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Via email: pubcom@finra.org

April 28, 2014

RE: Regulatory Notice 14-09:
Limited Corporate Finance Brokers

Integrated Management Solutions USA LLC ("IMS") is pleased to comment on Regulatory Notice 14-09 ("RN 14-09"), Limited Corporate Finance Brokers ("LCFB"). IMS is one of the largest providers of compliance consulting and financial accounting services to the financial services industry, providing such services to about 100 FINRA members, among others types of financial services firms.[1] We counsel clients daily on the scope of permissible broker-dealer activities under various FINRA, SEC and other rules. At any one time, we have several New Member Applications or Continuing Membership Applications submitted to FINRA on behalf of clients. We believe that our regular, daily experience with FINRA's membership categories and rules, SEC and other rules, and how they are implemented by the various regulators, enables us to assess the impact of RN 14-09 on current or future FINRA members from both a regulatory and business perspective.

[1] The statements in this comment letter incorporate the views of IMS, not those of our clients.

The Regulatory and Congressional Landscape for Advisory Services since Dodd-Frank

FINRA's LCFB proposal must be evaluated in context with other recent SEC and FINRA actions taken under both the Dodd-Frank and JOBS Acts, as well as pending Congressional legislation, with respect to the activities of broker-dealers that do not carry, clear or maintain customer accounts or even handle customer funds or securities (collectively, "Proposals Concerning Non-Custodial Brokers"). These include Crowdfunding[2]; the no-action letters issued to AngelList[3] and FundersClub;[4] the Six Lawyers No-Action Letter regarding the regulation of merger and acquisition brokers (the "Six Lawyers Letter")[5] and FINRA's proposal to improve the membership application process.[6]

Congress has also indicated its interest in taking some of these decisions away from both the SEC and FINRA. In H.R. 2274,[7] the House seeks to amend the Securities Exchange Act of 1934 (the "34 Act") and modify the FINRA registration and regulatory processes when a broker

2 SEC Release Nos. 33-9470; 34-70741; File Number S7-09-13; and RN 12-34.
3 SEC No-Action Letter, dated March 28, 2013, available at: http://www.sec.gov/divisions/marketreg/mr-noaction/2013/angellist-15a1.pdf .
4 SEC No-Action Letter, dated March 26, 2013, available at: http://www.sec.gov/divisions/marketreg/mr-noaction/2013/funders-club-032613-15a1.pdf .
5 SEC No-Action Letter, dated Jan. 31, 2014, revised February 4, 2014; available at: http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf. We note, somewhat ruefully, given the amount of time that has elapsed, that the Six Lawyers Letter largely incorporates a proposal first made in 2005 by the Task Force of the American Bar Association's Section of Business Law on Private Placement Broker-Dealers ("ABA Task Force Report"). 60 Bus. Law. 959 (2005) or http://www.sec.gov/rules/other/265-23/gvniesar091205.pdf . The ABA Task Force Report contains a very useful analysis of earlier rulings, by regulators and courts, to define the scope of permissible broker-dealer private placement activities. We fully agree with the statement by the Report's authors, as true in 2005 as it is today, that:

> The impetus for this Report is a widely held perception by many members of the Committees mentioned that there exists a major disconnect between the various laws and regulations applicable to securities brokerage activities, and the methods and practices actually in daily use by which the vast majority of capital is raised to fund early stage businesses in the United States. (Id.)

6 RN 13-29; RN 10-01. In addition, proposed amendments to Regulation A, known as Regulation A-plus, are also part of this liberalizing regulatory trend. Reg A-plus, if adopted, will allow issuers more flexibility when using an exemption from the SEC's registration requirements for securities offerings.
7 Introduced June 6, 2013.

advises the ownership transfer of smaller, privately held companies.[8] The House bill provides for a notice-filing registration procedure and more limited ongoing regulatory compliance requirements.[9] This bill has already been passed by the House.[10] A contemporaneous Senate bill, S. 1923,[11] goes even further. It seeks to amend the 34 Act by exempting from registration brokers who advise the ownership transfer of smaller, privately held companies.

The Fundamental Flaw

Regrettably, there is a fundamental flaw that permeates all of the Proposals Concerning Non-Custodial Brokers, including the LCFB proposal: the failure to regulate on the basis of risk.[12] We believe that an assessment of the business risk that these activities may cause in the marketplace would result in a much simpler, unified regulatory approach to the non-custodial or advisory activities of broker-dealers. Instead of perpetuating the archaic notion that receipt of transaction-based compensation automatically requires registration as a broker-dealer,[13] the analytic focus of all regulators should be on risk and risk management. As discussed below, these multiple Proposals Concerning Non-Custodial Brokers have resulted in the Balkanization[14] of financial services activities. Our recommendation would be for a joint committee composed of the SEC, FINRA and NASAA[15] to review the risks inherent in broker-dealer advisory services, with the intent of implementing a simple, unified regulatory approach. This committee

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[8] Defined as private companies with earnings less than $25 million and revenues of less than $250 million.

[9] It denies such registration exemption to brokers who: (1) receive, hold, transmit, or have custody of any funds or securities to be exchanged by parties to an ownership transfer of an eligible privately held company; or (2) engage on behalf of an issuer in a public offering of securities that are either subject to mandatory registration, or with respect to which the issuer must file periodic information, documents, and reports.

[10] Passed on January 14, 2014.

[11] Introduced January 14, 2014.

[12] Interestingly, although not explicitly, the Congressional proposals are more practical and incorporate an assessment of risk that may result from broker advisory services.

[13] We recognize that this concept was not created by FINRA but rather by the SEC many years ago.

[14] Bal·kan·ize, Bal·kan·ized, Bal·kan·iz·ing (from dictionary.com). 1. to divide (a country, territory, etc.) into small, quarrelsome, ineffectual states. 2. (often lowercase) to divide (groups, areas, etc.) into contending and usually ineffectual factions: a movement to balkanize minority voters.

[15] North American Securities Administrators Association.

should be joined by representatives of the CFTC, the NFA and responsible industry professionals. Hopefully, all of these individuals will ignore the fact that in many instances the current complexities represent employment security for each of them. They should act under a mandate to do the right thing for the marketplace and the investing public. Existing antiquated rules should be eliminated because they are expensive or wasteful and fail to incorporate a realistic assessment of risk. Without question, their recommendations should go far beyond the incredibly narrow proposals articulated in RN 14-09.

What is an LCFB?

Overall, RN 14-09 limits the activities of LCFBs to a short list of exclusive activities. Specifically, the following activities are encompassed:

(1) advising companies and private equity funds on capital raising, the purchase or sale of a business or assets, and corporate restructurings (including, without limitation, a going-private transaction, divestiture or merger);

(2) advising a company regarding its selection of an investment banker;

(3) assisting an issuer in the preparation of offering materials;

(4) providing fairness opinions; and

(5) qualifying, identifying or soliciting potential institutional investors.

Explicitly ineligible for LCFB status are firms that engage in a self-evident range of activities: firms that carry or maintain customer accounts, handle customers' funds or securities, accept customers' trading orders, exercise investment discretion on behalf of customers or engage in proprietary trading or market-making.[16] Collectively, most of these are traditional activities for which FINRA membership is mandatory. Nor may LCFBs engage in transactions involving municipal securities.

Is There a Benefit to Being or Converting to LCFB Status?

If an existing broker-dealer client that already provided only the limited list of services set out in RN 14-09 were to ask us if they should convert to LCFB status, our answer would be a resounding "no!" For a current FINRA member, there is hardly any business or regulatory advantage to changing its status.[17] Nor would we recommend a firm contemplating FINRA registration to seek LCFB status. There are too many intrinsic limitations to LCFB status, as discussed below. This Emperor has no clothes.

Sadly, LCFBs are one of the most poorly thought-out, and useless, proposals FINRA has come up with a long time. Some examples should suffice. There are no demonstrable cost savings for an LCFB firm. Such firms are still subject to the SEC's net capital rules, must file periodic FOCUS Reports, the Supplemental Statement of Income Report and Form Custody,[18] maintain the same books and records as other broker-dealers and must have an annual audit conducted by a PCAOB-registered auditor. A fidelity bond is mandatory. An LCFB must still pay for SIPC coverage because of the definition of "Customer" in the Securities Investor

[16] Actually, proprietary trading or, specifically certain market-making, does not necessarily trigger a requirement to become a FINRA member. There are many entities that engage in these activities and, as SEC registrants, elect to join a national securities exchange instead of joining FINRA. Many professional proprietary traders are not registered as broker-dealers at all. Moreover, some of the enumerated permissible LCFB activities are currently provided by many parties that are not registered with the SEC and thus are not even eligible for FINRA membership.

[17] We do not regard as a significant advantage the fact that LCFBs won't need to conduct an annual compliance meeting or that they won't need to deal with the regulatory element of the continuing education rule.

[18] Form Custody is particularly strange since by definition there should be virtually nothing for a non-custodial broker to report. Fortunately, it doesn't take much time to complete or file it.

Protection Act of 1970.[19] There are no benefits in terms of the registration process, for either the firm or its Registered Representatives; it can still take up to 6 months and require the filing of many meaningless documents. Under the LCFB proposal, in fact, the Registered Representatives of a firm who have the current standard FINRA licenses would apparently be penalized because they would be eligible for fewer registration categories.[20] The Firm still needs a Chief Compliance Officer and all Registered Persons must conduct the same know-your-customer and suitability[21] analysis as traditional broker-dealers, report outside business activities and are still subject to the firm element of Continuing Education compliance. An LCFB must have an AML Program in place in accordance with a new FINRA rule calling for biennial independent testing as opposed to annual independent testing.[22]

Most shocking is the restriction that LCFBs can only serve corporate issuers and only institutional investors. The failure to include partnership and limited liability company issuers ignores a very significant pool of investment opportunities that many existing FINRA members

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[19] SIPA Sec. 16(2). We note that clients of an LCFB would not benefit from its membership in SIPC except under very unusual circumstances, if any.

[20] Though the text of RN 14-09 seems to indicate that this is so, the text of the accompanying proposed Rule 121 seems to contradict that notion since it incorporates by reference NASD Rules 1021 and 1031, which clearly do not limit people from maintaining registrations so long as they remain active in the investment banking or securities business. We note that the proposed Rule 123 seems to exclude or disregard proposed Rule 121.

In addition, we continue to be appalled by the perpetuation of what we call the current "use it or lose it" rules where, if a registration is not used for two years, it lapses. We believe that the securities industry is the only one whose professionals lose their licenses even if they leave and use the competencies of those licenses in some related venue, such as when a sell-side person works on the buy-side for a few years, causing his or her licenses to lapse.

There are other professions where licenses do not lapse in a manner requiring requalification by examination. For example, we are aware of an attorney who has decades of experience as a prosecutor and in the private sector, too. She currently is employed by an agency of the United States government and when she finishes her tenure there, we doubt that this current member of the New York Bar would be required to requalify by examination to resume practicing law. Why should SEC Chair Mary Jo White be treated any differently than securities industry professionals, especially seasoned ones, who leave broker-dealers? We are also reminded that the FINRA person who is FINRA's designated contact for RN 14-09 and the Chairman and CEO of FINRA are both members of the D.C. Bar and we doubt that they would need to requalify by examination in order to practice law either.

[21] LCFB Rule 211(a) specifically spells out the suitability analysis to be undertaken with respect to retail customers, yet LCFBs are not authorized to transact business with retail customers. Who edits these proposed rules?

[22] At least the proposed rule does not define the time period between testing activities based on the calendar year as does current Rule 3310. This is wise.

service by raising money for non-corporate private equity funds or hedge funds. We regard this as a classic error of ignoring a huge constituency of FINRA members that raise money for those issuers. In addition, by ignoring high-net worth individuals, FINRA ignores a key customer base for many hedge funds – supposedly, the very client base an LCFB is intended to serve. These blatant omissions also demonstrate FINRA's failure to understand business practices and the market place. By ignoring other well-established and understood categories of investors, such as "qualified purchasers," FINRA eviscerates the utility of, and sabotages, the LCFB proposal.[23]

What is truly dismaying is these activities are subject to a set of newly proposed LCFB Rules that explicitly incorporate many of the existing FINRA Rules. Rather than have a succinct, useful set of rules that would, of necessity, be incorporated into an LCFB's WSPs, two sets of rules must be consulted to determine the appropriateness of a firm's business activities. Most of the proposed LCFB Rules merely parrot existing FINRA and NASD Rules. That clumsy approach alone would deter many firms from requesting LCFB status because it is a compliance trap waiting to happen. We sincerely hope that this approach of mandating a separate set of rules (currently, more than 45 separate rules), coupled with explicit references to other FINRA Rules, as the price of admission for a supposedly simplified regulatory status dies a very quick death.

We are baffled by FINRA's continued insistence on net capital (recognizing it is an SEC Rule) as the price of entry into the proposed new category of FINRA membership. Given the limited risk and scope of activities of an LCFB, in particular, and in the other carve-outs in the Proposals Concerning Non-Custodial Brokers, in general, we believe the net capital rule serves

[23] We read the endnotes of RN 14-09 wherein FINRA expresses concern about opening the floodgates of the new member category to serve accredited investors who may not be nearly as sophisticated as institutional investors. On the other hand, there are many potential investors that are sophisticated though they are not necessarily institutional. The authors of this letter regard themselves as being sufficiently sophisticated. Why should we not be able to be served by this new category of FINRA member?

no benefit either as a measure of fiscal integrity or as a meaningful barrier to entry into the business covered by the LCFB rules. We believe that, alternatively, the net capital rule should be replaced by a requirement to carry a significant insurance bond that could cover more than just what the existing fidelity bond rule covers. Reliance on market-based insurance underwriting standards, with insurers having their money and reputations on the line, would provide more realistic investor protection. Non-custodial brokers have no need for annual audited financial statements that no one reads or relies upon other than the regulators. With no customer funds or securities at risk, even the filing of periodic FOCUS Reports by non-custodial brokers is of marginal, if any, utility.

What this LCFB proposal appear to be is a last-minute attempt by FINRA to catch-up as the SEC begins to exempt certain activities from broker-dealer registration. If this is the best FINRA can do, the horses have already escaped past the barn door. It seems apparent to us that FINRA drafted the proposed LCFB Rules without hearing the concerns of many industry experts. Perhaps FINRA conferred with some industry participants who prefer the status quo since they are currently subject to it anyway. Members of a club enjoy preferences when the threshold for membership in the club remains high. After all, their thinking is that since they had to run through the gauntlet of the FINRA membership process, why shouldn't new participants do the same?

Effective regulation begins with an assessment of risk. A drastic re-evaluation of the role of regulators for firms with limited risk with respect to customers and the marketplace is needed. This should serve as a wake-up call to FINRA and other regulators.

Why the Balkanization of Financial Services Activities?

We have watched with great interest as both the SEC and FINRA have begun carving out certain broker-dealer activities from the maw of mandating FINRA registration for those receiving transaction-based compensation. Clearly, this has also prompted a Congressional response. With Crowdfunding, the SEC recognized the limited risk if an issuer were willing to raise only up to $1 million. Under the AngelList, FundersClub and Six Lawyers Letters, people engaged in certain restricted advisory activities can avoid SEC registration, presumably again because of the limited risk their activities create for investors. Under FINRA's proposals in RN 13-29, there are hesitant steps to simplify and improve the membership application process. With LCFBs, FINRA apparently acknowledges that institutional investors don't need the same set of protections as retail customers. What's new about that?

This piecemeal approach to regulating carved out activities is time-consuming and inefficient. Instead, FINRA, in conjunction with the SEC and NASAA, should be proposing rules that demonstrate sophisticated analysis based on risk, economic realities and financial and functional distinctions. Of course, FINRA can't do this unilaterally. Nor would such action, or the continued Balkanization of regulatory approaches, be cost effective. What the industry needs is a simplified, rational and uniform approach to the regulation of broker services. This would also benefit the end-users of such brokerage services. The key dictates for such an undertaking should be risk assessment and cost efficiency. The industry understands this; our customers expect it. Our regulators should be promoting customer protection and market integrity but not through the continuation of rules that are complex and often counter-productive. Rules should not have unintended consequences that are worse than what the rules were designed to prevent.

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Thank you for the opportunity to comment on RN 14-09. Should you have any further questions, please feel free to call Howard Spindel at 212-897-1688 or Cassondra Joseph at 212-897-1687, or contact us by e-mail at **hspindel@intman.com** or **cjoseph@intman.com,** respectively.

Very truly yours,

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