Fisher Phillips

FAQ's on FINRA's Broker Compensation Proposal

Insights
4.01.14

On March 10, 2014, FINRA filed proposed Rule 2243 with the SEC. The proposed rule would require firms and registered reps to disclose certain financial incentives offered to reps in connection with a change in employment and would require firms to report information concerning the same subject to FINRA. I spoke about the proposed rule this morning at SIFMA's C&L Annual Seminar in Orlando. Following are the most frequently asked questions concerning the proposed Rule.

What does the proposed rule require?
The rule basically has two components: a customer disclosure component and a FINRA reporting component. Firms and reps will be required to disclose to customers if the rep is receiving more than $100,000 in enhanced compensation in connection with a change in employment. They must also disclose the basis upon which the enhanced comp was or will be computed (e.g., trailing 12, AUM, production hurdles, etc.). Finally, they must disclose whether transferring will cause the customer to incur any costs and whether any of the customer's assets are not transferable. As far as reporting to FINRA is concerned, firms must report to FINRA upon hiring or associating with a rep if they believe the rep's compensation during the first year of employment will result in an increase over the rep's comp from the prior year by the greater of 25% or $100,000.

What types of "enhanced compensation" are covered by the rule?
Almost everything. Upfront payments; backend deals; forgivable loans; deferred cash bonuses; stock and stock option awards; tansition assistance; and more.

Copyright © 2024 Fisher Phillips LLP. All Rights Reserved.

When and how must disclosure be made?
Disclosure must be made at the time of the first "individualized contact" with the client. If that first contact is oral, the disclosure must be made orally and followed up in writing within ten business days. If the first contact is in writing, disclosure must be made in writing. Although FINRA has provided an acceptable sample form on which disclosures may be made, firms are free to create their own writing so long as it is substantially similar to FINRA's and the disclosure is clear and prominent. Reps don't have to disclose the exact amount of their comp package, but they do need to disclose if they fall within certain pre-specified ranges ($100K-$500K; $500K to $1 million; $1 million to $2 million; $2 million to $5 million; and over $5 million).

What if the customer is the one who calls the rep?
The disclosure must still be made. FINRA says disclosure is required at the time of the first individualized contact if the firm or rep has engaged in any action to induce former customers to transfer. According to FINRA, if a firm or rep makes a general announcement such as a tombstone advertisement or advertises on a billboard, this would be considered as an attempt to induce former customers to move their assets and the disclosure requirement would be triggered. In fact, if a former customer decides to transfer assets to the recruiting firm without individualized contact, the proposed rule would require the recruiting firm to provide the disclosures to the customers along with the account transfer approval documentation.

Why is FINRA proposing this rule?
Two reasons, basically. FINRA believes disclosure is always a good thing. It also wants to gather more information for possible future examinations or rulemakings.

With regard to FINRA's rationale that disclosure is in the best interest of the customer, FINRA says it believes that former customers currently are not receiving important information from firms and reps when they are induced to move assets to the recruiting firm. FINRA believes customers need to consider a number of factors when making a decision to transfer. These include, among other things, a representative's motives to move firms, whether those motives align with the interests and objectives of the former customer, and any costs, fees, or product portability issues that will arise as a result of an asset transfer to the recruiting firm. FINRA says that requiring disclosure of the basis for recruitment compensation will allow customers to review their account activity during the relevant time to see if any unusual activity occurred to boost the representative's revenue base in anticipation of a move.

As for possible examinations or rulemaking, FINRA says the reporting requirement will enable it to "assess the impact of [compensation] arrangements on a member's and representative's obligations to customers and detect potential sales practices abuses." FINRA openly says that it intends to use the reported compensation information as a data point in its risk-based examination program because it believes this data will help FINRA examiners target exams where concerns appear. It also openly reports that "such data would inform any future rulemaking to require firms to manage conflicts arising from specific compensation arrangements." Finally, FINRA says the data also will help it identify whether conflicts of interest arise from particular levels or structures of increased

Copyright © 2024 Fisher Phillips LLP. All Rights Reserved.

help it identify whether conflicts of interest arise from particular levels or structures of increased compensation and whether it results in customer harm that is not adequately addressed by current FINRA rules.

Is training required?

Yes. FINRA says firms are responsible for developing compliance policies, training and tracking for the proposed rule. Given FINRA's expansive powers to conduct investigations under Rule 8210, and considering FINRA's expressed intention to review and analyze the data reported by firms, firms would be well advised to get a head start in thinking about how they intend to implement this rule if it is passed.

Can reps provide background details when making disclosures?

Sometimes reps receive enhanced compensation to compensate for money left on the table when they leave their prior firm. FINRA says that allowing firms and reps an opportunity to provide context regarding the disclosures should alleviate concerns that the disclosures will be confusing or imply bad faith on the part of the rep. Consequently, FINRA's sample disclosure form provides a space within which reps can include optional comments.

What impact will this have on departing broker litigation?

If this rule is enacted, it will most certainly be the subject of litigation when reps leave non-protocol firms. It is not hard to imagine reps bound by non-solicitation agreements arguing that they called their former customers because they "had a regulatory obligation to do so." Former employers will undoubtedly point out that nothing in the rule requires a rep to initiate contact with former customers, and the express terms of the rule only require disclosure if the rep makes an attempt to induce a customer to transfer. There is no doubt -- this rule will be examined in many departing broker cases.

Michael R. Greco is a partner in the Employee Defection & Trade Secrets Practice Group at Fisher Phillips. To receive notice of future blog posts either follow Michael R. Greco on Twitter or on LinkedIn or subscribe to this blog's RSS feed.

Related People

Copyright © 2024 Fisher Phillips LLP. All Rights Reserved.

Michael R. Greco
Regional Managing Partner
303.218.3655
Email

Copyright © 2024 Fisher Phillips LLP. All Rights Reserved.