FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

August 17, 2015

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

Re: Regulatory Notice 15-22: Discretionary Accounts and Transactions

Dear Ms. Asquith:

On June 17, 2015 the Financial Industry Regulatory Authority (FINRA) published its request for public comment on a revised proposal to adopt a consolidated rule governing discretionary accounts and transactions (Proposed Rule).[1] FINRA initially sought comment on a similar proposal in 2009.[2] FINRA states that it is seeking to bring clarity and consistency to firms by consolidating the existing NASD and NYSE rules outlining supervisory responsibilities for discretionary accounts and transactions. The Proposed Rule aims to preserve the flexibility and convenience of exercising discretionary authority while ensuring that firms do not engage in unauthorized and excessive trading.

The Financial Services Institute[3] (FSI) supports FINRA's goal of preventing unauthorized or excessive trading in discretionary accounts and we appreciate the opportunity to comment on this important proposal. We further appreciate several additions and clarifications FINRA made to the Proposed Rule including the codification of previous guidance from both FINRA and the SEC on the use of negative response letters to effect a bulk transfer of customers' accounts. However, the Proposed Rule raises several concerns for our members and as such we offer a few suggested amendments to further enhance the Proposed Rule's clarity and efficiency.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

[1] Regulatory Notice 15-22, Discretionary Accounts and Transactions (June 2015).
[2] Regulatory Notice 09-63, Discretionary Accounts and Transactions (Nov. 2009).
[3] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. 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. Due to their unique business model, FSI member firms 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 investment goals.

Discussion

FSI appreciates the opportunity to comment on FINRA's Proposed Rule governing discretionary accounts and transactions. The Proposed Rule features several useful additions and clarifications from the original 2009 proposal. These changes include:

- Clarifying that Proposed FINRA Rule 3260(a) does not apply to fee-based only accounts, including accounts charged only a flat fee or a fee based on assets under management;[4]
- Stating that the authorization and approval requirements for the granting of discretionary authority pursuant to Proposed Rule 3260(a) may be performed through electronic means, including the use of electronic signatures;[5]
- Codifying existing FINRA guidance regarding the bulk transfer of customers' accounts and changes to the broker-dealer of record as well as incorporating changes concerning the treatment of customers' free credit balances and participation in sweep programs in light of SEC amendments to Rule 15c3-3.

We support these changes and appreciate FINRA's decision to seek further comment on the Proposed Rule. Additionally, we wish to offer several suggested amendments to address concerns posed by the Proposed Rule. Specifically, we are concerned about the requirement of Proposed Rule 3260(b) to obtain a manual signature from the authorized person, the inability for broker-dealers to exercise limited price and time discretion for more than one trading day and the impact of certain bulk transfer provisions on independent broker-dealers. We discuss these concerns in more detail below.

I. Manual Signature Requirement 3260(b)

A. Proposed FINR Rule 3260(b)

Proposed FINR Rule 3260(b) transfers the requirements of NYSE Rule 408(a) regarding accepting orders for a customer's account from someone other than the customer, with the exception of the requirement that the firm obtain the authorized person's signature. The requirements apply to (1) an investment adviser, other than an associated person, engaged in investment adviser discretionary activities in a customer's account at the firm; 2) any person, other

[4] RN 15-22, at 4.
[5] Id.

than an associated person, granted non-investment adviser discretionary authority by a customer of the firm, such as family member; 3) any person, including an associated person, engaged in non-discretionary trading in a customer's account; or (4) transactions by firms or associated persons in fee-based accounts exempted from Proposed FINRA Rule 3260(a). Notably, Proposed FINRA Rule 3260(b) requires that, where a customer gives written authorization to a natural person, firms and associated persons obtain the prior dated manual signature of the named person, and where a customer gives written authorization to an entity, firms and associated persons obtain the prior dated manual signature of a natural person authorized to act on behalf of the entity. For purposes of compliance with this requirement, FINRA would require firms to obtain a wet signature or a copy of a wet signature, such as a scanned or faxed copy.

Under Proposed FINRA Rule 3260(b), a customer may provide an electronic signature for purposes of satisfying the requirement that customers sign written authorization, however firms must obtain a wet signature or a copy of a wet signature from the natural person provided authorization by the customer or a natural person authorized on behalf of the entity provided authorization by the customer. This requirement is contrary to other provisions of the Proposed Rule, such as Proposed FINRA Rule 3260(a) which allows for electronic signatures in compliance with the E-Sign Act to be used by customers when providing written authorization to exercise discretionary power to a named associated person. FSI believes that extending the use of electronic signatures to the provisions of Proposed FINRA Rule 3260(b) will reduce compliance costs and increase the adoption of paperless office environments at member firms. FSI suggests that FINRA reconsider this provision of Proposed FINRA Rule 3260(b) and include language in any subsequent rule proposal that allows for electronic signatures to satisfy the rule's requirements.

II. Proposed Rule 3260(c)(1)(A)

A. Authorizing Temporary Price and Time Discretion for More than One Trading Session

Proposed Rule 3260(c)(1)(A) provides that, notwithstanding the requirements of Proposed Rule 3260(a), a firm or associated person may exercise time or price discretion: (1) during a normal trading session, provided that such time or price discretion is only in effect during that session; or (2) after a normal trading session, provided that such time or price discretion is only in effect during the next normal trading session. The Proposed Rule further provides that a firm can exercise time or price discretion pursuant to a good-til-canceled order instruction issued on a "not-held" basis for an institutional account.

NASD Rule 2510(d)(1) provides that limited price or time discretion may extend beyond a single trading session so long as it is subject to a specific, written indication signed and dated by the customer. FINRA has chosen to delete this provision from Proposed Rule 3260(c)(1)(A). FINRA states that it believes time or price discretion that is to extend beyond a trading session should be subject to the provisions of Proposed Rule 3260(a). Proposed Rule 3260(a) lays out requirements for the authorization of discretion over a customer account and the ongoing supervision required for orders placed in such discretionary accounts.

Applying the requirements of Proposed Rule 3260(a) to an order that grants limited time or price discretion that last beyond a single trading session poses several operational and compliance concerns for our members. In certain situations a firm may be required to "work" a customer order over a period of several trading sessions. Under the Proposed Rule, a broker-dealer would either be required to obtain customer consent each day until the order is filled, or comply with the provisions of Rule 3260(a). In some cases, it may not be possible to get timely reauthorization from the customer each day, which will impact the customer's execution quality. Applying Proposed Rule 3260(a) is equally challenging as it is unclear precisely how the provisions of the rule would apply to an order granting limited time or price discretion in an otherwise non-discretionary account.

Therefore, consistent with our comment letter in response to Regulatory Notice 09-63, we believe that FINRA should preserve the text from NASD Rule 2510(d)(1) and explicitly state in Proposed Rule 3260(c)(1)(A) that a customer is able to provide written limited time or price discretion that survives a single trading session. We believe that preserving this language will meet FINRA's objective of preventing excessive or unauthorized trading, will provide flexibility to customers in pursuit of their investment objectives, and will also provide firms clarity as to their compliance obligations.

III. Proposed Rule 3260(c)(1)(C)

A. Codification of Existing Guidance Regarding Negative Response Letters to Effect Bulk Transfers

Proposed Rule 3260(c)(1)(C) codifies FINRA's guidance regarding the use of negative response letters to effect a bulk transfer of customers' accounts. The Proposed Rule also expands upon this existing guidance and incorporates SEC guidance regarding the applicability of SEC Rule 15c3-3 to bulk transfers. Additionally, FINRA is codifying existing guidance authorizing the use of negative response letters to change the broker-dealer of record on directly held mutual fund and variable insurance product accounts.

FSI supports FINRA codifying this existing guidance. We appreciate FINRA's willingness to help minimize interruptions to customers' access to their accounts and markets while ensuring they receive appropriate protections. Moreover, we are grateful for the clarity provided to both introducing and clearing firms by the codification of this existing guidance. We wish to raise two points for FINRA to consider as it works to adopt the Proposed Rule.

B. Prohibition on Fees in Cases Where Customers Opt-Out of Bulk Transfer

Supplementary Material 3260.02 states that a firm that effects the transfer of a customer's account via negative consent shall not charge a fee to that customer. The Supplementary Material also states that a firm shall not charge a fee to a customer who in response to a negative response letter decides to move his or her account to another firm during the opt-out period. We believe that the text of Supplementary Material 3260.02 as written creates an opportunity for independent broker-dealers (IBD) that are seeking to effect a bulk transfer of their accounts to another firm to be subject to fees from their clearing firms that they will have difficulty repaying. Therefore, we request that FINRA explicitly state in Supplementary Material 3260.02 that clearing firms are prohibited from charging a transfer fee to an introducing firm for an account where the customer has opted-out of a bulk transfer consistent with Proposed Rule 3260(c)(1)(C), and instead chosen to transfer their account to a different firm.

When an IBD sells its business to another firm (Acquiring Firm), its affiliated financial advisors, as independent contractors, are not under an obligation to move to the Acquiring Firm. In many cases, the affiliated independent financial advisors are often the subject of intense recruiting activity and thereforemay choose to switch their affiliation to a different firm. In such a situation, if the IBD sought to effect a bulk transfer of customer accounts to the Acquiring Firm, the customers of financial advisors that are not affiliating with the Acquiring Firm may choose to transfer their account to their financial advisor's new firm during the opt-out period.

In such a situation, Supplementary Material 3260.02 would prohibit the IBD that is exiting the business from charging these customers a fee. However, our introducing firm members are concerned that the language proposed by FINRA does not explicitly prohibit their clearing firms from charging a fee to the introducing firm for effecting these transfers during the op-out period through the ACAT system. [6] These firms are concerned that in a situation where a large number of their affiliated financial advisors choose not to affiliate with the Acquiring Firm, they may be charged ACAT system transfer fees from their clearing firms that they would have great difficulty repaying. It is quite possible that the total amount of such transfer fees would greatly exceed an introducing firm's net capital.

To address this potential scenario, FSI recommends that FINRA amend the text of Supplementary Material 3260.02 to read as follows:

> In addition, a member that effects the transfer of a customer's account via a negative response letter shall not charge a fee to that customer, [and] a member shall not charge a fee to a customer who in response to a negative response letter decides to move his or her account to another member during the opt-out period provided in the letter<u>, and a clearing firm shall not charge a fee to an introducing firm for effecting the transfer of a customer's account to another member during the opt-out period provided in the letter</u>.

C. <u>Orphaned Accounts</u>

In the Proposed Rule, FINRA notes that it is interested in receiving additional information regarding clearing firm practices for the handling of "orphaned accounts."[7] When an account is "orphaned" at a clearing firm, the customer loses access to the vital services provided by a financial advisor. In an effort to minimize the disruption to an investor's access to the services of licensed financial advisor, FSI supports expanding Proposed Rule 3260(c)(1)(C) to allow for a clearing firm to use negative response letters to transfer "orphaned accounts" to an introducing firm on the clearing firm's platform. Expanding the Proposed Rule to account for these scenarios is consistent with the policy goals underlying the codification of the bulk transfer guidance.

In the Proposed Rule FINRA also requests information on due diligence activities conducted by clearing firms when seeking to transfer "orphaned accounts."[8] Several FSI members reported that currently the transfer of "orphaned accounts" by a clearing firm to an introducing firm on its platform is often an informal process not subject to any established guidelines. We understand and appreciate the importance of ensuring that such accounts are timely transferred to minimize the extent of customer disruption. Nevertheless, FSI requests that FINRA consider establishing guidelines governing transfer practices in these scenarios to ensure that all firms, both large and small, have an opportunity to be considered as a potential recipient of "orphaned accounts."

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[6] Notably, FINRA does not currently define what actions constitute a response to a negative consent letter, nor does FINRA define when such a response would end. Codifying that the conditions of Supplementary Material 3260.02 end at the time the negative response period ends would provide additional clarity on this aspect of the Proposed Rule.
[7] RN 15-22, at 18.
[8] Id.

Establishing a formal process will ensure fair access to firms of all sizes. Moreover, it has the potential to increase the likelihood that investors' accounts are transferred to the firm that is best able to meet the customers' investing needs. We stand ready to work with FINRA and other stakeholders to formalize this important process.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA on this and other important regulatory efforts

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

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