July 14, 2017

FINRA
Jennifer Piorko Mitchell
Office of the Corporate Secretary FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 17-14: FINRA Rules Impacting Capital Formation

Dear Ms. Piorko Mitchell,

I am writing to you today on behalf of the Third-Party Marketer's Association ("3PM" or "Association") to express the thoughts and concerns of our association's members based on the draft provisions proposed in FINRA Regulatory Notice 17-14. While it is our goal to respond to requests for comments in a manner beneficial to the majority of 3PM's members, it should be noted that the views of the commentators involved in preparing this response may not be representative of the views of the entirety of the 3PM membership or our industry group in general.

3PM believes that the FINRA360 initiation is a prudent step to ensure that regulations remain relevant in a changing environment. We applaud the steps FINRA is taking in this regard to turn the microscope inward. As capital raising agents for private funds, commonly referred to as Placement Agents or Third-Party Marketers, the precision and efficacy of the rules impacting capital formation are very important to our members and to the growth of our industry. Placement agents / third party marketers are a critical component of the industry, providing small investment firms with the ability to raise capital and diversify their client base and subsequently their revenue streams. In general, these small investment management organizations lack the resources and opportunities of the industry's largest investment management firms. It is the existence of placement agents / third party marketers that has allowed small investment firms to grow and thrive and eventually compete with their larger brethren. Given this backdrop, we appreciate the opportunity to be heard in regard to the issues outlined in RN 17-14 as well as some not mentioned in the Notice which we will address below.

While 3PM's members operate under a varied set of business models, approximately two-thirds of the Association's 3PM members engage in the business of referring private offerings to institutional investors. It is for this subset of our membership for which we will be commenting to this Regulatory Notice.

General Comments Regarding Rulemaking

Given the complex nature of the financial industry and the fact that many constituents of this industry are governed by multiple regulators, 3PM believes that there are a few basic tenets that FINRA should keep in mind when introducing new rules and or amending existing ones.

- ***Provide Definitions for Defined Terms***

  First, given that regulation often crosses several regulatory authorities, 3PM believes that it is essential that FINRA include definitions of defined terms in the footnotes of the actual rule text as well as in the Regulatory Notices issued for new rules and amendments to existing ones. While having a defined term will help individuals better understand FINRA's rulemaking, we believe this step is even more critical when it comes to terms that are defined by the SEC or another regulatory body.

  As an example, FINRA's Rule 5123 – Private Placement of Securities describes the filing requirements for private placement memorandums. The Rule goes on to define private placements that are exempt from the requirements of the Rule. Exemption 1 (J) states that accredited investors described in Securities Act Rule 501 (a)(1), (2), (3) or (7).

  At first a reader may believe that all private placements sold to accredited investors are exempt from filing. Review of Securities Act Rule 501 (a) shows us that only offerings sold to Accredited Investors that are *entities* are exempt from the filing requirements. If an offering is made to Accredited Investors who are natural persons, there is a private placement memorandum filing requirement.

  While FINRA does cite the parts of the Securities Act Rule that are exempt, much of the industry believes that the term Accredited Investor includes an individual with income that exceeds $200,000 for two of the past years or an individual with a net worth greater than $1 million.

  Furthermore, as most firms in our industry are small, these firms must either interpret the rules internally or hire expensive legal and compliance support. Simply providing clear and consistent definitions and placing them in the footnotes where they are utilized would provide significant clarity and efficiency.

  The omission of a definition in this case has led to the following:

  - Firms that have read the rule and assumed that all offerings to accredited investors are exempt

- Firms must take the time to research what the rule is referring to which means going back to the Securities Act and reviewing the full definition of an Accredited Investor

While large firms with full-time compliance staffs may not find issue with this, small firms whose CCOs wear multiple hats, need a more time efficient way to understand the rules they must abide. Simply including definitions in the footnotes of the Rule would help small firms to be better able to comply with the rules they must follow.

Furthermore, while FINRA does provide links to their own rules when viewing Rule text electronically, it would also be helpful to include hyperlinks to definitions of SEC Rules as well. This would also help to facilitate the true understanding of a rule and help to make compliance more efficient and effective.

- ***Codify "No Action" Letters***

When reviewing some of FINRA's rules, the entire scope of the requirements does not become clear unless one reads the No-Action letters associated with the rule. The Communication with the Public Rule (FINRA Rule 2210) is a perfect example of this.

It is our belief that when trying to comply with a rule, that FINRA members should be able to understand such requirements simply by reading the particular rule. This however is not the case.

As such, any requirements pertaining to a specific rule should be codified into that body of the rule. At a minimum, each rule should contain a list of applicable No-Action Letters that should be reviewed or could be relevant to the comprehensive understanding of that rule. This action would serve to eliminate confusion as to what the specific requirements of a rule are and would help to eliminate non-compliance by omission from firms that are unaware of the requirements contained in No Action Letters, and have unknowingly misinterpreted the totality of the rule. We believe that this further complicates a rule as important as the Communications with the Public Rule and leads to non-compliance by some firms.

Streamlining the rule set would go a long way in promoting consistency across the industry and allow for universal adherence to rules, that in general, have been promulgated to protect investors.

- ***Provide Guidance and Interpretations***

3PM's members are constantly seeking better guidance and clearer interpretations of the language written in the industry's rule sets. This is an inevitable result of rules being written to apply broadly to the constituents of a regulator or business activity. Very often our members

struggle to try to understand how a rule applies to our business model. This exercise can be equated with trying to fit a square peg in a round hole.

In general, it would be helpful if FINRA and other regulators could provide more guidance when new rules are issued or existing rules are amended as to how a rule applies specifically to a particular business model. Identifying an internal resource at FINRA, who could work with our industry when developing rules applicable to capital raising or issuing guidance would also be a helpful step. Typically, most of the guidance provided is extremely broad. This leaves significant room for speculation and varied opinions as to what is expected from members.

In this regard, we believe that FINRA should follow the lead of the MSRB that has recently issued guidance to Municipal Advisor Solicitors, recognizing that while some rules are easily applied to our industry, given the intricacies of our business model, sometime specific guidance is required.

Furthermore, we believe that it would be beneficial to all interested parties for regulators to include examples of the application of specific rules to a variety of business activities to facilitate interpretation of the rule. In addition, all rules should include references to any relevant No Action Letters that exist. This would assist members in understanding the full implications of the rule.

3PM has also chosen to reply to some of the specific questions to which FINRA requested comment. These responses are included below.

5. Are there other FINRA rules not identified above that impact the capital-raising process? If so what has been your experience with these rules?

Effective and compliant communication is at the crux of everything our members do. It is at the core of the capital raising process. As such, we do not believe a letter regarding the capital formation process would be complete without comment on Rule 2210.

The Communication with the Public Rule is a relatively new rule in the FINRA rule book. Since undergoing a major revision in 2012, the rule has received several updates and has undergone a "retrospective rule review". While we appreciate FINRA's attempt to get the rule "right", we firmly believe that room for improvement remains.

Content Standards

Rule 2210 (d) 1 (A) states that "All member communications must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts regarding any particular security or type of security, industry, or service. No member may omit any

material fact or qualification if the omission, considering the context of the material presented, would cause the communications to be misleading."

While a "full disclosure" may be required when working with retail investors, we would argue that this is one other section of the Communication with the Public rule that should be segregated with different treatment of "retail" and institutional investors.

When working with Institutional investors, our members work either with staff members, generally referred to as research analysts, whose role is to evaluate investments on behalf of their employer or with professional consultants who make their living evaluating private fund investments on behalf of their clients. As such, the professionals we are offering product to are extremely knowledgeable about the investments they review.

Given this level of sophistication, it is not appropriate to provide the same disclosure to an experienced professional as to a lay person with little to no investment experience. Section (E) of Rule 2210 (d) 1 includes language that "Members must consider the nature of the audience to which the communication will be directed and must provide details and explanation appropriate to the audience." We would argue that this should be interpreted to mean that in some cases it is appropriate to remove some basic language that would not be "appropriate" to provide to an institutional investor. This however, is not what has been conveyed by the Advertising Department of FINRA.

Compliance with this section of the rule, requires marketing materials to contain disclosures which are "fair and balanced" and "may not omit any material fact." As a result, it is not uncommon to see disclosures that range in length from 2-6 pages for a one-page document. We believe that this is not the right course of action when dealing with an institutional investor for the following reasons:

- Most people seeing a long disclosure will immediately skip the disclosure and jump right into the materials being presented. This causes these potential investors to miss important and relevant information hidden in the middle of pages of unnecessary words, doing the opposite of what a disclosure is supposed to do.

- Much of the information contained in a lengthy disclosure is a regurgitation of information contained in the PPM which an institutional investor will review in depth if considering an investment in the issue. Cluttering marketing material with this information only distracts from creating interest in the security at hand and remaining focused on the key information about the offering.

- Institutional investors are investment professionals which are required to have the requisite experience necessary to deal with the types of investments they evaluate, as such many of the basic risk information contained in the PPM as well as in the disclosure is information which they already are aware of and serves no purpose.

While our members are not averse to providing important and relevant disclosures, we believe the current approach is burdensome and provides little if any benefit to potential institutional investors. Given this we believe that the rule should be further reviewed to differentiate between investor types for the general content standards of this rule.

Given there is no definition of "fair and balanced", we believe that FINRA's interpretation of this term should also be revised to consider the prior knowledge and sophistication of an institutional investors and member firms should be permitted to either reference or link to the PPM as appropriate.

Rule 2210 (d) 1 (F) deals with projected performance. Please note that the information provided below contains summary information from 3PM's comment letter in response to RN 17-06 which has been attached to this comment letter in its entirety.

FINRA Rule 2210 (d) 1 (F) provides that communications may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. Regulatory Notice 17-06 goes on to state that "The general prohibition against performance projections is largely intended to protect ***retail*** investors from performance projections of individual investments, which often prove to be spurious, inaccurate or otherwise misleading".

RN 17-06 proposed an exception to this prohibition of projections for a hypothetical investment planning illustration. 3PM believes that the exception proposed by RN 17-06 is warranted, but requests further analysis to consider an exception to the prohibition of projections when offering private securities to institutional investors. 3PM believes that an exception of this nature is consistent with the spirit of the proposed amendment as well as with prevailing guidance.

3PMs exist, in part, to help level the playing field – i.e. to assist investment managers without internal sales and marketing resources to be able to compete with those that do, facilitate access to capital on a broader scale and to provide small managers and/or strategies newer to the market with access to a broader investor base. Our issue however, is that we ourselves are subject to an uneven playing field. Internal marketing teams at investment management firms do not fall under the purview of FINRA regulations.

Regulation that creates inconsistency, or provides one group with an advantage over another is harmful to 3PMs. It is also harmful to our investment manager clients, institutional investors and their constituents which include: pensioners, grant recipients, universities, charitable organizations, etc.

Should the unlevel playing field persist, 3PMs eventually will be forced to choose between exiting businesses that require more resources for a substantially lower probability of earning revenues or putting up with the disadvantages created by the regulation that is supposed to promote a fair market place for all. If investment managers who relied on 3PMs were to lose access to our services, taking many small

and mid-sized managers out of consideration by institutions, the largest and most well-funded investment management firms who can afford in house resources and sizeable infrastructures would hold a monopoly on asset gathering.

To an extent this is already the case, with larger investment managers holding a disproportionate share of institutional assets.

What we find most interesting about projected performance, is that it is not prohibited in Rule 221 of the CAB rule-set. While CAB communications are to institutional investors only, we see no reason why Rule 2210 cannot incorporate the same approach when materials are being presented to institutional investors only. It seems counter-intuitive that a member must formally "opt-in" to the CAB ruleset to be able to utilize this rule. Furthermore, as discussed below, there are some legitimate reasons, why more of 3PM's members have not become part of the CAB ruleset.

8. **As currently designed, are the eligibility requirements for the CAB rules over or under inclusive in any respect? What changes, if any, to these requirements should be considered? Are the requirements applicable to CABs appropriately tailored to their business activities? Should any changes to these requirements be considered?**

   3PM has been very vocal throughout the initiation of the CAB Ruleset and has participated not only by writing letters in response to the request for comments but has also worked closely with a variety of FINRA's staff to provide insight to our business model as well as to the rules that primarily impact our business activities.

   For your reference, we have attached 3PM's previous responses to requests for comment for RN 14-09 and SR-FINRA-2015-054.

   The CAB ruleset should be a great opportunity for small member firms that fit the CAB definition to alleviate some of the regulatory burden facing them by addressing some of the more onerous rules and requirements that are not relevant to our business practices. It is, however, our opinion that there are still some fundamental issues with CAB that either prevent our members from converting to a CAB or concern from our members that the ruleset does not provide enough relief to justify the change.

   We believe that the rule set falls short in the following ways:

   - Several of 3PM's members that fall under CAB, are also registered with the MSRB as a Municipal Advisors ("MA"). While the CAB ruleset does offer some relief to these firms, many of the areas where relief has been granted has been reversed by the MSRB's rules for MAs. An example of one such rule is business continuity. While the new CAB ruleset removed this

this requirement for firms opting into the CAB constituency, the MSRB has made BCP a requirement of MAs, reversing any relief provided by CAB. There are other such instances that exist and we would be happy to discuss this with FINRA in more detail.

At one point, members of 3PM addresses this issue with the MSRB and were told that because MAs were fiduciaries, while broker dealers were not, the MSRB would not consider any relaxation of their rules for MAs who were also CABs under FINRA.

Recently however, the MSRB published guidance for Solicitor Municipal Advisors ("SMAs") which clarified the point that SMAs are not fiduciaries. Given this clarification, we believe the timing is right for FINRA to approach the MSRB on this issue and to assess whether the MSRB may be open for extending some of the regulatory relief provided by CAB to SMAs.

- Several of our members have been told by FINRA that if they sponsor other placement agents or third-party marketers under their firm's membership that they are ineligible to convert to the CAB ruleset. We find this stance to be inconsistent with the original purpose of CAB.

  While we understand that if a CAB were to sponsor a firm that engages in business activities outside of the scope of CAB that the firm would be ineligible to convert to CAB. We do not however, understand why if a CAB firm were to sponsor other CAB firms who meet the ruleset's definition, why such a firm would be ineligible to be a CAB.

  3PM requests clarification on this point and would appreciate some direction to the area in the ruleset that outlines these rules.

- As discussed in several of the comment letters, from 3PM as well as other industry constituents, we do not believe that the rule-set went far enough in alleviating the regulatory burden for members of the CAB universe. While we understand that many of the rules we are referring to are outside of FINRA's purview, these rules are still extremely burdensome from both a financial and resources perspective. As such, we would like to ask FINRA to assist the CAB constituency in discussions with outside authorities to assist us in eliminating irrelevant requirements regardless of where they are initiated. We also thing that there are still some areas within FINRA's control where additional relief can be granted. The items below list both FINRA rules as well as other agency rules that need to be re-evaluated within the context of CAB:

  FINRA Rules:

  - ***Communications with the Public*** - 3PM proposes that FINRA revise Rule 2210 and specifically the general content standards to meet the realities of representing private issuers. Proposed modifications should include a realistic approach to setting fair and

balanced content standards for communications and marketing materials as well as an expansion of the exemptive provisions for our new definition of "**Qualified Investors**", especially those that are professional allocators or use the services of investment consultants.

- ***Suitability*** **-** 3PM is generally in agreement with Rule 211, however, we still believe that the rule as proposed fails by requiring the suitability analyses to be performed before any recommendation is made. While we agree that a CAB must reasonably believe that an investment is suitable for an investor before making a recommendation, we believe that the rule does not recognize that the process of diligence in our business is ongoing, in many cases can take several months to several years before an investment decision is made, and often does not, and should not, conclude until the deal is closed. We believe incorporation of this process is essential to Investor protections, and to the success of the rulemaking regime for CABs. We continue to believe that Rule 211 should emphasize this point and encourage RRs to periodically review their suitability analysis throughout the offering process, but no less frequently than once before the subscription agreement or relevant contract is signed and due diligence is as complete as it can be at that particular time. While this approach should apply to all recommendations, it is especially relevant in the case of the offering of private placements and other complex products.

  Most 3PMs are raising capital for Reg. D products and do so by approaching an "agent" who represents the institutional investor looking to allocate capital. As such, most of the communication that takes place is between the "agent" and the 3PM. It is not unusual for there to be little or no communication between the 3PM and the end investor. Given this, there is often some information regarding the institutional investor which may not be obtainable due to this construct. 3PMs are not making recommendations in the traditional definition of the term, and therefore, as an example, will not have insight into the overall composition of the institutional investor's portfolio – as a retail broker would have over one of their accounts. Accordingly, we believe the rules should address some type of minimum compliance that would be appropriate in these situations. We further suggest that a demonstrable best efforts basis may be a satisfactory alternative in such instances.

- ***Supplemental Focus Information*** **-** 3PM does not agree with FINRA proposal to subject CABs to FINRA Rule 452. While we understand that FINRA does not have the authority to set net capital rules, we do believe that FINRA does have the ability to improve the information requests made in the SSOI. 3PM also believes that the information FINRA receives from these forms are inaccurate due to the wide array of methods, timelines and fee structures applicable to CABs offering private placements.

The SSOI was clearly written under the assumption that there is consistency in the method, timeframe and fee structures that applies to both private placements and publicly traded securities. This is simply an inaccurate assumption. When FINRA was made aware of the inaccuracies, the response was that they understood the shortcomings of the reports, and it was suggested that firms use their best efforts to interpret the questions. While 3PM is not against enhanced reporting for gleaning new insights in to a firm's financial condition, we do not believe that it is acceptable for FINRA to issue reporting requirements that do not apply to a constituency or that may distort the findings because of the interpretation of an unclearly written question. As such we think that FINRA should revisit the SSOI requirements for CABs in their current form and consider requesting appropriate information from our constituency. To accomplish this task, we suggest convening a working committee of CABs to help write appropriate questions that accurately reflect our business model.

- ***Required Registrations*** **-** 3PM proposes that FINRA waive the Series 99 examination requirement for small firms who have a registered principal assigned to the covered functions outlined in the rule. We believe that the requirements of Rule 1230 should only apply to unregistered individuals handling any of the covered functions outlined.

Non-FINRA Rules:

- ***AML*** - 3PM recognizes that all financial institutions play an important role in the detection and prevention of money laundering. While we believe that extending the independent test requirement from annually to bi-annually is appropriate for LCFBs, we also suggest that FINRA consider amending the Customer ID Program (CIP) requirements to conform to the business of a LCFB. Specifically, 3PM recommends that LCFB's should be required to implement a CIP as follows:
    - For all Issuers and Intermediaries with which the LCFB does business
    - For all Investors when there is no Intermediary involved.

- ***PCAOB Audits*** - The rule requiring PCAOB audits was initially intended to cover firms working with public entities, not small, broker dealers like those that are covered by the CAB rule set. Furthermore, the PCAOB interim inspection program findings simply are not relevant to CABs, and would therefore would not be found

- ***SIPC fees*** - In SIPC's own words, their mission directly relates to protecting customer assets. CAB firms do not include any broker or dealer that carries or maintains customer accounts, holds or handles customers' funds or securities, accepts orders from customers to purchase or sell securities as a principal or as an agent for the customer". As such, CABs are continually paying assessments on their revenues in to the SIPC fund to protect investors that will never require coverage from such an event from a CAB. This rule is not

properly aligned with the business of CABs and creates significant expenses to CABs without providing any tangible benefit. CABs are paying into a fund that reimburses investors for somebody else's wrongdoing which is an unfair practice.

Thank you for the opportunity to share our thoughts with you regarding this proposal. Please feel free to reach out to me at (585) 364-3065 or by email at donna.dimaria@tesseracapital.com should you have any questions or require additional information pertaining to the proposed amendments to the Communication with the Public rule.

Regards,

<<Donna DiMaria>>

Donna DiMaria
Third Party Marketers Association
Chairman of the Board of Directors and
Chair of the 3PM Regulatory Committee

About the Third-Party Marketer's Association (3PM)

3PM is an association of independent, global outsourced sales and marketing firms that support the alternative and traditional investment management industry worldwide.

3PM Members are properly registered and licensed organizations consisting of experienced sales and marketing professionals who come together to establish and encourage best practices, share knowledge and resources, enhance professional standards, build industry awareness and generally support the growth and development of professional outsourced investment management marketing.

Members of 3PM benefit from:

- Regulatory Advocacy
- Best Practices and Compliance
- Industry Recognition and Awareness
- Manager Introductions
- Educational Programs
- Online Presence
- Conferences and Networking
- Service Provider Discounts

3PM began in 1998 with seven member-firms. Today, the Association has more than 35 member organizations, as well as significant number of prominent firms that support 3PMs and participate in the Association as 3PPs, Industry Associates, Member Benefit Providers, Media Partners and Association Partners.

A typical 3PM member-firm consists of two to five highly experienced investment management marketing executives with, on-average, more than 10 years' experience selling financial products in the institutional and/or retail distribution channels. The Association's members run the gamut in products they represent. Members work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. Some firms' business is comprised of both types of product offerings. Most 3PM's members are currently registered with FINRA or affiliated with a broker-dealer that is a member of FINRA.

For more information on 3PM or its members, please visit www.3pm.org.

March 27, 2017

FINRA
Marcia E. Asquith
Office of the Corporate Secretary FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 17-06: Communications with the Public

Dear Ms. Asquith,

I am writing to you today on behalf of the Third-Party Marketer's Association ("3PM") to express the thoughts and concerns of our association regarding the draft provisions proposed in FINRA Regulatory Notice 17-06. While it is our goal to respond to requests for comments in a manner beneficial to the majority of 3PM's members, it should be noted that the views of the commenters involved in preparing this response may not be representative of the views of the entirety of the 3PM membership or our industry group in general.

3PM believes that the initiation of a retrospective rule review is a prudent step to ensure that regulations remain relevant in a changing environment. In this regard, we applaud the steps FINRA is taking in this regard. We do also believe, however, that with respect to RN 17-06 and the amendments contemplated under this notice, that FINRA has not fully and appropriately updated the Communications with the Public standards to properly reflect the realities occurring in the marketplace.

While 3PM's members operate under a varied set of business models, approximately 2/3s of the Association's 3PM members engage in the business of offering of private funds to institutional investors. It is for this subset of our membership for which we will be commenting to this Regulatory Notice.

Rule 2210

FINRA Rule 2210 provides that communications may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. Regulatory Notice 17-06 goes on to state that "The general prohibition against performance projections is largely intended to protect ***retail*** investors from performance projections of individual investments, which often prove to be spurious, inaccurate or otherwise misleading".

RN 17-06 is proposing to provide an exception to this prohibition of projections for a hypothetical investment planning illustration. 3PM believes that the exception proposed by RN 17-06 is warranted, but requests further analysis to consider an exception to the prohibition of projections when offering private securities to institutional investors. 3PM believes that an exception of this nature is consistent with the spirit of the proposed amendment as well as with prevailing guidance as detailed below.

Precedent to Support our Thesis

In general, FINRA Rule 2210 correctly acknowledges the reality that business conducted with institutional investors is different than business conducted with retail investors. Under this rule, the differences inherent in these two investor groups are addressed; communications with retail investors require more stringent supervision and often pre-approval while institutional communications do not. While we believe that FINRA's decision to segregate this rule into components that provide adequate protection to each type of investor based on their experience and knowledge of investments is appropriate, we question why this standard was not applied to the rule in its entirety.

Furthermore, the suitability rule, FINRA Rule 2111, another sales practice rule, also differentiates the suitability process by retail investors and institutional investors. While documentation and suitability assessments for retail investors is very detailed, the approach for institutional investors is more streamlined and straightforward. This again reinforces the belief that retail investors require far more protection than institutional investors who are better able to assess an investment than their less experienced counterparts.

Additionally, FINRA has issued several interpretative letters that support this assertion. One example of this is evident in the letter issued to Mr. Budge Collins of Collins/Bay Island Securities (9/14/2004) regarding the "Use of related performance information in communications with the Public for Private Funds". The response to Mr. Collins, in-part, states "NASD staff believes that the presentation of related performance information to potential investors in 3(c)(7) funds, who are 'qualified purchasers', does not present the same investor protection concerns as the presentation of related performance information in other contexts."

Given the precedent that exists, we believe that FINRA should expand this approach, which is already applied in the same rule, to the prohibition of 'projected performance' discussed in this regulatory notice.

Retail vs. Institutional Investors

It is important to note that in the institutional arena there are a variety of inputs that investor use to determine whether an investment should be considered and ultimately whether an investment should be made. Projected performance is just one part of the equation.

When looking for an investment, investors, specifically institutional investors, want to be able to tell immediately if an investment warrants a further look. Today, when investors are inundated with product, they need a mechanism by which they can shrink down the enormous universe of investments into a small sub-set of strategies at which they can look at more closely. Projected performance is one of the ways they do this.

Once an institutional investor decides to look further at a security, a formal review begins. The due diligence process used by institutional investors is quite exhaustive. While it may differ somewhat by investment product, there are, however, four underlying areas of focus that all institutional investors review before making a judgement on the attractiveness of any investment product.

- First, it starts with an examination of the PEOPLE at the investment manager responsible for the product. Do they have adequate investment knowledge and familiarity with the offered product? How long has the team been working together and do they have any conflicts of interest with investors?

- Second, the institutional investor examines the PHILOSOPHY underlying the investment. Is it a well-articulated investment strategy? Can it be documented; does it make sense? Is there a consistent adherence to the strategy?

- Third, is an evaluation of the PROCESS or investment decision making. Who makes investment decisions? How are they generated, researched, pursued and screened? What are the lines of authority, responsibility and accountability?

- Fourth, is a full evaluation of PERFORMANCE, not just the projected performance. Were the results produced by current people utilizing current process? Was there a review an analysis of funds and benchmark with similar objectives and characteristics?

Institutional Investors realize that market conditions change and that past performance is not that reliable when trying to determine future expected returns. However, past performance may be helpful to complement or strengthen the institution's favorable evaluation of an investment manager's product.

Fund Projections

To understand why we think performance projections should be permitted, it is important to understand how investment managers offering private securities develop performance projections for their funds. Projected performance is not an arbitrary number that is pulled out of thin air, but rather a systematic derivation of several factors that combined result in that projection. It is the rate of return that the investment manager believes is achievable in light of their strategy, current market conditions and its deal flow.

To calculate performance of a Fund of alternative investments, the manager will calculate the Internal Rate of Return (IRR) for each investment in the fund. IRR is defined as the discount rate at which the net present value of a set of cash flows equals zero, where the initial investment is expressed negatively and the returns from real estate investments are expressed positively. In more simple terms, it is the rate at which an investment grows. In this sense, you can think of it as a time sensitive compounded annual rate of return.

For example, please consider an investment manager who is raising capital for a single investment, say an apartment complex. To calculate projected performance, the investment manager will calculate the IRR on the project given the costs of the project relative to the projected revenue it will receive from each investment. The inputs to the process are based on current and historical facts and figures, assumptions that could impact either the cost or revenue of the project as well as the managers experience in the industry. Generally, a formal model that outlines the inputs and assumptions is developed and provided to potential investors who are contemplating an investment. Forecasting returns in this manner is an important component of the investment decision-making process.

As with all investments, the projected performance is not a guarantee that the investment will return a certain percentage, but rather it is an estimate of the return that can be expected. Private Placement Memorandums (PPMs) inherent to the offering of any private security contain disclosures, often with emphasis, stating that there is no guarantee the investment will earn a certain return or that past performance is indicative of future returns. These projected returns are alternatively meant to help the investor determine whether the risks of the investment are justified by the potential rate of return and to compare other potential investments the investor is considering.

When looking at a Fund investment the process is similar although a bit more complex considering the Fund will invest in multiple projects, properties, companies or investments at the same time.

To determining the projected return of the Fund, an investment manager will often start with actual fund performance of its predecessor fund. The manager will then consider other inputs such as the size of the fund, terms of the current fund compared to past funds, current market conditions affecting the strategy, competition as well as any other factors that could impact the projected return.

When management of the Fund begins, the investment manager will model each investment and calculate the IRR to determine the attractiveness of the investment. If the IRR of a new investment exceeds a company's projected performance, then the investment is desirable. If IRR is below the required rate of return, the investment should be rejected.

Projected performance, is not arbitrary. It is based on hard facts. Furthermore, while most of the inputs that go into calculating the IRR are objective, an investment manager has the ability to adjust its model to account for facts that may not be evident based on historical performance.

In the Private Equity market, it is common for managers to come to market several times with funds utilizing the same investment approach. In most cases, the fund size grows each time a new fund is launched. At some point capital commitments, will grow to a point where the manager will no longer be

able to find enough suitable investments that meet its previous targeted return. In such instances, the manager must often look at other investments that are either outside his preferred criteria or that return less than his targeted return. This is often referred to as style drift.

To account for this phenomenon, a manager could adjust its projected performance to reflect this occurrence, signaling investors that something in the Fund approach has changed. Alternatively, if an investor does not have projected performance they will be forced to rely on past performance information which in this case would be misleading at best.

Use of Projected Performance

Investment managers who seek capital for their investment opportunities must be able to clearly and concisely convey their investment thesis and strategy and describe how that process has generated its historical track record. Projected performance is the way investment managers encapsulate all of these factors into a number that accurately and concisely represents their product. This is just one reason that projected performance has become a vital component of modern day investment analysis. Given the importance of this projected performance, calculations of such must be based on a sound and reasonable methodology. This explains why investment managers are constantly developing and refining these figures for accuracy through comprehensive scenario analysis.

Alternatively, institutional investors require projected performance form any of the multitude of investment opportunities available to them. Finite resources such as time and capital dictate that institutional investors employ effective filtering tools to distill large numbers of prospective investment opportunities to a manageable target universe that may ultimately lead to an allocation or two. One of the most common filters used by institutional investors is the data point of projected performance.

Institutional investors that utilize projected performance also pay close attention to the pro forma analysis which generally accompanies closed-end structured investment vehicles or securities such private equity and real estate. These forward-looking performance projections as well as the underlying methodology used to calculate the performance allow institutional investors to gauge a fund's approach. Simply put, institutional investors use performance projections to weigh the risk/reward attributes of a strategy and assist in understanding a variety of hypothetical illustrations used in the scenario analysis. This information enables the institutional investor to analyze, compare and determine their focus on each investment opportunity accordingly. Comparative analysis is commonly used by institutional investors and projected performance of various investments is what they are comparing.

Given the realities of the market, we believe that a general prohibition on the use of projected performance is unnecessarily restrictive.

Reasonable Basis

When discussing the proposed amendments, Regulatory Notice 17-06 states that "The proposal would require that there be a reasonable basis for all assumptions, conclusions and recommendations, and that the illustration clearly and prominently disclose the fact that the illustration is hypothetical and there is no assurance that any described investment performance or event will occur. All material assumptions and limitations applicable to the illustration would have to be disclosed."

We believe that this same approach could be applied to third party marketers or placement agents soliciting investments from institutional investors when using projected performance for a fund or security they are offering. In such a case, we believe any use of projected performance should be accompanied by a clear and prominent disclosure written by the distributing broker dealer which contains the following information:

- Statement that the broker dealer believes there is a reasonable basis to believe the projected performance is representative of the security or fund it represents
- Statement that the projected performance is hypothetical and there is no assurance that any described investment performance or event will occur.
- Description of the methodology used to develop the projected performance
- Explanation as to why the methodology used is a good predictor of the projected performance of the security or fund
- All material assumptions and limitations applicable to the calculation of the projected performance

Furthermore, we believe that several of the well-established precedents cited by FINRA, in its own rules and those of the SEC, are also applicable to 3PM's case.

To protect the institutional investors we work with, 3PM would also recommend that any projected performance along with the required disclosure, as outlined above, should also receive pre-approval, before use, by a registered principal of the broker dealer who plans to utilize this information. Given that the projected performance is likely to come from the Fund sponsor, the broker dealer's registered principal should be tasked with determining whether there is a reasonable basis to rely on the projected performance based on the methodology, assumptions and limitations provided with the projected performance. This approach would provide an independent assessment and help mitigate the conflict of interest inherent in the fact that the Fund Sponsor is not only projecting performance but is also determining the case for why its use is "reasonable".

Economic Impact Assessment

At the core of our assessment of economic impact is the question of common sense and fairness for the industry. Given this, we suggest a few baseline considerations in this regard:

1. In the case where 100% of the market is held to the same standard, while the economic assessment may still prove problematic, it is at least evenly applied.
2. Similarly, where rule sets are consistent across regulatory agencies in relation to the same business practice, with most firms being required to be regulated by more than one agency, economic impact is consistent.
3. If the rules provided create inconsistency among constituents and/or by regulatory body, this places a greater burden on some firms over others, which creates economic impact that is negative for many market constituents.

3PMs exist, in part, to help level the playing field – ie to assist investment managers without internal sales and marketing resources to be able to compete with those that do, obtain access to capital and to provide small managers and/or strategies newer to the market with access to a broader investor base. Our issue however, is that we ourselves are subject to an uneven playing field.

Regulation that creates inconsistency, or provides one group with an 'advantage' over another is harmful to 3PMs. It is also harmful to our investment manager clients, institutional investors and their constituents which include: pensioners, grant recipients, universities, charitable organizations, etc.

Should the unlevel playing field persist, 3PMs eventually will be forced to choose between exiting businesses that require more resources for a substantially lower probability of earning revenues or putting up with the disadvantages created by the regulation that is supposed to promote a fair market place for all. If investment managers who relied on 3PMs were to lose access to our services, taking many small and mid-sized managers out of consideration by institutions, the largest and most well-funded investment management firms who can 'afford' in house resources and sizeable infrastructures would hold a monopoly on asset gathering.

To an extent this is already the case, with larger investment managers holding a disproportionate share of institutional assets.

The unlevel playing field also hurts:

- Third party marketers who can no longer make a living due to the rising cost of regulation and the detrimental impact of Rules that prevent third party marketers from fairly competing with internal sales professionals
- investment managers who have no way to access institutional capital, will be forced to raise retail assets which is also not easy without a staff to do so

- the investment manager's staff who are out of work when the manager goes out of business because it can't raise assets and earn fees
- institutional investors who will no longer be able to access the strategies of investment managers with no internal sales support
- With no access to smaller managers, investors would be forced to invest with the largest investment managers, many of who do not offer the most competitive performance given their size
- Investments with the largest firms could impact performance causing the investor to underperform their targets
- Missing targets directly impacts the constituents of the institutional investor such as pensioners, grant recipients, universities, charitable organizations, all of whom rely on the institution for funding

It is our hope that regulators like FINRA, the MSRB and SEC will see how small businesses in the financial industry are suffering the consequences of over-regulation which leads to this uneven playing field. While regulatory support might not be the only solution, it would at least help by eliminating unreasonable restrictions on firms working with institutional investors.

Below are some examples and their related considerations:

- While we agree that past performance may not recur and thus understand the potential risk of a 'projection', we believe that this rule is actually forcing investors to rely on past performance if they do not have target returns to evaluate. In addition, the lack of a projected performance gives investors no frame of reference for performance. In some cases, it is more meaningful to provide a data based projected return which may in fact be lower than the past performance and should be in many cases.

  For example, a first-time real estate Fund performed exceptionally well, generating performance around 20%. The investment manager launches a second fund using the same strategy while the market conditions have changed and have lowered the projected performance of the fund. In such a scenario, we believe that a registered representative should be permitted to provide information to a prospective investor with a more realistic projected performance range rather than let the investor believe that the higher performance earned in the first fund will persist and be generated by the second fund.

  In the Private Equity market, it is common for managers to come to market several times with funds utilizing the same investment approach. In most cases, the fund size grows each time a new fund is launched. At some point capital commitments, will grow to a point where the manager will no longer be able to find enough suitable investments that meet its previous targeted return. In such instances, the manager must often look at other investments that are

either outside his preferred criteria or that return less than his targeted return. This is often referred to as style drift.

To account for this phenomenon, a manager could adjust its projected performance to reflect this occurrence, signaling investors that something in the Fund approach has changed. Alternatively, if an investor does not have projected performance they will be forced to rely on past performance information which in this case would be misleading at best.

Being allowed to discuss the targeted return for investment products and services should be permitted to at least some investors, namely institutional investors.

- Since the majority of investment managers third party marketers work with are registered with the SEC, Rules like 2210 which prohibit the use of projected performance do not apply to internal sales and marketing professionals. We believe that this creates an unfair playing field and is detrimental to the goal of fair and open markets.

  Third party marketers are put at a disadvantage when offering product to investors. Fund managers and their internal employees will always discuss the targeted return of an investment. This leads to an uneven playing field in a very competitive market place where many investors will immediately pass on a product that does not show a targeted return. It may even result in the investment manager electing not to hire a Solicitor as they may view, and correctly so, the marketing effort at a disadvantage.

- Should third party marketers choose to exit this business, investment managers will need to find other avenues to offer their services to institutional investors. If this were to occur, institutional investors would have less access to the products that third-party marketers represent and the investment arena would be further monopolized by the largest firms who can afford an internal team infrastructure.

To minimize economic impact of this and subsequent regulation, 3PM suggests a review of the consistency of rules across regulatory bodies in relation to these business practices and regardless of whether the delivery of information is from an internal employee or a third-party marketer. Similarly, 3PM suggests a clear delineation between institutional and retail audiences and standards.

FINRA specifically request comments concerning the following issues:

1. In addition to the economic impacts identified in this proposal, are there other significant sources of impacts, including direct or indirect costs and benefits, of the proposed amendments to the firms and investors? What are these economic impacts and what factors contribute to them? What would be the magnitude of these costs and benefits? Please provide data or other supporting evidence.

Please see the section above entitled Economic Impact Assessment.

4. Are there other alternative approaches FINRA should consider to accomplish the goals described in this proposal? If so, what are those alternatives and why are they better suited?

In RN 17-06, FINRA states that "the general prohibition against performance projections is largely intended to protect retail investors from performance projections of individual investments, which often prove to be spurious, inaccurate or otherwise misleading". We agree with this assessment and as such 3PM would like to see this portion of the advertising rule approached in the same manner as the rest of the Rule; namely by the same segmentation between retail and institutional investors.

Furthermore, we believe that allowing the use of projected performance when marketing securities to institutional investors would be more beneficial to investors rather than detrimental

For example, in the Private Equity market, it is common for managers to come to market several times with funds utilizing the same investment approach. In most cases, the fund size grows each time a new fund is launched. At some point capital commitments, will grow to a point where the manager will no longer be able to find enough suitable investments that meet its previous targeted return. In such instances, the manager must often look at other investments that are either outside his preferred criteria or that return less than his targeted return. This is often referred to as style drift.

To account for this phenomenon, a manager could adjust its projected performance to reflect this occurrence, signaling investors that something in the Fund approach has changed. Alternatively, if an investor does not have projected performance they will be forced to rely on past performance information which in this case would be misleading at best.

5. This Regulatory Notice includes examples of factors that would and would not provide a "reasonable basis" for performance projections under the proposal. Are the historical performance and performance volatility of asset classes appropriate factors that would provide a reasonable basis for performance projections? Are there other examples that FINRA should provide that would further clarify what would constitute a "reasonable" basis for a performance projection?

In addition to the information provided, we believe that the use of specific and relevant market indices, peer group comparisons, and other widely acceptable absolute and relative historical investment performance of a specific investment strategy should also be considered. For example, in the private equity market, it is very common to review performance on a vintage year basis. While in most cases, past performance in and of itself is not a guarantee of future performance, it is however used as a basis to compare other years of performance and to establish a base-line of performance for PE investments. Even the traditional public equity markets utilize past data to estimate the overall return on the stock market and we believe that same should hold for alternative asset classes.

6. The proposal would not permit performance projections for a single security. Securities Act Rule 156, which governs investment company sales literature, provides in part that a statement could be misleading because it includes representations about future investment performance. Are there single investment products that operate like an asset allocation or other investment strategy for which performance projections might be appropriate?

The current marketplace includes many investment products that operate and perform like an asset allocation. Nearly every type of alternative investment category has such a product. A few of the many examples that exist include the following:

- **Hedge Funds**: ***Multi-strategy Funds***. Covers a variety of sub-strategies in the Hedge Fund universe. Can be used by investors to obtain broad hedge fund exposure without investing capital with managers focused in a specific sub-strategy like long/shore, market-neutral, arbitrage, Emerging Markets, Event Driven, Corporate Governance, etc.

- **Real Estate**: ***Core Real Estate Products*** - Covers a variety of sub-strategies in the Real Estate universe. Can be used by investors to obtain broad real estate exposure without investing capital with managers focused in a specific residential, commercial, luxury, raw land or can be used to mimic overall exposure to a sub-category like residential – which might include single family and multifamily properties.

- **Private Equity** – ***Core Private Equity Funds*** - Cover a variety of sub-strategies in the Private Equity universe. Can be used by investors to obtain broad exposure without investing capital with managers focused in a specific sub-strategy like venture capital, buyouts, secondaries or co-investments. Like Real Estate these funds are also further segmented and may include the various stages of a venture capital deal from early to late stage, or differentiate investments by geography, whether it be in the US, or outside the US in developed or emerging markets.

- **Infrastructure Funds.** Infrastructure Funds roll-up a variety of different strategies including Renewable Energy, Non-Renewable Energy, Utilities and Pipelines, Power Generation & Transmission, Transportation. These funds also invest in raw land, parking structures, and hospitals. Not only has infrastructure morphed into its own investment category, but some of its investments also overlap with other sector strategies such as energy. Global Funds will also differentiate investments by geography, and will include allocations to the various sectors in the US and outside the US in both developed or emerging markets.

These single investment products were all designed to provide investors with broad exposure and as such operate like an asset allocation. Given this, there is no reason to differentiate these securities from the rules that govern the performance of an asset allocation or investment strategy.

Furthermore, if these securities, given their similarities to an asset allocation of investment strategy were to be permitted to use projected performance, it would be logical to also allow other securities to use projected performance.

As discussed throughout this comment letter, we believe that performance projections should be permitted when discussing the securities offered by a private fund. We however, do not believe that these projections should be permitted across the board but rather only when the recipient of these projections is an institutional investor.

While we understand that not all institutional investors are the same and that not all are sophisticated enough to determine the appropriateness of an investment, we do believe that most either employ internal staffs that have sufficient experience to make these determinations or utilize the services of an investment consultant who help the investor select the appropriate investments.

This leaves a small group of institutional investors that might not be capable to discern the relevance or reasonableness of projected performance. These investors would, however, not be without protection. In such instances, other FINRA rules would come into play and serve to protect these investors. Some examples of these include FINRA Rule 2090 (Know Your Customer), 2111 Suitability, 2310 (Direct Participation Programs), 5123 (Private Placements of Securities) as well as the guidance provided to members in notices such as NTM 03-71 (Obligations when selling Non-Conventional Investments) and NTM 03-07 (Members Obligations when Selling Hedge Funds).

Given the above we believe that there is a rationale case to permit the use of performance projections when offering securities offered by private funds to institutional investors.

7. The proposal would permit a single projection in a customized hypothetical investment planning illustration. Requiring a range for projections, however, could make the hypothetical nature of a performance projection more apparent. Should the proposal require a range of projections?

While most private Fund Sponsors generally determine a single projection for performance, we would not be averse to insisting that the Fund Sponsors we work with provide a range of projections for performance if FINRA were to consider allowing member firms working with institutional investors as third party solicitors to utilize performance projections.

In addition, we feel that the use of performance projections should be accompanied by a clear and clear and prominent disclosure written by the distributing broker dealer. This coupled with the requirement that performance projections be pre-approved, prior to use, by a registered principal of the broker dealer who plans to utilize this information, would serve to protect institutional investors.

Please see the section above titled "Reasonable Basis" for a further discussion on 3PM's thoughts on disclosure requirements and Principal approval of projected performance.

Thank you for the opportunity to share our thoughts with you regarding this proposal. Please feel free to reach out to me at (585) 364-3065 or by email at donna.dimaria@tesseracapital.com should you have any questions or require additional information pertaining to the proposed amendments to the Communication with the Public rule.

Regards,

<<Donna DiMaria>>

Donna DiMaria
Third Party Marketers Association
Chairman of the Board of Directors and
Chair of the 3PM Regulatory Committee

About the Third-Party Marketer's Association (3PM)

3PM is an association of independent, global outsourced sales and marketing firms that support the alternative and traditional investment management industry worldwide.

3PM Members are properly registered and licensed organizations consisting of experienced sales and marketing professionals who come together to establish and encourage best practices, share knowledge and resources, enhance professional standards, build industry awareness and generally support the growth and development of professional outsourced investment management marketing.

Members of 3PM benefit from:

- Regulatory Advocacy
- Best Practices and Compliance
- Industry Recognition and Awareness
- Manager Introductions
- Educational Programs
- Online Presence
- Conferences and Networking
- Service Provider Discounts

3PM began in 1998 with seven member-firms. Today, the Association has more than 35 member organizations, as well as significant number of prominent firms that support 3PMs and participate in the Association as 3PPs, Industry Associates, Member Benefit Providers, Media Partners and Association Partners.

A typical 3PM member-firm consists of two to five highly experienced investment management marketing executives with, on-average, more than 10 years' experience selling financial products in the institutional and/or retail distribution channels. The Association's members run the gamut in products they represent. Members work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. Some firms' business is comprised of both types of product offerings. Most 3PM's members are currently registered with FINRA or affiliated with a broker-dealer that is a member of FINRA.

For more information on 3PM or its members, please visit www.3pm.org.

3PM
THIRD PARTY MARKETERS ASSOCIATION

January 12, 2016

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

File Number: SR-FINRA-2015-054. [By electronic submission]

Dear Mr. Errett,

The Third Party Marketers Association ("3PM") strongly supports FINRA's initiative to issue a separate rule set for limited purpose firms such as third party marketers, placement agents, investment bankers and other financial advisors that advise companies on mergers and acquisitions, advise issuers on raising debt and equity capital in private placements with institutional investors, or provide advisory services on a consulting basis to companies that need assistance analyzing their strategic and financial alternatives ("Capital Acquisition Broker" or "CAB").

We applaud the steps that FINRA has taken in revisiting this proposal and incorporating the comments the industry had with respect to the original Limited Corporate Finance Broker ("LCFB") proposal issued in early 2015. In the aggregate, 3PM overwhelmingly supports FINRA's revised proposal. We would, however, like to bring the Commission's attention to the following items that should be considered in regards to this proposal. To that end, this letter will set forth our comments, suggestions and proposed amendments as applicable in the hope that we can participate in the forward-moving momentum of this initiative.

GENERAL STANDARDS (CAB RULE 010 SERIES)

Rule 016. Definitions

- **Capital Acquisition Broker (CAB)** – Although the modifications do not impact 3PM's members, we believe that the expanded definition makes sense and as such we are in agreement with the proposed change.

- **Institutional Investor –** 3PM supports FINRA's decision to incorporate "Qualified Purchasers" into the definition of an institutional investor.

MEMBER APPLICATION AND ASSOCIATED PERSON REGISTRATION (CAB RULE 100 SERIES)

Rule 116. Application for Approval of Change in Ownership, Control, or Business Operations

The application seems reasonable given the accommodation of all likely scenarios of establishing CAB member status and/or reinstating previous member status within one year following a member's conversion to CAB status.

Rule 123. Categories of Registration

3PM believes that CABs should not be subject to FINRA Rule 1230(b)(6) regarding Operations Professional registration because of the scope and nature of the examination.

3PM agrees with FINRA's decision to eliminate the limit on the principal and registration categories that would be available for persons associated with a CAB. 3PM requests FINRA's confirmation that CABs may hold all licenses previously sought and attained by their associated persons including Series 53, 4 and other licenses.

Rule 125. Continuing Education Requirements

In general, we support the requirement for CE testing to keep licensure active as well as the proposal to eliminate the requirement to hold an annual compliance meeting.

DUTIES AND CONFLICTS (CAB RULE 200 SERIES)

Rule 209. Know Your Customer

3PM is generally in agreement with Rule 209. Most 3PMs are raising capital for Reg. D products and do so by approaching an "agent" who represents the institutional investor looking to allocate capital. As such, the majority of the communication that takes place is between the "agent" and the 3PM. It is not unusual for there to be little or no communication between the 3PM and the end investor. Given this, there is often some information regarding the institutional investor which may not be obtainable due to this construct. 3PMs are not making recommendations in the traditional definition of the term, and therefore, as an example, will not have insight into the overall composition of the institutional investor's portfolio – as a retail broker would have over one of their accounts. Accordingly, we believe the rules should address some type of minimum compliance that would be appropriate in these situations. We further suggest that a demonstrable best efforts basis may be a satisfactory alternative in such instances.

3PM also seeks clarification of the statement "It also recognizes that a CAB or its associated person may look to an institutional investor's agent if the investor is represented by an agent" Specifically, clarification

as to what "look to" requires and whether this can be interpreted to mean that a CAB's responsibility under 209 is limited to learning the essential facts of the agent.

Rule 211. Suitability

3PM is generally in agreement with Rule 211, however, we still believe that the rule as proposed fails by requiring the suitability analyses to be performed before any recommendation is made. While we agree that a CAB must reasonably believe that an investment is suitable for an investor before making a recommendation, we believe that the rule does not recognize that the process of diligence is ongoing, in many cases can take several months to several years before an investment decision is made, and often does not, and should not, conclude until the deal is closed. We believe incorporation of this process is essential to Investor protections, and to the success of the rulemaking regime for CABs. We continue to believe that Rule 211 should emphasize this point and encourage RRs to periodically review their suitability analysis throughout the offering process, but no less frequently than once before the subscription agreement or relevant contract is signed and due diligence is as complete as it can be at that particular time. While this approach should apply to all recommendations, it is especially relevant in the case of the offering of Private Placements and other complex products.

Most 3PMs are raising capital for Reg. D products and do so by approaching an "agent" who represents the institutional investor looking to allocate capital. As such, the majority of the communication that takes place is between the "agent" and the 3PM. It is not unusual for there to be little or no communication between the 3PM and the end investor. Given this, there is often some information regarding the institutional investor which may not be obtainable due to this construct. 3PMs are not making recommendations in the traditional definition of the term, and therefore, as an example, will not have insight into the overall composition of the institutional investor's portfolio – as a retail broker would have over one of their accounts. Accordingly, we believe the rules should address some type of minimum compliance that would be appropriate in these situations. We further suggest that a demonstrable best efforts basis may be a satisfactory alternative in such instances.

Rule 221. Communications with the Public

3PM is generally in agreement with Rule 221 and supports FINRA's removal of the prohibition on predictions or projections of performance.

Rule 240. Engaging in Impermissible Activities

3PM recommends that FINRA consider a grace period incorporated into this rule, especially in regards to unintentional activities. To this end, we recommend circulating a FAQs piece for greater education and reference of the CAB member firms during the grace period which would outline the most common misunderstandings the Commission and or FINRA may be seeing.

SUPERVISION AND RESPONSIBILITIES RELATED TO ASSOCIATED PERSONS (CAB RULE 300 SERIES)

3PM is generally in agreement with the Rule 300 series with the exception of Rule 331. We applaud FINRA for implementing modifications to the traditional supervision rule that negatively impacts a CAB's business model while not necessarily adding any substantive investor protections and replacing it with Rule 311.

Rule 331. Anti-Money Laundering Compliance Program

3PM recognizes that all financial institutions play an important role in the detection and prevention of money laundering. Further, we are in agreement with FINRA's proposal to allow CABs to conduct independent compliance tests every two years rather than annually. We do however believe that the appropriate steps need to be taken to conform the Customer ID Program (CIP) requirement of the Bank Secrecy Act to the business of a CAB. Since CABs do not hold customer accounts, cash or securities, nor do they open accounts for clients, it is often difficult for firms to obtain the depth of confidential information necessitated by the Rule. When working with Funds, most AML information is collected by the Administrator or the Fund and AML responsibilities are often delegated to these firms by the issuer. Furthermore, if FINCEN's proposal to include investment advisers in the definition of a financial institution is approved, then the investment advisers who are actually opening the accounts with the clients who are investing in their strategies will then be able to conduct a more formal review than a CAB can as an intermediary. We strongly request that the SEC work with the appropriate authorities to revisit the AML responsibilities of CABs and apply consideration to require US registered entities such RIAs to share certain data with FINRA member firms so that all registered participants may satisfy their respective compliance obligations in the most complete and accurate manner possible.

In addition, 3PM seeks the SEC's confirmation that the terms and conditions of the No-Action letters initially dated 2004 and extended by subsequent No-Action letter in January 2015 apply to CABs to the extent that customer ID is reasonable performed by a federally regulated entity under a contractual obligation.

Removal of FINRA Rule 3050 from the CAB Ruleset

3PM is in agreement with FINRA's decision to remove this Rule from the CAB Ruleset.

FINANCIAL AND OPERATIONAL RULES (CAB RULE 400 SERIES)

Rule 411. Capital Compliance

3PM believes that proposed Rule 411 should remove the minimum net capital requirement of $5,000 currently applied to CAB members. While we understand that this is outside of FINRA's authority we urge the SEC to review the calculation of net capital for CABs and modify the Rule so that the nature of a CAB's business does not cause it to have to improperly report its financial condition to FINRA.

The current net capital requirement thresholds of $250,000, $100,000, and $50,000 respectively for carrying members and introducing members are rather arbitrary in nature; however, the materiality of these dollar amounts at least substantively supports the spirit of these minimum net capital requirements which is used to protect investors from unforeseen circumstances. In theory, the broker dealer carrying or clearing that customer account would have minimally sufficient reserves to apply a remedial solution to the customer. When applying this ideology to the $5,000 net capital requirement for CABs (non-carrying and non-clearing members), it is clear that $5,000 would universally be determined as an insufficient amount to apply to any hypothetical remedial solution involving a customer. Moreover, CABs do not hold any customer accounts nor have access to them, so it is unclear what value a net capital requirement has and for what purpose it would be applicable. One may then deduce that this specific net capital requirement remains in place to ensure that all member firms remain on the grid and adhere to the general net capital requirement apparatus, and that perhaps the intention was that a well thought out resolution would be implemented down the line. The time has now finally come, and we collectively need to implement specific rules which effectively and efficiently regulate the CAB universe of member firms.

Countless hours and resources have been allocated to this $5,000 minimum net capital requirement by CABs and FINRA examiners alike. This is clearly not an effective and efficient use of our collective resources when recognizing that the minimum net capital requirement of $5,000 for CABs (non-carrying firm) does not deliver any type of investor protection nor does the role of a VAB demonstrate any basis for a minimum net capital requirements given the limited scope of the activities permitted.

3PM believes that the calculation of net capital and FOCUS reporting requirements for CAB members needs to be overhauled as the current set of calculations and data points are not directly applicable to the business conducted by CABs and as such place a significant burden on CABs without any identified protection to investors. Furthermore, this approach is simply another attempt by the SEC to standardize reporting regardless of fit, rather than make the appropriate changes required for CABs to properly assess their financial viability and the ability to protect investors.

A specific issue that illustrates this disconnect is demonstrated through the revenue generation framework relative to private placement activity. When payment is due, a CAB will book a receivable for the incentive fee owed to the firm. Often a corresponding payable will be established that would pass-through a portion of that fee to the registered representative who gets paid a commission on that fee. Both of these entries are in compliance with the SEC and GAP standards. A disconnect, however occurs in the firm's calculation of net capital. Under SEC rules, the current net capital calculation does not allow the accrued receivable to be offset by the payable that is directly related to it. Instead, the entire net commission payable is required to be recorded as aggregate indebtedness (AI), in effect requiring the CAB to double count the payable. This methodology does not adhere to GAP standards which would allow for the corresponding offset to the receivable. Furthermore, a significant number of PCAOB registered accountants believe that this is the improper way to record revenue or calculate AI. By following the SEC's mandated approach, the CAB is not accurately reflecting its true capital condition.

Rule 414. Audit

Given the nature of a CAB's business, 3PM does not believe that the provision of audited financial statements in any way enhances investor protection. We also believe that the cost of Audits, which are extremely prohibitive to small firms, need to be addressed. Given the new requirement that PCAOB Auditors must now be audited by the Board, the costs of such audits, which will be absorbed by the broker dealer community, is growing exponentially. We are confident that the underlying purpose of Dodd Frank was to address shareholder protections. A CAB has no shareholders, no public customers and as such requiring a PCAOB audit of a CAB is meaningless exercise, well outside the intention of the law. Furthermore, issues raised in the PCAOB interim inspection program simply are not relevant to CABs, and would therefore should not influence the decision to eliminate this requirement for CABs.

3PM is aware that the PCAOB Board, and not FINRA or the SEC, has the authority under Dodd Frank to exempt CABS from this requirement. Accordingly, in addition to commenting in this letter, 3PM will also communicate its findings with the PCAOB directly.

Please see the Appendix for a report entitled PCAOB Audit Oversight and Small, Non-Public Non-Custodial Broker-Dealers; Attributes-Based Analysis of the Broker-Dealer Risk Profile which supports 3PM's perspective.

Rule 436. Fidelity Bonds

3PM is in full agreement with the revisions made to Rule 436.

Rule 452. Supplemental Focus Information

3PM does not agree with FINRA proposal to subject CABs to FINRA Rule 452. While we understand that FINRA does not have the authority to set net capital rules, we do believe that FINRA does have the ability to improve the information requests made in the SSOI. 3PM also believes that the information FINRA receives from these forms are inaccurate due to the wide array of methods, timelines and fee structures applicable to CABs offering private placements.

The SSOI was clearly written under the assumption that there is consistency in the method, timeframe and fee structures that applies to both private placements and publicly traded securities. This is simply an inaccurate assumption. When FINRA was made aware of the inaccuracies, the response was that they understood the shortcomings of the reports, and it was suggested that firms use their best efforts to interpret the questions. While 3PM is not against enhanced reporting for the purpose of gleaning new insights in to a firm's financial condition, we do not believe that it is acceptable for FINRA to issue reporting requirements that do not apply to a constituency or that may distort the findings because of the interpretation of an unclearly written question. As such we think that FINRA should revisit the SSOI requirements for CABs in their current form and consider requesting appropriate information from our

constituency. To accomplish this task, we suggest convening a working committee of CABs to help write appropriate questions that accurately reflect our business model.

Removal of the Requirements of FINRA Rules 4370 and 4380

3PM is in agreement with the removal of these rules from the CAB ruleset.

SECURITIES OFFERINGS (CAB RULE 500 SERIES)

3PM is in agreement with FINRA's proposed 500 series.

INVESTIGATIONS AND SANCTIONS, CODE OF PROCEDURE AND ARBITRATION AND MEDIATION (CAB RULES 800, 900 AND 1000)

3PM supports these proposed rules.

Rule 2266. SIPC Information

While neither FINRA nor the SEC have the authority to modify SIPC rules, we urge the Commission to work with SIPC to exempt CABs from membership in SIPC.

SIPC was created under the Securities Investor Protection Act as a non-profit membership corporation. SIPC oversees the liquidation of member broker-dealers that close when the broker-dealer is bankrupt or in financial trouble, and customer assets are missing. In a liquidation under the Securities Investor Protection Act, SIPC and the court-appointed Trustee work to return customers' securities and cash as quickly as possible. Within limits, SIPC expedites the return of missing customer property by protecting each customer up to $500,000 for securities and cash (including a $250,000 limit for cash only).

SIPC is an important part of the overall system of investor protection in the United States. While a number of federal and state securities agencies and self-regulatory organizations deal with cases of investment fraud, SIPC's focus is both different and narrow: restoring customer cash and securities left in the hands of bankrupt or otherwise financially troubled brokerage firms.

In SIPC's own words, their mission directly relates to protecting customer assets. CAB firms by definition ***"do not include any broker or dealer that carries or maintains customer accounts, holds or handles customers' funds or securities, accepts orders from customers to purchase or sell securities as a principal or as an agent for the customer".*** As such, CABs are continually paying assessments on their revenues in to the SIPC fund to protect investors that will never require coverage from such an event from a CAB. This rule is not properly aligned with the business of CAB and creates significant expenses to CABs without providing any tangible benefit. In reality CABs are paying into a fund that reimburses investors for somebody else's wrongdoing which is an unfair practice. Moreover, we believe the acknowledgement of

SIPC protection on the materials of a CAB who does not maintain any customer accounts, etc. is misleading to investors and may create a false sense of additional protection.

Not addressed in the FINRA rule proposal, but underlying and possibly interfering with the overall impact of the CAB rules on BDs are the new rules being implemented by the MSRB for Municipal Advisers. While CAB proposes to implement meaningful regulations for firms operating under FINRA's rules, the adoption of the tailored rule set would cause conflicts for FINRA members who are dual registrants and are required by their business model to also be registered as a Municipal Advisor with the SEC and MSRB. The CAB proposal streamlines many of the compliance requirements for firms who opt for this regime. However, many of these same firms are also registered as Municipal Advisers, requiring them to adopt many of the policies and procedures that FINRA has clarified and even eliminated. Regulations that would be at odds specifically include CABs elimination of the annual compliance meeting requirement, some of the relief afforded by the changes made to the communications with the public and supervision rules, most notably the elimination of the requirement to perform annual inspections and to send a letter to senior management regarding the firm's supervisory controls, and the change to the AML audit requirement that CABs only perform an independent compliance test every two years rather than yearly. It is our belief that given this, some firm's may choose not to opt into the CAB ruleset unless FINRA, the MSRB and SEC can work together to find a way to eliminate these conflicts. To do so would require acknowledgement from the MSRB and SEC that while 3PMs may be MAs, our firms perform a much more limited function than many other firms operating under the same regulatory scheme. We are happy to speak with FINRA, the SEC or MSRB further on this point should there be an interest in working to resolve this issue.

3PM is pleased that FINRA chose to continue its efforts on behalf of this proposal despite the negative feedback received from the industry. After the release of the first proposal, 3PM did not believe that many FINRA members would convert their registration to this new category given the limited benefits offered. FINRA however was able to take feedback from the industry and reformulate their original proposal into one we think qualifying firms should wholeheartedly take advantage of. Not only does this proposal take a meaningful step to refining an overly burdensome regulatory scheme, but it implements significant cost savings for small firms accomplished without compromising investor protection. While we believe there is still some work to do here, we are extremely grateful to FINRA for taking the first step in the process. In fact, we believe if implemented the CAB rules may increase the number of Firm's who elect to register and thus ultimately increase investor protection through broader oversight.

If you have any questions or comments regarding any of the information contained in this letter or would like to discuss any of these comments in further detail, please feel free to contact me directly by phone at (585) 364-3065 or by email at donna.dimaria@tesseracapital.com.

Thank you in advance for your consideration.

Regards,

//DONNA DIMARIA//

Donna DiMaria
Chairman of the Board of Directors
3PM Association

//LISA ROTH//

Lisa Roth
Board of Directors
3PM Association

Appendix

3PM is an association of independent, outsourced sales and marketing firms that support the investment management industry worldwide.

3PM Members are properly registered and licensed organizations consisting of experienced sales and marketing professionals who come together to establish and encourage best practices, share knowledge and resources, enhance professional standards, build industry awareness and generally support the growth and development of professional outsourced investment management marketing.

Members of 3PM benefit from:

- Regulatory Advocacy
- Best Practices and Compliance
- Industry Recognition and Awareness
- Manager Introductions
- Educational Programs
- Online Presence
- Conferences and Networking
- Service Provider Discounts

3PM began in 1998 with seven member-firms. Today, the Association has more than 65 member organizations, as well as significant number of prominent firms that support 3PMs and participate in the Association as 3PPs, Industry Associates, Member Benefit Providers, Media Partners and Association Partners.

A typical 3PM member-firm consists of two to five highly experienced investment management marketing executives with, on-average, more than 10 years' experience selling financial products in the institutional and/or retail distribution channels. The Association's members run the gamut in products they represent. Members work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. Some firms' business is comprised of both types of product offerings. The majority of 3PM's members are currently registered with FINRA or affiliated with a broker-dealer that is a member of FINRA.

For more information on 3PM or its members, please visit www.3pm.org

LIMITED PURPOSE BDS AND RISK

Attributes-Based Analysis of SIPC Distribution Data

Updated November 7, 2014

Background

PCAOB has received comments and information from trade associations and industry representatives in various capacities regarding its interim audit program and other matters related to its expanded authority under the Dodd Frank Act. Many of these groups have sought carve-outs from the PCAOB audit requirement for introducing firms, among other firm types. In this same context, the Board received a copy of a letter written by SIPC noting the extent to which it had made distributions on behalf of introducing firms.[1]

At a meeting of the members of the PCAOB Board in January 2011, certain Board Members expressed their interest in identifying and understanding trends related to firm attributes that might facilitate a meaningful dialogue regarding risk amidst the interests of the trade groups, the facts and data shared by SIPC, and its own underlying mission to protect investors.

The original version of this report was written in March 2011 in response to the Board's request, presenting preliminary conclusions that certain firms present little or no risk based an analysis of SIPC distributions for years 2008-2010 based on dollar amount and firm attributes.

The original report, presented a meaningful rationale for PCAOB to adopt in carving out certain firms from its audit requirements.

The November update is meant to provide refreshed data, and to restate the prior conclusion, as it remains true to this date.

RISK UPDATE

This report, as update in November 2014, presents updated dated to the tables provided in the original report. It is meant to restate the conclusion that small, privately owned, non-custodial broker-dealers should be exempt from the PCAOB audit requirement.

A review of SIPC distributions demonstrates that companies with only 1 or 2 business types or attributes in the following combinations present little or no risk of insolvency for investors and will not be found among firms subject to SIPC distributions:

- PLA – Private Placement
- Other
- MFR – Mutual Funds Retailer

[1] The SIPC letter is attached as Attachment B to this update.

- VLA – Variable life insurance or annuities
- PLA and Other
- MFR and VLA

Background

There are a high number of FINRA registrants with one or two business types only in the specific combinations noted in the hypothesis.
Consider the following approximate number of firms that fall into these categories:

- 189 broker-dealers report that private placement activity is their only business line;
- 165 broker-dealers do not fall into any of the customary FINRA business lines and disclose "Other" as their only line of business. Most of these describe their business as mergers and acquisitions;
- 562 broker-dealers disclose that they engage solely in private placement agent and "other" activity, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these 916 firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and which does not have customers in the retail sense. The business activities of these firms are governed by contract, and are not 'transactional.'

Consider also the following approximate number of firms that only engage in retail sales to customers by application:

- 32 broker-dealers report that their only business line is to retail mutual funds. Out of these 32 firms, all but 3 have fewer than 25 employees;
- According to FINRA BrokerCheck reports, 20 broker-dealers offer only variable annuities. 15 of the 20 report having fewer than 50 employees;
- 79 broker-dealer firms disclose having only two business lines, mutual funds and variable annuities. Nearly 80% of them have fewer than 10 employees.

These 126 broker dealers only engage in 'application-way' business, which means that their business is limited to purchases and sales of funds and annuities accomplished through direct paper-based application to the mutual fund or annuity companies. These companies do not have custody and also do not have clearing arrangements. Rather they operate through selling agreements with the fund and annuity companies.

It is important to note that the majority of these firms are also very small firms, and many have revenue of less than $1mm/year. (see the chart below) Of the 457 firms reporting only one line of business (private placements, "other", mutual funds, or variable annuities) all but 20 are small firms (fewer than 50 employees). Of those reporting two business lines (Private placements and "other"), 96% have fewer than 50 employees. Nearly 80% of 79 BD firms with combination of only two attributes MFR and VLA have fewer than 10 employees.

Attributes	#Firms	No. with Fewer than 50 RRs	As a %	#Firms with Fewer than $1mm revenue*
PLA	189	185	98%	
Other	165	156	95%	
PLA and Other	562	546	97%	
MFR	32	29	91%	
VLA	20	15	75%	
MFR and VLA	79	75	95%	
Total:	1047	1006	96%	

* To be provided by FINRA

Summary and Conclusion

When the original report[2] was delivered in 2011, the impact of the PCAOB's program on small privately held non-custodial broker-dealers was hypothetical. Now, however, as the PCAOB audit standards come into effect, the impact on small firms is being realized[3]. Audit fees are escalating, and most importantly the pool of auditors available and affordable to small firms is diminishing rapidly.[4] Were the audits meaningful to fulfilling the mission and vision of the PCAOB, then the added costs and burdens might be acceptable. But this is not the case.

The PCAOB's mission is "to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection."

Its vision is to be a model regulatory organization. Using innovative and cost-effective tools, the PCAOB aims to improve audit quality, reduce the risks of auditing failures in the U.S. public securities market and promote public trust in both the financial reporting process and auditing profession.

In a speech made by PCAOB Board Member Jay Hanson in 2012 he set forth the board's mission in clear terms. He advised his university audience: "Never lose sight of the fact that your true clients are the investors in the companies you are auditing, not the company's CFO, or

[2] The original Report is provided as an Attachment B to this update.

[3] [survey detail]

[4] [statistics]

the accounts receivable accountant, or even the internal auditor with whom you may be interacting day after day. When you are working long hours and dealing with difficult issues, it may be easy to forget about the public-interest mission auditors fulfill, but that mission is the only thing that distinguishes the auditor from the legions of others whose work affects the company's financial statements."

The PCAOB should follow Mr. Hanson's lead, and recognize that in the case of small privately held non-custodial broker-dealers, the "investors in the companies" being audited are NOT public investors. They are the broker-dealer principals, the owners, the CFO's themselves, and not the investors that PCAOB was charged with protecting. Oversight of the audits of these firms is nothing more than a distraction from the true objective and mission of the PCAOB.

ATTACHMENT A

SECURITIES INVESTOR PROTECTION CORPORATION
805 FIFTEENTH STREET, N.W., SUITE 800
WASHINGTON, D.C. 20005-2215
(202) 371-8300 FAX (202) 371-6728
WWW.SIPC.ORG

OFFICE OF THE GENERAL COUNSEL

November 2, 2009

BY MESSENGER

Honorable Scott Garrett
Ranking Republican, Capital Markets Subcommittee
House Financial Services Committee
U. S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Re: Investor Protection Act of 2009 Proposed Amendment

Dear Congressman Garrett:

We write to express the concern of the Securities Investor Protection Corporation ("SIPC") with respect to an amendment ("the Amendment") offered by you to the draft bill, the Investor Protection Act of 2009. Section 17(e)(1)(A) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U. S. C. §78q(e)(1)(A), requires registered securities brokers or dealers to file with the Securities and Exchange Commission ("SEC") a yearly balance sheet and income statement ("financial statement") that has been certified by a registered public accounting firm. "Registered public accounting firm" is one that is registered with the Public Company Accounting Oversight Board ("PCAOB") and is subject to its oversight and inspection. See 15 U.S.C. §§78c(59) and 7201(12). Under the proposed Amendment, only brokers or dealers providing clearing or custodial services would be required to have their financial statements audited by a PCAOB firm. "Introducing" broker-dealers, that is, brokerages that merely introduce business to other firms that provide the clearing or custodial services, would have the option of having their financial statements audited by a PCAOB firm or a non-registered independent public accountant.

Broker-dealers, known as introducing firms, may not have the financial resources or expertise to clear or complete securities transactions. Typically, they enter into clearing agreements with other broker-dealers, known as clearing firms, whereby the introducing firm "introduces" customer accounts to the clearing firm. While the introducing firm continues to service the customer accounts and has direct client contact, for example, by soliciting the opening of an account, helping to determine a customer's investment objectives, and accepting orders for the purchase or sale of securities, they rely upon the clearing firm to complete trades and to perform settlement and

custodial functions. See H. Minnerop, The Role and Regulation of Clearing Brokers, 48 The Business Lawyer 841 (May 1993). Introducing broker-dealers typically do not hold customer cash or securities. As such, there would seem to be good cause for the Amendment. Regrettably, history suggests otherwise.

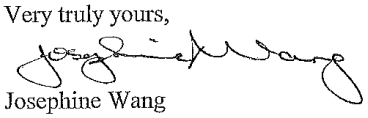
Although introducing firms should not hold customer assets, between 1995 and 2008, 52 introducing brokerage firms were placed in liquidation under the Securities Investor Protection Act, 15 U.S.C. §78aaa et seq. ("SIPA"), at a cost to SIPC of more than $137 million. A list of the firms is Attachment B hereto. Because of the direct client contact, key personnel at the brokerages have been able to acquire customer assets by conversion, unauthorized trading or other improper conduct. See, e.g., In re John Dawson & Associates, Inc., 289 B.R. 654 (Bankr. N.D. Ill. 2003) (claims of conversion and unauthorized trading by an introducing broker are customer claims under SIPA because "customer property" includes "the proceeds of any such property transferred by the debtor, including property unlawfully converted"); In re R.D. Kushnir & Co., 274 B.R. 768 (Bankr. N.D. Ill. 2002) (introducing broker employee used clearing broker computer system to make unauthorized trades in customer accounts).

An audit of the introducing brokerage by a registered public accounting firm could uncover wrongdoing and minimize or avoid losses to customers in such cases. Bernard L. Madoff Investment Securities LLC ("BLMIS") is a good example of the dire consequences if a broker, even one that clears for itself or for others, can avoid auditing by a registered accounting firm. Under an SEC exemption, Friehling & Horowitz, a three-employee accounting firm, was able to avoid oversight by the PCAOB and continue to audit BLMIS. David Friehling, the sole proprietor of the accounting firm, reportedly will plead guilty on November 3, 2009 for his role in the Ponzi scheme.

Currently, section 601(b) of the Investor Protection Act would amend section 101(a) of the Sarbanes-Oxley Act, 15 U.S.C. §7211(a), to require all companies, and not only "public companies," to be audited by accounting firms registered with the PCAOB "in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports...." This would include all brokerages -- introducing broker-dealers and clearing broker-dealers alike. Respectfully, we submit that the Amendment does not further those objectives by limiting the provision to registered brokers or dealers that provide clearing or custodial services.

A copy of this letter is being provided to Chairman Frank. If there is any additional information that we can provide, please let us know.

Very truly yours,



Josephine Wang
General Counsel

Encs.

ATTACHMENT B

[INTRODUCTION REDACTED]

Hypothesis

A review of SIPC distributions over the past 3 years will prove that companies with only 1 or 2 business types or attributes in the following combinations present little or no risk of insolvency for investors and will not be found among firms subject to SIPC distributions:

- PLA – Private Placement
- Other
- MFR – Mutual Funds Retailer
- VLA – Variable life insurance or annuities
- PLA and Other
- MFR and VLA

Background

There are a high number of FINRA registrants with one or two business types only in the specific combinations noted in the hypothesis.
Consider the following approximate number of firms that fall into these categories:

- 202 broker-dealers report that private placement activity is their only business line;
- 185 broker-dealers do not fall into any of the customary FINRA business lines and disclose "Other" as their only line of business. Most of these describe their business as mergers and acquisitions;
- 520 broker-dealers disclose that they engage solely in private placement agent and "other" activity, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these 907 firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and which does not have customers in the retail sense. The business activities of these firms are governed by contract, and are not 'transactional.'

Consider also the following approximate number of firms that only engage in retail sales to customers by application:

- 48 broker-dealers report that their only business line is to retail mutual funds. Out of these 48 firms, all but 3 have fewer than 25 employees;
- According to FINRA BrokerCheck reports, 22 broker-dealers offer only variable annuities. 16 of the 22 report having fewer than 50 employees;
- 93 broker-dealer firms disclose having only two business lines, mutual funds and variable annuities. Nearly 80% of them have fewer than 10 employees.

These 163 broker dealers only engage in 'application-way' business, which means that their business is limited to purchases and sales of funds and annuities accomplished through direct paper-based application to the mutual fund or annuity companies. These companies do not have custody and also do not have clearing arrangements. Rather they operate through selling agreements with the fund and annuity companies.

It is important to note that the majority of these firms are also very small firms, and many have revenue of less than $1mm/year. (see the chart below) Of the 457 firms reporting only one line of business (private placements, "other", mutual funds, or variable annuities) all but 20 are small firms (fewer than 50 employees). Of those reporting two business lines (Private placements and "other"), 95% have fewer than 50 employees.

Attributes	**# Firms**	**No. with Fewer than 50 RRs**	**As %**	**No. with Fewer than $1mm revenue****
PLA	202	198	98%	
Other	185	177	96%	
PLA and Other	520	513	99%	
MFR	48	46	96%	
VLA	22	16	73%	
MFR and VLA	93	74*	80%	
Total:	**1,070**	**1,024**	**96%**	

* Nearly 80% of 93 BD firms with combination of only two attributes MFR and VLA have fewer than 10 employees…data on 'MFR and VLA' BD firms with fewer than 50 employees is pending
**To be provided by FINRA

Observations and Conclusions

SIPC did not pay out for the firms with the attributes stated in our hypothesis. These findings support an exemption from the PCAOB audit requirement for firms whose business services are limited to these attributes alone or in combination.

When compiling data to test our hypothesis, we noticed several trends that may suggest other types of firms also absent among SIPC distributions and therefore possible candidates to be

carved out of PCAOB audit requirements. Further research is underway to ascertain whether or not any of these trends is worthy of such consideration.

Biography of Aliya Kaziyeva

American University graduate with major in Economics, minor in Mathematics, and 2-year work experience in Deloitte&Touche, Almaty, Kazakhstan, branch. Was accepted into the Full-time MBA program and offered an Assistantship Award at the Isenberg School of Management, University of Massachusetts. Ms. Kaziyeva is seeking a part-time job in the Western Massachusetts area starting from September, 2011. Contact at: 619-283-3500 or aliya.msk@gmail.com.

Biography of Lisa Roth

Lisa Roth is the CEO of Keystone Capital Corporation, an independent broker-dealer based in San Diego CA. Ms. Roth is a member of the Board of the Third Party Marketers' Assoc., heads Member Advocacy for the National Association of Independent Broker-Dealers and serves on FINRA's Small Firm Advisory Board, among other industry and professional affiliations. Contact at: 619-283-3107 or lroth@keystonecapcorp.com.

3PM
THIRD PARTY MARKETERS ASSOCIATION

April 28, 2014

Marcia E. Asquith
Office of the Corporate Secretary FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 14-09

Dear Ms. Asquith,

The Third Party Marketers Association ("3PM") supports FINRA's initiative to issue a separate rule set for limited purpose firms such as third party marketers, placement agents, investment bankers and other financial advisors that advise companies on mergers and acquisitions, advise issuers on raising debt and equity capital in private placements with institutional investors, or provide advisory services on a consulting basis to companies that need assistance analyzing their strategic and financial alternatives (Limited Corporate Financing Broker or "LCFB").

While we applaud the steps that FINRA has taken to move this initiative forward by establishing a working group of industry participants and undertaking a revised rule set, we believe that the proposed rule set requires amendments and changes in order to effectively address the nuances related to the constituency of LCFBs, in order to provide a clear roadmap for regulators, including regulatory examiners in their oversight efforts, and to afford appropriate investor protections.

To that end, this letter we will set forth our comments, suggestions and proposed amendments as applicable in the hope that we can participate in the forward-moving momentum of this initiative.

Rule 016. Definitions

Because the LCFB does not engage individual consumers in the same manner as full service BDs, the term "customer" does not fit in the vernacular of an LCFB. For regulators, regulatory field examiners and industry participants seeking to draft internal working procedures that both conform to regulations and address their business and operating needs, use of the term presents a fundamental obstacle.

In discussion with FINRA staff members we have ascertained that point (f) in the definition of a "LCFB" is intended to bring the institutional investors we work with into the definition of "customers". We feel, however that the way in which point (f) is written is unclear and leaves room for interpretation. Point (f) states that a LCFB is any broker that engages in any one or more of the following activities - qualifying,

identifying or soliciting potential institutional investors. FINRA asserts that this clause should be read to mean that an "institutional investor" is receiving corporate financing services from a LCFB and is thus a "customer". The definition, however, could be interpreted to mean that qualifying, identifying or soliciting potential institutional investors is a service that benefits the manager, fund sponsor or issuer not the "institutional investor". Rather than force the definition into existing terms, we believe a more sound approach involves clear new definitions tailored to the business of an LCFB.

We propose that the term "customer" be eliminated from the LCFB rules. In its place, we recommend the following terms:

- **"Issuer"** – A Manger, Fund Sponsor, GP, Offerer or other similar person or organization that engages the services of a LCFB.

- "**Investor**" – any person, whether a natural person, corporation, partnership trust, family office or otherwise, that commits or is solicited to commit money or capital to the Issuer.

- **"Qualified Investor"** – We propose substituting the term "Qualified Investor" for "Institutional Investor" and utilizing the current definition of "Institutional Investor" as defined in FINRA Rule 2210 with some modifications. One such modification should include allowing Qualified Purchasers, as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 [15 U.S.C. 80a–2 (a)(51)(A)], to be included in the definition of "Qualified Investors". While we recognize FINRA's concerns with lowering the threshold of "Institutional Investor" to "accredit investors", we see Qualified Purchasers as a prudent and reasonable standard for the following reasons:

    - It would provide a standard consistent with the highest requirements of alternative investment funds themselves mandated by the SEC - (3(c)(7) funds versus 3(c)(1) funds – and by extension other private placements and alternative investments; and

    - It would reduce ambiguity and inconsistency with SEC rules both where third party marketers and placement agents conduct business directly with Investors and indirectly through consultants, wealth managers and other investment advisors who serve as Intermediaries for the actual legal and beneficial investors.

- **Intermediary** – a Federally regulated entity that is compensated by an Investor to act on its behalf by engaging in any one of the following activities:

    - Advise the investor regarding its investment policy
    - Determine a target asset allocation

- Provide education on new investment opportunities
- Qualify, identify and select investment managers to handle mandates consistent with the Investors target allocations and risk tolerance

We believe these definitions clearly describe the counterparties involved in LCFB and provide a meaningful foundation and common vernacular for industry participants, regulators, regulatory examiners and investors alike. We believe these definitions effectively remove ambiguity and ensure the consistent application of rules as they are intended. Furthermore, by using terminology that more accurately reflects the business of a LCFB, we would eliminate any inconsistencies or uncertainty that currently exists in the proposed definitions.

Rule 116. Application for Approval of Change in Ownership, Control, or Business Operations

While FINRA has eliminated the need for members changing their status to a LCFB to file a CMA /NMA, firms would still be required to file a request to amend to their membership agreement. We believe that any firm opting into the LCFB category should be permitted to do so without a fee. We further believe that firms should have the ability to change their status back to that of a full broker dealer without the expense of transition or the need to file a CMA for at least the first year of the category's availability. We believe by making the transition period less complex and costly, FINRA will help to facilitate a broader adoption of the new rule set while allowing LCFB's to put these resources towards the revision of their compliance program.

Rule 123. Categories of Registration

3PM proposes that FINRA waive the S99 examination requirement for small firms who have a registered principal assigned to the covered functions outlined in the rule. We believe that the requirements of Rule 1230 should only apply to unregistered individuals handling any of the covered functions outlined.

Rule 125. Continuing Education Requirements

FINRA is waiving the RE requirement for LCFB, but is reserving the right to require firms to take educational courses if mandated. We would not be opposed to the requirement for additional training so long as the training is applicable to the LCFB's business and relevant from an industry perspective. In general, we support the requirement for CE testing to keep licensure active, but propose a two-year frequency which we believe to be more reasonable.

Rule 209. Know Your Customer

We encourage FINRA to consider redrafting the Know Your Customer requirements in the context of our proposed definitions to reinforce clarity and consistency.

3PM believes that regulators including exam personnel and the industry alike will require an understanding of the constituents if the rulemaking is to be effective. As such, 3PM believes that the term "customer" must be removed in order for the sake of relevance. For this reason, consistent with our proposed definitions above, we propose the following general guidelines for Rule 209:

- ***"Knowing you Issuer"*** standard should require the LCFB to conduct a full and thorough risk-based, due diligence review of an entity or person (Issuer) that engages the LCFB, consistent with a reasonable basis suitability review.

- ***"Knowing your Investor or Intermediary"*** " standard should require the LCFB to conduct thorough risk-based, due diligence review of the investor or intermediary that is reviewing the offering, again consistent with the reasonable basis review. This would include ensuring that the intermediary meets all applicable licensing standards, business and experience standards, among other reviews.

Rule 211. Suitability

We believe that Rule 211 is essential to providing meaningful, defining requirements for LCFBs. Because of the unique nature in which LCFBs conduct their business, we believe that Rule 211 must be properly crafted so that regulators, including regulatory examiners, and industry personnel alike will find a common ground, and a far more effective regulatory regime. We believe that the Rule as currently drafted does not adequately capture aspects of the suitability process that are inherent to LCFBs, and, importantly, that it does not adequately provide for investor protections.

We believe the rule as proposed fails in two primary regards:

1) by requiring the suitability analyses to be performed before any recommendation, and
2) by defining suitability in terms applicable to retail investors.

To remedy these issues, we propose that the Rule be redrafted as generally described below:

Regarding the timing of the suitability analysis, we encourage FINRA to recognize that the process of diligence related to offerings ranging from private placements offered to Investors and Qualified Investors, to placements, mergers and acquisitions of businesses of all sizes is ongoing and often does not, and should not, conclude until the deal is closed. We believe incorporation of this process is

essential to Investor protections, and to the success of the rulemaking regime for LCFBs. We encourage FINRA to redraft Rule 211 to require that the suitability analysis be complete by the time the subscription agreement or relevant contract is signed in recognition of the actual ongoing work performed by a LCFB, and, most importantly, to protect Investors in the non-institutional circumstances. With regard to the suitability requirements themselves, we again revert to our proposed definitions, suggesting as follows:

- The LCFB should be required to perform reasonable basis suitability analysis regarding each "**Issuer"** by which it is engaged.

- The LCFB should be required to perform a reasonable basis suitability analysis regarding each **"Intermediary**" with which it does business. The LCFB will perform no look-through to the underlying investor so long as the suitability review of the Intermediary, demonstrates that the Intermediary is qualified to recommend suitable securities to their clients and represents that their clients are Qualified Purchasers and thus "**Qualified Investors**".

- The LCFB should be required to perform Investor-Specific suitability analysis as per FINRA Rule 2111 for every **"Investor"** with which it directly conducts business (not through an Intermediary").

- The LCFB should be required to perform a suitability analysis similar to that required by the institutional investor exemption as per Rule 2111 for every "**Qualified Investor**" for which it directly conducts business (not through an intermediary). The requirement for a "**Qualified Investor**" to provide an affirmative indication of independent judgment should be waived.

Rule 221. Communications with the Public

While the LCFB proposal did remove two of the three communication categories covered by Rule 2210, Retail Communications and Correspondence, these are categories that by definition would not apply to a LCFB who can only work with institutional investors. Accordingly, the changes to the Rule did not make the rule more relevant to the members who may decide to register as a LCFB than it was before. LCFBs are still subject to the same provisions of Rule 2210 covering institutional communications as we were before which we believe do not accurately reflect how LCFB firms operate in a real life setting.

3PM proposes that FINRA revise Rule 2210 and specifically the general content standards to meet the realities of representing Issuers. Proposed modifications should include a realistic approach to setting fair and balanced content standards for communications and marketing materials as well as an expansion of the exemptive provisions for our new definition of "**Qualified Investors**", especially those that are professional allocators or use the services of investment consultants.

Rule 240. Engaging in Impermissible Activities

As proposed, FINRA may impose severe penalties on a LCFB if the firm engages in any activities that require the firm to be registered as a broker or dealer under the Exchange Act. To ensure an evenhanded approach, modification would include explicit language outlining a defined remedial period and process for any unintentional activities of an LCFB until the practical application has played out which will likely illuminate these areas of the Rule framework which warrant additional precision. Egregious and intentional disregard of an LCFB would still fall into the enforceable realm of FINRA authority.

Rule 331. Anti-Money Laundering Compliance Program

3PM recognizes that all financial institutions play an important role in the detection and prevention of money laundering. While we believe that extending the independent test requirement from annually to bi-annually is appropriate for LCFBs, we also suggest that FINRA consider amending the Customer ID Program (CIP) requirements to conform to the business of a LCFB. Specifically, 3PM recommends that LCFB's should be required to implement a CIP as follows:

- For all Issuers and Intermediaries with which the LCFB does business
- For all Investors when there is no Intermediary involved.

Rule 411. Capital Compliance

3PM believes that proposed Rule 411 should remove the minimum net capital requirement of $5,000 currently applied to the LCFB members. Furthermore, FINRA should assist the LCFB community in working with the SEC to correct the calculation of net capital for LCFBs so that the nature of our business does not cause us have to improperly report our financial condition to the FINRA. Additionally, we suggest that FINRA overhaul the current Supplemental Statement of Income ("SSOI") content by convening a working committee of LCFBs to help write appropriate questions that accurately reflect our business model. Further details regarding specific components of the proposal are described below.

- ***Net Capital Requirement*** - The current net capital requirement thresholds of $250,000, $100,000, and $50,000 respectively for carrying members and introducing members are rather arbitrary in nature; however, the materiality of these dollar amounts at least substantively supports the spirit of these minimum net capital requirements which is in part to protect the customer should a scenario unfurl which causes damage to an investor. In theory, the broker dealer carrying or clearing that customer account would have minimally sufficient reserves to apply to a remedial solution for the customer. When applying this ideology to the $5,000 net capital requirement for LCFBs (non-carrying and non-clearing members), it is clear that $5,000

would universally be determined as an insufficient amount to apply to any hypothetical remedial solution involving a customer. One may then deduce that this specific net capital requirement remains in place to ensure that all member firms remain on the grid and adhere to the general net capital requirement apparatus, and that perhaps the intention was that a well thought out resolution would be implemented down the line. This time has now finally come, and we collectively need to implement specific rules which effectively and efficiently regulate the LCFB universe of member firms.

Countless hours and resources have been allocated to this $5,000 minimum net capital requirement by LCFBs and FINRA examiners alike. This is clearly not an effective and efficient use of our collective resources when recognizing that the minimum net capital requirement of $5,000 for LCFBs (non-carrying firm) does not deliver any type of investor protection.

- ***FOCUS Reports and Calculation of Net Capital*** **-** 3PM believes that the calculation of net capital and FOCUS reporting requirements for LCFB members need to be overhauled as the current set of calculations and data points are not directly applicable to the business conducted by LCFBs. We believe that this approach is simply another attempt by both FINRA and the SEC to standardize reporting regardless of fit rather than make the appropriate changes required for LCFBs to properly assess their financial viability and ability to protect investors.

  A specific issue that illustrates this disconnect is demonstrated through the revenue generation framework relative to private placement activity. When payment is due, a LCFB will book a receivable for the incentive fee owed to the firm. Often a corresponding payable will be established that would pass-through a portion of that fee to the registered representative who gets paid a commission on that fee. Both of these entries are in compliance with the SEC and GAP standards. A disconnect, however occurs in the firm's calculation of net capital. Under SEC rules, the current net capital calculation does not allow the accrued receivable to be offset by the payable that is directly related to it. Instead, the entire net commission payable is required to be recorded as aggregate indebtedness (AI), in effect requiring the LCFB to double count the payable. This methodology does not adhere to GAP standards which would allow for the corresponding offset to the receivable. Furthermore a significant number of PCAOB registered accountants believe that this is the improper way to record revenue or calculate AI. By following the SEC's mandated approach, the LCFB is not accurately reflecting its true capital condition.

- ***Supplemental Statement of Income ("SSOI")*** **-** In an attempt to gather new information and intelligence, FINRA implemented the SSOI. The SSOI incorporated new questions and data requests regarding the financial condition of member firms. While the goal of this exercise was worthwhile, we believe that the results FINRA receives from these forms are inaccurate due to the wide array of methods, timelines and fee structures applicable to LCFBs offering private placements

The SSOI was clearly written under the assumption that there is consistency in the method, timeframe and fee structures that applies to both private placements and publicly traded securities. This is simply an inaccurate assumption. When FINRA was made aware of the inaccuracies, the response was that they understood the shortcomings of the reports, and it was suggested that firms use their best efforts to interpret the questions. While 3PM is not against enhanced reporting for the purpose of gleaning new insights in to a firm's financial condition, we do not believe that it is acceptable for FINRA to issue reporting requirements that do not apply to a constituency or that may distort the findings because of the interpretation of an unclearly written question.

Rule 414. Audit

3PM believes that the cost of Audits, which are extremely prohibitive to small firms, need to be addressed. Given the new requirement that PCAOB Auditors must now be audited by the Board, the costs of such audits, which will be absorbed by the broker dealer community, is growing exponentially. The rule requiring PCAOB audits was initially intended to cover firms working with public entities, not small, broker dealers like those that are covered by the LCFB rule set. Furthermore, the PCAOB interim inspection program findings simply are not relevant to LCFBs, and would therefore would not be found in the audits of our firms.

We believe that FINRA should work with other Authorities and Government Agencies, in this case the PCAOB, to help carve out small broker dealers, specifically LCFBs from this new oversight requirement. Please see the Appendix for a report entitled PCAOB Audit Oversight and Small, Non-Public Non-Custodial Broker-Dealers; Attributes-Based Analysis of the Broker-Dealer Risk Profile which supports 3PM's perspective.

Rule 436. Fidelity Bonds

3PM feels that Rule 4360 is not applicable to LCFBs and should be omitted from the rule set. Continuing to subject LCFBs to this Rule does not make sense and offers no protection to the LCFB or investors.

The LCFB proposal did not make any changes to Rule 4360 and as such LCFBs are still required to obtain a fidelity bond. A fidelity bond insures a firm against intentional fraudulent and dishonest acts committed by employees and registered representatives under certain specified circumstances. In cases of theft of customer funds, a fidelity bond generally will indemnify a firm for covered losses sustained in the handling of customers' accounts. Since, by definition, an LCFB is not permitted to hold or handle customer funds or securities, this rule is irrelevant to LCFBs. Under the current rules, LCFBs are required to secure costly insurance policies that would protect us and our customers from bankruptcy. While in theory the idea is sound, in practice if an LCFB was ever sued for wrongdoing, the fidelity bond policy would not cover our firms or provide the bankruptcy protection the Rule was designed to provide. Since

this rule does offer any type of protection, LCFBs are wasting capital on premiums that could alternatively be used to support business operations.

Additional Rules Not Covered in the LCFB Rule Set

3PM believes that LCFBs should be exempt from membership in SIPC. Furthermore, while we understand that FINRA was not the authority that mandated compliance with SIPA, we do believe that FINRA is in a position to assist the LCFB community in its mission to seek relief from this irrelevant requirement.

Rule 2266. SIPC Information

The proposed rule set did not make mention about Rule 2266 and whether or not this Rule applied to LCFBs. 3PM would however like to make clear our thoughts on the relevancy of this Rule to LCFB firms.

SIPC was created under the Securities Investor Protection Act as a non-profit membership corporation. SIPC oversees the liquidation of member broker-dealers that close when the broker-dealer is bankrupt or in financial trouble, and customer assets are missing. In a liquidation under the Securities Investor Protection Act, SIPC and the court-appointed Trustee work to return customers' securities and cash as quickly as possible. Within limits, SIPC expedites the return of missing customer property by protecting each customer up to $500,000 for securities and cash (including a $250,000 limit for cash only).

SIPC is an important part of the overall system of investor protection in the United States. While a number of federal and state securities agencies and self-regulatory organizations deal with cases of investment fraud, SIPC's focus is both different and narrow: restoring customer cash and securities left in the hands of bankrupt or otherwise financially troubled brokerage firms.

In SIPC's own words, their mission directly relates to protecting customer assets. LCFB firms by definition ***"do not include any broker or dealer that carries or maintains customer accounts, holds or handles customers' funds or securities, accepts orders from customers to purchase or sell securities as a principal or as an agent for the customer".*** As such, LCFB are continually paying assessments on their revenues in to the SIPC fund to protect investors that will never require coverage from such an event from a LCFB. This rule is not properly aligned with the business of LCFB and creates significant expenses to LCFBs without providing any tangible benefit. In reality LCFBs are paying into a fund that reimburses investors for somebody else's wrongdoing which is an unfair practice.

Questions posed by FINRA

FINRA particularly requested comment concerning the following issues:

- **Does the proposed rule set provide sufficient protections to customers of an LCFB? If not, what additional protections are warranted and why?**

  We believe it is FINRA's intent and consistent with investor protections in general, to offer the greatest level of protection to the individual or entity making the capital commitment or investment. In our language, as proposed above, this is the Investor. We believe that by changing the definitions that apply to LCFBs as we have proposed, FINRA would address the fundamental confusion and inconsistencies that exist in the current rulebook and close any loopholes that are open to interpretation as to who is actually a LCFB's "customer". Further, we believe that the suitability rules must be amended to better reflect the business those firms offering private placements actually engage in. This would ensure that reasonable basis and investor level suitability are considered ongoing requirements timed to the purchase of an investment rather than to the recommendation.

- **Does the proposed rule set appropriately accommodate the scope of LCFB business models? If not, what other accommodations are necessary and how would customers be protected?**

  We do not believe that the current rule set as written is relevant to the LCFB business model for the reasons articulated above is our discussion on the proposed rule set for LCFBs.

- **Is the definition of "limited corporate financing broker" appropriate? Are there any activities in which broker-dealers with limited corporate financing functions typically engage that are not included in the definition? Are there activities that should be added to the list of activities in which an LCFB may not engage?**

  We believe that definition of LCFB is appropriate.

- **Are there firms that would qualify for the proposed rule set but that would choose not to be treated as an LCFB? If so, what are the reasons for this choice?**

  We believe that firms may forego the new registration category until details regarding the NMA/CMA process are better defined. In particular, the cost of switching registration types and potential enforcement may outweigh the benefits gained by changing categories. For this reason, we request that consideration be given to preliminarily offering the LCFB registration as a category (in lieu of "Other") subjecting the relevant portion of a firm's business to the new rules, as opposed to requiring an all-or-none decision. This would facilitate an orderly transition

for firms, lessen the learning curve for examiners, and generally reduce the margin for unintended consequences.

- **What is the likely economic impact to an LCFB, other broker-dealers and their competitors of adoption of the LCFB rules?**

  3PM does not believe that this rule will have a meaningful economic impact on the LCFBs that are eligible to operate under this proposed rule set. We are not convinced that firms will adopt the rules unless and until LCFB registration eliminates costly and, we would argue irrelevant, financial audits and reporting, AML Independent Testing, and SIFMA registration.

- **FINRA welcomes estimates of the number of firms that would be eligible for the proposed rule set.**

  The below information was excerpted from a report presented to PCAOB in early 2013. While the data may not be as current as we would like, we believe numbers reflect a viable estimate of the firms that would be eligible to register as a LCFB.

  FINRA, defines a small firm is any firm with 150 or fewer licensees, or registered representatives. FINRA is comprised of approximately 4400 firms of which 85% are categorized as small firms. A significant percentage of small broker-dealers that have only 2 or fewer business lines, have less than $1mm in annual revenue, and/or engage in business lines such as private placements, mergers and acquisitions, and other such business lines which would fall under the category of LCFB.

  These types of small broker-dealers are readily identifiable using BrokerCheck, FINRA's public resource for broker-dealer background reviews, or through its central data depository (CRD) with the following acronyms:

    - Other
    - PLA – Private Placement
    - PLA and Other

  Of the 4400 FINRA broker-dealers registered, the statistics reveal the following:

  - 191 broker-dealers report that private placement activity is their only business line;
  - 174 broker-dealers do not fall into any of the customary FINRA business lines and disclose "Other" as their only line of business. Most of these describe their business as mergers and acquisitions;
  - 541 broker-dealers disclose that they engage solely in private placement agent and "other"

activities, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these 906 firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and does not have customers in the retail sense. The business activities of these firms are governed by contract and are not 'transactional.' As such, we would conclude that they would fall under the definition of a LCFB.

It is important to note that the majority of these firms are also very small firms, and many have revenue of less than $1mm/year. Of the 457 firms reporting only one line of business (private placements or "other") all but 13 are small firms (fewer than 50 employees). Of those reporting two business lines private placements and "other", 98% have fewer than 50 employees.

Attributes	# Firms	# with Fewer than 50 RRs	As %
PLA	191	188	98%
Other	174	164	94%
PLA and Other	541	528	98%
Total or Average	**906**	**880**	**97%**

- **Proposed LCFB Rule 123 would limit the principal and representative registration categories that would be available for persons associated with an LCFB. Are there any registration categories that should be added to the rule? Are there any registration categories that are currently included in the proposed rule but that are unnecessary for persons associated with an LCFB?**

  3PM does not believe that the Rule 123 should limit the principal and registration categories that would be available for persons associated with a LCFB. We believe that there are other registration categories that could apply to a LCFB that are not included in the proposed rule set. For example,

  - LCFB firms that are registered as a broker dealer with the ability to engage in investment advisory services would also need to hold the Series 65 or 66 registrations.
  - Some LCFBs may be required under state requirements to hold the Series 63 registration
  - LCFB firms that are distributing mutual funds may have associated persons holding the Series 6 and 26 registrations
  - LCFB firms may be acting as a solicitor for direct participation programs and may have associated persons holding the Series 22 and 39 registrations

- LCFB firms offering private placements whereby the Issuer is a CTA may be required to have associated person who hold the Series 3, 30, 31 or 32 registrations
- LCFB firms offering private placements whereby the Issuer's strategy involves options may hold the Series 4 and 42
- LCFB firms may have associated persons holding the Series 14 examination

As such we believe that FINRA should not restrict the principal and representative registration categories for persons associated with a LCFB.

- **Should principals and representatives that hold registration categories not included within LCFB Rule 123 be permitted to retain these registrations?**

  3PM believes that principals and representatives should be able to continue to retain their registrations so long as they continue to stay current with their CE requirements. We believe that prohibiting a principal or representative from maintaining a registration because it was not within LCFB 123 would be penalizing a professional for choosing to engage in a regulatory scheme that was more relevant to their current business operations. The financial industry has long been categorized by inventive and driven people who often change firms or focus several times throughout their careers. We believe allowing a LCFB to maintain additional registrations would be no different than someone who changed roles in a firm and continued to maintain registrations used in a previous role.

- **Does an LCFB normally make recommendations to customers to purchase or sell securities? Should an LCFB be subject to rules requiring firms to know their customers (LCFB Rule 209) and imposing suitability obligations (LCFB Rule 211) to an LCFB?**

  We believe that there are firms that would otherwise qualify as a LCFB that make recommendations to customers. We believe that our recommendations regarding the fundamental definitions of counterparties and their respective roles in suitability address concerns that may exist or arise from recommendations of this type.

- **Does the SEC staff no-action letter issued to Faith Colish, et al., dated January 31, 2014,9 impact the analysis of whether a firm would become an LCFB? Is it likely that some limited corporate financing firms will not register as a broker consistent with the fact pattern set forth in the no-action letter, or will they register as an LCFB?**

In general, 3PM members conduct a business that is very different than the business conducted by Faith Colish et al. As such we do not believe that this would be a reason for any of our constituents to choose not to register as a LCFB.

3PM does not believe that many FINRA members meeting the definition of this rule will convert their registration to this category. Our reasoning is that there are just not enough meaningful changes to the rule which would make it more conducive to the business of LCFBs. LCFBs are currently spending a great deal of time and resources following rules that are not appropriate or applicable to our businesses. These are resources that can alternatively be applied to making meaningful enhancements to our business and compliance operations.

While we are pleased that FINRA took on this initiative and convened a working industry group to address the issue, the feedback solicited from this group was only related to the definition of an LCFB not the underlying rule set. We believe that FINRA should have taken the initiative at least one step further and worked together with the industry to write a meaningful and relevant rule set rather than the one presented which did little more than remove the sections of rules that already did not apply to us. We only hope that all of the industry feedback received will not dissuade FINRA from revisiting this proposal and this time listening to what the industry has to say. 3PM stands ready to participate in any further initiatives regarding this proposal and looks forward to a day when LCFBs have a rule set that appropriately addresses our business model.

If you have any questions or comments regarding any of the information contained in this letter or would like to discuss any of these comments in further detail, please feel free to contact me directly by phone at (212) 209-3822 or by email at donna.dimaria@tesseracapital.com.

Thank you in advance for your consideration.

Regards,

Donna DiMaria
Chairman of the Board of Directors
3PM Association

Appendix

3PM is an association of independent, outsourced sales and marketing firms that support the investment management industry worldwide.

3PM Members are properly registered and licensed organizations consisting of experienced sales and marketing professionals who come together to establish and encourage best practices, share knowledge and resources, enhance professional standards, build industry awareness and generally support the growth and development of professional outsourced investment management marketing.

Members of 3PM benefit from:

- Regulatory Advocacy
- Best Practices and Compliance
- Industry Recognition and Awareness
- Manager Introductions
- Educational Programs
- Online Presence
- Conferences and Networking
- Service Provider Discounts

3PM began in 1998 with seven member-firms. Today, the Association has more than 35 member organizations, as well as significant number of prominent firms that support 3PMs and participate in the Association as 3PPs, Industry Associates, Member Benefit Providers, Media Partners and Association Partners.

A typical 3PM member-firm consists of two to five highly experienced investment management marketing executives with, on-average, more than 10 years' experience selling financial products in the institutional and/or retail distribution channels. The Association's members run the gamut in products they represent. Members work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. Some firms' business is comprised of both types of product offerings. The majority of 3PM's members are currently registered with FINRA or affiliated with a broker-dealer that is a member of FINRA.

For more information on 3PM or its members, please visit www.3pm.org

PCAOB Audit Oversight and Small, Non-Public Non-Custodial Broker-Dealers

Attributes-Based Analysis of the Broker-Dealer Risk Profile

January 2013

Report Objectives

Since its inception, the PCAOB has exerted diligent efforts to carry out its mission of investor protection. When Dodd Frank expanded the scope of PCAOB authority to include oversight of the audits and auditors of broker-dealers, the broker-dealer community responded with recommendations for exclusions of certain types of broker-dealers. While forging ahead with an interim audit program, Board members have continued to express their interest in identifying and understanding trends related to broker-dealer attributes, facilitating a meaningful dialogue regarding risk, and possibly leading to exclusions.

This brief report will present data and information to support exemption of certain classes of small and limited purpose broker-dealers from the PCAOB audit requirement. It presents an update to data previously shared in March 2011, and asserts that broker-dealers of limited size and/or with limited business purposes present little or no risk relative to the scope of PCAOB responsibilities to protect investors. To best ensure that risk is adequately considered, the report includes an analysis of SIPC distributions through 2012 based on dollar amount and broker-dealer attributes.

Data presented in this report may lead to other useful trend analyses, including the consideration of excluding other types of firms, such as introducing firms, firms with minimum net capital of $5,000, or firms with less than $1mm in annual revenue.

Background

To FINRA, a small firm is any firm with 150 or fewer licensees, or registered representatives. FINRA is comprised of approximately 4400 firms of which approximately 85% are categorized as small firms. But 'small' is relative. To a research analyst, a small cap company is one with $300 million to $2 billion in market capitalization. The JOBS Act, designed to lower the regulatory burdens for small companies intending to go public applies to companies with less than $1billion in revenues. By stark contrast, many of the smallest broker-dealers are scattered along a broad spectrum of characteristics and attributes much smaller than any of these standards.

Low Risk Broker-Dealers Based on FINRA Data

Significant percentages of small broker-dealers have only 2 or fewer business lines, have less than $1mm in annual revenue, and/or engage in business lines that do not inherently indicate high percentages of risk, such as 'application way' mutual funds, variable annuities,

private placements, mergers and acquisitions, and other such business lines. Many of these firms operate under a minimum net capital requirement of $5,000.

Small broker-dealers characterized by business lines are readily identifiable using BrokerCheck, FINRA's public resource for broker-dealer background reviews, or through its central data depository (CRD) with the following acronyms:

- MFR – Mutual Funds Retailer
- MFR and VLA
- Other
- PLA – Private Placement
- PLA and Other
- VLA – Variable life insurance or annuities

Of the 4400 FINRA registered broker-dealers, the statistics reveal the following:

- **191** broker-dealers report that private placement activity is their only business line;
- **174** broker-dealers do not fall into any of the customary FINRA business lines and disclose "Other" as their only line of business. Most of these describe their business as mergers and acquisitions;
- **541** broker-dealers disclose that they engage solely in private placement agent and "other" activity, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these **806** firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and which does not have customers in the retail sense. The business activities of these firms are governed by contract, and are not 'transactional.'

Consider also the following approximate number of firms that only engage in retail sales to customers by application:

- **39** broker-dealers report that their only business line is retail sales of mutual funds. Out of these 39 firms, **all but 3 have fewer than 25 employees**;
- **21** broker-dealers offer only variable annuities. **16 of the 21 report having fewer than 50 employees**;
- **87** broker-dealer firms disclose having only two business lines, mutual funds and variable annuities. **82% of these companies have fewer than 10 employees**.

The **147** broker dealers described above engage solely in 'application-way' business, which means that their business is limited to purchases and sales of funds and/or annuities accomplished through direct paper-based application to the mutual fund or annuity companies. These companies do not have custody of customer funds or securities, and also do not have clearing arrangements (they are not 'introducing'). Rather they operate through selling agreements with mutual fund and annuity companies, which are themselves regulated by the SEC.

It is important to note that the majority of these firms are also very small firms, and many have revenue of less than $1mm/year. (see the chart below). Of the 457 firms reporting only one line of business (private placements, "other", mutual funds, or variable annuities) all but 20 are small firms (fewer than 50 employees). Of those reporting two business lines (Private placements and "other"), 98% have fewer than 50 employees.

Attributes	**# Firms**	**No. with Fewer than 50 RRs**	**As %**
PLA	191	188	98%
Other	174	164	94%
PLA and Other	541	528	98%
MFR	39	37	95%
VLA	21	16	76%
MFR and VLA	87	82*	94%
Total or Average	**1,053**	**1,015**	**96%**

* Nearly 80% of 87 BD firms with combination of only two attributes MFR and VLA have fewer than 10 employees.

Low Risk Broker-Dealers Based on SIPC Data

SIPC weighed in against a statutory exemption for broker-dealers during Congressional deliberations regarding the PCAOB's scope of authority over broker-dealer audits. Later, in response to the request by broker-dealer trade associations and others encouraging PCAOB to carve out introducing broker-dealers from its audit scope, SIPC again wrote to PCAOB in favor of an all-inclusive audit program, citing statistics regarding its payouts related to introducing broker-dealer liquidations in particular.

While SIPC payouts may be used as a measure of risk, even SIPC has never undergone consideration of liquidation coverage for the types of small broker-dealers discussed in this report.

In this context, a review of SIPC distributions for the past 5 years demonstrates that companies with only 1 or 2 business types or attributes in the following combinations present little or no risk of insolvency for investors. In fact, no broker-dealer with 2 or fewer business lines, including those listed below has every been represented on SIPC bankrolls:

- MFR – Mutual Funds Retailer
- MFR and VLA
- Other
- PLA – Private Placement
- PLA and Other
- VLA – Variable life insurance or annuities

Low Risk Broker-Dealers Based on PCAOB Data

PCAOB's interim audit program preliminary results, reported August 2012, reveal certain material weaknesses in BD audit programs. While the findings appear proportionately significant, the results are less worrisome in the context of small broker-dealers as summarized in the table below:

Finding	Description	Application to Small and Limited Purpose Broker-Dealers
Supplemental Report on Material Inadequacies	21 of 23 did not adequately test for controls related to safeguarding securities	Not applicable to non-custodial broker-dealers
Exemption from Provisions of Customer protection Rule	All 14 audits of BDs claiming exemptions to 15c3-3 did not fully comply with conditions of the exemption	Not applicable to non-custodial broker-dealers
Customer Protection Rule	2 of the 9 audits of BDs required to maintain a customer reserve failed to properly verify and disclosure the appropriate restrictive provisions	Not applicable to non-custodial broker-dealers
Net Capital Rule	7 of 23 audits failed to sufficiently test the minimum net capital computation	Not materially significant to broker-dealers with $5,000 minimum net capital
Consideration of Risks of Material Misstatements Due to Fraud	13 of 23 audits did not incorporate adequate assessments of risks of material misstatement	Subject to FINRA reviews, requirements
Related Party Transactions	10 of 23 audits did not adequately test existence and/or sufficiency of procedures related to material third party transactions	Subject to FINRA reviews, requirements
Revenue Recognition	15 of 23 audits did not adequately test occurrence, accuracy and completeness of revenue	Not materially applicable to firms with <$1mm annual revenue
Establishing a Basis for Reliance on Records and Reports	12 of 23 audits did not evidence adequate procedures for reliance on third parties used in the audit process	Not applicable to the accounting firms most likely to perform the audits of small broker-dealers
Fair Value	6 of 9 audits involving valuations did not adequately test valuation	Not applicable to non-custodial

Finding	Description	Application to Small and Limited Purpose Broker-Dealers
measurements	practices	broker-dealers
Evaluation of Control Deficiencies	4 of 23 audits did not evidence sufficient evaluation of identified errors for determination of control weakness	Subject to FINRA reviews, requirements
Financial Statement Disclosures	7 of 23 audits did not evidence adequate tests of accuracy and completeness of financial statement disclosures	Subject to FINRA reviews, requirements
Auditor Independence	2 audits revealed inadequate procedures to test auditor independence	Subject to discussion

This summary data can be interpreted to mean that many of the PCAOB interim inspection program findings simply are not relevant, and therefore would not be found, in the audits of small broker dealers. Of those with a degree of relevance, most would be apparent as a result of the regulatory initiatives carried out by FINRA, which incorporate considerable depth in routine inspections of broker-dealer financial data. FINRA reviews include ongoing assessments of FOCUS filings carried out at both the district and national levels, and FINRA performs routine onsite inspections according to a risk-based cycle. These inspections include reviews of financial data, and cover all registered broker-dealers.

Summary

In its November 2012 Standing Advisory Group (SAG) meeting, the PCAOB SAG members considered important current initiatives, including the auditor's reporting model, PCAOB's standard setting agenda, and consideration of outreach or research regarding the auditor's approach to detecting fraud. In each discussion, in small group settings, audits of broker-dealers were considered and discussed as a specific agenda item. When PCAOB staffers reported summaries from their breakout groups in the large public meeting session, it was apparent that SAG members were receptive to the exclusion of certain types of broker-dealers based on risk. Among other comments, SAG members recommended excluding:

- Wholly owned non-public BDs
- BDs deemed to be low risk based on business model, net capital or ownership structure
- Small, non-public, non-custodial BDs
- BDs that are not issuers

Each of these considerations is consistent with the recommendation of this paper that broker-dealers in any of the following categories should be excluded:

- Non-custodial, non-public BDs with 2 or fewer business lines, including but not limited to the following:
    - MFR
    - VLA
    - PLA
    - 'Other'

Important to the practical implementation of this recommendation, each of the attributes listed above is based on data and information routinely reported to FINRA and/or the SEC. As such, this data is readily available from a reliable regulatory source.

By excluding BDs based on these attributes, the PCAOB will have trimmed its auditor oversight by a measurable degree (approximately 1,400 firms) without compromising its mission.