6/13/08

Proposed FINRA Rule 2267 imposes a new burden on members who do not carry customer accounts and do not hold customer funds or securities. That burden is to provide written notice to its customers once every calendar year which is to include three items of information. FINRA believes that customers who transact business with these member firms should be provided with such disclosures, but it is unclear that such disclosure will provide any significant benefit to customers with no cash or securities held by the member firm.

Existing NASD Rule 2280 applies to all member firms that carry customer accounts and hold customer funds or securities. Such firms send the required disclosures annually to their customers, who are presumably the active accounts which contain customer cash or securities. Apparently, effective immediately when an account is closed (because the customer has withdrawn all cash and securities), the annual requirement terminates.

In the case of firms who do not carry customer accounts and do not hold customer funds or securities, the definition of "customer" is unclear:

1. Conceivably, a direct participation member firm has a customer relationship only during the offering period of any direct participation program, but that relationship terminates at the closing of the direct participation program, when the account is closed because the customer has no cash or securities with the member firm. Therefore the annual disclosure requirement would apply only to customers with pending direct participation subscriptions on a selected annual date.

2. Conceivably, the intent of the rule is to provide such disclosure to any account who has been offered or who has purchased a direct participation interest within the prior twelve months. (It is doubtful that clearing and carrying member firms have employed this definition to their securities transactions).

3. Conceivably, the intent of the rule is to provide such disclosure to any account who has been offered or who has purchased a direct participation interest with the customer account retention period of the prior six years. (It is doubtful that clearing and carrying member firms have employed this definition for their securities transactions). It is of concern that FINRA auditors may apply this burdensome definition unless additional regulatory clarification is provided. It is often the case that offerees of two or three years ago have changed their address, and have no motivation to supply such address change to a member firm who does not carry any of their cash or securities. A requirement to send such "customers" a disclosure statement would be burdensome and of little value.

The proposed Rule 2267, as written, will cause confusion in its application to firms who do not carry customer funds or securities.

I believe that the existing exemption from NASD Rule 2280 (paragraph "b" of that rule) should be continued in FINRA Rule 2267 to exempt from the annual disclosure requirement any member firm that does not carry customer accounts and does not hold customer funds or securities.

If FINRA insists that the disclosure requirement is of value, then the rule must be clarified to define exactly which offerees or purchasers of direct participation programs must receive the annual notice. If such definition includes offerees or accounts with no cash or securities held by the member firm, then such definition should apply equally to offerees and/or closed accounts of member firms who do carry cash or securities on behalf of customers.

A possible middle ground for direct participation firms might be to require the disclosures to be included in the subscription documents for future direct participation offerings (without any "annual" disclosure requirement or "lookback" to prior closed offerings).

Respectfully,

Stephen R. Kinkade CPA
Financial & Operations Principal