FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

April 27, 2016

Brent J. Fields
Secretary
U.S. Securities & Exchange SEC
100 F Street, NE
Washington, DC 20549

Re: **SR-FINRA-2015-056: Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Adopt FINRA Rule 2030 and FINRA Rule 4580 to Establish "Pay-To-Play" and Related Rules**

Dear Mr. Fields:

On March 29, 2016, the Securities and Exchange Commission (SEC) published an Order to Institute Proceedings (Order) on the Financial Industry Regulatory Authority's (FINRA) proposal to establish pay-to-play rules for broker-dealers that engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers (Proposed Rule)[1]. FINRA states the Proposed Rule is modeled after the SEC's Pay-to-Play Rule 206(4)-5 under the Investment Advisers Act of 1940, which applies to investment advisers. The SEC Pay-to-Play Rule prohibits an investment adviser and its covered associates from providing payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser. Similar to the SEC Pay-to-Play rule, the FINRA Proposal mandates a "two-year time out" on engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser after the firm or one of its covered associates makes a contribution to an official of the government entity.

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on the SEC's Order. We support regulatory efforts to combat pay-to-play corruption activity. Nevertheless, we believe that both the SEC Pay-to-Play Rule and the Proposed Rule create compliance uncertainties for our members and we have provided comments outlining our concerns to both FINRA and the SEC[3]. As we have stated in our prior comments, we believe that practices that

[1] 80 Fed. Reg. 81650 (Dec. 30, 2015) and 81 Fed. Reg. 19260 (April 4, 2016)

[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[3] See FSI comment letter to FINRA dated December 15, 2014 here: http://www.finra.org/sites/default/files/notice_comment_file_ref/Financial%20Services%20Institute%20-%20Comments%20on%20Regulatory%20Notice%2014-37.pdf and FSI comment letter to SEC dated January 20, 2015 here: https://www.sec.gov/comments/sr-finra-2015-056/finra2015056-3.pdf.

carry little risk of quid pro quo corruption nevertheless are deemed to require compliance with the Proposed Rule. We respectfully request further clarification and changes to the Proposed Rule to ensure that participant-directed government-sponsored retirement plans maintain access to the array of financial products that are so critical to ensuring public sector workers can save for a dignified retirement. Most importantly, we continue to have concerns that the SEC Pay-to-Play Rule and the Proposed Rule attempting to achieve a compelling governmental interest in a far too broad and over restrictive manner that serve to chill the political speech of our members in contravention of their First Amendment rights.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors 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. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

Discussion

FINRA initially requested comments on the Proposed Rule in Regulatory Notice 14-50[4]. As a result of public comments received in response to Regulatory Notice 14-50, FINRA revised the Proposed Rule and its associated recordkeeping requirements. FINRA then filed the Proposed Rule with the SEC. The SEC received comments on the Proposal, including those from FSI. As noted in the Order, "on March 28, 2016, FINRA filed a letter with the SEC stating that it has considered the comments received by the SEC, and that FINRA is not intending to make changes to the proposed rule text in response to the comments."[5]

We continue to have concerns with the application of the rule to activities beyond those intended to be covered by the SEC Pay-to-Play Rule. More importantly we remain convinced that the SEC Pay-to-Play Rule and the Proposed Rule improperly chill the political speech of both IBD firms who offer their services to governmental entities and those who may one day do so. We detail our specific concerns below.

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[4] FINRA Requests Comment on a Proposal to Establish a 'Pay-to-Play' Rule, FINRA Regulatory Notice 14-50, (Nov. 14, 2014), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/14-50.pdf.

[5] See Letter from Victoria Crane, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated Mar. 28, 2016 available at https://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-056-response-to-comments.pdf.

I. Sales of Covered Investment Pools

We continue to have concerns with the apparent application of the rule to traditional brokerage sales of mutual funds and variable annuities to participant-directed government-sponsored retirement plans and assert that mutual fund and variable annuity sales should be excluded[6]. FINRA has reiterated that the Proposed Rule is intended to apply to distribution activities concerning registered pooled investment vehicles if they are an investment option of a participant-directed government-sponsored retirement plan. Proposed Rule 2030(d) states that the distribution or solicitation activities by a broker-dealer on behalf of a covered investment pool are to be treated as though the broker-dealer was engaging in distribution or solicitation activities on behalf of the investment adviser to the covered investment pool[7]. The Proposed Rule further states that an investment adviser to a covered investment pool in which a government entity invests shall be treated as though the investment adviser were providing investment advisory services to the government entity[8]. We continue to be concerned that the Proposed rule solely addresses the relationship between an investment adviser and a broker-dealer and serves to redefine the sale of securities, the hallmark of broker-dealer activity, as solicitation on behalf of an investment adviser. As we stated previously, such a categorical re-characterization of brokerage activities deserves ample debate and consideration. It should not be promulgated in the context of a narrow rule specifically addressing pay-to-play activities.

II. Application of Pay-to-Play Rules to the Independent Business Model and Impact on Political Speech

We continue to be very concerned with the difficulties our members have faced in attempting to comply with the SEC Pay-to-Play Rule, which is premised on the notion that solicitation of clients is performed pursuant to a centralized process controlled by the management of a Registered Investment Adviser (RIA). As outlined in our previous comments, independent financial advisors are not employees of a broker-dealer or RIA, but rather are independent contractors. While the broker-dealer or RIA provides transaction execution services and performs supervisory and oversight functions, the firms do not dictate the business decisions of individual financial advisors. Additionally, independent financial advisors may not even be aware of the other advisors in their immediate region that are also affiliated with their firm, let alone those advisors working and soliciting in other counties or states. As such, this business model poses little risk of the corruptive coordination that a pay-to-play rule is designed to prevent. We believe that the SEC Pay-to-Play Rule has inadvertently captured non-corrupting activity. We fear that the Proposed Rule may do the same.

As outlined in our prior comments, financial advisors affiliated with our members may provide advisory or brokerage services to government entities, typically defined benefit or defined contribution plans managing the retirement investments of state or municipal employees. Because these advisors pursue business independently, absent coordination with the home office, our member firms have faced difficulties in developing a compliance regime and have been forced to create blanket restrictions on advisors and employees contributing to political

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[6] See Letter from David T. Bellaire, Esq., Executive Vice President & General Counsel, FSI to Marcia E. Asquith, Corporate Secretary, FINRA (Dec. 15, 2014), *available at* http://www.finra.org/sites/default/files/notice_comment_file_ref/Financial%20Services%20Institute%20-%20Comments%20on%20Regulatory%20Notice%2014-37.pdf.

[7] Proposed FINRA Rule 2030(d)(1).

[8] Proposed FINRA Rule 2030(d)(2).

candidates above the de minimus levels. Again, we assert that the independent business model poses very little risk of the coordinated corruption that pay-to-play rules are intended to prohibit.

Supporters of the SEC Pay-to-Play Rule and the Proposed Rule often claim that such rules do not prohibit political speech, rather they limit the business activities of financial services firms who offer services to municipalities and other local governmental entities. However, our members' experience does not support this argument. Many of our member firms do not currently offer their services to state and local governmental entities. Nevertheless, they implement pay-to-play compliance policies, procedures, and supervision efforts because they may one day have an affiliated financial advisor who wishes to offer their services to such an entity. Since the firm will only learn of this interest upon receiving a new account form for the governmental entity, there is no means of anticipating such an eventuality. Therefore, our members find there is no effective means of operating their business while allowing their financial advisors to participate in the political process. As a result, they severely limit the political contributions of their financial advisors. Thus the pay-to-play rules act to chill the political speech not only of firms who offer services to local government entities, but also those who simply wish to avoid foreclosing such opportunities in the future. As a result, we believe the SEC Pay-to-Play Rule and the Proposed Rule are overbroad and there are less restrictive means to achieve the compelling governmental interest at stake.

Conclusion

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

Thank you for considering FSI's comments. Should you have any questions, please contact me at [redacted].

Respectfully submitted,

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