CARLTON FIELDS

FINRA Issues New Guidance on Succession Planning as Population of Registered Representatives Ages

November 02, 2022

On November 1, 2022, FINRA issued Regulatory Notice 22-23, which provides member firms with guidance on succession planning. Although the notice imposes no new legal or regulatory requirements, it provides insight into how FINRA will likely view firms' business continuity plans, which are governed by FINRA Rule 4370. It also provides a comprehensive list of "questions for consideration" intended to help firms and representatives develop and implement succession plans.

The notice discusses demographic trends in the securities industry and the attendant challenges firms have confronted; the benefits of proactive succession planning; common types of succession planning; and the intersection of succession planning and existing FINRA rules. This alert summarizes the notice and provides takeaways and tips.

Background on Demographic Trends in the Securities Industry and Attendant Challenges Firms Have Confronted

The notice identifies several challenges member firms recently have faced as the baby boomer generation (born between 1946 and 1964) retires. According to the notice, as of December 2021, 16.32% of representatives were age 60 or older, a percentage that has increased from 13.57% in 2017. The notice identifies several challenges presented by the lack of succession planning where a representative dies or experiences cognitive decline and other life events. These challenges include the inability to continue the business, lack of access to critical operational systems, and customer challenges.

The notice highlights an example of a firm co-owner without a succession plan calling FINRA's Securities Helpline for Seniors to discuss concerns that the other co-owner was exhibiting signs of diminished capacity. Without providing specifics, the notice explained that FINRA provided "relevant resources" to the firm to support it in the transition. The notice also provides examples of firms ceasing operations because an owner or co-owner of a firm died without a succession plan, leaving remaining colleagues without the knowledge or access to resources needed to continue business operations.

Although many of the examples provided in the notice focus on challenges for small firms, larger firms may confront critical gaps in communications with customers when a representative suffers from diminished capacity, becomes incapacitated, or dies.

The Benefits of Succession Planning

Succession planning, according to the notice, helps firms minimize operational risk and retain customer relationships while allowing representatives to plan for life events and receive compensation for their books of business. In addition, succession planning enables retiring representatives to transition their customer accounts to new representatives who will assist the customers, which helps to ensure that customers do not experience an interruption in service. Underlying all of the notice's stated benefits is predictability. In a small firm, if key personnel become incapacitated or die, others can quickly pivot to succession procedures to ensure a smooth transition.

Common Types of Succession Plans

The notice describes succession planning as falling into two broad categories: (1) **internal** programs (such as the use of customer service teams, internal sales of business, development of junior representatives, designation of successor representatives, reassignments of customer accounts, and other programs); and (2) **external** sales of the representative's book to another firm or representative at another firm, or the merger or acquisition of a firm. The notice also describes related succession planning education, tools, and services.

The Intersection of Succession Planning and Existing FINRA Rules

Although the notice states that it does not impose new legal or regulatory requirements, it is apparent that FINRA views succession planning as an integral part of business continuity. FINRA Rule 4370 (business continuity plans) requires firms to create, maintain, review, and update business continuity plans to address the possibility of an emergency or a significant business disruption. The notice explains that a registered representative's illness, incapacity, or death could be an emergency or significant business disruption that triggers the member firm's business continuity plan. In other words, firms should not be surprised to see the notice cited in exam findings or formal enforcement actions when an illness, incapacitation, or death of registered personnel leads to some disruption to a firm's operation.

The notice largely addresses succession planning due to an aging demographic; however, it also discusses other situations in which a representative's book of business transfers to another representative. For example, succession planning is needed when FINRA suspends or bars a registered representative, leaving that representative's customers, either temporarily or permanently, without someone with whom to communicate about the customers' accounts. Without a succession plan, a firm may expose itself to an inquiry regarding the reasonableness of its supervisory procedures.

As the notice illustrates, there also is a risk when a registered representative retires, is suspended, or is barred that he or she will continue to service customers through the newly assigned registered representative. The notice provides an example of a representative who permitted his barred and statutorily disqualified father to conduct a securities business through him. In that case, FINRA imposed a fine and a nine-month suspension against the son who allowed such misconduct. Depending on the facts and circumstances, however, firms also could face disciplinary action for not reasonably supervising activity that allowed a non-registered person to conduct a securities business.

The notice also reminds member firms of their obligations to comply with FINRA Rule 2040 (payments to unregistered persons). Generally, firms may not pay commissions to unregistered persons. Rule 2040(b), however, governs the circumstances under which member firms may pay continuing commissions to a retired representative.

Takeaways and Tips

- Although FINRA states that the notice does not provide any new legal or regulatory requirements, FINRA staff will likely view the guidance provided in the notice primarily through the lens of FINRA Rule 4370 (business continuity) and FINRA Rule 3110 (supervision).
- Firms should evaluate whether their existing policies and procedures for compliance with Rule 4370 address relevant aspects of succession planning raised in the notice.
- Firms should consider whether payments to retired representatives comport with the requirements of FINRA Rule 2040 (payments to unregistered persons).
- Firms should consider whether their existing policies and procedures address instances where a representative exhibits signs of diminished capacity and, if so, how the firm might balance the representative's privacy with the firm's obligation to its customers.

- Firms should consider whether their succession plan could include filing a continuing membership application (CMA) or engaging in the materiality consultation process (MatCon).
- In reviewing succession planning policies and procedures, firms should consider the “questions for consideration” set forth on pages 17–25 of the notice, which FINRA included to aid firms in developing, implementing, and evaluating succession plans.
- Representatives and firms should be mindful of the SEC or FINRA viewing continuing commission payments, or the sale of the business, through the lens of Regulation Best Interest. Specifically, regulators may look at whether recommendations made to customers provide a better income stream for a retiring representative or a higher business valuation but were not in the customers’ best interest.
- If firms or representatives intend to sell or otherwise transfer their business to a non-affiliated third party, they should ensure compliance with privacy notice requirements set forth under Regulation S-P, which allows customers the opportunity to opt out of having their nonpublic personal information shared with a third party.

Please contact the authors of this article with any questions concerning the notice or a firm’s succession planning.

Authored By

Tino M. Lisella

Richard T. Choi

Ann Began Furman

Related Practices

Financial Services Regulatory
Securities Litigation and Enforcement

Related Industries

Securities & Investment Companies