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Via E-Mail- pubcom@finra.org

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 08-24, Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls

Dear Ms. Asquith:

The Financial Planning Association ("FPA")[1] welcomes the opportunity to comment on the Financial Industry Regulatory Authority ("FINRA") Regulatory Notice 08-24 ("Regulatory Notice"), Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls. Nearly half of FPA's 29,000 members would be affected directly, or indirectly, by the proposed rule as affiliated representatives of FINRA member firms. Additionally, nearly one-half of FPA members are affiliated with SEC-registered investment advisers, and nearly one-quarter with state-registered advisers, many of whom carry separate FINRA licenses.

FPA would like to take this opportunity to express our serious concerns with certain aspects of the Regulatory Notice – specifically, proposed rule 3110 ("proposed rule"). As written, we believe the proposed rule could be interpreted as requiring FINRA member firms to supervise the business activities of separately regulated entities and persons, unrelated to securities and investment banking. Reading the proposal in that light, we offer these comments. Broadly stated, while we recognize the need for broker-dealers to be responsible for securities transactions undertaken by their registered representatives, we are very concerned about maintaining a clear separation of functional regulation under the federal securities laws between broker-dealers ("B-Ds") and financial planning, investment advisory and other activities subject to the Investment Advisers Act of 1940 ("Advisers Act").[2] Moreover, to the extent that the proposed rule would extend FINRA and FINRA member oversight of activities that are neither

[1]The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms, with approximately 29,000 individual members. Most are affiliated with investment adviser firms registered with the Securities and Exchange Commission or state securities administrators, and more than one-half are affiliated with broker-dealers. FPA is incorporated in Washington, D.C., where it maintains an advocacy office, with headquarters in Denver, Colo.

[2] 15 U.S.C. 80b.

investment banking nor securities transactions, FPA is concerned that it exceeds statutory limits on the authority of self-regulatory organizations.

I. Current Financial Services Regulatory Environment

It is appropriate to view the proposed rule in the context of the broader financial services regulatory environment. In particular, we note the widespread acceptance of the principal of functional regulation, whereby regulatory oversight is based on the type of *activity* a financial services entity is engaging in, rather than on the type of registration/charter the entity holds (broker-dealer, investment advisor, thrift, insurance producer, etc.). Functional regulation is sensible from the perspective of consumers and regulators, as well as for regulated entities. The principal of functional regulation was central to the reforms embodied in the Gramm-Leach-Bliley Act of 1999 ("GLBA")[3], the most significant reform of the financial services regulatory structure in six decades.

A significant challenge in carrying functional regulation forward is the blurring of lines between the financial services being provided to consumers – services that are governed by different laws and standards, and overseen by different regulators. The GLBA, for example, excepted bank depository institutions from registration under the Advisers Act, except in connection with mutual fund managers. The GLBA also created limited exceptions from brokerage activities for banks. In fact, the Regulatory Notice cites the GLBA and functional regulation as a reason for excepting bank-related securities activities from the general supervisory requirements, yet FINRA's concerns regarding functional regulation curiously seem to extend *only* to "bank-related securities activities of a dual employee." In order to apply consistent policy to functional regulation, we believe a second exception should be made from the general supervisory requirements for investment advisor-related activities of a dual employee, which come under the jurisdiction of either the Securities and Exchange Commission or state securities administrators.

More recently, the SEC commissioned a study[4] ("RAND Report") which examined B-D and Investment Adviser ("IA") business practices, and how individual investors understood the respective services, relationships and obligations of B-Ds and IAs. The RAND Report found significant confusion among individual investors regarding the nature of their relationship with their financial services provider and the differing legal duties owed them by the provider. Interestingly, in reviewing the regulatory filings of B-Ds and IAs the RAND Report found "many inconsistencies" which suggested that "many financial service professionals themselves are confused about how they should be reporting their activities." The SEC is now considering how to address this confusion between B-D and IA activities and regulation.

In this context, FPA is disappointed that FINRA is proposing a rule that would add to this confusion and conflict between higher and lower standards of accountability to the investor. Specifically, as discussed below, our concern lies with the expansion of B-D oversight of non-

[3] Pub. L. No. 106-102, 113 Stat. 1338 (November 12, 1999),
[4] Angela Hung, et al., RAND Corp., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2007) http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

securities business. The Regulatory Notice fails to specify any problem or gap in current supervision that the proposed rule is intended to address. At the very least, we believe it is incumbent upon FINRA to put forth a compelling reason for the significant expansion of supervisory responsibility into businesses that are independently regulated and supervised.

II. SRO Authority

FINRA is a national securities association registered pursuant to Section 15A of the Securities Exchange Act of 1934 (“Exchange Act” and “section 15A”).[5] In addition to authorizing creation of a national securities association or self-regulatory organization (“association” or “SRO”), section 15A defines the scope of authority of an SRO, through the requisite conditions. Among the conditions:

- [The association] has the capacity to be able to carry out the purposes of this chapter[6] and to comply, and …to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the association;[7]
- The rules of the association… are not designed…to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the association;[8]
- The rules of the association do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.[9]

The authority of a securities association then, can be reasonably be considered limited to carrying out the provisions and purposes of the Exchange Act. Investment advisers and their activities - regulated under the Advisers Act or state securities laws – would be beyond the scope of authority of FINRA, and subject to the exclusive oversight of the either SEC or appropriate state regulator. Aside from investment advisory services, financial services or other activities that fall outside the scope of the Exchange Act would likewise be beyond the scope of FINRA authority.

FPA believes it would be beneficial for FINRA to clarify how the proposed rule would be applied to different business models. The proposed rule would require FINRA members to designate a principal to supervise “each type of business in which it engages.” If the member has an affiliated registered investment adviser (RIA), for example, does FINRA consider the RIA’s advisory activity to be a business in which the member engages? Likewise, if an associated person of a member is an independent RIA, would the advisory activities of that associated person be considered subject to supervision by the member merely because the associated person also executes securities transactions?

[5] 15 U.S.C. 78o-3.
[6] Title 15, Chapter 2B of the United States Code, or the Securities Exchange Act.
[7] 15 U.S.C. 78o-3(b)(2).
[8] 15 U.S.C. 78o-3(b)(6).
[9] 15 U.S.C. 78o-3(b)(9).

FPA is concerned that the proposed rule would extend securities association oversight beyond what is authorized by the Exchange Act, to cover investment advisory, financial planning and other activities. We would welcome any clarification that would assure financial planners and others that the scope of the proposed rule is limited to authority under the Exchange Act.

III. Expanded Supervisory Requirement

Proposed Rule 3110 would require FINRA members, i.e., B-Ds, to designate an "appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages." This proposal is a broad expansion of the current NASD Rule 3010 ("Rule 3010"), which requires the designation of a principal to carry out supervisory responsibilities only, and appropriately, to business for which registration as a B-D is required.

As discussed above, we are concerned about an expansion of securities association authority beyond the scope of the Exchange Act. Rule 3010 reflects the limitations of the Exchange Act by requiring designation of a supervisor to oversee only those activities for which registration as a B-D is required. The proposed rule scraps that limitation, seemingly extending B-D oversight far beyond the Exchange Act.

Aside from questions regarding authority, FPA is very concerned that the proposed rule creates many practical problems which must weighed against the possible benefits of expanded B-D supervision.

A. **Conflicting and overlapping regulation and standards.** To the extent the proposed rule requires oversight of activities beyond the scope of the Exchange Act, FINRA would be overlaying an additional, potentially conflicting layer of regulation on those activities. At the very least, this would be contrary to the notion of functional regulation discussed above. Focusing on investment advisory services as an example, the proposed rule would potentially require a B-D operating under the Exchange Act to supervise the activities of an RIA, registered and operating under separate laws and subject to regulation by the SEC or a state regulator. This is particularly onerous for the RIA, which is subject to its own supervision requirements under the Advisers Act.

   Broker-dealer supervision of advisory activities is further complicated by the differing standards that govern securities and advisory activities. Generally, the B-D is subject to standards of "suitability" and "fair dealing," while RIAs are subject to a fiduciary standard. More than a decade ago, an SEC-commissioned report highlighted the conflicts inherent in the relationship between a B-D, its registered representative and investors.[10] The "Tully Report" noted that the B-D has three interests to balance: those of the customer, its registered representative and its own. Underscoring the inherent conflict, the Tully Report's recommended best practices include establishing compensation policies that "align" the interests of the firm, the registered representative and the customer. The

[10] Report of the Committee on Compensation Practices, April 10, 1995. http://www.sec.gov/news/studies/bkrcomp.txt.

conflicts may also be said to be reflected in the NASD Conduct Rules, which note that members have a "fundamental responsibility for fair dealing."[11] Generally then, the regulatory principals governing the relationship between a B-D and client can be thought of as a balancing of conflicting interests. In contrast, RIAs are subject to a fiduciary standard. Though not explicitly defined by statute, the Supreme Court has held that Congress intended the Advisers Act to apply a fiduciary standard to the advisory relationship. Implicit in the relationship is "an affirmative duty of 'utmost good faith and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' … clients."[12] Stated another way, Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations identified five components of the RIAs fiduciary duty: to put clients' interests first; to act with utmost good faith; to provide full and fair disclosure of all material facts; not to mislead clients; and to expose all conflicts of interest to clients.[13] In any event, it is widely accepted that a fiduciary is required to place the client's interests ahead of his own, not merely to balance those interests.

The U.S. Court of Appeals for the D.C. Circuit recently examined the intent of Congress in enacting the Advisers Act.[14] Citing the U.S. Supreme Court, the congressional record, and the statutory language, the court concluded that investment advisers could not properly service their clients unless all conflicts were eliminated. The Advisers Act was intended to protect consumers against fraud and to protect honest advisers from being unfairly tarnished by those perpetrating such frauds.

The point in contrasting B-D and IA standards is two-fold. First, if a B-D is supervising advisory activities, how are the different standards to be reconciled? Secondly, if an RIA is already subject to a standards that places the client's interests first, what benefit is there in overlaying a standard that essentially requires that the client's interests be balanced against that of the firm?

Additionally, any reach beyond the Exchange Act could be an encroachment into activities overseen, often exclusively, by other regulators. Again, using investment advisory services as an example, FINRA would be indirectly, through its members, supervising activities of a separate profession, governed by separate laws, and regulated exclusively by the SEC or a state regulator.

B. Expertise. As we noted, FPA is concerned that the proposed rule would require B-Ds to be responsible for supervising non-securities activities. This would be problematic not just for those being supervised, but also for the responsible B-D and supervisor. The proposed rule would require supervision by an appropriately registered principal. We understand this to be a registered securities principal. If so, one has to question on what

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[11] NASD Manual- Conduct Rules, IM-2310-2.
[12] *S.E.C. v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).
[13] *Fiduciary Duty: Return to First Principles,* by Lori A. Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission. Eighth Annual Investment Adviser Compliance Summit, Washington, D.C., February 27, 2006.
[14] *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007)

basis such a principal is considered to be qualified to oversee non-securities business. By extension, on what basis is a B-D qualified to supervise, and presumably thereby direct, non-securities business. Such interference with another regulated entity is inappropriate and potentially harmful. Even now, before the expansion of B-D supervision under the proposed rule, we hear reports that some broker-dealers require their reps to file a sample financial plan with them as part of their notification of outside activities. But because they have no expertise in financial planning – nor do current FINRA exams reflect the wide array of topics (89) covered in the CFP exam – they are not qualified to exercise meaningful supervision. By analogy, we ask if it would be appropriate for the SEC to promulgate a rule under the Advisers Act requiring RIAs to supervise the brokerage activities of an affiliated B-D?

C. **Costs.** Already, many B-Ds impose fees on dual registrants for the supervision they provide. The proposed rules requirement that a supervisor be designated to oversee non-securities business would certainly result in a significant increase in fees imposed for supervision, without any commensurate benefit. As noted above, the supervisor is not required, and in many cases will not be, expert in the business which he or she is supervising.

D. **Dual Regulatory Systems.** Another practical result of the proposed rule would be creation of a dual system of regulation for RIAs and others. Financial services providers who are affiliated with B-Ds will be subject not only to the oversight of their primary regulator, but also to their B-D, and indirectly to FINRA. Meanwhile, those operating independently of a B-D will be subject only to the oversight of their primary regulator.

IV. Conclusion

In sum, FPA is particularly concerned about broker-dealer regulation and oversight further bleeding into other businesses over which neither FINRA nor B-D firms have appropriate authority, nor necessarily the proper training or understanding. We think the provisions of proposed rule 3110 extending B-D oversight to other business areas is a remarkable departure from current trends toward functional regulation and current understanding of the financial services marketplace. Further, the supervisory provisions appear to be without an obvious purpose and addressed to no readily apparent problem. As discussed, the added supervision does not inure to the benefit of investors. Nor do we see it benefiting either the supervised business or the supervising B-D. We would point out that to the extent the additional supervision would benefit either the B-D or the supervised business, either is free to agree to or require such supervision as a condition of doing business together. Incurring the additional costs and burdens then would be a choice for FINRA member firms. Finally, we cannot imagine how other financial services regulators would benefit from having its regulated firms and persons subject to additional oversight from another regulated entity, or its regulator. Absent any compelling rationale FPA sees no reason to extend B-D supervision beyond its current limits.

Thank you for your consideration of our comments. Please contact me if you have any questions at 202-449-6343, or by e-mail at dan.barry@fpanet.org.

Sincerely,

Daniel J. Barry
Director of Government Relations