sifma

asset management group

May 9, 2022

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

Re: Comments on FINRA Regulatory Notice 22-08

Dear Ms. Mitchell:

The Asset Management Group (the "AMG") of the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide comments to the Financial Industry Regulatory Authority ("FINRA") on FINRA's Regulatory Notice 22-08 concerning complex products.[2] SIFMA AMG's comments will focus only on the questions FINRA asks in Notice 22-08 concerning whether to impose additional regulatory requirements with respect to complex products, not on its summary of FINRA's existing guidance to broker-dealers about recommendations of complex products to their customers, nor on issues relating to FINRA's regulation of options.[3] SIFMA AMG includes a variety of member firms that sponsor, advise or distribute all kinds of investment products, including some products that FINRA in the past has labeled as complex.

Notice 22-08 requests comments on whether FINRA should impose a variety of potential regulatory requirements. For example, it asks whether:

- investors should be required to be "pre-approved" by broker-dealers for transactions in complex products even for self-directed transactions,

[1] SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset management firms whose combined global assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

[2] FINRA Reminds Members of Their Sales Practice Obligations for Complex Products and Options and Solicits Comment on Effective Practices and Rule Enhancements, Regulatory Notice 22-08 (March 8, 2022) (available at https://www.finra.org/sites/default/files/2022-03/Regulatory-Notice-22-08.pdf) ("Notice 22-08").

[3] SIFMA is submitting a separate comment letter on behalf of its membership on the broader issues in Notice 22-08. This comment letter is submitted solely on behalf of SIFMA AMG.

- after this initial approval, investors should be required to be continuously or periodically reapproved by their broker-dealers for transactions in complex products, even in self-directed transactions,

- investors should be required to pass a "knowledge test" before being permitted to trade complex products,

- all communications by broker-dealers concerning complex products be filed with FINRA before first use, and

- complex product transactions should be subject to heightened supervision by broker-dealers, even for self-directed investor transactions.[4]

SIFMA AMG appreciates FINRA's long-standing concern for investor protection. But SIFMA AMG opposes the concept of FINRA limiting investor access to any kind of securities product in the absence of a broker-dealer recommendation of that product. SIFMA AMG urges FINRA not to propose any new regulations of the sort about which Notice 22-08 requests comments. For the reasons discussed below, these proposals are contrary to the disclosure-based principles of the federal securities laws, and appear to lack legal authority. SIFMA AMG is concerned there is neither a factual nor legal basis to adopt the proposals it discusses in Notice 22-08. Such regulations, if adopted, would deprive investors of choice and access to useful investment products, chill product innovation, harm competition, and burden capital formation.

FINRA Lacks a Legal Basis for the Proposals

We do not believe FINRA has legal authority to prevent investors from making their own decisions to access complex products.[5] Congress created the concept of a "national securities association" in the Maloney Act in 1938 because it was concerned that broker-dealers that were then not members of securities exchanges might unfairly take advantage of investors.[6] Congress has revisited the authority of national securities associations multiple times through the years, including in 1964 and 1975, and notably in 1983 when it required that all broker-dealers that do business with the public (even exchange members) become members of a national securities association. But in all of Congress' consideration of FINRA and its predecessor, the statutory focus of the authority of a national securities association has been on the regulation of broker-dealers, *not* on the regulation of decisions by investors themselves. The idea that FINRA can impose substantive restrictions on investors' own decisions to buy securities labeled as "complex" – because the investors do not meet a FINRA-imposed eligibility restriction or cannot pass a FINRA-imposed testing requirement - is beyond what the federal securities laws contemplate or authorize for a national securities association.[7]

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[4] See Notice 22-08 at pages 13-15, questions 6-10.

[5] Notice 22-08 conspicuously lacks any discussion of FINRA's legal authority for imposing substantive limits on investor access to complex products.

[6] FINRA, and its predecessor the National Association of Securities Dealers ("NASD"), is the only national securities association that the SEC has ever approved under Section 15A of the Exchange Act.

[7] Pursuant to Exchange Act Section 15A, a rule filing by a national association must be filed with the SEC for approval, and to approve such a rule filing, the SEC must conclude that it is consistent with and authorized by the federal securities laws. The SEC's decision to approve an SRO rule filing is then subject to judicial review under

The text of Exchange Act Section 15A does not give a national securities association such as FINRA substantive authority to limit investors' own decisions about what securities products in which to invest (nor any other federal securities law). Such an assertion of authority is contrary to the scheme of the federal securities laws, which requires full disclosure but rejects the concept of merit regulation that prevents some investors from having access to some securities at all. As SEC Chair Gary Gensler explained just last week:

> Going back to the 1930s, we have a disclosure-based regime, not a merit-based one. The core bargain is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures.[8]

As FINRA's own former Chairman and CEO observed in connection with the regulation of complex products in 2012:

> Some countries have implemented a form of merit regulation, in which they prohibit certain speculative products from reaching the retail market. This approach would be a significant departure from the product disclosure model on which the federal securities laws are based.[9]

Or as the U.S. Supreme Court has stated about the federal securities laws: "Disclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress."[10] Here, FINRA is requesting comments on concepts that are contrary to the overall disclosure-based policy scheme of the federal securities laws, without any statutory authority to do so.

Neither FINRA nor its predecessor have ever previously asserted authority to limit investor access to whole classes of securities products (a fact which suggests that the authority does not exist). Exchange Act Section 15A(b)(6) sets forth the permissible subjects for rulemaking by a national securities association, and they are traditional subjects such as preventing fraudulent and manipulative acts and practices, processing information with respect to, and facilitating transactions in securities, removing impediments to a free and open market, and preventing unfair discrimination or fixing of fees and commissions. While the Exchange Act grants rulemaking authority to FINRA, it also imposes clear limits on that rulemaking authority. In the words of the legislative report to what became 1975 Act Amendments:

> The purposes to be served by self-regulatory rules would be expressed affirmatively and negatively (what the rules must be, and what they may not be, designed to accomplish).... [A] self-regulatory organization's rules must not be designed …. to regulate matters not

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Exchange Act Section 19. *See Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995) (discussing challenge to MSRB rule filing). SIFMA regularly participates in challenges to SRO rules as being contrary to the Exchange Act. *See, e.g.*, *Intercontinental Exchange Inc. v. SEC*, No. 20-1470 (D.C. Cir., Jan. 21, 2022) (upholding SEC decision not to approve SRO rules, based in significant part on comment letter from and amicus brief filed by SIFMA).

[8] *See* SEC Chair Gary Gensler, A Century with a Gold Standard, (May 6, 2022) (available at https://www.sec.gov/news/speech/gensler-acfmr-20220506?utm_medium=email&utm_source=govdelivery); *see also id.* (describing the 1933 and 1934 Acts: "A number of principles informed these statutes…. First, a basic faith that investors could make decisions if there was full, fair, and truthful disclosure"). *Cf.* SEC Chair Gary Gensler, Building Upon a Long Tradition - Remarks before the Ceres Investor Briefing (April 12, 2022) ("[w]e have a disclosure-based regime, not a merit-based one") (available at https://www.sec.gov/news/speech/gensler-remarks-ceres-investor-briefing-041222).

[9] Richard Ketchum, Chairman and CEO, FINRA, Remarks from the SIFMA Complex Products Forum (Sept 27, 2012) (https://www.finra.org/media-center/speeches-testimony/remarks-sifma-complex-products-forum-0).

[10] *Basic, Inc. v. Levinson*, 485 U.S. 224, 234 (1988).

> related to the purpose of this title or the administration of the exchange, or to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[11]

Nothing in Section 15A or any other provision of the federal securities laws permits FINRA to regulate investors' own decisions about what securities in which to invest. Nor does FINRA have any authority to regulate products appropriately registered with the SEC (or products properly exempt from registration) or investment advisers and investment companies directly regulated by the SEC. In the absence of an explicit statutory grant, the concepts about which FINRA requests comment simply are beyond its statutory authority.

We acknowledge FINRA long has had authority to regulate broker-dealer conduct that is inconsistent with just and equitable principles of trade (current FINRA Rule 2010). This "just and equitable principles" authority allows FINRA to regulate broker-dealers' recommendations to customers (current FINRA Rule 2111) and broker-dealer marketing communications with customers (current FINRA Rule 2210), as FINRA and its predecessor also long have done. But nothing in the text or structure of the Exchange Act grants FINRA any authority to regulate the substantive decisions of investors themselves. The concepts about which FINRA requests comment here go well beyond broker-dealer recommendations and communications to regulating investors' own self-directed trading decisions. Simply giving an investor access to trade a product is not the sort of broker-dealer "conduct" that could be inconsistent with just and equitable principles.[12] Here, FINRA is requesting comment on regulating substantive investor conduct, and that is just not a subject over which the federal securities laws give FINRA authority.

Complex products generally are issued by registrants subject to SEC registration and ongoing reporting under the Securities Act of 1933,[13] and in many cases complex products constitute investment companies that are subject to SEC registration and oversight under the Investment Company Act of 1940. Exchange-listed complex products must meet extensive initial and ongoing listing requirements implemented by the securities exchanges, all of which are subject to SEC approval and oversight.[14] Further, complex products typically are managed by investment advisers subject to a comprehensive SEC regulatory scheme under the Investment Adviser Act of 1940. None of these statutory schemes grant FINRA a role for substantive oversight of who is permitted to trade complex products. Following the SEC study of oversight of investment advisers pursuant to Section 914 of the Dodd-Frank Act, FINRA

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[11] National Securities Market Reform Act of 1974, Report of the Committee on Banking, Housing and Urban Affairs, U.S. Senate, Report No. 93-865 at 24 (93rd Cong., 2d Sess.) (May 22, 1974).

[12] Indeed, although no broker-dealer has an obligation to offer any particular product, once the broker-dealer does offer a product, generally the broker-dealer has a best execution obligation to execute a customer's order for that product promptly, correctly and in full – not to prevent the customer from placing the order. See FINRA Rule 5310.

[13] Certain complex products may be offered to investors through private placements, because the Securities Act and the SEC in its implementing regulations have determined that private placements (generally only available to accredited investors) support the public interest in capital formation and competition. FINRA has no warrant to upset the statutory and SEC determinations to permit private placements.

[14] Note 5 to Notice 22-08 observes that certain SIFMA AMG members have supported an exchange-traded product ("ETP") classification system; other SIFMA AMG members do not support that proposal. However, nothing in the proposed ETP classification program supports a role for FINRA to impose substantive limits on investor access to ETPs; nor do we believe FINRA would have legal authority to adopt an ETP classification program, for many of the reasons discussed above.

suggested it be granted oversight authority over "certain" or "retail" registered investment advisers.[15] But Congress rejected this request and FINRA withdrew its support.[16] FINRA's suggestion that it be permitted to impose substantive regulation on complex products and who can trade them is contrary to the scheme of the federal securities laws and beyond FINRA's jurisdiction as specified in the Exchange Act.[17] In sum, the questions in Notice 22-08 suggest an attempt to obtain "back-door" regulatory authority over products and entities that the federal securities laws consciously do not grant to FINRA.

The only authority for substantive limits on investor access to securities cited in Notice 22-08 is with respect to options. FINRA Rule 2360 requires broker-dealers to establish investor eligibility requirements for different types of option trading, as do comparable rules adopted by the options exchanges. These rules require broker-dealers to limit the availability of at least some complex options strategies to at least some investors, even on a self-directed basis. However, FINRA and the options exchanges adopted these options eligibility rules in response to a clear legislative mandate. Congress passed the 1975 Act Amendments to the federal securities laws just as options exchanges were beginning to trade (and cross-list) standardized options, and in conjunction with the launch of centralized clearing of options through the Options Clearing Corporation. The 1975 Act Amendments directed the SEC to study and report to Congress concerning the options markets, and in response, in 1978 the SEC delivered to Congress the Special Study of the Options Markets.[18] The Special Study endorsed, and after hearings Congress determined to accept, the current SRO regulatory scheme for options trading oversight, in significant part due to systemic risk concerns about the potential impact of options trading on the financial markets as a whole. Section 9(b) of the Exchange Act (first adopted in 1982 for options and since expanded to include securities futures and securities-based swaps) grants the SEC specific authority to regulate options.[19] Options are a unique case. There is no similar statutory or historical authority for FINRA to regulate substantively investor trading of complex products beyond options. The options rules, because of their unique statutory background and history, do not provide authority for FINRA to limit investor access to other types of securities products.

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[15] *See* FINRA Statement on Introduction of Investment Adviser Oversight Act of 2012 (April 25, 2012) (https://www.finra.org/media-center/news-releases/2012/finra-statement-introduction-investment-adviser-oversight-act-2012).

[16] *See* FINRA Drops Bid to be SRO for Registered Investment Advisors, For Now (Feb. 13, 2013) (https://www.corecls.com/blog/finra-drops-bid-to-be-sro-for-registered-investment-advisors-for-now/).

[17] We also observe that granting FINRA authority to regulate who can invest in complex products through broker-dealers would be ineffective because it would not cover purchases of exactly the same products through registered investment advisers or through banks engaging in permissible securities activities under Regulation R. FINRA's authority also would not extend to sales equity indexed annuities or similar complex insurance products sold through insurance brokers subject only to state insurance regulation. Nor would FINRA's regulation cover complex products such as commodity futures subject to CFTC regulation, or spot commodities (such as foreign exchange, precious metals or many cryptocurrencies) subject to CFTC anti-fraud authority.

[18] See House Committee on Interstate and Foreign Commerce, Report of the Special Study of the Options Markets to the Securities and Exchange Commission (96th Cong., 1st Sess.) (Dec. 22, 1978) (available at https://ufdc.ufl.edu/AA00023995/00001/images/2).

[19] Congress is fully capable of specifying agency authority to limit investor access to a financial product, as it did in the definition of an "eligible contract participant" who can purchase a swaps contract, in Section 1a(18) of the Commodity Exchange Act. The fact that there is no parallel grant of authority to FINRA in the Exchange Act indicates that FINRA does not have similar authority.

For the reasons set forth above, there is no explicit or implicit statutory authority for the types of merit-based substantive regulation limiting investor choice about which FINRA seeks comment here. Where "decisions of vast 'economic and political significance'" are concerned, the statute must "speak clearly" to authorize the agency's action. *Utility Air Regulatory Group v. EPA*, 134 S. Ct. 2427, 2444 (2014) (*quoting FDA v. Brown & Williamson Tobacco Corp*., 529 U.S. 120, 133 (2000)).[20] Further, FINRA's expertise and authority concerns the activities of broker-dealers, not those of investors nor securities issuers, investment companies and investment advisers. The need for the statute to contain a clear grant of statutory authority is "especially" important where the agency "has no expertise" in the matter. *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015). In short, if FINRA believes it should be given the ability to regulate the substantive decisions of investors, and thereby also to regulate the activities of securities issuers, investment companies and investment advisers, it should request explicit statutory authority to do so – it lacks that authority today.

FINRA Has Not Defined What Is a Complex Product

Beyond FINRA's lack of substantive authority, FINRA's description of "complex" products suffers from fatal flaws. Notice 22-08 does not define what constitutes a complex product, and indicates that FINRA does not plan to provide any definition. Historically, the FINRA staff at various times has provided a long list of products it considered potentially complex,[21] and it is not clear to us what is the unifying theme or principle for these products. But in any event, FINRA's "I know it when I see it" approach[22] to defining (or in this case, not defining) what is a complex product simply does not work. Investors need to have fair notice, in advance, of the products for which they must pre-qualify or pre-test. Investors cannot be in the position of finding out, when there is a market event requiring prompt response, that they are not permitted to make a trade they desire to protect their portfolios.

Moreover, broker-dealers need to know which products they can and cannot offer to investors, under what circumstances. And product sponsors and advisers need to know whether their new products would be subject to the substantive complex product restrictions. Under an "I know it when I see it" standard lacking a clear definition, the inevitable result would be that different broker-dealers would apply different standards. This result would create inconsistency, investor confusion, and competitive pressure towards a lowest common denominator. The lack of a clear definition would chill the offering of

[20] *Cf. Whitman v. American Trucking Assns. Inc*., 531 U.S. 437, 468 (2001) ("Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions— it does not, one might say, hide elephants in mouseholes").

[21] Among the products FINRA has, at various times, indicated it considered "complex" are interval funds, closed-end funds, global real estate funds, opportunistic, tactical, multi-strategy funds, target date funds, high yield bond funds, unconstrained bond funds, floating-rate loan funds, leveraged loan funds, defined outcome funds, absolute return funds, start-up company funds, funds investing in unlisted securities, distressed debt funds, emerging market funds, funds using derivatives for hedging or leverage, funds selling short, funds using cryptocurrency futures, investment trusts investing in cryptocurrency, geared funds, volatility-linked funds, commodity funds, currency funds, exchange-traded notes, principal protected notes, market-linked CDs, structured notes, variable annuities, asset-backed securities, funds of hedge funds, non-traded REITs, business development companies, reverse convertible notes, range accrual notes, nontraditional index funds (smart beta, quant, custom index or ESG), insurance-linked securities, and most recently liquid alternative funds.

[22] *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (concerning the Court's inability to provide a workable definition of "obscenity" – a standard widely derided and subsequently abandoned by the Court).

new, innovative and beneficial products, including products with low correlations to U.S. equity markets that therefore provide investors with valuable portfolio diversification and hedging opportunities.

If FINRA were to impose new substantive restrictions on investors buying or selling particular types of products, then FINRA should give investors notice and an opportunity to comment on exactly what the definition is of a "complex" product, and exactly what products it believes meet that definition. Then, before FINRA deems any new product or class of products "complex", FINRA must give investors notice and opportunity to comment on whether that new product is in fact complex and whether it should be subject to the complex product restrictions. Imposing such a substantive restriction on investor access to a new product type is a rule change that must be submitted to the SEC for approval under Section 15A of the Exchange Act.

If FINRA's concern is investor protection, we are not even sure that "complexity" or "investor understanding" is the correct rubric to use. A retail money market mutual fund (targeting a stable $1/share net asset value) is relatively complex in terms of how it calculates its NAV and yield, what it is permitted to invest in, who is eligible to purchase it, the possibility of swing pricing, redemption gates and liquidity fees, and the various regulatory restrictions on the fund's management. But no one would suggest that an investor should have to take a test or meet a qualification requirement before buying a money market mutual fund. Or, even more tellingly, an equity security (which FINRA has never suggested is a "complex" product) actually can be quite complex, requiring an informed investor to evaluate the issuer's revenues, expenses, assets, liabilities, suppliers, customers, competitive market position, balance sheet and capital structure. FINRA requires research analysts to pass two famously difficult exams (the Series 86 and 87) before expressing opinions about equity securities. But FINRA does not appear to view equity securities (even those not listed on any exchange) as being "complex". The lack of a definition for "complex products" suggests a lack of clarity about what FINRA actually means by "complex", and when or why complexity is a valid regulatory concern in the first place.

In addition, we respectfully suggest that one-size-fits-all regulation of complex products does not make sense. A variable annuity or variable life insurance policy with many choices about insurance riders and nuances about tax treatment, surrender charges and conversion features is "complex" in a completely different way from (for example) a non-traded REIT investing in a particular real estate asset class. An investor test relevant to (for example) variable annuities would be almost entirely irrelevant to other types of "complex" products.[23] A single up-or-down designation of a product as "complex" is burdensome and chilling without providing any meaningful investor protection. Designating some products as "complex" may give investors a false sense of security when investing in other securities (such as unlisted equity securities) that in fact pose significant risks to investors. Further, delegating to broker-dealers the assessment of investor sophistication will be subjective and inevitably will lead to arbitrary results.[24]

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[23] We also observe that FINRA restrictions on investments in variable annuities and variable life would have no effect on investments in equity indexed annuities, which, although nearly equivalent from an economic perspective, are not required to be sold through broker-dealers. The restrictions about which FINRA requests comment would simply serve to put securities-regulated products at a competitive disadvantage to pure insurance products without providing any meaningful increase in investor protection.

[24] Allowing broker-dealers to make subjective decisions about who is sufficiently "sophisticated" and "experienced" to make their own investment decisions also has the potential to encourage invidious (if sometimes unconscious) bias against historically under-served populations, such as women, minority, immigrant and first-generation

FINRA Does Not Have a Sufficient Factual Basis for the Proposals

In addition, we do not believe that FINRA has established a factual basis that would justify imposing substantive limits on investors' ability to decide when and whether to purchase complex products. The Notice makes no effort to measure investor understanding of complex products as compared to other products in order to quantify the scope of the problem (if any) or why features of complex products may be harder to understand than the features of other products. FINRA's examples in Notice 22-08 of "problems" with complex products all relate to broker-dealer recommendations of complex products (or in a few cases inadequate disclosure by issuers of the products). These examples say little or nothing about investor understanding of such products. FINRA already has full authority to oversee broker-dealers' recommendations of complex products, and the SEC has authority over issuer disclosure practices. FINRA has not provided any factual justification for preventing self-directed customers from accessing complex products – it is a solution in search of a problem.[25]

Notice 22-08 lacks any economic analysis of any kind to support limits on investors' self-directed trading. Before FINRA proceeds with an actual proposal, FINRA's Office of the Chief Economist should quantify the supposed investor harm from having access to complex products, as well as the investor harm from denying or delaying some investors' access to those products (as well as the cost to broker-dealers and product sponsors of implementing FINRA's proposal). By putting "speed-bumps" and substantive limitations on investors' ability to make their own decisions to buy products, FINRA would prevent investors from the ability to hedge their portfolios quickly when market conditions change. FINRA also should analyze the effects on competition of substantive limits on investor access to complex products, as discussed below.

We observe that many broker-dealers, because of Regulation Best Interest and related initiatives, already have significantly limited their "shelf" of products that can be recommended to investors. The effect of FINRA's concepts would be require all broker-dealers to review all of the products they current make available to determine if they are "complex" and if so, which investors should be permitted to invest in them. The likely result would be that many broker-dealers would severely limit product availability, at least until they can complete this process. Some broker-dealers may stop making available some (or even all) complex products permanently that they now offer to investors. Going forward, the effect of FINRA's concepts would require all broker-dealers to delay the availability of any *new* products until the broker-dealers can review those products through their new product committees and determine if they are "complex" and if so, which investors should be permitted to invest in them. In many cases, resource

investors. Cf. FINRA Regulatory Notice 21-17 (April 29, 2021) (seeking comment on barriers to greater diversity and inclusion in the securities industry).

[25] Notice 22-08 cites certain foreign regulations concerning complex products as potential precedents. We have several responses. First, the U.S. securities markets are the most liquid, deep and innovative in the world; it is far from obvious why U.S. regulators should copy regulations from less successful markets. Second, some of those foreign regulatory schemes explicitly impose merit-based regulation of securities, contrary to the clear policy decisions of Congress expressed in the U.S. securities laws, and thus are not relevant precedents here. Third, all of those foreign regulations appear to be imposed by national or (in the case of Canada) provincial governmental regulators akin to the SEC; none are imposed by SROs analogous to FINRA. Fourth, FINRA has not analyzed those foreign regulatory schemes in their totality; cherry-picking particular regulations or guidance provides little insight into the effectiveness or desirability of those regulatory schemes. Last, most of the foreign regulations cited by FINRA appear to involve limits on broker-dealer recommendations or marketing; it is not clear that they support the type of substantive restrictions on investors suggested in Notice 22-08, nor do they provide any insight concerning the Exchange Act legal authority issues discussed above.

constraints may cause some broker-dealers not to approve some new products at all (or only to do so long after they have been introduced). The net effect will be to chill new product innovation, protect entrenched incumbent products and companies, and discourage competition. These consequences will harm investors by limiting their product choices. Deterring new product innovation will harm capital formation and market liquidity by preventing capital from flowing from those new products to the underlying issuers in which they invest.

A blanket designation of products as complex, and subject to pre-approval or testing, is inconsistent with FINRA's historical practice for products such as CMOs, direct participation programs, and variable annuities. In those cases, FINRA has taken more targeted approaches to products it deemed to present unusual or new risks, and it has done so on a product-type-by-product-type basis. FINRA has not presented any justification for departing from its historical practice of using such a targeted, product-by-product approach. Nor has FINRA presented any justification for departing from the regulatory approach it has taken for each of those products, which focuses on FINRA Advertising Regulation review of broker-dealer marketing materials for those products, and broker-dealers' recommendations of those products – an approach within FINRA's traditional authority. It would be arbitrary and capricious for FINRA to abandon without explanation or justification its historical approach to regulation of new types of securities products.[26] We also observe that existing FINRA rules about broker-dealer marketing and recommendations do not support the type of substantive restrictions on investors suggested in Notice 22-08, nor do they provide any insight concerning the Exchange Act legal authority issues discussed above.

Exchange Act Section 3(f) requires that all SRO rule proposals, including those from FINRA, promote investor protection, competition and capital formation. Nothing in Section 3(f) indicates or suggests that the Act was meant to protect investors from themselves. It is not clear that restricting investors' own choices is a valid "investor protection" interest for the purposes of Section 3(f) at all. And as set forth above, whatever interest is served by protecting investors from themselves is outweighed by the harm from preventing investors from making time-sensitive decisions in fast-moving markets to protect and diversify their portfolios. But further, for the reasons discussed above, as a factual matter the harms to efficiency, competition and capital formation from the proposals in Notice 22-08 would substantially outweigh any speculative, uncertain and entirely unquantified benefits to investor protection. For this reason as well, the concepts on which FINRA requests comment are inconsistent with the statutory standards to which FINRA rule proposals must comply.

[26] Notice 22-08 asks whether FINRA should require that all broker-dealer marketing materials for all complex products be filed with FINRA. First, as discussed above, this proposal suffers from the flaw that FINRA has not defined complex products, so broker-dealers and product sponsors would not know what products would be subject to this filing requirement. Second, we believe this proposal is burdensome and overbroad, and will serve to discourage some broker-dealers from offering some complex products at all. FINRA should follow its historical precedents and consider on a product-type-by-product-type basis whether advertising review filing is appropriate, and FINRA should give the public the opportunity to comment on this filing requirement on a product-type-by-product-type basis. Similarly, FINRA has not explained what "heightened supervision" would mean in the context of self-directed trading of complex products: "heightened supervision" is a concept that relates to the activities of broker-dealer registered representatives, not the conduct of investors themselves.

Conclusion

For all of the reasons discussed above, SIFMA AMG respectfully suggests that (1) FINRA lacks statutory authority to impose limits on investor access to complex products, (2) FINRA has failed to define what constitutes a complex product or give market participants a fair opportunity to comment on what products should be deemed complex, (3) FINRA has not established a sufficient factual basis for these access limits, and (4) such limits would have the potential to harm investors and be contrary to the statutorily mandated interests of investor protection, capital formation and promotion of competition. Therefore, we urge FINRA not to proceed with the concepts about which Notice 22-08 seeks comment. We would be happy to discuss our concerns about the concepts set forth in Notice 22-08 with you further. Please feel free to reach out to me at (202) 962-7312 or lkeljo@sifma.org. Thank you for the opportunity to comment on this matter.

Sincerely,

Lindsey Weber Keljo, Esq.
Head – Asset Management Group

cc: W. Hardy Callcott, Sidley Austin LLP