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May 13, 2020

Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Via Email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)**

**Re: File No. SR-FINRA-2020-007 (Proposed Rule Change to FINRA’s Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest)**

Dear Ms. Countryman:

This letter is being submitted by Financial Industry Regulatory Authority (“FINRA”) in response to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced rule filing. The proposed rule change would: (1) amend the FINRA and Capital Acquisition Broker (“CAB”) suitability rules to state that the rules do not apply to recommendations subject to Regulation Best Interest (“Reg BI”),<sup>1</sup> and to remove the element of control from the quantitative suitability obligation; and (2) conform the rules governing non-cash compensation to Reg BI’s limitations on sales contests, sales quotas, bonuses and non-cash compensation.

The Commission published the proposed rule change for public comment in the Federal Register on March 25, 2020.<sup>2</sup> The Commission received six comment letters directed to the rule filing.<sup>3</sup> Four commenters supported all aspects of the

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<sup>1</sup> 17 CFR 240.15l-1.

<sup>2</sup> See Securities Exchange Act Release No. 88422 (March 19, 2020), 85 FR 16974 (March 25, 2020) (Notice of Filing of File No. SR-FINRA-2020-007).

<sup>3</sup> See Letter from Christopher A. Iacovella, American Securities Association, to Vanessa Countryman, Secretary, SEC, dated April 20, 2020 (“ASA”); Letter from Clifford Kirsch and Eric Arnold, Eversheds Sutherland (US) LLP, for the Committee of Annuity Insurers, to Vanessa Countryman, Secretary, SEC,

proposal.<sup>4</sup> Two commenters had concerns with the proposed changes to the FINRA non-cash compensation rules.<sup>5</sup>

The following are FINRA's responses to the commenters' material concerns.

#### Proposed Changes to Suitability Rules

Five commenters supported the proposed changes to FINRA Rule 2111 (Suitability) and CAB Rule 211 (Suitability) to provide that these rules do not apply to recommendations that are subject to Reg BI,<sup>6</sup> and none objected. These commenters expressed appreciation for the clarification of which rules would apply to recommendations to retail and non-retail customers. Accordingly, FINRA sees no reason to alter the proposed rule text amending FINRA Rule 2111 and CAB Rule 211.

#### Proposed Changes to Non-Cash Compensation Rules

As discussed above, four commenters supported the proposed changes to the non-cash compensation provisions in FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities) and 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements). ASA stated that it supported aligning FINRA's non-cash compensation rules with Reg BI's requirements to adopt written policies and procedures reasonably designed to identify and eliminate sales contests, sales quotas, bonuses and non-cash compensation that are tied to sales of specific securities or

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dated April 15, 2020 ("CAI"); Letter from Kristen Malinconico, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, to Vanessa Countryman, Secretary, SEC, dated April 15, 2020 ("CCMC"); Letter from Robin Traxler, Financial Services Institute, to Vanessa Countryman, Secretary, SEC, dated April 15, 2020 ("FSI"); Letter from Emily Micale, Insured Retirement Institute, to Vanessa Countryman, Secretary, SEC, dated April 15, 2020 ("IRI"); and Letter from Samuel B. Edwards, Public Investors Advocate Bar Association, to Brent J. Fields, Secretary, SEC, dated April 15, 2020 ("PIABA").

<sup>4</sup> See ASA, CCMC, IRI and PIABA. FSI also supported the proposed changes to the suitability rules.

<sup>5</sup> See CAI and FSI.

<sup>6</sup> See ASA, CCMC, IRI, FSI and PIABA. While PIABA supported the proposed changes to the suitability rules, it expressed reservations about Reg BI itself.

specific types of securities within a limited period of time. ASA noted that “[t]hese prohibitions are reasonable and necessary to protect investors from harmful incentives that go against their best interest.” Likewise, PIABA stated that it “supports the removal of internal sales contests of securities. Retail investors’ life savings are too important to be subjected to sales goals and contests similar to the way a used car dealership might incentivize its car dealers.”

In contrast, CAI and FSI expressed concerns with statements in FINRA’s proposed rule filing suggesting that contests based on sales of securities within particular product categories (such as mutual funds or variable annuities) would no longer be allowed under Reg BI. These commenters noted that in the SEC’s adopting release for Reg BI, the SEC refers to mutual funds and variable annuities as “general categories of securities,” and, in contrast, refers to “stocks of a particular sector or bonds with a specific credit rating” as examples of “specifically identified types of securities.”<sup>7</sup>

These commenters stated that, since the text of Reg BI prohibits limited period sales contests if they involve “specific types of securities,” it seems difficult to comprehend that mutual funds or variable annuities, in the SEC’s view, are both “general categories of securities,” but also “specific types of securities” that are subject to the limited period sales contest prohibitions under the Conflict of Interest Obligation of Reg BI. These commenters believe that the SEC intended with respect to variable contracts and mutual funds that the Conflict of Interest Obligation’s prohibition of limited period sales contests merely applies to specific types of variable annuities or funds within those general product categories, such as contests involving only large cap equity mutual funds. The commenters recommended that FINRA clarify that its amendments to the non-cash compensation rules do not prohibit sales contests and other non-cash compensation arrangements that are permissible under Reg BI.

It is not FINRA’s intent to propose changes to its non-cash compensation rules that would prohibit sales contests, sales quotas, bonuses or non-cash compensation that are permissible under Reg BI. Accordingly, should the SEC approve the proposed changes to FINRA’s non-cash compensation rules, FINRA will include language in the Regulatory Notice announcing SEC approval of its intent that the FINRA rule changes at issue be read consistent with the SEC’s interpretation of Reg BI. As stated in Partial Amendment No. 1, FINRA also is modifying its proposal by not deleting rule text in FINRA Rules 2320(g)(4)(D) and 2341(l)(5)(D) that requires non-cash

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<sup>7</sup> See Securities Exchange Act Release No. 86031 (June 5, 2019), 84 FR 33318, 33396 (July 12, 2019) (Final Rule; Regulation Best Interest: The Broker-Dealer Standard of Conduct).

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compensation arrangements between a member and its associated persons, or between a non-member company and its sales personnel who are associated persons of an affiliated member, for the sale of variable insurance products (under Rule 2320) or investment company securities (under Rule 2341) to be based on the total production and equal weighting of sales of those products. FINRA also is not deleting rule text in FINRA Rules 2310(c)(2)(C), 2320(g)(4)(C), 2341(l)(5)(C), and 5110(h)(2)(C) that references Rules 2310(c)(2)(D), 2320(g)(4)(D), 2341(l)(5)(D), and 5110(h)(2)(D), respectively.

FINRA cautions members, however, not to conclude that any sales contest that awards non-cash compensation for sales of securities within particular product categories is per se permissible under Reg BI.

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FINRA believes that the foregoing responds to the material issues raised by the commenters to the rule filing. If you have any questions, please contact me at (240) 386-4534, email: [joe.savage@finra.org](mailto:joe.savage@finra.org).

Best regards,

/s/ Joseph P. Savage

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