

Regulatory Notice

15-19

Recruitment Practices

FINRA Requests Comment on a Proposed Rule to Require Delivery of an Educational Communication to Customers of a Transferring Representative

Comment Period Expires: July 13, 2015

Executive Summary

FINRA seeks comment on a proposed rule that would require a member firm that hires or associates with a registered representative (recruiting firm) to provide an educational communication to former retail customers who the member, directly or through the transferring representative, attempts to induce to transfer assets to the recruiting firm or who choose to transfer assets to the recruiting firm. The educational communication would highlight the potential implications of transferring assets to the recruiting firm and suggest questions a customer may want to ask to make an informed decision. The recruiting firm would be required to provide the educational communication at or shortly after the time of first contact with a former retail customer regarding the transfer of assets to the recruiting firm.

The proposed rule text is available as Attachment A. The proposed educational communication is available as Attachment B.

Questions regarding this *Notice* should be directed to:

- ▶ Philip Shaikun, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8451; or
- ▶ Jeanette Wingler, Assistant General Counsel, OGC, at (202) 728-8013.

May 2015

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

Key Topics

- ▶ Conflicts of Interest
- ▶ Customer Account Transfers
- ▶ Disclosure

Referenced Rules & Notices

- ▶ FINRA Rule 4512



Financial Industry Regulatory Authority

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by July 13, 2015.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.¹

Before becoming effective, the proposed rule change must be authorized for filing with Securities and Exchange Commission (SEC) by the FINRA Board of Governors and must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).²

Background & Discussion

FINRA remains concerned that retail customers may not be aware of important factors to consider in making an informed decision whether to transfer assets to their transferring registered representative's new firm. Therefore, to provide former customers³ with a more complete picture of the potential implications of a decision to transfer assets to a new firm, FINRA is requesting comment on a proposed rule to require delivery of an educational communication that highlights key considerations in transferring assets to the recruiting firm, and the direct and indirect impacts of such a transfer on those assets.

Prior Proposal

In developing the proposed rule, FINRA considered the comments received in response to the initial proposal filed with the SEC in March 2014.⁴ The initial proposal included two components: (1) a disclosure obligation to former retail customers who the recruiting firm attempts to induce to follow a transferring registered representative; and (2) a reporting obligation to FINRA where a transferring representative receives a significant increase in compensation. The disclosure obligation would have required a member recruiting firm to disclose to former customers ranges of recruitment compensation that the representative has received or will receive in connection with moving firms and the basis for that compensation (*e.g.*, asset-based or production-based). In addition, the initial proposal would have required disclosure if a former customer would incur costs to transfer assets to the member firm that would not be reimbursed by the member firm and if any of the former customer's assets were not transferrable to the recruiting firm. The initial proposal would have required disclosure for one year following the date the registered representative began employment or associated with the recruiting firm.

Commenters to the initial proposal conveyed concerns about the proposal's competitive implications and operational aspects, as well as the effectiveness of the proposed compensation disclosures.⁵ In June 2014, FINRA withdrew the initial proposal to further consider the comments.⁶

Revised Proposal

FINRA requests comment on a proposed rule that would require delivery of a FINRA-created educational communication focused on key considerations for a customer who is contemplating transferring assets to the recruiting firm.⁷

Content of Communication

The educational communication would highlight the potential implications of transferring assets to the recruiting firm and suggest questions the customer may want to ask to make an informed decision regarding: (1) whether financial incentives received by the representative may create a conflict of interest; (2) assets that may not be directly transferrable to the recruiting firm and as a result the customer may incur costs to liquidate and move those assets or inactivity fees to leave them with his or her current firm; (3) potential costs related to transferring assets to the recruiting firm, including differences in the pricing structure and fees imposed between the customer's current firm and the recruiting firm; and (4) differences in products and services between the customer's current firm and the recruiting firm.⁸ The educational communication is intended to prompt a former customer to make further inquiries of the transferring representative (and, if necessary, the customer's current firm), to the extent that the customer considers the information important to his or her decision making.

Delivery of Communication

The proposed rule would require the educational communication to be provided at or shortly after the time of first contact with a customer regarding the transfer of assets to the recruiting firm. If the contact is in writing, the educational communication must accompany the written communication. If the contact is by electronic communication, the recruiting firm may hyperlink directly to the educational communication. If the first contact is oral, the educational communication must be sent to the customer within three business days or with any other communication sent by the recruiting firm to the former customer in connection with a potential transfer of assets, whichever is earlier. In addition, if the first contact is oral, the recruiting firm or representative must inform the former customer that he or she will be receiving a document that contains important considerations in determining whether to transfer assets to the recruiting firm.

The proposed rule further would require the educational communication to be provided to a former customer who seeks to transfer assets to an account assigned, or to be assigned, to the representative at the recruiting firm absent contact (*e.g.*, where a customer decides to transfer assets after learning from a general announcement or other sources that his or her registered representative has changed firms). In those circumstances, the communication must be included with the account transfer approval documentation. Although the proposal does not specify supervisory procedures, FINRA expects that firms can implement a system reasonably designed to achieve compliance with the delivery requirements through training, spot checks, certifications or other measures.

The requirement to provide the communication would continue to apply for six months following the date that the registered representative begins employment or associates with the recruiting firm.

The requirement to provide the communication would not apply when the former customer who the member or registered representative attempts to induce to transfer assets expressly states that he or she is not interested in transferring assets to the recruiting firm. If the former customer subsequently decides to transfer assets to the recruiting firm without further individualized contact within the period of six months following the date the registered representative begins employment or associates with the member, then delivery of the communication with the account transfer approval documentation is required.

Reporting to FINRA

The proposed rule does not include the reporting obligation to FINRA that was in the initial proposal. FINRA will instead consider potential customer harm resulting from recruitment compensation as part of its broader conflicts management review.

FINRA believes the proposal is an effective and efficient alternative to the initial proposal that would achieve the regulatory objective of informing decisions by retail customers whether to transfer assets to the recruiting firm, while reducing the direct costs on firms to provide the educational communication and the operational challenges of the initial proposal. In place of mandating disclosure of the magnitude of recruitment compensation paid, the proposal would highlight in the educational communication that firms may pay financial incentives to recruit or retain representatives and encourage retail investors to consider whether the incentives may impact the advice they receive. FINRA also considered, as some commenters suggested, a general disclosure requirement of the fact of additional compensation received by a transferring representative. However, FINRA believes the revised proposal is a more effective approach; the educational communication allows for more context and explanation about financial incentives and is more likely to prompt a discussion with the transferring representative or current firm.

Investor Testing

FINRA tested the educational communication with a diverse group of retail investors. In general, the investors indicated that the educational communication effectively conveyed important and useful information. Investors also indicated that the communication identified issues to consider that they had previously been unaware of and that would be meaningful in making a decision whether to transfer assets to the representative's new firm.

Economic Impacts

The proposed rule is intended to provide investors with relevant information to make an informed decision whether to transfer assets to their representative's new firm. FINRA believes the proposed rule would enhance investor protection by alerting retail customers to important considerations that may impact their costs and investment objectives and performance. FINRA seeks comment on the usefulness of such a disclosure to a representative's former retail customers.

FINRA recognizes that a member firm that hires or associates with a registered person would incur costs to comply with the proposed rules on an initial and ongoing basis. Member firms would need to establish and maintain written policies and procedures reasonably designed to ensure compliance with the proposed rule, including monitoring communications by the transferring representative and other associated persons of the recruiting firm with former retail clients of the representative. The compliance costs would likely vary across member firms based on a number of factors such as the size of a firm, the extent a firm hires registered representatives from other firms, and the effectiveness and application of existing procedures to the types of communications that must be monitored under the proposal. FINRA seeks comment about the specific sources of these costs, their magnitude and how the costs might differ with a firm's size, business model and other relevant factors.

Request for Comment

In addition to generally requesting comments, FINRA specifically requests comment regarding whether the proposed rule should:

1. require any additional or alternative information be included in the educational communication;
2. include a requirement that a customer affirm receipt of the educational communication at or before account opening at the recruiting firm;
3. apply beyond former retail customers to all customers recruited by or assigned to the transferring representative during the six months after transfer to the recruiting firm; or
4. apply to a time period different from the proposed six months following the date the registered representative associates with the recruiting firm.

FINRA also specifically requests comments on the economic impact and expected beneficial results of the proposed rule.

5. What direct costs for the recruiting firm will result from the proposed rule? How do these costs relate to a firm's size, business model or other relevant characteristics?
6. What indirect costs will arise for the member recruiting firm or its transferring representatives? How do these costs relate to a firm's size, business model or other relevant characteristics?
7. What benefits would result for individual investors and their agents? How extensive are these benefits?
8. Are the costs imposed by the rule warranted by the potential benefit of the education communication to investors?
9. Is the proposed rule well designed to inform investors regarding the potential conflicts of interest and the direct and indirect impacts of transferring assets to a new firm?
10. How will the rule change business practices and competition among firms? Will these impacts differently affect small or specialized broker-dealers?

We request quantified comments where possible.

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. The proposed rule would define the term “former customer” to mean any customer that had a securities account assigned to a registered person at the registered person’s previous firm. The term shall not include an account of a non-natural person that meets the definition of an institutional account pursuant to FINRA Rule 4512(c). FINRA Rule 4512(c) defines institutional account to mean the account of: (1) a bank, savings and loan association, insurance company, or registered investment company; (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (3) any other person (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.
4. *See* Securities Exchange Act Rel. No. 71786 (Mar. 24, 2014), 79 FR 17592 (Mar. 28, 2014) (SR-FINRA-2014-010).
5. *See* the SEC’s [website](#) for a list of commenters to the initial proposal.
6. *See* Securities Exchange Act Rel. No. 72459 (June 30, 2014), 79 FR 36855 (June 30, 2014) (SR-FINRA-2014-010).
7. The text of the proposed rule is set forth in Attachment A.
8. *See* Attachment B.

Attachment A

Text of Proposed New FINRA Rule

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2200. COMMUNICATIONS AND DISCLOSURES

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2272. Educational Communication Related to Recruitment Practices and Account Transfers

(a) Educational Communication Delivery Requirement

A member that hires or associates with a registered person shall provide to a former customer of the registered person, individually, in paper or electronic form, an educational communication prepared by FINRA when (1) the member, directly or through that registered person, attempts to induce the former customer of that registered person to transfer assets or (2) the former customer of that registered person, absent inducement, transfers assets to an account assigned, or to be assigned, to the registered person at the member.

(b) Means and Timing of Delivery

(1) A member shall deliver the communication in paragraph (a) at the time of first individualized contact with a former customer by the registered person or the member that attempts to induce the former customer to transfer assets to the member.

(A) If the contact is in writing, the written communication required in paragraph (a) must accompany the written communication. If the contact is by electronic communication, the member may hyperlink directly to the educational communication.

(B) If the contact is oral, the member or registered person must notify the former customer orally that an educational communication that includes important considerations in deciding whether to transfer assets to the member will be provided not later than three business days after the contact. The educational communication must be sent within three business days from such oral contact or with any other documentation sent to the former customer related to transferring assets to the member, whichever is earlier.

(2) If a former customer attempts to transfer assets to an account assigned, or to be assigned, to the registered person at the member, but no individualized contact with the former customer or inducement by the registered person or member occurs before the former customer seeks to transfer assets, the member shall deliver the educational communication in paragraph (a) to the former customer with the account transfer approval documentation.

(3) The delivery of the communication required by paragraph (a) shall apply for a period of six months following the date the registered person begins employment or associates with the member.

• • • **Supplementary Material:**-----

.01 Definition. For the purpose of this Rule, the term “former customer” shall mean any customer that had a securities account assigned to a registered person at the registered person’s previous firm. This term shall not include an account of a non-natural person that meets the definition of an institutional account pursuant to Rule 4512(c).

.02 Express Rejection by Former Customer. The requirement in paragraph (a) shall not apply when the former customer who the member, directly or through that registered person, attempts to induce to transfer assets expressly states that he or she is not interested in transferring assets to the member. If the former customer subsequently decides to transfer assets to the member without further individualized contact within the period of six months following the date the registered person begins employment or associates with the member, then the requirements of paragraph (b)(2) shall apply.

* * * * *

Attachment B



Issues to consider when your broker changes firms

You're receiving this notice because your broker has changed firms. If you're thinking about whether to follow your broker or stay with your current firm, it's a good idea to examine key issues that will help you make an informed decision.

A good relationship with your broker is surely valuable to you, but it's not the only factor in determining what's in your best interest. Before making a final decision, talk to your broker or someone at your current firm about the following questions, and make sure you're comfortable with the answers.

Could financial incentives create a conflict of interest for your broker?

In general, you should discuss the reasons your broker decided to change firms. Some firms pay brokers financial incentives when they join, which could include bonuses based on customer assets the broker brings in, incentives for selling in-house products or a higher share of commissions. Similarly, some firms pay financial incentives to retain brokers or customers. While there's nothing wrong with these incentives in either case, they can create a conflict of interest for the broker. Whether you stay or go, you should carefully consider whether your broker's advice is aligned with your investment strategy and goals.

Can you transfer all your holdings to the new firm? What are the implications and costs if you can't?

Some products, such as certain mutual funds and annuities, may not be transferable. If that's the case, you'll face an additional decision if you follow your broker to the new firm: whether to liquidate the non-transferable holdings or keep just these holdings at your current firm. Either way, there could be costs to you, such as fees or taxes if you liquidate, or different service fees if you leave some assets at the current firm. Your broker should be able to explain the implications and costs of each scenario.

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What costs will you pay—both in the short term and ongoing—if you change firms?

In addition to liquidation fees or taxes if you sell non-transferable assets, you may have to pay account termination or transfer fees if you close your current account, or account opening fees at the new firm. (Even if the new firm waives its fees as an incentive to transfer, that wouldn't reduce any transfer or closure costs at your current firm.) Moving forward, the new firm may have a different pricing structure for maintaining your account or making transactions (such as fee-based instead of commissions, or vice versa), which could increase or lower your account costs. Your broker should be able to explain the pricing structure of the new firm and how your ongoing costs would compare.

How do the products at the new firm compare with your current firm?

Of course, not all firms offer the same products. There may be some types of investments you've purchased in the past or are considering for the future that aren't available at the new firm.

If that happens, you should feel comfortable with the products they offer as alternatives. If you tend to keep a lot of cash in your account, ask what investment vehicles are available at the new firm for the cash sweep account and whether the interest rate would have an effect on your return.

What level of service will you have?

Whether you follow your broker to the new firm or choose another broker at your current firm, consider whether you'll have access to the types of service, support and online resources that meet your needs.

FINRA is the Financial Industry Regulatory Authority.

FINRA is an independent, not-for-profit organization with a public mission: to protect America's investors by making sure the securities industry operates fairly and honestly. FINRA is not a part of the government, but we play a critical role in safeguarding investors by enforcing high ethical standards, bringing the necessary resources and expertise to regulation, and promoting investor education—all at no cost to taxpayers.

Learn more at www.finra.org.