Ladies and Gentlemen:

Summary:

Respectfully, Regulatory Notice 15-22 (June 2015) and proposed FINRA Rule 3260 fail to address in a reasonably transparent and up-front manner the elephant in the room: namely, whether a FINRA member securities broker dealer or associated person of the FINRA member will be able LEGALLY to exercise "full" "discretionary power" in a customer's account WITHOUT ALSO BEING DULY REGISTERED AS AN INVESTMENT ADVISER.

Background and Discussion:

In years past, it was not uncommon for securities broker dealers to accept written authorization from customers (usually in the form of a written trading authorization or power of attorney) that specifically granted an individual properly licensed registered representative "full" discretionary trading power/authority over a customer's securities brokerage account. Such "full" discretionary trading power/authority meant that the duly authorized registered representative was empowered legally to effect purchase and sale transactions in the account without first obtaining any other separate or specific authorization from the customer. (Such written authorizations typically did not permit the duly authorized registered representative to transfer or withdraw any funds or securities from the customer's account, and indeed any such purported authority would raise serious concerns.)

Of course, such "full" discretionary accounts raise potential sales practice issues (e.g., churning), potential conflicts of interest and other concerns such as potential undue influence. As a result, various protections were required for all such accounts including, for example, that: a licensed principal must specifically review and approve in writing each and every such discretionary account; each and every trade/transaction for which discretion was exercised must be specifically noted/designated as such, for books and records and supervisory purposes; and such discretionary accounts must be carefully supervised and monitored for potential abuses and irregularities.

Such "full" discretionary trading accounts seemed to be well established and part of the securities broker dealers' routine and ordinary business -- potentially problematic but manageable if properly established, supervised and monitored. And as a matter of course, FINRA examiners devoted some of their examination time and other focus on FINRA members to carefully review such accounts.

This "standard" securities broker dealer practice was turned on its head when, in 2005, the SEC adopted Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (the "Advisers Act") that included "a provision that any account over which a broker-dealer exercises investment discretion (other than on a temporary or limited basis) is subject to the Advisers Act." FINRA Regulatory Notice 15-22 (June 2015), n. 42. In March 2007, a D.C. Circuit decision vacated Rule 202(a)(11)-1, and in September 2007 "the SEC re-proposed its interpretive positions for comment, including the provision regarding the application of the Advisers Act to discretionary accounts." Id. (citing, in relevant part, IA Release No. 2652 (September 24, 2007), 72 FR 55226 (September 28, 2007)). Since 2007, IA Release No. 2652 apparently has languished without further action or final resolution.

All of this should not be buried in a footnote near the end of FINRA Regulatory Notice 15-22. In IA Release No. 2652, the SEC stated very clearly its legal determination that "any account over which a

broker-dealer exercises investment discretion is subject to the Advisers Act." IA Release No. 2652, pg. 8. The SEC explained:

> Specifically, [proposed] rule 202(a)(11)-1(a) would clarify that discretionary investment advice is not "solely incidental to" the business of a broker-dealer within the meaning of [Advisers Act] section 202(a)(11)(C) and, accordingly, brokers and dealers are not excepted from the [Advisers] Act for any accounts over which they exercise investment discretion as that term is defined in section 3(a)(35) of the Exchange Act (except that investment discretion granted by a customer on a temporary or limited basis is excluded).

Id. (footnote reference omitted).

As specified in the quotation above, the SEC would exclude from the Advisers Act scope "investment discretion given on a temporary or limited basis." The SEC explained in IA Release No. 2652 what it meant by this, as follows:

> We would view a broker-dealer's discretion to be temporary or limited within the meaning of rule 202(a)(11)-1(d) when the broker-dealer is given discretion: (i) as to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite amount or quantity of a specified security; (ii) on an isolated or infrequent basis, to purchase or sell a security or type of security when a customer is unavailable for a limited period of time not to exceed a few months; (iii) as to cash management, such as to exchange a position in a money market fund for another money market fund or cash equivalent; (iv) to purchase or sell securities to satisfy margin requirements; (v) to sell specific bonds and purchase similar bonds in order to permit a customer to take a tax loss on the original position; (vi) to purchase a bond with a specified credit rating and maturity; and (vii) to purchase or sell a security or type of security limited by specific parameters established by the customer.

Id., n. 13. Presumably, proposed FINRA Rule 3260(c) attempts to be responsive, at least in part, to the SEC's views as stated in this footnote 13. However, proposed FINRA Rule 3260(c) does not neatly align to the scope of that footnote 13 (and such alignment seems appropriate).

On its face, proposed FINRA Rule 3260(a) largely codifies the previous broker dealer practice described above but WITHOUT, however, giving a clear heads up to FINRA members that, if the SEC's views in IA Release No. 2652 become final, no such "full" discretionary power would be lawful unless the FINRA member or associated person ALSO were registered as an investment adviser. Proposed FINRA Rule 3260 Supplementary Material .01 states, without mentioning this context (and rather unhelpfully stating the obvious without explanation): "Members may maintain discretionary accounts or otherwise exercise discretion in an account only as permitted under the federal securities laws."

The text of Regulatory Notice 15-22 (June 2015) only vaguely alludes to these important investment adviser implications. On page 4 (footnote reference omitted), FINRA stated: "The requirements of proposed FINRA Rule 3260(a) apply to an associated person of a firm who is engaged in investment adviser discretionary activities in a customers' account at the firm or who is granted non-broker dealer and non-investment adviser discretionary authority by a customer of the firm, such as a family member who had given a power or attorney to the associated person." On page 14 (citing to footnote 42, discussed in part above), FINRA stated that it included Supplementary Material .01 "to address the

ability of broker-dealers to maintain discretionary accounts or otherwise exercise broker-dealer discretion in light of a pending SEC rulemaking proposal."

On July 23, 2015, I telephoned FINRA's Afshin Atabaka, Esq., to discuss these matters. We had an excellent substantive discussion. Mr. Atabaka was knowledgeable and professional. He pointed out in particular, among other things, subpart (vii) of footnote 13 in IA Release No. 2652, quoted above, as supporting proposed FINRA Rule 3260(c)(A). He stated that the SEC's views about the federal securities laws control these matters.

Finally, and admittedly anecdotally, my impression from speaking informally with SEC legal staff about these matters is that the SEC believes that the SEC interpretations in IA Release No. 2652 eventually will become final and legally binding. One SEC senior attorney told me that he believes (and that his colleagues believe) that no securities broker dealer or associated person is legally authorized to exercise full trading discretion over any customer account without also being registered as an investment adviser.

Conclusion:

In my personal opinion, by failing to be fully up-front about these matters Regulatory Notice 15-22 (June 2015) and proposed FINRA Rule 3260 are guilty of important errors of omission and, as such, represent traps for the unwary. If the SEC's proposed rulemaking in IA Release No. 2652 becomes final:

- Securities broker dealers and their associated persons would NOT have legal authority to exercise discretionary power in a customer's account pursuant to proposed FINRA Rule 3260(a) UNLESS they also were duly registered as investment advisers; and
- Securities broker dealers and their associated persons NOT duly registered as investment advisers legally could exercise ONLY "investment discretion given on a temporary or limited basis" as defined by the SEC in footnote 13 of IA Release No. 2652 (presumably the scope of this footnote (and/or any successor(s) thereto) would be primary authority) and/or as proposed in FINRA Rule 3260(c) (presumably, FINRA's rule would be subject to the SEC's views in these regards).

I would be happy to discuss these matters with FINRA staff.

Sincerely, Kent Lund

Important Notes: This email and all opinions herein are mine alone and do not necessarily reflect the views of SDR Ventures, Inc. and/or its wholly owned subsidiary SDR Capital Markets, Inc., Member FINRA. Moreover, SDR Capital Markets, Inc. does not open and/or maintain any customer accounts. I am writing in my personal capacity as a securities professional who, over the years, has encountered these types of issues. My personal view, which may or may not be shared by SDR Ventures, Inc. and/or its wholly owned subsidiary SDR Capital Markets, Inc., is that Regulatory Notice 15-22 (June 2015) and proposed FINRA Rule 3260 expressly should provide full context as outlined above in this email. Thank you.

KENT LUND
General Counsel

SDR VENTURES, INC.