

MEMO# 24675

October 29, 2010

FINRA Issues Concept Release Seeking Comment On Disclosure Document That Would Be Required To Be Provided To Retail Customers

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 53-10
INVESTMENT COMPANY DIRECTORS No. 25-10
OPERATIONS COMMITTEE No. 35-10
SEC RULES COMMITTEE No. 47-10
SMALL FUNDS COMMITTEE No. 19-10
TRANSFER AGENT ADVISORY COMMITTEE No. 73-10 RE: FINRA ISSUES CONCEPT RELEASE
SEEKING COMMENT ON DISCLOSURE DOCUMENT THAT WOULD BE REQUIRED TO BE
PROVIDED TO RETAIL CUSTOMERS

FINRA has issued a concept release seeking comment on whether to pursue a new rule that would require FINRA members, “at or prior to commencing a business relationship with a retail customer” to provide the customer a disclosure document including specified information. [\[1\]](#) The intended purpose of this new disclosure document and its contents as envisioned by FINRA are briefly described below.

Comments on the proposal are due to FINRA by December 27, 2010. The Institute will hold a conference call on Thursday, November 18th at 2 p.m. Eastern to discuss comments to include in our letter. If you are interested in participating on the call, please email Gwen Kelly at gwen.kelly@ici.org no later than Friday, November 12th. If you are unable to participate in the call but have comments on the proposal, please provide them to Tami Salmon prior to the call by phone (202-326-5825) or email (tamara@ici.org).

Intended Purpose

According to the Release, FINRA's staff believes that a disclosure document that sets forth in plain English a member's accounts and services, its associated conflicts of interest, and any limitation of duties owed to a retail customer may be "an outright necessity" in light of recent regulatory initiatives. These initiatives include the enactment of the Dodd-Frank Act, which requires the SEC to study any regulatory gaps between broker-dealer and investment adviser regulation. One such gap is the disclosure that must be provided to customers. While the Investment Advisers Act requires that customers receive a brochure containing specified information about the adviser and its representatives, there is no comparable disclosure imposed on broker-dealers. FINRA envisions broker-dealers being required to deliver a document "similar in purpose" to that required under the Advisers Act. In FINRA's view, this new document would "enhance retail investors' understanding of the business, relationships and conflicts of their brokers."

Potential Disclosure Document Content

According to the Release, FINRA's staff envisions that this new disclosure document "would include the following characteristics and subject matter:"

- I. The types of brokerage accounts and services the firm provided to retail clients (e.g., research, underwriting and recommendations of securities, products, and strategies);
- II. Disclosures that are reasonably designed to permit existing and prospective retail customers of the firm to evaluate:
 - a. The scope of services provided by the member to its retail customers and any limitation on the scope of these services;
 - b. The scope of products offered to the firm's retail customers;
 - c. To the extent applicable, that the firm may not offer all products of a certain class or type and that it or its affiliates may be the sponsor or originator of certain products and may determine in some cases to act as a distributor or placement or sales agent for a fee from the issuer or sponsor of the product; and
 - d. All fees associated with each brokerage account and services offered to retail customers, a specific description of the service provided for each fee, and whether fees are negotiable. (This information would presumably be presented in a standardized manner to allow customers to make comparisons between broker-dealers);
- III. Disclosure as to financial or other incentives that a firm or its registered representatives have to recommend certain products, investment strategies, or services over similar ones, including:
 - a. In the case of investment company securities, information relating to their cash/non-cash compensation arrangements as would be required by proposed FINRA Rule 2341; [\[2\]](#)
 - b. Any arrangement in which the firm receives any economic benefit from any person (including an issuer) in connection with providing a particular product, investment strategy, or service to a customer;
 - c. Any arrangement in which the firm compensates or receives any economic incentive for customer referrals from or to any individual or firm; and
 - d. Any arrangement in which a registered representative receives different payouts or other rates of compensation for certain products or services that are reasonably likely to provide an incentive for the representative to offer that product or service in lieu of similar ones offered by the broker-dealer;

- IV. Disclosure of conflicts that may arise between a firm and its customers, as well as those that may arise in meeting the competing needs of multiple customers and how the firm manages such conflicts; and
- V. Limitations on the duties a firm owes to its customers, such as that the firm:
 - a. Does not assure the ongoing suitability of an investment or portfolio of investments;
 - b. Takes no responsibility for the propriety of unsolicited orders, other than to discharge best execution obligations; or
 - c. May execute any transaction on a principal basis, absent instructions to act in an agency capacity.

Request for Comment

FINRA seeks comment on all aspects of the proposal including its: scope (e.g., the products, services, and conflicts discussed); delivery method (e.g., hard copy or electronic); form and content (e.g., level of detail, one-tier or two-tiered disclosure); and timing (e.g., how often it should be updated and provided to customers).

Tamara K. Salmon
Senior Associate Counsel

endnotes

[1] See Disclosure of Services, Conflicts and Duties, FINRA Notice 10-54 (October 2010) (the “Release”), which is available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122361.pdf>.

[2] See Institute Memorandum No. 23568, dated June 19, 2009, summarizing FINRA’s proposal, which remains pending. The Institute filed a comment letter supporting the proposed rule but recommending revisions relating to electronic delivery of the information and elimination of existing detailed prospectus disclosure of cash compensation arrangements. See Institute [Memorandum](#) No. 23676, dated August 4, 2009, summarizing the Institute’s comment letter.