

## **FINRA Moves Toward SEC Anti-Churning Proposal**

SECURITIES TRANSACTIONS AND COMPLIANCE | FINANCIAL SERVICES REGULATORY | LIFE, ANNUITY,  
AND RETIREMENT SOLUTIONS | SECURITIES & INVESTMENT COMPANIES | JUNE 25, 2018



**Thomas C. Lauerman**

On April 18, the SEC voted to propose major rule changes to reconcile and clarify the standards of conduct that apply to broker-dealers and investment advisers. See "SEC Regulation Best Interest: Charting a Course for Securities and Annuity Sales, Avoiding Collision and Potential Regulatory and Litigation Issues" on page 8. Among other things, the SEC's proposal would require that a registered broker-dealer have a reasonable basis for believing that any "series" of securities transactions it recommends is not excessive, even if each transaction in that series, viewed individually, is in the customer's best interest.

The SEC's proposing release specifically recognizes that this requirement — which addresses a practice commonly known as "churning" of customer accounts — omits a key element necessary to establish a churning violation under federal securities law anti-fraud requirements or under the current "Quantitative Suitability" obligation under FINRA's Rule 2111. Specifically, under these provisions, a churning violation arises only if the broker-dealer has actual or de facto control over the customer's account, a limitation that the SEC did not include in its proposal.

On April 20, however, FINRA proposed to amend its Quantitative Suitability obligation so that — like the SEC's anti-churning proposal issued two days earlier — it would no longer be limited to cases in which the broker-dealer has actual or de facto control over the customer's account. FINRA stated that it had reconsidered this limitation in light of the SEC's proposal and FINRA's experience. In particular, FINRA's notice proposing this amendment explained that:

- Disputes can arise as to whether a broker-dealer has actual or de facto control over an account;
- Unscrupulous broker-dealers can use the current limitation as a shield against FINRA sanctions; and
- It is fair and appropriate for FINRA to hold broker-dealers accountable for their recommendations, even if another party decides whether to implement those recommendations.

It can be expected that FINRA will continue to adjust other current positions in response to the SEC's ongoing consideration of the standards of conduct applicable to broker-dealers and investment advisers. For example, FINRA's notice stated that it will consider the potential impact of the SEC's proposal for broker-dealer recommendations, if adopted, on FINRA's suitability rule more generally.