INSURED RETIREMENT INSTITUTE

May 9, 2022

VIA ELECTRONIC SUBMISSION

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

Re: 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. Countryman:

The Insured Retirement Institute, Inc. ("IRI")[1] appreciates the opportunity to comment on the Regulatory Notice 22-08, Financial Industry Regulatory Authority's ("FINRA") reminder to its Members of their sales practice obligations for complex products and options, and to solicit comment on effective practices and rule enhancements, or (the "Notice").[2]

In response to FINRA's Notice 22-08 solicitation of comments, IRI has a heightened interest in FINRA's efforts to address complex products and options and offer general and specific comments, as set forth below:

I. Complex Products

FINRA maintains a dynamic definition of a complex product in order to accommodate the evolution of new financial products. Generally speaking, FINRA defines a complex product as "a product with specific and unusual or non-standard features and risks that are objectively

[1] The Insured Retirement Institute (IRI) is the leading association for the entire supply chain of insured retirement strategies, including life insurers, asset managers, broker-dealers, banks, marketing organizations, law firms, and solution providers. IRI members account for 90 percent of annuity assets in the U.S., include the foremost distributors of protected lifetime income solutions, and are represented by financial professionals serving millions of Americans. IRI champions retirement security for all through leadership in advocacy, awareness, research, and the advancement of digital solutions within a collaborative industry community.

[2] Request for Comment (Effective Practices and Rule Enhancements for Members Sales Practice Obligations for Complex Products and Options), Regulatory Notice 22-08 (Mar. 8, 2022).

difficult for a retail investor to understand ….”[3] Specifically, FINRA has identified the following as complex products, among others:[4]

- leveraged and inverse exchange-traded products (ETPs) (collectively, “geared” ETPs),
- volatility-linked ETPs
- structured products,
- non-traded REITs,
- defined outcome exchange-traded funds (ETFs) that offer structured retail product-type features,
- mutual funds and ETFs that offer strategies employing cryptocurrency futures, and
- interval funds, or tender-offer funds that provide limited liquidity.

IRI believes that FINRA should not attempt to define “complex products” but allow the industry to take a flexible approach in line with FINRA’s guidance in determining for itself what is a “complex product.” The focus for firms would be regarding the risks and costs to a retail investor, with a particular focus on the potential for significant loss or high costs or fees that is not readily understandable to the retail investor.

The current regulatory regime for sales of complex products to retail investors is based on Regulation Best Interest, the Investment Advisers Act, the Investment Company Act, and a host of guidance that FINRA has published over the years, including regarding heightened supervision (RN 12-03), product specific guidance (03-07, 03-71, 05-50, 05-59, 09-31, 09-73, 10-09, 10-51, 17-32, 20-14), and product specific education for investors (e.g., volatility-linked ETPs, leveraged and inverse ETPs, alternative mutual funds, ETNs, structured notes, reverse convertibles), and new product review guidance (NTM 05-26).

With respect to disclosure, for certain complex products such as hedge funds and private equity funds, investors are provided disclosure of material risks through a private placement memorandum (“PPM”), and investors are required to execute subscription agreements in which the investor acknowledges receipt and review of the PPM, as well as an understanding of the risks attendant with the complex product (among other things).

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[3] FINRA RN 22-08 at p. 3.

[4] *Id.* at p. 3 – 4.

Recommendations of Complex Products

The regulatory regime surrounding recommendations of complex products is adequate and does not need to be amended. Under Reg BI, broker-dealers must adhere to the Care Obligation, and determine that the recommended complex product is in the best interest of some retail investors (prong 1), and in the best interest of the particular retail investor based on that person's investment profile (prong 2). The registered representative must, under Reg BI, fully understand the product being recommended, and that puts the burden on the broker-dealer to adequately train the representative about the risks, rewards and costs, and reasonably available alternatives (if any) for the particular complex product being recommended. Given the unique features and risks of complex products, this requires firms to take a product-by-product approach to assess the best interest for retail customers generally and their ability to understand these unique characteristics and risks.

Certain complex products, such as defined outcome ETFs, mutual funds and ETFs that offer strategies employing cryptocurrency futures, and interval funds, use Form N-2 or Form N-1A to file registration statements under the Securities Act of 1933 and the Investment Company Act. As part of the registration process, the SEC staff reviews and provides comments on such registration statement, including in respect of the complex product's articulated objective, strategies, and risk disclosures, and whether such information is communicated consistently with the SEC staff's "Plain English" directive.

IRI believes that Regulation Best Interest adequately protects retail customers who receive recommendations of complex products from broker-dealers. Coupled with the extensive FINRA guidance and education on specific products over the last 20 years, there appears to be sufficient information both for broker-dealers and customers to understand the risks and features of these products.

Self-directed accounts: Complex Products

The SEC does not apply Reg BI to self-directed transactions, and neither has FINRA applied its suitability rule to such transactions. There is no reason to extend Reg BI to "complex products" that are purchased or sold in self-directed accounts when no recommendation has been made. This would turn upside down the existing regulatory scheme that the industry relies on. As discussed above, broker-dealer firms are expected to follow FINRA guidance for assessing complex products offered by the firm that are recommended. To the extent that firms allow self-directed clients to trade complex products (e.g., those that trade on listed exchanges), then firms should have the flexibility to establish a governance process to decide whether to allow such trading in self-directed accounts to occur at all.

Although we appreciate regulatory concerns for sales of complex products, we do not see any widespread evidence that retail customers do not understand the risks and characteristics of complex products; nor have we seen published statistics from FINRA demonstrating a rise in customer complaints in self-directed accounts for complex products. The existing regulatory structure adequately protects retail investors.

IRI opposes imposing any new due diligence requirements that would be modeled after FINRA Rule 2260 regarding options. IRI believes such due diligence requirements would be burdensome, costly, and would ultimately frustrate customers who have made their own decision to transact in a complex product on an unsolicited basis.

Specifically, IRI opposes a "Form CRS" type disclosure. Complex products vary significantly from one another, and it would be virtually impossible to draft such a disclosure across the landscape of complex products. In addition, it also would be legally impermissible for broker-dealers to accomplish this without each issuer of the complex product agreeing to do so, preparing the disclosure, and file it with the SEC as a prospectus.

IRI also opposes requiring member firms to file communications that promote or recommend complex products with the Advertising Regulation Department of FINRA before first use since such communications may be "prospectuses" that are filed with the SEC (Rule 2210 specifically carves out the requirement to file such documents with FINRA if they've already been filed with the SEC).

IRI opposes extending Reg BI to self-directed accounts, including with respect to disclosure. To the extent that FINRA believes self-directed accounts require disclosures that are not already mandated by law and rule (e.g., prospectuses), then that should be specifically addressed by the SEC if there is a gap identified. IRI also does not believe that "push notifications" sent to retail customers should be subject to specific restrictions. Rule 2210 adequately addresses the appropriate standards for communications with the public and there is no demonstrable evidence that this rule has been proven to be inadequate relating to communications about complex products. If the communication constitutes a recommendation, then Reg BI will apply.

IRI also opposes establishing rules that would require self-directed customers to take a test before trading a complex product. These customers are not receiving recommendations from a member firm. The burden should not be placed on member firms to administer a test to a retail self-directed customer before that customer places an order for a complex product. Such a burden will likely lead to a decline in such transactions, and further restrict access to certain products.

II. Options

The current regulatory regime for options is based on Regulation Best Interest and FINRA Rules 2360 (Options) and 2220 (Options Communications). The primary options disclosure is the Options Disclosure Documents ("ODD").[5] FINRA has also issued RN 21-15 on options account approval, supervision, and margin. FINRA has also issued numerous educational

[5] Characteristics and Risks of Standardized Options, https://www.theocc.com/Company-Information/Documents-and-Archives/Options-Disclosure-Document.

materials for investors.[6] IRI understands that FINRA believes that retail investors may trade options in self-directed accounts without adequately understanding the risks of options (see RN 22-08 at p. 5). IRI believes that the current regulatory regime is sufficient for options.

For options accounts where recommendations are made, Reg BI applies, and thus the Care Obligation protects retail investors. On top of that, FINRA Rule 2360 contains a due diligence component, including having a reasonable belief that the retail customer has the knowledge and experience to evaluate the risks involved and the financial wherewithal to withstand any losses.

For self-directed accounts, Reg BI does not apply and should not apply. FINRA should not seek to extend Reg BI to unsolicited transactions. FINRA's options rules already impose numerous protections for self-directed investors, including at account opening, with approval requirements, and ongoing supervision of options approvals. FINRA detailed all of these requirements in RN 21-15. In addition, IRI believes that the mandated ODD disclosure, which describes the features, different types, and risks associated with options, adequately informs retail customers about options. IRI does not support amending the existing options regulatory regime.

With respect to specific questions asked in RN 22-08, IRI does not support FINRA creating specific standards to be applied to options levels. Firms have developed their own standards for options levels, and supervision relating to approval of those levels, which are informed by their experiences with their customers bases and have been examined by FINRA and other Exchanges over the years, and this existing state of the regulatory scheme should continue as is.

Moreover, for self-directed accounts, IRI does not support requiring broker-dealers to make a "suitability determination" for each options account level since no recommendations have been made. Firms ensure that it has on file the required information in existing Rule 2360(b)(16)(B)(i), which is then verified in Rule 2360(b)(16)(C).

Similarly, regarding FINRA's questions on margin used for options levels, some options strategies do require the use of margin to effectuate the strategy. If a client applies to an option level that includes that strategy, and the account is not yet enrolled in or approved for margin, that strategy would then be rejected. If the account is already enrolled in margin, then it would be reviewed under the established FINRA options standards under Rule 2360 (with the knowledge that the strategies require margin). Again, since no recommendation is being made to use margin or to engage in options, IRI does not favor extending Reg BI or create an amendment to Rule 2360 for the use of margin in option accounts.

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[6] For example, see "Options A-Z: The Basics to The Greeks" (regarding options terminology) (Jun. 2015) https://www.finra.org/investors/insights/options-z-basics-greeks. "Trading Options: Understanding Assignments" (Dec. 2020), https://www.finra.org/investors/insights/trading-options-understanding-assignment; Investor Bulletin: An Introduction to Options (Mar. 2015), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_introductionoptions.html; Investor Bulletin: Opening an Options Account (Mar. 2015). https://www.sec.gov/oiea/investor-alerts-bulletins/ib_openingoptionsaccount.html.

IRI also does not believe that FINRA should impose a rule requiring firms "to have a conversation" with self-directed clients prior to approving trading in options. There is no precedent for this in self-directed accounts trading securities. Firms already are required to conduct due diligence on all options customers. IRI does not see any value to this "conversation" being imposed on member firms.

IRI does see value in re-confirming with the retail customer periodically the options account level that the customer has been approved for. IRI believes that this would help self-directed clients because it would remind them periodically what they have previously committed to with respect to the risks of their options level.

IRI does not support having targeted communications about options, such as push notifications to self-directed customers, be subject to rules beyond FINRA Rules 2210 and 2260 on options communications. We note, however, if these "push notifications" were actually a "recommendation," then Reg BI would apply and provide protection for retail customers.

IRI also does not support amending Rule 2220(c)(1) to pre-file all retail communications involving options or options strategies (which are defined in rule 2210(a)5). Such a change would create significant burdens on the firms, including additional costs to comply with such a change. These communications must already be fair and balanced and not misleading under Rule 2220(d)(2) and are already subject to supervisory review under Rule 2210(b)(1)(A). There is no reason to add a filing requirement to the supervision requirement

IRI also does not believe that retail customers, whether advised or self-directed, should be required to take a test before trading options. Firms already provide the ODD. The burden of creating and administering a "test" for retail customers would be significant, costly, and operationally complex.

With respect to disclosure, IRI believes that the ODD should continue to be the standard disclosure document, and that document already contains the risks of options trading (see pages 59-85 of the existing "Characteristics and Risks of Standardized Options"). If FINRA is going to create a single page that focuses on the key risks of options trading, then why not instead amend the ODD instead with an executive summary since there is already a three page "Introduction" to the document. The ODD also contains 26 pages of risks about options, and IRI does not believe that retail customers need even more disclosure on such risks.

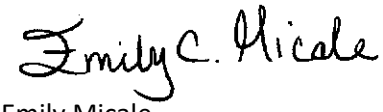
IRI also opposes FINRA imposing "heightened supervisory" requirements on options trading, whether advised or self-directed customers. It should be within the purview of each member firm to establish its own supervisory system regarding options that is tailored to its business model, and FINRA can use its examination program to test the effectiveness of those systems.

Finally, FINRA asks whether firms should be required to give investors to 5:30 pm EST to make a final exercise decision. Firms should not be required to give investors to 5:30 pm ET to make a final exercise decision. Firms should continue to be allowed to set a deadline for

customers prior to 5:30 pm ET. As a practical matter, firms could not reasonably be expected to process a volume of exercise instructions all at once, and so require a window prior to 5:30pm ET within which to process them.

Thank you again for the opportunity to provide these comments. If you have questions, or if IRI can be of any further assistance in connection with this important regulatory effort, please feel free to contact the undersigned at emicale@irionline.org.

Respectfully submitted,



Emily Micale
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