addresses, phone numbers, email addresses, and account title information when they change firms, provided they leave a copy of this information, including account numbers, with their branch manager when they resign.").

²¹ SEC, *Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Personal Information*, Exchange Act Rel. No. 57427, 73 Fed. Reg. 13692, 13702 n.91 (Mar. 13, 2008) (emphasis added) ("2008 Reg. S-P Amendments"). In this release, the SEC proposed rules that would universally have allowed (but not required) firms to permit departing representatives to provide their new firm the name and contact information of former customers; however, the proposal was never adopted.

²² FINRA Regulatory Notice 07-36 (FINRA clarifies guidance relating to SEC Regulation S-P under Notice to Members 07-06, Supervision of Recommendations after a Registered Representative Changes Firms) (Aug. 2007) ("RN 07-36"), available at <https://www.finra.org/sites/default/files/NoticeDocument/p036445.pdf>.

Regulation S-P”²³ Unlike those notices, the Proposal does not adequately address the fact that Reg. S-P might preclude firms from obtaining the very information the Proposed Rule assumes is available to the new firm.²⁴ FINRA states that “the proposed change . . . does not require members to disclose information in a manner inconsistent with Regulation S-P,” but the basis for this conclusion is not readily apparent. The Proposal cites to a general exception in Reg. S-P related to sharing information as necessary to comply with applicable legal requirements, but it is far from clear that this general exception applies.²⁵ This important issue should be clarified before the Proposed Rule is approved.

2. Transferring Representatives Should be Able to Provide Their New Firms with Certain Limited Customer Information

In order to facilitate compliance, transferring representatives must be permitted to take limited customer information with them to a new firm, *e.g.*, the same information permitted by the Protocol.²⁶ Allowing all transferring representatives to supply their new firm with certain limited customer information would allow firms to meaningfully track and better supervise compliance with the Proposed Rule. Additionally, giving transferring representatives the ability to provide limited customer information to their new firms would also enhance firms’ requirement (imposed by FINRA) to maintain records of former customers contacted by the member, directly or through the representative.²⁷

This limited sharing would be substantially similar to the Commission’s 2008 proposal to amend Reg. S-P. That proposal would have allowed firms to permit transferring representatives (or a supervised person of a registered investment adviser) to provide their new firm with certain limited customer information of former customers (hereinafter, the “Reg. S-P Limited Disclosure Exception”).²⁸ The Reg. S-P Limited Disclosure Exception was “designed to provide an orderly framework under which firms with departing representatives could share certain limited customer contact information and could supervise the information transfer.”²⁹

²³ FINRA Regulatory Notice 15-22 (Discretionary Accounts and Transactions) (June 2015) (“RN 15-22”) at 10, available at https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Noteice_15-22.pdf.

²⁴ See *SEC Initial Decision In the Matter of NEXT Financial Group, Inc.*, File No. 3-12738 (Jun. 18, 2008), available at <https://www.sec.gov/litigation/aljdec/2008/id349jtk.pdf>; see also *SEC Order Instituting Administrative and Cease and Desist Proceedings In the Matter of NEXT Financial Group, Inc.*, File No. 3-12738 (Aug. 24, 2007) available at <https://www.sec.gov/litigation/admin/2007/34-56316-o.pdf>; *HFP Capital Markets, LLC, Letter of Acceptance Waiver and Consent No. 20090193202-01* (Mar. 26, 2012), available at <http://disciplinaryactions.finra.org/Search/ViewDocument/31596>.

²⁵ 17 C.F.R. § 248.15(a)(7)(i) (“To comply with federal, State, or local laws, rules and other applicable legal requirements.”).

²⁶ Proposal, *supra* note 20, at 81591 n.5.

²⁷ Proposal, 80 FR at 81597.

²⁸ See 2008 Reg. S-P Amendments, *supra* note 21.

²⁹ *Id.*

Without the Reg. S-P Limited Disclosure Exception (or a similar measure), firms who recruit representatives do not have any meaningful way to gather necessary information regarding who is a former customer as implicitly required by the Proposed Rule. Accordingly, the Reg. S-P Limited Disclosure Exception (or similar provision allowing the sharing of information necessary) is necessary. Furthermore, because Reg. S-P was promulgated by the Commission, any interpretation creating a general exception to Reg. S-P as necessary to comply with the Proposed Rule similarly must come from the Commission.

3. Transferring Representatives Contractual Obligations May Prevent Them From Sharing Customer Information With Recruiting Firms

Even if sharing information is permitted under Reg. S-P, transferring representatives may be prohibited by contract from taking customer NPPI when they leave their prior firm. This would again preclude transferring representatives from providing recruiting firms with the information needed to comply with the Proposed Rule. FINRA has not made clear that the Proposed Rule supersedes any private contractual restrictions that firms have prohibiting representatives from taking customer information. This has widespread implications that counsel strongly against adopting the Proposed Rule.

Furthermore, if a transferring representative is subject to a prohibition against soliciting former clients, the “individualized contact” standard might let the former firm argue that the transferring representative breached his or her agreement. This is an issue because the “individualized contact” could be interpreted as an attempt to solicit the former customer to transfer assets to the recruiting firms, which might encourage litigation. HD Vest supports SIFMA’s suggestion that FINRA should clarify that the Proposed Rule only governs disclosure obligations, and delivery of the Educational Communication is not evidence that a former customer has been solicited.³⁰ Thus, the Educational Communication “should contain an explicit statement that delivery of the Educational Communication is not intended as a solicitation or to encourage or discourage the transfer of assets.”³¹

B. It is Not Possible to Supervise Communications with a Representative’s Former Clients Before They Even Establish Accounts

Assuming that recruiting firms can obtain the baseline customer information necessary to perform the required mailings, to comply with the Proposed Rule firms would still have to establish compliance programs to somehow track all of the communications transferring representatives have with former customers. Under the Proposed Rule, firms would be required to deliver the Educational Communication if a transferring representative has individualized contact with a former customer to transfer assets to the new firm – orally or in writing. The only way recruiting firms will know this is if the contact is self-reported. Most firms will have to rely

³⁰ See SIFMA Comment Letter Regarding FINRA Regulatory Notice 15-19 (July 13, 2015) at 10, available at https://www.finra.org/sites/default/files/notice_comment_file_ref/15-19_sifma_comment.pdf.

³¹ See SIFMA Comment Letter re: the Proposed Rule, *supra* note 2, at 14.

on representatives' voluntary compliance because firms have no way to track telephone calls or whether a representative held an in-person meeting.

Firms do not have existing infrastructure or systems to supervise communications – both written and oral – in real time. To the extent this is possible (which is doubtful), it would require firms to create completely new supervisory systems. Firms would need to establish written supervisory procedures and related supervisory control procedures, and dedicate ongoing additional compliance resources. Firms would also be challenged in trying to facilitate compliance with these ambiguous requirements by brand new representatives who are just joining the firm. The costs of the Proposed Rule would be very substantial, and many of those costs are caused by the practical problems associated with trying to monitor formal and informal communications.

Even if a representative reports an oral communication with a former customer, firms will still have to make subjective determinations regarding whether the representative actually discussed transferring assets based on second-hand accounts of the conversation. Firms will have to use their own judgment on a case-by-case basis. Evaluating every contact with a former customer will be extremely burdensome.

SIFMA highlighted several of these challenges in its comment letter to Proposed Rule 2243, when it noted:

Firms will face significant challenges creating a supervisory system that will be reasonably designed to monitor the fluid and dynamic oral communications between representatives and customers. For example, there are potential challenges associated with pinpointing the exact date when a communication may morph into a solicitation to transfer assets. The challenge is enhanced by the fact that these communications may occur prior to the representative joining the new member firm. Indeed, firms may reach investors that may have already expressed a desire to remain with the current member firm – thereby creating needless confusion rather than providing useful information.³²

Even though FINRA replaced the “inducement” concept (which was initially proposed in RN 15-19) with the “individualized contact” standard in the Proposed Rule, the discussion between the firm or its representative and the former customer still revolves around transferring assets, and it is not clear whether these two concepts differ materially.³³

³² See SIFMA, Comment Letter on FINRA Proposed Rule Change regarding Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices) (Apr. 17, 2014) at 3, available at <http://www.sifma.org/issues/item.aspx?id=8589948662>.

³³ See also, SIFMA Comment Letter re: the Proposed Rule, *supra* note 2, at 10.

FINRA summarily dismisses these concerns, stating without substantive explanation that “FINRA does not believe that setting up policies and procedures to supervise a registered person’s communications with former customers presents an unreasonable burden to members.”³⁴ In reality, trying to supervise varied communications – and then having to determine subjectively whether there was individualized contact about transferring assets – is impractical if not impossible.

C. If the Rule is Adopted Delivery Deadlines Should be Lengthened.

The proposed time frame to deliver the Educational Communication is insufficient. Assuming no other written communications are sent after an oral “individualized contact,” firms would have three business days to send the Educational Communication. As outlined above, before even determining whether mailing is required, firms will have to: (1) gather the necessary customer information (in compliance with Reg. S-P); (2) obtain information from representatives about informal communications they might have had with customers; and (3) evaluate whether there was an “individualized contact.” This will be a very labor intensive process that is impossible to systematize. Faced with these significant challenges, firms will need ample time make these evaluations. Three days is simply not enough.

Firms should be afforded at least ten business days to deliver the Educational Communication. Alternatively, as suggested below in Section IV, FINRA should allow firms the flexibility to deliver the Educational Communication with account opening documents if the client decides to transfer firms.

* * *

The challenges identified above would require firms to incur significant costs to implement a new compliance apparatus that is reasonably designed to comply with the Proposed Rule, if it is possible at all. Compliance with Proposed Rule will divert compliance resources away from other more significant compliance initiatives with greater customer benefit. The cost to firms is clearly greater than any perceived benefits investors would realize by receiving the Educational Communication, at least as currently proposed.

III. ADDITIONAL DISCLOSURE OF GENERAL INFORMATION ON ACCOUNT TRANSFERS IS UNNECESSARY AND POTENTIALLY CONFUSING

The Proposal asserts that former customers of a transferring representative should receive the Educational Communication because they “may not be aware of other important factors to consider in making a decision whether to transfer assets to the recruiting firm, including direct costs that may be incurred”³⁵ FINRA largely rests its *beliefs* and *concerns* on a focus group which FINRA describes as a “diverse group of retail investors...[who] indicated that the educational communication effectively conveyed important and useful information...to consider

³⁴ See Proposal, 80 FR at 81595.

³⁵ Proposal, 80 FR at 81591.

that they had previously been unaware of and that would be meaningful in making a decision whether to transfer assets to the representative's new firm."³⁶ Some individuals in FINRA's test group cited in RN 15-19 might have found these disclosures helpful when they were asked in isolation. FINRA did not specify whether any members of the test group found some of the disclosures more meaningful than others, or whether they would have found them helpful if the issues were irrelevant to their situation. As former Commissioner Gallagher rightly noted, "from an investor's standpoint, excessive illumination by too much disclosure can have the same effect as obfuscation — it becomes difficult or impossible to discern what *really* matters."³⁷

While HD Vest supports investors receiving material information that will allow them to make informed decisions, the Proposed Rule ignores disclosure requirements that already exist, and the resulting costs of creating an entirely new disclosure process to support the new Educational Communication. FINRA has not identified any systemic problems associated with the account transfer process, or the current disclosure regime, that would justify the substantial costs associated with the Proposed Rule.³⁸ Select statements by participants in a focus group should not serve as the sole basis for a rule that will impact every firm, and even if they justified additional disclosure there are much better ways to accomplish the desired result. Before establishing another burdensome disclosure requirement that may or may not add marginal incremental value, FINRA should establish that a problem actually exists and fashion a solution that leverages existing industry infrastructure.

A. There is no Systemic Issue with Account Transfers, and Disclosure Regarding Portability of Assets is Already Required by Existing FINRA Rules

The "portability" disclosure in the Educational Communication notes that some products may not be transferrable if an investor transfers an account to a new firm. While this may be true in some instances, there is no evidence of widespread problems transferring securities (especially among the large number of firms that primarily do business in mutual funds). In fact, the evidence is to the contrary. The SEC has found that "[m]any investors transfer their accounts from one brokerage firm to another **without a hitch**."³⁹ FINRA has similarly noted that "[w]hile the [transfer] process **generally runs smoothly for the vast majority of thousands of accounts transferred each year**, there are times when delays occur and investors pose questions."⁴⁰

³⁶ Proposal, 80 FR at 81592.

³⁷ See Daniel M. Gallagher, *Remarks at the 2nd Annual Institute for Corporate Counsel* (Dec. 6, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540462287>.

³⁸ See HD Vest Comment Letter re: RN 15-19, *supra* note 4 at 8.

³⁹ See SEC Investor Publication *Transferring Your Brokerage Account: Tips on Avoiding Delays* ("SEC Investor Publication Regarding Transferring Brokerage Accounts"), available at <http://www.sec.gov/investor/pubs/acctxfer.htm>.

⁴⁰ See FINRA, *Understanding the Brokerage Account Transfer Process* ("FINRA Investor Publication Regarding the Brokerage Account Transfer Process") (emphasis added), available at <http://www.finra.org/investors/understanding-brokerage-account-transfer-process>.

Delays might occur for any number of reasons (including reasons not addressed in the Educational Communication), but this is not indicative of a systemic problem with the transfer process. In fact, the most common assets – including equities, corporate and municipal bonds, unit investment trusts, mutual funds, options, annuities, and cash – are readily transferable among firms through the Automated Customer Account Transfer Service (“ACATS”) system.⁴¹

Additionally, there is no evidence that current disclosure regarding account transfers is inadequate. On the contrary, there is already a comprehensive disclosure regime in place governing the account transfer process.⁴² FINRA incorrectly asserts that “there is no current rule that requires representatives to inform former customers in a timely manner of the potential implications of transferring assets, so as to allow them to make an informed decision that may have cost and service implications, among others.”⁴³ In fact, FINRA Rule 11870 already mandates written disclosures carrying firms and/or receiving firms must promptly provide customers with respect to the transfer and disposition of “nontransferable assets,” as well as other matters that may arise during the transfer process.⁴⁴

In addition, FINRA has already told firms that “[i]f the new firm is unable or unwilling to service a customer’s mutual fund or variable product, the new firm or the registered representative should advise the customer of this fact, as well as the options the customer may have to continue to hold the investment at the customer’s prior firm, before recommending that the customer liquidate or surrender the investment.”⁴⁵ This occurs as a matter of course in servicing client accounts, and is the appropriate way to deal with the isolated instances when an asset cannot be transferred.

The Educational Communication provides information that is less specific and largely duplicative of existing requirements. In the Proposed Rule, FINRA does not explain why FINRA Rule 11870 does not provide investors sufficient disclosure in a timely manner, or why the highly generalized “Educational Communication” is better than the specific disclosures already required. There is no substantial need for the Educational Communication, but if it is required the Proposed Rule should be reconciled with existing disclosure requirements to avoid duplication, confusion and unnecessary costs.

B. The Proposed Expense Disclosures are Redundant and Unnecessary

With regard to the disclosures regarding expenses and fees, these are also unnecessary and redundant, particularly since investors already get specific disclosures regarding costs to evaluate

⁴¹ See DTCC website, available at <http://www.dtcc.com/clearing-services/equities-clearing-services/acats.aspx>.

⁴² See generally FINRA Rule 11870.

⁴³ Proposal, 80 FR at 81598.

⁴⁴ FINRA Rule 11870(C)(1)(D).

⁴⁵ See FINRA Regulatory Notice 07-06 (Supervision of Recommendations after a Registered Representative Changes Firms) (Feb. 2007) (“RN 07-06”) at 3, available at <https://www.finra.org/sites/default/files/NoticeDocument/p018630.pdf>.

their decision to transfer assets. As the Commission has recognized, “[y]our old firm may charge you a fee for the transfer to cover administrative costs. Sometimes, the new firm will also charge a fee. These fees are typically spelled out in your account agreements with the firms.”⁴⁶ Investors who are worried about the short-term costs of an account transfer (e.g., termination fees or transfer fees), can simply refer to their existing account documents or those they are asked to sign at the new firm. Investors who are concerned with the long-term costs to move firms will be able to evaluate these fees in the account agreement when they establish a new account. Many firms also publish their fee schedules online. Representatives are certainly capable of reminding former customers that they can refer to their account agreements (or call their current firm) regarding specific costs they might incur if they close their account with their current firm and/or transfer assets among firms.

Intuitively, we know that people who are concerned about fees will already ask questions and obtain information even in the absence of an Educational Communication. For the rest, the Educational Communication will join their prospectuses and privacy notices in one of the nation’s landfills.

C. The Proposed Products and Services Disclosures are Unnecessary

Two of the five issues highlighted in the Educational Communication raise topics related to the products and level of services that may (or may not) be available at the transferring representative’s new firm. FINRA has not offered any evidence that this is a frequent or significant problem that customers face. Common sense dictates that representatives who transfer firms want to be able to offer the same or better products and services to their customers. Therefore, based on market factors, representatives will tend to transfer to a firm that will enable them to keep their former customers’ business. Situations where this is not the case are likely to be the exceptions rather than the rule, and these exceptions should not drive additional costly and potentially confusing disclosure requirements. Absent compelling evidence of a significant issue and a lack of adequate information, these disclosures in the Educational Communication are unnecessary.

* * *

In sum, absent a systemic problem associated with transferring assets or one that demonstrates that investors lack sufficient information to make educated decisions, the Proposal should not create an overly complex disclosure regime that will create significant, ongoing expenses for firms.

IV. There Should be Uniform Delivery Requirements that Utilize Existing Industry Account Opening Infrastructure

Firms should be able to incorporate delivery of the Educational Communication into existing processes for delivering disclosures to new clients. In their comments on the Proposed Rule, firms and industry groups suggested ways to enhance compliance with the Proposed Rule

⁴⁶ See SEC Investor Publication Regarding Transferring Brokerage Accounts, *supra* note 39 (emphasis added).

while limiting the significant additional compliance burden.⁴⁷ For example, firms could incorporate it into existing processes, such as including the communication with the account transfer approval documentation,⁴⁸ or integrating it into verification letters to customers sent in compliance with Rule 17a-3 under the Exchange Act.⁴⁹ As discussed above, the Proposed Rule as currently drafted only permits this where firms or representatives have not had any individualized contact with the former customer.⁵⁰

Allowing firms to uniformly deliver the Educational Communication to all former customers would make implementation and ongoing compliance with the Proposed Rule *much* more cost effective without materially reducing FINRA's stated investor protection goals. FINRA rejected these suggestions because it "believes requiring delivery of the communication at the time of first individualized contact is more effective than requiring delivery of the communication at or prior to account opening because customers typically have already made the decision to transfer assets by that point in the process."⁵¹ If delivery with account opening is too late, then just allow the new firm to obtain a customer list, and the firm should have the option of sending the Educational Communication to all customers when the representative joins the firm. This is not warranted, but at least would be more susceptible to reasonable compliance than the unworkable framework of the Proposal.

VI. CONCLUSION

The disclosures in the Educational Communication do not solve widespread problems associated with the account transfer process and the current disclosure regime is sufficient. If firms are forced to comply with the Proposed Rule they will incur significant costs without providing material benefits to investors or enhancing investor protection. Put simply, rules with very high costs and marginal potential benefit should not be adopted.

HD Vest urges the Commission not to adopt this Proposed Rule, especially in its current form. To the extent the Commission believes there is some value in providing former customers with the Educational Communication, representatives should be permitted to provide firms with limited customer contact information so firms can track and supervise compliance with the Proposed Rule. Lastly, firms should be able to incorporate the delivery of the Educational Communication into existing processes so it can be delivered to former customers in a uniform manner.

⁴⁷ Proposal, 80 FR at 81595 (referencing comment letters submitted by SIFMA, FSR, CAI, Cambridge, Leaders Group, Lincoln, LPL, JJA, RJFS, Ameriprise, and HD Vest Investment Services).

⁴⁸ Proposal, 80 FR at 81594, n.29 (referencing comment letters submitted by SIFMA, FSR, FSI, CAI, Commonwealth, Lincoln, LPL, Ameriprise, Wells Fargo, Janney, and HD Vest Investment Services).

⁴⁹ Proposal, 80 FR at 81595, n.30 referencing Leaders Group Comment Letter.

⁵⁰ See Proposed Rule 2273(b)(2).

⁵¹ Proposal, 80 FR at 81595.

Mr. Robert W. Errett
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Sincerely,



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