December 23, 2010

Marcia E. Asquith
Senior Vice President and Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street Northwest
Washington, DC 20006

Re: Concept Proposal Regarding Requiring a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship
FINRA Regulatory Notice 10-54

Dear Ms. Asquith:

I write this letter on behalf of the National Society of Compliance Professionals ("NSCP"). NSCP is the largest organization in the securities industry serving compliance professionals exclusively through education, certification,[1] publications, consultation forums, and regulatory advocacy. Since its founding in 1987, NSCP membership has grown to over 1800 members including compliance professionals at broker-dealers, investment advisers, banks, insurance companies, hedge funds, independent consultants, and attorneys.

The NSCP appreciates the opportunity to comment on FINRA's Regulatory Notice 10-54 (the "Concept Proposal"). Our comments are intended to offer constructive observations and simplified alternatives. FINRA is proposing some significant changes, and we applaud FINRA's efforts to streamline and enhance disclosures to retail investors. We shall focus our comments on the proposed changes which concern us, specifically the timeliness, objectives to be achieved, scope, and mechanisms regarding disclosures to retail investors set forth in the Concept Proposal. This letter also recommends development of proposed uniform model formats for disclosures to retail investors if FINRA undertakes rulemaking.

Premature Nature of the Concept Proposal. Under Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC is required to conduct a study regarding the obligations of both broker-dealers and investment advisers. In addition, the SEC is authorized to promulgate rules that establish a "standard of conduct for all brokers, dealers, and investment advisers when providing personalized investment advice about securities to retail customers . . . to act in the best interest of the customer without regard to the financial or other

[1] NSCP offers training and qualification testing for industry professionals committed to demonstrating expertise in both broker-dealer and investment adviser compliance best practices, rules, regulations, and industry standards. NSCP's Certification Program enables professionals to earn the Certified Securities Compliance Professional® (CSCP®) credential. For a detailed description of the program, see the NSCP website at http://www.cscp.org.

interest of the broker, dealer, or investment adviser providing the advice."[2] Section 913 also requires the SEC to "facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest." (Emphasis added.)

The Concept Proposal appears to be an attempt to establish a foundation for future FINRA rulemaking related to an eventual fiduciary standard. Toward this end, the Concept Proposal suggests that firms develop a disclosure statement for their products and services along with conflicts related to offering those products and services. NSCP agrees that transparent disclosure of a firm's business, fee structures, and conflicts of interest is helpful for clients. Such information assists clients to determine whether a firm has their best interests in mind and can assist them in reaching their financial goals.

To the extent the Concept Proposal is intended to get ahead of future SEC rulemaking, however, NSCP suggests it may be premature. Because the SEC study has not been completed, it is difficult, if not impossible, to ascertain what ensuing SEC rules required by Section 913 might entail. We believe that the Concept Proposal is a good first step in generating an active dialogue on what SEC and, if necessary, FINRA rules should be implemented.

While SEC rules might include some form of a fiduciary standard, it is not clear that those rules would mandate the development of a disclosure statement, such as the one discussed in the Concept Proposal. Thus, NSCP believes it is prudent for FINRA to delay rulemaking until the SEC promulgates final rules. Investors are not harmed by this delay. To the contrary, a disclosure document that becomes obsolete as a result of subsequent SEC guidance will cause confusion among both investors and firms. Further, FINRA has an interest in postponing review of the disclosure document so that it can dovetail with forthcoming guidance from the SEC.

Scope of the Disclosure Document. We note that the Concept Proposal appears to envision a disclosure requirement similar to the Form ADV brochure format required by the Investment Advisers Act and SEC rules promulgated thereunder. We observe that Form ADV including a part II brochure delivery requirement has been in place since January 1979.[3]

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[2] Section 913 provides that "[i]n accordance with such rules, any material conflicts of interest shall be disclosed and may be consented to by the customer." (Emphasis added.) Such standard shall be comparable to the standard applicable to investment advisers under Sections 206(1) and (2) of the Investment Advisers Act.

[3] *See Investment Adviser Requirements Concerning Disclosure, Recordkeeping, Applications for Registration and Annual Filings*, Investment Advisers Act Release No. 664, 44 Fed. Reg. 7870 (Jan. 30, 1979).

When the Part II requirement was established, investment advisers had the choice of either using the Part II format as published or supplying a plain-English brochure so long as the brochure included all the information called for by Part II. Concerns about being second-guessed as to the adequacy of less rigid formats has apparently severely limited compliance departments' efforts to employ a plain-English brochure which might be more readable. Thus, almost universally, compliance departments have resorted to the less investor-friendly Part II format to satisfy this requirement in an effort to manage regulatory and litigation risks.

As FINRA is aware, investment advisers are now expending an enormous amount of time and effort to comply with the new plain-English brochure requirement. This process has begun in earnest thirty years after the SEC promulgated disclosure requirements permitting, but not requiring, a more investor-friendly presentation. Clearly, to expect broker-dealer compliance departments to develop the investor-friendly presentation contemplated in the Concept Proposal in a short period of time is unrealistic. While some aspects of the Concept Proposal appear relatively easy with which to comply, other aspects are daunting, perhaps impossible. All this is to suggest that both FINRA and the SEC should anticipate a long time period for compliance departments to develop compliant disclosures which are understandable to retail investors. As part of any contemplated "ramp-up," extensive guidance will be called for to help compliance departments identify potential and actual conflicts of interest requiring disclosure. Applicable laws, securities litigation, and regulatory enforcement during the last thirty years have surfaced a vast array of practices engendering actual or potential conflicts of interest.[4] Satisfying regulatory prescriptions and litigious plaintiffs' lawyers would suggest an infinite number of carefully drafted disclosures. Some not readily apparent today. Lawyers attempt to write these documents carefully and thoroughly by working with firms' management and compliance staff. Presenting clear, succinct, and understandable descriptions to retail investors – which will be read and understood – is an enormous task.

NSCP believes that the currently envisioned disclosure statement is overly broad. The Concept Proposal would require each firm to draft a substantial document to address the five discrete "characteristics and subject matter" specified. An abbreviated, *standardized format* would be essential if the intent is to give existing and prospective clients the ability to make meaningful comparisons between firms without being overwhelmed.

In addition, NSCP is concerned the scope may be overly broad in that it would treat all broker-dealers alike, despite the fact that broker-dealers can have very different business models. Take, for example, a broker-dealer that exists purely as a distributor for a mutual fund company.

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[4] By example, legal treatises' efforts to capture these changes have grown erroneously and must be updated frequently, the PLI Investment Advisor Regulation Treatise was recently expanded from one to two volumes, *i.e.*, almost double the number of pages. The comparable PLI Broker-Dealer Regulation Treatise has been two large volumes for several years and Volume III is probably coming soon.

Where customer service representatives perform duties solely incidental to their activities as a fund distributor, and receive no special compensation of any kind for such services, the need for a full-length disclosure document regarding conflicts of interest appears unnecessary to us. A registered representative who has no financial interest in selling one particular product over another can generally be seen as acting in the client's best interests.

Another example would be a call center, non-commissioned environment where clients may conduct a variety of financial transactions spanning numerous areas with one multi-disciplinary, cross-licensed individual. In this case, determining when to send a disclosure document and what it should contain for the broker-dealer would be extremely difficult and burdensome.

A third example would be firms that sponsor wrap fee accounts. Typically, these firms require clients to open a brokerage account in connection with the wrap fee accounts (the broker-dealer is the execution venue and the custodian). It appears that for these firms both an ADV brochure and the proposed broker-dealer disclosure document is necessary. At the very least, firms should be able to incorporate the disclosure document by reference. Alternatively, firms that deliver the ADV brochure should not be required to deliver the disclosure document.

The requirement to disclose financial or other incentives that a firm or its registered representatives have to recommend certain products, investment strategies, or services over similar ones would subject larger firms to an overly burdensome requirement. Firms with extensive product sets would be required to develop substantial additional disclosure documentation since many have financial or other incentives tailored to specific products. Wouldn't extensive listings of these incentives confuse customers interested in a limited number of products? We believe investors would be better served by requiring general disclosures of financial or other incentives as part of a brochure. More detailed disclosures about specific products could be made upon customer request at the point-of-sale.

Disclosure Document Content. NSCP believes that most, if not all, firms provide disclosures of the "types of brokerage accounts and services the firm provides to retail customers" in their promotional materials and on their websites. Publishing this information in summary form in a specific disclosure document appears to be redundant without substantial benefits to clients. Presumably, compliance departments would be permitted to update their current publications incorporating additional information mandated by SEC and FINRA rulemaking.

FINRA has suggested disclosures that should be "reasonably designed to permit existing and prospective retail customers of the firm to evaluate" various aspects of the services and products offered by the firm and the firm's fees. The Concept Proposal does not define the guidance firms' compliance departments will need to provide to customers to enable them to "evaluate" the information provided. If FINRA's intent is to require firms to provide more than

simply a listing or description of their services, products and fees, then additional clarification is necessary.

NSCP believes that disclosure as to the "scope of services provided by the firm to its retail customers and any limitations on the scope of the services offered" can reasonably be combined with the first disclosure listed in the Concept Proposal, *i.e.*, a listing of types of brokerage accounts and services firms provide.

NSCP believes that requiring firms to disclose the "scope of products offered to the firm's retail customers" could be unduly burdensome given the wide variety of products available from brokerage firms and the latitude those firms have in defining the scope of individual products (*e.g.*, levels of options trading, restrictions on types of penny stocks, availability of mutual fund families). In view of the general availability of this information in firms' promotional materials and on websites, this disclosure should not be required in other than very general terms.

NSCP believes requiring each firm to disclose that it "may not offer all products of a certain class or type and that it or its affiliates may be the sponsor or originator of certain products and may determine in some cases to act as a distributor or placement or sales agent for a fee from the issuer or sponsor of the product," combines disclosures that should be addressed separately. The first section of the disclosure ("the firm may not offer all products of a certain class or type") should not be required for the reasons described in the preceding paragraph. The second section of the disclosure (the firm "or its affiliates may be the sponsor or originator of certain products and may determine in some cases to act as a distributor or placement or sales agent for a fee from the issuer or sponsor of the product") could reasonably be combined with the fee disclosure.

Recommendation: Uniform Model Formats. NSCP recommends that FINRA, along with the SEC, conduct intensive studies of investors' needs for information, building on the information developed by the SEC in connection with the RAND Corporation study[5] and similar research conducted in connection with Gramm Leach Bliley legislation requiring privacy disclosures to clients.[6] The SEC developed a Small Entity Compliance Guide together with model privacy forms based in part upon in-person investor studies directed at the most effective way to help them read and understand certain industry-related disclosures. Together with existing research, the SEC and FINRA could develop an understanding of investors' needs and ability to comprehend various kinds of disclosures. Without this careful study and analysis, firms will be required to publish ever more arcane information that may be of sole interest to

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[5] RAND Corporation, Investor and Industry Prospectives on Investment Advisers and Broker-Dealers, *available at* http://www.sec.gov/news/press/2008/2008/2008-1/randiareport.pdf.

[6] *See* http://www.sec.gov/divisions/marketreg/tmcompliance/modelprivacyform-secg.htm.

regulators and plaintiffs' attorneys. From this collaborative work, we recommend that model disclosure formats be developed for use by firms. If offered the opportunity, NSCP believes that many compliance departments would be willing to assist with this development process. Without this careful collaborative effort, we fear that the flood of more "words on paper" or websites will simply proliferate with little benefit to investors.

Fees Disclosures. We are concerned about requiring firms to disclose all fees associated with each account. First, if FINRA contemplates requiring firms to disclose commission schedules, a document of hundreds of pages might be required. Rate schedules for many firms can be quite detailed and extensive. Even more problematic, such a requirement might pose a substantial competitive impact for many firms which do not currently publish their fee and rate schedules – especially commission rates. This subject surely requires analysis and public discussion about its economic and competitive impact.

If the SEC and FINRA ultimately determine that firms must disclose "all fees associated with each brokerage account and service offered to retail customers, a specific description of the service provided for each fee and whether fees are negotiable presented in a manner to allow customers to make comparisons between broker-dealers," they should consider standardizing the types of fees to be disclosed and the manner of their presentation to better enable investors to make comparisons between firms. For example, FINRA could establish a list of firms and their fees on FINRA's website so that investors could comparison shop. This would eliminate the need for firms to develop separate disclosure documents with this information. Naturally, this would represent a departure from current practices where firms' fees and commissions are not published or controlled by FINRA. It would however best facilitate the objectives of transparency and customers' ability to compare prices and services more efficiently. NSCP also suggests that FINRA define "all," as there may be fees that firms incur which do not affect clients. For example, if a firm pays for research, it might not pass this fee down to clients.

NSCP believes that the disclosure of "financial or other incentives that a firm or its registered representatives have to recommend certain products, investment strategies or services over similar ones," while appropriate, is not easily amenable to presentation in an ADV-like document. Although the inclusion of this information in a single document might be a simple matter for small firms with limited lines of business, the requirement to disclose "any arrangement in which the firm receives any economic benefit" could be overly burdensome for larger firms, and certainly more complex. Firms with broad product arrays may have financial or other incentives tailored to specific products. An extensive listing of these incentives would be potentially confusing to customers who might only be interested in a limited number of products. Investors might be better served by requiring only a general disclosure of financial or other incentives as part of the brochure with more detailed disclosure about specific products made upon customer request or at the point-of-sale.

We note that Section 919 of the Dodd-Frank law mandates that any documents required to be supplied by firms to retail investors be "in summary format and contain clear and concise information about (i) investment objectives, strategies, costs and risks; and (ii) any compensation or other financial incentive receive . . . in connection with the purchase of retail investment products." (Emphasis added.)

NSCP believes the proposal that each firm disclose "conflicts that may arise between a firm and its customers, as well as those that may arise in meeting the competing needs of multiple customers, and how the firm manages such conflicts" requires clarification. As currently presented, this could refer to conflicts arising in the course of conducting business as well as potential conflicts of interest between a firm and its clients.

Delivery of the Disclosure Document. The Concept Proposal asks how the disclosure document should be delivered to clients, *i.e.*, in paper or electronic format. NSCP suggests that clients be given the opportunity to decide how they would like to receive these disclosures. Electronic delivery, either via e-mail or posting on a firm's website could result in significant cost savings, and would permit updating more quickly and easily. We are mindful, however, that millions of Americans neither have access to nor use internet resources.

The Concept Proposal leaves open whether firms will have an ongoing requirement to deliver the document after initial delivery. Will the document need to be delivered anew when a firm changes business models, modifies fees, or in any other circumstance contemplated by a rule? Such a requirement could be very costly, and ensuring compliance with it would be challenging. Akin to the privacy notice requirement, NSCP believes that annual delivery would be sufficient. NSCP also suggests that after initial delivery, clients be given the opportunity to opt out of receiving subsequent disclosure documents.

NSCP recommends a two-tiered approach to delivery of the proposed document. Clients could initially be provided a summary disclosure, with a hard copy available upon request. Clients could also be provided with more detailed information via the firm's website, again with a hard copy available upon request. This approach is akin to the summary prospectus delivery guidelines that satisfy Section 5(b) of the Securities Act. The SEC adopted this approach to "provide investors with better ability to choose the amount and type of information to review, as well as the format in which to review it (online or paper)."[7] This approach is practical and would benefit both clients and firms.

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[7] *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Rel. No. 33-8998 (Jan. 13, 1999), *available at* http://www.sec.gov/rules/final/2009/33-8998.pdf.

The Concept Proposal suggests that firms provide a disclosure document to retail clients "at or prior to the commencing a business relationship." This phrase is vague and could be misinterpreted. Is it the time a registered representative is introduced to a person? In the practical world, sales representatives hope that *every* person they meet becomes a client. This could lead to the impractical result that a casual meeting in any setting would trigger a delivery requirement. Therefore, NSCP believes that the timing of the delivery obligation should be clearly defined.

NSCP suggests that, if the Concept Proposal becomes reality, the disclosure document should be provided *at the time the person becomes a client* (*i.e.*, at the time new account documentation is offered to), or no later than 10 business days after the person becomes a client. In this scenario, the firm would incur the cost of production of the document for a real-time client. Further, there is no room to misinterpret when the document is required to be delivered, because the execution of the new account documents is a bright line triggering event.

Regarding delivery of the disclosure document to clients, and proof thereof, NSCP suggests that FINRA contemplate defining how firms will evidence delivery and maintain such evidence in their books and records. NSCP believes that having the client acknowledge receipt in the new account form would be sufficient proof of delivery.

FINRA Advertising Rule Requirements. Since the disclosure document would clearly be a "communication with the public" under FINRA Rule 2210, FINRA should clarify whether disclosure documents will need to be reviewed by FINRA. FINRA should also clarify whether every change to the disclosure document will require FINRA review. Review would add time and cost for firms developing their disclosure document. The cost and time burden of such reviews might be offset, however, by the comfort firms derive from regulatory review and approval.

The Concept Proposal is unclear as to when the document needs to be delivered to *existing* clients, if at all. NSCP suggests that if the proposal evolves into a rule, firms should be allowed an adequate timeframe to deliver the document to existing clients. We suggest firms be permitted to provide the document to clients within twelve months of SEC, approval of a rule, or to include the document along with its next scheduled annual delivery of the privacy policy, whichever is later.

NSCP suggests that FINRA conduct an analysis of the cost impact to firms to produce and distribute such a document. We observe that adding an extensive new disclosure document will place a far greater burden on smaller firms.

Liability Limitations. NSCP welcomes a disclosure document as an appropriate means for firms to disclose the extent of their fiduciary and other duties to clients. For example, a disclosure document could enable broker-dealers and investment advisers to define the standards

of fiduciary care when recommending investment products or strategies to clients. A disclosure document could also limit a firm's duty to track the ongoing suitability of a product recommended to a client at an earlier point in time. As with many other aspects of the proposed disclosure document, however, NSCP believes that it would be most productive to have the benefit of SEC rulemaking before proceeding.

NSCP appreciates the opportunity to provide comments on the Concept Proposal Regarding Requiring a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship (FINRA Regulatory Notice 10-54). We look forward to discussing the issues we have addressed in this letter with FINRA staff members, if that would be helpful. Please feel free to contact the undersigned at 860.672.0843 if you have any questions or require further information regarding our comments.

Thank you in advance for considering our comments.

Sincerely,

Joan Hinchman
Executive Director, President and CEO