May 23, 2014

By Electronic Mail (*pubcom@finra.org*)

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

Re: **Regulatory Notices 14-14 and 14-15, Retrospective Rule Review on Communications with the Public, Gifts, Gratuities and Non-Cash Compensation**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the first two notices issued by the Financial Industry Regulatory Authority ("FINRA") concerning its retrospective rule review. SIFMA is pleased to submit the following comments in response to Regulatory Notice 14-14, concerning FINRA's Communications with the Public Rules (FINRA Rules 2210 through 2216) and Regulatory Notice 14-15, concerning FINRA's Gifts and Gratuities Rule (FINRA Rule 3220) and the Non-Cash Compensation Rules (FINRA Rules 2310(c), 2320(g)(4) and 5110(h) and NASD Rule 2830(l)(5)).

SIFMA strongly supports FINRA's decision to engage in this retrospective rule review process. We recognize that securities laws, rules and regulations are often issued in response to actual or perceived problems that impact investors or the capital markets. We applaud FINRA's stated purpose to review, after the passage of time since the adoption of its rules, if they were actually effective at addressing those problems, or if the actual costs and burdens of those rules outweighed the anticipated benefits of the rules. We anticipate that the results of this review may result in amendments to existing rules, or the repeal or replacement of rules that no longer square with a cost-benefit analysis.

SIFMA and its member firms expect a number of benefits to flow from retrospective rule review, and potential resulting actions by FINRA. Among other things, we expect that

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit www.sifma.org.

the effectiveness of firms' overall supervisory and compliance efforts could improve as rules are adapted to be more directed to the compliance issues they were designed to address, in addition to being potentially more efficient and less burdensome for firms to implement. We also support FINRA's retrospective review because we expect this will also benefit investors; an improved and more efficient supervisory and compliance program will enable the compliance and supervision to be more targeted to higher risk issues which will further help protect investors. We agree with Richard Ketchum's recent remarks, when he said, "[e]mbracing strong regulation is good for your business. And a well-regarded broker is something we should all be proud of. Our interests are aligned…"[2] In addition, once the rules have been revised to address effectiveness and efficiency, overall compliance costs could decrease, which may improve the cost structure for member firms.[3]

FINRA had hoped that the creation of a single rule book, harmonizing the former NASD and NYSE rules, resulting from the merger of the NASD and NYSE, would help address this problem of outdated and ineffective rules. However, the sheer scale and complexity of that harmonization project made it difficult to combine the two sets of rules at the same time as FINRA evaluated the efficiency and effectiveness of those rules. For these reasons, SIFMA applauds FINRA's decision to engage in the retrospective rule review, and we urge FINRA to continue the retrospective rule review so as to conduct a thorough review of its entire rule book.

In addition, SIFMA supports FINRA's decision to use its recently-enhanced capabilities for economic analysis in connection with the retrospective rule review. Section 3(f) of the Securities Exchange Act of 1934 (the "Exchange Act") requires the SEC to consider the effect of proposed FINRA rule changes on the promotion of efficiency, competition and capital formation. FINRA has made laudable efforts in the past year to provide economic analysis on major new rules to allow the SEC to make these determinations. However, the Section 3(f) requirement only applies to proposed rule changes, not to existing rules. Many current FINRA rules predate the adoption of Section 3(f), and have never been subject to any kind of economic or cost-benefit analysis. SIFMA strongly agrees with FINRA that a robust economic analysis of the effectiveness and efficiency of its rules should be an integral part of the retrospective rule review.

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[2] Richard Ketchum, Restoring Investor Trust in the Markets, FINRA Annual Conference Welcome Remarks (May 19, 2014) (***available at:*** http://www.finra.org/Newsroom/Speeches/Ketchum/P506341) [last visited May 22, 2014].

[3] Indeed, such potentially lower supervisory and compliance costs should help smaller member firms that lack the scale to implement ever more complex regulatory requirements, and should help investors, who ultimately bear the cost of unnecessary or inefficient regulatory mandates.

I. *Overview*

A. <u>Principles-Based Regulation</u>

Before we will address the specific rules under consideration below, we thought it would be useful to discuss several themes that will run through our comments. First, SIFMA encourages FINRA where possible to consider principles-based regulation, rather than highly prescriptive and specific rules. Very specific and detailed rules pose a number of challenges that do not exist with principles-based regulation. For example, given the innovation and client driven nature of the financial services business, specific rules that in turn detail specific parameters or speak to a particular product, technology or business model are more likely to become outdated and ineffective than rules that establish general principles of investor protection that will endure over time. As we will discuss in more detail below, the communications with the public rules are an example of this. Several of those rules require filing with FINRA certain types of materials that were of regulatory concern at the time those rules were adopted, such as materials concerning bond mutual fund volatility ratings, or investment analysis tools. However, once the substantive standards for these types of materials have been established, it is not apparent why these specific types of materials should continue to require filing with FINRA, when other types of materials concerning products or services that present much greater risks to investors do <u>*not*</u> require filing. We believe a more principles-based approach to communications with the public, focusing on potential customer harm, especially to retail customers, would be both more efficient and more effective.

B. <u>Risk-Based Approach to Rules</u>

Second, SIFMA encourages FINRA to employ a risk-based approach to its rules. In short, FINRA's rules should focus on the areas where the risks to investors (especially retail investors) or capital markets are greatest. For example, in connection with the communications with the public rules, the strictest rules in terms of filing requirements should apply to the products and services that present the highest risks to investors. FINRA has embraced a risk-based approach in its own examination program, and has encouraged member firms to employ a risk-based approach in designing their supervisory systems and compliance programs. We believe the same risk-based approach should be applied when FINRA drafts substantive rules. In cost-benefit terms, more stringent rules are best justified when the risks of harm to retail investors are greatest and most apparent (and not just temporary). While supporting a risk-based approach should not be controversial, in our view some existing rules do not fully reflect such an approach.

C. <u>Staff-Level Guidance</u>

Third, SIFMA encourages FINRA to explore ways to make its staff-level guidance about its rules more consistent and transparent. FINRA currently issues guidance concerning its rules in a number of ways, including by issuing Regulatory Notices and Regulatory and Compliance Alerts, by issuing interpretative or exemptive letters, and by providing podcasts and speaking at conferences. In some cases, FINRA has helpfully gathered different types of guidance together under the "Industry Issues" tab on the finra.org website. However, these types of guidance are typically static. We observe that the SEC staff commonly provides website guidance that it updates on a regular basis (*e.g.,* the Securities and Exchange Commission (the "SEC" or "Commission"), Division of Corporation Finance's Financial Reporting Manual,[4] or its Compliance and Disclosure Interpretations).[5] Similarly, the SEC Division of Trading and Markets regularly produces FAQs on various rules, including at least four which have been updated since the beginning of this year.[6] We recognize that the FINRA staff sometimes has used FAQs for certain limited areas, and we encourage the expansion of this approach.[7] We believe that both communications with the public and gifts and gratuities/non-cash compensation would be good candidates for FAQs that are updated on a regular basis to provide substantive guidance about the standards that the FINRA staff is applying in its review of these issues.

One of the benefits of the online FAQ approach is that, in contrast to Regulatory Notices which are by their nature less likely to be regularly updated and reissued, FAQs can easily be updated to reflect new developments. As discussed below, we understand that the FINRA staff believes that certain parts of a key 1999 Notice to Members addressing non-cash compensation rules for variable products and investment company securities, NASD Notice to Members 99-55 ("NTM 99-55"), are outdated and should no longer be relied upon. However, NTM 99-55 remains in effect with no indication that it is not current. This is the type of guidance that the FINRA staff should update, an update to be applied consistently to all non-cash compensation securities products. An online FAQ approach would allow it to so.

Similarly, and again as discussed further below, as the GAO found in its Report on Mutual Fund Advertising (GAO-11-697, July 2011),[8] there is substantial frustration among member firms that the FINRA staff's interpretations of the communications with the public rules are not consistent either within or across member firms. We understand that the SEC Division of Corporation Finance has found that its online Compliance and Disclosure

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[4] SEC Division of Corporation Finance, Financial Reporting Manual (last updated Feb. 6, 2014) (***available at:*** http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml) [last visited May 22, 2014].

[5] SEC Division of Corporation Finance, Compliance and Disclosure Interpretations (last updated Apr. 24, 2014) (***available at:*** http://www.sec.gov/divisions/corpfin/cfguidance.shtml) [last visited May 22, 2014].

[6] SEC Division of Trading and Markets, List of Frequently Asked Questions (last updated Apr. 15, 2014) (***available at***: http://www.sec.gov/divisions/marketreg/mrfaq.htm) [last visited May 22, 2014].

[7] For example, as relevant here, the FINRA staff has issued FAQs on the advertising review process, although these FAQs are not designed to provide guidance about the substantive standards its uses to review communications with the public. *See* http://www.finra.org/Industry/Issues/Advertising/FAQ/. [last visited May 22, 2014]. FINRA also has issued FAQs on the suitability rule. *See* http://www.finra.org/Industry/Issues/Suitability [last visited May 22, 2014].

[8] ***Available at:*** http://www.gao.gov/new.items/d11697.pdf [last visited May 22, 2014].

Interpretations have been effective not only in providing public companies and underwriters with transparency about the staff's views, but also in encouraging consistency among different parts of its own staff. Allowing the FINRA staff to address new products or services through this less formal approach may be both faster and more effective than attempting to write a new rule or interpretative material whenever a new product (such as single-stock securities futures) or new service (such as investment analysis tools) becomes available.

This being said, SIFMA believes it is equally important that FINRA not use informal staff guidance or the examination program to avoid the process of filing a substantively new standard or rule for approval with the SEC as required by Section 19(b) of the Exchange Act. The SEC has recently underscored the importance of the Section 19(b) filing process for substantive self-regulatory organization rules.[9] While we encourage the FINRA staff to provide online interpretative guidance and to keep that guidance up to date, FINRA must remain mindful of the line between interpretative guidance and substantive rules, for which it must seek SEC approval.[10]

II. Comments on the Communications with the Public Rules

SIFMA strongly supports the purpose of the communication with the public rules and standards embedded therein, which require that member firms' communications be fair and balanced, not contain misleading statements or omit material facts, and provide a sound basis for evaluating securities including balanced treatment of risks and potential benefits.[11] Fair, accurate and balanced communications are essential requirements to protect investors. Generally speaking, SIFMA believes the communication with the public rules have been effective; we do not believe anyone in the securities industry would seriously suggest abolishing or fundamentally changing the core substantive standards set forth in these rules. We believe the fairness and balance of the advertising and marketing materials prepared by the broker-dealer industry compare favorably to those of virtually any other American industry. Moreover, in our experience, the FINRA staff who administer the communication with the public rules make consistent and very helpful efforts to engage in outreach to member firms about the rules. However, we do have suggestions for how these rules could be made more effective and efficient.

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[9] *See New York Stock Exchange LLC*, Exch. Act Rel. No. 72065 (May 1, 2014) (sanctioning NYSE and related exchanges for failing to file certain practices as rule changes under Section 19(b)).

[10] *Cf. General Motors Corp. v. Ruckelshaus*, 742 F.2d 1561, 1565 (D.C. Cir. 1984) (en banc) (discussing the difference between interpretative and legislative rules under the Administrative Procedure Act).

[11] These basic substantive standards applying to all communications with the public are set forth in FINRA Rule 2210(d).

A. <u>The Structure of FINRA Rule 2210</u>

1. Public Appearances

Generally speaking, SIFMA supports the decision in FINRA Rule 2210 (effective in February 2013) to condense the former categories of communications to the current three categories of retail communications, institutional communications and correspondence.[12] However, we note that "public appearances" effectively constitute a fourth category in the rule, with its own specific standards. We suggest that the rule be re-organized to treat "public appearances" as a fourth category. The rule should define what constitutes a "public appearance," and should better define whether or not a script is required for all public appearances. In this connection, and because FINRA has treated use of most types of social media as akin to public appearances, we suggest FINRA codify in the rule the basic treatment of social media set out in FINRA Regulatory Notices 10-06 and 11-39. In that vein, FINRA should define in Rule 2210 what constitutes an "online interactive electronic forum" that is treated as akin to a "public appearance," and what constitutes "static content" that is treated as a retail communication. We note that the social media issues are a good example of the FAQ approach discussed in the preceding section: once the general principles are incorporated into the rule, then factual variations (in the rapidly evolving social media landscape) can be addressed in FAQs.[13]

2. "One Click Away"

More generally, not only in connection with social media but in other online contexts, FINRA has approved of information being "one click away" from an electronic communication.[14] We think it would be beneficial for FINRA to provide more clarity about when "one click away" disclosure is sufficient, and when disclosure must be on the same online screen as the original communication.[15]

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[12] If we were rewriting the rule from scratch, we might suggest placing the fundamental substantive standards that apply to all communications with the public, currently contained in Rule 2210(d), in the first subsection of the rule (or perhaps the second subsection, after the relevant definitions), rather than in the fourth of seven subsections.

[13] For example, it is unclear how the "interactive content" concept applies to materials posted or linked to a social media interaction – can content that a representative links to an interactive discussion (not subject to filing) be deemed static (and thus subject to filing)?

[14] FINRA Rule 2210(d)(1)(C) currently provides that information may be placed in a legend or a footnote if it would not inhibit an investor's understanding of the information; FINRA has applied the "one click away" concept by analogy to this provision.

[15] SIFMA has separately expressed its reservations about FINRA's proposal to require ubiquitous links to its BrokerCheck site. *See* http://www.sifma.org/issues/item.aspx?id=8589942087 [last visited on May 16, 2014].

3. Correspondence v. Retail Communication

SIFMA urges FINRA to rethink certain concepts in the three categories of communications in FINRA Rule 2210. Currently, an item that constitutes "correspondence" will become a "retail communication" if it is sent to more than 25 retail investors in a 30-day period. We have found that this distinction is nearly impossible to administer in practice. It is simply impractical to track on a continuing basis how many investors have been sent a particular piece of correspondence. What makes this distinction particularly difficult is the fact that correspondence is supervised after-the-fact, but retail communications must be supervised before first use. Therefore, after the 25th copy of the letter is sent, all of the prior supervision of that letter becomes untimely – and yet the supervisor may not have even seen the 25th copy that pushes the letter over this threshold. We suggest allowing firms to make a reasonable up-front judgment whether the material is intended to be sent to more than 25 people (in which case it would be treated as a retail communication), rather than imposing this continuing tracking obligation.

4. Institutional Communications Not Distributed to Retail Investors

Similarly, the requirement set forth in Regulatory Notice 12-29 that Rule 2210 mandates policies and procedures reasonably designed to ensure that institutional client communications are not distributed to retail investors is nearly impossible to administer in practice. This is another example of creating significant compliance costs for no obvious benefit to investors.

B. **FINRA Should Move to a More Principles-Based Approach to Filing and Supervisory Review Requirements**

SIFMA urges FINRA to consider a more principles-based and risk-based approach to communications with the public, especially with respect to filing requirements and supervisory pre-review requirements. In an ideal world, the types of pieces that have the greatest risk of misleading investors would be subject to pre-filing. The types of pieces that have a serious risk of misleading investors (but not the highest risk) would be subject to post-use filing. Other pieces would not be filed at all, but would be reviewed during FINRA's examinations or through spot-check procedures.

Today, in our view, the list of materials required to be pre-filed or post-use-filed bears almost no relationship to the potential risks these products represent. Some of the materials currently required to be pre-filed, such as materials containing bond mutual fund volatility ratings, or post-use filed, such as investment analysis tools, are in our view unjustified and outdated. Neither of these types of filings pose such ongoing significant risks as to justify

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We appreciate FINRA's recent Regulatory Notice 14-19 (April 2014) requesting additional comment on this issue, and we anticipate providing additional comments in response to that Notice.

special treatment under the communications with the public rules.[16] By contrast, materials concerning products that widely would be considered high-risk, such as penny stocks, or complex structured products with embedded options, futures or derivatives features, are not required to be filed at all.[17]

1. Investment Company Securities

In particular, SIFMA urges FINRA to reconsider the current filing requirements with respect to communications about investment company securities. It is very difficult to justify on a principles or risk basis the current difference in filing treatment for materials relating to registered investment company securities and those relating to privately offered funds. Private funds often employ more leverage, have less diversification, provide less liquidity, have higher, performance-based fees, and can engage in riskier strategies than registered mutual funds. It is also difficult to justify the current difference in treatment between materials relating to investment company securities and to separately managed accounts that employ exactly the same strategies as those registered mutual funds.[18]

We recognize that much of the current treatment of registered investment company securities is driven by SEC Investment Company Act Rules 24b-3 and 34b-1 and Securities Act Rules 497 and 482, and is not subject to unilateral change by FINRA. However, we believe FINRA should explore with the SEC whether the SEC would be open to using its exemptive authority to reconsider its filing mandates in this area. In particular, we suggest that FINRA discuss with the SEC the possibility of a regulatory regime in which mutual fund performance advertising is subject to post-use review, and other mutual fund advertising is exempt from filing altogether.[19] In the alternative, perhaps all television and radio advertising for mutual funds (because of their potential to reach broad numbers of potentially

[16] As discussed above, investment analysis tools and bond mutual fund volatility ratings are good examples of issues that, when new, were fully worthy of FINRA guidance, but which did not need to be included in the filing regime on an ongoing basis.

[17] We recognize that FINRA has attempted to mitigate the costs and burdens of the filing process through the exclusions from filing it has provided in FINRA Rule 2210(c)(7). While these exclusions from filing are certainly helpful, they are not a complete substitute for considering what types of materials should be required to be filed in the first place. We note that the industry would benefit from guidance about how the "reprint" exclusion in 2210(c)(7)(I) applies to online materials such as videos. Also, the exclusion from filing for materials filed by another member should be clarified – what happens if the material was originally subject to a limited review, and subsequently receives a full review?

[18] To be clear, we are not arguing that private fund materials or separate account materials should be incorporated into the pre- or post-filing regime: this would only encourage investment advisers to self-distribute these products rather than sell them through broker-dealers, which would result in even less protection for investors.

[19] If there are other types of mutual fund marketing that the SEC and FINRA believe are particularly subject to abuse (for example, use of third-party ratings), perhaps those could also be subject to post-use review.

unsophisticated investors) could be subject to post-use filing, but not other mutual fund marketing materials.[20]

2. How Supervision Rule Works with Communications Rules

As part of its retrospective rule review, FINRA should also consider how its new supervision rule, explained in Regulatory Notice 14-10 (March 2014), works with the communications with the public rules. SIFMA is concerned that, even if the review uses a risk-based approach, the supervisory review of internal communications is simply not cost-justified. This concern is exacerbated by the attenuated link between internal communications and the purpose of the communications with the public rule, which is to protect the public. We acknowledge that in a handful of enforcement cases, internal emails have identified problems that, if a supervisor had seen those emails, might have been more promptly escalated. However, because of the vast number of internal communications at broker-dealers, we seriously doubt that even with the new supervisory rule, those needles would have been picked out of those haystacks. Moreover, requiring supervisory review of internal communications (even using a risk-based approach, which doubtless will result in a review of a much smaller percentage of internal communications than external communications) diverts supervisory and compliance resources that would be better applied to higher-risk areas, in particular to external communications. We believe the adage that "if everything is a priority, then nothing is a priority" applies with particular force to the supervisory review of internal communications at broker-dealers.

C. FINRA Should Apply a Layered Approach to the Communications with the Public Rules

The FINRA staff in practice appears to be moving to a standard in which each communication "must stand alone on its own," even for products (such as mutual funds) that are sold pursuant to a prospectus, registration statement or private placement memorandum that are provided with or linked to the communication. We do not believe this "must stand alone on its own" approach is justified by FINRA's rules or by any compelling policy arguments. We believe a layered approach to disclosure, relying on links to the product offering document, is appropriate, and Rule 2210 should reflect that approach. Otherwise advertisements and other marketing materials become over-burdened with duplicative disclosures and disclaimers, which cause "disclosure overload" and ultimately harm investors.[21] It is not realistic to require every marketing piece to repeat every risk factor

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[20] We note that the GAO, in Report GAO-11-697 (July 2011), which reviewed mutual fund advertising pursuant to Section 918 of the Dodd-Frank Act, found at most limited evidence that there were any current problems in mutual fund performance advertising. *See* (http://www.gao.gov/new.items/d11697.pdf) [last visited May 22, 2014].

[21] *See, e.g.,* Troy A. Paredes, "*Blinded by the Light: Information Overload and its Consequences for Securities Regulation*," 81 Wash. U.L.Q. 417 (June 1, 2003).

contained in a registration statement – that is what offering documents are intended for. Instead, FINRA should encourage investors to read those offering documents, especially in an electronic environment in which the offering documents are linked.

Similarly, FINRA should clarify that treatment of comparisons in FINRA Rule 2210(d)(2). We urge that FINRA permit comparisons to be satisfied by a layered-disclosure approach that incorporates links to the underlying offering documents. Otherwise, many comparisons, in order to be full and complete, are simply too lengthy to be practical. Yet comparisons of reasonable alternatives can be valuable to customers, and FINRA should not apply its rule in a way that discourages their use.

D. FINRA should explore ways to make its staff-level decisions about communications with the public more consistent and transparent

As discussed above, SIFMA encourages FINRA to provide more transparency about how its staff interprets its rules. We believe the communications with the public area is a particularly strong candidate for this approach. The GAO, in Report GAO-11-697, noted widespread concern that the FINRA staff's interpretations are not consistent either within or across firms.[22] In our experience, it creates a very difficult environment for communications with the public supervisory and compliance staff when FINRA objects to language that the firm has previously used without objection. Even worse is the situation where the firm's business people are able to point to advertisements published by other firms that use the same language to which FINRA has objected for that firm, or which that firm's supervisors will not permit.

We believe the goal of transparency would be substantially advanced if the FINRA staff would provide online, updated FAQs or other similar interpretations that set forth their views about permissible and impermissible communications with the public language. Moreover, we believe standardized public guidance would be helpful in providing clarity to the FINRA staff itself, and would help address the perception that it applies inconsistent standards to different firms. In preparing this letter, we received many examples of very specific communications issues as to which industry-wide guidance would be desirable, but which clearly should not be codified in the rules themselves.

E. FINRA and the SEC Should Harmonize the Different Communications Rules for Broker-Dealers and Investment Advisers

SIFMA suggests that FINRA harmonize its current Rule 2210(d)(1)(F), which bans predictions and projections,[23] with the SEC investment adviser standard contained in

[22] GAO cited as an example what constitutes improper "promissory" language. This is an issue on which we believe the staff sometimes currently takes positions that are more restrictive than the rule warrants.

[23] When it adopted the current version of Rule 2210(d)(1)(F)(iii), FINRA provided an explicit exception for price targets in research reports, which on their face would appear to have violated the prior rule's ban against

Investment Advisers Act Section 206 and Rule 206(4)-1. The SEC investment adviser standard allows predictions and projections so long as they have a reasonable basis and the assumptions underlying the projections are adequately explained. Currently, investment advisers may use predictions and projections in their offering materials (such as SEC registration statements which are not subject to FINRA review), but our understanding of FINRA's position is that broker-dealers in those same offerings cannot use that same data in marketing materials for those products.[24] There is no principled basis for the different treatment of broker-dealers and investment advisers.[25] Moreover, data (for example) about targeted returns is highly material to potential investors, and FINRA should not be in the business of denying material information to investors.[26] FINRA's current ban on reasonable, non-misleading predictions and projections is arguably inconsistent with current First Amendment principles concerning commercial speech which apply to any SRO rules approved by the SEC under the D.C. Circuit's *Blount* decision.[27] Incidentally, adopting a

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predictions and projections, even though of course broker-dealers have been providing price targets in research reports for decades. *See* FINRA Regulatory Notice 12-29 (June 2012).

[24] *See, e.g. M.D. Sass* (May 2013, FINRA Case #2009018187701) (***available at***: http://www.finra.org/web/groups/industry/@ip/@enf/@da/documents/disciplinaryactions/p260959.pdf) [last visited May 22, 2014]; *Hedge Fund Capital Partners LLC* (January 2011) (Extended Hearing Panel Decision) (***available at*** https://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/ohodecisions/p123474.pdf) [last visited May 22, 2014]; *Altegris Investments, Inc*. (April 2003) (***available at:*** http://www.finra.org/Newsroom/NewsReleases/2003/p002940) [last visited May 22, 2014]. We note that there is continuing uncertainty about the treatment of predictions and projections in offering materials for Regulation D offerings, which are not clearly addressed by the exception for materials filed with the SEC in FINRA Rule 2210(c)(7)(F). We also note there is inconsistency between the NASD's 2006 interpretative letter to SIA and the Bond Market Association concerning the application of NASD Rule 2210 to issuer-prepared materials (***available at***: http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P017285) [last visited May 22, 2014], cited with approval in FINRA Regulatory Notice 12-29, and FINRA Regulatory Notice 10-52. At a minimum, this area would benefit from additional interpretative guidance.

[25] The SEC Staff Study on Investment Advisers and Broker-Dealers (January 2011) (***available at***: http://www.sec.gov/news/studies/2011/913studyfinal.pdf [last visited May 22, 2014]), produced in response to Section 913 of the Dodd-Frank Act, noted the difference in broker-dealer and investment adviser advertising standards, and recommended that they be harmonized.

[26] *See* Schwartz and Seo, Targeted Returns under FINRA's Communications Rules, N.Y.L.J. (Mar. 24, 2014) (advocating allowing use of targeted returns in appropriate circumstances, if appropriately substantiated and supported by adequate risk disclosures).

[27] *See Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995), (holding ordinary First Amendment principles apply to SRO rules submitted to the SEC for approval). *Cf. National Association of Manufacturers v. SEC*, No. 13-5252 (D.C. Cir., Apr. 14, 2014) (holding that commercial speech protections apply to speech required by the federal securities laws) (***available at***: http://www.cadc.uscourts.gov/internet/opinions.nsf/D3B5DAF947A03F2785257CBA0053AEF8/$file/13-5252-1488184.pdf [last visited May 22, 2014]).

more principles-based approach to predictions and projections would obviate the need for a separate rule for investment analysis tools, which as we have suggested above is unnecessary.

Similarly, FINRA should discuss with the SEC harmonizing the SEC's ban on testimonial advertising for investment advisers with FINRA's approach. FINRA Rule 2210(d)(6) allows testimonial advertising with a reasonable basis and subject to appropriate disclosures. SEC Rule 206(4)-1 imposes a flat ban on testimonial advertisements. Once again, there is no principled basis for the current difference in approach.[28] The different rules create significant difficulties for individuals or firms which are registered under both regulatory schemes. In our view, the FINRA rule, which allows truthful, non-misleading testimonials subject to reasonable disclaimers, is preferable to the SEC approach both as a matter of policy and law.

F. <u>Other Comments on the Communications with the Public Rules</u>

Currently FINRA Rule 2210(d)(7)(A)(ii) requires a member and its associated person, when making recommendations, to disclose any financial interest in the securities of the issuer. We suggest that this requirement be should be re-thought. Historically, the claim "I own this stock in my own account" has lent itself to use in high-pressure sales pitches. We believe this disclosure is more harmful than helpful; rarely will an associated person's personal account holdings be a reliable basis for a client's potential investments. In any event, it is unclear under what circumstances in which this disclosure currently is required - for example, what constitutes "material involvement" in the preparation of the content, and what constitutes a "nominal" investment not subject to disclosure.

III. The Gifts and Gratuities and Non-Cash Compensation Rules

Once again, SIFMA supports the overall purpose of the non-cash compensation and gifts and gratuities rules. Generally speaking, we believe these rules have been effective at limiting conflicts of interest on the part of both clients and registered representatives. We support restricting the use of sales targets and requiring that eligibility for training events be determined on the basis of total production, not the sale of specific securities. However, we do believe these rules could be made more efficient and effective. FINRA Regulatory Notice 14-15 itself makes one point very effectively: currently the non-cash compensation ("NCC") rules - Rules 2310(c), 2320(g)(4) and 5110(h) - are scattered throughout the FINRA rulebook. These rules must be centralized in a single place in the FINRA rulebook. We recommend that FINRA also consider whether these rules should be applied consistently to all securities products, rather than (as today) just to investment company securities, variable products and public offerings of securities.

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[28] The SEC Staff Study on Investment Advisers and Broker-Dealers (January 2011) (***available at***: http://www.sec.gov/news/studies/2011/913studyfinal.pdf [last visited May 22, 2014]) similarly recommended harmonization in this area.

A. FINRA Should Use the Same Principles-Based Approach to Both Gifts and Entertainment

SIFMA supports the current "reasonableness" and "not raise any question of propriety" standards already applied to entertainment in FINRA Rules 2310(c), 2320(g)(4) and 5110(h). We believe the same principles-based standards, rather than a specific dollar threshold of $100, also should be applied to gifts in FINRA Rule 3220.[29] Indeed, the employment of the $100 threshold is exactly the type of prescriptive rule that SIFMA would like FINRA to revisit. The same principles of reasonableness, propriety and avoiding conflicts should underlie the supervision of both gifts and entertainment. The application of the $100 threshold provides challenges for firms that operate in multiple diverse markets across the United States, where the buying power of $100 varies greatly. The $100 threshold also presents challenges over time as the buying power of that amount could change (and, SIFMA submits, has changed).[30] The current difference in treatment requires difficult judgments about what constitutes a "gift" and what constitutes "entertainment" (or a mix of both) which have no relationship to the overall purpose of the rules.[31] Pursuant to a principles-based approach, FINRA already recognizes categories of certain logo wear, deal mementos and *de minimis* gifts as exempt from the $100 gift rule, as well as personal (non-business-related) gifts. The overall result of these two different standards with a complicated set of exceptions, is that supervision and compliance in this area has become more complex, costly, and burdensome than it needs to be. Instead, we suggest that the rule focus on investor protection, reasonableness and avoiding conflicts.

If FINRA is unwilling to adopt a principles-based approach to gifts, then we suggest that FINRA at least consider a "not raise any question of propriety" or "no intent to evade" standard for sub-$100 gifts. Currently, firms are required to track and aggregate sub-$100 gifts over the course of a year (again with the exception of some but not all logo wear, deal mementos and *de minimis* gifts). The difficulty and cost of tracking and supervising these

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[29] The NASD, in Notice to Members 06-06, proposed interpretative material to NASD Rule 3060, the predecessor rule to FINRA Rule 3220, so as to codify the "reasonableness" and "not raise any question of propriety" standards for entertainment. These standards previously had been announced in a 1999 interpretative letter. Although FINRA did not incorporate this proposed interpretative material when it adopted FINRA Rule 3220, we understand the standard articulated in Notice 06-06 and the 1999 interpretative letter still apply to entertainment generally, not only in specific circumstances of the products covered by the current NCC rules.

[30] If it retains a numerical limit, FINRA should at least consider an inflation adjustment of the $100 limit. The current $100 cap was set more than 20 years ago, and today may be insufficient to cover (for example) a commercially reasonable holiday fruit basket or light-weight logo-wear jacket.

[31] For example, it is permissible "entertainment" to take a client and his or her spouse to a baseball game, but if the member firm's associated person becomes ill or gets stuck in traffic and cannot reach the game, then the baseball tickets may become an impermissible "gift". Can the firm use the face value of the ticket, or must it research the secondary market value? We submit that these distinctions are far removed from the purpose of the rule.

minor gifts is substantial, and we believe outweighs the benefits.[32] This tracking and supervision process uses supervisory and compliance resources that would better be deployed elsewhere.

Similarly, SIFMA urges that charitable contributions, even those made at the request of a client, be expressly excluded from the limits on gifts and gratuities in FINRA Rule 3220. In our view, charitable contributions simply do not present the same potential for abuse that FINRA Rule 3220 was meant to address in the context of gifts made directly to a client. Charitable contributions benefit the beneficiaries and goals of the charitable organization, and the community generally, and do not provide the same benefit to the individual business partner that requests the contribution that perhaps a gift would.[33]

In addition, we request that FINRA not apply the $100 limit on gifts made in recognition of bereavement, and extend this to hospitalizations as well. FINRA has already allowed certain gifts in excess of $100 to be made in the same circumstances but has limited that relief to perishables (generally food or flowers sent in condolence).[34]

B. FINRA Should Use a Principles-Based Approach for Non-Cash Compensation

SIFMA believes that the product-specific NCC rules also should be more principles-based, using a reasonableness or "not raise any question of propriety" standard. These rules do not need to specify the minutiae of issues such as where the event can occur, and whether a guest's travel cost can be reimbursed.[35] Our experience is that different broker-dealers interpret the NCC rules differently.[36] Tracking these different firm approaches creates a substantial burden for firms who send associated persons to multiple product training events.

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[32] For example, the current tracking process at many firms includes gifts to different people at the same legal entity, or sometimes even at affiliated entities under common control.

[33] In fact, if a FINRA member firm or an associated person makes a contribution to a charitable organization, the business partner that made the request should not receive any direct benefit from the contribution.

[34] FINRA Interpretive Letter, Reasonable and Customary Bereavement Gifts, Gary Goldshall, FINRA response to Amal Aly, SIFMA, Dec. 17, 2007. ***Available at:*** http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P037695 [last visited May 23, 2014].

[35] We suggest that the "any question of propriety" standard would be sufficient to prevent most international trips, at least where international investments are not at issue. We do not believe that bringing registered representatives from the Southeast to a seminar in New York or Chicago (rather than regionally in Atlanta or Orlando) presents a risk of impropriety that FINRA needs to regulate.

[36] Of course, the NCC rules interact with the gift rule: is an event at a training seminar permissible "entertainment" or do the pads of paper, pens, water bottles, breath mints and bags involve "gifts" subject to the $100 limit? FINRA member firms are posed with numerous questions as they implement compliance policies to

We also suggest that the product-specific NCC rules should exempt less-than-day-long "lunch and learn" -type educational seminars, either at the location of the product wholesaler or at the location of a member firm, so long as the primary purpose of the event is education and training. Currently, to the extent that providing a meal in connection with such an event is addressed at all, it is under the "occasional meal" provision of the NCC rules, which does not adequately address these events. We agree that a "not raise any question of propriety" standard should apply to such meals. FINRA should encourage training events that give registered representatives the basic product understanding required to make "reasonable basis" suitability assessments under FINRA Rule 2111, and which is consistent with prior FINRA guidance such as Regulatory Notice 12-03 on complex products. The rules for these "lunch and learn" -type events should explicitly permit meals to be delivered to persons who are attending the event remotely (*e.g.,* by videoconference).

C. **FINRA should make its staff guidance concerning the NCC and gift rules more consistent and transparent**

As suggested above for the communications with the public rules, we urge the FINRA staff to use tools such as FAQs to update its guidance on the NCC and gift and gratuities rules. Once again, FAQs are a helpful tool to collect in one place guidance that now is scattered across different Notices and Interpretative Letters of uncertain continued applicability, or that may not be public at all. One of the many benefits of using such an approach is that the such guidance could evolve and be updated as needed over time. As discussed above, we understand that the FINRA staff believes that parts of a key 1999 Notice to Members addressing non-cash compensation, NASD Notice to Members 99-55, are outdated and may pertain to certain securities products, but not others. (We are not exactly clear which parts of the Notice the staff believes should no longer be relied upon or if the 1999 non-cash compensation FAQs have general product application.) However, the Notice to Members remains outstanding in its entirety with no indication that in part it may not be current. This is the type of guidance that the FINRA staff should update and make public online.

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address gifts, gratuities and NCC, for example, how should a firm treat a seminar where the water bottle has a firm logo stamped on it, but the pen does not? Or what if the presenting firm's representative finds himself unable to make it to the breakfast – does that turn it into a gift rather than entertainment? Our suggestion is that "the game isn't worth the candle" in terms of the supervisory regime necessary to comply with the current NCC and gift rules.

IV. Conclusion

SIFMA thanks FINRA for commencing its retrospective rule review. We look forward to a continuing dialogue and working together to make FINRA's rules both more effective and more efficient.

If you have any questions or require further information, please contact me at 202.962.7386 (kzambrowicz@sifma.org), or our outside counsel W. Hardy Callcott at 415.772.7402 (hcallcott@sidley.com).

Very truly yours,

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