June 18, 2018

Via E-Mail to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 18-13 (proposed amendments to the quantitative suitability obligation under FINRA Rule 2111)

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on Notice 18-13 (the "Notice" or the "Proposal").[2] The Proposal would amend the current quantitative suitability obligation under FINRA Rule 2111 to remove the element of control that currently must be proved to demonstrate a violation. We respectfully submit the following comments and recommendations for your consideration.

FINRA should allow the SEC's rulemaking process to run its course before proceeding with its own.

As a threshold matter, FINRA points out that the SEC's proposed Regulation Best Interest – which is currently out for comment until August 7, 2018 – incorporates a prohibition on excessive trading that expressly excludes the control element in FINRA's quantitative suitability rule.[3] Thus,

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] FINRA Regulatory Notice 18-13, available at http://www.finra.org/industry/notices/18-13.

[3] *See* Notice at fn. 4. *See also* Exchange Act Release No. 83062 (Apr. 18, 2018) at p. 150, available at https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

FINRA concludes, the SEC's proposal is consistent with FINRA's proposed amendment.[4]

The better approach would be the reverse. FINRA should allow the SEC proposal to run its course, and then ensure that any subsequent FINRA proposal is consistent with the final SEC rules. If the SEC's final rules eliminate the control element – just as FINRA is proposing here, query whether FINRA would even need its own rule change. And, if the SEC's final rules turn out somewhat differently, then FINRA should consider conforming its rules accordingly. For the foregoing reasons, we respectfully recommend that FINRA set-aside its Proposal pending the completion of the SEC's rulemaking process.

FINRA's investor protection mandate does not extend to facilitating civil recoveries and enforcement actions.

In the Notice, FINRA states that *"[it] has reconsidered the appropriateness of the control element in light of its experience with the rule…."* This is a euphemistic way of saying that FINRA has not been prevailing in its excessive trading cases as frequently as it would like. This interpretation is reinforced as FINRA explains that *"[r]emoving the control element ... would likely increase FINRA's ability to [successfully bring enforcement actions for excessive trading.]"*

It also means that claimants are not prevailing in their private civil claims as often as FINRA would like. FINRA likewise acknowledges that the control element places *"a heavy and unnecessary burden on customers"* and that removing it *"increases the probability of establishing a violation in the presence of less evidence."* Thus, FINRA concludes that the control element is *"an impediment to investor protection."*

We understand and appreciate FINRA's strong interest in regulating conduct and enforcing standards, but we question whether FINRA's investor protection mandate extends to lowering the evidentiary burden for a cause of action in order to facilitate civil claims and enforcement actions. And if it does so extend, then what would prevent FINRA from stopping there? Why not lower the evidentiary burden for every cause of action – not just excessive trading – if investor protection means making it easier for claimants and FINRA to prevail in their lawsuits?

For the foregoing reasons, the Proposal sets an inappropriate and detrimental precedent and we urge FINRA to reconsider it and reverse course on those grounds.

FINRA should preserve the control element because it provides essential due process protections for financial advisors.

Evidentiary burdens exist for a reason. They are part of due process. They ensure the process is fair to *both* parties. In 2010, when FINRA *"codified the line of cases on excessive trading (sometimes referred to as 'churning'),"* it accepted that the control element was part of the burden of proof. Now it seeks to substitute its judgement by fiat for that of the many courts and judges who created the legal precedent in the first place.

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[4] *Id.* at fn. 4.

In the Notice, FINRA states that *"[t]he inclusion of the control element has its historic roots … in the … need to ensure that the culpability for excessive trading rested with the party responsible for* *__initiating__ the transactions…."* (emphasis added). But that is simply not true. It's not just about who "initiated" the transaction.

FINRA's own footnote proves this point. If the customer initiates the transactions, then clearly the financial advisor cannot be liable for overtrading. But if the financial advisor "initiates" (i.e. recommends) the transactions, the standard is different. In that case, the question is *"whether the broker occupied 'such a status with respect to the customer that he may be held responsible for excessive trading in such customer's account.'"*[5] That is essentially a restatement of the control element.

The control element is an essential due process protection for the financial adviser. It ensures that the customer cannot have it both ways, i.e., if the high-volume trading is profitable, then the customer takes the profits and doesn't complain. If, however, the high-volume trading is not, then the customer can force the firm to reimburse the losses under an excessive trading claim. To avoid this outcome, the customer should continue to be held to a standard of showing that the financial advisor controlled the account, and regardless, in order to adequately defend him or herself, the financial advisor should be allowed to introduce evidence of the customer's sophistication, experience, involvement in the investment decisions, and history of rejecting investment recommendations in the past (i.e., prove that the financial advisor did not control the account).

For the foregoing reason, FINRA should preserve the control element of an excessive trading claim. Alternatively, if FINRA strikes the control element, it should at a minimum issue formal guidance acknowledging that financial advisors may introduce, and panels must continue to consider, evidence that the financial advisor did not in fact control the account.

The retention of the "recommendation" requirement does not restore the due process that the Proposal erodes by eliminating the control element.

In the Notice, FINRA essentially states, don't worry if we strike the control element because *"culpability for excessive trading will still rest with the appropriate party"* because *"FINRA must show that the broker __recommended__ the transactions in order to prove a Rule 2111 violation."* (Emphasis supplied). Now it is clear why FINRA seeks to retroactively revise the historical purpose of the control element to make excessive trading liability appear to rest entirely on whomever __initiated__ the transaction.[6]

As discussed above, however, the recommendation is clearly *not* all that matters. Financial advisors should continue to be able to introduce, and hearing panels should be required to consider and weigh, evidence of the customer's sophistication, experience, involvement in the investment decisions, and history of rejecting investment recommendations in the past.

FINRA approvingly cites to the following statement in the SEC's proposed Regulation Best Interest, *"the fact that a customer may have __some__ knowledge of financial markets or __some__ 'control'*

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[5] *See* Notice at fn. 7 and accompanying text.

[6] *Id.*

should not absolve the broker-dealer of its ultimate responsibility to have a reasonable basis for any recommendation that it makes."[7] (Emphasis supplied). We do not disagree and are not suggesting otherwise. But the level of the customer's control matters, and it should continue to be appropriately considered and weighed by adjudicators and regulators.

By the same token, while some knowledge and some control are not dispositive, it should also be the case that the fact that a customer exercised control over the account (by virtue of his or her sophistication, knowledge, exercise of independent judgment, and ultimate control over the decision-making, for example) should not allow the customer to prevail on an excessive trading claim for what was essentially their *own* excessive trading. FINRA guidance should clarify that a broker-dealer has no duty to prevent a customer from engaging in his or her own financial ruin through their own excessive trading.

Thus, the retention of the recommendation requirement does not cure the elimination of the control requirement, particularly where the recommendations are made to a customer who clearly has the sophistication and ability to evaluate those recommendation, and who has a well-established history of asserting final decision-making authority over those recommendations. Even if FINRA ultimately decides to eliminate the control element, control still matters, and FINRA should issue appropriate guidance to recognize a financial advisor's due process right to raise control element issues, as discussed above.

If the control element is eliminated, then hearing and enforcement sanctions should be revised.

If FINRA ultimately decides to strike the control element, then it will be essentially creating a new, lesser offense, with a lower burden of proof, making it easier for customers to prevail in arbitration and for FINRA to prevail in enforcement actions. Churning is a violation of Rule 10b-5 and requires proof of scienter and control, among other things. FINRA's prospective new excessive trading claim would require neither proof of scienter nor control.

If FINRA proceeds, then it would be appropriate for FINRA to concurrently establish new hearing and enforcement sanctions guidelines that recognize this new, far less serious offense. Likewise, FINRA should concurrently ensure that hearing officers receive training on the significant differences in severity between churning, on the one hand, and excessive trading on the other. Finally, FINRA should issue guidance on the statutory disqualification implications for violations of each of these distinct causes of action.

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[7] Exchange Act Release No. 83062 (Apr. 18, 2018) at p. 155, available at https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

If you have any questions or would like to further discuss these issues, please contact the undersigned.

Sincerely,

Kevin M. Carroll
Managing Director and
Associate General Counsel

cc: ***via e-mail to*:**
Robert L.D. Colby, Chief Legal Officer, FINRA
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