

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-84788; File No. SR-FINRA-2018-040)

December 11, 2018

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to FINRA Rule 4512 (Customer Account Information)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“SEA,” “Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 28, 2018, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend paragraph (a)(3) of FINRA Rule 4512 (Customer Account Information) to permit the use of electronic signatures and to clarify the scope of the rule.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

With respect to a discretionary customer account maintained by a member, FINRA Rule 4512(a)(3) requires the firm to obtain the manual dated signature of each named, natural person authorized to exercise discretion in the account. Because the rule only applies to discretionary accounts maintained by a member, the named natural person would inevitably be an associated person of the firm.³ Currently, to comply with the rule, members must obtain the associated person’s “wet” signature or a copy of his or her wet signature, such as a scanned or faxed copy of the wet signature.⁴ The rule also requires

³ There is a corresponding requirement under NASD Rule 2510 (Discretionary Accounts) prohibiting members and their registered representatives from exercising any discretionary power in a customer’s account unless the customer has given prior written authorization to a stated individual or individuals, and the account has been accepted by the firm as evidenced in writing by the firm or a designated partner, officer or manager of the firm. These signatures need not be manual. In addition, SEA Rule 17a-3(a)(17)(ii) requires that, for discretionary accounts with a natural person, broker-dealers maintain a record containing the dated signature of each natural person to whom discretionary authority was granted. This signature also need not be manual.

⁴ The terms “manual” and “wet” are used interchangeably in this proposed rule change.

members to maintain and preserve a record of the signature for at least six years after the date the account is closed.⁵ The purpose of the signature is to validate that the authorized associated person is who he or she purports to be. In light of the industry's shift towards automated and electronic processes, members have requested that FINRA reevaluate the need for wet signatures under the rule.

In general, members have stated that the requirement to obtain wet signatures raises operational and cost concerns without providing meaningful investor protection benefits. In addition, some members have noted that the requirement puts them at a competitive disadvantage over investment advisers because investment advisers are allowed to obtain electronic signatures. Finally, members that have adopted automated and electronic processes have stated that the current requirement results in significant administrative inefficiencies, particularly because all other account documentation, including the customer authorization form, and related recordkeeping may be completed electronically through a streamlined process.⁶

Given technological advances relating to electronic signatures, including with respect to authentication and security, FINRA believes that the requirement under Rule 4512(a)(3) that members obtain an associated person's wet signature has become obsolete. Therefore, FINRA is proposing to amend the rule to permit the use of

⁵ For retention purposes, members may choose to maintain and preserve the signature record on any of the acceptable media specified in SEA Rule 17a-4, including electronic storage media consistent with SEA Rule 17a-4(f).

⁶ To comply with FINRA Rule 4512(a)(3), most of these firms currently print a paper copy of the account record and require that the authorized associated person physically sign it. They then convert the paper record to an electronic record for retention on electronic storage media. These firms have stated that this two-step process creates unnecessary inefficiencies and administrative burdens.

electronic signatures. The proposed rule change is consistent with the Electronic Signatures in Global and National Commerce Act (“E-Sign Act”), which facilitates the use of electronic signatures. The proposed rule change is also consistent with the requirements of SEA Rule 17a-3(a)(17)(ii),⁷ which does not prescribe the type of signature that must be obtained from an authorized individual. While FINRA Rule 4512(a)(3) would continue to require members to obtain the signature of an associated person, it would provide firms the option of obtaining either a manual or an electronic signature.

For purposes of compliance with FINRA Rule 4512(a)(3), a valid electronic signature would be any electronic mark that clearly identifies the signatory and is otherwise in compliance with the E-Sign Act, the guidance issued by the Securities and Exchange Commission relating to the E-Sign Act,⁸ and the guidance provided by FINRA staff through interpretive letters.⁹

In addition, FINRA is proposing to amend Rule 4512(a)(3) to clarify that the rule is limited to discretionary customer accounts maintained by a member for which associated persons of the member are authorized to exercise discretion. Specifically, FINRA is proposing to amend the rule to state that for a discretionary customer account maintained by a member, the member must obtain the dated signature of each named,

⁷ 17 CFR 240.17a-3(a)(17)(ii).

⁸ See Securities Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001) (Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media Under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f)).

⁹ See, e.g., Letter from Nancy Libin, NASD, to Jeffrey W. Kilduff, O’Melveny & Myers, LLP, dated July 5, 2001, <http://www.finra.org/industry/interpretive-letters/july-5-2001-1200am>.

associated person of the member authorized to exercise discretion in the account. This proposed change would eliminate any potential confusion regarding the scope of the rule and aid members' compliance efforts.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change would provide members the option of obtaining either manual or electronic signatures for purposes of compliance with FINRA Rule 4512(a)(3). FINRA believes that permitting the use of electronic signatures will provide flexibility in compliance without diminishing investor protection. The proposed rule change would also clarify that the signature requirement for discretionary accounts is limited to customer accounts maintained by a member for which associated persons of the member are authorized to exercise discretion, which would eliminate any potential confusion regarding the scope of the rule and assist members in their compliance efforts.

¹⁰ 15 U.S.C. 78o-3(b)(6).

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet its regulatory objective.

Regulatory Need

FINRA Rule 4512(a)(3) requires a member to validate the identity of associated persons who are authorized to exercise discretion in customer accounts maintained by the member. However, the current rule only allows members to validate the identity of such individuals by obtaining their manual signatures. This requirement may present operational and administrative burdens for members that have adopted automated and electronic processes for account documentation and related recordkeeping. In light of technological advances and the widespread use of electronic signatures in the financial services industry, FINRA believes that it is appropriate to provide members the option of obtaining electronic signatures to satisfy the signature requirement under FINRA Rule 4512(a)(3). FINRA believes that the clarifying amendment regarding the scope of the rule will eliminate potential confusion and assist members in their compliance efforts.

Economic Baseline

Current FINRA Rule 4512(a)(3) requires that a member validate the identity of an associated person authorized to exercise discretion in a customer's account by obtaining the associated person's wet signature. This typically requires that the customer authorization form be printed, manually signed by the associated person, and—if the member keeps electronic records—scanned for retention purposes.

Assets in discretionary accounts grew from 10% to 15% of total retail assets between 2014 and 2017.¹¹ Further, there are more than 100 million brokerage accounts and 14 million fee-based accounts,¹² and approximately 60% of U.S. households own one or more investment accounts.¹³ However, FINRA does not know what percentage of these accounts are discretionary accounts maintained by members.

Economic Impact

The proposed rule change to permit the use of electronic signatures provides an additional avenue for complying with an existing requirement. The primary benefit of the proposed rule change is that it may yield a net cost savings to members because they will no longer be required to conduct a manual process. Members may experience cost

¹¹ See PriceMetrix, The State of Wealth Management, 7th ed., <https://www.mckinsey.com/~media/mckinsey/industries/financial%20services/our%20insights/the%20state%20of%20retail%20wealth%20management%20in%20north%20america/the-state-of-retail-wealth-management.ashx>.

¹² See Wall Street Journal, Is It Time to Adopt a Uniform Fee-Only Standard for Financial Advice? (March 18, 2018) (stating that U.S. investors hold more than 100 million brokerage accounts and 14 million fee-based accounts), <https://www.wsj.com/articles/is-it-time-to-adopt-a-uniform-fee-only-standard-for-financial-advice-1521424980>.

¹³ See FINRA Investor Education Foundation, A Snapshot of Investor Households in America (September 2015), <https://www.finrafoundation.org/files/snapshot-investor-households-america>.

savings in the form of time and physical supplies as a result of the proposed rule change. This benefit will accrue to those members that maintain discretionary accounts and that wish to validate the identity of their associated persons via electronic signature as well as to the associated persons of such firms.

The proposed rule change will benefit those members willing to leverage electronic signatures more than those that will maintain their manual (wet signature) process. Further, greater benefit will accrue to members that frequently accept discretionary authority over customer accounts than those that do so infrequently. However, the proposed rule change will apply to all members equally. Even if a member does not experience cost savings, the proposed rule change would not result in a greater cost burden to any firm because the proposed rule change provides an additional option for compliance and does not impose a new requirement. Further, it should not interfere with or impede the forces of competition among members.

An additional benefit may be increased regulatory consistency insofar as similar requirements by other regulators allow for electronic signatures. For example, the SEC allows investment advisers to utilize electronic signatures for documentation of discretionary authority.¹⁴ The proposed rule change should facilitate compliance for all members, but especially for dually-registered firms. Further, because investment advisers are already allowed to use electronic signatures for discretionary accounts, allowing members to use them will create a more level playing field between investment advisers and broker-dealers.

¹⁴ Moreover, as noted above, SEA Rule 17a-3(a)(17)(ii) does not impose a manual signature requirement on broker-dealers. See supra note 3.

Finally, the proposed rule change should not undermine investor protection because the primary investor protection features relating to the exercise of discretion in a customer account, including the customer's prior written authorization permitting the exercise of discretion, remain intact under NASD Rule 2510.¹⁵ In addition, associated persons with discretionary authority will continue to be required to acknowledge their discretionary authority over accounts, and firms will have documented evidence of that authority.

Alternatives Considered

FINRA considered whether members could authenticate the identity of an authorized associated person other than by obtaining the individual's signature. FINRA determined that requiring members to use different means, other than signatures, to validate the identity of authorized associated persons could create confusion and potential compliance issues, particularly in light of the signature requirement under SEA Rule 17a-3(a)(17)(ii).¹⁶

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date

¹⁵ See supra note 3.

¹⁶ 17 CFR 240.17a-3(a)(17)(ii).

if it finds such longer period to be appropriate and publishes its reasons for so finding or
(ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2018-040 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2018-040. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed

with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2018-040 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷

Eduardo A. Aleman
Deputy Secretary

¹⁷ 17 CFR 200.30-3(a)(12).