July 13, 2015

Ms. Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street N.W.
Washington, D.C. 20006-1506

RE: FINRA Regulatory Notice 15-19: Proposed Rule to Require Delivery of an Electronic Communication to Customers of a Transferring Representative

Dear Ms. Asquith:

Charles Schwab & Co., Inc., ("Schwab")[1] appreciates the opportunity to comment on FINRA's proposed rule (the "Proposal") to require delivery of an educational communication to customers of a transferring representative. Schwab strongly supports FINRA's overarching goal of making more information available to customers about the potential conflicts and costs that could arise when their registered representative transfers to another firm and attempts to induce former clients to transfer their assets to the new firm.

Previous iterations of this proposal[2] would have provided customers with specific information about the financial incentives a representative received or could receive as part of the representative's transition to a new firm, and the costs associated with transferring customer assets to the representative's new firm. The newest version of the Proposal fails to provide meaningful information on either of these subjects. Instead, it places the onus on the customer to pose questions to the transferring representative in the hope that the key information will be disclosed. Customers should not have to bear the burden of asking difficult questions to receive material information – certain disclosures should be required. We respectfully request that FINRA withdraw the Proposal and return to its previously-stated goal of requiring "targeted and meaningful information"[3] to customers about the conflicts that could exist when a registered representative transfers firms.

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[1] Charles Schwab & Co., Inc., is the broker-dealer subsidiary of The Charles Schwab Corporation (NYSE: SCHW), a leading provider of financial services, with more than 325 offices and 9.6 million active brokerage accounts, 1.5 million corporate retirement plan participants, 1.0 million banking accounts, and $2.57 trillion in client assets as of May 31, 2015. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, money management and financial advisory services to individual investors and independent investment advisors.

[2] FINRA has previously published two alternative versions of a proposed rule to disclose conflicts of interest to customers of transferring brokers: Regulatory Notice 13-02, *Proposed Rule to Require Disclosure of Conflicts of Interest Relating to Recruitment Compensation Practices* (available at http://www.finra.org/sites/default/files/NoticeDocument/p197599.pdf) and SR-FINRA-2014-010, *Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2243 (Disclosure and Reporting Obligations Relating to Recruitment Practices* (available at https://www.sec.gov/rules/sro/finra/2014/34-71786.pdf).

[3] 79 Fed. Reg. 17592, 17593 (March 28, 2014).

Previous Iterations of the Rule Benefitted Customers

Schwab strongly supports the idea that a customer serviced by a registered representative who has transferred to another firm should be made aware of the conflicts that might exist when the representative contacts the customer regarding moving his or her account to the representative's new place of employment. In its original rule proposal, FINRA noted that it "believes that customers would benefit from knowing the incentives that may have led their representative to change firms before they transfer an account to a new firm."[4] To that end, the proposal required disclosure of enhanced compensation paid to the registered person as part of his or her transfer to another firm when the registered person contacts a former client about the transfer of employment, or when the client contacts the registered person about the transfer of an account to the new firm. The proposal defined enhanced compensation as including "signing bonuses, upfront or back-end bonuses, loans, accelerated payouts, transition assistance and similar arrangements, paid in connection with the transfer of securities employment (or association) to the recruiting member."[5] There was also a sensible *de minimis* exception for enhanced compensation.

Schwab believes disclosure is the hallmark of securities regulation. The original proposal would have provided customers with clear, plain-English information about the financial incentives that may have contributed to the representative changing firms, and allowed the customer to weigh that information when deciding whether to transfer assets to the new firm. For clients unfamiliar with industry recruiting practices, this information may have brought to light a conflict not previously considered: that the registered representative has a financial incentive – beyond a normal salary or commission – to encourage the transfer of assets to his or her new firm, regardless of cost to the client or whether such a move makes sense for the client's particular situation.

To address privacy concerns concerning a representative's compensation and other comments, FINRA revised and re-proposed the rule in 2014. Importantly, the goal of the revised proposal did not change:

> FINRA believes that former customers would benefit from knowing, among other things, the ***magnitude of the financial incentives*** that may have led their representative to change firms, how the former customer's assets, or trading activity, factored into the calculation of such incentives, and whether moving their assets to the recruiting firm will ***impact their holdings or impose new costs***. The proposed rule change is intended to focus a former customer's attention on the decision to transfer assets to a new firm, and the direct and indirect impacts of such a transfer on those assets, so they are in a position to make an informed decision whether to follow their representative.[6]

The revised rule proposal dropped the concept of providing former customers with specific, detailed information on the transferring representative's enhanced compensation and instead

[4] *Regulatory Notice 13-02* p. 4.
[5] *Id.* at p. 5.
[6] 79 Fed. Reg. 17592, 17593 (March 28, 2014) (emphasis added).

proposed that a general idea of the range of enhanced compensation be disclosed. The disclosure was broken down into “aggregate upfront payments” and “aggregate potential future payments,” and required reporting of both numbers within broad ranges. Moreover, the rule added an additional disclosure about the costs to the former customer of transferring assets to the new firm, including account termination or account transfer fees from the previous firm; account opening or maintenance fees at the recruiting member firm; information about whether any of the client’s assets are not transferable to the new firm; and details about any costs associated with the liquidation and transfer of assets to the new firm.

Again, Schwab applauded the proposal for providing clear, detailed information to a client about the potential incentives for a representative to encourage a transfer of assets, as well as the information about the costs of doing so. As many firms did at the time, we acknowledged some of the operational concerns about the proposal, particularly around the disclosure of information about the costs of transferring assets from one firm to another. But, as FINRA concluded, we believe those concerns were solvable and that customers would clearly have benefitted from this revised rule proposal. Unfortunately, in June 2014, the revised rule proposal was withdrawn.

The New Rule Proposal Fails to Inform Investors of Potential Conflicts of Interest and Costs Associated with the Transfer of Assets

The Proposal represents a significant and disappointing step backwards. Inexplicably, the Proposal abandoned the original goal of providing important information to clients and eliminated the most important provisions of the previous proposals. The title of the proposal illustrates the change in focus. Where the previous proposals required “*disclosure*,” the new proposal requires “delivery of an *educational communication*.” The distinction is important. An “educational communication” is not disclosure. Clients should be told the objective information that exists, not taught how to elicit that information from a registered representative through a question and answer process that by its very nature is entirely subjective.

The Proposal also falls short of its objective because it does not require <u>any</u> information to be provided to the customer. Instead, the customer would receive a communication outlining “issues to consider when your broker changes firms.”[7] The document “would highlight the potential implications of transferring assets to the recruiting firm and suggest questions the customer may want to ask to make an informed decision”[8] about transferring his or her assets. The burden is entirely on the customer to ask questions of the registered representative, including questions about the representative’s compensation. Although FINRA asserts that the proposal “is more likely to prompt a discussion with the transferring representative or current firm,”[9] Schwab believes the opposite is true. The awkwardness of asking a professional to describe his or her financial compensation in detail is obvious. Few customers will be willing to ask these questions. Worse, nothing in the rule requires the representative to provide meaningful answers to any question in the “educational communication.” As a result, it is uncertain whether any

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[7] *Regulatory Notice 15-19: Proposed Rule to Require Delivery of an Electronic Communication to Customers of a Transferring Representative*, p. 10.
[8] *Id.* at p. 3.
[9] *Id*. at p. 5.

material information about possible conflicts of interest and costs associated with a transfer of assets will be disclosed to the customer.

In the Proposal, FINRA states that it believes the revised Proposal "would achieve the regulatory objective of informing decisions by retail customers whether to transfer assets to the recruiting firm, while reducing the direct costs on firms to provide the educational communication and the operational challenges of the initial proposal."[10] Apparently cost to the firms has now become an equal priority to informing retail customers about potential conflicts of interest. While Schwab believes that all regulation should rely on sound cost-benefit analysis, we believe that adequate disclosure to investors should always be paramount. This is especially true where, as here, the cost at issue is minimal. As this proposal fails to provide customers with meaningful disclosure, Schwab respectfully requests that FINRA withdraw the Proposal.

If the Proposed Rule Is Not Withdrawn, It Should Be Modified

Schwab believes that FINRA should return to the key principles of the previous proposals, especially the idea of clear and concise disclosure of critical information to customers of a transferring representative. That disclosure should include information about upfront payments, including any signing bonus, and potential future payments beyond what is ordinarily provided to similarly situated representatives. It is also important that the disclosure provide information to the client about the real costs resulting from the transfer of assets to the representative's new firm – including increased fees and tax consequences. In addition, the transferring representative should be required to provide disclosure to the customer regarding the standard fees and trading costs at the new firm, whether any discounts are being offered, and for what period of time any discounts would apply.

Furthermore, Schwab believes that any required disclosure to a customer regarding the transfer of a representative to another firm should not have an expiration date. The impact of an attempt to induce a client to change firms does not diminish over time. It is unfair to deprive certain customers of information that is disclosed to others simply based on the passage of time or the date a representative chooses to contact a customer. There is no rational customer-focused reason that could justify such a rule. At a minimum, we recommend FINRA extend the requirement from six months to one year following the date that the registered representative begins employment or associates with the new firm.

Schwab also believes it is important for the rule to clarify that it does not affect the ability of member firms to use employment agreements to prevent former representatives from soliciting customers. The rule should also state that it does not require or permit registered persons to take customer contact information from their former firm – particularly in violation of Reg. S-P or contractual obligations. These principles were adopted by FINRA in the prior proposal.[11]

In addition, we recommend returning to what was proposed in 2014 – a *de minimis* exception of $100,000. The 2014 rule proposal would have required disclosure of whether the registered representative "received or will receive $100,000 or more of either (1) aggregate 'upfront

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[10] *Id.* at p. 5.
[11] 79 Fed. Reg., 17592, 17602 (March 28, 2014).

payments' or (2) aggregate 'potential future payments' in connection with transferring"[12] assets to the new firm. Schwab believes that enhanced compensation in amounts less than that is not likely sufficient to present a material conflict, and it also would exclude firms that do not pay any type of recruitment compensation.

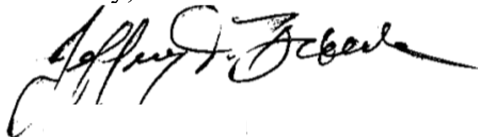
Finally, we recommend that FINRA require disclosure *prior* to the time a customer decides to transfer their account to the new firm. This ensures that a customer will have sufficient time to consider and evaluate the disclosed information. To accomplish this objective, disclosure should be made at the first communication with the customers, whether in oral discussion, or a mailing to the customer. Some commenters have suggested that FINRA should require disclosure at the time account transfer forms are provided to a customer in order to minimize operational costs. Such a requirement would deprive a customer of the opportunity to evaluate the disclosed information because a customer has likely already committed to transfer to the new firm by the time account transfer forms are sent. The new - but late - disclosure would likely go unnoticed, or easily dismissed by a broker as "just something I need to send." Moreover, operational costs cannot be used to justify a failure to timely provide disclosures, or trump a client's right to timely disclosure.

Conclusion

Schwab feels strongly that FINRA should return to the original intent of increasing disclosure around incentives for transferring representatives that could result in conflicts of interest for investors. By placing the burden on customers to ask uncomfortable questions of the transferring representative, FINRA's new Proposal all but guarantees that no meaningful information about conflicts of interest will be disclosed. As a result, the Proposal fails to meet FINRA's fundamental goal of protecting investors. We urge withdrawal or significant modification of the Proposal.

Schwab would welcome the opportunity to discuss our views more thoroughly. If you have any questions or require additional information, please contact me at (202) 638-3750 or jeff.brown@schwab.com. Thank you very much for the opportunity to comment on this important proposal.

Sincerely,



Jeffrey T. Brown
Senior Vice President and Head,
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[12] *Id.* at 17954.