



June 22, 2017

SENT VIA ELECTRONIC MAIL
PUBCOM@FINRA.ORG

Philip Shaikun, Esquire
Vice President and Associate General Counsel
FINRA
Office of General Counsel

Re: Comments to Regulatory Notice 17-20

Dear Mr. Shaikun:

This letter is in response to FINRA's request for comments on the Effectiveness and Efficiency of its Rules on Outside Business Activities (Rule 3270) and Private Securities Transactions (Rule 3280).

IAA is a small to medium sized broker-dealer registered with the SEC and all 50 states, the District of Columbia and Puerto Rico and a member of FINRA. IAA has been registered with the SEC and a member of FINRA since 1982.

The IAA sales platform is based on independent contractor registered representatives ("RR/IA"), who are also associated with a registered investment adviser ("RIA"), some of which are not affiliated with IAA. The RR/IA's provide investment advisory services through the unaffiliated RIA for which they receive asset based or performance based fees and do not receive transaction based compensation through the unaffiliated broker-dealer which executes transactions on behalf of the unaffiliated RIA's client.

Rule 3280

As you know, current FINRA Rule 3280, has not changed in over thirty (30) years and has not been interpreted or clarified in over twenty (20) years. However, during that time period the laws, rules and regulations governing both broker-dealers and registered investment advisers has increased substantially.

Conflict with Gramm-Leach-Bliley and Regulation S-P

Pursuant to 15 USC §6802(a), a financial institution may not disclose to a nonaffiliated third party any nonpublic personal information unless the financial institution provides the required privacy notice to the consumer which includes the disclosure and provides for the consumer to "opt out" of the disclosure.

It is important to note that while both GLBA and Regulation S-P provide an exception to permit disclosure of nonpublic personal information to nonaffiliated entities in order “to comply with federal, State, or local laws, rules and other applicable legal requirements” and to “self-regulatory organizations” (“SRO”), there is no exception for compliance with a SRO’s rules. It is presumed that under this exception information may be provided to SROs to comply with such SRO’s request; however, there is no guidance that the exception permits SRO members to collect the personal information of the non-affiliated entity’s clients in order to comply with member’s SRO rules.

By way of example, a customer of the RR/IA initially consents to the unaffiliated RIA providing nonpublic personal information to IAA and IAA consents to the transaction under Rule 3280. IAA receives the information it is required to maintain and review. After the approved transaction or transactions have occurred, the customer updates his or her nonpublic personal information and also revokes his or her consent. In order for IAA to maintain accurate records for the customer, IAA is required to receive the updated nonpublic personal information.

IAA is concerned that the transmittal of the updated nonpublic personal information after the customer has revoked his or her consent would violate GLBA and Regulation S-P. However, if IAA does not receive the updated information, it cannot comply with the FINRA supervision requirements.

Definition of Selling Compensation is too Broad

As noted in all of the Notices to Members interpreting this rule, the definition of “selling compensation” is “deliberately broad in its scope.” While we understand the need for a broad definition, the fact that FINRA has included non-transaction based investment adviser management fees as “selling compensation” goes beyond a reasonable definition of “selling compensation”.

In Notices to Members 94-44 and 96-33, the Board reiterated the position taken in Notice to Members 91-32 that if the RR/IA “executed” a securities transaction for an advisory client, irrespective of what type of compensation the RR/IA received, the compensation would be deemed “selling compensation” for purposes of the private securities transaction rule.

To hinge definition of “selling compensation” on whether the RR/IA “executes” the transaction, seems arbitrary. If a RR/IA “executes” a purchase of a security in a managed account, and only receives a specified managed fee based on all of the assets in the managed account or receives a flat fee for managing the account as a whole, neither the RR/IA or the RIA receives compensation for “selling” the security. Moreover, a fee based on the total assets in the managed account or a flat fee for managing the account, is not “compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security”.

The definition of “selling compensation” should be more in line with a traditional understanding and interpretation. In other words, “selling compensation” should not hinge on

whether the RR/IA “executed” a securities transaction for an advisory client. Instead, the definition should hinge on whether the compensation received is as a result of the purchase or sale of a particular security or securities.

Requirements are more stringent than for member’s own transactions

If the RR/IA directly or indirectly receives transaction based compensation for a private securities transaction, prior approval of each trade by IAA is required. As a result, the RR/IA is required to submit every transaction of the unaffiliated RIA client to IAA for approval prior to executing each transaction away from IAA. This pre-clearance requirement for every trade is more stringent than the review requirements for brokerage business done through IAA.

This requirement is particularly onerous and unnecessary since both the RIA and the executing firm must review and approve the transaction. Not only is this review redundant, it is not necessarily in the client’s best interest, and could in fact be to the detriment of the client, to delay a trade so that it can be reviewed by three (3) different regulated entities before execution.

Lastly, it should be noted that RIAs are registered and regulated entities. The RIAs, depending of business model and assets under management, are regulated federally by the Securities and Exchange Commission or the various States. As such, requiring member firms to apply the current rule and meet current expectations appears cumbersome and does very little to protect the investing public.

Regulation has Increased Significantly

When the original Private Securities Transaction Interpretation was issued in the 1970’s, there was understandably a concern that these types of transactions could result in securities being sold to public investors without appropriate levels of supervision and that a member firm could be liable for the actions of an associated person even though the member firm was not aware of the associated person’s participation in the transaction. It is also understandable that in 1985 the NASD promulgated Conduct Rule 3040 to ensure that member firms were not only aware of the private securities transactions engaged in by their associated persons, but that these transactions were approved, reviewed and supervised by a regulated entity; e.g. a member firm.

While the original purposes underlying the Interpretation and the Rule served a purpose, to fill the regulatory gap created when an associated person engages in securities transactions away from his or her member firm and to limit the potential liability of the member firm for the private securities transactions of their associated persons, these concerns are now nonexistent or greatly diminished, particularly with respect to unaffiliated RIA transactions. The Interpretation and Rule 3040 were adopted and interpreted during a period when the regulated entities for which associated persons may have performed securities related functions were not as highly regulated as they are today, including investment advisers.

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Given the regulatory landscape when the Interpretation, Rule 3040 (now 3280) and the NTMs addressing the Interpretation and Rule, it is understandable that none of them differentiate between private securities transactions executed pursuant to an associated person's employment with a regulated entity and an unregulated entity. However, the time has come to modify Rule 3280 to acknowledge the modern reality that many of these entities are well supervised and regulated under other statutory regimes.

In fact, RIA's and their IA Representatives have a fiduciary duty to their clients to act in the best interest of the client, which is a higher standard of duty than an associated person of a member firm. Given the legal and regulatory standards for RIA business, the RIA and the IA Representative could subject themselves to liability for breach of their fiduciary duty due to the member firm's refusal to permit the execution of a transaction for an advisory client.

Given the increased regulatory scrutiny of RIA's, as well as banks and other regulated entities, Rule 3280 should be modified to apply only when the "private security transaction" is executed through non-regulated entities. In other words, if the transaction is executed for an advisory client of a Registered Investment Adviser and/or is executed through a member firm, the transaction should be subject to the outside business activity requirements of Rule 3270, not the private security transaction requirements of Rule 3280.

We appreciate the opportunity to comment on Rule 3280 and look forward to positive changes to Rule 3280.

Respectfully,

/s/Myra P. Nicholson

Myra P. Nicholson, Esquire
General Counsel