

MEMO# 32295

March 17, 2020

FINRA Proposes Amendments to Suitability and Related Rules to Conform to Reg BI

[32295]

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TO: ICI Members

Bank, Trust and Retirement Advisory Committee

Broker/Dealer Advisory Committee

Internal Sales Managers Roundtable

Investment Adviser and Broker-Dealer Standards of Conduct Working Group

Operations Committee

Pension Committee

Pension Operations Advisory Committee

Sales and Marketing Committee

SEC Rules Committee

Small Funds Committee

Transfer Agent Advisory Committee

Variable Insurance Products Advisory Committee SUBJECTS: Compensation/Remuneration
Compliance

Disclosure

Distribution

Fees and Expenses

Pension

Portfolio Oversight

Variable Insurance Products RE: FINRA Proposes Amendments to Suitability and Related
Rules to Conform to Reg BI

The Financial Industry Regulatory Authority, Inc. (FINRA) recently filed with the Securities and Exchange Commission proposed amendments to FINRA's suitability rule (FINRA Rule 2111), and certain of its other rules, to conform to the SEC's adoption of Regulation Best Interest.^[1] If the SEC approves the proposed amendments, following an opportunity for public comment,^[2] FINRA will issue a Regulatory Notice announcing the proposed amendments no later than 60 days following SEC approval. The effective date of the amendments would be the Reg BI compliance date (June 30, 2020). The proposed amendments are attached and are summarized below.

FINRA proposes to amend Rules 2111 (Suitability), 2310 (Direct Participation Programs),

2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements), and Capital Acquisition Broker (CAB) Rule 211 (Suitability). The proposed amendments would: (1) amend the FINRA and CAB suitability rules to state that the rules do not apply to recommendations subject to Regulation Best Interest (“Reg BI”) and to remove the element of control from the quantitative suitability obligation, consistent with Reg BI; and (2) conform the rules governing non-cash compensation to Reg BI’s limitations on sales contests, sales quotas, bonuses, and non-cash compensation.

FINRA explains that it does not propose to eliminate its suitability rule because that rule still applies broadly to all recommendations to customers, while Reg BI applies only to recommendations to a “retail customer.”^[3] For example, FINRA’s suitability rule will still apply with respect to recommendations by FINRA members or associated persons to entities and institutions (e.g., pension funds), and to natural persons who will not use recommendations primarily for personal, family, or household purposes (e.g., small business owners and charitable trusts).

FINRA also proposes to amend the quantitative suitability obligation under FINRA Rule 2111.05(c) to remove the element of control that currently must be proved to demonstrate a violation. Currently, the rule requires that a FINRA member or associated person who has actual or de facto control over a customer account must have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile. FINRA’s proposed change is consistent with Reg BI, which eliminates the control element from its Care Obligation.^[4] It also is consistent with FINRA’s 2018 proposal to remove the control element from its quantitative suitability obligation.^[5]

In addition, FINRA proposes to amend its rules governing non-cash compensation arrangements, including Rules 2310, 2320, 2341, and 5110, to specify that any non-cash compensation arrangement permitted by those rules must be consistent with the requirements of Reg BI. FINRA would eliminate provisions in Rules 2320 and 2341 that require internal non-cash compensation arrangements to be based on total production and equal weighting of securities sales. Firms would therefore no longer be permitted to sponsor or maintain internal sales contests based on sales of securities within a product category within a limited time, even if they are based on total production and equal weighting. FINRA explains that the proposed requirement also would apply to the non-cash compensation provisions governing gifts, business entertainment, and training or education meetings.

Sarah A. Bessin
Associate General Counsel

[Attachment](#)

endnotes

^[1] Rule 15l-1 under the Securities Exchange Act of 1934.

^[2] The public will have 45 days to comment. ICI does not plan to submit comments.

[3] Reg BI defines a “retail customer” as a natural person, or the legal representative of a natural person, who: (A) receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and (B) uses the recommendation primarily for personal, family, or household purposes.

[4] Reg BI’s Care Obligation requires that a broker-dealer or associated person, in making a recommendation, exercises reasonable diligence, care, and skill to, among other things,

Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker, dealer, or such natural person making the series of recommendations ahead of the interest of the retail customer.

[5] See FINRA Regulatory Notice 18-13 (April 2018), *available at* <https://www.finra.org/rules-guidance/notices/18-13>.