



Cornell University
Cornell Law School

William A. Jacobson, Esq.
Associate Clinical Professor
Director, Securities Law Clinic
G57 Myron Taylor Hall
Ithaca, New York 14853
t. 607.254.8270
f. 607.255.3269
waj24@cornell.edu

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Via E-Mail (pubcom@finra.org)

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

**Re: Regulatory Notice 13-02 (Requiring Disclosure of Conflicts of Interest
Relating to Recruitment Compensation Practices)**

Dear Ms. Asquith:

The Cornell Securities Law Clinic (the "Clinic") welcomes the opportunity to respond to the Financial Industry Regulatory Authority's ("FINRA") request for comment on the proposal ("Proposed Rule") to require disclosure of enhanced compensation packages in order to inform investors of the potential conflicts of interest that such recruitment practices may encourage. The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education regarding investment fraud to the largely rural "Southern Tier" region of upstate New York. For more information, please see:
<http://securities.lawschool.cornell.edu>.

The Clinic supports the Proposed Rule. Disclosure will (1) equip individual investors with the knowledge needed to ensure that their interests are being considered by their registered representatives and (2) impose minimal burdens on recruiting member firms.

As early as 1995, the SEC has identified the use of enhanced compensation to recruit registered reps as a practice prone to conflicts of interest. In that study, the SEC recommended that the industry abandon enhanced compensation entirely to conform to best practice standards.¹ However, given the reality that enhanced compensation is an entrenched industry-wide practice, the Proposed Rule is a satisfactory alternative.

¹ Report of the Committee on Compensation Practices (Apr. 10, 1995) available at <http://www.sec.gov/news/studies/studiesarchive/1995archive.shtml>.

I. Firms Should Disclose Enhanced Compensation Because it is Often a Primary Factor in a Representative's Decision to Switch Firms

Enhanced Compensation packages tied to recruitment can be as high as \$15 million for some representative teams and include financial perks beyond the costs associated with transferring a representative's business from one firm to another.² When one considers the vast similarities in services and products offered by the major wirehouses,³ it seems apparent that enhanced compensation is the primary factor in the decision to switch firms, not the client's best interest.

While a representative may pursue financial incentives, clients have a right to know the reason for the move so they can ensure that their interests are being looked after. Clients tend to be more loyal to their representative than the rep's firm and will likely follow the recruited rep instead of exerting the effort to build a relationship with a new representative.⁴ Given this almost blind loyalty, clients need the information the Proposed Rule would make available.

Without disclosure, clients might remain unaware of the lucrative recruitment compensation packages member firms dangle in front of representatives and the pressures such compensation puts on representatives to reach certain production thresholds. Therefore, disclosing this potential material conflict of interest provides clients with the requisite information to adequately ensure that the management of their investment accounts is not being improperly motivated by the allure of an enhanced compensation package. Furthermore, a client unaware of the financial motivations behind the recruitment might not realize that they should discuss with their registered rep the possible costs and disruptions to their portfolio and investment objectives that would result from the proposed transfer.

Finally, the SEC already requires Registered Investment Advisors ("RIAs") to disclose all conflicts of interest,⁵ including interests that arise when RIAs switch between firms.⁶ Thus, not only will the Proposed Rule harmonize the regulation requirements

² See Jed Horowitz, *Broker Bonus Bidding War Comes at a Cost*, REUTERS, Apr. 10, 2012, <http://www.reuters.com/article/2012/04/10/us-bonusbubble-brokers-idUSBRE8391EV20120410>.

³ Melanie Waddell, *FINRA to Mull Broker Compensation Disclosure Rule: Board Will Consider a Number of Potential Rules and Amendments at December Meeting*, ADVISOR ONE, Nov. 29, 2012, <http://www.advisorone.com/2012/11/29/finra-to-mull-broker-compensation-disclosure-rule>.

⁴ Horowitz, *supra* note 2.

⁵ U.S. SECURITIES AND EXCHANGE COMMISSION, *Information For Newly-Registered Investment Advisors*, <http://www.sec.gov/divisions/investment/advoverview.htm> (last visited Feb. 20, 2013); see also *In Sec. & Exch. Comm'n v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963).

⁶ See Waddell, *supra* note 3.

between RIAs and registered reps, it recognizes that if disclosure helps protect RIA clients, it will also help protect registered representative clients.

II. FINRA Should Require Written Client Acknowledgement of Disclosure by Utilizing a Standardized Form

To ensure that the Proposed Rule meets its objective of illuminating possible material conflicts of interest created by enhanced compensation, FINRA should require that clients acknowledge in writing the receipt of the disclosure. Requiring written acknowledgement will not prove overly burdensome because member firms can standardize the acknowledgement form and include it with the new account paperwork the client already has to sign in order to transfer his or her accounts.

The Clinic recommends that FINRA require recruiting member firms to provide the potential client with a single page form that uses easy-to-understand English to inform the client that the registered representative is receiving an enhanced compensation package exceeding \$50,000, and that although this representative is under no suspicion of acting unethically, FINRA has identified enhanced compensation as an area prone to conflicts of interest, and the client should discuss any concerns regarding past and future management of his or her investment accounts and investment objectives with his or her representative.

Such a requirement will also help protect representatives concerned that clients later unhappy with performance will attempt to misuse the proposed disclosure requirement as a form of blackmail. The representative can inform the client that the written acknowledgement proves that the client had been notified of the potential conflict and was instructed to discuss any possible concerns with the representative before agreeing to follow the representative to the new firm.

III. Any Additional Cost to Member Firms Will be Minimal

The concern that the Proposed Rule will result in burdensome costs is largely unwarranted, and to the extent that such costs can be minimized, the proposed rule can be modified before promulgation.

As mentioned in Part II, written disclosure can be included with the transfer paperwork so long as recruiting firms advise the clients on what the disclosure is. Therefore, generating a single-paged form that accompanies already existing paperwork will neither result in an expensive endeavor nor significantly delay the transfer process. If a client decides it is in his or her best interests to discuss the transfer with his or her registered rep, or take additional time to thoroughly weigh the consequences of transferring his or her accounts, that is a decision rightfully in the client's purview.

Moreover, so long as the disclosure is worded in a way that informs the client without alarming them, fears that disclosure will result in a sizeable number of clients not

following their advisors are again overblown. Perhaps as an unintended benefit, such disclosure will help curb the enhanced compensation practices that many agree are a cannibalistic and costly—if unavoidable—drain of industry resources.⁷

IV. We Suggest FINRA Consider Incorporating the Following Proposed Additions to the Rule

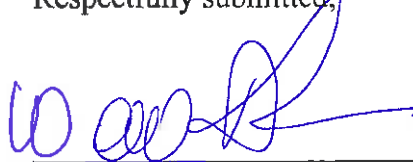
Though the Clinic supports the Proposed Rule, we think it could be improved by requiring disclosure to the registered rep's new clients in addition to existing clients. Enhanced compensation is not based on any distinction between existing and new business, and may even pressure recently transferred representatives to drive up business in order to justify the compensation. Moreover, the pressure may be greater with new clients because there is no established relationship between the two parties.

Given that new clients are exposed to the same material conflict of interest that FINRA seeks to eliminate with this Proposed Rule, it logically follows that new clients should also be included under this protection. Therefore, the Clinic asks FINRA to consider requiring such disclosure when the registered rep makes first contact with a potential new client within a year of transferring.

Conclusion

The Clinic appreciates the opportunity to comment on Proposed FINRA Rule 13-02 and hopes that FINRA will consider the arguments in this comment letter that support the Proposed Rule and further the goals of protecting individual investors unaware of the enhanced compensation practices that the industry currently employs.

Respectfully submitted,



William A. Jacobson, Esq.
Associate Clinical Professor
Director, Cornell Securities Law Clinic



Anthony Vita
Cornell Law School, Class of 2014

⁷ See, e.g., Horowitz, *supra* note 2.