**THOMPSON  
HINE**

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**INVESTMENT MANAGEMENT  
UPDATE****FINRA Proposes Broker Disclosure Statement for Retail Investors**

The Financial Industry Regulatory Authority (FINRA) issued a concept release requesting comment on a proposal requiring that member firms provide new retail customers with a written disclosure statement that details the types of brokerage accounts and services the firm provides to retail customers and the conflicts associated with such services.<sup>1</sup> A member firm would be required to provide the disclosure document to the retail customer at or prior to commencement of the business relationship. According to the release, the proposal anticipates future rule-making by the Securities and Exchange Commission (SEC) to satisfy mandates in the Dodd-Frank Wall Street Reform and Consumer Protection Act that the SEC study the obligations of broker-dealers and investment advisers, undertake rule-making to establish a fiduciary duty for broker-dealers and facilitate simple and clear disclosures of material conflicts by broker-dealers and investment advisers.

**THE PROPOSED DISCLOSURE DOCUMENT**

As conceived by the FINRA staff, the proposed disclosure document would serve the same purpose as the newly revised Part 2 of Form ADV, which each federally registered investment adviser is required to provide to customers at the time an advisory account is established. Like Part 2 of Form ADV, the proposal would require member firms to provide an up-front disclosure document that sets forth in plain English a firm's accounts and services, its associated conflicts of interest and any limitations on duties owed to the customer.<sup>2</sup> As proposed, the disclosure document would cover the following matters:

**Accounts and Services.** The types of brokerage accounts and services the firm provides to retail customers, such as research, underwriting and recommendations of securities, products and strategies.

**Scope of Services and Fees.** Disclosures that are reasonably designed to permit existing and prospective retail customers of the firm to evaluate:

- The scope of services provided by the firm to its retail customers and any limitations on the scope of the services offered (*e.g.*, that the universe of research covered may be limited or influenced by the issuers with which the firm maintains an investment banking relationship or the securities for which the firm acts as a market maker or otherwise engages in proprietary trading);
- The scope of products offered to the firm's retail customers;
- To the extent applicable, that the firm may not offer all products of a certain class or type and that it or its affiliates may be the sponsor or originator of certain products and may determine



in some cases to act as a distributor or placement or sales agent for a fee from the issuer or sponsor of the product; and

- All fees associated with each brokerage account and service offered to retail customers, a specific description of the service provided for each fee and whether fees are negotiable presented in a manner that allows customers to make comparisons between broker-dealers.

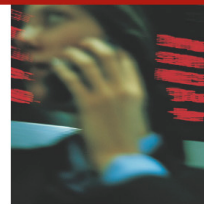
***Financial or Other Incentives.*** Disclosures as to financial or other incentives that a firm or its registered representatives have to recommend certain products, investment strategies or services over similar ones, including:

- In the case of investment company securities, the information required by proposed FINRA Rule 2341(l)(4);
- Any arrangement in which the firm receives an economic benefit (including cash, revenue sharing, commissions, equipment, research or non-research services) from any person, including an issuer or product manufacturer in connection with providing a particular product, investment strategy or service to a customer;
- Any arrangement in which the firm compensates or receives an economic incentive for customer referrals from or to an individual or firm; and
- Any arrangement in which a registered representative receives different payouts or other rates of compensation for certain products or services that are reasonably likely to provide an incentive for the registered representative to offer that product in lieu of similar products offered by the firm.

***Conflicts.*** Disclosure of conflicts that may arise between a firm and its customers, as well as those that may arise in meeting the competing needs of multiple customers, and how the firm manages such conflicts.

***Limitations.*** Limitations on the duties a firm owes to its customers. For example, that the firm:

- Does not assure the ongoing suitability of an investment or portfolio of investments;
- Takes no responsibility for the propriety of unsolicited orders, other than to discharge its best execution obligation; or
- May execute any transaction on a principal basis, absence instructions to act only in an agency capacity.



## COMMENTS

Comments on the proposal are due on December 27, 2010. FINRA is seeking a broad range of comments, including whether the proposal is either overly broad or too narrow in the products, services and conflicts requiring disclosure.

## FOR MORE INFORMATION

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<sup>1</sup> *Disclosure of Services, Conflicts and Duties*, Regulatory Notice 10-54 (October 2010). A “retail customer” would mean a customer that does not qualify as an institutional account under NASD Rule 3110(c)(4). An “institutional account” under that rule consists of a bank, savings and loan, insurance company, registered investment company, registered investment adviser or any entity (which includes natural persons) with total assets of at least \$50 million.

<sup>2</sup> Firms would continue to provide the more particularized sales practice disclosures currently required in interactions between registered representatives and customers.