

May 27, 2014

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, DC 20006-1506

RE: Comments on the Effectiveness and Efficiency of the Communications with the Public Rules (Regulatory Notice 14-14)

Dear Ms. Asquith:

FOLIOfn Investments, Inc. ("Folio") welcomes the opportunity to express its views on the effectiveness and efficiency of certain of the Financial Industry Regulatory Authority ("FINRA") communications with the public rules (the "Rules") and commends FINRA staff (the "Staff") for undertaking a retrospective review of the Rules as outlined in Regulatory Notice 14-14.

Folio is a self-clearing broker-dealer that engages in a range of business lines via web interface, including equity trading, mutual fund sales, facilitation of unlisted securities offerings, securities transaction clearing and custody, and other web-based securities businesses such as exclusive secondary market trading platforms for registered notes. Folio does not underwrite securities offerings, recommend or market securities transactions or solicit customers to purchase securities. Folio's customers consist of self-directed individuals (and their traditional investing vehicles such as trusts), clients of independent, unaffiliated registered investment advisors and clients introduced to Folio under fully-disclosed clearing arrangements.

Folio's views about the effectiveness and efficiency of the Rules are below. Section I sets forth our comments on the application of the Rules to online media such as website content, social media websites and online market newsletters; Section II identifies specific requirements or interpretations under Rule 2210 that should be further reviewed and reconsidered; and Section III notes our view on an impediment to investor protection that is presented by the practice of filing retail communications for pre-review and approval, which is in some circumstances optional, but in all instances costly and anti-competitive.

I. Application of the Rules to Online Media and Content Created and Provided By Third Parties

There continues to be uncertainty about how the Rules apply to member firms who offer their services primarily online. It is critical that appropriate distinctions be drawn between content a member firm has directly or indirectly (such as through entanglement or endorsement) assumed responsibility for or has

control over as opposed to content controlled and managed by a third party or which is otherwise outside of a member firm's control. Specifically, a member firm should not be deemed responsible for communications by third parties (whether or not such third parties are subject to FINRA oversight) merely because, for example, the member firm's logo is evident on the third party's website or there is a link on a third party website to the member firm.

FINRA, along with the U.S. Securities and Exchange Commission ("SEC"), has correctly provided that member firms are responsible for content on a third party website where the firm "has adopted or has become entangled with [the third party's] content."¹ However, the usefulness of this interpretation by FINRA is limited in that there is insufficient guidance regarding what, in FINRA's view, constitutes "adoption" of content or "entanglement."

The current FINRA guidance should be enhanced by, among other things, making clear that a member firm is not responsible for a website that is controlled by a third party, in the absence of red flags, if a member firm clearly disclaims any, and has no, role in (A) the activities conducted on or through the third party website (*e.g.*, an original issuance of securities); (B) approving, endorsing, reviewing, or recommending securities or services offered by the third party (*e.g.*, is not recommending or endorsing advisory services offered by a registered investment advisor that uses the member firm's brokerage offering); and/or (C) does not represent to investors that it is entangled with the third party by indicating, for example, that it has conducted due diligence to confirm the accuracy, reliability, or completeness of any data or information presented by a third party on the third party's website (such as on a newsletter publisher's website that includes a link to one or more member firm websites to facilitate implementation of published investment ideas).

In all instances, the mere utilization of the services of the member firm where the member firm itself is not endorsing or recommending or is otherwise the real party in interest to a third party's activities, should not make the member firm responsible for the activities of that third party or its representations. In reality, this is understood to be the law today when member firms offer, for example, securities such as equities or mutual funds to retail investors. When a member firm makes available information about an equity or a fund by linking to a prospectus on the SEC's website or the issuer's website – where the member firm is not itself acting as an underwriter of the security – there is no current expectation that the member firm is responsible for all of the disclosures on the issuer's website or in the prospectus. However, FINRA has not adopted that approach under the Rules, which leads to arbitrary and capricious enforcement and has a chilling effect across the industry. Such a view, oddly, precludes most traditional broker-dealer business models, which cannot be FINRA's intent.

¹ FINRA Regulatory Notice 11-39, p. 3 (Aug. 2011); see *also* Commission Guidance on the Use of Company Web Sites, Exchange Act Rel. 58288, 73 Fed. Reg. 45862 (Aug. 7, 2008).

II. Requirements and Interpretations under Rule 2210 for Reconsideration

As a general matter, there is a need for consistency between the text and application of the Rules by FINRA and the federal securities laws. In addition, there should be a recognized need for flexibility to permit firms to develop and market (or provide support for others to develop or market) innovative products and services that will benefit investors. With that approach in mind, we note the following text, and interpretive application, of FINRA Rule 2210 for further review and consideration for modification.

A. Some Requirements under the Rules Are Ambiguous and Subjectively Applied

FINRA Rule 2210(d)(1)(A) provides that:

All member communications must be based on *principles of fair dealing* and good faith, must be *fair and balanced*, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may *omit any material fact or qualification if the omission, in light of the context of the material presented*, would cause the communications to be misleading. (Emphasis added).

Further, FINRA Rule 2210(d)(1)(B) provides that:

No member may make any false, *exaggerated, unwarranted*, promissory or misleading statement or claim in any communication. No member may publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. (Emphasis added).

Concepts such as “principles of fair dealing”, “fair and balanced”, “exaggerated”, and “unwarranted” are open to wide interpretation by an individual (including each FINRA staff person in the context of an audit, examination or enforcement proceeding) and are ripe for inconsistent and arbitrary conclusions in the absence of detailed interpretive guidance. For example, potential investors are permitted to open brokerage accounts with Folio online 24 hours a day, 7 days per week and we state on the Folio website that “[i]t is quick and easy to establish a brokerage account for trading.” We worked hard to ensure that our account opening process is quick and easy for investors – and by all accounts we have succeeded. Yet, this statement, which happened also to be in reference to a brokerage account to trade registered notes on one of the secondary market trading platforms offered by Folio, was found to be “exaggerated and/or

unwarranted in light of the fact that regulatory and other requirements must have been met before individuals were authorized to use the [t]rading [p]latform.”

To ensure that there is no subsequent complaint about whether a member firm is complying with the Rules, a member firm essentially is required to submit each retail communication to FINRA for review and document FINRA’s approval. There is no way for a member firm to determine for itself whether a reviewer will decide that certain statements are “exaggerated and/or unwarranted” as was the case with the language above. The alternative is to assume the risk that a reviewer could interpret any communication to be “unwarranted” and be subject to a FINRA Enforcement action.

As discussed further below in Section II.B., we believe FINRA should reduce the room for subjectivity and arbitrary results with respect to audit and examination findings against member firms. The most obvious way to do this is by adopting as the correct standard for review the standards established under the federal securities laws and its anti-fraud provisions, such as Rule 10b-5.² It is difficult to understand how the primary line of defense for investors from unscrupulous or defrauding broker-dealers are enforcement actions based on “exaggerated” or “unwarranted” standards that do not rise to the level of material misstatements or omissions. The enormous amount of resources – both internally at member firms and within FINRA – directed to these issues instead of matters that materially adversely impact investors should be worthy of review by FINRA.

B. FINRA’s Interpretation of “False” and “Misleading” Is Inconsistent with Commonly Understood Principles under the Federal Securities Laws

The types of communications that rise to violations of the anti-fraud provisions under the federal securities laws on the basis that statements contained in such communications are “false” or “misleading” are well established. However, the terms “false” and “misleading” under Rule 2210(d)(1)(B) apparently do not have the same meaning as when used under the federal securities laws. Specifically, where statements were made both in a website disclosure that was deemed to constitute a Folio disclosure relating to the secondary trading platform for certain registered notes, and in a prospectus filed by the issuer of those notes with the SEC, the statements on the Folio website were deemed to be “false and misleading” under Rule 2210(d)(1)(B). The statements though remain in the prospectus and the issuer is engaged in a continuous offering of the notes, with no apparent action by FINRA to suggest that the statements should be subject to scrutiny under the federal securities laws. In effect, FINRA’s interpretation of false and misleading creates a higher standard for a provider of a facility for secondary market trading than for the issuer that is engaged in a continuous offering of such

² 17 CFR 240.10b-5(b); e.g., Section 12 under the Securities Act of 1933, 15 U.S.C. § 77l.

securities pursuant to an effective registration statement. This result renders Rule 2210(d)(1)(B) inconsistent with the allocation of liability under the federal securities laws and turns the understanding by industry participants of the laws on its head. As a practical matter, that position is unsustainable because it leads to arbitrary and inconsistent enforcement. Clearly, member firms have not been held to consistent standards – otherwise every time an issuer is deemed to have a materially misleading prospectus or filing pursuant to the Securities Exchange Act of 1934 there would be a FINRA Enforcement action against each broker-dealer that allowed such issuer's securities to be sold to its customers. Such a result would impact most broker-dealers with respect to generally available public securities, which clearly is not the case.

It would seem that consistency between the content standards and the federal securities laws, in all instances, would greatly assist member firms in defining the appropriate boundaries for compliance with the Rules and make FINRA's audit and examination processes more efficient and effective. Such an approach also will maintain FINRA's ability to properly address "bad actor behavior" falling within the same boundaries or arising to the same level as that which would be actionable under the federal securities laws. The alternative is that we are left with standards that are remarkably inconsistently applied and antithesis to the SEC's approach, which we believe to be more effective, of strong deterrence against real wrongdoing as opposed to strong prohibition of innovation and focus on what are innocent, and seemingly only perceived, missteps.

C. The Content Standards Require Prospectus-style Disclosure or Merit Review

FINRA Rule 2210(d)(1) provides, in relevant part, that:

(C) Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

(D) Members must ensure that statements are clear and not misleading within the context in which they are made, and that they provide balanced treatment of risks and potential benefits.

Requiring each communication, within its four corners, to "provide balanced treatment of risks and potential benefits" without placing information in a legend, footnote, interstitial page or document (*e.g.*, a prospectus) to which an investor is able to link, leads to overly long and inclusive disclosures and content that, are not read or easily understood by investors. In its broadest interpretation, this could require a member firm to repeat substantial portions of a prospectus or other offering document within the body of each communication rather than providing a direct link to the prospectus or offering document that would include all risk factors in context. Such an interpretation puts member firms that do not recommend or

endorse securities in the position of extracting out specific risk factors from a prospectus and making a judgment with respect to their relative importance; an impossible task when considering the many thousands of securities ordinarily made available by a member firm and the information available to the member firm.

Given the generality of the concepts set forth in Rule 2210(d)(1)(C) and (D), the standards would appear to require each presentation of material about securities sold in a secondary market transaction to be similar to that provided in an original issuance. Essentially, a member firm not involved in the original issuance of the securities would be required to present all material information, pro and con, to investors tailored to the expected audience for each secondary transaction. Alternatively, the end result is that member firms either substantially limit the amount of information made available to investors by limiting their description of securities or services offered or directly engage FINRA and negotiate an acceptable outcome. We do not believe this to be FINRA's intent, but certainly is permitted under the current regulatory regime and should be unacceptable.

We believe that ensuring that investors have available to them the material information necessary to make an investment decision is of utmost importance. However, it is not practical or reasonable to expect that all material information can be, or should be, contained on a single sheet of paper or the online media equivalent. Further, a requirement to provide the same level of detail to a purchaser of securities in a secondary market transaction as that provided to an initial purchaser is contrary to longstanding market practice and the expectations of market participants. FINRA could improve its current application of the Rule to the activities of member firms by expressly acknowledging that a communication contains relevant material information, provided such information is easily available, or made available, to an investor through such methods as a link, interstitial page, "pop up" communication, or the like.

D. Some Requirements Lead to Practices that are Inconsistent with Investor Protection

Communications that include performance rankings or ratings require judgment about what constitutes all of the material differences with respect to the comparison, including, for example, and as applicable, the investment objectives, costs and expenses, liquidity, guarantees, fluctuation of principal or return, and tax features. Because of the breadth of the requirements and the depth needed to meet the content standard prohibiting statements that are "exaggerated" or "unwarranted", we believe that member firms avoid presenting investors with potentially valuable information about how certain investments or services compare to other investments or services. A by-product of Rule 2210(d)(1)(F) is that investors are left to their own devices to compare information presented by various member firms about their services or the securities products offered, which, in some case, could lead them to unknowingly compare apples to oranges. This result

seems to be inconsistent with FINRA's objectives of enhancing the information available to investors and furthering investor education and protection.

We believe a better approach could be to permit performance rankings and ratings that cite relevant sources and studies and let investors make their own determination about the quality of the information presented. The general content standards and anti-fraud provisions under the federal securities laws would continue to apply broadly to the communications that contain the performance rankings and ratings, which afford FINRA a more than adequate basis to ensure that communication materials continue to meet the standards expected of industry participants.

E. Recordkeeping Requirements

The recordkeeping requirements under Rule 2210(b)(4) work well for communications that were easily printed, initialed and dated such as letters, sales material and other physical written correspondence. Where the communication is a website, or text that constitutes a link to a website within other content – particularly third party content that can be continuously updated and changed in real time – the recordkeeping requirements are burdensome and ineffective.

Member firms should not be required to have screen shots, with a registered principal signing and dating each such webpage, on which an approved logo or approved words that constitute a link to the member firm's website appears in order to comply with paragraph (b)(4) of FINRA Rule 2210. An approach to improving the implementation of the recordkeeping requirement would be, for example, to permit the registered principal of the member firm to approve a logo or the words that constitute the link to a website once and maintain a record of that approval. FINRA risks being perceived as misunderstanding the possible benefits of innovation by continuing to impose requirements that only traditional firms offering traditional services in traditional ways can accommodate.

III. Impediments to Competition

The current system for retail communications essentially can be perceived, although we are sure this is not the intent, as designed for firms to pay FINRA a fee for it to review retail materials. Such a system is anti-competitive and makes FINRA a marketing and communications partner with each member firm that files its communication. Such an intimate relationship with FINRA is a barrier to robust competition. Each non-filing member firm becomes an outsider and more susceptible to regulatory findings. The current regime, which should not be continued or perpetuated, requires substantial departments of legal and compliance professionals dedicated to distinguishing between tweets, interactive postings, semi-static "status updates" and correspondences, etc. without allowing member firms to rely upon principle-based compliance. The infrastructure required for even the smallest of firms to interface with FINRA on such communications is not in

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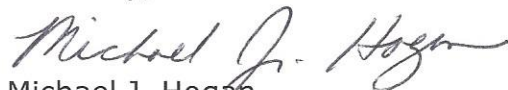
balance with the potential confusion or harm to the public; it also diverts resources away from real frauds and investor abuses. Currently, efforts are too focused on relatively arcane nuances of subtle interpretations of ambiguous principles and arbitrary interpretations of rules. This cannot be the best way to establish a regulatory regime to protect investors.

* * * *

The Rules, initially designed for written communications, have been, and continue to be in many ways, an obstacle inhibiting innovation and greater use of online media to communicate with, and provide information to, investors. There should be a regulatory infrastructure that is sufficiently flexible to adapt to new modes of communication.

As previously noted, Folio commends FINRA for undertaking this retrospective review and taking the time to reconsider the principles and goals FINRA intends to espouse and achieve in promulgating the Rules. We would be delighted to discuss any of the comments set forth in this letter, and would welcome the opportunity to assist further.

Sincerely,



Michael J. Hogan
President & Chief Executive Officer

cc: Philip Shaikun, Vice President and Associate General Counsel, Office of General Counsel
Joseph E. Price, Senior Vice President, Corporate Financing/Advertising
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