

COMMENT LETTER

August 13, 2015

ICI Files Comment Letter with FINRA on Proposed Discretionary Authority Rule (pdf)

August 13, 2015 Marcia E. Asquith Office of Corporate Secretary FINRA 1735 K Street, NW Washington, DC 20006-1506 Re: Discretionary Accounts and Transactions; FINRA Notice 15-22 Dear Ms. Asquith: The Investment Company Institute¹ appreciates the opportunity to file a comment letter supporting the adoption of FINRA Rule 3260 relating to discretionary accounts and transactions.² The proposed rule is intended to incorporate previous rules of the NASD and NYSE relating to discretionary accounts and transactions into the FINRA rulebook. Generally speaking, in the absence of exceptional circumstances, the rule would require broker-dealers to obtain affirmative written consent from a customer prior to exercising discretionary authority in the customer's account.³ The proposed rule would also address the treatment of customers' free credit balances, sweep programs, bulk transfer of customers' accounts, and change of the broker-dealer of record on a customer's account. Based upon the nature of our membership, our interest in this proposal is limited to its impact on mutual fund shareholders and the mutual fund shares they hold in their accounts. Consequently, 1 The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of \$18.0 trillion and serve more than 90 million U.S. shareholders. 2 See Discretionary Accounts and Transactions, FINRA Regulatory Notice No. 15-22 (June 2015), which is available at: http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Notice_15-22.pdf. 3 Under exceptions circumstances, which are set forth in the rule, broker-dealers would be permitted to use negative consent letters to exercise limited discretionary authority. Marcia E. Asquith August 13, 2015 Page 2 the provisions in the proposal that are primarily of interest to us are those that would permit the use of negative consent letters in lieu of affirmative written discretionary authority. These exceptions can be found in Rule 3260(c)(1)(B) and (C). Subsection 3260(c)(1)(B) of the proposed rule would govern the use of negative consent letters in connection with the transfer of money market fund accounts in the event of a merger or acquisition; Rule 3260(c)(1)(C)(i) would permit negative consent letters to be used in connection with the bulk transfer of customer accounts (including mutual fund accounts) and changes in the name of the broker-dealer of record in very limited circumstances.⁴ As noted above, we support the proposed rule. We concur with

FINRA that, by limiting the circumstances under which negative consent letters can be used, the rule will facilitate the quick and efficient bulk transfer of accounts under exigent circumstances, thereby avoiding the “potential risks to investors and costs to firms that could result if firms were required to solicit individual transfer instructions from each customer as required under proposed FINRA Rule 3260(a).”⁵ Additionally, permitting the use of negative response letters in the limited situations set forth in the proposed rule “also helps minimize interruptions to customers’ access to their accounts and the trading markets.”⁶ In our view, the interest of the customer should be paramount in determining when a broker-dealer is permitted to exercise discretionary authority in a customer account without first obtaining affirmative customer consent. The use of negative consent letters should only be permitted when such use is in the best interest of the customer, without regard to how the use of such letters might also benefit the broker-dealer of record. Accordingly, we would not support any efforts of FINRA to broaden the use of negative consent letters in instances where the primary beneficiary of such expediency is not the customer. We believe that Rule 3260 in its current form accomplishes this. While some members of FINRA might advocate for FINRA permitting more liberal use of negative consent letters (e.g., to permit the transfer of mutual fund accounts held directly at a mutual fund company with a broker-dealer of record on the account to the broker-dealer’s trading platform), we encourage FINRA to resist expanding the rule’s exceptions except in exigent circumstances. In the absence of exigent circumstances, FINRA should not permit the use of negative consent letters and should, instead, require a broker-dealer to obtain from the customer a written authorization permitting the broker-dealer to exercise discretion over the account. Presumably, in order to obtain such affirmative authorization, the broker-dealer would need to explain to the customer why providing such discretionary authority would be in the customer’s best interest (as opposed to the broker-dealer’s),⁴ as set out in Rule 3260(c)(1)(C)(a)-(g), these circumstances are: when an introducing firm enters into a clearing arrangement with a different clearing firm; in the event an introducing or clearing firm is experiencing financial or operational difficulties; when a firm is going out of business or eliminating a line of business; when a firm has gone out of business; in the event of a merger; or in response to the termination of a networking relationship.⁵ FINRA Notice at p. 9. ⁶ Id. Marcia E. Asquith August 13, 2015 Page 3 thereby ensuring that any consent provided by the customer is informed consent. In addition, unlike the use of negative consent in exigent circumstances, requiring the customer’s affirmative consent in non-exigent situations should ensure that the customer receives the full protections intended by the conditions set forth in Rule 3260(a). In summary, we support FINRA’s proposed Rule 3260. We believe the rule is drafted to afford broker-dealers effective means to protect their customers in the event of exigent circumstances impacting the broker-dealer’s business. Consistent with the rule’s provisions, we oppose the use of negative consent letters in non-exigent circumstances. We appreciate FINRA’s consideration of our comments. If you have any questions concerning them, please do not hesitate to contact the undersigned by phone (202-326-5825) or email (tamara@ici.org).
Regards, /s / Tamara K. Salmon Associate General Counsel