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Marcia E. Asquith
Office of the Corporate Secretary
FINRA

Via email pubcom@finra.org
Re: Regulatory Notice 10-33

Integrated Management Solutions ("IMS") is pleased to have the opportunity to comment on FINRA's proposed Rule 4524 (the "Rule") requiring the filing of Supplemental FOCUS Information and a Proposed Supplementary Schedule to the Statement of Income (Loss) Page of FOCUS Report Parts II and IIA. By way of background, IMS is one of the largest providers of financial accounting and compliance consultants to the securities industry, providing such services to about 100 FINRA Members. We believe that this perspective enables us to assess the impact of the Rule on FINRA Member firms.

On an overall basis, we agree that FINRA should have sufficient data so that it can perform its functions. To that end, insufficient FOCUS report information does not allow FINRA to do its job properly. Were FINRA to ask for just a little more detail to avoid Members stuffing data into the "other" categories in the FOCUS report we would quite understand. Instead FINRA has proposed overbearing report formats that do not make total sense to us. And the burden on most of FINRA's Members, of data which arguably are of dubious usefulness to FINRA or the Members, is quite considerable.

A. The Flaw in Broad Undefined Powers

In the Rule, FINRA is requesting broad, open-ended authority to "…require[ ] firms to file such additional financial or operational schedules or reports as FINRA may deem necessary or appropriate for the protection of investors or in the public interest." Such "…schedules and reports, their formats and the frequency of such supplemental filings, would be specified in a future *Regulatory Notice* (or similar communication) to be filed with the SEC."

While the need for such regulatory discretion may appear, at first blush, laudable, it is seriously flawed on both procedural and substantive grounds. As a procedural matter, FINRA is attempting to create a dangerous precedent in asking for authority to implement changes without complying with the usual procedural and notice safeguards

to Members. These safeguards are vital to allow Members to both comment on, and make any necessary internal adjustments as a result and in anticipation of, the proposed changes. Data preparation for FOCUS Reporting, which many firms have systematized and computerized, is not an emergency enforcement issue that requires immediate internal changes regardless of cost, personnel and systemic burdens, inconvenience and the likelihood of errors because the changes have not been adequately analyzed or tested. As a matter of substance, the exercise by FINRA of such broad, undefined power fails to recognize the unintended consequences to Members that hastily implemented requirements may impose. FINRA recognizes the importance and consequences of imposing its protocols summarily by seeking comments on their impact such as by issuing the Regulatory Notice that prompts this response. What justifies FINRA's change in procedure now?

FINRA Members should generally not be asked to compile information in a FINRA-designated format that the Members themselves would not utilize and which they do not necessarily have at their fingertips. In fact, many FINRA Members maintain their books and records in diverse ways to suit their individual needs. Rather than always requiring Members to adapt their reporting to FINRA's convenience, Members should be able to report based upon the nature and scope of their businesses, their size, etc.

For example, we note that at many Members income earned is not defined by a particular product but rather by which locale generates the income or by which business-generating unit produces the income. This diversity in record compilation techniques often reflects the perception that a particular Member has of its business operations. Imagine a trading desk that buys or sells options and their underlying stocks. Aside from the fact that it is often virtually impossible to isolate the income attributable to options or stock, especially if they are being traded in tandem, why should anyone care? At some Members, the stock trading department handles all of these transactions; at others, the options department handles them. At still others, there's a single trading department and all the income is accumulated in a single account. We do not object to FINRA knowing on a broad basis the tenor of the products traded by its Members; our objection is that FINRA need not know how much money is earned by each product. In fact, the knowledge by product is arguably misleading or counterproductive to FINRA itself and it is hard for us to imagine that FINRA sees a need to compile information for which the Members themselves find little use in managing their businesses.

As a general comment, we feel the format of the proposed Schedule is disorganized and not logical in terms of business activities. We are not concerned about the number of new categories proposed, as some in the press and elsewhere have emphasized, but rather on the relevance of some of the proposals, the burdens they impose without a corresponding benefit, particularly in their impact on small firms, and their failure to recognize how Member firms record income and expense.

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Separately, in the interest of transparency into a Member firm's business activities and to better understand industry trends, FINRA is also proposing a supplementary schedule to the Statement of Income (Loss) page of the FOCUS Report Parts II and IIA. FINRA is seeking greater detail of revenues earned or expenses incurred by product or other more specific categories to correct the practice of many firms which now report much of their revenue and expense as "other" (miscellaneous). In mitigation, FINRA asserts that this proposed regulatory burden would not affect firms with limited product offerings. We applaud FINRA for seeking a better breakdown of "other" income and expense, but have concerns as to whether the current proposal meets FINRA's goals efficiently and consistent with how Members operate.

FINRA also proposes to require additional information about a Member firm's underwriting and/or selling group activities when revenue from unregistered offerings exceeds 10 percent of total revenue. When that 10 percent threshold is reached, Member firms would be required to complete the corresponding section of a new Operational Page that is referenced in the proposed supplementary schedule. The proposed regulations create problems of implementation, including, for example, the timing of the reporting requirements and whether small firms which do a private placement perhaps less frequently than once per month are disproportionately burdened by these additional reporting requirements.

One of the biggest problems with the proposed supplemental data form is that the classifications in some instances are absurdly ridiculous and are not consistent with the way firms accumulate data. Another problem is that FINRA has not provided any definitions or instructions. Still another problem is that for some items, the form doesn't conform to generally accepted accounting principles ("GAAP"). This would create the need for two or more sets of books, one for FINRA's FOCUS Report Supplement, a second for a Member's external financial statements, which are constrained by GAAP, and even another for its internal management reporting. We do not see much incremental benefit to FINRA, the securities industry, or its customers by providing a reporting regimen that many Members just don't use for any other purposes.

B. <u>Capital Gains from Investments</u>

Our industry correctly recognized years ago that all similar financial instruments issued by the same issuer are fungible. Their values are the same no matter whether they are acquired to be held for a year, a month or a second. Accordingly, securities broker-dealer financial statements prepared under generally accepted accounting principles make no distinction between how long financial instruments are held or whether they are part of trading portfolios, which presumably are short term in nature, or part of investment portfolios. We simply don't care about how the instruments are treated for tax purposes. The accounting profession recognized this lack of distinction years ago

by combining income from trading and investment portfolios of financial instruments. The industry audit guide published by no less an authority than the American Institute of Certified Public Accountants recognizes that phenomenon, too. Furthermore, different Members may treat the very same transaction differently. For example, a market maker may treat its position in a particular security as a trading position but another broker-dealer that perhaps trades almost as actively may treat the same position as part of its investment account. In fact, a market maker may have a trading position in a particular security and also have a position in the same security in an investment account. We believe that the income from proprietary transactions in financial instruments should all be merged together, without tax distinctions.

We are surprised that FINRA would propose to capture trading income data for twelve separate product categories but at the same time would have only one line for capital gains or losses. Even if FINRA did not agree with our comment, we note that for Members all of the securities transactional income of which is considered to be capital gains, the form as proposed defeats the very purpose of providing more granular information by product. Why have the information reported only on one line when by combining gains or losses from all financial instruments without regard to how they are classified tax-wise, the relevant information would be reported with greater detail? A further benefit of this approach is that FINRA examiners will not need to ask for a further breakdown of the income that is subject to capital gains treatment.

We do note that for purposes of the SIPC assessment, that tax and other definitions do apply. But that's not a reason for thrusting irrelevant or insufficient information before the eyes of FINRA examiners.

C. **Specific Comments on Attachment B**

The Regulatory Notice includes an Attachment B, which details the new information FINRA is requesting. Under the category "Interest/rebate/dividend income," FINRA should separately add: income earned on accounts or other business introduced to other broker-dealers, including referral fees and interest. The question under "Fee Income" of whether the firm manages discretionary accounts is appropriate, but simply does not belong in a financial disclosure document. The "Compensation Costs" guaranteed to LLC Members and Limited Partners inexplicably excludes general partners, officers and directors. We further note that the words "guaranteed to" should be replaced by the word "for" so that all owner compensation can be included in a similar fashion. Finally, the category "Losses in error accounts and bad debt costs" should be amended as follows: "Losses in error accounts, if not reflected in income, and bad debt costs".

We are well aware that at some Members, rather than receiving compensation, owners receive profit distributions or, perhaps, regular periodic draws. We see some merit to

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FINRA gaining an understanding of Member profitability by knowing more about how income is distributed to owners or the other stakeholders of a Member, such as employees. However, FINRA has not recognized this important issue in the Regulatory Notice.

We assume that FINRA may choose to receive more detailed information regarding other parts of the FOCUS report at some time in the future, at which time, FINRA might wish to further modify the information requested in the proposed Supplemental Schedule. Simply put, while it may be easier to roll out schedules one by one, they all really should be looked at as a totality because the systems necessary to produce data in areas other than revenue and expense are similar to those that produce data about Member assets, liabilities and capital.

D. Instructions

It is an exercise in futility to comment on specific line items without instructions. We note with great dismay that there are inconsistencies even in the current instructions between the way that certain transactions are reported in Part II when compared to how they're reported in Part IIA. This evidences, in part, how confusing FOCUS preparation has become. The income from a riskless principal transaction may find its way into commission income at one Member or into trading income at another Member. We are not offended by these differences. We just hope that each Member will report consistently. We need instructions badly.

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Thank you for the opportunity to comment on this matter.

Should you have any questions about our comments, feel free to call me at your convenience at 212-897-1688.

Very truly yours,

Howard Spindel
Senior Managing Director

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