sigma FINANCIAL CORPORATION Member FINRA/SIPC

parkland SECURITIES, LLC Member FINRA/SIPC

July 10, 2025

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, DC 20006

Re: Comments on Regulatory Notice 25-07

Dear Ms. Mitchell:

Sigma Financial Corporation and Parkland Securities, LLC (collectively, the "Companies," "we," "us," or "our") are registered broker-dealers and FINRA member firms located in Ann Arbor, Michigan.[1] The Companies value FINRA's longstanding self-regulatory compact with member firms,[2] and we appreciate the opportunity to provide constructive feedback on the various issues raised for comment in Regulatory Notice 25-07. The requests for comments to which the Companies are responding are set forth below and follow the same labeling as in Regulatory Notice 25-07.

A. Branch Offices and Hybrid Work

Request for Comment A.2: Should the Supervision Rule's branch office and OSJ definitions, inspection requirements, and designation and registration of offices be modernized to eliminate unnecessary burdens or ambiguities while maintaining investor protection and market integrity? Should the branch office definition be amended in light of the technological advances that have changed how and where individuals work? Is the OSJ definition still relevant in today's environment?

Response: We strongly encourage FINRA to revise FINRA Rule 3110.19(c)(1) to loosen the restrictions of this provision. In the case of a registered principal who is in good standing and newly hired to perform supervisory functions remotely or on a hybrid basis, there is little reason to prevent such an individual's location from qualifying as an RSL for an entire year. Supervision is largely now an electronic and automated effort, meaning "new" employees can get up to speed quickly and perform their functions from any location with reliable and

---

1 The Companies' CRD numbers are 14303 and 115368, respectively.

2 This compact was articulated by one of FINRA's former CEOs. *See* Richard G. Ketchum, Chief Regulatory Officer, NYSE, Keynote Speech at the Practising Law Institute, Nov. 11, 2004 ("if we do not accept the fact that the burden of self-regulation is collaborative with equal responsibility to the industry and those in this hall who advise them, as it is with the SROs, then we have already failed").

secure Wi-Fi. Therefore, prejudicing a new hire's location by requiring "one year of direct supervisory experience with the member" for RSL status only adds an unnecessary burden.

Simply put, there is no clear benefit derived from regarding an individual's living room, kitchen table, attic, basement, or spare bedroom as an OSJ rather than an RSL. Such an artificial label makes little sense given the realities of the work context, nor is it likely, even with an OSJ's concomitant one-year inspection requirement, to enhance the individual's ability to "gain supervisory experience with the member firm's systems and overall compliance culture" as FINRA originally envisioned.[3] Such familiarity with the member's compliance culture will certainly come with time, but the awkward fiction of treating an employee's home as an OSJ will do nothing to further the process.

B. Registration Process and Information

Request for Comment B.2: Should changes be made to the substance or presentation of the information provided to the public?

Response: Unless FINRA is prepared to revise the Code of Arbitration Procedure for Industry Disputes (the "Code") to provide member firms with qualified immunity against defamation claims, we believe that in the case of a registered representative's termination for cause, the public should not be provided with the member firm's explanation submitted in response to the "Reason for Termination" in section 3 of Form U5.[4] Absent meaningful immunity from liability, this explanation, which shows up on a public BrokerCheck report as part of a "Disclosure" (e.g., Employment Separation After Allegations), should be available only to FINRA staff (and other regulators) for investigative purposes and not widely published to the public so as to precipitate a defamation claim against the member firm.[5]

Conceptually, *defamation* is "an attack on the reputation of another through the unprivileged utterance or publication of false statements that proximately result in injury to that person. A communication is considered defamatory if it tends so to harm the reputation of another as to lower him in the estimation of the community or to deter third persons from associating or

[3] *See* Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, To Adopt Supplementary Material .19 (Residential Supervisory Location) Under FINRA Rule 3110 (Supervision), Exchange Act Release No. 98980, 88 Fed. Reg. 82447, 82455 (Nov. 24, 2023).

[4] Section 3 states: "If the Reason for Termination entered above is Permitted to Resign, Discharged or Other, provide an explanation below[.]"

[5] This information need not be permanently denied to the investing public. When a representative is terminated for cause, FINRA regularly conducts an inquiry regarding the matter. If that inquiry ultimately leads to enforcement action against the representative (e.g., a Letter of Acceptance, Waiver and Consent), FINRA itself can disclose the matter to the public through a Form U6 filing, thereby shielding the member from defamation liability. Conversely, if no enforcement action ultimately results, there is no legitimate need for a related disclosure.

dealing with him, or if it tends to expose him to public hatred, contempt or ridicule."[6] Furthermore, even an *incomplete statement* can be sufficient for defamation liability.[7]

A key element of any defamation claim is *publication*. This presents member firms with a dilemma when terminating a registered representative for cause, or what one legal commentator described as a "Modern-Day Hobson's Choice."[8] On the one hand, FINRA rules require members to fully report the reasons for such a termination, and also to generally inform customers of the representative's departure.[9] If a member fails to fully report the reasons for termination, it can face civil and even criminal penalties.[10] On the other hand, members have an incentive to "whitewash" a Form U5 disclosure as much as possible in order to avoid the risk of a defamation lawsuit from the representative who was terminated. The result is a no-win situation for member firms which are caught between the proverbial rock of disclosure and the hard place of defamation liability. Even if full disclosure is made, the risk of a potential defamation claim—even if frivolous—looms large and has a very real chilling effect.

This is not mere speculation. Even though many states provide a qualified immunity privilege for potentially defamatory statements made to quasi-governmental bodies such as FINRA,[11]

---

6 David E. Robbins, 3 Securities Arbitration Procedure Manual § 15-8 (2024) (quotation marks and citation omitted).

7 *James Patrick Robertson v. Raymond James Fin. Servs., Inc.*, FINRA Case No. 12-01755, p. 6 (Jan. 30, 2014) ("True but incomplete statements can fulfill the falsity requirement for defamation").

8 Robbins, 3 Securities Arbitration Procedure Manual § 15-8.

9 *See* FINRA Regulatory Notice 19-10 (Apr. 5, 2019).

10 NASD Notice to Members 88-67 (Sept. 1, 1988) ("The NASD would also point out that members and their associated persons may be subject to administrative, civil, and even criminal penalties for failing to provide complete and accurate information on Forms U-4 and U-5.").

11 Qualified immunity is provided for such disclosure in Section 507 of the Uniform Securities Act of 2002. Among the jurisdictions that have adopted the Uniform Securities Act of 2002, in full or in part, at least 21 of them have included the Section 507 qualified immunity provision: (1) Alaska [Alaska Stat. § 45.56.560]; (2) Georgia [Ga. Code Ann. § 10-5-56]; (3) Hawaii [Haw. Rev. Stat. § 485A-507]; (4) Idaho [Idaho Code Ann. § 30-14-507]; (5) Indiana [Ind. Code Ann. § 23-19-5-7]; (6) Iowa [Iowa Code § 502.507]; (7) Kansas [Kan. Stat. Ann. § 17-12a507]; (8) Maine [Me. Rev. Stat. Ann. tit. 32, § 16507]; (9) Michigan [Mich. Comp. Laws § 451.2507]; (10) Minnesota [Minn. Stat. § 80A.74]; (11) Mississippi [Miss. Code Ann. § 75-71-507]; (12) Missouri [Mo. Rev. Stat. § 409.5-507]; (13) New Hampshire [N.H. Rev. Stat. Ann. § 421-B:5-507]; (14) New Mexico [N.M. Stat. Ann. § 58-13C-507]; (15) Oklahoma [Okla. Stat. tit. 71, § 1-507]; (16) South Carolina [S.C. Code Ann. § 35-1-507]; (17) South Dakota [S.D. Codified Laws § 47-31B-507]; (18) the U.S. Virgin Islands [V.I. Code Ann. tit. 9, § 657]; (19) Vermont [Va. Stat. Ann. tit. 9, § 5507]; (20) Wisconsin [Wis. Stat. § 551.507]; and (21) Wyoming [Wyo. Stat. Ann. § 17-4-507].

This appears consistent with legal conclusions that Form U5 is not entitled to absolute immunity, but only qualified immunity, because it is not part of a judicial proceeding. *See Glennon v. Dean Witter Reynolds, Inc.*, 83 F.3d 132, 137 (6th Cir. 1996) ("the arbitration panel's failure to afford the statements on the Form U-5 an absolute privilege was not in manifest disregard of Tennessee law"). In contrast, New York law provides for an absolute privilege. *See Rosenberg v. Metlife, Inc.*, 866 N.E.2d 439, 445 (N.Y. 2007) ("Statements made by an such qualified privilege carries less weight in FINRA arbitration which is an equitable forum[12] where legal precedent can be disregarded[13]:

> Whether state law affords firms absolute, qualified, or no immunity, at the end of the day, most U5 defamation claims are compelled to proceed to arbitration, not court, and FINRA arbitrators often do not evaluate whether a privilege applies until all evidence has been entered. Further, FINRA arbitrators often focus their awards on simply whether the Form U5 disclosures are inaccurate or false, and not whether the claimant can satisfy each element of a defamation claim. Brokers have been successful in receiving substantial arbitration awards in their defamation claims against major brokerage firms.[14]

At one time, the NASD sympathized with member firms on this issue and endorsed granting qualified immunity for Form U4 and Form U5 disclosures:

> In recent years, registered persons have brought a number of defamation claims for allegedly untrue or misleading statements made on Form U-5. The claims are primarily brought in arbitration . . . [and] because of the personal and financial interests at issue, the members' potential exposure to liability as a result of such claims may be substantial.
>
> At common law, courts have generally found that employers are entitled to a qualified privilege for statements made about former employees to prospective employers. This qualified privilege has been codified in many state statutes. . . . The potential liability for statements made on Forms U-5 has created a disincentive for member firms to provide full disclosure. Members have also questioned the fairness of exposure to potentially significant liability for disclosures they are required by the NASD to make. . . . [F]ull disclosure of disciplinary problems on Forms U-4 and U-5 is in the public interest. Accordingly, NASD Regulation believes it is appropriate to provide some degree of protection for members for statements made on required forms in order to encourage full

employer on a NASD employee termination notice are subject to an absolute privilege in a suit for defamation.").

12 FINRA Dispute Resolution Services Arbitrator's Guide, p. 9 (Mar. 2025) ("Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail.").

13 SEC Office of Investor Education and Advocacy, *Broker-Dealer/Customer Arbitration: Investor Bulletin* (June 14, 2022) ("Arbitrators are not required to follow state or federal rules of evidence and are not bound by legal precedent."), available at https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/broker-dealercustomer-arbitration-investor-bulletin.

14 Gary Lieberman, "Form U5 Defamation Claims on the Rise at FINRA: Be Prepared!", *littler.com*, Mar. 25, 2021, available at https://www.littler.com/news-analysis/asap/form-u5-defamation-claims-rise-finra-be-prepared. *See also* ROBBINS, 3 SECURITIES ARBITRATION PROCEDURE MANUAL § 15-8 (noting that arbitrators should be "encouraged to apply" the specific legal standards for defamation claims).

> disclosure. Inadequate disclosure has the potential to compromise the integrity of the Central Registration Depository, and hinders regulatory enforcement action by the NASD and other regulators. . . . The proposed Rule is designed to strike a balance between the interests of the member firms, the employees, and the public by providing qualified immunity for statements made in good faith by member firms on certain required forms, and by providing employees with an opportunity to seek changes to disclosures contained in Forms U-5 prior to their filing.[15]

Unfortunately, FINRA's sympathy has seemingly waned, and proposed NASD Rule 1150 never came to be.[16] As a result, member firms have continued to be at the mercy of arbitration panels willing to grant enormous defamation awards in connection with Form U5 disclosures.[17] Moreover, recent FINRA arbitration statistics show no signs of such cases slowing down:

FINRA Arbitration Cases Involving Libel or Slander on Form U5[18]					
Time Period	**2025 Cases Served**	**2024**	**2023**	**2022**	**2021**
Through May	35	47	43	36	44
Year-End	-	90	104	84	89

Our request is straightforward: Enshrine in the Code the qualified immunity (or even the absolute immunity) that is already available in dozens of states throughout the nation. Doing so would protect the public interest and ensure full and fair disclosure, as the NASD recognized decades ago in proposing NASD Rule 1150. Otherwise, if FINRA is still unwilling to offer member firms qualified immunity, we request that the reasons for termination provided on Form U5 not be made available through BrokerCheck or to anyone except FINRA staff and other regulators, as this will help prevent the "publication" from occurring that is necessary for defamation.

---

15 NASD Notice to Members 97-77, pp. 661–62 (Nov. 1997) (proposing NASD Rule 1150 under SR-NASD-1998-018).

16 Proposed NASD Rule 1150 was withdrawn after being published in Exchange Act Release No. 39892 (Apr. 21, 1998) and was never acted upon by the SEC. *See* UNIFORM SECURITIES ACT OF 2002 § 507 cmt. 2 ("In 1998, the National Association of Securities Dealers proposed qualified immunity for statements made in Forms U-4 and U-5 to address this problem. This proposal was reprinted in Securities Exchange Act Release 39,892 . . . [but] was not acted on by the Securities and Exchange Commission.").

17 *See, e.g.*, *Dustin B. Luckett v. J.P. Morgan Securities, LLC*, FINRA Case No. 19-03075 (Feb. 4, 2022) (awarding the claimant $1.4 million in compensatory damages, with no discussion of qualified immunity, while leaving unchanged the Reason for Termination in Section 3 of the claimant's Form U5); *James L. Springer v. UBS Fin. Servs.*, FINRA Case No. 15-00100 (Oct. 26, 2017) (awarding the claimant $3 million in compensatory damages for defamation, with no discussion of qualified immunity, while also denying the claimant's request for expungement of the Reason for Termination in Section 3 of the claimant's Form U5 and Question 7F(1)).

18 *See* FINRA Dispute Resolution Services Statistics, available at https://www.finra.org/arbitration-mediation/dispute-resolution-services-statistics.

Either way, the status quo is becoming increasingly untenable. Member firms are forced to walk an increasingly challenging disclosure tightrope of publicly disclosing sensitive information with reputational consequences but without the benefit of even qualified immunity in the event a terminated representative chooses to file a Statement of Claim alleging defamation. Such a difficult situation leaves no one better off—the public, terminated representatives, member firms, or FINRA.

C. Qualifications and CE

Request for Comment C.2: Are there more effective or efficient ways for individuals to demonstrate their qualifications?

Response: Similar to the investment adviser context, we believe that earning certain professional designations is sufficient for individuals to demonstrate their qualifications. While states may require an investment adviser representative of an SEC-registered investment adviser to satisfy a qualification requirement (i.e., the Series 65 or Series 66 examination), many states waive the examination and deem the qualification requirement satisfied if the investment adviser representative has been awarded one of the following professional designations:

- Certified Financial Planner (CFP) awarded by the Certified Financial Planners Board of Standards;
- Chartered Financial Consultant (ChFC) or Masters of Science and Financial Services (MSFS) awarded by the American College, Bryn Mawr, Pennsylvania;
- Chartered Financial Analyst (CFA) awarded by the Institute of Chartered Financial Analysts;
- Personal Financial Specialist (PFS) awarded by the American Institute of Certified Public Accountants; or
- Chartered Investment Counselor (CIC) awarded by the Investment Adviser Association.[19]

Importantly, earning one of these professional designations is sufficient to permit an investment adviser representative who is not dual-registered[20] to purchase, sell, and trade

---

[19] CLIFFORD E. KIRSCH, INVESTMENT ADVISER REGULATION: A STEP-BY-STEP GUIDE TO COMPLIANCE AND THE LAW, § 35:15.5 (3d ed. 2025) (citing NASAA Model Rule 412(e)-1 under the Uniform Securities Act of 2002 and commenting that "NASAA has endorsed and most states have adopted a uniform examination waiver for individuals holding certain designations and IARD is able to accommodate these examination waivers automatically," as a result of which the "examination requirement is waived for individuals who have been awarded [these] designations and, at the time of filing of the registration application, currently are in good standing").

[20] Complete freedom to trade is not available in the case of dual registration. For example, a dual-registered financial professional with only a Series 6 license cannot trade equity securities in the accounts of advisory clients. *See* FINRA Regulatory Notice 96-33, pp. 239–40 (May 1996) ("A limited RR who is otherwise in

any type of security—stock, bond, option, ETF, etc.—just as a Series 7 representative can, but without a qualifying examination and in the more stringent fiduciary context of discretionary account management.[21]

In short, we believe that if one of these professional designations is adequate qualification in the investment adviser context, it should also be in the broker-dealer context as well. The differing standards serve no clear regulatory purpose and result in a sort of "licensing arbitrage" that incentivizes individuals to avoid broker-dealer affiliation altogether. For these reasons, we encourage FINRA to incorporate NASAA Model Rule 412(e)-1 into FINRA Rule 1220(b)(2) such that holding one of these professional designations is sufficient to qualify as a General Securities Representative and waive the SIE and Series 7 examination requirements. This would help to achieve FINRA's goal of addressing the "differences between FINRA's requirements for broker-dealers and the requirements that apply for investment advisers engaging in similar activities[.]"[22]

Request for Comment C.3: Are members or individuals facing specific challenges relating to the qualification examinations? For example, should regulators continue to require association with a member before individuals can take qualification examinations (beyond the SIE examination)?

Response: We believe that FINRA should shorten the waiting periods in FINRA Rule 1210.06. For a test taker who fails an examination, two weeks is usually sufficient time to "hit the books" harder in preparation for retaking the examination, and therefore the 30-day waiting period could reasonably be shortened to 15 days. Failing an examination can be a powerful motivation for some individuals, and requiring them to wait a full 30 days to retake the examination, even though they may be ready sooner than that, serves no useful purpose. Moreover, those who need additional time to prepare can always schedule their examination more than 15 days after the last failed examination attempt.

In addition, we believe the 180-day waiting period after multiple failed examinations serves no useful purpose and should be eliminated. This 180-day waiting period is especially problematic in light of FINRA Rule 1210.04 which limits representatives to acting as principals for only 120 days prior to passing an appropriate principal qualification examination (a "temporary principal"). In particular, the Series 24 examination is widely known for its difficulty,[23] and a representative may need multiple attempts to pass the

---

compliance with applicable federal and state registration requirements, such as the SEC's investment adviser registration requirements, may not execute transactions in securities not covered by his or her NASD registration. . . . A limited representative who wishes to execute transactions in securities not covered by his or her registration category is required to pass an appropriate qualification exam.").

21 *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 191 (1963) (finding that the Investment Advisers Act of 1940 reflects a congressional recognition "of the delicate fiduciary nature of an investment advisory relationship").

22 FINRA Regulatory Notice 25-04, p. 5 (Mar. 12, 2025).

23 "The Series 24 is a very hard exam. Although there are no official pass rates or figures, a quick search will bring up forums of those who have taken [it] and the general consensus is that it is one of the hardest

examination while also operating within the 120-day window. Delaying a retake examination for 180 days is not only likely to encourage individuals to abandon the goal of becoming a registered principal but could also force someone out of a temporary principal role because the 180-day examination waiting period exceeds the 120-day temporary principal time limit.

<u>Request for Comment C.4</u>: Should FINRA consider any changes to the CE program?

<u>Response</u>: We believe FINRA should eliminate the Firm Element CE requirements of FINRA Rule 1240(b) and leave in place only the annual compliance meeting ("ACM") requirement of FINRA Rule 3110(a)(7) and the anti-money laundering ("AML") training requirement of FINRA Rule 3310(e). In other words, the ACM and AML training requirements should *fully* satisfy, rather than partially count toward satisfying,[24] the Firm Element CE requirement for member firms' registered persons.

We believe such a change is warranted based on the state of the current CE landscape. While there was once a need for member firms to develop training plans appropriate for their business that covered "topics related to the role, activities or responsibilities of the registered person and to professional responsibility,"[25] this is no longer the case. Instead, registered representatives receive such training from numerous third parties, including FINRA. In particular:

- <u>FINRA CE</u>: The Regulatory Element CE mandated by FINRA became an annual requirement[26] beginning in 2023.[27] As FINRA explains, the "Regulatory Element is composed of online training courses on rule changes and other regulatory developments ***relevant to each registration category that a registered person holds***. FINRA assigns courses to registered persons ***based on their active registrations***[.]"[28] Because FinPro courses are tailored in this manner, they necessarily relate "to the role, activities or responsibilities of the registered person and to professional responsibility," meaning the Regulatory Element CE courses have substantial overlap with the minimum standards for Firm Element CE programs, resulting in unnecessary content reduplication.

---

financial exams[.]" Julia Kagan, "Series 24: Definition, Prerequisites, Exam, Difficulty," *Investopedia*, July 13, 2022, available at <u>https://www.investopedia.com/terms/s/series24.asp</u>.

[24] *See* FINRA Rule 1240(b)(2)(D) ("A member may consider a registered person's participation in the member's anti-money laundering compliance training under Rule 3310(e) and a registered person's participation in the member's annual compliance training under Rule 3110(a)(7) toward satisfying the registered person's continuing education requirement").

[25] FINRA Rule 1240(b)(2)(B).

[26] FINRA Rule 1240(a)(1).

[27] *See* Information Notice: FINRA Reminds Registered Persons and Firms of Continuing Education Regulatory Element Annual Deadline, p. 1 (July 26, 2023) ("Beginning January 1, 2023, FINRA Rule 1240 . . . requires all registered persons to complete the Regulatory Element annually by December 31"), available at <u>https://www.finra.org/sites/default/files/2023-07/Information-Notice-072623.pdf</u>.

[28] *Id*. at p. 2 (emphasis added).

- Insurance CE: Most registered representatives have state insurance licenses, especially because state insurance licensure is required in order to sell variable insurance products which are also securities. Each jurisdiction imposes its own substantial insurance CE requirements. For example, in the State of Michigan where the Companies are located, "Resident producers and solicitors must earn 24 credits of State-approved education credit every two years. Of the 24 credits, a minimum of 3 credits must be in 'ethics' coursework."[29]

- IAR CE: Many registered representatives are dual-registered as investment adviser representatives ("IARs") of an investment adviser. In November 2020, the North American Securities Administrators Association ("NASAA") adopted its Model Rule on Investment Adviser Representative Continuing Education (the "IAR Model Rule"). Under the IAR Model Rule, IARs must annually "complete six (6) Credits of IAR Regulatory and Ethics Content offered by an Authorized Provider, with at least three (3) hours covering the topic of ethics[.]"[30] According to NASAA, 23 jurisdictions presently have an IAR CE requirement.[31]

- Professional Designation CE: Many professional designations impose ongoing CE requirements. For example, the Certified Financial Planner (CFP) designation comes with a requirement to complete "30 hours of continuing education (CE) each reporting period: 2 hours of CFP Board Ethics CE, and 28 hours of CE covering one or more of CFP Board's Principal Topics."[32]

- NAIC and Insurance Company CE: To comply with the revised Suitability in Annuity Transactions Model Regulation #275 promulgated in 2020 by the National Association of Insurance Commissioners (the "NAIC Model Rule"), many insurance companies offering annuities and other insurance products now require producer training.[33] As a leading insurance CE vendor explains, "Carriers must provide product-specific training. Producers must complete a 4-hour course on the best interest standard and general

---

[29] Michigan Department of Insurance and Financial Services, *Insurance Licensee Continuing Education FAQ* (May 29, 2024), available at https://www.michigan.gov/difs/news-and-outreach/faq/insurance/ins-licensee-continuing-education.

[30] IAR MODEL RULE § 1(A), available at https://www.nasaa.org/wp-content/uploads/2020/10/NASAA-IAR-CE-Model-Rule.pdf. Under § 3 of the IAR Model Rule, this ethics training requirement can be satisfied by completing the CE requirements of certain qualifying credentials (i.e., professional designations).

[31] These jurisdictions are Arkansas, California, Colorado, Florida, Hawaii, Kentucky, Maryland, Michigan Minnesota, Mississippi, Nebraska, Nevada, New Jersey, North Dakota, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Vermont, Washington, D.C., Wisconsin, and the U.S. Virgin Islands. In addition, Illinois will begin requiring IAR CE in 2026. *See* https://www.nasaa.org/industry-resources/investment-advisers/investment-adviser-representative-continuing-education/iar-ce-map/.

[32] *See* https://www.cfp.net/career-and-growth/continuing-education.

[33] *See* NAIC MODEL RULE § 7.

annuities content before selling annuities."[34] To date, the NAIC Model Rule has been adopted in 48 jurisdictions.[35]

All of these CE hours quickly add up, imposing a substantial burden on the time resources of registered persons. While each regulatory body across the land—FINRA, NASAA, NAIC, and state regulators—can now proudly say that it, too, requires CE training for registered persons under its jurisdiction, the result has become "CE overload"—a national patchwork of CE requirements with a high degree of content overlap and therefore questionable benefit.

In order to successfully navigate this regulatory patchwork of CE requirements, many member firms (including the Companies) have chosen to outsource Firm Element CE training to third-party CE vendors (e.g., RegEd, Quest CE, or Smarsh) because developing training content in-house can be impractical and time-consuming. Not surprisingly, the Firm Element CE training provided by such third-party vendors, which is designed to address multiple regulatory frameworks, also has substantial overlap with the Regulatory Element CE courses required through FinPro. Consequently, to prevent ongoing "CE overload" and duplicative training that likely yields little additional benefit, as well as to reduce member firms' vendor costs, we encourage FINRA to scale back its current Firm Element CE requirements as described above.

In the alternative, we invite FINRA to adopt the approach of the IAR Model Rule and permit a registered representative's Firm Element CE to be satisfied through completion of CE requirements for certain qualifying professional designations. Based on the IAR Model Rule, such a new provision (e.g., FINRA Rule 1240(b)(2)(E)) could read something like the following:

> (E) Credentialing Organization Continuing Education Compliance — Credits of continuing education completed by a registered person who was awarded and currently holds in good standing a Qualifying Credential satisfy the registered person's continuing education requirement under this paragraph (b), provided all of the following are true:
>
> (i) The registered person completes all the credits of continuing education required or recommended by the credentialing organization; and
>
> (ii) The credits of continuing education completed by the registered person, if required by the credentialing organization, are mandatory to maintain the credential.
>
> For purposes of this paragraph (b), a "Qualifying Credential" is any of the following:

---

34 RegEd, "Annuity Training – Best Interest Standard: Frequently Asked Questions," available at https://www.reged.com/wp-content/uploads/2024/01/Annuity-Training-Best-Interest-Standard-FAQs-1.pdf.

35 As of February 1, 2025, the NAIC Model Rule has been adopted in 48 states and is pending in one state (New Jersey). *See* https://content.naic.org/sites/default/files/government-affairs-brief-annuity-suitability-best-interest-model.pdf.

The lone exception is New York which promulgated its own Best Interest Regulation known as Regulation 187. *See* N.Y. COMP. CODES R. & REGS. tit. 11, part 224.

- Certified Financial Planner (CFP) awarded by the Certified Financial Planners Board of Standards;

- Chartered Financial Consultant (ChFC) or Masters of Science and Financial Services (MSFS) awarded by the American College, Bryn Mawr, Pennsylvania;

- Chartered Financial Analyst (CFA) awarded by the Institute of Chartered Financial Analysts;

- Personal Financial Specialist (PFS) awarded by the American Institute of Certified Public Accountants;

- Chartered Investment Counselor (CIC) awarded by the Investment Adviser Association; and

- Any other credential that qualifies for an examination waiver under Rule USA 2002 412(e)-1 promulgated by NASAA.[36]

Mirroring the IAR Model Rule in this way would be yet another instance in which FINRA can modernize its rules to address the "differences between FINRA's requirements for broker-dealers and the requirements that apply for investment advisers engaging in similar activities[.]"[37]

D. Delivery of Information to Customers

Request for Comment D.1: What are the costs and risks for investors and members associated with the current standards for electronic delivery? How has the balance among these costs and risks changed with advances in technology as customers have become more familiar with electronic communications? What protections should be available to customers who are less comfortable with receiving electronic communications?

Response: We believe regulation has not kept pace with advances in technology. For example, the SEC last issued guidance on electronic delivery in 2000—a quarter century ago.[38] Despite this ongoing silence from a key regulator, the past 25 years have witnessed a technological revolution involving computers, wireless communication, navigation, and AI

---

36 *See* NASAA EXAMINATION REQUIREMENTS FOR INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES, MODEL RULE USA 2002 412(e)-1, available at https://www.nasaa.org/wp-content/uploads/2011/08/34-IA-Rules_Exams_1956_2002.pdf.

37 FINRA Regulatory Notice 25-04, p. 5 (Mar. 12, 2025).

38 *See* Use of Electronic Media, Exchange Act Release No. 42728, 65 Fed. Reg. 25843 (May 4, 2000); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Exchange Act Release No. 37182, 61 Fed. Reg. 24644 (May 15, 1996); Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 36345, 60 Fed. Reg. 53458 (Oct. 13, 1995).

This guidance remains in effect. For example, it is referenced in Instruction 10.A to Form CRS. It is also enshrined in FINRA's guidance through the publication of NASD Notice to Members 98-03.

tools that once seemed possible only in *Star Trek*, to say nothing of Moore's Law, high-speed Internet, Starlink satellites, and the proliferation of electronic signatures and transactions.[39]

Smartphones are ubiquitous, with 91% of Americans now owning one.[40] Significantly, 79% of Americans age 65 or older own a smartphone, meaning the widespread acceptance and usage of smartphones is not limited to just young people.[41] Never before has electronic delivery been safer and more convenient, and yet the current SEC regime for electronic delivery remains stuck in the past.

The costs to members are not insignificant. For example, when we last updated our Form CRS in 2023 and delivered it to existing customers, as required by Instruction 8, the total printing and mailing costs amounted to $44,280.25. As another example, the Companies' investment adviser affiliate spent $18,126.15 in 2025 to print and mail its annual Form ADV brochure update to clients in accordance with Rule 204-3 of the Investment Advisers Act of 1940, as amended (the "Advisers Act").

These printing and mailing costs were incurred because electronic delivery is not permitted absent a recipient's affirmative opt-in consent.[42] Unfortunately, the Companies' repeated campaigns to encourage customers to opt-in to electronic delivery have met with only limited success.[43] Moreover, such printing and mailing costs are simply wasteful. Not only are electronically delivered documents more secure and easier to preserve and store, but there is little indication that customers are reading or meaningfully benefiting from the voluminous and detailed disclosure that has come to characterize the securities industry. As one former SEC commissioner has concluded:

> An extensive literature shows that investors and other securities market participants are subject to cognitive biases and, because of bounded rationality,

---

39 In addition to the E-Sign Act enacted by Congress in 2000 (Pub. L. 106-229), 49 states and three U.S. territories have adopted the Uniform Electronic Transactions Act (UETA). Although New York has not adopted UETA, it has enacted its own electronic signature law, the Electronic Signatures and Records Act, which achieves a similar legal equivalence of electronic and handwritten signatures.

40 *Mobile Fact Sheet*, PEW RESEARCH CENTER, November 13, 2024, available at https://www.pewresearch.org/internet/fact-sheet/mobile/.

41 *Id*.

42 *See* Exchange Act Release No. 42728, 65 Fed. Reg. at 25854 (rejecting an implied consent or "access-equals-delivery" framework).

43 For example, the Companies' most recent "click-to-agree" campaign in March 2025 had a low success rate of 6.7%. Additionally, the March 2025 scorecard provided by the Companies' clearing firm showed an average e-notification success rate (i.e., customers choosing e-delivery) of approximately 34%, which is well below the average rates of 45–54% across the clearing firm's entire platform.

The Companies actually *make money* from marking up paper delivery costs, a fact which is openly disclosed to customers and for which ample notice was provided. Like many of their peers, the Companies made this decision, after careful consideration, in an effort to incentivize customers to opt-in to electronic delivery. Despite this markup revenue, our preference is still for electronic delivery as the industry default. We believe this would be more convenient and secure for all parties involved.

> adopt heuristics in making investment decisions. . . . At bottom, information overload raises doubts about the effectiveness of the disclosure philosophy at the core of the federal securities laws. Investors might be better off if the mandatory disclosure system were scaled back by deleting certain disclosure requirements. . . . Some material disclosures might be worth putting on the chopping block too.[44]

In a technological age of increasing information overload, continuing to require an opt-in delivery process that effectively mandates printing and mailing paper disclosures that are very likely to be ignored and discarded—all at the cost of thousands of dollars—is ineffective, outmoded, and unnecessary.

In 2000, when the SEC last opined on the matter, an opt-out or "access-equals-delivery" regime of electronic delivery could have left many customers out in the digital cold. However, that is no longer the case in our present age of widespread smartphone usage. In other words, it no longer makes sense to keep member firms mired in antiquated electronic delivery requirements from the last century out of concern for a very small segment of the American adult population.

We strongly encourage FINRA to partner with the SEC to issue updated electronic delivery guidance. In particular, we urge FINRA (and the SEC) to adopt an opt-out, implied consent, or "access-equals-delivery" regime so that electronic delivery becomes the default method of delivery. Those customers who wish to receive paper mailings will still be able to do so and are therefore protected, whereas those customers who do not can conveniently access what they need electronically through websites, secure portals, and email.

<u>Request for Comment D.3</u>: Would principles-based guidance on using negative consent letters be useful for members, rather than the current guidelines? What principles should FINRA apply?

<u>Response</u>: We do not believe that principles-based guidance would be useful in this context. As discussed below, SEC Regulation Best Interest ("Reg BI") extends as far as recommendations for customers to change firms, however the facts-and-circumstances analysis involved offers members no bright-line test. Therefore, we believe it would be more helpful if FINRA articulated *specific* additional situations in which the use of negative response letters would be appropriate.

Historically, FINRA has not permitted the general use of negative response letters with customers, including to transfer their accounts. However, FINRA has granted exceptions to permit the use of negative response letters to accomplish bulk transfers of customers' accounts in the following specific situations:

1. An introducing firm that has entered into a clearing arrangement with a different clearing firm is seeking to transfer its customer accounts to the new clearing firm;

---

[44] Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 484 (Summer 2003).

2. An introducing firm or a clearing firm that is experiencing financial or operational difficulties is seeking to transfer all of its customer accounts, including in the case of a clearing firm all of the accounts carried by such clearing firm, to another introducing firm or clearing firm;

3. An introducing firm or a clearing firm that is going out of business, other than for financial or operational difficulties, is seeking to transfer all of its customer accounts to another introducing firm or clearing firm;

4. An introducing firm or a clearing firm that is divesting itself of a specific business line or area, such as its retail brokerage business or some of its branch offices, is seeking to transfer the affected customer accounts to another introducing firm or clearing firm;

5. A clearing firm, for an introducing firm that has gone out of business, is seeking to transfer all of the introducing firm's customer accounts to another introducing firm at the same clearing firm;

6. A firm that is acquired by or merged with another firm is seeking to transfer all of its customer accounts to the new firm;

7. Effecting the bulk transfer of employee equity compensation plan accounts; and

8. Upon the conclusion or termination of a networking arrangement between a firm and a financial institution pursuant to FINRA Rule 3160, the firm is seeking to transfer all customer accounts established under the arrangement to a new firm with which the financial institution has formed a networking arrangement pursuant to FINRA Rule 3160.[45]

FINRA previously proposed to codify these exceptions in proposed FINRA Rule 3260(c)(1)(C).[46] Conceptually, what is common to these situations is the significant impact

---

[45] *See* FINRA Regulatory Notice 15-22, p. 9 (June 2015); NASD Notice to Members 04-72 (Oct. 5, 2004); NASD Notice to Members 02-57 (Sept. 11, 2002); Interpretive Letter to Janet Dyer, National Financial Services, LLC, from Ilana Herscovitz Reid, Associate General Counsel, FINRA (Apr. 23, 2023), available at https://www.finra.org/rules-guidance/guidance/interpretive-letters/interpretive-letter-janet-dyer-national-financial-services; Interpretive Letter to T. Douglas Hollowell, UBS Financial Services, Inc., from Afshin Atabaki, Special Advisor and Associate General Counsel, FINRA (July 24, 2020), available at https://www.finra.org/rules-guidance/guidance/interpretive-letters/interpretive-letter-t-douglas-hollowell-ubs-financial-services-inc; Interpretive Letter to Michael R. Trocchio, Esq., Bingham McCutchen LLP, from Patricia Albrecht, Associate General Counsel, FINRA (June 2, 2006), available at https://www.finra.org/rules-guidance/guidance/interpretive-letters/michael-r-trocchio-esq-bingham-mccutchen-llp-1; Memorandum from NASD Office of General Counsel, Regulatory Policy and Oversight (Nov. 8, 2004) (clarifying Notice to Members 04-72), available at https://www.finra.org/rules-guidance/guidance/interpretive-letters/nasd-office-general-counsel-regulatory-policy-and-oversight; Letter to Barry Harris, Chief Counsel, Banc of America Investment Services, Inc., from Patricia Albrecht, Assistant General Counsel, NASD (Oct. 20, 2004), available at https://www.finra.org/rules-guidance/guidance/interpretive-letters/barry-harris-banc-america-investment-services-inc-use-negative-response-letters.

[46] *See* FINRA Regulatory Notice 15-22, pp. 8–11.

on customers' accounts due to increased risk or a permanent event occurring with respect to the firm itself. In these instances, the use of negative consent letters is very plausibly in the best interest of customers because transferring their accounts in this manner reduces the "potential risks" they face from "interruptions to customers' access to their accounts and the trading markets."[47]

However, in the more common context in which members ideally would like to utilize negative response letters—namely that of a new representative looking to efficiently transfer customer accounts to his or her new firm—no such "potential risks" exist, which is why FINRA has indicated that the use of negative response letters would not be permissible.[48] FINRA's policy rationale for this position was articulated clearly in Notice to Members 02-57:

> The staff generally believes that a customer should affirmatively consent to the transfer of his or her account to another firm. **Various factors may affect an investor's decision to move an account to a new firm, including, for example, the level and quality of service of the new firm, the fees and charges imposed by the new firm, and the cost of the transfer itself**. However, when a firm initiates the transfer of a customer's account, there is no assurance that the customer has had sufficient time or information with which to decide whether to object to the transfer. Further, members may be inclined to use negative response letters because of the convenience these letters provide without giving due consideration to whether soliciting affirmative customer consent is a viable alternative. For these reasons, transfers of customer accounts by a member using negative response letters may, under certain circumstances, conflict with a member's obligation to observe high standards of commercial honor and just and equitable principles of trade under NASD Rule 2110.[49]

The highlighted factors are in alignment with the same sort of factors identified by SEC staff years later in connection with the Care Obligation of Reg BI. This is why, for example, even a "hire me" recommendation is subject to the requirements of Reg BI:

> If you engage in a communication with a retail customer that rises to the level of a "recommendation," whether in the context of a "hire me" conversation or

[47] *See* NASD Notice to Members 02-57, p. 563 ("The staff believes that the use of a negative response letter to facilitate the bulk transfer of customer accounts in these situations is appropriate, given the potential risk to investors and costs to firms that could result if firms were required to solicit individual transfer instructions from each customer. The bulk transfer of accounts in these situations also helps minimize interruptions to customers' access to their accounts and the trading markets.").

[48] Letter to Justine Rusin, Merit Capital Associates, Inc., from Sarah J. Williams, Office of General Counsel, NASD Regulation, Inc. (predecessor to NASD Regulatory Policy and Oversight) (Oct. 16, 2000) ("[W]hen a member seeks to transfer a customer from one introducing broker to another, the customer should be provided the opportunity to make an informed decision and should give affirmative consent to the transfer. Failure to provide the customer with that ability may conflict with a member's obligation to observe high standards of commercial honor and just and equitable principles of trade pursuant to NASD Rule 2110."), available at https://www.finra.org/rules-guidance/guidance/interpretive-letters/justine-rusin-merit-capital-associates-inc-use-negative-response-letters.

[49] NASD Notice to Members 02-57, p. 562 (emphasis added).

> otherwise, the recommendation will be subject to Regulation Best Interest. . . . The staff understands that it is common industry practice for an associated person of a broker-dealer leaving Firm A to go to Firm B to call his or her Firm A customers prior to his departure to attempt to persuade the customers to move their accounts to Firm B. In such circumstances, the staff believes that there is a significant possibility that a communication may be reasonably likely to be viewed as a "call to action." However, whether a communication involves a "recommendation" turns on the facts and circumstances of the particular communication.[50]

Based on this existing SEC staff guidance, it seems that the most commonly desired use case for negative response letters—transferring customer accounts when representatives change firms—is already precluded under the Care Obligation. Even if FINRA wished to scale back its general position articulated in Notice to Members 02-57 by issuing new principles-based guidance, permitting anything other than a customer's affirmative consent to the transfer of his or her account would seemingly run afoul of the Care Obligation, as the bulk transfer[51] would occur without considering the factors articulated by SEC staff (i.e., the new firm's level and quality of service, fees and charges, and the cost of the transfer) for each retail customer on an individual basis.[52]

---

[50] SEC Division of Trading and Markets, *Frequently Asked Questions on Regulation Best Interest* (June 26, 2024), available at https://www.sec.gov/rules-regulations/staff-guidance/trading-markets-frequently-asked-questions/faq-regulation-best.

[51] Some might object that no recommendation is made in connection with a bulk transfer accomplished through a negative response letter, and therefore the Care Obligation is inapplicable. However, a negative response letter necessarily functions as an implicit recommendation or exercise of discretion. For example, such a negative response letter essentially informs the customer, "A decision has been made by someone else to move your account to another firm, and this will take place unless you timely object."

Both the decision to move the account (absent an objection) and the decision of where to move it, when made without specific authorization from the customer, are sufficient to rise to the level of an implicit recommendation. *See, e.g.*, *In re Rafael Pinchas*, Exchange Act Release No. 41816, 1999 SEC LEXIS 1754, 54 S.E.C. 331, 341 n.22 (Sept. 1, 1999) ("Transactions that were not specifically authorized by a client but were executed on the client's behalf are considered to have been implicitly recommended within the meaning of the NASD rules."); *In re Paul C. Kettler*, Exchange Act Release No. 31354, 1992 SEC LEXIS 2750, 51 S.E.C. 30, 32 n.11 (Oct. 26, 1992) (stating that transactions a broker effects for a discretionary account are implicitly recommended). *See also Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Exchange Act Release No. 86031, 84 Fed. Reg. 33318, 33337 (July 12, 2019) (interpreting the term "recommendation" consistently with how FINRA has applied the term).

[52] This follows from the customer-specific component of the Care Obligation: "[Rule 15*l*-1(a)(2)(ii)(B)] will require a broker-dealer to have a reasonable basis to believe, based on its understanding of the potential risks, rewards, and costs of the recommendation, and in light of the retail customer's investment profile, that the recommendation is in the best interest of a *particular* retail customer and does not place the broker-dealer's interest ahead of the retail customer's interest." Exchange Act Release No. 86031, 84 Fed. Reg. at 33378 (emphasis in original).

As noted above, in the circumstances for which FINRA has permitted bulk transfers by means of negative response letters, there are sufficient "potential risks" that customers face from access "interruptions" to their "accounts and the trading markets" which warrant a blanket recommendation to move their accounts. However, these same risks are not present in the specific (and common) context of "an associated person of a broker-dealer leaving Firm A to go to Firm B," and the potential conflicts of interest are much greater, which is

Therefore, specific guidance seems preferable to principles-based guidance in this instance. In the context of transferring customer accounts when a representative changes firms, principles would leave members in the challenging position of trying to determine how to reconcile FINRA's new guidelines with the guidance already provided by SEC staff with respect to the Care Obligation, whereas specific guidance would not.

<u>Request for Comment D.4</u>: Are the practices regarding the transfer of investment advisory accounts instructive in the broker-dealer context? Given many customer advisory accounts are also accounts with a broker-dealer, would alignment be warranted and feasible?

<u>Response</u>: We do not believe that the practices regarding the transfer of investment advisory contracts (i.e., accounts) are instructive in the broker-dealer context. Specifically, we believe the existing investment adviser practices are already reflected in Notice to Members 02-57 and Notice to Members 04-72.

Pursuant to Section 205(a)(2) of the Advisers Act, an advisory contract must include a provision prohibiting the investment adviser from assigning the advisory contract without the client's consent.[53] SEC staff have clarified that Section 205(a)(2) does not prohibit the assignment of investment advisory contracts, but rather imposes a requirement to include a clause in the contract itself to the effect that such assignment requires the client's consent. In this way, the assignment of the contract without obtaining client consent could constitute a breach of the advisory contract, however it is not a violation of Section 205(a)(2):

> Section 205(a)(2) of the Advisers Act generally makes it unlawful for a registered investment adviser to enter into or perform any investment advisory contract unless the contract provides, in substance, that no assignment of such contract may be made by the investment adviser without the consent of the client. This section does not, however, prohibit an adviser's assignment of an investment advisory contract without client consent. The section merely provides that the contract must contain the specified provision. Thus, the assignment of a non-investment company advisory contract, without obtaining client consent, could constitute a breach of the advisory contract, but not a violation of Section 205(a)(2).[54]

In this way, the validity of such consent—whether negative, affirmative, or written—is ultimately determined under state contract law. Furthermore, reliance on negative consent could be problematic if the advisory contract expressly requires written or affirmative

---

why we believe that SEC staff would plausibly find the use of negative response letters problematic under the Care Obligation in this context.

53 15 U.S.C. § 80b-5(a)(2) (requiring advisory contracts "to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract"). Note the absence of the words "written" or "affirmative" before the word "consent" in the statute.

54 American Century Co., Inc./J.P. Morgan & Co., Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 1107, at *14 (Dec. 23, 1997).

consent to an assignment, as the non-assigning party would have a breach of contract claim and a resulting ability to void the assignment.[55]

Because the Advisers Act defines the term "assignment" quite broadly,[56] it can potentially include any direct or indirect transfer of an advisory contract or of a controlling block of the adviser's outstanding voting securities by a security holder of the adviser. However, to address the breadth of the definition, Advisers Act Rule 202(a)(1)-1 provides that a transaction not resulting in a change of actual control or management of an investment adviser is not an assignment.[57] Ultimately, "whether a particular transaction involves a change of actual control or management is primarily a factual determination."[58]

In addition to the inclusion of a no-assignment-without-consent provision in an advisory contract, investment advisers, in order to enable clients to make an informed decision, are expected to seek consent by providing clients with written notification and sufficient information within a reasonable amount of time before the assignment.[59] The Advisers Act does not specify a particular method of obtaining consent or the appropriate timeframe, however SEC staff at the Division of Investment Management have granted no-action relief for the use of negative consent letters, provided written notification (paper or electronic) is given to clients at least 60 days in advance.[60]

In this way, there is already substantial overlap between FINRA's guidance and SEC guidance. For example, both Section 205(a)(2) of the Advisers Act and Notice to Members 02-57[61]

---

55 *See, e.g.*, *Hy King Assocs., Inc. v. Versatech Mfg. Indus., Inc.*, 826 F. Supp. 231, 239 (E.D. Mich. 1993) (no valid assignment where "the agreement clearly and unambiguously declares that any assignment without defendant's written consent 'shall be deemed null and void and of no effect'"); *Abu v. Dickson*, No. 19-175483-CB, 2021 Mich. Cir. LEXIS 1025, at *13 n.25 (Mich. Cir. Ct. Dec. 22, 2021) ("an assignment in contravention of an anti-assignment clause permits a breach of contract action between the parties to the contract").

56 The term "assignment" includes "any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor[.]" 15 U.S.C. § 80b-2(a)(1).

57 17 C.F.R. § 275.202(a)(1)-1 ("A transaction which does not result in a change of actual control or management of an investment adviser is not an assignment for purposes of section 205(a)(2) of the Act.").

58 Certain Transactions Not Deemed Assignments, Advisers Act Release No. 1034, 1986 SEC LEXIS 805, at *6 (Sept. 11, 1986).

59 Investment Management Staff Issues of Interest, Advisory Contracts—Consent (June 15, 2012) ("it must provide sufficient information to its clients to enable them to make an informed decision, and the opportunity for the clients to withhold consent"), available at https://www.sec.gov/investment/investment-management-no-action-letters/investment-management-staff-issues-interest.

60 Jennison Associates Capital Corp., SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2823 (Dec. 2, 1985).

61 "NASD rules do permit member firms to use 'negative response letters' to obtain authorization to take certain actions on behalf of their customers without obtaining affirmative consent, but only in limited circumstances." NASD Notice to Members 02-57, p. 562.

reflect a regulatory expectation that client/customer consent will be obtained, in some manner, before effecting a transfer. Additionally, SEC no-action letters and Notice to Members 02-57 both permit obtaining consent through the use of negative consent letters provided reasonably far in advance.

As summarized above, Notice to Members 02-57 permits the use of negative consent letters to transfer accounts only in specific unique circumstances. In contrast, the SEC no-action letters impose no such limitations on the use of negative consent letters to assign advisory contracts. Even so, this is not the whole story.

Importantly, the non-assignment provision requirement of Section 205(a)(2) was meant to restrict an investment adviser's sale of its fiduciary office and prevent the "trafficking" of advisory contracts. This is clear both from SEC staff guidance and original Congressional intent:

> The [Investment Company Act of 1940] and the Advisers Act contain similar provisions regarding the assignment of advisory contracts. . . . Section 15(a)(4) of the Investment Company Act and Section 205(a)(2) of the Advisers Act were designed to prevent trafficking in investment advisory contracts by ensuring that individuals entrusted with a fiduciary obligation to manage other people's money did not assign that obligation, either directly or by transferring control of an advisory entity, without the consent of their clients. These provisions protect the fiduciary relationship by guaranteeing that "the management contract is personal, that it cannot be assigned, and that you cannot turn over the management of other people's money to someone else."[62]

Conceptually, such an "anti-trafficking" stance with respect to advisory contracts is entirely consistent with FINRA's belief "that a customer should affirmatively consent to the transfer of his or her account to another firm." [63] In this way, the practices regarding the transfer of investment advisory contracts, while in alignment with the broker-dealer context, are not "instructive" here for the simple reason that they reflect no significant additional insight or innovation.[64]

---

[62] Dean Witter, Discover & Co.; Morgan Stanley Group Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 548, at *2, *34 (Apr. 18, 1997) (citing Investment Trusts and Investment Companies: Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. 253 (1939–1940) (statement of David Schenker, Chief Counsel, Securities and Exchange Commission Investment Trust Study)). *See also* Investment Company Act Release No. 354, 1942 SEC LEXIS 1458, at *4 (May 11, 1942) ("The legislative history of Section 15 manifests a clear Congressional intention to prevent all trafficking in investment advisory contracts and to prevent an investment adviser from transferring his fiduciary obligations by turning over the management of the stockholders' money to a different person.").

[63] NASD Notice to Members 02-57, p. 562.

[64] Moreover, the SEC no-action letters issued with respect to assignments commonly involve a merger, acquisition, or change in control, all of which are scenarios addressed in NASD Notice to Members 02-57.

E. Recordkeeping and Digital Communications

Request for Comment E.1: The phrase business as such under Exchange Act Rule 17a-4(b)(4) is not defined. What questions, concerns or challenges, if any, does this raise with respect to ensuring compliance with the recordkeeping requirements? Are there categories of records that are especially costly or difficult to capture or retain, and which may provide no appreciable regulatory benefit?

Response: One federal court has interpreted the phrase "business as such" in Exchange Act Rule 17a-4 to mean "records kept in the ordinary course of business."[65] With regard to electronic communications, the SEC has not provided guidance on this question[66] and instead has defaulted to a vague test based on content:

> The Commission understands that broker-dealers use email and the Internet to communicate important information relating to the broker-dealer's business internally, to customers, and to the general public. The Commission is also aware that many broker-dealers use such electronic systems to communicate about issues unrelated to the business of the broker-dealer. Consistent with the Commission's recommendation to the SROs regarding the appropriate standard for prior supervisory review for electronic communications, the Commission believes that for record retention purposes under Rule 17a-4, the content of the electronic communication is determinative, and therefore broker-dealers must retain only those email and Internet communications (including inter-office communications) which relate to the broker-dealer's "business as such."[67]

Where this becomes challenging is in the context of "mixed" or "quasi-business" communications as well as incidental communications. For example:

- What constitutes a business communication when a personal relationship exists? For example, if a registered representative has a personal relationship with a customer, is texting with that customer to schedule a dinner an example of a business communication or a personal communication?

- Is texting a customer merely to confirm an appointment or to inform them "I'm on my way" truly an example of a "business as such" communication, or should such simple messages be considered incidental?

---

65 *Pensacola Firefighters' Relief Pension Fund Bd. of Trs. v. Merrill Lynch Pierce Fenner & Smith, Inc.*, No. No. 3:09-cv-53-MCR-MD, 2011 U.S. Dist. LEXIS 88468, at *24 (N.D. Fla. July 7, 2011) (interpreting Exchange Act Rules 17a-4(b)(5) and 17a-4(b)(7)).

66 For example, FINRA includes no interpretations of Exchange Act Rule 17a-4(b)(4) in its published guidance. *See* SEA Rule 17a-4 and Related Interpretations (Mar. 24, 2025), available at https://www.finra.org/rules-guidance/guidance/interpretations-financial-operational-rules/sea-rule-17a-4-and-related-interpretations.

67 Reporting Requirements for Brokers or Dealers under the Securities Exchange Act of 1934, Exchange Act Release No. 38245, 1997 SEC LEXIS 266, at *17 (Feb. 5, 1997) (amending Exchange Act Rule 17a-4).

In short, it would be helpful if FINRA could clarify what constitutes a business communication when a personal relationship exists and when a communication is sufficiently trivial so as not to reasonably qualify as "business as such." Further guidance on such matters would be helpful for at least two reasons.

First, capturing and retaining such communications does not appear to provide any appreciable regulatory benefit, however *significant* fines for off-channel communications have injected uncertainty into the industry. Second, and more importantly, in the event of litigation or an investigation, the costs of retaining the services of a third-party e-discovery vendor can be *very* substantial. Specifically, these costs are driven by both the labor hours expended on technology and project management services as well as the number of gigabytes ("GBs") involved with data ingestion, metadata extraction, data enrichment, TIFFing, uploading, and other production efforts.[68] Consequently, anything that can be done to reduce the amount of data stored—and therefore the amount of data produced in discovery—could go a long way to keeping member firms' costs down.

<u>Request for Comment E.3</u>: What are members' recordkeeping challenges regarding AI-generated communications and how do these challenges vary based on the type of AI-generated communication (e.g., AI-powered chatbot, AI-generated transcripts or summaries of meetings)?

<u>Response</u>: The recordkeeping challenges faced by members include knowing definitively *which* AI-generated documents qualify as books and records that are required to be maintained and preserved under Exchange Act Rules 17a-3 and 17a-4. A bright-line test for making this determination, or a detailed FAQ addressing common scenarios, would be helpful guidance for members. For example:

- Would entering nonsensitive data into an AI chatbot to generate electronic correspondence (e.g., an e-mail template for use with customers) qualify as engaging in off-channel communications?

- If an AI chatbot listens to and records a customer meeting, can the transcript be automatically purged after a predetermined amount of time (e.g., 48 hours) once a meeting summary has been extracted, assuming the transcript is never shared with the customer?

These are just examples of common scenarios. Overall, the challenge is not the recordkeeping itself, but rather in knowing *when* recordkeeping is required versus when it is not, as AI tools can produce many documents that are helpful but may not clearly rise to the level of a "communication" or other record described in Exchange Act Rule 17a-4.

[68] *See, e.g.*, *Mukherjee v. The Children's Mercy Hosp.*, Case No. 4:16-cv-01291-ODS, Document No. 157-1 (W.D. Mo. June 25, 2018) (disclosing vendor charges of $90/GB for e-discovery pre-processing); *Recognicorp, LLC v. Nintendo Co., LTD*, Case No. 2:12-cv-01873-RAJ, Document No. 135-2 (W.D. Wa. Jan. 11, 2016) (disclosing vendor charges of $150/GB for data processing, $600/GB for TIFFing/production, $175/hour for technology associate services, and $235/hour for project management services).

<u>F. Compensation Arrangements</u>

<u>Request for Comment F.1</u>: If you are a member, what is your experience with supervising persons receiving their compensation through PSEs?

> **<u>Response</u>:** Our experience is that supervision requires effective policies, procedures, controls, and safeguards to ensure that securities compensation (e.g., commissions) is *<u>never</u>* paid to a representative's PSE, otherwise FINRA will impose a fine for violating FINRA Rule 2040. This has been the experience of a number of member firms.[69] FINRA enforcement efforts have done much to discourage this practice and signal that paying compensation through PSEs is strictly prohibited.[70] In other words, we have no reason to believe that representatives are currently permitted to "receiv[e] their compensation through PSEs."

<u>Request for Comment F.2</u>: Are there regulatory or rulemaking changes that could facilitate these types of compensation arrangements, while continuing to preserve effective broker-dealer supervision?

> **<u>Response</u>:** Yes. SEC staff guidance on this issue has not been the model of clarity over the years. For example, the staff of the Division of Trading and Markets has effectively concluded that receipt of transaction-based compensation *alone* can cause someone to be an unregistered broker.[71] However, no-action letters possess no binding legal authority and are

---

[69] *See, e.g.*, *In re Spartan Capital Sec., LLC*, FINRA AWC No. 2013035258901, pp. 1–2 (Apr. 23, 2015) ("This matter concerns Spartan Capital's violation of NASD Rule 2420 and FINRA Rule 2010 by paying commissions to six unregistered entities controlled by Spartan's registered representatives, rather than paying the registered representatives directly."); *In re Royal Sec. Co.*, FINRA AWC No. 2011025857803, p. 2 (Dec. 18, 2013) ("Royal made payments to an unregistered entity in violation of FINRA Rules.").

[70] This also has been the position of SEC staff for many years. *See, e.g.*, Denial of No-Action Request of Wolff Juall Investments, LLC, SEC No-Action Letter, 2005 SEC No-Act. LEXIS 602, at *3 (May 17, 2005) ("We note that the Division has previously declined to grant no-action relief to the practice of routing commissions or other transaction-related compensation from a broker-dealer directly or indirectly to an unregistered entity for the benefit of the broker-dealer's registered representatives."); Vanasco, Wayne & Genelly, SEC Interpretive Letter, 1999 SEC No-Act. LEXIS 188 (Feb. 17, 1999); Denial of No-Action Request of Birchtree Fin. Servs., Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 875, at *2 (Sept. 22, 1998) ("No exemption from broker-dealer registration exists for corporate entities formed by registered representatives of broker-dealers that receive securities commissions."); Denial of No-Action Request of Century Investment Group Inc., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 181 (Jan. 29, 1996); Denial of No-Action Request of Lombard Securities Inc., SEC No-Action Letter, 1994 SEC No-Act. LEXIS 920 (July 12, 1994).

[71] Denial of No-Action Request of Brumberg, Mackey & Wall, P.L.C., SEC No-Action Letter, 2010 SEC No-Act. LEXIS 406, at *2 (May 17, 2010) ("any person receiving transaction-based compensation in connection with another person's purchase or sale of securities typically must register as a broker-dealer or be an associated person of a registered broker-dealer").

See also Denial of No-Action Request of John W. Loofbourrow Associates, Inc., SEC No-Action Letter, 2006 SEC No-Act. LEXIS 523 (June 29, 2006) (denying no-action relief under Exchange Act § 15 and NASD Rule 2420 in light of the "traditional concern" that "transaction-based compensation represents a potential incentive for abusive sales practices that registration is intended to regulate and prevent"); SEC Division of Trading and Markets, GUIDE TO BROKER-DEALER REGISTRATION § II.D.1 (Apr. 2008) ("**For example, associated persons cannot set up a separate entity to receive commission checks.** An unregistered entity that receives only informational in nature.[72] Moreover, such a single-factor determination has been criticized by federal courts as not accurately reflecting the federal securities laws or the requirements of Section 15 of the Exchange Act,[73] nor is this position consistent with older staff guidance regarding so-called "finders"[74] or the more recent staff guidance cited in Regulatory Notice 25-07.[75]

Instead, "an array of factors determine the presence of broker activity," and "the test for broker activity must remain cogent, multi-faceted, and controlled by the Exchange Act."[76] Because Section 3(a)(4) of the Exchange Act defines neither "engaged in the business" nor "effecting transactions in securities," a multitude of factors ultimately determines whether a person qualifies as a broker.

---

commission income in this situation must register as a broker-dealer."), available at https://www.sec.gov/about/divisions-offices/division-trading-markets/division-trading-markets-compliance-guides/guide-broker-dealer-registration.

72 *SEC v. Kramer*, 778 F. Supp. 2d 1320, 1336 n.50 (M.D. Fla. 2011) ("A 'no-action' letter is a method of seeking advice from the Commission's staff on compliance with the securities laws. A 'no-action' letter is informal and possesses no binding legal authority.").

73 *Id*. at 1341 n.54 ("the Commission's proposed single-factor 'transaction-based compensation' test for broker activity [set forth in the Brumberg, Mackey & Wall no-action letter] is an inaccurate statement of the law both in 2003 and in 2011").

Because the district court's order was found to not be a final decision in the case, the Eleventh Circuit dismissed the SEC's appeal of this decision, which had been certified by the district court (*see SEC v. Sky Way Global, LLC*, No. 8:09-cv-455-T-23TBM, 2011 U.S Dist. LEXIS 101973 (M.D. Fla. Sept. 9, 2011)), for lack of jurisdiction by Order dated December 2, 2011. The SEC thereafter declined to appeal at the conclusion of the underlying case.

74 *See* Paul Anka, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 925 (July 24, 1991) (granting no-action relief despite the fact that Anka received a transaction-based finder's fee for units sold either to Anka himself or to investors he identified without any involvement of Anka in the sales); John DiMeno, SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2791 (Apr. 1, 1979) (granting no-action relief to a person who would introduce investors to an issuer seeking financing and would receive a 5% commission on sales of privately placed securities to those persons he introduced to the company).

Although the *Paul Anka* no-action letter has not been withdrawn, the SEC staff has indicated that it would not provide no-action relief today under a comparable fact pattern regarding compensation arrangements. *See* Comments by Kristina Fausti, Special Counsel, Office of Chief Counsel, SEC Division of Trading and Markets, at the Private Placement Broker and M&A Broker Panel at the SEC's Forum on Small Business Capital Formation (Nov. 20, 2008) ("The truth is, from the staff point of view, there is no progeny of Paul Anka, in fact, and the ways that we look at broker-dealer regulation today, I'm not even sure that we would issue the Paul Anka letter again."), available at https://www.sec.gov/info/smallbus/sbforumtrans-112008.pdf.

75 *See* FINRA Regulatory Notice 25-07, p. 20 n.36 (citing an Exchange Act release published in 2020 that proposes an exemption from broker registration requirements for certain activities of finders).

76 *Kramer*, 778 F. Supp. 2d at 1341 n.54. *See also Landegger v. Cohen*, No. 11-cv-01760-WJM-CBS, 2013 U.S. Dist. LEXIS 140634, at *18 (D. Colo. Sept. 30, 2013) (stating that courts should take a "measured approach" when affording weight to the factors determining whether a person's activities constitute broker status and that receipt of transaction-based compensation "must not be weighted so heavily so as to subsume" other factors).

In *SEC v. Pension Trust Corp.*, the federal court compiled a list of 11 factors that courts consider when determining whether someone is acting as a broker. These factors include whether the person (1) actively solicited investors; (2) advised investors as to the merits of an investment; (3) acted with a certain regularity of participation in securities transactions; (4) received commissions or transaction-based remuneration; (5) is an employee of the issuer; (6) is selling, or previously sold, the securities of other issuers; (7) is involved in negotiations between the issuer and the investor; (8) analyzes the financial needs of an issue; (9) recommends or designs financing methods; (10) discusses the details of securities transactions; and (11) makes investment recommendations.[77] However, the most important factor in determining whether an individual or entity is a broker is the regularity of participation in securities transactions at key points in the chain of distribution.[78]

Consequently, what is needed is not a regulatory or rulemaking change, but rather a shift in perspective *based on existing* federal case law and SEC staff guidance. In other words, these types of compensation arrangements involving registered representatives and their PSEs already are (or should be) permitted under FINRA Rule 2040 and Section 15 of the Exchange Act based on what courts have already said on the matter. While a representative receiving compensation through their PSE necessarily means that the PSE will receive transaction-based compensation, that alone should not be sufficient to trigger broker-dealer registration under Section 15(a) of the Exchange Act, especially since the PSE neither participates "in securities transactions at key points in the chain of distribution" nor materially satisfies any of the other 11 factors.

<u>Request for Comment F.3</u>: With respect to both PSE compensation arrangements and Continuing Commission Programs, are there other ways to ease burdens while continuing to assure effective supervision?

<u>Response</u>: Yes. We encourage FINRA to add a new Supplementary Material .02 to FINRA Rule 2040 indicating that PSE compensation arrangements meeting certain requirements (outlined below) are permitted under FINRA Rule 2040. For context, it is essential to understand the reasons *why* representatives might wish to utilize PSE compensation arrangements. One of the main reasons involves tax considerations, as the important case of *Fleischer v. Commissioner*[79] demonstrates.

---

77 *SEC v. Pension Trust Corp.*, No. 07-22570-civ-Martinez-Brown, 2010 U.S. Dist. LEXIS 102938, at *53–54 (S.D. Fla. Sept. 30, 2010) (citations and quotation marks omitted). *See also* FINRA Regulatory Notice 25-07, p. 19 n.35 (citing *SEC v. Helms*, No. 13-cv-01036, 2015 U.S. Dist. LEXIS 110758, at *50–51 (W.D. Tex. Aug. 21, 2015), a case involving so-called "finders" in which the court outlined a six-factor test for defining "engaged in the business" and a three-factor test for defining "effecting transactions in securities" for purposes of Exchange Act § 3(a)(4)).

78 *SEC v. Bravata*, No. 09-12590, 2009 U.S. Dist. LEXIS 64609, at *8 (E.D. Mich. July 27, 2009) ("The most important factor in determining whether an individual or entity is a broker or dealer is whether that individual or entity may be 'characterized by a certain regularity of participation in securities transactions at key points in the chain distribution.'").

79 T.C. Memo 2016-238 (2016).

In *Fleischer*, a registered representative named Ryan Fleischer ("Fleischer") incorporated an entity named Fleischer Wealth Plan ("FWP") and elected S corporation status[80] for the company, serving as its sole shareholder, president, secretary, and treasurer. In addition, Fleischer entered into two types of contracts: (1) agreements signed in his personal capacity with the broker-dealers with which he was affiliated (first LPL and later MassMutual Financial Group), stating that he was an independent contractor and not an employee; and (2) an employment agreement with FWP pursuant to which FWP paid him a salary to "perform duties in the capacity of Financial Advisor" but did not include a provision that required Fleischer to remit any commission or fees from the broker-dealers (or any other third party) to FWP. Importantly, there was no agreement between FWP and either of the broker-dealers with which Fleischer was associated.

The payments made to Fleischer by the broker-dealers were reported on Forms 1099 issued to Fleischer as an individual. In turn, Fleischer caused those payment amounts to be reflected on the Form 1120S corporate tax returns filed by FWP. Fleischer also filed his own personal returns indicating that he was not responsible for any self-employment taxes.

The Internal Revenue Service ("IRS") determined that the gross receipts and sales FWP reported on its Forms 1120S should have properly been reported by Fleischer as self-employment income on the Schedules C attached to his Forms 1040 for the years in issue. The IRS took the position that Fleischer was responsible for self-employment tax deficiencies because the income received from the broker-dealers was earned by him as an individual and not by FWP.

The Tax Court agreed with the IRS and held that Fleischer should have treated the income attributed to FWP as his own income on Schedule C for the years in question. As a result, Fleischer also should have reported and paid self-employment tax on that income. The Tax Court came to this conclusion because Fleischer, not FWP, controlled the earning of the income. In determining that FWP could not properly recognize the income as its own, the Tax Court relied on a two-prong test set forth in the case of *Johnson v. Commissioner*, namely:

1. Whether the individual providing the services is an employee of the corporation whom the corporation can direct and control in a meaningful sense; and

2. Whether there exists between the corporation and the person or entity using the services a contract or similar indicium recognizing the corporation's controlling position.[81]

---

80 S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations are limited in number and report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income. S corporations are responsible for tax on certain built-in gains and passive income at the entity level. *See* https://www.irs.gov/businesses/small-businesses-self-employed/s-corporations.

81 78 T.C. 882, 891 (1982).

The Tax Court ultimately concluded that FWP could not meet the second criterion. This conclusion was based on the following facts:

- FWP had no contractual relationship with either broker-dealer;

- The revenue in question was attributable to contracts between third parties and Fleischer, not FWP;

- The employment agreement that Fleischer signed did not require him to remit revenues he received to FWP; and

- There was no indication that either broker-dealer was aware that Fleischer was employed by FWP.

Relevant for this analysis is that Fleischer attempted to argue that it was effectively impossible for the broker-dealers to contract directly with FWP or pay commissions to FWP, as FWP was not a registered entity under Section 15 of the Exchange Act. However, the Tax Court was unsympathetic to this argument:

> While [Section 15 of the Exchange Act] clearly provides that neither "a natural person" nor "a person other than a natural person" can effect any transactions in or induce the purchase or sale of securities unless that person is properly registered to do so, the section does not prohibit an entity from becoming registered to do so. . . . Petitioner testified that it would be overly burdensome and "would cost millions and millions of dollars" for FWP to register under the [Exchange] Act, but he offered no other evidence to corroborate his testimony. The fact that FWP was not registered, thus preventing it from engaging in the sale of securities, does not allow petitioner to assign the income he earned in his personal capacity to FWP.[82]

As a tax tribunal, the Tax Court's minimization of the significant effort involved in registering FWP as a broker-dealer[83] is unfortunate but not surprising.

The takeaway is that Fleischer set up FWP as an S corporation—presumably to avoid self-employment tax[84]—but was unable to satisfy IRS requirements because the proper contracts

---

82 T.C. Memo 2016-238, at *P14.

83 For example, applicants must satisfy the 14 Standards of Admission in FINRA Rule 1014(a). Additionally, a Form NMA submission requires substantial preparation and documentation prior to a FINRA review that can take as long as 180 days. *See* https://www.finra.org/registration-exams-ce/broker-dealers/how-become-member-membership-application-time-frames.

84 Other tax motivations are possible as well. For example, if he had been permitted to assign his revenue from the broker-dealers to FWP (i.e., treat the revenue as FWP's), Fleischer would have been able to net ordinary business expenses attributable to FWP (e.g., administrative staff, insurance, rent, supplies, overhead, etc.) against such revenue to arrive at a lower net income figure for tax purposes. This is important, because expenses without offsetting revenue will lead to losses, and deduction of losses for S corporation shareholders is capped at the shareholder's investment in the corporation (i.e., the sum of the shareholder's basis in the

with FWP could not be put in place with the broker-dealers due to FWP's unregistered status. In particular, FWP could not contract with a broker-dealer and thereby satisfy the second *Johnson* criterion without running afoul of FINRA Rule 2040 and Section 15 of the Exchange Act.

Here, FINRA can ease the tax burden on representatives and their PSEs by permitting PSEs to enter into the sort of contractual relationships with broker-dealers necessary to satisfy the second *Johnson* criterion. The relationship could be structured as follows:

1. The PSE must be majority owned by the representative and his or her "immediate family members," as such term is defined in FINRA Rule 3241(c).

2. The representative must be employed by the PSE and must notify the broker-dealer of the employment relationship and provide the broker-dealer with a copy of the employment agreement.

3. The employment agreement must require the representative to assign all revenue that he or she receives from the broker-dealer directly to the PSE.

4. The representative must disclose to all customers that the PSE is not registered and is not affiliated with the broker-dealer.[85] The PSE must also be disclosed on the representative's Form U4.

5. The PSE and the broker-dealer must enter into a written agreement for the representative's services as an independent contractor, thereby establishing the revenue as belonging to the PSE. The broker-dealer must also enter into an agreement with the representative in his or her individual capacity setting forth the terms and conditions of the representative's status as an associated person of the broker-dealer.[86]

6. In the agreement between the PSE and the broker-dealer, the PSE must agree to a number of contractual provisions intended to protect investors and ensure proper supervision,

---

corporation's stock and in any indebtedness of the corporation to the shareholder). *See* LEANDRA LEDERMAN AND MICHELLE KWON, UNDERSTANDING CORPORATE TAXATION § 1.02[B] (4th ed. 2020).

[85] With proper disclosure, FINRA has permitted entities like PSEs (i.e., companies owned by representatives or the assumed DBA names of such entities) to be displayed on customer account statements and to be mentioned in communications with the public. *See* FINRA Rule 2231.07 (permitting logos on account statements); 2021 REPORT ON FINRA'S EXAMINATION AND RISK MONITORING PROGRAM, p. 21 (Feb. 2021) (listing as a finding under FINRA Rule 2210 the failure to maintain DBA-related WSPs to "identify the broker-dealer clearly and prominently as the entity through which securities were offered in firm communications, such as websites, social media posts, seminars or emails that promote or discuss the broker-dealer's securities business and identify a non-member entity, such as a representative's OBA").

[86] Unlike the representative, who is a natural person, the unaffiliated PSE—which is a legal entity not under the member's control—would not qualify as an "associated person" under the various definitions found in Exchange Act § 3(a)(18), FINRA Rule 1011(b), and FINRA By-Laws art. I, § (rr).

many of which are found in SEC no-action letters issued in the context of professional employer organizations.[87] For example:

- The broker-dealer, and not the PSE, must be responsible for the proper registration, licensing, training, and supervision of the representative with respect to broker-dealer obligations under all applicable securities laws, rules, and regulations;

- The PSE may not hold itself out as a broker-dealer or otherwise engage in any securities-related activities that would require registration as a broker-dealer (e.g., participating in securities transactions at any points in the chain of distribution);

- All books and records in the possession of the PSE relating to the services provided by the representative must be made available for inspection by the SEC, FINRA, and any other regulatory authority with jurisdiction over the broker-dealer's business;

- The broker-dealer must retain the right to discipline and terminate the representative; and

- The PSE may not assert that the existence of the employment agreement with the representative in any way affects the ability of the broker-dealer, the SEC, FINRA, or any other relevant regulatory authority to regulate or discipline the representative.

This sort of framework, which could become new Supplementary Material .02 to FINRA Rule 2040, would continue to assure effective supervision while also enabling representatives to structure their PSEs and PSE-related contracts in a manner designed to efficiently achieve important tax savings and other benefits.

G. Fraud Protection

Request for Comment G.3: Should FINRA expand the application of Rule 2165: such as (1) beyond "specified adults" to any customer where there is a reasonable belief of financial exploitation; or (2) where there is a reasonable belief that the customer has an impairment that renders the individual unable to protect his or her own interests (e.g., a cognitive impairment or diminished capacity), irrespective of whether there is evidence that the customer may be the victim of financial exploitation by a third party?

Response: FINRA Rule 2165(a)(1) defines the term "Specified Adult" to mean "(A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests." We do not support an expansion of this definition to cover a natural person who is under age 65 and does not appear to have a mental or physical impairment that renders them unable to protect their own interests.

[87] *See* eEmployers Solutions, Inc., SEC No-Action Letter, 2007 SEC No-Act. LEXIS 692 (Dec. 3, 2007); TriNet Group, Inc., SEC No-Action Letter, 2006 SEC No-Act. LEXIS 274 (Feb. 17, 2006).

Based on their age and mental faculties, such natural persons are presumably capable of fending for themselves, making their own decisions (even bad ones), and are in a position to protect themselves from falling victim to financial exploitation. For example, the multiple scam alerts published by the SEC's Office of Investor Education and Advocacy in connection with its anti-fraud public service campaign are undergirded by this assumption that such investors can act in their own self-interest and self-preservation.[88] Our industry has long shunned paternalistic oversight and taken the view that customers have the right to do what they wish with their assets.[89]

The Supplementary Material to FINRA Rule 2165 makes clear that temporary holds are optional in nature and not required:

> This Rule provides members and their associated persons with a safe harbor from FINRA Rules 2010, 2150 and 11870 when members exercise discretion in placing temporary holds on disbursements of funds or securities from the Accounts of Specified Adults or transactions in securities in the Accounts of Specified Adults consistent with the requirements of this Rule. **This Rule does not require members to place temporary holds on disbursements of funds or securities from the Accounts of Specified Adults or transactions in securities in the Accounts of Specified Adults**.[90]

Even so, we are concerned about this proposed expansion of the application of FINRA Rule 2165 because of the increased risk that it poses to member firms. Despite the fact that FINRA Rule 2165 is permissive in nature, there is legal sentiment that when a member *can* place a temporary hold in order to prevent financial harm, it *must* do so or else it risks a lawsuit on a fiduciary theory of negligence and "economic suicide." As one legal commentor explains:

> Customer counsel argue . . . that common decency and respect for their profession must be required in an industry where trust plays such a central role. In the securities industry, brokers, managers, and firms know when a customer is walking the ledge of economic ruin. From experience and training, they know how to prevent it. That is rarely an issue in these cases. The question is whether the

---

88 *See, e.g.*, Office of Investor Education and Advocacy, "SEC's Anti-Fraud Public Service Campaign Warns Investors About Relationship Investment Scams," Press Release No. 2025-63 (May 14, 2025), available at https://www.sec.gov/newsroom/press-releases/2025-63.

89 As one legal commentator observes, "In the seventh edition of its book, *Series 7, Principles & Practices, General Securities Representative* (Dearborn Financial Publishing, Inc. 1993), there was an interesting discussion on the responsibilities of a broker who believes the customer is about to engage in what the broker perceives to be unsuitable transactions: 'Occasionally a customer will ask a registered rep to enter a trade for a customer's account that the rep feels is unsuitable. It is the rep's responsibility to discuss the trade with the customer, and explain why that particular trade might not be suitable. . . . In any event, **the account belongs to the investor to do with as he pleases**—while the rep may attempt to counsel the customer against unsuitable trades, **the customer has the right to enter into any transaction he chooses and to be given good service on all transactions**.'" ROBBINS, 1 SECURITIES ARBITRATION PROCEDURE MANUAL § 5-27 (emphasis added).

90 FINRA Rule 2165.01 (emphasis added). *See also* FINRA Rule 2165(b)(1) ("A member may place a temporary hold on a disbursement of funds or securities").

> broker has any obligation to do anything about it. They have the knowledge. But do they have any obligations, armed with that knowledge? . . . A customer's attorney who is considering taking an economic suicide case usually starts with the presumption that because brokerage firms have a greater knowledge of financial affairs than their customers do, they owe certain fiduciary duties to those customers . . . . Some go so far as to say that a broker has a duty to refuse to accept orders the broker knows, or reasonably believes, will result in a loss to the customer.[91]

Such a theory of liability, while not common, is also not unheard of. For example, in 1990, a panel of AAA arbitrators in Florida ruled that a brokerage firm had a duty "to take adequate steps when it became apparent that [the customer] was trading inappropriately, that he was losing large amounts of money and that he was putting excessive amounts of his net worth at risk."[92] In particular:

> Mr. Peterzell claimed that the firm and several of its brokers were liable to him for failing to step in and stop him from ruinous options trading. In the AAA case, the Panel expressly found that the firm breached its fiduciary duty to Peterzell. In their Award, the arbitrators held that, notwithstanding the fact that it was a nondiscretionary account and that Peterzell controlled his money, the firm had a duty to take appropriate steps once there was clear evidence that Peterzell was embarking on a "course which was destined to cause financial ruin."[93]

This is significant, because even when a member firm can see that a customer's decision is destined to cause financial ruin (e.g., withdrawing funds and sending them to an obvious scammer), the customer himself may be *unwilling* to see as much. This has been the Companies' experience as well as a common occurrence noted by the FINRA Investor Education Foundation.[94] For example, a customer who has been lured into a romance scam may still choose to press forward, despite the red flags brought to their attention, because the desire for human connection is so strong that the customer "wishes" the relationship to be real and proceeds as if it is. In other words, in the Companies' experience, temporary holds are often placed against the customer's wishes *in order to protect the customer from himself* (i.e., to prevent the customer from going along with the scam).

---

91 ROBBINS, 1 SECURITIES ARBITRATION PROCEDURE MANUAL § 5-27 (discussing economic suicide cases). *See also* Barbara Black and Jill I. Gross, *Economic Suicide: The Collision of Ethics and Risk in Securities Law*, 64 U. PITT. L. REV. 483 (Spring 2003).

92 *Joel Peterzell v. Dean Witter Reynolds, Inc.*, AAA Case No. 32-136-0416-88-ID (Nov. 9, 1990), cited and quoted in ROBBINS, 1 SECURITIES ARBITRATION PROCEDURE MANUAL § 5-27.

93 Black and Gross, *supra* note 91, at 516–17.

94 FINRA INVESTOR EDUCATION FOUNDATION, EXPOSED TO SCAMS: WHAT SEPARATES VICTIMS FROM NON-VICTIMS?, at p. 10 (Sept. 2019) ("Looking back, it was so obvious that it was a scam. I guess I wanted it to be true. I didn't read the comments until it was too late."), available at https://www.finrafoundation.org/sites/finrafoundation/files/exposed-to-scams-what-separates-victims-from-non-victims_0_0.pdf.

This puts a member firm in a no-win situation. Placing a temporary hold on such a customer's account in these circumstances can and often does lead to significant conflict between the customer and their registered representative. It is not uncommon for such a customer to feel like they are being wronged and denied access to their money—which they perceive as theirs to do with as they wish—leading to frustration, anger, threats of legal action, and eventually a soured relationship. Sadly, the phrase "no good deed goes unpunished" has proven true in this context. On the other hand, declining to place a temporary hold could result in liability from the customer or, more likely, the customer's heirs who later question how their inheritance was squandered in a scam and seek to hold the member firm (with its "deep pockets") accountable for inaction.

It would be a perverse outcome indeed if FINRA Rule 2165, which is intended as a shield for member firms, could be ultimately weaponized against members by the plaintiffs' bar. If FINRA does decide to expand the application of FINRA Rule 2165, in order to help members out of this no-win situation, we encourage FINRA to revise FINRA Rule 2165.01 to read something like the following (new language is italicized):

> *This Rule does not create a private right of action and does not impose a duty that can serve as the basis for a negligence or other tort claim*. This Rule provides members and their associated persons with a safe harbor from FINRA Rules 2010, 2150 and 11870, *and a safe harbor from liability to customers under the Code of Arbitration Procedure for Customer Disputes*, when members exercise discretion in placing temporary holds on disbursements of funds or securities from the Accounts of Specified Adults or transactions in securities in the Accounts of Specified Adults consistent with the requirements of this Rule. This Rule does not require members to place temporary holds on disbursements of funds or securities from the Accounts of Specified Adults or transactions in securities in the Accounts of Specified Adults, *and members may not be held liable by any person for a decision not to place such a temporary hold on disbursements of funds or securities*.

With this added language, member firms would have greater assurance that they will not be held liable for choosing not to act under a rule that is clearly intended to be permissive in nature.

<u>Request for Comment G.5</u>: Are there other tools (including rules, guidance or technology solutions) that FINRA can provide to members to further facilitate protection of senior and vulnerable investors from fraud and other types of financial exploitation?

<u>Response</u>: Yes, we believe members would benefit from additional guidance regarding FINRA Rule 2165.03. This provision states:

> A member's reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect his or her own interests may be based on the facts and circumstances observed in the member's business relationship with the natural person.

It is unclear which "facts and circumstances observed" would be sufficient to make a member's belief "reasonable." Courts have concluded that registered representatives have no duty to assess a customer's mental capacity.[95] The reason is not surprising: registered representatives "cannot be expected to have *any expertise* in assessing mental capacity."[96]

This is why, for example, determining mental impairment (e.g., incapacity) is usually left to licensed medical professionals in the analogous context of trusts and estate planning.[97] Absent a determination from a licensed medical professional, it would be helpful to know if the following are sufficient to form a "reasonable" belief:

- An assertion, whether written or oral, from the customer's spouse, child, attorney-in-fact, or trusted contact person, indicating or stating that the customer has diminished capacity, has dementia, is experiencing memory or cognition problems, etc.; or

- Several successive or repeat occurrences, directly observed by the registered representative or their office staff, of the customer struggling with memory recall or comprehension.

These are just examples of the types of scenarios that can arise. In general, member firms are commonly provided with only these subjective impressions of well-meaning individuals who have no expertise whatsoever in medical, mental health, psychological, or psychiatric matters.

Overall, member firms lack clarity as to whether they can simply accept the word of, and act upon the mental health assessments made by, individuals who know the customer well but are not licensed medical professionals, or whether registered representatives can reasonably make their own assessments given that they "cannot be expected to have any expertise in assessing mental capacity." Stated differently, under FINRA Rule 2165.03 it is not clear at what point member firms should (or may) no longer rely upon the conclusions of untrained individuals and instead must rely upon assessments from licensed medical professionals.

---

95 *See, e.g.*, *Edward D. Jones & Co. v. Fletcher*, 975 S.W.2d 539, 544 (Tex. 1998) ("There simply is no responsibility on the part of service providers in general or stockbrokers in particular to determine the competence of their clients.").

96 *Id*. (emphasis added).

97 *See, e.g.*, MO. REV. STAT. § 456.6-603(5) (adopting Section 603 of the Uniform Trust Code with modification by defining an "affidavit of incapacity" to mean a written certificate furnished by "at least one licensed medical doctor that states that the settlor lacks capacity to revoke the trust"). *See also* David J. Feder and Robert H. Sitkoff, *Revocable Trusts and Incapacity Planning: More than Just a Will Substitute*, 24 ELDER L.J. 1, 31 (2016) (noting that a "familiar solution" to the question of incapacity is "to put the determination in the hands of the settlor's physician and one or more additional named persons, such as the settlor's spouse or children").

H. Leveraging FINRA Systems to Support Member Compliance

Request for Comment H.4: What other enhancements to its systems should FINRA consider to create efficiencies for its members or provide improved functionality? Would any such enhancements result in investor protection issues? If so, please explain.

Response: We believe two enhancements to FINRA's systems would be very helpful for members. First, we encourage FINRA to enhance the searchability of its online database of disciplinary actions[98] to allow for more advanced Boolean searches and the use of connectors. Examples include the following which are available in LexisNexis:

- AND
- OR
- AND NOT
- ATLEAST (require that a term or terms appear at least so many times in a document)
- W/N (find documents in which the first word appears within *N* words of the second one)
- W/P (a within paragraph connector)
- W/S (a within sentence connector)
- W/SEG (find documents in which the search terms appear in the same segment)
- ! (find a root word plus all the words made by adding letters to the end of it)
- ? (find variations of a word by replacing characters anywhere in the word, except the first character)

Disciplinary actions are an important source of guidance for member firms, and the ability to research and analyze them would be significantly enhanced and made more efficient with improved Boolean search capabilities.

Second, we are aware that FINRA carefully monitors public records for registered representatives' undisclosed criminal, civil, and financial matters (e.g., liens), including through the use of LexisNexis. To the extent FINRA is willing and able to confidentially and securely share such information with member firms, doing so would help facilitate and enhance members' investigations into the good character, business reputation, qualifications, and experience of applicants as required by FINRA Rule 3110(e).

98 *See* https://www.finra.org/rules-guidance/oversight-enforcement/finra-disciplinary-actions-online.

Conclusion

The Companies sincerely appreciate the opportunity to comment on these important matters and add their voice to the policy discussion. Thank you for considering our feedback and inviting us to play a role in helping FINRA further evolve its rules and guidance to reflect modern business practices and markets, promote efficiency, and eliminate unnecessary regulatory burdens.

Sincerely,

Randolph F. Pistor

Randolph F. Pistor, JD, CFA
Chief Legal Officer
Sigma Financial Corp.
Parkland Securities, LLC

300 Parkland Plaza
Ann Arbor, MI 48103

rpistor@axtella.com
(734) 663-1611