

Broker/Dealers Speak Out on Regulatory Vexation

Working in recruiting, the growth segment of financial services, it has always baffled me that FINRA can dictate the number of advisors that small and mid-sized broker dealers can bring on in a given year. Imagine a broker/dealer being able to allot the amount of assets financial advisors can bring on in a given year, as if the broker/dealer knows better what the advisor can handle in asset growth.

Even more perplexing is the fact that large broker/dealers have no restriction on mergers, acquisitions, branch offices or rep count, while small and mid-sized firms have restrictions on all of these.

FINRA can use growth allotment as a weapon to penalize a firm, as one recruiter colleague of mine can attest. This recruiter called me for help in finding a new broker/dealer when he had to find a new home because his firm had compliance run-ins on products, which resulted in FINRA imposing a penalty of zero growth for the next two years. FINRA asks for more and more but does not grant the smaller firms the avenues for revenue to pay for what they are asking.

Is it any wonder the number of broker/dealers has dropped from 4,067 in 2014 to 3,507 in 2018? That's a 14% decrease in just four years, and this has occurred in favorable market conditions. What happens when markets turn?

The frustration rates for broker/dealer management and compliance have been especially high since DOL rules were supposed to be implemented, but things have only gotten worse. It is so commonplace that we thought it would be illuminating to give broker/dealers an opportunity to express their annoyances and concerns in a way that will not expose them to retaliation by FINRA, i.e. anonymously.

We restricted our interview of broker/dealer senior management to small and mid-sized BDs, because this segment of firms has the most derogatory and frequency of bias against them by FINRA.

Out of Step with the Direction of the Industry

For this mid-sized broker dealer, FINRA needs to do a 180-degree turn in order to get back on track:

“FINRA seems to be missing the boat entirely on the direction of the industry as a whole. For over two decades, the trend line of advisors leaving the securities side of the business to go RIA-only has continued to grow. Advisors continue to site hyper regulation with lack of business sense as the main driver for that migration. What has been FINRA's response?

Make rules even more complex, remove application of common sense, and penalize the good guys for everything the bad guys do wrong.”

Unequal Measures Favor Larger Firms

This smaller broker dealer sees blatant bias against firms his size:

“FINRA changes the rules without notice and has different rules for different firms. One example of this is through the industry fines generated by “L” share variable annuity sales. Almost every notice to members surrounding variable annuities mentions the concern over longer surrender charges. As a result of an SEC comment, FINRA started to focus on L shares in 2015. There are multiple components besides share class that can affect price in one of these products, but FINRA focused on share class.

Even if you stopped selling “L” shares in 2015, you were still facing a fine. When fines were imposed, some firms had to pay restitution while some did not. A small firm that sold 400 contracts paid a fine and restitution while a large firm that sold 14,000 contracts paid no client restitution and a small fine. In no way were disclosed fines in proportion to volume of “L” share business, revenue of firm or of total annuity business.

For a larger firm it may have been a rounding error, but for a smaller firm it may have set back their technology and compliance program by two years. If the purpose was to eliminate “L” shares, FINRA could have issued a simple notice to members. If, however, the purpose was to line their pockets, make headlines, eliminate more small firms and make up their operating deficit, then job well done.”

Lack of Collaborative Relationship

A compliance officer's hopes for our industry are summed up by the words of Rodney King, “Can't we all just get along?”

“FINRA should go back to the days when the industry had productive and collaborative relationships with their district managers (15+ years ago). The industry could casually talk to their districts about best practices and FINRA (NASD) would talk to their members to solicit opinions and thoughts as far as best practices. Today's regulatory world seems one-sided.

I don't disagree with the industry feeling that regulators have abandoned informally educating and giving direction

during the course of the exam process because they wanted firms to be the best they could be. Countless times over the past many years, I have asked examiners questions and have been told they are not at liberty to answer or express their own opinions, which is too bad because the industry wants to learn from FINRA and I believe overwhelmingly wants to be better. Informal feedback is important.”

Another senior management official explained:

“FINRA fails to recognize firms for their culture of compliance and passion for serving the investing public. Instead, it seems their focus during an audit is to find any miniscule oversight so that they can impose a fine.

Of course, that has to be their modus operandi because FINRA is a self-regulatory organization. They have no government funding and pay the executives exorbitant salaries that cause firms to increase fees, further causing harm to clients. The investing public indirectly pays these fees.

FINRA has been allowed to run rampant, self-proclaiming greatness in their Robin Hood ways. Meanwhile, they're rarely the ones to find true wrongdoing. Firms self-report their findings, and are rapidly penalized for doing the right thing for seeking guidance on proper resolution.”

Your Firm Is Problematic But We Won't Tell You Why

This broker dealer president vents his frustration over the opaque nature of FINRA:

“We've been very frustrated with FINRA because we feel we are in a cloud when it comes to the risk of our firm from FINRA's optics. In the past, when asked if we can have more details on the data points and how our firm specifically looks, the response was “We don't disclose that information to member firms.”

This approach is similar to a patient receiving blood work results that have multiple date points marked through, with the physician stating that they don't disclose that information to patients, but they can say the patient is at a higher health risk because of several negative data points within the results.”

Exams That Go on Forever

This firm's outcry over examination length and frequency resonates with many broker-dealers:

“In the future, I would like to be in a regulated environment where I don't feel under a perpetual cycle or cause examination, or receiving so many FINRA information requests every time one of their automated alarms goes off. Cycle examina-

tions are so frequent and always extend months longer than represented. When an exam is finally concluded, we know we have very little downtime until they announce they are coming back. Firms like ours, with impressive regulatory records, can still feel as if they are regulated as a borderline rogue firm.”

Unfair Expectations of Supervisory Systems

It boggles the mind to think that a broker/dealer would face a regulatory bias against them for setting a higher technology standard, but they do:

“A minority of firms invest a lot of resources into developing technology to help them do a better job of supervision and surveillance. These firms are nimbler in terms of being able to produce records and data whether or not they are required by the rules to do so.

When a firm demonstrates their ability to build customized reports in any format at FINRA's request, FINRA takes advantage of that ability and imposes a higher regulatory expectation than they would on lower-tech firms that are still running blotters and commissions on Excel spreadsheets. If you have little or no technology as a member firm, FINRA's expectation of your supervisory systems is very low, which is a huge advantage for small firms. The opposite holds true for firms that have invested in developing or investing in technology: FINRA's expectations are much higher. It's unfair!”

A New Approach on the Horizon?

There is a recent bright spot with the July 2019 appointment of Robert Cook to CEO at FINRA. Broker/dealer management has noticed a more kind and courteous FINRA since Cook has been at the helm. One broker/dealer senior manager gave their regulatory wish list going forward, which Robert Cook (FINRA), SEC and state regulators should take note of:

“Ultimately, what needs to happen is that all advisors, brokers and insurance agents beat to the same drum and have the same responsibilities to serve the public in a reasonable way: one where every transaction or engagement is what's right for the investor. This can only be accomplished through a streamlined and collaborative approach by each regulatory body. They need to stop fighting with one another and vying for power. Broker/dealers and regulators need to realize they sit on the same side of the fence and are passionate about protecting the investing public. Advisors who don't fit that mentality should not be permitted to run to a less regulated environment (FINRA to SEC or SEC to State or IA to Insurance Agent).”