

## VIA ELECTRONIC MAIL

December 27, 2010

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

RE: Regulatory Notice 10-54 – Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship

Dear Ms. Asquith:

On October 27, 2010, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 10-54 (RN 10-54) requesting comment on a concept proposal that would require member firms, at or prior to commencing a business relationship with a retail customer, to provide a written statement to the customer describing the types of accounts and services it provides, as well as conflicts associated with such services, and any limitations on the duties the firm otherwise owes to retail customers.<sup>1</sup> FINRA is requesting input on the following specific issues regarding the concept described in RN 10-54:

- Scope: Is the proposal too broad or too narrow with respect to products, services, and conflicts requiring disclosure?
- Delivery method: Should the disclosure be delivered in hard copy, electronic, or both?
- Form and Content: How detailed should the disclosures be? Should there be a two-tiered disclosure, such as a general disclosure that provides hyperlinks or web site references where investors could obtain more detailed information if they choose?
- Timing: How often should the form be updated and provided to retail investors?

The Financial Services Institute (FSI)<sup>2</sup> welcomes this opportunity to comment on RN 10-54. FSI supports enhancing disclosures to facilitate customer understanding. We believe it is important that the disclosures be carefully designed to ensure their effectiveness. As a result, FSI urges FINRA to consider the comments we offer in this letter as it develops a pre-engagement disclosure document rule.

### Background on FSI Members

FSI represents independent broker-dealers (IBD) and the independent financial advisors that affiliate with them. The IBD community has been an important and active part of the lives of American investors 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

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<sup>1</sup> See FINRA Regulatory Notice 10-54, available at <http://www.finra.org/web/groups/industry/@ip/@req/@notice/documents/notices/p122361.pdf>.

<sup>2</sup> 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 126 Broker-Dealer member firms that have more than 188,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 14,500 Financial Advisor members.

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; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser 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.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.<sup>3</sup> 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.<sup>4</sup> 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 mission is to ensure 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.

#### Comments on the Proposed Rule

FINRA's RN 10-54 seeks comment on a possible new rule proposal that would require a firm, at or prior to commencing a business relationship with a retail customer, to provide to the customer a written statement that sets forth the types of brokerage accounts and services the firm offers and the conflicts associated with such services. We urge FINRA to consider the following comments as it develops a proposed rule concerning pre-engagement disclosure documents:

- Amend Definition of Retail Customers – FINRA RN 10-54 represents an initiative to respond to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010's (Dodd-Frank Act)<sup>5</sup> requirement that the SEC facilitate simple and clear conflict disclosures for retail investors. RN 10-54 states that FINRA's intention is to define “retail customer”

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<sup>3</sup> Cerulli Associates at <http://www.cerulli.com/>.

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

<sup>5</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act. Public Law No: 111-20, *available at* [http://docs.house.gov/rules/finserv/111\\_hr4173\\_finsvcr.pdf](http://docs.house.gov/rules/finserv/111_hr4173_finsvcr.pdf).

as a customer that does not qualify as an institutional account under NASD Rule 3110(c)(4). The definition of “institutional account” under that rule consists of a bank, savings and loan, insurance company, registered investment company, registered investment adviser or any entity (which includes natural persons) with total assets of at least \$50 million. However, this definition differs substantially from that included in Section 913 of the Dodd-Frank Act.<sup>6</sup> We urge FINRA to conform their definition of “retail customer” to that of the Dodd-Frank Act as a means of insuring uniformity of statutory and regulatory requirements for broker-dealers.

- Review the Disclosures with Focus Groups to Insure Effectiveness – FSI supports an effective broker-dealer disclosure regime. Investors can make wise choices when they are informed of the differences between the advice and services being offered by the broker-dealers and financial advisors they are considering. The effectiveness of the provided disclosures will be enhanced by insuring investors receive concise, consolidated disclosure documents focused on information material to the typical investor’s decision-making process and not on arcane details of interest to a select few or designed to avoid liability. We believe that investors must be engaged in the process of developing disclosures if effectiveness is to be assured. As a result, FSI urges FINRA to develop model pre-engagement disclosure documents that have been thoroughly focus group tested to insure they provide investors with the information they want in a format they find useful.
- Deliver the Disclosure Electronically – The Investment Company Institute (ICI) found in a recent study that 95% of investors surveyed use the Internet and that 90% of those surveyed “agree or strongly agree with the statement that getting investment information online is the wave of the future.”<sup>7</sup> We believe FINRA should use this opportunity to satisfy the obvious investor demand for electronic delivery of financial disclosures by allowing firms the option of provide the disclosure documents contemplated by RN 10-54 in an electronic format.<sup>8</sup>
- Adopt a Two-Tiered Approach – FINRA should adopt a two-tiered approach to investor disclosures. Under such an approach, a short-form targeted disclosure would be provided in electronic form at the point of engagement. Investors wanting additional information could access such information via the broker-dealer’s website. This approach would mirror recently adopted Securities and Exchange Commission (SEC) rules that permit mutual funds to use a new summary section of the prospectus as an optional “summary prospectus” to satisfy the fund’s prospectus delivery requirements under Section 5(b) of the Securities Act.<sup>9</sup> Under these Rules, funds are permitted to use short-form summary prospectuses only on the condition that they make their full statutory prospectus and other specified fund documents available on the Internet, with paper copies available upon request. The SEC stated that this approach is “intended to provide investors with better ability to choose the amount and type of information to review, as well as the

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<sup>6</sup> Section 913 of the Dodd-Frank Act defines “retail customer” as “a natural person, or the legal representative of such natural person, who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and (2) uses such advice primarily for personal, family or household purposes.”

<sup>7</sup> “Investor Views on U.S. Securities and Exchange Commission’s Proposed Summary Prospectus” at 19 (March 14, 2008), available at [http://www.ici.org/stats/res/ppr\\_08\\_summary\\_prospectus.pdf](http://www.ici.org/stats/res/ppr_08_summary_prospectus.pdf).

<sup>8</sup> Investors who choose not to receive the disclosures in electronic format could obtain hard copy versions free of charge.

<sup>9</sup> Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Rel. No. 33-8861 (Nov. 21, 2007), available at <http://www.sec.gov/rules/proposed/2007/33-8861fr.pdf>.

format in which to review it (online or paper).<sup>10</sup> We believe investors would derive these same benefits from a two-tiered approach to broker-dealer disclosures.

This two-tiered approach is described more fully below:

- Timing of the First Tier Disclosure – FSI recommends that the first tier disclosure document be provided to investors prior to the establishment of a brokerage account, at the time the person becomes a client (i.e., at the time new account documentation is completed by the client), or no later than 10 business days after the person becomes a client of the broker-dealer.
- Focus the Content of the First Tier Disclosure – The first tier disclosures should be focused on the issues of greatest importance to investors. We believe a brief summary of the following information will prove most helpful to investors:
  - The standard of care owed by the broker-dealer to each investor;
  - The nature and scope of the business relationship between the parties, the services to be provided, and the length of the engagement;
  - A general description of the nature and form of the compensation to be received by the broker-dealer and financial advisor;
  - A general description of the nature and form of any material conflicts of interest that may exist between the broker-dealer/financial advisor and the investor;
  - An explanation of the investor’s obligation to provide the broker-dealer and financial advisor with information on their investment objectives, risk tolerance, financial situation, and needs;
  - An explanation of the investor’s need to inform the broker-dealer and financial advisor if their investment objectives, risk tolerance, financial information, or needs change;
  - A phone number and/or e-mail address the investor can use to contact the broker-dealer should they have concerns about the advice or service they have received; and
  - A description of the means by which a customer can obtain more detailed information on these issues free of charge.<sup>11</sup>

While we believe customers will find this information supportive of a productive business relationship with their chosen broker-dealer and especially relevant to their choice of broker-dealer, we encourage FINRA to test these assumptions through extensive investor focus group testing.

- Access to Full Details in the Second Tier Disclosure – As mentioned above, investors who wish to receive more detailed disclosure information would be able to access this information through broker-dealer websites or brochures offered free of charge to those without Internet access. These detailed disclosures would include a schedule of the typical fees and service charges

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<sup>10</sup> See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Rel. No. 33-8998 (Jan. 13, 2009), available at <http://www.sec.gov/rules/final/2009/33-8998.pdf>.

<sup>11</sup> We note that Section 919 of the Dodd-Frank Act 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.”

that may apply to the investor's account, the specific details of all arrangements in which the firm receives an economic benefit for providing a particular product, investment strategy or service to a customer, and similar information.

- Limit the Volume of Post Engagement Disclosures – In general, we believe the amount and frequency of mandated post-engagement disclosures should be limited in an effort to reduce the likelihood of information overload for investors.<sup>12</sup> As a result, we urge FINRA to require only the distribution of the first tier disclosure document to existing clients of the broker-dealer. This distribution could be combined with the annual privacy policy, other required broker-dealer mailings, or e-mail messages to reduce the cost passed on to investors. As stated above, the first tier disclosure document would describe the means by which a customer could obtain more detailed information and, therefore, would provide a gateway for clients in need of that supplemental information. FSI also suggests that after initial delivery, clients be given the opportunity to opt out of receiving subsequent disclosure documents.
- Advertising Review Requirements – We believe the disclosure documents could properly be classified as “communication[s] with the public” under FINRA Rule 2210. As a result, the disclosure documents, and any subsequent amendments to these documents, could be subject to review by supervisory personal at the broker-dealer and by FINRA. Since review would add time and cost to the process of developing the disclosure documents, we urge FINRA to adopt a safe harbor model form for disclosures and exempt those following the safe harbor form from FINRA review. Such an approach would limit the cost and the time of such reviews while providing firms with comfort that they are complying with the disclosure requirements.
- Implementation of Disclosure Requirements – The process of drafting the required disclosure documents is likely to be very time consuming. Therefore, we urge FINRA to provide firms an extensive period in which to develop compliant disclosures that are understandable to retail customers. Drafting concise plain English disclosures for retail investors is a large task. We urge FINRA to provide broker-dealers with at least 180 days to draft these disclosures. In addition, we ask FINRA to provide one year from the date of implementation for broker-dealers to complete the time consuming task of distributing the disclosure to existing clients.

FSI believes these recommendations will result in a layered and measured approach to disclosure that will facilitate customer understanding, allowing investors to make wise choices about the broker-dealers and financial advisors with whom they work. As a result, FSI urges FINRA to consider these concerns as it develops a simple and concise point-of-engagement disclosure document that that has been focus group tested with investors for effectiveness.

### Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to develop effective pre-engagement disclosure documents for retail investors.

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<sup>12</sup> The majority of investors interviewed by RAND's researchers expressed the view “that disclosures do not help protect or inform the investor, primarily because few investors actually read the disclosures.” The “RAND Corporation Study on Investor and Industry Perspectives on Investment Advisers and Broker-Dealers” available at [http://www.sec.gov/news/press/2008/2008-1\\_randiabreport.pdf](http://www.sec.gov/news/press/2008/2008-1_randiabreport.pdf)

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8488.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" followed by "Bellaire".

David T. Bellaire, Esq.  
General Counsel & Director of Government Affairs