INTEGRATED MANAGEMENT SOLUTIONS

39 Broadway, Suite 1601, New York, NY 10006-3003
(212) 509-7800 • Fax: (212) 509-8347
Direct Dial Fax: 212-202-4066
E-Mail: hspindel@intman.com

November 26, 2004

NASD

VIA E-Mail pubcom@nasd.com

Comments in response to Notice to Members 04-75
Submitted by Howard Spindel

We applaud the notion that persons financing the activities of broker-dealers be provided with adequate information relating to their proposed investment. We have difficulty with rules that mandate specific disclosures. Some of those proposed seem to us to be relatively irrelevant.

In addition, the entire concept ignores the fact that broker-dealers are financed by many different means including equity contributions and non-subordinated borrowings all of which have an impact on any proposed financing using subordinated borrowings.

While generally business enterprises are moving away from rules-based concepts, instead favoring principle-based concepts, this initiative emphasizes specific rules with bright-line tests. The end result from such an initiative is that financing will be accomplished using less strictly governed vehicles thus defeating the ultimate purpose of the rule change.

Our specific comments regarding each of the numbered points follows:

1. Disclosure of intended use of proceeds

We anticipate that broker-dealers would simply declare that new subordinated borrowings would be used for general business purposes. The proposal ignores the fact that financing is fungible. Thus it makes little difference to a business entity whether specific funds it borrows or which have been invested are used for specified purposes. So long as funds are not specifically earmarked and are available for general business purposes, the use of proceeds disclosure is not too relevant. More relevant is that potential lenders or investors in broker-dealers be given reasonably good disclosure of the investee's financial position, including any material contingencies.

2. Disclosure of intended plan of financing

This requirement presumes that the financing plan is quite formal. In so many instances, the plan is informal and financing occur serially as needs develop over

time. Effectively, the mandate assumes that if a plan exists that full disclosure be made to all investors. If a formal plan does not exist, the investors will simply not receive the disclosure that the rule might be intended to give them. We believe it is far better to simply declare that financiers/investors be given full and adequate disclosure of financial position and plans without bright line tests of what that means.

3. Details of senior debt

Clearly the intention here is to force the proposed subordinated lender to recognize some of the risk of making the loan. The proposal does not make clear whether this would include all of a broker-dealer's general obligations in addition to other subordinated debt that would be senior to the proposed subordinated loan. Once again, we believe that the concept of risk disclosure is important but we believe that it is handled more than adequately by the current disclosure document that explains that the proposed lender's claims are subordinate to the claims of others. Let the proposed lender inquire of the borrower what that means. But a rule requiring the disclosure of interest rates and maturities of existing debt might actually cause a lender to falsely rely on that information as if it was the only relevant information. And ignoring non-interest-bearing and non-specific-maturity debt such as accounts payable, taxes payable, and contingencies would serve to only confuse and mislead the potential lender.

4. Details of existing subordinated loans

Once again, these data are only but a few of the data that a subordinated lender needs to make an informed decision. Other data are equally important. In fact, some of the other data are likely to be even more important. Why not simply require full and appropriate disclosure without the bright-line test?

5. Most recent audited financial statement

In general, audited financial statements are at least 60 days or more stale. For a subordinated borrowing that occurs toward the end of the fiscal year of a broker-dealer, the data are often virtually irrelevant. The audited financial statements need to be supplemented by more current financial information or reports. Recently filed FOCUS reports might be helpful in this regard but even these do not include all of the data that a lender might find useful.

<u>Our response to the specific questions follows:</u>

(1) We believe a general requirement for full and adequate disclosure is much better than the specific disclosures that are proposed.

(2) The whole concept of dealing with intentions is fraught with problems. Of course, we don't believe that prior subordinated lenders should be notified of new subordinated financing based upon specific rules. Perhaps subordinated lenders should be kept informed by periodic reporting. What's particularly interesting is that once the loan is

approved and accepted by the broker-dealer, there is little that a subordinated lender can do about protecting the lender's interests as the loans are non-transferable. A minor equity investor generally does not suffer that same plight and thus often has more practical rights than a subordinated lender

(3) Generally, lenders should be somewhat sophisticated. However, there are many situations where non-sophisticated persons should be permitted to lend to broker-dealers, e.g. family members of equity owners should be permitted to lend. Perhaps, NASD should understand the lender's relationship and whether the lender is an accredited investor. Non-accredited investors should be permitted to lend to broker-dealers if a bona fide relationship and reason exists.

(4) See item (3).

(5) The lender should acknowledge the risks by signing a disclosure document. This not only protects the lender by making sure that the lender has the requisite knowledge. It also protects the broker-dealer to some extent.

(6) The disclosure of other subordinated borrowings is only one factor that should be disclosed. There are other data that are likely to be far more relevant. The concept should be full and fair disclosure. Mandates of specific information are counter-productive.

Just as important as the need for properly informing lenders is the need for proposed subordinated loans to be processed expeditiously. If making the rules more complex will result in slowing down a process that often is already too slow, the end result is that segments of the broker-dealer community will suffer needlessly. To that end, we believe that the approval timeframes should be tightened somewhat especially if new rules are adopted in this area.