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March 5, 2013

Via Email Only
pubcom@finra.org

Marcia Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 13-02—Disclosure of Conflicts of Interest Relating to Recruitment Compensation Practices

Dear Ms. Asquith:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"). PIABA is a 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. Our members and their clients have a strong interest in FINRA rules relating to both investor protection and disclosure.

FINRA believes that public investors would benefit from being informed of enhanced compensation being paid to a registered representative to change firms so that investors are made aware of the material conflicts of interest created by that compensation. Accordingly, FINRA seeks comment on a proposed rule that would require specific disclosure by the recruiting member firm of the financial incentives a representative receives as part of his or her relationship with the new firm.

PIABA supports the proposed rule. Enhanced compensation creates potential (if not actual), material conflicts of interest by incentivizing conduct harmful to customers, including churning of accounts, recommending unsuitable investment products, or otherwise engaging in activity that generates commission revenue but is not in investors' interests. See SEC Chairman M. Schapiro, Open Letter to Broker-Dealer CEOs (Aug. 31, 2009).

In light of the risks posed by these material conflicts, PIABA believes that disclosure of enhanced compensation is necessary to permit investors to weigh a representative's solicitation to switch firms or recommendation to purchase investment services or products against the representative's economic self-interest.

Public Investors Arbitration Bar Association
2415 A Wilcox Drive Norman, OK 73069 Phone: (405) 360-8776 Fax: (405) 360-2063
Toll Free: (888) 621-7484 Website: *www.PIABA.org* Email: *piaba@piaba.org*

Consistent with FINRA's reasoning, PIABA believes that the proposed rule should be broadened to also require disclosure of such incentives to all of the registered person's new customers with the recruiting firm. A recently-recruited registered person will feel the same need to justify enhanced compensation in transactions with new customers as he or she would with a transferring customer. Indeed, that pressure may be greater with new customers, who otherwise lack a preexisting relationship with the registered person.

Moreover, enhanced compensation based on post-recruitment production does not differentiate between new and transferring customers. Enhanced compensation is ordinarily calculated on 12 month's trailing production at the old firm, taking into account the registered person's book of business and years of service. However, FINRA correctly observes that some enhanced compensation packages are made contingent on the registered person's production at the new firm. Under those circumstances, new and transferring customers face the same exposure to the conflict of interest created by enhanced compensation. Accordingly, PIABA believes that FINRA should adopt a broader rule requiring disclosure of enhanced compensation to new and transferring customers alike.

PIABA believes that the first individualized contact with the customer about the enhanced compensation should be in writing. Enhanced compensation packages may be very detailed. An oral disclosure creates the risk of incomplete disclosure, would be difficult to monitor, and could lead to possible misunderstanding by the customer that would not always be cured by a later writing. Furthermore, if the writing is not required until the transfer documentation is provided to the customer, it could easily be overlooked. A universal written disclosure protects investors, members, and representatives alike.

In addition, the proposed rule's one-year time limit for disclosure may be too narrow. FINRA notes that some firms calculate enhanced compensation based on current production. Consistent with the proposed rule's purposes, PIABA believes that registered persons should disclose enhanced compensation for so long as he or she receives it.

The proposed rule contains a *de minimus* exception that would not require disclosure of enhanced compensation less than \$50,000. The proposed rule's purpose is to protect investors from a registered person's conflicts of interest, including the pressure felt by the associated person to justify the new firm's investment. Since transition assistance amounts to an out-of-pocket cost to the member, the pressure felt by a registered person to justify such an expense remains. PIABA believes that for recruiting compensation to be classified as *de minimus*, the amount should be lowered from \$50,000 to \$25,000.

Finally, PIABA notes that the proposed rule is consistent with existing federal and state law, which may require disclosure under the circumstances identified by Regulatory Notice 13-02. Bonus commissions are generally considered material to a reasonable investor's investment decisions. <u>See</u>, <u>e.g.</u>, <u>Press v. Quick & Reilly</u>, 218 F.3d 121, 130 (2d Cir. 2000) (extra commissions represent a

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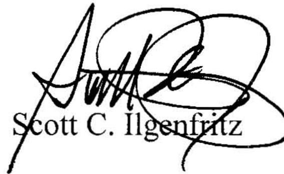
"conflict of interest" that is "material"); Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230, 242 (2d Cir. 1985) ("Commissions that defendants receive on the CDs they sell to the public are relevant and must be disclosed."). Representative persons who assume fiduciary obligations toward customers must disclose all facts material to that relationship. See, e.g., United States v. Laurienti, 611 F.3d 530, 540 (9th Cir. 2010); United States v. Skelly, 442 F.3d 94, 97-98 (2d Cir. 2006). Even in the absence of fiduciary obligations, a registered person may be exposed to securities antifraud liability if his or her failure to disclose bonus commissions makes other statements by the registered person materially misleading. Laurienti, 611 F.3d at 541; Chasins v. Smith, Barney & Co., 438 F.2d 1167, 1172 (2d Cir. 1970) ("Failure to inform the customer fully of its possible conflict of interest, in that it was a market maker in the securities which it strongly recommended for purchase by [plaintiff], was an omission of material fact in violation of Rule 10b-5.").

PIABA supports FINRA's efforts to educate investors as to the risks posed by the conflicts of interest arising from enhanced compensation and recruiting practices. We appreciate the opportunity to comment on the proposed rule and look forward to commenting on a final rule.

Sincerely,



Scott C. Ilgenfritz

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