



January 20, 2016

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

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
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:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to comment on the Financial Industry Regulatory Authority’s (“FINRA”) proposal to adopt FINRA Rule 2273 (the “Proposal”). The Proposal will establish an obligation for FINRA member firms to deliver an educational communication in connection with member recruitment practices and account transfers.²

SIFMA would like to thank FINRA for its continued efforts to develop a rule that encourages customers to consider the potential implications of transferring assets to a different firm while “ensur[ing] that [the rule] is narrowly tailored to achieve its purpose . . . without imposing unnecessary costs and burdens” on member

¹ SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² See generally Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2273 (Educational Communication Related to Recruitment Practices and Account Transfers), Securities Exchange Act Release 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> (last visited Jan. 15, 2016).

firms.³ Consistent with SIFMA’s longstanding support of disclosure and investor education, SIFMA supports FINRA’s efforts to create simple, plain-English disclosures that permit investors to make informed choices. Notwithstanding this support, however, SIFMA submits this comment letter to highlight various operational and supervisory challenges raised by the Proposal.

I. BACKGROUND

A. Initial Proposal Filed with the SEC – March 2014

FINRA filed its initial proposal on broker recruitment compensation disclosure with the U.S. Securities and Exchange Commission (“SEC”) in March 2014 (the “Initial Proposal”).⁴ The Initial Proposal included two core elements: (1) a disclosure obligation to former retail customers who a recruiting firm attempts to induce to follow a transferring representative; and (2) a reporting obligation to FINRA where a transferring representative receives a significant increase in compensation. The disclosure obligation would have required a recruiting firm to disclose to former customers ranges of recruitment compensation that the representative has received or will receive in connection with changing firms. The Initial Proposal included various additional components, including disclosures related to fees and portability of assets.

The Initial Proposal garnered much attention. Commenters raised various issues with the proposal, including concerns about the proposal’s costs, competitive implications, operational aspects, and the effectiveness of the proposed compensation disclosures. In June 2014, FINRA withdrew the Initial Proposal.⁵

³ Proposal, 80 FR at 81593.

⁴ See generally Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices), Securities Exchange Act Release No. 71786 (Mar. 24, 2014), 79 FR 17592 (Mar. 28, 2014) (SR-FINRA-2014-010), available at <https://www.sec.gov/rules/sro/finra/2014/34-71786.pdf> (last visited Jan. 15, 2016). See also Regulatory Notice 13-02 (Recruitment Compensation Practices) (Jan. 2013), available at <http://www.finra.org/sites/default/files/NoticeDocument/p197599.pdf> (last visited Jan. 15, 2016).

⁵ See Notice of Withdraw of Proposed Rule Change to Adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Related to Recruitment Practices), Securities Exchange Act Release No. 72469 (June 24, 2014), 79 FR 36855 (June 30, 2014) (SR-FINRA-2014-010), available at <http://www.finra.org/industry/rule-filings/sr-finra-2014-010> (last visited Jan. 15, 2016).

B. Regulatory Notice 15-19 – May 2015

FINRA issued Regulatory Notice 15-19 (“RN 15-19”) in May 2015.⁶ RN 15-19 reflected significant changes to the Initial Proposal, including removal of its two main components – the disclosure obligation and the reporting requirement. RN 15-19 would have required a member firm that recruits a registered representative to provide a FINRA-created “educational communication” to former retail customers who the recruiting member, directly or through the transferring representative, attempts to induce to transfer assets to the recruiting firm or who otherwise choose to transfer assets to the recruiting firm. The educational communication would highlight the potential implications of transferring assets to the recruiting firm and suggest questions a customer may want to ask to make an informed decision. The recruiting firm would be required to provide the educational communication at or shortly after the time of first contact with a former retail customer regarding the transfer of assets to the recruiting firm.

II. OVERVIEW OF THE CURRENT PROPOSAL

The Proposal is structurally similar to RN 15-19. The Proposal would require delivery of an educational communication to a former retail customer of a transferring representative that highlights key considerations in transferring assets to the recruiting firm. The educational communication is intended to encourage former retail customers 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.

A. Educational Communication

The educational communication is a FINRA-created document. The educational communication would highlight the potential implications of transferring assets to the recruiting firm and suggest questions the customer may want to ask regarding:

- Whether financial incentives received by the transferring representative may create a conflict of interest;

⁶ RN 15-19 (Recruitment Practices) (May 2015), available at https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Noteice_15-19.pdf (last visited Jan. 15, 2016). Comments on RN 15-19 are available at <https://www.finra.org/industry/notices/15-19> (last visited Jan. 15, 2016).

- Assets that may not be directly transferrable to the recruiting firm and as a result the customer may incur costs to liquidate and move those assets or inactivity fees to leave them with the customer's current firm;
- Potential costs related to transferring assets to the recruiting firm, including differences in the pricing structure and fees imposed between the customer's current firm and the recruiting firm; and
- Differences in products and services between the customer's current firm and the recruiting firm.

The Proposal includes a copy of the educational communication.⁷ Firms would not be permitted to modify the format or content of the educational communication.

B. Delivery Requirement

The educational communication must be provided at or shortly after the time of the first "individualized contact" with a former customer regarding the transfer of assets to the recruiting firm. The manner of delivery of the educational communication depends on the mode of initial contact with the customer:

- Written Contact: The educational communication must accompany the written communication.
- Electronic Contact: The recruiting firm may hyperlink directly to the educational communication.
- Oral Contact: The recruiting firm or transferring representative must notify the former customer orally that a document that contains important considerations in determining whether to transfer assets to the recruiting firm will be provided within three business days. The educational communication must be sent to the customer within three business days or with any other documentation sent by the recruiting firm to the former customer related to transferring assets, whichever is earlier.

⁷ 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 (last visited Jan. 15, 2016).

- Unsolicited Transfers: The educational communication must be provided to a former customer who seeks to transfer assets to an account assigned, or to be assigned, to the transferring representative at the recruiting firm even absent contact from the recruiting firm or transferring representative. The educational communication must be included with the account transfer approval documentation.

The requirement to provide the educational communication would continue to apply for three months following the date that the transferring representative begins employment or associates with the recruiting firm.

The proposal includes several exceptions to the delivery requirement. The delivery requirement would not apply:

- When the former customer expressly declines to transfer assets to the recruiting firm. If the former customer subsequently decides to transfer assets to the recruiting firm without further individualized contact, then the educational communication would be required to be provided with the account transfer approval documentation.
- Where a customer's account is proposed to be transferred to a new member via bulk transfer or due to a change of broker-deal of record.
- To a customer account that meets the definition of an "institutional account" under FINRA Rule 4512(c). Accounts held by a natural person would not qualify for the institutional account exception.

C. Supervisory Procedures

FINRA states that it expects firms to implement a system reasonably designed to achieve compliance with the delivery requirements of proposed Rule 2273. The Proposal does not specify the types of supervisory procedures that firms should implement.

III. POSITIVE CHANGES REFLECTED IN THE PROPOSAL

The Proposal includes various changes to the proposed rule included in RN 15-19 that address comments raised by SIFMA:

- Reducing the time period for which the proposed rule's delivery obligation would apply;⁸
- Excluding from the delivery obligation bulk transfer and change of broker-dealer of record situations;⁹ and
- Providing clarity with respect to treatment of dual-hatted persons under the proposed rule.¹⁰

SIFMA believes that these changes improve the effectiveness and efficiency of the Proposal without compromising the Proposal's underlying goals. SIFMA thanks FINRA for considering these previous comments and amending the Proposal to account for SIFMA's comments.

IV. SIFMA SUPPORTS DISCLOSURE OF MATERIAL TERMS

SIFMA has a longstanding history of supporting disclosure and investor education. SIFMA supports FINRA's efforts to create simple, plain-English disclosures that permit investors to make informed choices, which should serve to foster strong and vibrant securities markets.

V. OPERATIONAL AND SUPERVISORY CHALLENGES RAISED BY THE PROPOSAL

Consistent with SIFMA's comments on RN 15-19, SIFMA believes proposed Rule 2273 raises various operational and supervisory challenges due to, among other things, the oral communications component of the proposed rule and the multi-tiered structure of the proposed rule's delivery obligation. With respect to oral contacts, this structure is operationally complex, costly, inefficient, and may be unworkable from a supervisory perspective. The Proposal would benefit from the recommendations included in this comment letter because SIFMA's recommended

⁸ See *id.* at 81952.

⁹ See *id.* at 81596.

¹⁰ See *id.* at 81601.

changes would better align the Proposal's investor protection benefits with its direct and indirect costs. Reducing the costs and inefficiencies of the Proposal will benefit investors, as they ultimately bear such costs and are burdened by such inefficiencies.

A. Oral Discussions as a Trigger for the Delivery Obligation

Proposed Rule 2273(b)(1)(B) requires that “[t]he educational communication must be sent within three business days from . . . [an] oral contact or with any other documentation sent to the former customer related to transferring assets to the member, whichever is earlier.”¹¹

SIFMA has concerns with the Proposal's inclusion of oral contacts as a potential trigger for the delivery obligation because developing a reasonably designed supervisory system around this aspect of the Proposal would require a significant and costly undertaking that is not necessarily counterbalanced by any appreciable investor protection benefits. Firms would need to dedicate considerable resources to building controls around, identifying, and documenting such contacts. Firms also would need to train representatives on the scope and practical application of the individualized contact concept so that representatives are able to make accurate judgments about whether a particular contact with a former customer comes within the rule. This undertaking is made particularly challenging by the broad and hazy “individualized contact” trigger under the Proposal.

Assuming the registered representative correctly understands FINRA's intended scope for the individualized contact concept, the firm must rely on the registered representative to timely report such contact to the firm so the educational communication can be sent within the three-day period. In addition, the prospective client list must be formatted and provided to the firm's mailing facility in order to perform the mailing. The rule's three-day requirement presents various logistical challenges that may prove to be unworkable in practice.

The Proposal's approach to oral contacts would subject firms to substantial costs, significant operational and supervisory challenges, and undue compliance and legal risk without any countervailing appreciable investor protection benefits. SIFMA believes this aspect of proposed Rule 2273 should be eliminated. If FINRA deems it necessary to maintain the Proposal's approach to oral contacts, and believes there is not a reasonable alternative that more appropriately balances the costs and benefits of the proposal's delivery requirement (*see* Section IV.B of this comment

¹¹ Proposed Rule 2273(b)(1)(B).

letter), SIFMA recommends that FINRA extend the time period within which the education communication must be sent. Three business days is not enough time. This time period is so short that it effectively sets-up firms for failure.

B. SIFMA Supports a Uniform Delivery Mechanism

SIFMA reiterates its support for a uniform delivery mechanism tied to firms' existing processes, such as the delivery of account transfer approval documentation.¹² SIFMA believes that adopting a uniform approach that applies consistently across the various modes of customer contact would be operationally efficient and less costly yet, at the same time, continue to provide customers with sufficient time to take appropriate action in connection with the educational communication. SIFMA believes following this approach represents a better balance of the costs of the Proposal and FINRA's underlying goals for the Proposal.

In declining to adopt SIFMA's previous suggestion of a uniform delivery mechanism, FINRA states:

FINRA 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.¹³ (emphasis added)

FINRA, however, provides no support for its assertion that "customers typically have already made the decision to transfer assets" when they receive documentation to open an account. In the experience of SIFMA members, it is not uncommon for former customers to wait weeks or months after receiving account transfer approval documentation to send completed forms back to the firm, and some customers never complete the process to transfer assets. Given the costs and complexity associated with the multi-tiered delivery requirement of the Proposal and the potential reduction or elimination of those costs and complexities by using members' existing account

¹² SIFMA previously expressed support for a uniform delivery mechanism in its comments on RN 15-19. See Letter from Kevin Zambrowicz, Associate General Counsel and Managing Director, and Stephen Vogt, Assistant Vice President and Assistant General Counsel, SIFMA, to Marcia E. Asquith, Office of the Corporate Secretary, FINRA (Jul. 13, 2015) ("SIFMA Comment Letter on RN 15-19"), available at https://www.finra.org/sites/default/files/notice_comment_file_ref/15-19_sifma_comment.pdf (last visited Jan. 15, 2016).

¹³ Proposal, 80 FR at 81595.

opening process, SIFMA believes that FINRA should provide a deeper analysis of and justification for this assertion. SIFMA believes such an analysis is mandated by FINRA's own *Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking*.¹⁴

SIFMA believes the cost and complexity of the Proposal can be reduced, without materially impacting investor protection concerns, if FINRA replaces the Proposal's multi-tiered delivery requirement with a uniform delivery mechanism. SIFMA recommends that delivery of the educational communication be tied to firms' existing processes for delivery of account transfer approval documentation.

C. "Individualized Contact" Concept

FINRA explains in the Proposal that RN 15-19's "inducement" concept has been removed from proposed Rule 2273 "[t]o lessen any potential confusion regarding whether a communication by a member, directly or through the representative, with a former customer was an inducement to transfer assets."¹⁵ FINRA acknowledges that commenters on RN 15-19 characterized the inducement concept "as undefined and imprecise, resulting in operational and supervisory challenges for members."¹⁶ As modified, the Proposal would utilize an "individualized contact" concept:

FINRA instead proposes to trigger delivery of the educational communication when: (1) [t]he member, directly or through a representative, individually contacts a former customer of that representative *to transfer assets*; or (2) a former customer of the representative, absent individual contact, transfers assets to an account assigned, or to be assigned, to the representative at the member.¹⁷ (emphasis added)

As evidenced above, proposed Rule 2273(a)'s text suggests that an individualized contact must be made "to transfer assets" of the former customer to

¹⁴ See FINRA Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking (September 2013), available at http://www.finra.org/sites/default/files/Economic%20Impact%20Assessment_0_0.pdf (last visited Jan. 15, 2016).

¹⁵ Proposal, 80 FR at 81594.

¹⁶ *Id.* (footnote omitted).

¹⁷ *Id.* at 81594. See also Proposed Rule 2273(a).

the member to trigger the proposed rule's delivery obligation. FINRA also states, however, that "a broad range of communications by a recruiting firm or its registered representative would constitute individualized contact that would trigger the delivery requirement under the proposal."¹⁸ As examples, FINRA explains that the following oral or written communications may come within the individualized contact concept:

- Informing the former customer that the transferring representative is now associated with the recruiting firm, including customer communications permitted under the Protocol for Broker Recruiting (the "Protocol");
- Suggesting that the former customer consider transferring his or her assets or account to the recruiting firm;
- Informing the former customer that the recruiting firm may offer better or different products or services;
- Discussing with the former customer the fee or pricing structure of the recruiting firm; or
- Group contact with former customers, such as mass mailing of information, sending copies of information via e-mail, or automated phone calls or voicemails.¹⁹

In light of these examples, SIFMA believes it is unclear if the "individualized contact" concept differs materially, if at all, from the "attempt to induce" concept included in RN 15-19. The individualized contact change to the proposal does not appear to materially clarify when the rule is triggered nor does it lessen the myriad ways in which the Proposal's delivery obligation may be triggered by oral or written communications with a former customer. SIFMA believes that commenters' concerns with RN 15-19's inducement concept apply with equal force to the Proposal's individualized contact approach. If proposed Rule 2273 goes into effect as proposed, member firms will be faced with a broad, undefined, and imprecise term that raises operational and supervisory challenges.

SIFMA recommends that FINRA provide guidance – in the form of principles-based limitations – on the scope of the Proposal's individualized contact

¹⁸ *Id.* at 81591.

¹⁹ *See id.*

triggering mechanism, which should serve to potentially reduce some of the uncertainty surrounding the application of the proposed rule.

D. Scope of the Proposed Rule -- Transferring Representatives

SIFMA requests clarification on the scope of transferring representatives who will fall within the requirements of proposed Rule 2273. SIFMA believes the proposed rule should not cover registered representatives who are hired into a non-financial advisor role, such as registered personnel hired into the following roles:

- Operations;
- Non-producing branch/complex managers;
- Sales assistants and other registered support staff; and
- Capital Markets and other non-retail employees.

While these registered persons may have accounts incidental to their primary job function at the hiring firm, those accounts usually are held by the individual's family members and close friends. SIFMA believes that FINRA's previous proposals did not contemplate that registered persons in non-financial advisor roles would be subject to the proposed rule's requirements. Registered persons functioning in a non-financial advisor role do not trigger the Proposal's core underlying purpose of facilitating the disclosure of potential conflicts of interest.

E. Exception for Institutional Accounts under FINRA Rule 4512(c)

FINRA Rule 4512(c) defines an “institutional account” to include accounts of any natural person with total assets of at least \$50 million.²⁰ Various other FINRA rules incorporate Rule 4512’s definition of institutional account. Some of these FINRA rules tie exceptions to the rules’ requirements to Rule 4512’s definition of institutional account without including an additional carve-out for natural persons. For example, FINRA Rule 2111 (Suitability) contains an institutional-account exemption that relies on Rule 4512(c)’s definition of institutional account.²¹

Consistent with the basis for Rule 4512(c)’s carve-out of “institutional accounts,” FINRA explains that proposed Rule 2273 would not apply to institutional accounts as defined in Rule 4512(c) because, FINRA believes, “such accounts are more sophisticated in their dealings with representatives and that the proposed educational communication would not have as significant impact on their decision

²⁰ See FINRA Rule 4512(c), available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9958.

Rule 4512(c) provides:

For purposes of this Rule, the term "institutional account" shall mean the account of:

- (1) a bank, savings and loan association, insurance company or registered investment company;
- (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or
- (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.

²¹ FINRA Rule 2111, available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859.

FINRA Rule 2111(b) provides:

A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in [Rule 4512\(c\)](#), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated [decision making] authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.

whether to transfer assets to a new firm.”²² The Proposal’s institutional account exception, however, excludes accounts held by natural persons. The Proposal and response to comments are unclear on why FINRA believes that natural persons with assets of at least \$50 million should be excluded from the Proposal’s institutional account exception. As noted above, other FINRA rules include exceptions that are tied to the 4512 definition of institutional account that do not further exclude natural persons.

SIFMA recommends that proposed Rule 2273 incorporate Rule 4512(c)’s definition of institutional accounts without modification. Firms’ technology and compliance systems already incorporate Rule 4512(c)’s definition of institutional account. SIFMA is unaware of any investor protection benefits that outweigh the operational, supervisory, and related costs associated with creating yet another category of institutional, high-net worth, or sophisticated customer.²³

SIFMA also believes it is inconsistent to determine that natural persons should fall within the institutional account exemption of the suitability rule while also maintaining that natural persons should not fall within the institutional account exemption of the Proposal.

F. Relief from Delivery Obligation in Certain Contexts

FINRA proposes to interpret proposed Rule 2273 “as not applying to circumstances where a customer’s account is proposed to be transferred to a new firm via bulk transfer or due to a change of broker-dealer of record.”²⁴ SIFMA supports excluding these types of situations from the proposed rule.²⁵

²² Proposal, 80 FR at 81600.

²³ FINRA has indicated that the definition of “institutional account” in 4512(c) is “the more common definition of ‘institutional account.’” *See* FINRA Rule 2111 FAQs, Question 8.1, available at <https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq> (last visited Jan. 15, 2016).

²⁴ Proposal, 80 FR at 81596.

²⁵ *See* SIFMA Comment Letter on RN 15-19 at 10.

VI. Continuing Contractual and Legal Concerns Related to Delivery of the Educational Communication

FINRA states in the Proposal that “FINRA does not intend for the provision of the educational communication to have any relevance to a determination of whether a representative impermissibly solicited a former customer in breach of a contractual obligation.”²⁶ FINRA further states in the Proposal:

[T]o the extent that a firm brings a legal challenge against a representative or his or her new firm, FINRA does not intend for the delivery of the educational communication pursuant to the proposed rule change to have any relevance to determine whether or not a representative or the new firm has engaged in improper solicitation of former customers or has committed some other contractual or legal violation. Further, the information contained in the educational communication is generic, making no reference to any firm or registered representative and comparable to other public information that may be shared, such as a news article. As such, FINRA believes that the educational communication provides no unique information intended to encourage or discourage transfer of assets.²⁷

While FINRA’s statements are helpful, SIFMA continues to have concerns that delivery of the educational communication could be used in other contexts, such as litigation and arbitration. To address this concern, SIFMA believes that the educational communication should contain an explicit statement that its delivery is not intended as a solicitation or to encourage or discourage transfer of assets.

VII. Compliance Date Should Provide Adequate Implementation Time

SIFMA believes that firms will need sufficient time to design, adopt, and implement appropriate policies and procedures to achieve compliance with the proposed rule. Firms also will need to design or modify various operational procedures. As SIFMA has stated in this and previous comment letters, SIFMA believes the Proposal includes various conditions that will require the investment of significant firm resources to achieve compliance with the Proposal. SIFMA requests that the effective date of the final rule be at least 180 days from the date the rule is finalized.

²⁶ Proposal, 80 FR at 81599.

²⁷ *Id.*

VIII. Conclusion

SIFMA appreciates the opportunity to comment on the Proposal. SIFMA looks forward to a continuing dialogue and working together on this important proposal.

If you have any questions or require further information, please contact Stephen Vogt, Assistant Vice President & Assistant General Counsel, SIFMA, at [REDACTED] ([REDACTED]) or Kevin Zambrowicz, Managing Director & Associate General Counsel, SIFMA, at ([REDACTED]) ([REDACTED]) ([REDACTED]) ([REDACTED]).

Very truly yours,



Stephen Vogt
Assistant Vice President &
Assistant General Counsel



Kevin Zambrowicz
Associate General Counsel &
Managing Director