

VIA ELECTRONIC MAIL

November 11, 2011

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

RE: FINRA RN 11-44 – Customer Account Statements

Dear Ms. Asquith:

On September 29, 2011 the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 11-44 on Customer Account Statements (RN 11-44).<sup>1</sup> In RN 11-44, FINRA proposed amendments (Proposed Amendments) to NASD Rule 2340<sup>2</sup> affecting how firms report per share estimated values of unlisted Direct Participation Programs (DPPs) and unlisted Real Estate Investment Trusts (REITs) on customer account statements. The amendments would limit the time period that the offering price may be used as the basis for a per share estimated value and would also require firms to deduct organization and offering expenses from per share estimated values during the Initial Offering Period.<sup>3</sup> Finally, the Proposed Amendments would prohibit a firm from using a per share estimated value, from any source, if it “knows or has reason to know the value is unreliable,” based on available information that is publicly available or nonpublic information that has come to the firm’s attention, and would allow omission of the per share estimated value on a customer account statement provided that the most recent annual report of the DPP or REIT does not contain a value that comports with the disclosure requirements under NASD Rule 2340.<sup>4</sup>

The Financial Services Institute (FSI)<sup>5</sup> welcomes the opportunity to comment on the Proposed Amendments. We support the intent of the Proposed Amendments which seek to enhance investor protection by providing improved disclosure regarding the value of illiquid DPPs and REITs. However,

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<sup>1</sup> FINRA Regulatory Notice 11-44, available at

<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124538.pdf>

<sup>2</sup> Available at

[http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=4324&element\\_id=3647&highlight=2340#r4324](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4324&element_id=3647&highlight=2340#r4324)

<sup>3</sup> FINRA Regulatory Notice 11-44, available at

<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124538.pdf>

<sup>4</sup> Id.

<sup>5</sup> The Financial Services Institute is an advocacy organization for the financial services industry – the only one of its kind – FSI is the voice of independent broker-dealers and independent financial advisors in Washington, D.C. Established in January 2004, FSI’s mission is to create a healthier regulatory environment for their members through aggressive and effective advocacy, education and public awareness. FSI represents more than 125 independent broker-dealers and more than 31,000 independent financial advisors, reaching more than 15 million households. FSI is headquartered in Atlanta, GA with an office in Washington, D.C.

we do have concerns regarding certain aspects of the Proposed Amendments and seek clarification regarding several issues. These concerns are discussed in detail below.

### Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisors – or approximately 64% percent of all practicing registered representatives – operate in the IBD channel.<sup>6</sup> These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>7</sup> Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to insure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

### Comments on the Proposed Amendments

As noted above, FSI welcomes the opportunity to comment on the Proposed Amendments. While we applaud FINRA's efforts to improve investor protection through the Proposed Amendments, we have several concerns that we urge FINRA to consider. These concerns are addressed below.

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<sup>6</sup> Cerulli Associates at <http://www.cerulli.com/>

<sup>7</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

- Application of Proposed Amendments to an Introducing Broker-Dealer that Does Not Custody the Security or Hold Customer Funds – NASD Rule 2340 requires each general security member to send customer account statements on at least a quarterly basis. The Rule also contains specific provisions regarding estimated values of DPPs and REITs contained in the customer account statement. Under the current Rule, a general securities member must provide a per share value of a DPP or REIT which is based on information which is no more than 18 months old. The Proposed Amendments would alter this requirement by obligating a general securities member to provide a per share estimated value based on an appraisal of the value of the assets, liabilities and operations of the DPP or REIT derived from data which is no less current than the data in the most recent annual report.

While we note that the definition of “general securities member” excludes a member that does not “not carry customer accounts and does not hold customer funds or securities,” we seek specific guidance from FINRA on an introducing broker’s obligations under the Proposed Amendments. Specifically, we seek explicit language in the Proposed Amendments indicating that an introducing broker will not be required to provide a per share estimated value for a DPP or REIT where the introducing broker does not carry customer accounts and does not hold customer funds or securities. Further, we urge FINRA to adopt language that states clearly that introducing broker-dealers may reasonably rely upon valuations provided by the firm custodialing the DPP and/or REIT securities.

- Member Obligations Under the “Knows or Has Reason to Know” Standard – Under the Proposed Amendments, a member is prohibited from providing a per share estimated value for a DPP or REIT if the member “knows or has reason to know” that the value is unreliable. The Proposed Amendments indicate that actual knowledge or a reason to know that the value is unreliable may come from publicly available or non-public information that has come to the firm’s attention. However, we seek additional guidance regarding a member’s obligations and FINRA’s expectations regarding when a member “has reason to know.” Specifically, we urge FINRA to indicate the factors it would use to determine if a firm “knows or has reason to know” that an estimated per share value is unreliable. Additionally, we urge FINRA to provide guidance regarding a firm’s responsibilities with respect to information “that comes to the firm’s attention.” Is a member required to actively pursue information to confirm the reliability of the valuation? If a member does not engage in active research to confirm the reasonableness of the valuation and receives no information questioning the validity of the per share estimated value, has the member satisfied its obligations under the Proposed Amendments? Absent this clarification, our members will lack the information necessary to develop policies and procedures designed to achieve compliance with the Proposed Amendments.
- Increased Cost to Investors – We urge FINRA to reconsider the requirement in the Proposed Amendments to derive the estimated per share value of the DPP or REIT from data that is no less current than the data in the most recent annual report. Changing the requirement that member firms use data that is no less current than the data in the most recent annual report from the existing requirement that they use data that is no more than 18 months old will increase costs for member firms. These costs will result from the obligation to recalculate the per share estimated value more frequently. These costs will ultimately be passed on to investors. Therefore, we urge FINRA to retain the existing 18 month requirement which properly balances the costs of valuation calculations with the benefit of enhanced investor protections.

- Presenting Estimated Per Share Value Net of Organization and Offering Expenses – The Proposed Amendments would require member firms to provide an estimated per share value that is net of organization and offering expenses. Organization and offering expenses consist of expenses incurred in connection with registration and distribution of shares, and include all compensation paid to broker-dealers and affiliates paid in connection with the offering.

This proposal unnecessarily singles out DPPs and REITs for adjustments to value that are not required in other investments. For example, values of five-year certificates of deposit are not required to be adjusted to reflect early withdrawal fees. Similarly, the value of a variable annuity is not required to be adjusted to reflect a potential surrender penalty at the time the statement is prepared. On these investment products, disclosures at the point of sale and in the prospectus are deemed to be sufficient. We urge FINRA to treat DPPs and REITs in a similar manner.

#### Conclusion

We remain committed to constructive engagement in the regulatory process and welcome the opportunity to work with FINRA to enhance investor protection and broker-dealer compliance efforts.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8488.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" followed by "Bellaire".

David T. Bellaire, Esq.  
General Counsel and Director of Government Affairs