

Recruitment Practices

SEC Approves Rule Requiring Delivery of an Educational Communication to Customers of a Transferring Representative

Effective Date: November 11, 2016

Summary

The SEC approved the adoption of FINRA Rule 2273 (Educational Communication Related to Recruitment Practices and Account Transfers), which establishes an obligation to deliver an educational communication in connection with firm recruitment practices and account transfers.¹ The rule becomes effective November 11, 2016.

The rule text is available in Attachment A. The educational communication is available as Attachment B.

Questions regarding this *Notice* should be directed to:

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Background and Discussion

Representatives who leave their firms often contact former customers and emphasize the benefits the former customers would experience by transferring their assets to the firm that recruited the registered representative (recruiting firm) and maintaining their relationship with the representative. In this situation, the former customer's confidence in and prior experience with the representative may be one of the customer's most important considerations in determining whether to transfer assets to the recruiting firm. However, former customers may not be aware of other important factors to consider in making a decision whether to transfer assets

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Notice Type

- ▶ New Rule

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

Key Topics

- ▶ Conflicts of Interest
- ▶ Customer Account Transfers
- ▶ Disclosure

Referenced Rules & Notices

- ▶ FINRA Rule 2273
- ▶ FINRA Rule 4512

to the recruiting firm, including direct costs that the customer may incur. Therefore, to provide former customers with a more complete picture of the potential implications of a decision to transfer assets, Rule 2273 requires delivery of a FINRA-created educational communication by the recruiting firm that highlights key considerations for former customers in transferring assets to the recruiting firm, and the direct and indirect impacts of such a transfer on those assets.

Scope of New Rule

Educational Communication

The rule requires a firm that hires or associates with a registered representative to provide to a former customer of the representative, individually, in paper or electronic form, an educational communication prepared by FINRA.² The rule requires delivery of the educational communication when:

- ▶ the firm, directly or through a representative, individually contacts a former customer of that representative to transfer assets; or
- ▶ a former customer of the representative, absent individual contact, transfers assets to an account assigned, or to be assigned, to the representative at the firm.³

To facilitate uniform communication under the rule and to minimize the burden on firms in providing the communication to former customers of a representative, the rule requires firms to provide the FINRA-created communication, in paper or electronic form, and does not permit firms to use an alternative format.

The educational communication focuses on important considerations for a former customer who is contemplating transferring assets to an account assigned to his or her former representative at the recruiting firm. The educational communication highlights the following potential implications of transferring assets to the recruiting firm:

- ▶ whether financial incentives the representative receives may create a conflict of interest;
- ▶ that some assets may not be directly transferrable to the recruiting firm and as a result the customer may incur costs to liquidate and move those assets or incur account maintenance fees to leave them with his or her current firm;
- ▶ potential costs related to transferring assets to the recruiting firm, including differences in the pricing structure and fees the customer's current firm and the recruiting firm impose; and
- ▶ differences in products and services between the customer's current firm and the recruiting firm.

The educational communication is intended to prompt a former customer to make further inquiries of the transferring representative (and, if necessary, the customer's current firm), to the extent that the customer considers the information important to his or her decision making.

Requirement to Deliver Educational Communication

The rule intends for a broad range of communications by a recruiting firm or its registered representative to constitute individualized contact that would trigger the delivery requirement. These communications may include, but are not limited to, oral or written communications by the transferring representative:

- ▶ informing the former customer that he or she is now associated with the recruiting firm;
- ▶ suggesting that the former customer consider transferring his or her assets or account to the recruiting firm;
- ▶ informing the former customer that the recruiting firm may offer better or different products or services; or
- ▶ discussing with the former customer the fee or pricing structure of the recruiting firm.

Furthermore, FINRA would consider oral or written communications to a group of former customers to similarly trigger the requirement to deliver the educational communication under the rule. These types of oral or written communications by a firm, directly or through the representative, to a group of former customers may include, but are not limited to:

- ▶ mass mailing of information;
- ▶ sending copies of information via email; or
- ▶ automated phone calls or voicemails.

Timing and Means of Delivery of Educational Communication

The rule requires a firm to deliver the educational communication at the time of first individualized contact with a former customer by the firm, directly or through the representative, regarding the former customer transferring assets to the firm. If such contact is in writing, the rule requires the educational communication to accompany the written communication. If the contact is by electronic communication, the rule permits the firm to hyperlink directly to the educational communication.

If the first individualized contact with the former customer is oral, the rule requires the firm or representative to notify the former customer orally that an educational communication that includes important considerations in deciding whether to transfer assets to the firm will be provided not later than three business days after the contact. The rule requires the

educational communication be sent within three business days from such oral contact or with any other documentation sent to the former customer related to transferring assets to the firm, whichever is earlier.

If the former customer seeks to transfer assets to an account assigned, or to be assigned, to the representative at the firm, but no individualized contact with the former customer by the representative or firm occurs before the former customer seeks to transfer assets, the rule mandates that the firm deliver the educational communication to the former customer with the account transfer approval documentation. The educational communication requirement in the rule applies for a period of three months following the date that the representative begins employment or associates with the recruiting firm.

The educational communication requirement would not apply when the former customer expressly states that he or she is not interested in transferring assets to the firm. If the former customer subsequently decides to transfer assets to the firm without further individualized contact within the period of three months following the date that the representative begins employment or associates with the firm, then the educational communication is required to be provided with the account transfer approval documentation.

Endnotes

1. See Securities Exchange Act Release No. 77430 (March 23, 2016), 81 FR 17513 (March 29, 2016) (Order Approving File No. SR-FINRA-2015-057).
2. For purposes of the rule, a “former customer” includes any customer that had a securities account assigned to a registered person at the representative’s previous firm. The term “former customer” does not include a customer account that meets the definition of an “institutional account” pursuant to FINRA Rule 4512(c) (Customer Account Information); provided, however, accounts held by a natural person do not qualify for the institutional account exception.
3. FINRA has interpreted the rule as not applying to circumstances where a customer’s account is proposed to be transferred to a new firm via a bulk transfer or due to a change of broker-dealer of record. See Securities Exchange Act Release No. 76757 (December 23, 2015), 80 FR 81590 (December 30, 2015) (Notice of Filing of File No. SR-FINRA-2015-057).

ATTACHMENT A

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Text of New FINRA Rule

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2200. COMMUNICATIONS AND DISCLOSURES

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2273. Educational Communication Related to Recruitment Practices and Account Transfers

(a) Educational Communication Delivery Requirement

A member that hires or associates with a registered person shall provide to a former customer of the registered person, individually, in paper or electronic form, an educational communication prepared by FINRA when (1) the member, directly or through that registered person, individually contacts the former customer of that registered person to transfer assets or (2) the former customer of that registered person, absent individualized contact, transfers assets to an account assigned, or to be assigned, to the registered person at the member.

(b) Means and Timing of Delivery

(1) A member shall deliver the communication in paragraph (a) at the time of first individualized contact with a former customer by the registered person or the member regarding the former customer transferring assets to the member.

(A) If the contact is in writing, the written communication required in paragraph (a) must accompany the written communication. If the contact is by electronic communication, the member may hyperlink directly to the educational communication.

(B) If the contact is oral, the member or registered person must notify the former customer orally that an educational communication that includes important considerations in deciding whether to transfer assets to the member will be provided not later than three business days after the contact. The educational communication must be sent within three business days from such oral contact or with any other documentation sent to the former customer related to transferring assets to the member, whichever is earlier.

(2) If a former customer attempts to transfer assets to an account assigned, or to be assigned, to the registered person at the member, but no individualized contact with the former customer by the registered person or member occurs before the former customer seeks to transfer assets, the member shall deliver the educational communication in paragraph (a) to the former customer with the account transfer approval documentation.

(3) The delivery of the communication required by paragraph (a) shall apply for a period of three months following the date the registered person begins employment or associates with the member.

••• Supplementary Material:-----

.01 Definition. For the purpose of this Rule, the term “former customer” shall mean any customer that had a securities account assigned to a registered person at the registered person’s previous firm. This term shall not include an account of a non-natural person that meets the definition of an institutional account pursuant to Rule 4512(c).

.02 Express Rejection by Former Customer. The requirement in paragraph (a) shall not apply when the former customer who the member, directly or through that registered person, individually contacts to transfer assets expressly states that he or she is not interested in transferring assets to the member. If the former customer subsequently decides to transfer assets to the member without further individualized contact within the period of three months following the date the registered person begins employment or associates with the member, then the requirements of paragraph (b)(2) shall apply.

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ATTACHMENT B

Issues to consider when your broker changes firms

You're receiving this notice because your broker has changed firms. If you're thinking about whether to follow your broker or stay with your current firm, it's a good idea to examine key issues that will help you make an informed decision.

A good relationship with your broker is surely valuable to you, but it's not the only factor in determining what's in your best interest. Before making a final decision, talk to your broker or someone at your current firm about the following questions, and make sure you're comfortable with the answers.

Could financial incentives create a conflict of interest for your broker?

In general, you should discuss the reasons your broker decided to change firms. Some firms pay brokers financial incentives when they join, which could include bonuses based on customer assets the broker brings in, incentives for selling in-house products or a higher share of commissions. Similarly, some firms pay financial incentives to retain brokers or customers. While there's nothing wrong with these incentives in either case, they can create a conflict of interest for the broker. Whether you stay or go, you should carefully consider whether your broker's advice is aligned with your investment strategy and goals.

Can you transfer all your holdings to the new firm?

What are the implications and costs if you can't?

Some products, such as certain mutual funds and annuities, may not be transferable. If that's the case, you'll face an additional decision if you follow your broker to the new firm: whether to liquidate the non-transferable holdings or keep just these holdings at your current firm. Either way, there could be costs to you, such as fees or taxes if you liquidate, or different service fees if you leave some assets at the current firm. Your broker should be able to explain the implications and costs of each scenario.

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What costs will you pay—both in the short term and ongoing—if you change firms?

In addition to liquidation fees or taxes if you sell non-transferable assets, you may have to pay account termination or transfer fees if you close your current account, or account opening fees at the new firm. (Even if the new firm waives its fees as an incentive to transfer, that wouldn't reduce any transfer or closure costs at your current firm.) Moving forward, the new firm may have a different pricing structure for maintaining your account or making transactions (such as fee-based instead of commissions, or vice versa), which could increase or lower your account costs. Your broker should be able to explain the pricing structure of the new firm and how your ongoing costs would compare.

How do the products at the new firm compare with your current firm?

Of course, not all firms offer the same products. There may be some types of investments you've purchased in the past or are considering for the future that aren't available at the new firm.

If that happens, you should feel comfortable with the products they offer as alternatives. If you tend to keep a lot of cash in your account, ask what investment vehicles are available at the new firm for the cash sweep account and whether the interest rate would have an effect on your return.

What level of service will you have?

Whether you follow your broker to the new firm or choose another broker at your current firm, consider whether you'll have access to the types of service, support and online resources that meet your needs.

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FINRA is an independent, not-for-profit organization with a public mission: to protect America's investors by making sure the securities industry operates fairly and honestly. FINRA is not a part of the government, but we play a critical role in safeguarding investors by enforcing high ethical standards, bringing the necessary resources and expertise to regulation, and promoting investor education—all at no cost to taxpayers.

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