

VIA ELECTRONIC MAIL

October 24, 2014

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

Re: Release No. 34-73238; File No. SR-FINRA-2014-38

Dear Mr. Fields,

On September 18, 2014 the Financial Industry Regulatory Authority (FINRA) filed a proposed rule change (Proposed Rule) to adopt NASD Rule 3010 (Qualifications Investigated) relating to background investigations as FINRA 3110(e) (Responsibility of Member to Investigate Applicants for Registration) in the consolidated FINRA Rulebook. The rule change would retain and clarify existing requirements and add a provision to require members to adopt written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant's Form U4. It would also require a firm's written procedures to, at a minimum, provide for a search of reasonably available public records to verify the accuracy and completeness of the information contained in an applicant's Form U4. This Proposed Rule is occurring alongside FINRA's one-time search of specific financial public records, including bankruptcies, judgments, and liens, on all registered persons. FINRA is also proposing to add Supplementary Material .15 (Temporary Program to Address Underreported Form U4 Information), a temporary program that will issue a refund of Late Disclosure Fees to members for late filings of unsatisfied judgments if 1) the U4 amendments are filed between April 24, 2014 and March 31, 2015; 2) the judgment or lien is under \$5,000 and more than five years old; and 3) the registered person was not employed by or otherwise associated with the firm filing the amended Form U4 on the date the judgment or lien was filed with the court.

The Financial Services Institute¹ (FSI) appreciates the opportunity to comment on this important proposal. FSI supports the Proposed Rule's changes with respect to written procedures that are reasonably designed to verify the accuracy and completeness of the information contained in an applicant's Form U4. As FINRA notes in its filing, many firms are already meeting or exceeding these expectations under the current regulatory regime. These changes clarify existing requirements and rule language which will enhance firms' compliance programs. Regarding FINRA's proposed one-time search of financial public records, further clarification would be

¹ The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 100 broker-dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 37,000 financial advisor members.

helpful. In addition, FSI suggests some adjustments to the criteria outlined by FINRA to qualify for temporary reimbursement. We expand on these points below and provide suggestions for addressing these issues.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64 percent of all practicing registered representatives – operate in the IBD channel.² These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.³ Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

² Cerulli Associates at <http://www.cerulli.com/>.

³ These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisers.

Comments

FSI's members are committed to ensuring that investors receive meaningful information necessary to make informed decisions with respect to their investments and the professionals with whom they choose to work. FSI members seek to ensure that the industry is held to high standards of professional quality and that the bad actors are forced out. To that end, most firms are already implementing background checks that meet or exceed the new requirements under the Proposed Rule.

I. The language on Form U4 is confusing with respect to unreported satisfied liens

Question 14M on Form U4 asks whether "a registered person has any unsatisfied judgments or liens against him or her." This question is not entirely clear. For example, it is not uncommon that a person will be unaware that they are subject to a lien. Once a registered person becomes aware of an unsatisfied lien they may then satisfy the lien within a few days. Under FINRA rules, registered persons have 30 days to file Form U4 amendments. However if he or she satisfied the lien within 30 days, one could argue that the firm would not have to file an amended U4 to mark Question 14M as "yes," because the lien is satisfied. In addition, if a firm hires a representative and upon performing a background check discovers that there was a lien that was satisfied but unreported, the current language of the instructions in the Form U4 Disclosure Reporting Procedures does not provide for a reporting or amending process. The U4 language only asks for amendments in instances where the liens are currently unsatisfied. The result is that firms who have performed background checks on registered representatives and discover unreported but satisfied liens would not be following the instructions on Question 14M of Form U4 if they were to answer the question as "yes."

FSI recommends that FINRA issue specific guidance on this issue and commit to clarifying existing language. To that end, FSI suggests FINRA consider the following language should FINRA choose to amend the language in Question 14M: "Do you have any unsatisfied, or previously satisfied but unreported liens against you?" Absent additional clarity with respect to Question 14M, this question regarding unreported but previously satisfied judgments or liens will continue.

II. FSI appreciates FINRA'S flexibility and willingness to provide reimbursement and recommends adjustments to the criteria

FINRA has determined that firms will be reimbursed for reporting previously unreported satisfied judgments or liens if three very specific conditions are met: 1) the U4 amendments are filed between April 24, 2014 and March 31, 2015; 2) the judgment or lien is under \$5,000 and more than five years old; and 3) the registered person was not employed by or otherwise associated with the firm filing the amended Form U4 on the date the judgment or lien was filed with the court. It is unclear from the proposed rule how FINRA formulated these conditions. We suggest FINRA make some adjustments to this approach.

Under the currently proposed conditions, firms would not be issued reimbursements for unreported but previously satisfied liens. For example, a financial advisor who, 15 years prior and while with the same broker-dealer, did not report a \$200 lien because it was satisfied in three days, would not meet the conditions for reimbursement. Because of the ambiguity in Question 14M with regard to reporting previously satisfied but unreported judgment or liens, FSI suggests that, instead, FINRA provide reimbursements for previously satisfied but unreported judgments or liens in the

following circumstances: the judgment or lien 1) occurred while the representative was registered with a prior firm; or 2) is more than five years old; or 3) is under \$5,000. As a result of these changes, denial of reimbursements would take place in circumstances where investors did not receive information necessary to make informed decisions with respect to their investments and the professionals with whom they choose to work. This would also ensure that firms without adequate procedures to verify the accuracy and completeness of the information contained in an applicant's Form U4 do not receive reimbursement. FSI also suggests that FINRA provide more details regarding whether the reimbursement will be automated or whether the burden will be on firms to prove that they satisfy the requirements to receive reimbursement.

FSI also identified an additional concern regarding this proposed approach to reimbursements. Prior to interpretative guidance published by FINRA in 2012,⁴ adequate guidance did not exist with respect to the treatment of short sales under Question 14K as a creditor compromise. Credit compromises require the filing of an amended U4. FINRA clarified that short sales under certain conditions are a creditor compromise and therefore reportable, which creates a situation where firms would now be fined for these instances but not qualify for reimbursement. FSI suggests FINRA provide clarification that firms will not be issued fines in these instances due to recently issued guidance with regard to treatment of short sales for Form U4.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with FINRA and the SEC on this and other important regulatory efforts.

Thank you for your consideration of our comments. Should you have any questions, please contact me at [REDACTED].

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" and a stylized "Bellaire".

David T. Bellaire, Esq.
Executive Vice President & General Counsel

⁴ See Form U4 and U5 Interpretive Questions and Answers, available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p119944.pdf>.