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Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via Email to rule-comments@sec.gov

Re: File No. SR-FINRA-2020-032 – Response to Comments

Dear Ms. Countryman:

This letter responds to a comment submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced filing, a proposed rule change to adjust FINRA fees to provide sustainable funding for FINRA's regulatory mission.[1] As FINRA discussed in detail in the filing, it has not raised its core regulatory fees materially since 2010, despite the fact that FINRA's regulatory responsibilities have significantly increased over the past decade. While FINRA was able to defer fee increases for so long by strategically spending down its financial reserves and carefully managing its expenses, these steps alone are not a sustainable strategy in the long term, particularly in the context of FINRA's increasing regulatory responsibilities and finite reserves.

Due to these circumstances, FINRA submitted the filing to adopt a carefully calibrated package of fee increases to address the structural deficit in FINRA's budget and provide sustainable funding for FINRA to carry out its regulatory mission. As a not-for-profit self-regulatory organization, FINRA's regulatory operations are funded by industry fees, and FINRA must prudently manage its finances to ensure it can appropriately support its mission to protect investors and promote market integrity in a manner that facilitates vibrant capital markets. To help ensure adequate support for its mission, and consistent with FINRA's published Financial Guiding Principles, FINRA's filing was designed around several core elements: (1) significant advance notice to members before fee increases take effect; (2) proportional fee increases that largely preserve the existing allocation of fees among FINRA's diverse membership; and (3) FINRA's ongoing

[1] Securities Exchange Act Release No. 90176 (October 14, 2020), 85 FR 66592 (October 20, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-032) ("filing").

commitment to reasonable cost management and rebates to members where revenues exceed costs.[2]

The Commission received one comment letter on the filing.[3] The PFSI Letter supported "fully funding FINRA's important regulatory mission" and noted that its "securities business depends on fair and efficient markets vigorously defended by a formidable regulatory body."[4] However, PFSI expressed concern that the filing imposes an "unjustified" fee increase on its particular business model.[5] PFSI further questioned the timing of FINRA's fee increases—which are not scheduled to begin taking effect until 2022, with a gradual phase in between 2022 and 2024—given the current economic uncertainty caused by the global pandemic.[6]

As FINRA discussed in detail throughout the filing, FINRA uses an overall cost-based pricing structure designed to be reasonable, achieve general equity across its membership, and correlate fees with regulatory costs to the extent feasible. Here, the new fee increases that are scheduled to begin in 2022 were measured to maintain FINRA's longstanding fee structure, which the Commission has previously approved as "reasonable in that it achieves a generally equitable impact across FINRA's membership and correlates the fees assessed to the regulatory services provided by FINRA."[7]

PFSI's main concern is that the proportional fee increases FINRA adopted in the filing create an undue impact on the firm, given its profile of branch offices, registered persons, and business activity. Specifically, PFSI expressed concern "that FINRA's allocation of its fee increase equally across the three components of a firm – the size of the firm, the firm's trading activity, and the number of its registered persons – results in an unjustified fee increase on our branch offices that function as small businesses, and the representatives who join our business from the middle-income market."[8] Instead of a

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[2] *See id.* at 66593 (providing background on FINRA's mission and financial condition and discussing the core elements of the filing, informed by FINRA's Financial Guiding Principles).

[3] *See* Letter to Commission from John S. Watts, SVP and Chief Counsel, PFS Investments Inc., dated November 10, 2020 ("PFSI Letter").

[4] *See id.* at 1, 3.

[5] *See id.* at 1-3.

[6] *See id.* at 3.

[7] *See* filing at 66594.

[8] *See* PFSI Letter at 1.

proportional fee increase, PFSI contends it would have been more equitable to adopt a disproportionate increase that raised the Trading Activity Fee ("TAF") more than other fees that correlate to the size of a firm (the Gross Income Assessment, or "GIA") and the number and activity of a firm's registered persons (the Personnel Assessment, or "PA," registration, and qualification examination fees).

FINRA notes that it already considered PFSI's recommended alternative, among others, in the filing. As FINRA explained:

> FINRA considered altering the mix of fees as part of this proposal. Some examples of approaches considered included placing greater weight on fees associated with registered persons, placing greater weight on trading-related fees, and reducing the level of cross-subsidization between large and small member firms. In each of these scenarios, the total amount raised in the proposal would have remained constant, but how the increases would be distributed across member firms would differ. Each scenario had associated with it a shift in the burdens based on firm size or business model. FINRA believes that these alternatives did not yield a more equitable fee mix. As a result, FINRA rejected these alternative formulations because the proposed approach maintains the current equitable structure, provides member firms with greater consistency and predictability in expected fees and the potential for complex impacts on competition inherent in the alternatives. FINRA believes that an overall proportional fee increase that maintains the current distribution of fees imposes the least aggregate impact on market participants and on the competition between them.[9]

FINRA's decision to pursue a proportional overall fee increase, rather than disproportionate alternatives like the one advanced by PFSI, was supported by substantial economic analysis. FINRA's filing included detailed discussion, with a number of accompanying charts, of the anticipated fee increases that would be experienced by member firms with different sizes and business models.[10] The filing further included an analysis of the dispersion of the rate of growth in aggregate fees to better contextualize the impact of the fee increases across member firms within each size category. As explained in the filing, lower dispersion is associated with a higher degree of consistency in terms of the impact of the fee increases.[11] Based on this analysis, FINRA projected that the filing

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9 *See* filing at 66606.

10 *See id.* at 66604-06.

11 *See id.*

would impose one of the narrowest distributions of fee rate changes across members among the alternatives considered. Accordingly, FINRA concluded that, "[g]iven this limited distributional impact," the filing "will preserve the same equitable and not unfairly discriminatory fee allocation that has long served as the foundation for FINRA's funding model and has been approved by the Commission."[12]

FINRA's economic impact analysis in the filing further considered other points raised in the PFSI Letter. PFSI suggested that a disproportionate TAF increase would be more appropriate given its belief that FINRA's increasing costs over the last decade relate primarily to FINRA' efforts to regulate trading activity. However, FINRA explained that the costs it seeks to fund through the filing have been driven by significantly expanded regulatory responsibilities in a number of areas. For example, in addition to increasing responsibilities that relate to the growth in trading volumes and venues, the filing cited increased responsibilities that relate more traditionally to firms' registered persons' activity, including oversight related to Regulation Best Interest, new financial products, and the SEC's increasing reliance on FINRA as a first-line supervisor of broker-dealers.[13]

In addition, PFSI asked that FINRA consider the impacts of registration and qualification examination fees given that the number of registered representatives at the end of 2019 was lower than in prior years. These factors were also analyzed in detail in the filing. For example, FINRA discussed changes over the last decade in the number of registered member firms and registered representatives. FINRA's study of these trends noted that while there has been a consolidation in the number of member firms between 2009 and 2018, the number of registered persons remained fairly constant over the period, and FINRA's aggregate supervision costs fell only minimally.[14] In addition, while the filing recognized that firms may choose to pass the PA, registration, and qualification examination fees through to registered persons, the filing also recognized that firms may pass the TAF through to their customers.[15]

FINRA appreciates PFSI's concern about increasing fees that may be borne by registered persons or those seeking to become registered, and FINRA takes those concerns very seriously. However, FINRA believes that it must also balance the potential impacts to member firms, investors, and the markets that could be associated with a disproportionate TAF increase. Ultimately, as noted above and explained in the filing with substantial supporting analysis, FINRA determined that a proportional increase to its existing fee

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[12] *See id.* at 66601.

[13] *See id.* at 66593 and 66601.

[14] *See id.* at 66601-02.

[15] *See id.* at 66603.

structure provided firms with greater consistency and predictability while preserving the fair, reasonable, and equitable allocation of fees across its diverse set of member firms.

Finally, in response to PFSI's concerns about the timing of the fee increases given the current economic uncertainty, FINRA notes that it fully recognizes the difficult climate and has deferred these fee increases for as long as it believes feasible. FINRA has not increased its members' core regulatory fees since 2013, and it has not imposed any significant fee increase since 2010. As FINRA explained in the filing, it considered delaying the implementation of the fee increases beyond 2022 due to the current uncertainty in the markets. But, as FINRA noted further, the same market conditions that may create challenges for member firms also impact FINRA. Moreover, FINRA's role protecting investors is of vital importance, particularly in times of market turmoil where FINRA has seen an increase in customer complaints, regulatory actions against fraud, and increased resources for surveillance. After full consideration of these issues and FINRA's finite reserves, which FINRA continues to rely on to support a deferred implementation and gradual phase-in as much as possible, FINRA concluded that "the most prudent course of action is to delay implementation until 2022, but no further."[16]

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FINRA believes that the foregoing responds to the material issues raised by comments on the filing. If you have any questions, please contact me at (202) 728-8152 or alexander.ellenberg@finra.org.

Sincerely,

/s/ Alexander Ellenberg

Alexander Ellenberg
Associate General Counsel

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16 *See id.* at 66606.