FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

April 15, 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: SR-FINRA-2020-007

Proposed Rule Change to FINRA's Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest

Dear Secretary Countryman:

On March 25, 2020, the Securities and Exchange Commission (SEC) published a notice to solicit comments on the Financial Industry Regulatory Authority, Inc.'s (FINRA) proposed changes to FINRA Rules 2111 (Suitability), 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements), and Capital Acquisition Broker (CAB) Rule 211 (Suitability) (collectively, the Proposed Rules).[1] The Proposed Rules are intended to: (1) amend the FINRA and CAB suitability rules so that they are not applicable to recommendations subject to SEC Regulation Best Interest (Reg BI)[2] and remove the element of "control" from Rule 2111's quantitative suitability obligation; and (2) conform FINRA's rules governing non-cash compensation to Reg BI's limitations on sales contests, sales quotas, bonuses and non-cash compensation.

The Financial Services Institute[3] (FSI) appreciates the opportunity to comment on the Proposed Rules. FSI supports FINRA's approach to amending FINRA Rule 2111 and CAB Rule 211 so that they are not applicable to recommendations subject to Reg BI. Similarly, and for reasons outlined in our previous comment letter on FINRA Rule 2111,[4] FSI generally supports FINRA's decision to remove the element of control from the quantitative suitability obligation. FSI also appreciates that FINRA and the SEC are coordinating their examination and enforcement efforts

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[1] Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to FINRA's Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest, 85 Fed. Reg. 16974 (Mar. 25, 2020).

[2] 17 C.F.R. 240.15*l*-1 et seq.

[3] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial professionals and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[4] Letter from Robin Traxler, Vice President, FSI, to Jennifer Piorko Mitchell, Office of the Corp. Sec'y, FINRA (June 19, 2018).

in connection with Reg BI. FSI offers comments below related to FINRA and the SEC's coordination, and the proposed amendments to the rules governing non-cash compensation.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.[5] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).[6]

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.[7]

Discussion

As noted above, FSI is generally supportive of the Proposed Rules. We offer one specific comment related to the proposed amendments to FINRA's rules governing non-cash compensation.

Before we address this comment, FSI would like to address and commend FINRA's efforts in aligning its rulebook with Reg BI and moreover in collaborating with the SEC to develop a uniform approach to Reg BI examinations and enforcement.[8] In particular, FSI believes that firms will benefit tremendously from the SEC and FINRA's continued alignment on examination and enforcement regarding Reg BI, especially with respect to the risk alerts published by the SEC's

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[5] Cerulli Associates, Advisor Headcount 2016, on file with author.

[6] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[7] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

[8] FINRA, News Release, *FINRA Provides New Reg BI and Form CRS Resources to Assist Member Firms in Complying with SEC Rules by June 30, 2020* (Oct. 8, 2019).

Office of Compliance Inspection and Examination.[9] Such alignment promotes a mutual understanding of Reg BI, and increases the likelihood that firms will meet the SEC and FINRA's expectations. The first few years following the compliance date will be especially important, as firms look to the SEC and FINRA for consistent guidance on compliance with Reg BI.

FSI would also like to commend FINRA for its willingness to work with firms on issues that may arise in connection with Reg BI examinations and enforcement as a result of COVID-19.[10] In particular, FINRA noted recently that, like the SEC, its "focus will be on firms continuing good faith and reasonable efforts, including taking into account firm-specific effects from disruptions caused by COVID-19."[11] FSI agrees with this approach, and welcomes the opportunity to generally provide insight from its members on the impact of COVID-19 on Reg BI implementation during this time.

<u>Proposed Amendments to Non-cash Compensation Rules</u>

Among other things, Reg BI requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the ***sales of specific securities or specific types of securities*** within a limited period of time.[12] In its Proposing Release, FINRA notes that its non-cash compensation rules permit internal firm sales contests that may not comply with Reg BI, because the non-cash compensation rules "permit contests based on sales of specific types of securities (such as mutual funds or variable annuities)."[13] To align with Reg BI, the Proposed Rules include modifications to FINRA's rules governing non-cash compensation arrangements to specify that any non-cash compensation arrangement permitted by those rules must be consistent with the requirements of Reg BI.

We are concerned that FINRA's assertion that its non-cash compensation rules may not comply with Reg BI because the non-cash compensation rules "permit contests based on sales of specific types of securities (such as mutual funds or variable annuities)" may be problematic.[14] Reg BI does not explicitly require broker-dealers to eliminate sales contests that are based on the sales of mutual funds or variable annuities. In fact, the Reg BI adopting release acknowledges that "some associated persons may focus their business on certain general categories of securities (*e.g.*, mutual funds, variable annuities, bonds, or equities) and that broker-dealers may provide compensation or other incentives related to such sales."[15] Further, the SEC notes that Reg BI is not intended to prevent such incentives, as long as they do not "create high-pressure situations to sell a specifically identified type of security (*e.g.*, stocks of a particular sector or bonds with a specific credit rating) within a limited period of time, such that the associated person cannot make a recommendation in the retail customer's best interest."[16] Based on the Reg BI adopting release, FSI believes that the SEC considers mutual funds or variable annuities to be "general categories of

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[9] See e.g., FINRA, News Release, *FINRA Statement on SEC's OCIE Risk Alerts for Reg BI and Form CRS* (Apr. 8, 2020).
[10] FINRA, News Release, *FINRA Statement on SEC's OCIE Risk Alerts for Reg BI and Form CRS* (Apr. 8, 2020).
[11] FINRA, News Release, *FINRA Statement on SEC's OCIE Risk Alerts for Reg BI and Form CRS* (Apr. 8, 2020).
[12] 17 C.F.R. 240.15*l*-1(a)(2)(iii)(D) (emphasis added).
[13] 85 Fed. Reg. at 16976.
[14] 85 Fed. Reg. at 16976.
[15] 84 Fed. Reg. 33396.
[16] 84 Fed. Reg. 33396.

securities," and not "specific types of securities." FSI suggests that FINRA clarify in its Adopting Release that its non-cash compensation rules are meant to align with Reg BI in all respects, including what constitutes sales of specific types of securities.

Conclusion

FSI is committed to constructive engagement in the regulatory process and welcomes the opportunity to work with the SEC on this and other important regulatory efforts. Thank you for considering FSI's comments. Should you have any questions, please contact me at 202-393-0022.

Respectfully submitted,

Robin Traxler
Senior Vice President, Policy & Deputy General Counsel