PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION
2415 A Wilcox Drive | Norman, OK 73069
Toll Free (888) 621-7484 | Fax (405) 360-2063
www.piaba.org

July 5, 2016

Robert W. Errett, Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
rule-comments@sec.gov

Re: *SR-FINRA-2016-018 - Proposed Rule Changes for FINRA Rules 2210, 2213, and 2214 Regarding Communications with the Public*

Dear Mr. Errett:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority ("FINRA") to govern the conduct of securities firms and their representatives. In particular, our members and their clients have a strong interest in FINRA rules relating to the information provided to investors.

Pursuant to Regulatory Notice 15-16, in 2015, FINRA sought comment regarding changes to Rules 2210, 2213, and 2214 regarding communications with the public. PIABA opposed these rules changes in 2015. Despite the numerous issues highlighted in our previous letter, FINRA has refused to consider the harmful implications that these rule changes will have on investor protection.

As detailed below, PIABA opposes these rule proposals, as they relax FINRA's regulatory oversight and would likely serve to harm investors.

New Firm Communications

FINRA rules currently require that, for a period of one year from the effective date of a new FINRA member firm's membership, all new firms file with FINRA "any retail communication that is published or used in any electronic or other public media . . ." at least 10 business days prior to the first use of communication. FINRA is proposing to drop this requirement and instead require that new members file retail communications within 10 business days of first use. FINRA's justification for the change is that the current rule predates the Internet and FINRA believes that member firms primarily reach customers and potential customers through the firms' websites. FINRA also believes that the long-standing requirement of filing retail communications 10 business days before using them "unnecessarily delays firms' abilities to communicate with the public" and there is no benefit to investors that cannot be accomplished by FINRA's post-use review of communications.

FINRA claims that the changes it is proposing are the result of a "retrospective review" of its rules regarding communications with the public that it launched in April 2014, the results of which were published by FINRA in a December 2014 report. The report found that the rules "could benefit from some updating to better align the investor protection benefits and the economic impacts." FINRA further claims that the rule amendments will result in significant cost savings that "may" encourage members to communicate additional information to investors.

Rather than "aligning the investor protections benefits" with "the economic impacts" (or anything else for that matter), FINRA's proposed rule changes eliminate the pro-active investor protection the current rule affords customers. If the proposed rule goes into effect, new FINRA member firms would not have to obtain any FINRA pre-approval for common retail communications such as those in newspapers, magazines, or other periodicals and/or those on the radio, television, telephone or audio recording, video display, signs or billboards or motion pictures.

Of course, as FINRA well knows, not every customer or potential customer uses the Internet as the primary source of information about financial advisors, brokerage firms or investments. Indeed, the "National Senior Investor Initiative" report that was released in April 2015, by the SEC and FINRA illustrates the different forms of communications that reach and are relied on by one growing segment of investors – seniors. The report contains the observations from examinations conducted by the SEC Office of Compliance Inspections and Examinations and FINRA as part of their "collaborative effort" to determine and report on issues pertinent to "senior investors" (age 65 and older).

In the "Marketing and Communications" section of the report, the SEC and FINRA observed that firms promoted senior-related investment themes "through various channels such as **brochures, print and electronic advertisement, newspaper columns, radio and television commercials, and seminars**."[1] Yet, under the proposed rule changes, FINRA will not review and approve any such communications prior to them going to senior investors. Moreover, with regard to certain communications (radio shows and seminars), the SEC and FINRA examinations revealed potential rule violations such as misleading advertisements and failure to properly supervise the content of the shows, as well as the potential failure to comply with a firm's written supervisory procedures for seminar materials.[2]

"Post-use" review of all retail communications by FINRA will not provide adequate investor protection for customers who lose their life savings after investing with an unknown start-up firm's broker featuring flashy television or radio ads or a fancy seminar presentation. Further, it is not clear that FINRA can effectively regulate advertising on a post-use basis. For example, according to the large defense firm, Sutherland Asbill & Brennan LLP ("Sutherland"), FINRA disciplinary actions in 2013 reflected a troubling enforcement trend – an "incredible

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[1]*See* http://www.sec.gov/ocie/reportspubs/sec-finra-national-senior-investor-initiative-report.pdf, p. 13(last visited on June 20, 2016) (emphasis added).
[2]*Id*. at 13-15.

slowdown in the amount of fines imposed in advertising cases."[3] This stood out to Sutherland because advertising had been on its "Top Enforcement Issues" list in 2010-2012 (based on the amounts of fines assessed), and yet in 2013, there was a seventy-three percent (73%) decrease in the total fines assessed in advertising cases (even though there were 53 cases in 2013 and only 50 in 2012).[4] Although advertising returned to Sutherland's "Top Enforcement Issues" list for FINRA disciplinary actions in 2014, there were only 31 advertising disciplinary cases.[5] It simply does not seem to be in the investing public's interest to rely on FINRA to effectively regulate retail communications only after-the-fact.

Further, requiring pre-approval for retail communications is worth the cost to members, because it provides a deterrent effect to potential bad actors. Permitting post-use filing may embolden risky retail communications from members, who may feel they can rely on "market adjustments" to explain away their advertising efforts.

In SR-FINRA-2016-018, FINRA acknowledged that "a higher percentage of new members' communications require revisions to be compliant with applicable standards as compared with all communications filed with FINRA." *See* SR-FINRA-2016-018, pg. 25. Accordingly, FINRA deems it necessary that only public media communications still be pre-approved, but this is a clear indication that minimal cost savings should not outweigh the need for investor protection at the advertising level.

In light of the importance of the existing retail communication rules, and the real potential for greater harm to investors without those rules, FINRA should not eliminate the need for pre-use oversight of all but one form of retail communication. FINRA has not provided sufficient evidence that brokerage firms will save enough money if they are not required to file for pre-use approval of retail communications to outweigh the resulting harm to investors who could have been protected by the current rule. Further, if it is too much of a financial burden on a new firm to comply with existing industry rules related to pre-use approval of communications with the public, then perhaps that firm should not be in the brokerage industry at this time.

Investment Company Shareholder Reports

FINRA currently requires firms to file the manager's discussion of fund performance ("MDFP") portion of a registered investment company's shareholder report if it to be made available or distributed to potential investors. FINRA has required the filing of MDFPs and treated them like any other retail communication even though shareholder reports are also required to be filed with the SEC. FINRA is proposing to specifically exclude MDFPs from the filing requirements of the retail communications rules if the shareholder's report containing the MDFP has been filed with the SEC. FINRA's rationale for this proposed rule change seems to be that the MDFP "presents less investor risk than other types of promotional communications" and excluding MDFPs would be consistent with the fact that FINRA has previously excluded other similar types of documents from the filing requirements.

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[3] *See* http://www.sutherland.com/NewsCommentary/Press-Releases/161244/Annual-Sutherland-Analysis-of-FINRA-Sanctions-Shows-27-Decrease-in-Fines-Number-of-Cases-Nearly-Identical. Sutherland generally only includes in its review those cases that resulted in fines of $200,000 or more.

[4] *Id*.

[5] *See* http://www.sutherland.com/NewsCommentary/Press-Releases/170501/Annual-Sutherland-Analysis-of-FINRA-Sanctions-Reveals-Blockbuster-Year-in-Fines-for-FINRA-but-Decrease-in-the-Number-of-Cases. Sutherland did note that the large increase in amounts fined in 2014 (to $17.2 million) was largely attributable to a $15 million research analyst and research report case which included allegations related to improper promotions at IPO road shows. *Id*.

In order for the proposed rule to offer any investor protection whatsoever, FINRA has to assume that the SEC adequately reviews regulatory filings when they are received and that the SEC will bring improper retail communications to FINRA's attention. The problem with these assumptions is that the SEC does not fully review all regulatory filings made on the EDGAR system, which is where such filings would be made.

On May 28, 2015, Reuters reported that the SEC "does not fact check or make corrections to filings," which makes sense if the SEC receives approximately 4,000 filings per day.[6] The Reuters article was prompted by a letter that Senator Charles Grassley, from Iowa, sent to the SEC about his concern with a "systemic vulnerability" exposed with the EDGAR system when a fraudster was able to use the EDGAR site to file documents that reflected a phony takeover bid for Avon Products Inc.[7]

FINRA's attempt to pass responsibility off to the SEC is unacceptable under these circumstances. Given that the SEC receives an estimated 4,000 filings per day and can't review that many, FINRA's estimate that the new rule would result in a decrease of 5,000 filings per year makes no appreciable difference in the SEC's workload. The best solution would be for FINRA to do its job and review the filings before publication.

FINRA acknowledged that "while the SEC may not review all securities-related filings contemporaneous with their submission, the staff can review higher risk communications as needed." *See* SR-FINRA-2016-018, pgs. 26-27. This comment confirms FINRA's intent to shift its review obligations to the SEC's limited staff and resources. To be sure, the rule proposal does nothing to aid investor protection, FINRA's overarching stated goal.

Filing Exclusion for Templates

Under the current rules, firms are not required to file retail communications that were previously filed with FINRA but changed only to update recent statistical or non-narrative information. FINRA proposes to expand this exemption and allow firms to include "non-predictive" narrative descriptions of market events covered by the communication without needing to re-file the template.

PIABA opposes this proposal, as FINRA should be reviewing any narrative descriptions included in retail communications for misleading information. Often, firms may blame decreases in NAVs on "market events" or other occurrences, although that is not necessarily accurate in some circumstances. One example is FINRA's investigation of the Morgan Keegan proprietary bond funds in 2010. According to FINRA's press release announcing the investigation, FINRA alleged that:

Morgan Keegan became aware, beginning in early 2007, of the adverse market effects on the bond funds, the firm failed to timely warn its brokers or revise its advertising materials to reflect the disproportionately adverse effect the market was having on the performance of the securities that comprised the bond funds – which Morgan Keegan brokers continued to sell widely. At this time, the firm reassured, rather than warned, its sales force about the riskiness of the bond funds. As a result, some of the firm's brokers were unaware of the then-turbulent market's effects on the funds and failed to disclose the negative effects caused by market forces.

[6] *See* http://www.reuters.com/article/2015/05/28/senate-sec-avon-prdcts-idUSL1N0YJ21G20150528.
[7] *Id*.

See https://www.finra.org/newsroom/2010/finra-files-complaint-against-morgan-keegan-company-misleading-customers-regarding (last visited June 20, 2016). Other examples include the following:

a) FINRA fined Fidelity $375,000 in September 2012 for, among other things, using misleading materials its mutual funds marketing that "failed to accurately portray the negative impact of the sub-prime crisis on the value of the fund's portfolio investments and shares"[8];
b) FINRA fined Nuveen Investments $3 million in May 2011 for a failure to revise disclosures in its auction rate securities brochures about material changes in the auction rate markets in January 2008[9].

These examples show that any misleading narratives regarding the market condition could subject investors to further harm, and FINRA should be closely monitoring these narratives made in retail communications.

In response to PIABA's previous comments about this issue, FINRA simply argues that such narratives have "rarely generated comments from the staff and generally has been low-risk in nature." FINRA's flippant attitude towards this problem is disconcerting. FINRA seems content to allow this loophole to expand, despite its awareness of the existence of this on-going problem.

Bond Fund Volatility Ratings

Under FINRA's current rules, firms may use retail communications that include ratings provided by independent third parties that address the sensitivity of the bond fund's net asset value to changes in market conditions. These communications must be accompanied or preceded by the bond fund's prospectus and contain specific disclosures. Firms must file these communications with FINRA at least 10 days prior to use. The proposed rule seeks to modify the rule, requiring the filing of such communications *within* 10 days of first use, rather than 10 days *prior* to use. The proposed rule also eliminates the requirement that the rating must be accompanied or preceded by the prospectus.

In the interests of the investing public, FINRA should not enact these proposed rule modifications. There have been numerous bond fund scandals and regulatory investigations brought by FINRA and other regulators in the last five years, demonstrating that bond funds should be more highly regulated:

a) Morgan Keegan paid $200 million to settle with FINRA and several state regulators in June 2011 regarding claims on its proprietary bond funds;
b) Charles Schwab paid $18 million to settle with FINRA in January 2011 regarding claims on the YieldPlus Fund;
c) Oppenheimer paid $35 million to settle with the SEC in June 2012 regarding claims on the Champion Income Fund and Core Bond Fund;
d) In the Fall of 2015, UBS agreed to pay $34 million to settle claims with the SEC and FINRA, and Santander Securities agreed to pay $6.4 million to FINRA, related to each firm's sales of Puerto Rico bond funds;
e) In June 2012, the Attorney General of New York and the Massachusetts Attorney General began investigations into Citigroup's MAT, ASTA, and Falcon funds, which were municipal arbitrage bond funds.

8. See https://www.finra.org/sites/default/files/DisciplinaryAction/p169615_0.pdf, at 5-6 (last visited June 20, 2016).
9. See https://www.finra.org/newsroom/2011/finra-fines-nuveen-3-million-use-misleading-marketing-materials-concerning-auction (last visited June 20, 2016).

As demonstrated from these numerous investigations, it is important for FINRA to increase its regulation over bond funds and any communications directed to public investors regarding bond funds or their volatility. Instead of trying to increase its regulation, FINRA ignored our previous concerns and wants to scale back its regulation to the detriment of investors.

In sum, PIABA opposes the implementation of these rule proposals, which are a step backwards in protecting investors. Thank you for the opportunity to comment.

Sincerely,

Hugh Berkson