

VIA ELECTRONIC MAIL

May 27, 2008

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

RE: Comments on Proposed Changes to Forms U4 and U5

Dear Ms. Asquith:

On April 24, the Financial Industry Regulatory Authority, Inc. (FINRA) proposed revisions to Forms U4 and U5 (Proposed Revisions).¹ The Proposed Revisions are intended to benefit regulators, investors, and the industry. The Proposed Revisions would require firms to report, as customer complaints, allegations of sales practice violations made in arbitration claims and civil lawsuits against registered persons who are not named as parties in those proceedings. The proposal also includes revisions to Forms U4 and U5 designed to ease, clarify, or facilitate reporting requirements, raise the dollar threshold for reporting some settlements to \$15,000, and that would allow firms to amend the reason for termination and date of termination on Form U5.

The Financial Services Institute² (FSI) supports the adoption of many of the Proposed Revisions. However, we are very concerned about the potential unintended consequences of requiring firms to report, as customer complaints, allegations of sales practice violations made in arbitration claims and civil lawsuits against registered persons who are not named as parties in those proceedings. While we understand FINRA's concerns, we believe FINRA's solution will deprive financial advisors of due process and create evidentiary problems for broker-dealers. As a result, we strongly oppose this portion of the Proposed Revisions.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American consumers for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products, by "check and application"; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment advisor firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

¹ See FINRA Regulatory Notice 08-20 at <http://www.finra.org/RulesRegulation/NoticestoMembers/2008Notices/P038384>.

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 119 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 12,500 Financial Advisor members.

In the U.S., approximately 98,000 independent financial advisors – or approximately 42.3% percent of all practicing registered representatives – operate in the IBD channel.³ These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.⁴ Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI’s primary goal is to insure our members operate in a regulatory environment that is fair and balanced. FSI’s advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

The Proposed Revisions are of particular interest to FSI. In fact, FSI supports many of the proposed changes to Form U4 and U5. Specifically, we support the adoption of the proposal to allow firms to amend the reason for termination and date of termination on Form U5. In addition, we support the proposal to raise the dollar threshold for reporting some settlements to \$15,000. FSI also supports the adoption of the technical, conforming, and other changes to Form U4 and U5 that have been proposed. Each of these proposals represent helpful improvement to the disclosure provide by the CRD to regulators, investors, and the industry.

Comments on Certain Proposed Revisions

However, we have serious concerns about the Proposed Revisions to Form U4 and U5 that would require firms to report, as customer complaints, allegations of sales practice violations made in arbitration claims and civil lawsuits against registered persons who are not named as parties in those proceedings. While FSI members are aware of the practice among plaintiff’s attorneys to name the broker-dealer firm as the sole respondent in arbitration claims, we believe FINRA’s solution will deprive financial advisors of due process and create evidentiary problems for broker-dealers. As a result, we strongly oppose these specific Proposed Revisions to Form U4 and U5 for the following reasons:

³ Cerulli Associates Quantitative Update: Advisor Metrics 2007, Exhibit 2.04. Please note that this figure represents a subset of independent contractor financial advisors. In fact, more than 138,000 financial advisors are affiliated with FSI member firms. Cerulli Associates categorizes the majority of these additional advisors as part of the bank or insurance channel.

⁴ These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

- Due Process Concerns – FSI opposes the Proposed Revisions to Form U4 and U5 because they have the potential to deny due process to financial advisors. A review of question 14I(2) will demonstrate the point. The proposed language of question 14I(2) appears to require a financial advisor who has not been named in the Statement of Claim to disclose on his or her Form U-4 that the named respondents in an arbitration matter agreed to a settlement of \$10,000 or more.⁵ The question does not require a finding that the settlement related to the unnamed financial advisor's conduct. As a result, a financial advisor's Form U4 can be stained with the black mark of a settlement even though the financial advisor had no opportunity to participate in settlement negotiations between the parties. Likewise, a financial advisor's Form U4 must be amended if an arbitration award or civil judgment is issued against the named respondents, regardless of the dollar amount. Since Statements of Claim often allege multiple claims for recovery, an arbitration panel could base an award of damages upon a claim for recovery unrelated to the activities of the unnamed financial advisor. Nevertheless, the matter would still be disclosed on the financial advisor's Form U4 by virtue of the panel granting claimants an award and despite the financial advisor being denied the opportunity to mount a defense. Similar due process concerns arise in the context of Proposed Revisions to Form U4 questions 14I(3) and Form U5 7E(2) and 7E(3).
- Evidentiary Concerns – FSI also opposes the Proposed Revisions because they may create evidentiary problems that disadvantage broker-dealers in arbitration and civil litigation matters. The Proposed Revisions would provide financial advisors an opportunity to respond on Form U4 to the required disclosures or, if they are no longer registered with a FINRA member firm, through a Broker Comment.⁶ This process can create substantial difficulties for named respondents in arbitration matters, as claimant's counsel will certainly obtain copies of the unnamed financial advisor's Form U4 or Broker Comment responses through the subpoena process or otherwise. Promoting these means of responding to substantive claims away from the litigation forum is very troubling. For example, if the financial advisor's position is adverse to the firm or other respondents, there is a real risk that the unnamed financial advisor's statements will be used in arbitration without the benefit of cross-examination.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to enhance investor protection through candid and accurate disclosure on Forms U4 and U5.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,



Dale E. Brown, CAE
President & CEO

⁵ The Proposed Revisions include proposal to raise this dollar threshold from \$10,000 to \$15,000. FSI supports this proposal.

⁶ A Broker Comment can be filed by individuals who are currently not registered with FINRA, but who have been registered within the last two years.