



October 22, 2014

***Via Electronic Mail to rule-comments@sec.gov***

Brent J. Fields  
Secretary, Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: File No. SR-FINRA-2014-037; Release No. 34-73210  
SIFMA Comment on FINRA Proposed Rule Changes (the “Proposal”)  
Relating To Payments to Unregistered Persons**

Dear Mr. Fields:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on the Financial Industry Regulatory Authority’s (“FINRA”) proposal to adopt FINRA Rule 2040 – Payments to Unregistered Persons (“Proposed Rule 2040”) and FINRA Rule 0190 – Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation (“Proposed Rule 0190”) and to amend FINRA Rule 8311 – Effect of a Suspension, Revocation, Cancellation, or Bar (“Rule 8311”).<sup>2</sup>

SIFMA supports FINRA’s effort to develop clear and consolidated rules related to payments to unregistered persons. SIFMA appreciates FINRA’s efforts to incorporate comments, including input provided by some of our member firms, regarding the Proposal, as previously issued in *Regulatory Notice* 06-09.<sup>3</sup> Without detracting from the support stated herein, SIFMA’s comments on the Proposal highlight various issues that SIFMA believes require further consideration to ensure effective and efficient implementation by our member firms.

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<sup>1</sup> SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit [www.sifma.org](http://www.sifma.org).

<sup>2</sup> SEC Release No. 34-73210; File No. SR-FINRA-2014-037, *Proposed Rule Change to Adopt FINRA Rules 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation) and 2040 (Payments to Unregistered Persons) in the Consolidated FINRA Rulebook, and Amend FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar)* (September 25, 2014), available at <http://www.sec.gov/rules/sro/finra/2014/34-73210.pdf>.

<sup>3</sup> See *Regulatory Notice* 09-69 (December 2009), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120480.pdf>.

## **I. EXECUTIVE SUMMARY**

SIFMA has long supported enhanced clarity in the rules applicable to dealings with unregistered persons, and we believe that FINRA has thoughtfully developed and proposed revisions to its rules that reflect a cohesive vision of applicable regulatory framework related to payments of commissions or fees derived from a securities transaction to unregistered persons. One example, for which SIFMA commends FINRA, is the Proposal's codification of existing FINRA staff guidance on the payment by members of continuing commissions to retiring registered representatives.

Several revisions included in the Proposal respond to prior industry comments and provide valuable feedback to the industry, including:

- the proposed Supplementary Material .01 to proposed FINRA Rule 2040, designed to provide guidance to members regarding reasonable support for determination of compliance with Section 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act"); and
- the retention, rather than deletion, of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to foreign finders.

SIFMA believes that some aspects of the Proposal would benefit from additional guidance, and notes that certain interpretive challenges remain in the Proposal with respect to the foreign finders exception, for which further guidance is necessary to enact a final rule that is efficient and effective in accomplishing the stated policy goals.

## **II. GENERAL COMMENTS**

FINRA generally has interpreted the NASD Non-Member Rules,<sup>4</sup> which govern payments by members to unregistered persons, to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer. The potential incentives for abusive sales practices inherent in the receipt of transaction based compensation serves as the foundation for FINRA's current interpretation of the NASD Non-Member Rules. SIFMA supports the consolidation of existing rules and interpretations in this area, noting certain comments in the following sections.

### **A. Payments to Unregistered Persons – Rule 2040(a)**

The Proposal adopts new FINRA Rule 2040(a), which prohibits members or associated persons from, directly or indirectly, paying any compensation, fees, concessions, discounts, commissions or other allowances to: (1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such

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<sup>4</sup> The "NASD Non-Member Rules" as used in the Proposal, refers to NASD Rule 1060(b) (Persons Exempt from Registration), NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members), and NASD IM-2420-2 (Continuing Commissions Policy).

payments and the activities related thereto, is required to be so registered<sup>5</sup> under applicable federal securities laws and SEA rules and regulations; or (2) any appropriately registered associated person, unless such payment complies with all applicable federal securities laws, FINRA rules and Exchange Act rules and regulations.

Per the Proposal, members that are uncertain as to whether an unregistered person may be required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto can derive support for their determination by, among other things,

- (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances;
- (2) seeking a no-action letter from the Commission staff; or
- (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area.

The Proposal states that the member's determination as to whether an unregistered person may be required to be registered must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

SIFMA supports FINRA's Rule 2040(a) in the Proposal. While Proposed Rule 2040(a) serves the stated purpose, guidance would be useful for two concepts used in the Proposal. SIFMA respectfully requests further guidance to illustrate the standard "reasonable under the circumstances" as well as guidance on the expected frequency of the periodic review.

#### **B. Retiring Representatives – Rule 2040(b)**

FINRA is also proposing to adopt new FINRA Rule 2040(b), that permits members to pay continuing commissions to retiring registered representatives<sup>6</sup> of the member, after they cease to be associated with the member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided that:

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<sup>5</sup> FINRA has refrained from providing interpretive guidance on whether a person is acting as an unregistered broker-dealer, noting that the authority to interpret Section 15(a) of the Exchange Act rests with the SEC.

<sup>6</sup> Per the Proposal, the term "retiring registered representative" means an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. As explained in the Proposal, in the case of death of the retiring registered representative, the retiring registered representative is the beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated.

- (1) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts or servicing the accounts generating the continuing commission payments; and
- (2) the arrangement complies with applicable federal securities laws and Exchange Act rules and regulations.

SIFMA believes the Proposal is consistent with existing guidance on the payment of compensation to retiring representatives. SIFMA commends FINRA for a concise and effective framework on the payment by members of continuing commissions to retiring registered representatives, which is consolidated by the Proposal's codification of existing FINRA staff guidance.

### **C. Nonregistered Foreign Finders – Rule 2040(c)**

In the Proposal, FINRA seeks to transfer NASD Rule 1060(b) (Persons Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders) (together, the "Existing Nonregistered Foreign Finder Rules") with minor technical changes into the Consolidated FINRA Rulebook as FINRA Rule 2040(c). The Existing Nonregistered Foreign Finder Rules provide that members and persons associated with a member may pay transaction-related compensation to nonregistered foreign finders, based upon the business of customers such persons direct to members, subject to certain conditions.

SIFMA encourages FINRA to provide additional guidance to assist in the implementation and operation of Proposed Rule 2040(c). For example, one condition notes that, "(4) customers receive a descriptive document, similar to that required by Rule 206(4)–3(b) of the Investment Advisers Act, that discloses what compensation is being paid to finders." Investment advisers must disclose the additional amount that will be charged to the investment advisory fee (normally expressed as a percent of assets under management) and the differential attributable to the finder arrangement. Given that, in general, the nature of fees between an investment adviser and its clients differ from the nature of fees between a broker-dealer and its customers, SIFMA believes that it would be useful to have examples of how the condition would operate.

SIFMA notes that the Proposal may be read to modify understood interpretations of permissible arrangements. In the Proposal, FINRA states that it is proposing non-substantive, technical changes to the proposed rule text to make it easier to read. The Proposal, however, notes that Rule 2040(c) permits compensation when the foreign finders' sole involvement would be the initial referral to a member. Per the Proposal, any activities beyond the initial referral of non-U.S. customers and payment of transaction-based compensation for any such activities "would not be within the permissible scope of the foreign finders exception as set forth in proposed FINRA Rule 2040(c)." SIFMA notes that the Existing Nonregistered Foreign Finder Rules include such a provision as a safe harbor, not as an exclusive means of

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compliance with the Existing Nonregistered Foreign Finder Rules. As noted later in the Proposal, with the use of the phrase “unless otherwise permitted by the federal securities laws or FINRA rules,” there may be other permissible activity, beyond the initial referral, that would be within the permissible scope of the foreign finders exception. SIFMA, therefore, respectfully requests that the language be clarified to reflect existing guidance.

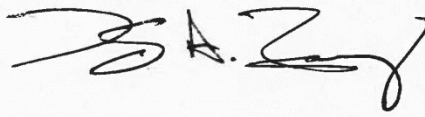
### III. CONCLUSION

SIFMA appreciates this opportunity to comment on the Proposal. SIFMA continues to support FINRA’s efforts to establish a Consolidated Rulebook and streamline existing rules.

Specifically, SIFMA supports the Proposal, and submits this comment to note the above referenced aspects of the Proposal that would benefit from additional guidance, and to highlight certain interpretive challenges that remain in the Proposal with respect to the foreign finders exception.

If you have any questions or require further information, please contact me at (202) 962-7386 ([kzambrowicz@sifma.org](mailto:kzambrowicz@sifma.org)).

Very truly yours,

A handwritten signature in black ink, appearing to read "K. Zambrowicz", is centered within a light gray rectangular box.

Kevin Zambrowicz  
Associate General Counsel  
& Managing Director

cc: Robert Colby, Chief Legal Officer, FINRA

Evan Charkes, Co-Chair, Compliance & Regulatory Policy Committee, SIFMA

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