

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-77430; File No. SR-FINRA-2015-057)

March 23, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Adopt FINRA Rule 2273 (Educational Communication Related to Recruitment Practices and Account Transfers)

I. Introduction

On December 16, 2015, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt FINRA Rule 2273, which would establish an obligation for a member to deliver an educational communication in connection with member recruitment practices and account transfers.

The proposed rule change was published for comment in the Federal Register on December 30, 2015.<sup>3</sup> The Commission received twelve comment letters on the proposal.<sup>4</sup> On

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See 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 (December 23, 2015), 80 FR 81590 (December 30, 2015) (“Notice”).

<sup>4</sup> Comment letters were submitted by Georgia State University College of Law Investor Advocacy Clinic (“GSU”); Commonwealth Financial Network (“Commonwealth”); Securities Industry and Financial Markets Association (“SIFMA”); Financial Services Institute (“FSI”); Public Investors Arbitration Bar Association (“PIABA”); Wells Fargo Advisors (“Wells Fargo”); The Committee of Annuity Insurers (“Committee of Annuity Insurers”); Lincoln Financial Network (“Lincoln”); LPL Financial (“LPL”); Raymond James Financial Services (“RJFS”); Raymond James & Associates (“RJA”); and HD Vest Investment Services (“HD Vest”).

February 4, 2016, FINRA extended the time period for Commission action on the proposed rule change until March 29, 2016. On March 17, 2016, FINRA responded to the comments.<sup>5</sup> The proposed rule change is unchanged from the original proposal. This order approves the proposed rule change. The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA, on the Commission's website at <http://www.sec.gov>, and at the Commission's Public Reference Room.

## II. Description of the Proposed Rule Change

### Background

FINRA is concerned that representatives who switch their member firm often contact former customers and emphasize the benefits the former customers would experience by following the representative and transferring their assets to the firm that recruited the registered representative ("recruiting firm") and maintaining their relationship with the representative. In this situation, former customers' confidence in and prior experience with the representative may be one of the customers' most important considerations in determining whether to transfer assets to the recruiting firm. As stated in the Notice, FINRA is concerned that former customers 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. Therefore, to provide former customers with a more complete picture of the potential implications of a decision to transfer assets, the proposed rule change would require delivery of an educational communication by the recruiting firm that highlights key considerations in transferring assets to the recruiting firm, and the direct and indirect impacts of such a transfer on those assets.

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<sup>5</sup> Letter from Jeanette Wingler, Assistant General Counsel, FINRA, to Brent J. Fields, Secretary, Commission, dated March 17, 2016.

As stated in the Notice, FINRA believes that former customers would benefit from receiving a concise, plain-English document that highlights the potential implications of transferring assets. The proposed educational communication is intended to encourage former 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 to his or her decision making.

#### Educational Communication

The proposed rule change would require a member that hires or associates with a registered representative to provide to a former customer of the representative, individually, in paper or electronic form, an educational communication prepared by FINRA. The proposed rule change would require delivery of the educational communication when: (1) the 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.<sup>6</sup>

The proposed rule change would define a "former customer" as any customer that had a securities account assigned to a registered person at the representative's previous firm. The term "former customer" would not include a customer account that meets the definition of an "institutional account" pursuant to FINRA Rule 4512(c); provided, however, accounts held by a natural person would not qualify for the institutional account exception.<sup>7</sup>

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<sup>6</sup> See proposed FINRA Rule 2273(a).

<sup>7</sup> See proposed FINRA Rule 2273.01 (Definition). FINRA Rule 4512(c) defines the term institutional account to 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 of 1940 or with a state securities commission (or any agency or office performing like functions);

The educational communication focuses on important considerations for a former customer who is contemplating transferring assets to an account assigned to his or her former representative at the recruiting firm. The educational communication would highlight the following potential implications of transferring assets to the recruiting firm: (1) whether financial incentives received by the representative may create a conflict of interest; (2) that some assets 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 account maintenance fees to leave them with his or her current firm; (3) potential costs related to transferring assets to the recruiting firm, including differences in the pricing structure and fees imposed by the customer's current firm and the recruiting firm; and (4) differences in products and services between the customer's current firm and the recruiting firm.

The educational communication is intended to prompt a former customer to make further inquiries of the transferring representative and recruiting firm (and, if necessary, the customer's current firm), to the extent that the customer considers the information important to his or her decision making.

#### Requirement to Deliver Educational Communication

As stated in the Notice, FINRA believes 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.<sup>8</sup> These communications may include, but are not limited to, oral or written communications by the transferring representative: (1) informing the former customer that he or she is now associated with the recruiting firm, which

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or (3) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.

<sup>8</sup> See Notice, supra note 3, 80 FR at 81591.

would include customer communications permitted under the Protocol for Broker Recruiting (“Protocol”);<sup>9</sup> (2) suggesting that the former customer consider transferring his or her assets or account to the recruiting firm; (3) informing the former customer that the recruiting firm may offer better or different products or services; or (4) discussing with the former customer the fee or pricing structure of the recruiting firm.

Furthermore, as stated in the Notice, FINRA would consider oral or written communications to a group of former customers to similarly trigger the requirement to deliver the educational communication under the proposed rule change.<sup>10</sup> These types of oral or written communications by a member, directly or through the representative, to a group of former customers may include, but are not limited to: (1) mass mailing of information; (2) sending copies of information via email; or (3) automated phone calls or voicemails.

#### Timing and Means of Delivery of Educational Communication

The proposed rule change would require a member to deliver the educational communication at the time of the first individualized contact with a former customer by the member, directly or through the representative, regarding the former customer transferring assets to the member.<sup>11</sup> If such contact is in writing, the proposed rule change would require the educational communication to accompany the written communication. If the contact is by

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<sup>9</sup> 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.

<sup>10</sup> See Notice, supra note 3, 80 FR at 81591.

<sup>11</sup> See proposed FINRA Rule 2273(b)(1).

electronic communication, the proposed rule change would permit the member to hyperlink directly to the educational communication.<sup>12</sup>

If the first individualized contact with the former customer is oral, the proposed rule change would require the member or representative to notify the former customer orally that an educational communication that includes important considerations in deciding whether to transfer assets to the member will be provided not later than three business days after the contact. The proposed rule change would require the educational communication be sent within three business days from such oral contact or with any other documentation sent to the former customer related to transferring assets to the member, whichever is earlier.<sup>13</sup>

If the former customer seeks to transfer assets to an account assigned, or to be assigned, to the representative at the member, but no individualized contact with the former customer by the representative or member occurs before the former customer seeks to transfer assets, the proposed rule change would mandate that the member deliver the educational communication to the former customer with the account transfer approval documentation.<sup>14</sup> The educational communication requirement in the proposed rule change would apply for a period of three months following the date that the representative begins employment or associates with the member.<sup>15</sup>

Pursuant to the proposed rule change, the educational communication requirement would not apply when the former customer expressly states that he or she is not interested in transferring assets to the member. If the former customer subsequently decides to transfer assets

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<sup>12</sup> See proposed FINRA Rule 2273(b)(1)(A).

<sup>13</sup> See proposed FINRA Rule 2273(b)(1)(B).

<sup>14</sup> See proposed FINRA Rule 2273(b)(2).

<sup>15</sup> See proposed FINRA Rule 2273(b)(3).

to the member without further individualized contact within the period of three months following the date that the representative begins employment or associates with the member, then the educational communication would be required to be provided with the account transfer approval documentation.<sup>16</sup>

#### Format of Educational Communication

To facilitate uniform communication under the proposed rule change and to assist members in providing the proposed communication to former customers of a representative, the proposed rule change would require a member to deliver the proposed educational communication prepared by FINRA to the former customer, individually, in paper or electronic form.<sup>17</sup> The proposed rule change would require members to provide the FINRA-created communication and would not permit members to use an alternative format.<sup>18</sup> As stated in the Notice, FINRA believes that the FINRA-created uniform educational communication will allow members to provide the required communication at a relatively low cost and without significant administrative burdens.<sup>19</sup>

### III. Summary of Comment Letters and FINRA's Response

#### Overall Proposal

Two commenters stated that the current proposal is an improvement from the previous version of the proposal.<sup>20</sup> Eight additional commenters expressed support for a regulatory effort to provide investors with meaningful information upon which to base a decision to transfer assets

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<sup>16</sup> See proposed FINRA Rule 2273.02 (Express Rejection by Former Customer).

<sup>17</sup> See proposed FINRA Rule 2273(a) and Exhibit 3.

<sup>18</sup> See proposed FINRA Rule 2273(a).

<sup>19</sup> See Notice, supra note 3, 80 FR at 81592.

<sup>20</sup> Lincoln and FSI.

but did not support all aspects of the current proposal.<sup>21</sup> Two commenters opposed the current proposal and instead supported a return to the requirement in a previous version of the proposal to provide specific information about any financial incentives received by the representative and costs associated with the former customer transferring assets.<sup>22</sup> Alternatively, another commenter suggested requiring the member to provide written answers to the questions included in the educational communication if the customer so requests.<sup>23</sup> One commenter maintained that the proposal is not justified by its costs because there are no systemic issues with the current account transfer process, which also includes some disclosure.<sup>24</sup>

In its response to commenters, FINRA states that it believes that the proposal will promote investor protection by highlighting important conflict and cost considerations of transferring assets and encouraging customers to make further inquiries to reach an informed decision about whether to transfer assets to the recruiting firm. Furthermore, FINRA's response to commenters notes that, as explained in more detail in the Notice, FINRA considered several alternatives to the proposal to help ensure that it is narrowly tailored to achieve its purposes without imposing unnecessary costs and burdens on members.<sup>25</sup> FINRA believes that the proposed rule is an effective and efficient alternative to the previous proposal. While educating former customers about important considerations to make an informed decision whether to transfer assets to the recruiting firm, FINRA believes the proposed rule eliminates or reduces the privacy and operational concerns raised regarding the previous proposal (e.g., by removing the

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<sup>21</sup> SIFMA, LPL, Wells Fargo, RJFS, RJFA, Commonwealth, and HD Vest.

<sup>22</sup> PIABA and GSU.

<sup>23</sup> GSU.

<sup>24</sup> HD Vest.

<sup>25</sup> See Notice, supra note 3, 80 FR at 81593.

requirement to disclose to former customers the magnitude of recruitment compensation paid to a transferring representative). FINRA notes that the dialogue prompted by the educational communication could include a discussion with the transferring representative about more specifics related to the incentives and costs associated with the transfer.

FINRA further states in its response to commenters that it believes that former customers would benefit from receiving a concise, plain-English document that highlights the potential implications of transferring assets, such as conflict and cost considerations, several of which are not disclosed or otherwise brought to the attention of a customer as part of the account transfer approval documentation.

#### Requirement to Deliver the Educational Communication

One commenter supported the proposal's delivery requirements as providing a "clear and straightforward standard."<sup>26</sup> The commenter further stated that with the "straightforward standard, firms will be able to easily create and implement policies, procedures and systems to comply with the rule."<sup>27</sup> Some commenters, on the other hand, stated that the triggers for delivering the educational communication would be complex and difficult for members to implement as members would be dependent on reporting by representatives to members with respect to each individualized contact with a former customer.<sup>28</sup> Some commenters commented that compliance with the proposed rule would require significant time and effort on the part of members and would result in significant costs.<sup>29</sup>

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<sup>26</sup> FSI.

<sup>27</sup> FSI.

<sup>28</sup> Commonwealth and HD Vest.

<sup>29</sup> Commonwealth and HD Vest.

In its response to commenters, FINRA states that it does not believe that the burdens associated with tracking whether there has been individualized contact with a former customer are unreasonable relative to the value in providing the educational communication to such customers. Moreover, FINRA's response to commenters notes that, as FINRA stated in the Notice, members already are obligated to supervise representatives' communications with existing or prospective customers and have flexibility to design their supervisory systems to track communications soliciting new business from former customers of representatives.<sup>30</sup> As such, FINRA does not believe the proposed rule change imposes substantially new or burdensome obligations by requiring firms to establish policies and procedures reasonably designed to ensure that the educational communication is timely delivered to former customers.

One commenter stated that a member cannot supervise communications between representatives and former customers before such customers establish accounts at the member.<sup>31</sup> In its response to commenters, FINRA states that it disagrees. If a representative is associated with or employed by a member, FINRA notes that the member is required to supervise the representative's conduct consistent with FINRA rules, including FINRA Rule 2210 (Communications with the Public). FINRA notes that the standards applicable to retail communications and correspondence under Rule 2210, as well as the requirements to supervise correspondence pursuant to FINRA Rule 3110 (Supervision), are not limited to communications with current customers. FINRA states that therefore, the fact that a former customer or any other individual has not yet established an account at the member does not obviate those supervision requirements.

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<sup>30</sup> See Notice, supra note 3, 80 FR at 81595.

<sup>31</sup> HD Vest.

### *Individualized Contact*

Some commenters requested additional guidance as to what individualized contact with a former customer would trigger the requirement to deliver the educational communication.<sup>32</sup> FINRA's response to commenters notes that, as stated in the Notice, it intends for a broad range of oral or written communications by a recruiting firm, directly or through a representative, to constitute individualized contact with a former customer to transfer assets and therefore trigger the delivery of the educational communication under the proposed rule.<sup>33</sup> FINRA notes that the Notice provides several examples of such individualized contacts, including a written or oral communication informing the customer that the representative is now associated with the recruiting firm.<sup>34</sup> In its response to commenters, FINRA states that it will consider giving additional guidance, as appropriate, where questions about specific types of individualized contact arise.

The proposed rule change would require delivery of the educational communication, absent individualized contact, with account transfer approval documentation. One commenter supported requiring delivery of the educational communication to a former customer, where there is not individualized contact, before the transmittal of the account transfer approval documentation.<sup>35</sup> FINRA's response to commenters notes that to lessen any associated operational and supervisory burdens of implementing the proposed rule, FINRA has not proposed requiring that the educational communication be provided to former customers before the account transfer approval documentation where there is not individualized contact.

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<sup>32</sup> SIFMA, HD Vest, RJA, and RJFS.

<sup>33</sup> See Notice, supra note 3, 80 FR at 81591.

<sup>34</sup> See Notice, supra note 3, 80 FR at 81591.

<sup>35</sup> GSU.

One commenter expressed the view that the different delivery requirements based on whether there was individualized contact would be unworkable as members could not reasonably determine that the receipt of account paperwork was the result of no contact between the registered person and the former customer.<sup>36</sup>

FINRA's response to commenters states that, as set forth in the Notice, FINRA believes that a representative reasonably should know whether an individual had an account assigned to him or her at the representative's prior firm and whether the representative has individually contacted the former customer regarding transferring assets to the recruiting firm.<sup>37</sup> FINRA also states in its response to commenters that it believes that a reasonably designed supervisory system would require the representative to communicate with a member whether he or she had individualized contact with a former customer. As such, FINRA does not believe it is unworkable to distinguish account transfers that resulted absent individualized contact.

Some commenters requested clarification regarding whether the requirements of the proposed rule would be triggered by "unanticipated communications" between a representative and a former customer.<sup>38</sup> In its response to commenters, FINRA explains that the proposed rule would apply where a member, directly or through a representative, individually contacts a former customer of that representative to transfer assets or where a former customer transfers assets to an account assigned to the representative at the member absent individualized contact. As such, FINRA notes that whether contact that occurs with a former customer is planned or serendipitous is not dispositive; rather, it is the substance of the communication that determines if the delivery

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<sup>36</sup> Commonwealth.

<sup>37</sup> See Notice, supra note 3, 80 FR at 81594.

<sup>38</sup> Lincoln, LPL, RJA, and RJFS.

requirement is triggered. Thus, FINRA explains that unanticipated contact with a former customer (*e.g.*, at a sporting or social event) without a communication from the representative to the former customer that would constitute individualized contact, as described above, about transferring assets would not trigger the requirements of the proposed rule. In its response to commenters FINRA notes that, if, for example, the representative took the opportunity of the situation to inform the former customer of his or her move to a new firm and the merits of transferring assets to that new firm, the delivery requirement would be triggered.

#### *Timing and Delivery of Educational Communication*

Several commenters expressed concern with the means and timing of the delivery requirement. Some commenters contended that the requirement to deliver the educational communication within three business days after oral contact by a representative with a former customer would present operational and supervisory challenges, such as training representatives on the scope and practical implications of the requirement, relying on representatives to timely report contacts to the member, and preparing the mailing to former customers within the required period of time.<sup>39</sup> One commenter suggested eliminating the requirement to deliver the educational communication within three business days after oral contact and instead require written delivery in all circumstances.<sup>40</sup> Along with that commenter, some commenters suggested that the requirement to deliver the educational communication be integrated into an existing process, such as including the communication with the account transfer approval documentation, so as to make implementation of the requirement more cost effective and efficient for

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<sup>39</sup> SIFMA, Committee of Annuity Insurers, Lincoln, RJA, RJFS, Commonwealth, and HD Vest.

<sup>40</sup> Wells Fargo.

members.<sup>41</sup> Alternatively, one commenter suggested lengthening the period to deliver the educational communication to 10 business days.<sup>42</sup>

One commenter requested additional analysis and justification for FINRA's belief that delivering the communication at or prior to account opening would be too late because customers typically have already made the decision to transfer assets by that point in the process.<sup>43</sup>

Another commenter stated that requiring the educational communication to accompany the first written communication would mean that any efforts taken by a member to review written communications that have already occurred between a representative and a former customer would be too late to prevent a rule violation.<sup>44</sup>

FINRA's response to commenters notes that with respect to delivery after oral contact, as stated in the Notice, FINRA believes that the three-business-day period gives a representative sufficient time to inform the recruiting firm of the former customers who have been contacted and, in turn, for the recruiting firm to send the educational communication to those former customers.<sup>45</sup> Furthermore, as stated in its response to commenters, FINRA understands that members frequently send account opening documentation within that time frame to customers that have indicated an interest in opening an account. FINRA also notes that it sought data and evidence around the associated costs of the proposed rule and that commenters did not provide specific data or analysis to support their contention that the delivery requirements as proposed

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<sup>41</sup> Wells Fargo, SIFMA, Lincoln, Committee of Annuity Insurers, RJA, RJFS, Commonwealth, and HD Vest.

<sup>42</sup> HD Vest.

<sup>43</sup> SIFMA.

<sup>44</sup> Commonwealth.

<sup>45</sup> See Notice, supra note 3, 80 FR at 81595-81596.

would present considerable additional costs for recruiting firms. Accordingly, FINRA does not propose to change the requirement in the proposed rule.

As explained in its response to commenters and in more detail in the Notice, FINRA believes that to be effective, the proposed educational communication must be accessible to the former customer at or shortly after the time the first individualized contact is made by the recruiting firm or the representative.<sup>46</sup> In its response to commenters, FINRA notes that the delivery requirement will allow the customer the time needed to have discussions with the registered representative and the customer's current firm about the implications of transferring assets in close proximity to receipt of any information the representative may have provided to encourage a transfer and will facilitate an informed and reasoned decision. FINRA further notes that some commenters to its Regulatory Notice 15-19,<sup>47</sup> where FINRA first proposed the delivery requirements, noted the benefits of timely delivery. FINRA points out that two commenters to Regulatory Notice 15-19 supported requiring delivery of the educational communication prior to the time that a former customer decides to transfer assets to the recruiting firm to ensure that the former customer has sufficient time to consider and respond to the information in the communication.<sup>48</sup> FINRA also notes that another broker-dealer commenter that favored contemporaneous delivery of the educational communication at the time

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<sup>46</sup> See Notice, *supra* note 3, 80 FR at 81595.

<sup>47</sup> See FINRA Requests Comment on a Proposed Rule to Require Delivery of an Educational Communication to Customers of a Transferring Representative, Regulatory Notice 15-19, at 4 (May 2015) ("Notice 15-19").

<sup>48</sup> See Letter from Jeffrey T. Brown, Senior Vice President and Head of Legislative and Regulatory Affairs, Charles Schwab & Co., Inc., to Marcia E. Asquith, Senior Vice President and Corporate Secretary of FINRA, dated July 13, 2015; and letter from Joseph C. Peiffer, President, Public Investors Arbitration Bar Association, to Marcia E. Asquith, Senior Vice President and Corporate Secretary of FINRA, dated July 13, 2015.

of first individualized contact stated that permitting three business days following an oral communication was too late as many customers will make a determination to transfer assets prior to receiving the communication.<sup>49</sup>

In its response to commenters, FINRA states that it agrees with the commenters that providing the communication at the time of account opening would be less effective than the proposed approach as customers have already made the decision to transfer assets at the time the customer has initiated the account opening process. Similarly, FINRA states that it believes a requirement to permit delivery of the educational communication at any time prior to account opening would allow members to wait until the customer agrees to transfer assets to the member or until shortly before the account is opened before delivering the educational communication.

Finally, with respect to one comment that post-use review of communications cannot prevent a violation of the requirement that the educational communication accompany written first individualized contact,<sup>50</sup> FINRA notes in its response to commenters that its rules provide members' some flexibility with respect to review of representatives' communications with customers and require review of only some communications prior to first use or distribution.<sup>51</sup> Consistent with those rules, FINRA states that a member would not necessarily need to implement prior use approval of every written communication to a former customer to have

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<sup>49</sup> See Letter from Jesse Hill, Principal – Government and Regulatory Relations, Edward Jones, to Marcia E. Asquith, Senior Vice President and Corporate Secretary of FINRA, dated July 14, 2015.

<sup>50</sup> Commonwealth.

<sup>51</sup> FINRA states, for example, that correspondence with customers is subject to the supervision and review requirements of FINRA Rules 3110(b) and 3110.06 through .09. While review of all institutional communications is not required prior to first use or distribution, FINRA states that FINRA Rule 2210(b)(1)(A) requires that an appropriately qualified registered principal of the member must approve each retail communication before the earlier of its use or filing with FINRA's Advertising Regulation Department.

policies and procedures reasonably designed to achieve compliance with the proposed rule change.

#### Duration of Delivery Requirement

Under the proposed rule change, the delivery of the educational communication would apply for three months following the date the representative begins employment or associates with the member. One commenter supported shortening the applicable time period from six months as proposed in Notice 15-19<sup>52</sup> to three months as proposed in the Notice.<sup>53</sup> On the other hand, two commenters supported extending the period to one year.<sup>54</sup>

In its response to commenters, FINRA states that it believes the three-month period strikes an appropriate balance between achieving the regulatory objective of an informed decision by former customers most likely to consider transferring assets as the result of their representative's move to a new firm, while lessening the economic impacts on members.

#### Efforts by Current Firm to Retain Customers

One commenter favored requiring a customer's current firm to deliver the educational communication to the customer and including questions in the communication that a customer may wish to consider if the current firm is soliciting a customer to keep his or her account with the firm.<sup>55</sup> Another commenter also supported including specific disclosure about the incentives that employees of the current firm may receive for retaining the customer.<sup>56</sup>

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<sup>52</sup> See Notice 15-19, supra note 47, at 4.

<sup>53</sup> SIFMA.

<sup>54</sup> PIABA and GSU.

<sup>55</sup> Lincoln.

<sup>56</sup> PIABA.

FINRA's response to commenters states that, as noted in the Notice, FINRA is focused on providing customers impactful information to consider when deciding whether to transfer assets to a representative's new firm, where cost and portability issues are most likely to arise and where some potential conflicts (*e.g.*, financial incentives to attract new assets) are more pronounced.<sup>57</sup> In its response to commenters, FINRA states that while the proposed rule change would not require the current firm to provide the educational communication to a customer, the proposed educational communication does note that "some firms pay financial incentives to retain brokers or customers." FINRA further states that it believes that the communication will prompt customers to consider the implications of both staying and moving when urged to do so by representatives of either firm. Furthermore, FINRA notes that requiring the current firm to also provide the educational communication to a customer whose representative has transferred to a new firm would result in the customer receiving multiple copies of the same communication.

#### Contractual and Legal Considerations

Three commenters suggested including a statement in the educational communication that the communication is not intended as a solicitation or to encourage or discourage the transfer of customer assets.<sup>58</sup> Two commenters asked FINRA to amend the proposed rule to include a provision stating that compliance with the rule is not intended to interfere with members' obligations under Regulation S-P, the Protocol or other contractual non-solicitation obligations.<sup>59</sup>

In its response to commenters, and as noted in the Notice in response to earlier comments of the same nature, FINRA states that it does not intend the proposed rule to impact any

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<sup>57</sup> See Notice, *supra* note 3, 80 FR at 81598.

<sup>58</sup> SIFMA, HD Vest, and LPL.

<sup>59</sup> RJA and RJFS.

contractual agreement between a representative and his or her former firm or new firm and does not require members to disclose information in a manner inconsistent with Regulation S-P.<sup>60</sup>

FINRA notes that the proposed rule change assumes that recruiting firms and representatives will act in accordance with the contractual obligations established in employment contracts, state law, and, if applicable, the Protocol. Furthermore, in its response to commenters, FINRA states that it 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. FINRA does not believe it necessary or appropriate to include any statement regarding solicitation in the educational communication, which by itself and its own terms cannot reasonably be considered to encourage or discourage the transfer of assets.

One commenter stated that an exception from Regulation S-P was needed to permit transferring representatives to take limited customer information with them to their new firms in order to comply with the requirements of the proposed rule.<sup>61</sup> In its response to commenters, FINRA disagrees. FINRA states that the proposed rule does not require contact with any former customers, but rather, only requires delivering the educational communication once a transferring representative or the recruiting firm makes individualized contact with a former customer about transferring assets to an account assigned to the representative at the member. FINRA states that it believes that in most instances, a former customer will not be contacted in the first instance unless the representative or recruiting firm already has the customer's contact information. In those rare circumstances where individualized contact that triggers the requirements of the rule happens by chance or without contact information, FINRA believes the

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<sup>60</sup> See Notice, supra note 3, 80 FR at 81599.

<sup>61</sup> HD Vest.

representative or recruiting firm can ask the customer for the contact information needed to deliver the educational communication.

### Scope of Proposal

#### *Customers*

Two commenters supported expanding the requirement to apply to all customers of a representative, not just a representative's former customers.<sup>62</sup> One commenter recommended that the proposed rule incorporate the definition of institutional account in FINRA Rule 4512(c) (Customer Account Information) without excluding accounts held by any natural person.<sup>63</sup>

In its response to commenters, FINRA declines to revise the definition of "former customer" or to extend the requirement to apply to other customers of a representative. Furthermore, FINRA's response to commenters notes that, as stated in the Notice, FINRA believes that former customers that a member or representative individually contacts to transfer assets to a new firm are most impacted in recruitment situations because they have already developed a relationship with the representative and because their assets may be both the basis for the representative's recruitment compensation and subject to potential costs and changes if the customer decides to move those assets to the recruiting firm.<sup>64</sup> In its response to commenters, FINRA states that it believes that it is appropriate to include natural persons who would be considered institutional accounts under Rule 4512(c), as these individuals may not be aware of the implications of transferring assets.

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<sup>62</sup> PIABA and GSU.

<sup>63</sup> SIFMA.

<sup>64</sup> See Notice, supra note 3, 80 FR at 81600.

Two commenters supported requiring customer affirmation of the receipt of the educational communication.<sup>65</sup> FINRA's response to commenters explains that, as noted in more detail in the Notice, while some firms may elect to include a customer affirmation requirement as part of their supervisory controls in implementing the proposed rule change, FINRA believes the requirements of the rule will ensure that former customers receive and have an opportunity to review the information in the proposed educational communication before they decide to transfer assets to a recruiting firm.<sup>66</sup> In addition, FINRA states that it does not want to impose any additional obligations that may impede the timely transfer of customer assets between members.

*Members and Registered Representatives*

One commenter requested clarification regarding whether the proposed rule would apply to representatives who are employed by or associated with a member in a non-financial advisor role (*e.g.*, operations or non-producing branch/complex managers), but who may have customer accounts assigned to them that are incidental to their primary job function.<sup>67</sup> FINRA states in its response to commenters that to the extent a representative has accounts assigned to him or her at the new firm, FINRA sees no reason to distinguish those accounts based on the representative's primary function, as the implications for the former customers are the same. Accordingly, FINRA believes that because an account assigned to a representative may be incidental to a representative's primary job function should not obviate the requirements of the proposed rule.

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<sup>65</sup> PIABA and GSU.

<sup>66</sup> See Notice, supra note 3, 80 FR at 81597.

<sup>67</sup> SIFMA.

Two commenters requested clarification on whether the proposed rule would apply when a representative transfers between broker-dealer subsidiaries of the same holding company.<sup>68</sup> In its response to commenters, FINRA states that it believes that the facts and circumstances of such representative transfers may vary. FINRA will consider giving additional guidance, as appropriate, where specific questions arise regarding representative transfers between broker-dealer subsidiaries of the same holding company.

In the Notice, FINRA interpreted the proposed rule change as not applying to circumstances where a customer's account is proposed to be transferred to a new member via bulk transfer or due to a change of broker-dealer of record.<sup>69</sup> Four commenters supported the clarification provided in the Notice in these contexts.<sup>70</sup> One commenter stated that the interpretation that the proposed rule would not apply should be extended to include all changes in networking arrangements between a financial institution and a broker-dealer, and not just those for which bulk transfers are used.<sup>71</sup>

In its response to commenters, FINRA states that it believes that the considerations set forth in the educational communication do not have the same application in the context of a bulk transfer as they do when a customer has a viable choice between staying at his or her current firm with the same level of products and services or transferring assets to the recruiting firm, with the attendant impacts. Because the facts and circumstances of changes in networking arrangements between a financial institution and a broker-dealer outside the bulk transfer context may vary,

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<sup>68</sup> RJA and RJFS.

<sup>69</sup> See Notice, supra note 3, 80 FR at 81596.

<sup>70</sup> SIFMA, FSI, Committee of Annuity Insurers, and LPL.

<sup>71</sup> LPL.

FINRA will consider giving additional guidance, as appropriate, where specific questions arise for changes in networking arrangements outside the bulk transfer context.

In the Notice, FINRA stated that the proposed rule change would apply to a registered person dually registered as an investment adviser and broker-dealer at the former firm who associates with a member firm in both an investment advisory and broker-dealer capacity.<sup>72</sup> One commenter supported the clarification provided in the Notice regarding the treatment of dual hatted persons.<sup>73</sup> Another commenter noted that there may be instances where dually registered representatives have former clients with only investment advisory accounts at the former firm and requested clarification on whether the proposed rule would apply to such former customers.<sup>74</sup>

In its response to commenters, FINRA notes that it proposed to define “former customer” to include any customer that had a securities account assigned to a representative at the representative’s previous firm, excluding a customer account that meets the definition of an institutional account pursuant to Rule 4512(c) other than accounts held by any natural person. FINRA would interpret this definition to include an individual who had only an investment advisory account at the representative’s old firm. FINRA notes that the proposed rule would not apply if the registered person transferred to a non-member firm or associated with a member firm only as an investment adviser representative.

### Terminology

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<sup>72</sup> See Notice, supra note 3, 80 FR at 81601.

<sup>73</sup> SIFMA.

<sup>74</sup> LPL.

Two commenters supported replacing the term “broker” in the educational communication with the term “registered representative.”<sup>75</sup>

In its response to commenters, FINRA declines to make the requested change as it believes “broker” is a commonly understood generic term for a registered representative. It is used in the proposed educational communication for readability and brevity purposes, which FINRA believes is important to encourage customers to read the document.

#### Implementation Date

One commenter requested that the implementation date of the proposed rule be at least 180 days from the date that the proposed rule is finalized so as to provide members with sufficient time to design, adopt, and implement appropriate policies and procedures to achieve compliance with the rule.<sup>76</sup>

In its response to commenters, FINRA states that it will consider the need to develop compliance systems and make operational changes in establishing an effective date for the proposed rule.

#### IV. Discussion and Commission Findings

After carefully considering the proposal, the comments submitted, and FINRA’s response to the comments, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and rules and regulations thereunder applicable to a national securities association.<sup>77</sup> In particular, the Commission finds that the proposed rule change is

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<sup>75</sup> RJFS, RJFA.

<sup>76</sup> SIFMA.

<sup>77</sup> In approving the proposed rule change, the Commission has considered the impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

consistent with Exchange Act Section 15A(b)(6),<sup>78</sup> which requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change would increase the information available to investors regarding the potential implications of transferring assets. The Commission further believes that the proposed educational communication may encourage former customers to make inquiries of their representatives, which could increase communication between customers and representatives about the potential implications of transferring assets. The Commission believes that the increase in information and communication about the potential implications of transferring assets will benefit customers when deciding whether to transfer assets.

The Commission does not believe that the proposed rule change will result in a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission believes FINRA has carefully crafted the proposed rule change to achieve its intended and necessary regulatory purpose while minimizing the burden on firms. Although the proposed rule change will impose new requirements upon FINRA members, it will apply equally to all FINRA members when hiring or otherwise associating with a registered representative.

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<sup>78</sup> 15 U.S.C. 78o-3(b)(6).

The Commission has considered the commenters' views on the proposed rule change and believes that FINRA responded appropriately to the concerns raised.

For the reasons stated above, the Commission finds that the rule change is consistent with the Act and the rules and regulations thereunder.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Exchange Act Section 19(b)(2)<sup>79</sup> that the proposed rule change (SR-FINRA-2015-057) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>80</sup>

Brent J. Fields  
Secretary

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<sup>79</sup> 15 U.S.C. 78s(b)(2).

<sup>80</sup> 17 CFR 200.30-3(a)(12).