

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89091; File No. SR-FINRA-2020-007]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to FINRA's Suitability, Non-Cash Compensation and Capital Acquisition Broker (CAB) Rules in Response to Regulation Best Interest

June 18, 2020.

#### I. Introduction

On March 12, 2020, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend FINRA Rules 2111 (Suitability), 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) and Capital Acquisition Broker (CAB) Rule 211 (Suitability). The proposed rule change would: (1) Amend the FINRA and CAB suitability rules to state that the rules do not apply to recommendations subject to Regulation Best Interest ("Reg BI"),<sup>3</sup> and to remove the element of control from the quantitative suitability obligation; and (2) conform the rules governing non-cash compensation to Reg BI's limitations on sales contests, sales quotas, bonuses and non-cash compensation.

The proposed rule change was published for comment in the **Federal Register** on March 25, 2020.<sup>4</sup> The public comment period closed on April 15, 2020.<sup>5</sup> On April 28, 2020, FINRA consented to an extension of the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine

whether to approve or disapprove the proposed rule change to June 23, 2020.<sup>6</sup>

On May 14, 2020, FINRA responded to the comment letters received in response to the Notice and filed an amendment to the proposed rule change ("Amendment No. 1").<sup>7</sup> The Commission is publishing this notice to solicit comments on Amendment No. 1 from interested persons, and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

#### II. Description of the Proposed Rule Change

##### Background

On June 5, 2019, the Commission adopted Reg BI, a new rule under the Exchange Act, which establishes a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as "broker-dealer") when they make a recommendation of any securities transaction or investment strategy involving securities to a retail customer.<sup>8</sup>

As stated in the Reg BI Release, Reg BI enhances the broker-dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by requiring broker-dealers, among other things, to: Act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict.<sup>9</sup> The date by which broker-dealers must

comply with Reg BI is June 30, 2020.<sup>10</sup> FINRA proposed to amend its suitability and non-cash compensation rules to address inconsistencies between the FINRA rules and Reg BI, and to make clear how these rules will intersect. The effective date of FINRA's proposed rule change will be the compliance date of Reg BI.

##### Original Proposal

##### Suitability

As FINRA stated in its Notice, FINRA Rule 2111 requires that a broker-dealer "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile."<sup>11</sup> Rule 2111 further explains that a "customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."<sup>12</sup>

Rule 2111 imposes three main suitability obligations: Reasonable basis suitability, customer-specific suitability and quantitative suitability.<sup>13</sup> Reasonable basis suitability requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors.<sup>14</sup> Customer-specific suitability requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile.<sup>15</sup> Quantitative suitability requires a member or associated person who has actual or *de facto* control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.<sup>16</sup>

<sup>10</sup> *Id.*

<sup>11</sup> See Notice at 16975.

<sup>12</sup> See *id.*

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See *id.*

<sup>16</sup> *Id.*

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.15l-1.

<sup>4</sup> See Exchange Act Release No. 88422 (Mar. 19, 2020), 85 FR 16974 (Mar. 25, 2020) (File No. SR-FINRA-2020-007 ("Notice")).

<sup>5</sup> All comment letters received on the proposed rule change are available on the Commission's website at <https://www.sec.gov>.

<sup>6</sup> See Letter from Joseph Savage, Vice President and Counsel, Office of General Counsel, FINRA, to Daniel Fisher, Branch Chief, Division of Trading and Markets, U.S. Securities and Exchange Commission, dated April 28, 2020.

<sup>7</sup> See Letter from Joseph Savage, Vice President and Counsel, Office of General Counsel, FINRA, to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission, dated May 13, 2020 ("FINRA Letter"). The FINRA Letter and the text of Amendment No. 1 are available at the Commission's website at <https://www.sec.gov/comments/sr-finra-2020-007/srfinra2020007.htm>.

<sup>8</sup> See Securities Exchange Act Release No. 86031 (Jun. 5, 2019), 84 FR 33318 (Jul. 12, 2019) ("Reg BI Release").

<sup>9</sup> See Reg BI Release at 33318.

Rule 2111(b) provides an exemption to customer-specific suitability for recommendations to institutional customers under specified circumstances. FINRA rule 2111 sets forth three criteria that must be satisfied in order for this exemption to apply. First, the account must meet the definition of institutional account as defined in FINRA Rule 4512(c).<sup>17</sup> Second, the broker-dealer must have a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities.<sup>18</sup> Third, the institutional customer must affirmatively indicate that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decision making authority to an agent, such as an investment adviser or a bank trust department, these factors are applied to the agent.<sup>19</sup>

Reg BI requires firms to satisfy four component obligations: Disclosure, Care, Conflict of Interest, and Compliance.<sup>20</sup> Consistent with the Commission's statements, FINRA stated that Reg BI's Care Obligation incorporates and enhances principles that are also found in Rule 2111.<sup>21</sup> FINRA stated that two key enhancements are that Reg BI explicitly imposes a best interest standard and requires a consideration of costs. In addition, FINRA stated in its Notice that as compared to suitability, Reg BI: (i) Places greater emphasis than the suitability rule on consideration of reasonably available alternatives;<sup>22</sup> (ii) explicitly applies to recommendations of types of accounts (e.g., broker-dealer or investment adviser, or among broker-dealer accounts, including recommendations of IRA rollovers); and (iii) eliminates the "control" element of the quantitative suitability obligation.<sup>23</sup>

FINRA stated that in light of these enhancements included in Reg BI and to provide clarity on the intersection between Reg BI and the FINRA rules, it proposed to amend its suitability rule to provide that it will not apply to recommendations subject to Reg BI.<sup>24</sup> FINRA stated that it did not propose to

eliminate the suitability rule because it applies broadly to all recommendations to customers whereas Reg BI applies only to recommendations to "retail customers," which Reg BI defines as a natural person, or the legal representative of such natural person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer and uses the recommendation primarily for personal, family, or household purposes.<sup>25</sup> Thus, FINRA believed its suitability rule is still needed for entities and institutions (e.g., pension funds), and natural persons who will not use recommendations primarily for personal, family, or household purposes (e.g., small business owners and charitable trusts).<sup>26</sup>

In addition, the proposed rule change modified the quantitative suitability obligation under FINRA Rule 2111.05(c) to remove the element of control that currently must be proved to demonstrate a violation of that rule.<sup>27</sup> FINRA stated that this change is consistent with Reg BI, which eliminates the control element from the third component of its Care Obligation.

Finally, the proposed rule change amended CAB Rule 211 to state that it will not apply to recommendations subject to Reg BI.<sup>28</sup>

#### Non-Cash Compensation

FINRA Rules 2310 (Direct Participation Programs), 2320 (Variable Contracts of an Insurance Company), 2341 (Investment Company Securities), and 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) each include provisions restricting the payment and receipt of non-cash compensation in connection with the sale and distribution of securities governed by those rules.<sup>29</sup> FINRA stated that, as a general matter, these rules limit non-cash compensation arrangements to:

- Gifts that do not exceed \$100 in value and that are not preconditioned on the achievement of a sales target;
- An occasional meal, a ticket to a sporting event or the theater, or other comparable entertainment that does not raise any question of propriety and is not preconditioned on the achievement of a sales target;
- Payment or receipt by "offerors" (generally product sponsors and their affiliates) in connection with training or

education meetings, subject to specified conditions, including that the payment of such compensation is not conditioned on achieving a sales target; and

- Internal non-cash compensation arrangements between a member and its associated persons, subject to specified conditions. If the internal non-cash compensation arrangement is in the form of a sales contest, the contest must be based on the total production of associated persons with respect to all securities within the rule's product category, and credit for those sales must be equally weighted.<sup>30</sup>

Reg BI's Conflict of Interest Obligation requires, among other things, that broker-dealers establish, maintain, and enforce written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited time period.<sup>31</sup> FINRA stated that its current non-cash compensation rules permit internal firm sales contests that may not meet this standard, since they permit contests based on sales of specific types of securities (such as mutual funds or variable annuities).<sup>32</sup>

FINRA proposed to modify its rules governing non-cash compensation arrangements to specify that any non-cash compensation arrangement permitted by those rules must be consistent with the requirements of Reg BI. FINRA also proposed to eliminate provisions in Rules 2320, 2341, and 5110 that require internal non-cash compensation arrangements to be based on total production and equal weighting of securities sales.<sup>33</sup> FINRA stated that firms generally would no longer have been permitted to sponsor or maintain internal sales contests based on sales of securities within a product category within a limited time, even if they were based on total production and equal weighting and that this requirement also would have applied to the non-cash compensation provisions governing gifts, business entertainment and training or education meetings.<sup>34</sup> Further, FINRA stated that these forms of non-cash compensation may not be preconditioned on achievement of a sales target.<sup>35</sup> Nevertheless, FINRA

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *See id.*

<sup>20</sup> *See id.* *See also* Reg BI Release.

<sup>21</sup> *See* Notice at 16975.

<sup>22</sup> *See id.* *See also* Reg BI Release at 33381.

<sup>23</sup> *See* Notice at 16975.

<sup>24</sup> *See* proposed FINRA Rule 2111.08.

<sup>25</sup> *See* 17 CFR 240.151-1(b)(1).

<sup>26</sup> *See* Notice at 16975.

<sup>27</sup> *See* proposed FINRA Rule 2111.05(c).

<sup>28</sup> *See* proposed CAB Rule 211.03.

<sup>29</sup> *See* Notice at 16975.

<sup>30</sup> *See* FINRA Rules 2310(c), 2320(g), 2341(l)(5), and 5110(h).

<sup>31</sup> *See* 17 CFR 240.151-1(a)(2)(iii)(D).

<sup>32</sup> *See* Notice at 16976.

<sup>33</sup> *See* proposed amendments to FINRA Rules 2310(c), 2320(g), 2341(l)(5), and 5110(h).

<sup>34</sup> *See* Notice at 16976.

<sup>35</sup> *Id.*

believed that it must make clear that these provisions do not permit arrangements that conflict with Reg BI.

*Proposed Rule Change as Modified by Amendment No. 1*

In response to comments<sup>36</sup> (discussed below), FINRA is modifying its proposed rule change by not deleting rule text in FINRA Rules 2320(g)(4)(D) and 2341(l)(5)(D) that require non-cash compensation arrangements between a member and its associated persons, or between a non-member company and its sales personnel who are associated persons of an affiliated member, for the sale of variable insurance products (under Rule 2320) or investment company securities (under Rule 2341) to be based on the total production and equal weighting of sales of those products.<sup>37</sup> FINRA also is not deleting rule text in FINRA Rules 2310(c)(2)(C), 2320(g)(4)(C), 2341(l)(5)(C) and 5110(h)(2)(C) that reference Rules 2310(c)(2)(D), 2320(g)(4)(D), 2341(l)(5)(D), and 5110(h)(2)(D), respectively.<sup>38</sup> In its Amendment No. 1, FINRA also cautions members not to conclude that any sales contest that awards non-cash compensation for sales of securities within particular product categories is *per se* permissible under Reg BI.<sup>39</sup> FINRA's Proposed Amendment No. 1 does not alter the proposed suitability changes to FINRA Rule 2111 and CAB Rule 211.

### III. Discussion and Commission Findings

After careful review of the proposed rule change, as modified by Amendment No. 1, the comment letters, and FINRA's response to the comments, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.<sup>40</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,<sup>41</sup> which requires, among other things, that FINRA rules be designed to prevent

fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

*Proposed Suitability Rule Changes*

Most commenters supported the changes to FINRA Rule 2111 (Suitability) and CAB Rule 211 (Suitability),<sup>42</sup> and none objected.<sup>43</sup> For example, one commenter commended FINRA for the proposed changes and encouraged the SEC to approve the proposed rule change because "it brings important clarity and consistency to the standards governing broker-dealers' relationships with retail customers."<sup>44</sup> However, one commenter that supported the proposed rule change stated that "Reg BI should have gone further."<sup>45</sup> No commenters suggested amendments to the proposed rule text amending Rule 2111 and CAB Rule 211.

Taking into consideration the comments, the Commission believes that the proposed suitability rule changes are consistent with the Exchange Act. As the Commission stated in the Reg BI Release, the Care Obligation of Reg BI incorporates and enhances existing suitability requirements.<sup>46</sup> In light of the overlap, the Commission believes that it would be redundant and unnecessary for FINRA's suitability rule to apply to recommendations that are subject to Reg BI.

As stated by FINRA, without these changes, a broker-dealer would be required to comply with both Reg BI and FINRA's suitability rules when making recommendations to retail customers, and in such circumstances, compliance with Reg BI would result in compliance with FINRA's suitability rules.<sup>47</sup> The Commission agrees with FINRA and believes that the proposed rule change will help protect investors and the public interest by avoiding potential confusion surrounding whether Reg BI or FINRA's suitability obligations apply, which in turn will facilitate compliance with applicable regulations. In addition, the changes

will provide continued protections of FINRA's suitability rules for customers that are not retail customers for purposes of Reg BI.

The Commission further believes that the removal of the element of control from the quantitative suitability obligation will align FINRA's suitability rule with the Care Obligation of Reg BI, which the Commission believes will enhance investor protection for customers that are not retail customers for purposes of Reg BI by requiring a broker-dealer to always form a reasonable basis as to the recommended frequency of trading in a retail customer's account—irrespective of whether the broker-dealer "controls" or exercises "*de facto* control" over the retail customer's account.<sup>48</sup>

For these reasons, the Commission finds that the proposed rule change to the suitability rules is appropriate and designed to protect investors and the public interest, consistent with Section 15A(b)(6) of the Exchange Act and the rules and regulations thereunder.

*Proposed Changes to Non-Cash Compensation Rules*

Most commenters supported the changes to the non-cash compensation provisions in FINRA Rules 2310, 2320, 2341, and 5110.<sup>49</sup> These commenters generally supported FINRA's goal of aligning its non-cash compensation rules consistent with Reg BI.<sup>50</sup>

However, a few commenters expressed concerns with FINRA's statements suggesting that contests based on sales of securities within particular product categories, such as mutual funds or variable annuities, would no longer be permitted under Reg BI.<sup>51</sup> One commenter stated "what seems more consistent with what the SEC had in mind with respect to variable contracts and mutual funds would be to apply the limited period sales contest prohibition to specific types of variable annuities or funds within those general product categories."<sup>52</sup> The commenter also said that "FINRA has effectively converted the language restricting limited period sales contests for 'specific types of securities' under Reg BI to a restriction on limited period sales contests that are for a 'product category'" and that FINRA's conclusion that variable contracts be viewed as constituting a specific type of security under Reg BI is

<sup>36</sup> See letter from Clifford Kirsch and Eric Arnolds, Eversheds Sutherland (US) LLP, for the Committee of Annuity Insurers, dated April 15, 2020 ("CAI Letter") and letter from Robin M. Traxler, Financial Services Institute, April 15, 2020 ("FSI Letter").

<sup>37</sup> See FINRA Letter.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> In approving the proposed rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>41</sup> 15 U.S.C. 78o-3(b)(6).

<sup>42</sup> See letter from Christopher A. Iacovella, American Securities Association, dated April 20, 2020 ("ASA Letter"); letter from Kristen Malinconico, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated April 15, 2020 ("CCMC Letter"); letter from Emily Micale, Insured Retirement Institute, dated April 15, 2020 ("IRI Letter"); letter from Samuel B. Edwards, Public Investors Advocate Bar Association, dated April 15, 2020 ("PIABA Letter"); and FSI Letter.

<sup>43</sup> One commenter did not address the proposed changes to the Suitability Rules. See CAI Letter.

<sup>44</sup> See CCMC Letter.

<sup>45</sup> See PIABA Letter.

<sup>46</sup> Reg BI Release at 33327.

<sup>47</sup> See Notice at 16974.

<sup>48</sup> See Reg BI Release at 33374.

<sup>49</sup> See PIABA Letter, CCMC Letter, ASA Letter, and IRI Letter.

<sup>50</sup> See *id.*

<sup>51</sup> See FSI Letter and CAI Letter.

<sup>52</sup> See CAI Letter.

“fundamentally inconsistent with how the SEC describes and interprets that phrase under the Reg BI Adopting Release.”<sup>53</sup> The other commenter expressed similar concerns and suggested that FINRA clarify that its non-cash compensation rules are meant to align with Reg BI in all respects, including what constitutes sales of specific types of securities.<sup>54</sup>

In response, FINRA stated it was not its intent to propose changes to its non-cash compensation rules that would prohibit sales contests, sales quotas, bonuses or non-cash compensation that are permissible under Reg BI.<sup>55</sup> Accordingly, as noted above, FINRA modified its proposed rule change by not deleting rule text in FINRA Rules 2320 and 2341 that require non-cash compensation arrangements between a member and its associated persons, or between a non-member company and its sales personnel who are associated persons of an affiliated member, for the sale of variable insurance products or investment company securities to be based on the total production and equal weighting of sales of those products.<sup>56</sup> FINRA also modified its proposed rule change by not deleting rule text in FINRA Rules 2310, 2320, 2341, and 5110.<sup>57</sup> Finally, FINRA cautioned members not to conclude that any sales contest that awards non-cash compensation for sales of securities within particular product categories is *per se* permissible under Reg BI.<sup>58</sup>

Taking into consideration the comments, the FINRA Letter, and Amendment No. 1, the Commission believes that the proposed rule change to FINRA’s non-cash compensation rules, as amended, is consistent with the Exchange Act. The Commission recognizes that some commenters raised concerns about the proposed changes to the non-cash compensation rules on the basis that FINRA suggested that contests based on sales of securities within particular product categories would no longer be permitted under Reg BI.<sup>59</sup> The Commission further recognizes FINRA’s response and Amendment No. 1, and believes that the Amendment No. 1 appropriately addresses commenters’ concerns by clarifying that the proposed changes to its non-cash compensation rules are to be read consistent with Reg BI.<sup>60</sup>

The Commission believes that FINRA’s proposed rule change, as amended by Amendment No. 1, facilitates consistency between FINRA’s non-cash compensation rules and Reg BI. In particular, the relevant FINRA rules as amended will be consistent with the applicable requirements under Reg BI. As described above, commenters raised concerns that FINRA’s proposed rule change would prohibit certain sales contests that may be permitted under Reg BI. In response, FINRA amended its proposal to be consistent with Reg BI, but cautioned members not to conclude that any sales contest that awards non-cash compensation for sales of securities within particular product categories is *per se* permissible under Reg BI.<sup>61</sup> Similarly, the Commission reiterates that, while certain practices will not be *per se* prohibited by Reg BI, such practices are not *per se* consistent with Reg BI or other obligations under the federal securities laws.<sup>62</sup>

The Commission believes that the approach proposed by FINRA with respect to its non-cash compensation rules is appropriate and designed to protect investors and the public interest, consistent with Section 15A(b)(6) of the Exchange Act. In particular, the Commission believes that the proposed rule change, as amended by Amendment No. 1, will help protect investors and the public interest by clarifying that the incentives broker-dealers may offer pursuant to non-cash compensation arrangements under the relevant FINRA rules as amended are consistent with the applicable requirements under Reg BI. For these reasons, the Commission finds that the proposed rule change to the non-cash compensation rules is consistent with the Exchange Act and the rules and regulations thereunder.

#### IV. Solicitation of Comments on Amendment No. 1 to the Proposed Rule Change

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 1, is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

##### Electronic Comments

- Use the Commission’s internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2020-007 on the subject line.

<sup>61</sup> See FINRA Letter.

<sup>62</sup> See Reg BI Release at footnote 148.

##### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.
- All submissions should refer to File Number SR-FINRA-2020-007. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission’s Public Reference Room, 100 F Street NE, Washington, DC 20549-1090, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-007 and should be submitted on or before July 15, 2020.

#### V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of notice of the amended proposal in the **Federal Register**.

As discussed above, the revisions made to the proposed rule change in Amendment No. 1 clarify that it was not FINRA’s intent to propose changes to its non-cash compensation rules that would prohibit sales contests, sales quotas, bonuses or non-cash compensation that are permissible under Reg BI.<sup>63</sup> Specifically, FINRA modified its proposal by not deleting rule text in FINRA Rules 2320 and 2341 that requires non-cash compensation

<sup>63</sup> See FINRA Letter.

<sup>53</sup> See *id.*

<sup>54</sup> See FSI Letter.

<sup>55</sup> See FINRA Letter.

<sup>56</sup> See *id.*

<sup>57</sup> See *id.*

<sup>58</sup> See *id.*

<sup>59</sup> See FSI Letter and IRI Letter.

<sup>60</sup> See FINRA Letter.

arrangements between a member and its associated persons, or between a non-member company and its sales personnel who are associated persons of an affiliated member, for the sale of variable insurance products or investment company securities to be based on the total production and equal weighting of sales of those products.<sup>64</sup> FINRA also modified its proposal by not deleting rule text in FINRA Rules 2310, 2320, 2341, and 5110.<sup>65</sup>

The Commission believes that this modification responds to the primary concerns raised by commenters on the proposal and clarifies that the proposal was intended to be read consistent with Reg BI.<sup>66</sup> As stated earlier, the Commission believes that the proposed rule change, as amended by Amendment No. 1, will help protect investors and the public interest by clarifying that the incentives broker-dealers may offer pursuant to non-cash compensation arrangements under the relevant FINRA rules are consistent with the applicable requirements under Reg BI, thereby ensuring a consistent approach with respect to conflicts of interest. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,<sup>67</sup> to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

## VII. Conclusion

*It is therefore ordered* pursuant to Section 19(b)(2) of the Exchange Act<sup>68</sup> that the proposed rule change (SR-FINRA-2020-007), as modified by Amendment No. 1, be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>69</sup>

**J. Matthew DeLesDernier,**  
Assistant Secretary.

[FR Doc. 2020-13539 Filed 6-23-20; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89092; File No. SR-MSRB-2020-04]

### Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of a Proposed Rule Change Consisting of Amendments to MSRB Rules A-3 and A-6 That Are Designed To Improve Board Governance

June 18, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 5, 2020, the Municipal Securities Rulemaking Board (“MSRB” or “Board”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The MSRB filed with the Commission a proposed rule change consisting of amendments to MSRB Rules A-3 and A-6 (the “proposed rule change”) that are designed to improve Board governance. As described below, the draft amendments would:

- Extend to five years the length of time that an individual must have been separated from employment or other association with any regulated entity to serve as a public representative to the Board;
- Reduce the Board’s size from 21 to 15 members through a transition plan that includes an interim year in which the Board will have 17 members;
- Replace the requirement that at least one and not less than 30% of regulated members on the 21-member Board be municipal advisors with a requirement that the 15-member Board include at least two municipal advisors;
- Impose a six-year limit on Board service;
- Remove overly prescriptive detail from the description of the Board’s nominations process while preserving in the rule the key substantive requirements;
- Require that any Board committee with responsibilities for nominations,

governance, or audit be chaired by a public representative; and

- Make certain other reorganizational and technical changes.

The effective date for the proposed rule change will be October 1, 2020. The current versions of MSRB Rules A-3 and A-6 would remain applicable in the interim period between SEC approval and the effective date.

The Board previously issued a Request for Comment on potential changes to MSRB Rule A-3 (the “RFC”).<sup>3</sup> The proposed rule change reflects the Board’s consideration of the comments it received, which are discussed below, along with the Board’s responses.

The text of the proposed rule change is available on the MSRB’s website at [www.msrb.org/Rules-and-Interpretations/SEC-Filings/2020-Filings.aspx](http://www.msrb.org/Rules-and-Interpretations/SEC-Filings/2020-Filings.aspx), at the MSRB’s principal office, and at the Commission’s Public Reference Room.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The MSRB has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

###### Background

The Exchange Act establishes basic requirements for the Board’s size and composition and requires the Board to adopt rules that establish “fair procedures for the nomination and election of members of the Board and assure fair representation in such nominations and elections.”<sup>4</sup> As amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of

<sup>3</sup> MSRB Notice 2020-02 (Jan. 28, 2020), available at <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2020-02.ashx?n=1>. Comments on the RFC are available on the Board’s website at <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2020/2020-02.aspx?c=1>. The proposed rule change includes certain reorganizational and technical changes that were not included in the RFC, as described herein.

<sup>4</sup> Exchange Act Section 15(B)(2)(B), 15 U.S.C. 78o-4(b)(2)(B).

<sup>64</sup> See *id.*

<sup>65</sup> See *id.*

<sup>66</sup> See CAI Letter and FSI Letter. See also FINRA Letter.

<sup>67</sup> 15 U.S.C. 78s(b)(2).

<sup>68</sup> *Id.*

<sup>69</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.