November 5, 2014

By Electronic Mail to rule-comments@sec.gov

Brent J. Fields
Secretary, Securities and Exchange Commission
100 F Street, NE

Re: File No. SR–FINRA–2014–037; Release No. 34–73210
Comments to Notice of Filing of Proposed Rule Change
Relating to Payments to Unregistered Persons

Dear Mr. Fields:

This comment letter is submitted on behalf of the Federal Regulation of Securities Committee (the "*Committee*" or "*we*") of the Business Law Section (the "*Section*") of the American Bar Association (the "*ABA*"), in response to the request for comment by the U.S. Securities and Exchange Commission (the "*Commission*") in the above-referenced Notice of Filing of a Proposed Rule Change, Release No. 34-73210, published in the Federal Register on October 1, 2014 (the "*Release*").[1] The Release contains the proposal by the Financial Industry Regulatory Authority ("*FINRA*") to adopt (among other things) 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*"). The FINRA's stated purpose in proposing these and related regulatory modifications is to consolidate and codify certain existing rules and interpretations of the NASD and NYSE, and to create a general prohibition on transaction-based payments to persons that are not registered as broker-dealers with the Commission, but would be as a consequence of such payments.

[1] 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), 79 Fed. Reg. 59322 (Oct. 1, 2014), available at http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p600987.pdf.

This letter was prepared by members of the Committee's Trading and Markets Subcommittee. While this letter represents the views of the Committee, this letter has not been reviewed or approved by the ABA's House of Delegates or Board of Governors. Accordingly, this letter does not represent the official position of either the ABA or the Section.

Overview

We commend and support FINRA's efforts to clarify and consolidate the guidance applicable to the payment of transaction-based compensation to unregistered persons. FINRA's holistic approach is particularly welcome in light of the recognition that this has been an area of recent regulatory, examination[2] and enforcement[3] emphasis at FINRA. Our comments and recommendations focus primarily on those areas of the proposed rules that we believe require further clarification, so that they may be implemented by FINRA members in a consistent manner.

Discussion and Analysis

FINRA Rule 2040(a) – Payments to Unregistered Persons

The Release seeks to adopt proposed new FINRA Rule 2040(a), which would prohibit FINRA member firms and their associated persons from, directly or indirectly, paying any compensation, fees, concessions, discounts, commissions or other allowances to any person that is not registered with the Commission as a broker-dealer but, by reason of receipt of any such payments and the activities related thereto, would be required to register with the Commission pursuant to Section 15(a) of the Securities and Exchange Act of 1934 (the "*Exchange Act*"). Proposed Rule 2040 also prohibits payments to appropriately registered associated persons unless such payments comply with applicable federal securities laws (including Exchange Act rules and regulations) and FINRA rules.

In applying Proposed Rule 2040 (if adopted as proposed), FINRA will expect member firms to determine that the contemplated activities would not require the recipient of the payments to register as a broker-dealer with the Commission, and to have a reasonable basis to support such determination.

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[2] *See, e.g.*, 2012 Regulatory and Examination Priorities Letter, (January 31, 2012), available at http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p125492.pdf.
[3] *See, e.g.*, Bulltick Securities, LLC AWC No. 2009015969501. (Dec. 13, 2011); Monex Securities, Inc., AWC No. 2008014078801 (April 26, 2011).

Member firms may 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;
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> (2) seeking a no-action letter from the Commission staff; or
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> (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area.[4]

The member's determination must be "*reasonable under the circumstances*" and should be "*reviewed periodically*" if payments to the unregistered person are ongoing in nature.

Comment:

We urge FINRA to provide greater flexibility in the range of measures on which a member firm may rely on to "reasonably support" its determination. In particular, we note that the third prong cited above provides for a "legal opinion" from independent and reputable U.S. licensed counsel. We believe this standard, at least when viewed in isolation, would be unduly restrictive because the analysis necessary to make a determination regarding broker-dealer registration is highly fact-intensive. In many cases, it may not be appropriate for a law firm to deliver a formal legal opinion on the subject. Nonetheless, a member firm may reasonably reach a determination in this regard based on advice from knowledgeable outside counsel. Therefore, we urge FINRA to amend Proposed Rule 2040(a)(3) to provide that a member firm support its determination based on "advice of knowledgeable outside counsel." The advice of counsel may be documented in a variety of forms, as appropriate under the given circumstances. In this regard, we also urge FINRA to make clear that the enumerated bases for determining that the necessary "reasonable support" exists are not exclusive, and that there may be additional ways in which a member firm might be able to satisfy itself that it has the requisite support for its determination.

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[4] *See* 79 Fed. Reg. at 59323-24.

FINRA Rule 2040(b) – Payments to Retiring Representatives

FINRA also proposes to adopt new FINRA Rule 2040(b), which permits member firms to pay continuing commissions to retiring registered representatives of the member firm, after they cease to be associated with the member, that are derived from accounts held for continuing customers regardless of whether customer funds or securities are added to the accounts during the period of retirement; provided that:

(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 including relevant Exchange Act rules and regulations.

Comment:

We applaud FINRA's proposed creation of a concise regulatory framework regarding the payment of continuing commissions to retiring registered representatives by member firms. In our view, the proposed rule effectively consolidates existing guidance.

FINRA Rule 2040(c) – Payments to Foreign Finders

With the adoption of Proposed Rule 2040(c), FINRA would transfer existing 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*") into the Consolidated FINRA Rulebook. 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. FINRA noted its intention to transfer those rules with only minor technical changes.

We commend FINRA for highlighting the important policy goals that underlie these rules, but note our concern that Proposed Rule 2040(c) may be read to modify certain existing interpretations of permissible arrangements.

Comment:

Global Competitiveness: The Release notes the important policy goals underlying existing guidance related to payments to unregistered persons, which include enhancing the competitive position of firms registered in the United States. In citing to the SEC Foreign Finders Approval Order in the Release, FINRA states that,

> [existing guidance] was intended to give members the opportunity to enhance their competitive position in foreign countries where new accounts are frequently opened on a referral basis with ongoing compensation for such referral.

Accordingly, Proposed Rule 2040 should continue to be mindful of the competitive position of member firms and the global product demands of customers around the world. This goal is also consistent with the principle of investor protection. Indeed, as the Commission has recognized:

> [T]he use of a U.S. broker-dealer to enter the U.S. securities markets provides protection to the U.S. markets. Moreover, the staff believes that, in contrast to the more expansive scope of the antifraud provisions the U.S. broker-dealer registration requirements were not intended to protect foreign persons dealing with foreign securities professionals outside the United States. Rather, the primary responsibility for protecting foreign investors from wrongful conduct of foreign securities professionals properly lies with foreign securities regulators.[5]

We suggest some refinements to the proposed rule that would advance FINRA's policy objectives without imposing undue or unnecessary restraints on competition.

Foreign Finder is Not a "Person Associated with a Member": In the Release, FINRA states that it is proposing non-substantive, technical changes to the proposed rule text to make it easier to read. We are concerned, however, that

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[5] *Registration Requirements for Foreign Broker-Dealers*, Release No. 34-27017 (July 11, 1989); 54 FR 30013 (July 18, 1989).

the new rule (if adopted as proposed) may not fully incorporate existing guidance and may be subject to misinterpretation.

In particular, by moving this provision, which is currently contained in NASD Rule 1060(b), to new FINRA Rule 2040, FINRA appears to be changing the character of this provision from a registration "safe harbor" to a prescriptive rule that sets forth the only permissible basis on which transaction-based compensation may be paid to a foreign finder. Specifically, the Release notes that Rule 2040(c) permits compensation when the foreign finder's sole involvement would be the initial referral to a member. As a result, 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)."

We believe the inclusion of the word "*sole*" is unnecessarily restrictive and could lead to inconsistent and anti-competitive results. For example, if the foreign finder wishing to make a referral to a member was a non-U.S. broker-dealer, bank or investment adviser (whether or not affiliated with the member) that had a separate and continuing relationship with the referred customer as permitted under applicable non-U.S. law, Proposed Rule 2040(c) could lead the member firm to conclude that the payment of a referral fee would not be permissible, which may discourage the non-U.S. firm from making the initial referral. Or, in the alternative, the member firm could conclude that it must register the non-U.S. firm's involved personnel as associated persons of the member if it pays referral fees or other transaction-based compensation and the non-U.S. firm continues to provide services to the referred customer or has any other involvement with the referred accounts (including as permitted under its own local law) after the initial referral.[6] Indeed, other FINRA statements appear to express this view.[7] However, this would not be consistent with FINRA's registration rules, which only require the registration of those considered

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[6] It is not uncommon for a non-U.S. firm to refer a customer to a U.S. broker-dealer so that the customer can directly access the U.S. securities markets, while still maintaining a relationship with the customer for the purpose of executing non-U.S. securities transactions and/or advising the customer on all or a portion of its investment portfolio (including investments made through the U.S. broker-dealer). As proposed, this rule could be read to prohibit such ongoing activities, which we believe are consistent with existing guidance.

[7] *See* FINRA Examination Priorities Letter, January 31, 2013, available at http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p125492.pdf (stating that finders "whose activities go beyond an initial referral of non-U.S. customers to the firm and who are involved in the servicing of non-U.S. customer accounts . . . [are] required to be registered as [] Foreign Associate[s]."

"persons associated with a member" as defined in FINRA's By-Laws. Under the By-Laws, only those persons who are "engaged in the investment banking or securities business who [are] directly or indirectly controlling or controlled by a member" are considered associated persons. Absent a foreign finder being "engaged in the investment banking or securities business of the member" and "controlling or controlled by the member," no registration as an associated person of the member is required.

As noted later in the Release, activities that are "otherwise permitted by the federal securities laws or FINRA rules," should remain within the permissible scope of the foreign finders exception. Therefore, we suggest the proposed language be clarified in accordance with existing guidance to reflect that the compensation payment will be permitted so long as the activities of the foreign finder are otherwise permitted. In addition, the rule should make clear that the foreign finder can continue to maintain brokerage, banking, advisory and/or other relationships with referred accounts if such services are provided pursuant to applicable local non-U.S. law.

Permit Foreign Finders to be Foreign U.S. Citizens and to Deal with Foreign U.S. Citizens: The Release states, as a condition to reliance on the foreign finders exemption, that the finder not be a U.S. citizen and the customers be "foreign nationals (not U.S. citizens)." We believe that such a requirement imposes an undue burden on FINRA members. Rather, the residency of customers provides a brighter and more enforceable line for all concerned. The Commission has recognized residency as a better policy guide for the proper application of the broker-dealer registration requirements,[8] except in very limited circumstances.[9]

Accordingly, we recommend that the text of the proposed rule be modified to reflect that both the finder and the customers must be non-U.S. residents.

Conclusion

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[8] As the Commission noted in the Rule 15a-6 Adopting Release: "Most U.S. citizens residing abroad typically would not expect, in choosing to deal with foreign broker-dealers, that these foreign broker-dealers would be subject to U.S. registration requirements. Nor would foreign broker-dealers soliciting U.S. citizens resident abroad expect that they would be covered by U.S. broker-dealer requirements, since they generally would not be directing their sales efforts toward U.S. nationals." *Registration Requirements for Foreign Broker-Dealers*, 54 FR at 30017.

[9] The Commission historically has taken the view that foreign broker-dealers that specifically target identifiable groups of U.S. persons resident abroad; *e.g.*, U.S. military and embassy personnel, could be subject to broker-dealer registration.

In closing, we appreciate the opportunity to comment on the Release, which we consider an important step in the right direction. We hope that the comments and recommendations set forth above will assist FINRA and the Commission in improving upon the very constructive proposals in the Release. We are available to meet and discuss these matters with members of FINRA and Commission staff, and to respond to any questions you may have.

Very truly yours,

/s/ Catherine T. Dixon

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Catherine T. Dixon, Chair
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