CARLTON FIELDS

Continued SEC/FINRA "Complex" Product Concerns: Will Good Regulatory Harvest Arrive?

May 11, 2022

Like farmers uncertain about what crop to plant, the SEC and FINRA continue to cast about for ways to enhance their regulatory framework for "complex" products, particularly with regard to retail investor understanding. The regulators have been hampered by, among other things, the lack of any clear and consistent definition of what products should be regarded as "complex" for purposes of any such regulatory initiative.

In October 2021, the SEC approved rule changes by Cboe BZX Exchange Inc. to list and trade two complex exchange-traded products (ETPs). The next week, SEC Chair Gary Gensler issued a statement on complex ETPs in which he called for additional rulemaking to strengthen the investor protections around those products.

For their part, SEC Commissioners Allison Herren Lee and Caroline Crenshaw issued a joint statement about the approval of the complex ETPs, noting, "[W]e want to be clear that the Commission is not expressing a view as to these products' suitability, either as a general matter or with respect to any specific investor."

As the SEC staff studies ways to enhance regulation of ETPs, FINRA has solicited comment on ways to enhance regulation of complex products and options. On March 8, 2022, FINRA issued Regulatory Notice 22-08 soliciting comment on:

- Effective practices that firms have developed for complex products and options; and
- Whether the current regulatory framework is sufficient to address current concerns raised by complex products and options.

Ten years ago, FINRA issued guidance on heightened supervision of complex products and identified examples of complex products, including certain asset-backed securities, products with an embedded derivative component, leveraged and inverse ETFs, and certain structured notes, among others. Variable insurance products were not mentioned in the 2012 guidance.

FINRA expands the examples of complex products in Regulatory Notice 22-08 to include defined outcome ETFs, mutual funds and ETFs that offer strategies employing cryptocurrency futures, and interval funds that provide limited liquidity to investors, among others. Variable insurance products are not included as examples.

But in its release adopting Regulation Best Interest, the SEC gave examples of complex products that included variable insurance products and leveraged and inverse ETFs. And in 2004, when the NASD (now FINRA) sought to impose sales practice standards and supervisory requirements on variable annuity transactions, the NASD referred to variable annuities as “complex investment instruments.”

In its March 8 solicitation of comments on effective complex product regulation, FINRA addresses its product-specific rules relating to variable insurance products as examples of how FINRA rules deal with specific products, particularly variable product rules identifying factors to consider when making recommendations, restrictions on non-cash compensation, and content standards for variable product communications. Query whether FINRA will adopt a similar regulatory approach for ETPs and other identified complex products. The comment period ended on May 9, 2022.

Authored By

Ann Began Furman

Related Practices

Financial Services Regulatory
Life, Annuity, and Retirement Solutions

Related Industries

Life, Annuity, and Retirement Solutions
Life, Annuity, and Retirement Solutions
Securities & Investment Companies