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March 1, 2013

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

Dear Ms. Asquith:

Janney Montgomery Scott LLC ("Janney") appreciates the opportunity to comment on Regulatory Notice 13-02 (Recruitment Compensation Practices). While Janney supports FINRA's efforts to protect investors and better regulate conflicts of interests, and, in particular, perceived conflicts raised by recruitment packages,[1] Janney is concerned that Regulatory Notice 13-02 goes too far and is not sufficiently tailored to address the perceived conflict that FINRA is attempting to regulate. Further, Janney has a number of concerns with the rule proposal and respectfully requests that FINRA consider the issues outlined below before finalizing the rule for submission to the Securities and Exchange Commission (SEC).

I. Fair Competition

Janney is concerned that an unintended consequence of FINRA's rule proposal would be to quell competition or inappropriately restrain compensation. In August 2009, former SEC Chairman Mary Schapiro reminded firms of their supervisory obligations. Her letter struck the appropriate balance and recognized that firms are ultimately responsible for implementing a reasonable system of supervision to ensure that sales practice misconduct is not implicated in the recruitment process. FINRA's rule proposal, by requiring precise and detailed disclosure of actual dollar values negotiated during the recruitment process, would sensationalize recruitment compensation and may curtail the movement of experienced financial advisors within the industry, even when movement is in the best interest of clients.

Regional and smaller firms may be confined in their ability to grow revenues or employees because this type of regulation would impact the ability to hire from a competitor.

[1] "Recruitment packages" and "recruitment compensation" are used interchangeably throughout this comment letter and may refer to enhanced payouts, guaranteed salaries, and up-front/back-end bonuses, which are commonly structured as forgivable loans.

Financial advisors would be less likely to move to a FINRA-regulated[2] competitor because of the disclosures required to be made about their compensation. From a public policy perspective, courts frown on restrictive covenants not to compete that eliminate or negatively impact an employee's freedom of choice or movement to another employer. FINRA's proposed rule may constructively operate as a restrictive covenant not to compete if financial advisors are essentially restrained from transitioning to a new firm because of disclosures that are applicable only to their population within the financial services or any industry.

Indeed, Janney queries whether FINRA's rule proposal is actually intended to eliminate recruitment packages altogether. This rule proposal certainly could result in a restraint on trade and suppression of fair competition through an indirect method of price-fixing compensation. The Exchange Act contains clear prohibitions for SROs, like FINRA, from advancing any rules designed to fix rates of compensation or unnecessarily impose any burdens on competition. <u>See</u> Securities and Exchange Act of 1934, Section 15A(b)(6) and (9), 15 U.S.C. § 78o-3(6), (9). FINRA should not further an agenda through indirect regulation when doing so cannot be accomplished directly.

II. <u>Cost-Benefit Analysis</u>

FINRA should also conduct a more rigorous cost-benefit analysis prior to issuing the proposed rule. While FINRA is not legally obligated to engage in a "cost-benefit analysis" of its proposed rules, it has stated publicly that there should be more consideration of costs and alternatives when proposing rules. Further support for such a cost-benefit analysis is consistent with public statements by the SEC. At an October 2012 *SIFMA Annual Market Structure Conference*, SEC Commissioner Daniel Gallagher described the Commission's 19(b)[3] review process for SRO rule-filings and explained that rulemaking, "whether by an SRO or the Commission itself, should be the product of a careful and balanced assessment of the potential consequences that could arise." Daniel M. Gallagher, Commissioner, U.S. Secs. & Exch. Comm'n, Market 2012: Time for a Fresh Look at Equity Market Structure and Self-Regulation, Address Before SIFMA's 15th Annual Market Structure Conference (Oct. 4, 2012), *available at* http://www.sec.gov/news/speech/2012/spch100412dmg.htm. With any rulemaking,

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[2] FINRA should also consider how this rule could further fragment the brokerage and investment advisory industries. FINRA's rule proposal might ultimately encourage a defection of financial advisors from FINRA regulated member firms to Registered Investment Advisors, which would not require such burdensome and detailed disclosures on compensation.

[3] The Securities Exchange Act of 1934, Section 19(b)(1) requires each self-regulatory organization to file with the Commission "copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization . . . accompanied by a concise general statement of the basis and purpose of such proposed rule change." Securities Exchange Act of 1934 Section 19(b)(1), 15 U.S.C. § 78s(b)(1).

Commissioner Gallagher articulated that a thorough analysis of both the benefits and costs needs to be undertaken.

> Specifically, it requires identifying the scope and nature of the problem to be addressed, determining the likelihood that the proposed rulemaking will mitigate or remedy the problem, evaluating how the rule change could impact affected parties for better and for worse, and justifying the recommended course of action as compared to the primary alternatives.

Id.

With respect to this proposed rule, no such cost-benefit analysis appears to have been conducted thus far. Janney respectfully requests that FINRA focus on each of the four elements outlined by Commissioner Gallagher: (1) scope and nature of the problem, (2) likelihood that rulemaking will mitigate or remedy the problem, (3) evaluation of how the rule change impacts affected parties and (4) course of action compared to alternatives.

A. Scope and Nature of Problem

FINRA has expressed its concerns that recruitment packages raise the potential for conflicts of interests and that this rule proposal is designed to inform customers of those conflicts. Janney understands that the seven (7) questions outlined at the conclusion of the Regulatory Notice are designed to elicit data for FINRA's cost-benefit analysis. However, Janney believes that even if FINRA obtains answers to these questions, FINRA will fall short of an acceptable cost-benefit analysis because it has yet to identify the true scope and nature of the problem.

Recruitment packages, as that phrase is used by FINRA, have been consistently used in the industry for over thirty (30) years. These recruitment packages have allowed financial services firms to fairly compete by attracting experienced financial advisors who might not otherwise be interested in employment with a regional or smaller financial services firm. The recruitment packages have also served to compensate experienced financial advisors during the transition from the prior firm.

It is unclear from this proposal what the actual scope of the problem is that FINRA is seeking to address. Is FINRA seeking to regulate sales practice misconduct or simply regulate disclosure of potential conflicts? A review of the disciplinary actions over the course of the last two decades does not reveal any significant enforcement actions taken by regulators to address either rampant sales practice misconduct associated with recruitment packages or possible conflicts of interest in this area. Further, during that same time period, there has not been a significant regulatory examination focus on sales practices or potential conflicts associated with recruitment packages. Janney is concerned that FINRA is pursuing a regulatory rule proposal that is excessive, in light of the actual scope and nature of the problem to be addressed.

B. Mitigation, Evaluation & Alternatives

Janney is concerned that FINRA's rule proposal will not mitigate perceived conflicts. Rather, it may have the unintended consequences of creating additional conflicts, burdens, problems and issues. The rule proposal seems to suggest that recruitment packages and recruitment compensation are the only reasons that a financial advisor chooses to leave one financial industry firm and move to another. In reality, there are many reasons that impact a financial advisors' decision to move. In addition to compensation, financial advisors weigh their current firm's reputation and stability, the push towards proprietary products and banking services, and the customer service platform in deciding whether to leave their current employer. If there is a regulatory requirement to specifically disclose each dollar of recruitment compensation, experienced financial advisors may be unwilling to leave their current employer, even when doing so is in the best interest of their customers.

Indeed, there are myriad solutions to manage and disclose potential conflicts without requiring a detailed and sensational disclosure of every dollar paid to a new employee as part of recruitment package or a customer's written affirmation that he or she received the detailed disclosures prior to opening an account. Financial services firms are able to structure recruitment compensation so as to manage perceived conflicts by awarding bonuses that are not tied to revenue generation. In addition, firms are able to enhance their existing supervisory structure to ensure that sales practice misconduct cannot occur when recruitment compensation is awarded.

Finally, if this rule is implemented as proposed, there is nothing prohibiting future regulations requiring the disclosure of detailed compensation earned by other sales-oriented investment professionals or, taken to the extreme, all employees within the financial services industry. To address the perceived risks that FINRA is seeking to mitigate, firms can make more generic disclosures and disclose the existence of recruitment packages or recruitment compensation, including the potential for conflicts that may arise as a result of such recruitment packages, without detailing every precise dollar paid to the new employee. These types of disclosures are certainly consistent with other types of regulated disclosures and would not leave the perception that FINRA is being overly-selective about regulating this type of personal compensation. Janney would support such a proposal.

III. Privacy

Janney is also concerned that FINRA's rule proposal, as written, could violate applicable state and federal privacy regulations, including the Gramm-Leach-Bliley Act (GLBA), and ultimately the SEC's implementation of those privacy requirements through Regulation S-P, which are designed to protect the dissemination of non-public personal information. As described in Regulatory Notice 13-02, many recruitment packages are structured through a combination of guaranteed salary, enhanced payouts and loans extended to financial advisors for a term of years. From a public policy perspective, it is reasonable for an employee to have an expectation of privacy of the terms of these recruitment packages, especially loan parameters.

Indeed, dissemination of this type of personal information, especially the loan parameters, could expose an employee to criminal acts like identity theft, financial fraud or even kidnapping.[4] Credit reporting agencies and financial institutions use details of loans and loan data to verify identity, which is precisely why there is no widespread dissemination of this type of financial data. Unfortunately, identity theft is still one of the most prevalent crimes reported to the Federal Trade Commission (FTC), which is charged with protecting America's consumers. FINRA should be mindful of what impact requiring the disclosure of this type of financial data, especially loan parameters, could have and how it could be used as the key to successful identity theft.

One additional privacy concern is the inability of financial services firms to protect the further dissemination of the information once it is disclosed to a client or prospective client. While FINRA member firms have an obligation to limit the dissemination of non-public personal information to third parties, FINRA's current rule proposal has no such mechanisms for ensuring that consumers have the same undertakings. Taken to the extreme, there would be nothing stopping a consumer, competitor, blogger or any other individual from posting the highly sensitive and confidential compensation details on a social media forum like FaceBook, LinkedIn or Twitter. Any consumer, competitor or blogger could begin to compile compensation and income paid to financial services employees for any purpose, not just to evaluate potential conflicts a financial advisor may have. Certainly, the widespread dissemination of this type of private information is not something that FINRA intended as a consequence of its rule proposal.

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[4] Many senior executives at publicly traded companies retain personal security officers because of threats made in connection with the income they receive, which is publicly disclosed. Many companies also have Kidnap and Ransom Insurance policies for highly compensated employees. With these personal security concerns in mind, FINRA should evaluate what impact the proposed detailed disclosures on income and compensation would have on financial advisors if the rule proposal is finalized and approved.

IV. Trade Secrets & Proprietary Interests

Janney has spent years developing and improving its recruitment practices through significant analysis, metrics and evaluation. Indeed, Janney's offer letters to prospective employees contain contractual provisions that prohibit prospective employees from disclosing the financial terms so that Janney can ensure its trade secrets and proprietary business formulas are protected and confidential. FINRA's proposal, requiring detailed disclosure of recruitment terms, would destroy proprietary business formulas that have been developed over the years. While FINRA's goal is to eliminate or reduce conflicts, it would clearly have the impact of destroying otherwise protectable trade secret interests.

V. Conclusion

FINRA's current proposal is premature, as FINRA needs to engage in a *bona fide* analysis to determine if an actual conflict exists. FINRA then needs to ensure that the solution to the potential conflict, if one exists, is reasonable, appropriate and actually addresses the conflict of interest. Currently, the financial services industry has mechanisms in place to identify, mitigate and manage possible conflicts of interests. By the dearth of enforcement actions and regulatory settlements or fines, it appears that those mechanisms are effective and that this current rule proposal is more akin to a solution looking for a problem, rather than a solution to a problem.

Janney certainly supports FINRA's efforts to reduce conflicts of interests where they exist and provide meaningful, plain English disclosures to address those potential conflicts. Janney also supports a disclosure proposal that would provide investors with general information on the types of compensation that a financial advisor may receive as recruitment compensation.

However, Janney is not supportive of the rule proposal as currently described by FINRA, requiring detailed, clear and prominent information on every dollar value associated with a financial advisor's recruitment package. Janney also does not support FINRA's implications that customers would need to provide written affirmations that they received the disclosures prior to opening or transferring their accounts to a new firm. This additional burden on clients and the potential delay in the Automated Customer Account Transfer (ACAT) process would seem directly contrary to prior regulatory guidance issued in NASD Notice to Members 02-07 and NASD Regulation, Inc.'s adoption of Interpretative Material 2110-7 ("IM 2110-7"). In IM 2110-7, there was a clear regulatory pronouncement that it would be inconsistent with just and equitable principles of trade for a member or person associated with a member to interfere with a customer's request to transfer his or her account in connection with the change in employment of the customer's registered representative. FINRA itself should not engage in rule-making that would interfere with a customer's ACAT request or otherwise be inconsistent with just and equitable principles of trade.

FINRA should continue to evaluate the costs and benefits of this particular rule proposal. A survey, which assesses the impact not only on customers, but the attendant impact on financial advisors, firms and restraint of trade would be crucial in assisting FINRA with its cost-benefit analysis. Indeed, if FINRA is unwavering in its decision to require such detailed disclosures, it should contemporaneously evaluate whether the proposed solution should be applicable to all client-facing professionals (investment bankers, institutional sales representatives, financial planners, sales traders, etc.) who receive recruitment compensation. Finally, if conflict disclosures need to be enhanced, FINRA should do a global assessment of conflicts and not limit their rule proposal to the isolated and singular conflict described in Regulatory Notice 13-02.

Thank you for providing Janney Montgomery Scott the opportunity to comment on Regulatory Notice 13-02. If you have any questions regarding this comment, please do not hesitate to e-mail me at cchelko@janney.com or call me at 215-665-6484.

Regards,

Carrie L. Chelko
Deputy General Counsel
Litigation & Regulatory Affairs