



**VIA ELECTRONIC MAIL**

May 9, 2022

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

**Re: FINRA Regulatory Notice 22-08: FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements**

Dear Ms. Mitchell:

We are submitting this letter on behalf of the Financial Services Institute (“FSI”), in response to FINRA Regulatory Notice 22-08, *FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements* (the “Notice”), issued by the Financial Industry Regulatory Authority, Inc. (“FINRA”) on March 8, 2022.<sup>1</sup> The Notice solicits comment on effective practices and rule enhancements related to the sale of complex products and options.

The Notice acknowledges that the number of accounts trading in complex products and options has increased significantly in recent years – particularly through accounts on self-directed platforms.<sup>2</sup> The Notice further acknowledges that there is no standard definition for the term “complex product.”<sup>3</sup> Instead, FINRA construes the term flexibly to include “product[s] with feature[s] that may make it difficult for a retail investor to understand the essential characteristics of the product and its risks . . . .”<sup>4</sup> The Notice provides that “complex products serve a role in our financial markets” and “do not always translate into more investment risk” but, at the same time, they do present a risk of “confus[ing] investors who may not adequately understand their features.”<sup>5</sup> The Notice takes a similar view with regard to options transactions, stating that buying or selling options can be risky for retail investors who may not understand their vocabulary, strategies, and risks.<sup>6</sup>

The Notice focuses on the potential for heightened confusion when a retail investor transacts in complex products or options through a self-directed platform and without the assistance of a

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<sup>1</sup> FINRA Regulatory Notice 22-08, *FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comments on Effective Practices and Rule Enhancements* (March 8, 2022), available [here](#) (Notice).

<sup>2</sup> See Notice at 1.

<sup>3</sup> *Id.* at 3.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 4.

<sup>6</sup> *Id.* at 5.

financial advisor to explain the key features and risks of the product.<sup>7</sup> The Notice seeks comment on: (1) effective practices that members have developed for complex products; and (2) whether the current regulatory framework, which was adopted at a time when the majority of individuals accessed financial products through financial advisors, rather than through self-directed platforms, is appropriately tailored to address current concerns raised by complex products.<sup>8</sup> FSI offers specific comment on these areas below.

### **Background on FSI Members**

FSI is an advocacy association comprised of members from the independent financial services industry. The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.<sup>9</sup> These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).<sup>10</sup> FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate \$35.7 billion in economic activity. This activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly \$7.2 billion annually to federal, state, and local government taxes.<sup>11</sup>

Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI members and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

### **Discussion**

FSI appreciates the opportunity to submit comments in response to this Notice. For the reasons described in further detail below, to the extent FINRA undertakes future rulemaking targeting retail investor transactions in complex products and options, FINRA should focus on transactions in self-directed accounts – where retail investors are not afforded the advice and guidance of a licensed financial advisor. FSI offers the following specific comments in response to this Notice.

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<sup>7</sup> *Id.* at 4, 5, 10, 13.

<sup>8</sup> *Id.* at 1.

<sup>9</sup> Cerulli Associates, Advisor Headcount 2016, on file with author.

<sup>10</sup> The use of the term “financial advisor” or “advisor” in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term “investment adviser” or “adviser” in this letter is a reference to a firm or individual registered with the Securities and Exchange Commission (SEC) or state securities division as an investment adviser.

<sup>11</sup> Oxford Economics for the Financial Services Institute, *The Economic Impact of FSI's Members* (2020).

**A. Any Potential Rulemaking Concerning Complex Products Should Focus on Self-Directed Accounts.**

**a. FINRA and the SEC Have Acknowledged the Increased Risk Posed By Retail Investors Transacting in Complex Products and Options in Self-Directed Accounts.**

For more than a decade, FINRA has published guidance regarding the application of FINRA rules to transactions by retail investors in complex products and options.<sup>12</sup> As stated in the Notice, FINRA's interest in complex products is fueled by the inherent risk of confusion when a retail investor transacts in a product with essential characteristics and features that may be difficult for the retail investor to understand.<sup>13</sup> The Notice acknowledges that the risk of retail investor confusion may be heightened "when retail investors make self-directed decisions through online platforms without the assistance of a financial advisor."<sup>14</sup> In fact, one of the central underlying themes in the Notice is that the current regulatory framework, which was built on the premise that the majority of retail investors would engage a financial advisor, may not be appropriately tailored to online, self-directed platforms, where retail investors have increasingly been provided access to complex products and options.<sup>15</sup> For example, the Notice specifically provides that, after being approved for options trading, self-directed investors on many online platforms can trade through multiple exchanges "without engaging with individuals or seeking professional advice."<sup>16</sup>

The SEC echoed this same sentiment in an October 2020 Joint Statement Regarding Complex Financial Products and Retail Investors.<sup>17</sup> In the Joint Statement, then-SEC Chairman Jay Clayton, and then-directors of the Division of Investment Management, Corporation Finance, and Trading and Markets, noted that they were undertaking a review of the "effectiveness of the existing regulatory requirements in protecting investors – particularly those with self-directed accounts – who invested in leveraged/inverse products and other complex products."<sup>18</sup> The SEC's Joint Statement highlights the agency's concern over retail investors' independent selection of complex products and noted "self-directed investors do not have the required protections that apply when they receive recommendations or advice from a broker or investment adviser."<sup>19</sup> The Joint Statement described those protections as, in part, advice as to the characteristics and potential risks and rewards of an investment.

The risk of investor confusion in connection with transactions in complex products and options is mitigated by the presence of a licensed financial advisor who can educate the investor about the benefits, risks, rewards, and features of a recommended product. FSI's membership is comprised of independent financial advisors, who are subject to comprehensive regulatory requirements, including the SEC's Regulation Best Interest ("Reg BI"), when making

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<sup>12</sup> See e.g., FINRA Regulatory Notice 12-03, Complex Products, Heightened Supervision of Complex Products (Jan. 2012), available [here](#).

<sup>13</sup> See the Notice at 3.

<sup>14</sup> *Id.* at 5.

<sup>15</sup> *Id.* at 1.

<sup>16</sup> *Id.* at 12.

<sup>17</sup> See Securities and Exchange Commission, Joint Statement Regarding Complex Financial Products and Retail Investors (Oct. 28, 2020), available [here](#).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

a recommendation to a retail customer. The presence of a financial advisor in a transaction involving complex products or options affords the retail investor the opportunity to learn the benefits and risks of a particular investment. This interaction between the retail investor and a financial advisor is the precise interaction that the Notice implies is lacking when a retail investor transacts in a complex product or option through an online, self-directed platform. To this end, FSI believes that any FINRA rulemaking regarding complex products and options should take a risk-based approach that focuses on self-directed accounts and platforms – where retail investors can transact in a wide range of products without the opportunity to receive advice from a licensed financial advisor.

**b. Reg BI Provides Protection to Retail Investors in Connection With Recommendations of Complex Products and Options Made By Financial Advisors.**

Reg BI already affords substantial protection for retail investors transacting in complex products and options through a licensed financial advisor. Reg BI establishes a “best interest” standard of conduct for broker-dealers and associated persons when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities (the “General Obligation”).<sup>20</sup> The General Obligation is satisfied by meeting the four component obligations: Disclosure Obligation, Care Obligation, Conflict of Interest Obligation, and Compliance Obligation.

- *Disclosure Obligation:* The Disclosure Obligation requires broker-dealers or natural persons who are associated persons of a broker-dealer to, prior to or at the time of the recommendation, provide the retail customer, in writing, full and fair disclosure of all material facts relating to the scope and terms of the relationship with the retail customer and all material facts related to conflicts of interest that are associated with the recommendation.<sup>21</sup>
- *Care Obligation:* The Care Obligation requires broker-dealers or natural persons who are associated persons of a broker-dealer to exercise reasonable diligence, care, and skill in making the recommendation.<sup>22</sup>
- *Conflict of Interest Obligation:* The Conflict of Interest Obligation requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to: (1) identify and at a minimum disclose, or eliminate, all conflicts of interest associated with recommendations; (2) identify and mitigate any conflicts of interest associated with recommendations that create an incentive for an associated person of a broker-dealer to place the interest of the broker-dealer, or associated person ahead of the interest of the retail customer; (3) identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, and prevent such material limitations and associated conflicts of interest from causing the broker-dealer, or an

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<sup>20</sup> See Regulation Best Interest, Securities Exchange Act Release No. 86031 (June 5, 2019), 84 Fed. Reg. 33318 (July 12, 2019) (“Reg BI Adopting Release”).

<sup>21</sup> 17 C.F.R. § 240.15l-1(a)(2)(i).

<sup>22</sup> 17 C.F.R. § 240.15l-1(a)(2)(ii).

associated person of the broker-dealer to make recommendations that place the interest of the broker-dealer, or such associated person ahead of the interest of the retail customer; and (4) identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.<sup>23</sup>

- *Compliance Obligation:* The Compliance Obligation requires broker-dealers to establish, maintain, and enforce policies and procedures reasonably designed to achieve compliance with Reg BI as a whole. As a result of this requirement, a broker-dealer's Reg BI policies and procedures must address not only conflicts of interest, but also compliance with the Disclosure Obligation and Care Obligation under Reg BI.<sup>24</sup>

A broker-dealer and its associated persons must comply with the General Obligation and the four component obligations under Reg BI when making a recommendation to a retail customer, including a recommendation to buy or sell complex products or options. In fact, while Reg BI's rule text does not explicitly address complex products, the Reg BI Adopting Release provides guidance as to how broker-dealers should handle recommendations of complex products in certain contexts. As stated in the Notice, Reg BI's Adopting Release "emphasized the importance of understanding the terms, features, and risks of complex products" before broker-dealers recommend them to a retail customer.<sup>25</sup> Further, the Adopting Release provides that "when broker-dealers are recommending complex or costly products, they should first consider whether less complex or costly products could achieve the same objectives for their retail customers."<sup>26</sup> These are important investor protection standards that advisors must follow when making a recommendation of a complex product to a retail customer.

In contrast to an advisor's recommendation to buy or sell complex products or options which is subject to Reg BI, a self-directed or otherwise unsolicited transactions by a retail customer is generally not subject to Reg BI.<sup>27</sup> Therefore, retail customers transacting in complex products and options through online, self-directed platforms are not afforded Reg BI's investor protection mechanisms in the same way they would be if they bought the same product through a financial advisor. For these reasons, and those set forth above, FSI believes that should FINRA propose new regulatory requirements concerning retail investor transactions in complex products and/or options, any new rulemaking should be narrowly tailored to address the issues outlined in this Notice, mainly those raised by retail investors' growing access to these products through online, self-directed platforms that do not offer personal financial advice (and generally are without the investor protection safeguards provided by Reg BI).

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<sup>23</sup> 17 C.F.R. § 240.15l-1(a)(2)(iii).

<sup>24</sup> 17 C.F.R. § 240.15l-1(a)(2)(iv).

<sup>25</sup> See Notice at 10.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 33384.

**Conclusion**

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts. Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,

A handwritten signature in blue ink that reads "Robin Traxler". The signature is written in a cursive style with a long horizontal line extending to the right.

Robin Traxler  
Senior Vice President, Policy & Deputy General Counsel