



June 1, 2015

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Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File No. S7-05-15: Exemption For Certain Exchange Members (Exchange Act Release 34-74581)

Dear Mr. Fields:

Hold Brothers Capital LLC ("Hold") appreciates the opportunity to comment on the Securities and Exchange Commission's (the "Commission") above referenced release (the "Proposing Release") proposing amendments to Rule 15b9-1 (the "Rule") under the Securities Exchange Act of 1934, as amended. If approved, the proposed amendments to the Rule (the "Proposed Amendments") would require broker-dealers that engage in proprietary trading in the off-exchange market ("Proprietary Traders") to become members of a National Securities Association, in other words, FINRA<sup>1</sup>. Hold strongly objects to the Proposed Amendments and believes that the concerns expressed by the Commission in the Proposing Release would be more effectively and equitably addressed through other regulatory means, discussed below<sup>2</sup>.

Hold is a non-FINRA member firm that engages in individual trader proprietary off-exchange trading not using high frequency trading algorithms in reliance upon the Rule.

### **The Effect of the Proposed Amendments is Overbroad**

If the Proposed Amendments are approved, they would impact all Proprietary Trading firms and subject them to the full range of FINRA rules and regulations applicable to traditional broker-dealers. However, based upon the language of the Proposing Release, the Commission's stated purpose for the Proposed Amendments are largely to address concerns about firms conducting high-frequency trading and FINRA's ability to properly monitor such activity.

In the Proposing Release, the Commission notes that "[n]ew types of proprietary trading firms have emerged, including those that engage in so-called high frequency trading strategies."<sup>3</sup> The Commission goes on to state that:

"As noted, FINRA currently is the SRO to which off-exchange trades are reported. However, because it does not have jurisdiction over Non-Member Firms, it is unable to enforce compliance with the federal securities laws and rules, or apply its own rules, to broker-dealers that conduct a significant amount of off-exchange

<sup>1</sup> FINRA is currently the only National Securities Association registered with the Commission.

<sup>2</sup> Question 42 of the Proposing Release (see page 58 of the Proposing Release).

<sup>3</sup> Page 9 of the Proposing Release.

trading activity, including those that engage in so-called high-frequency trading strategies. As a result, FINRA's ability to perform comprehensive market surveillance, especially for violations of Commission rules, as well as its ability to understand and reconstruct activity in the off-exchange market generally, is limited because Non-Member Firms are not consistently identified in trade reports to the TRFs or the ADF, and their order activity is not captured by OATS. Accordingly, FINRA is unable to monitor the off-exchange market activity of Non-Member Firms, and detect potentially manipulative or other illegal behavior, as efficiently or effectively as it can with FINRA members."<sup>4</sup>

Although the Proposed Release makes numerous references to "High-Frequency Traders" and the need to monitor their trading activity, the Proposed Amendments fail to recognize that not all Proprietary Traders are engaged in high-frequency trading. Many Proprietary Traders, including those associated with Hold, engage in proprietary trading using traditional methods ("Traditional Proprietary Traders") and that do not involve the same risks and concerns as high-frequency traders.

The Commission noted a number of factors in the Proposing Release that distinguished High Frequency Traders from Traditional Proprietary Traders:

"Many, but not all, such proprietary trading firms are often characterized by: (1) the use of extraordinarily high-speed and sophisticated computer programs for generating, routing and executing orders; (2) the use of co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies; (3) the use of very short time-frames for establishing and liquidating positions; (4) the submission of numerous orders that are cancelled shortly after submission; and (5) ending the trading day in as close to a flat position as possible (that is, not carrying significant, unhedged positions over night)."<sup>5</sup>

Accordingly, Hold objects to the Proposed Amendments because they would have the effect of treating all Proprietary Traders the same, regardless of the recognized differences between High-Frequency Traders and Traditional Proprietary Traders. As an alternative to requiring all Proprietary Traders to become FINRA members, Hold believes that a more equitable solution would be to revise the trade reporting rules so as to allow for surveillance of such trading by High-Frequency Traders by FINRA.

### **The Current FINRA Membership Rules are Not Appropriate for Proprietary Traders**

The current rules applicable to FINRA members were designed for customary broker-dealers that carry customer accounts and execute trades on behalf of their customers using customer funds. As such, they are not suitable for, and would impose an undue regulatory burden on Proprietary Traders that by definition carry no customer accounts and trade for their own accounts. The process of applying for, and then maintaining, FINRA membership can require a significant investment of both time and money. Such costs would be unduly burdensome to smaller, less well funded Proprietary Traders. If required to become FINRA members, Proprietary

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<sup>4</sup> Page 27-28 Proposing Release.

<sup>5</sup> Footnote 18, page 9 Proposing Release.

Traders will most likely have to implement procedures and hire additional personnel, more typically suited to FINRA members that are traditional broker dealers.

Notwithstanding Hold's general objections to imposing FINRA membership on Proprietary Traders, we recognize the concerns raised by the Commission in the Proposing Release, particularly with respect to High-Frequency Trading. Accordingly, we believe that the Commission should focus on the trading conducted by such firms, and if FINRA membership is the only way to address its concerns, it should propose a limited membership similar to FINRA's rules relating to Limited Corporate Finance Brokers.<sup>6</sup>

### **The Proposed Rule Change Raises Several Constitutional Concerns**

I articulate, below some Constitutional concerns arising from the new rule. While some of my Constitutional concerns may be waived off, they resonate loudly and clearly.

Important considerations in my view are:

- (i) 8<sup>th</sup> Amendment, excessive fines consideration;
- (ii) 14<sup>th</sup> Amendment taking of property without due process;
- (iii) 14<sup>th</sup> Amendment, equal protection under the law;
- (iv) Monopoly and Anticompetitive considerations;

- A) The number of FINRA broker dealers has been sharply and intentionally reduced by FINRA over recent years, with small business enduring nearly all of the impact<sup>7</sup>. This raises equal access concerns under the 14<sup>th</sup> Amendment.

Noteworthy is that the reduction in FINRA licensed broker dealers in the US is materially attributable to increased regulatory and operating costs which jeopardizes further reduction in the number of small proprietary broker dealers who cannot afford the increased cost of FINRA regulation<sup>8</sup>.

- A) FINRA seems to have changed its behavior relating to fines, after the appellate court decision regarding Fiero Brothers vs. NASD, FINRA has greatly increased fines. In some cases settlement amounts charged, in fines and disgorgements, by FINRA or by FINRA in conjunction with other regulators, to some broker dealers, far exceeds the net capital of those firms, putting them out of business. This is inconsistent with the regulatory standard that they are supposed to be remedial and not punitive.

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<sup>6</sup> The situation is somewhat analogous that which faced corporate financing firms that applied for and became FINRA members based upon the fact that, in some instances, they would receive transaction based compensation for their services ("M&A Brokers"). Notwithstanding that M&A Brokers did not engage in many of the types of activities typically associated with broker-dealers, once they became FINRA members, they were subject to all of FINRA's rules and regulations for broker-dealers, regardless of their applicability. For example, an M&A Broker required to file a continuing membership application (a "CMA") with FINRA, was subjected to the same process as a retail broker-dealer, at a significant cost in both time and money, regardless of the fact that many of the CMA requirements did not apply. Following the issuance of the Commission's No Action Letter Regarding M&A Brokers dated January 31, 2014 (revised: February 4, 2014), FINRA proposed a separate set of rules for M&A Brokers (FINRA NTM 14-09).

<sup>7</sup> FINRA membership has declined 11% from 2010 through 2014. Source: <http://www.finra.org/newsroom/statistics>

<sup>8</sup> FINRA's revenue from fines imposed increased a total of 122% between 2013 and 2014. Sources:

<https://www.finra.org/industry/enforcement> and <https://www.finra.org/file/finra-2013-year-review-and-annual-financial-report> (page 30)

(Considerations of the Constitution's 8<sup>th</sup> Amendment, which protects against excessive fines, also applies).<sup>9</sup>

- 1) The Constitution's 14<sup>th</sup> Amendment protects against the unlawful taking of property. The government, by forcing a firm to join FINRA, when it is not workable, is essentially confiscating that firm's right to do business, and therefore that firm's business.
- 2) Passage of this rule would make FINRA a monopoly. The law protects us against monopolies. The SEC release references a national securities association but there is just one-FINRA.

The SEC release says that other firms could rise to compete and become national securities associations but essentially, it's like saying "anyone is free to go to Mars".

It was one thing when you could eat at Joe's diner or join the country club (with barriers to entry like high membership dues and acceptance) to eat, but soon you have no choice- just the country club, which may not be a real option for some.

Whenever you give monopolist powers to anyone, including a regulator, it jeopardizes fair and reasonable discretion- FINRA would, by definition be controlling the industry.

A monopoly limits the natural competitive forces of the market place. Monopolies lead to added cost, mismanagement and inefficiency because there are not offsetting competitive forces. Monopolistic entities tend to charge higher fees.

Wikipedia says "Monopolies are thus characterized by a lack of economic competition to produce the good or service, a lack of viable substitute goods, and the existence of a high monopoly price well above the firm's marginal cost that leads to a high monopoly profit."

FINRA may be protected by legislation that exempts it from being characterized as a monopoly. However, that was contemplated decades ago with the idea of regulating customer business, not proprietary trading. No one could have predicted the damage a FINRA monopoly would inflict. Any person with some understanding of economics can see the harm that a FINRA monopoly could cause.

Proprietary day traders have been a recognized participant in providing liquidity and order to the markets. If the small proprietary day trader is disadvantaged, the market balance provided by day traders may be lost.

**Amongst other, Less Compelling Arguments, which May not be as Grounded in the Law as the others but Raise Issues of Fairness and Resonate Emotionally are:**

- A) The rate of personal sanctions imposed by FINRA is much higher for management of small broker dealers than large ones, especially in certain sectors like day trading.<sup>10</sup> This raises 14<sup>th</sup> Amendment concerns of unequal application of the law.

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<sup>9</sup> Ibid.

<sup>10</sup> For calendar year 2012, the percentage of FINRA registered representatives sanctioned seriously industry wide was 0.18% (1143 suspended or barred out of 630,391 FINR A registered representatives). During the same period, 40% of senior

B) The 1<sup>st</sup> Amendment of the Constitution guarantees, among other things, freedom of association. In any institution, even a regulator and its members, there can be disagreements, irreconcilable differences and splits. Forcing individuals to join FINRA (because no other real option exists), who do not want to be with FINRA, is unfair. The government will have purposefully created a monopoly that endangers small proprietary day trading broker dealers.

In conclusion, Hold strongly objects to the Proposed Amendments because, they draw no distinction between High-Frequency Traders and Traditional Proprietary Traders, and subject Traditional Proprietary Traders to an unnecessarily broad range of rules and regulations that the current FINRA membership rules require, which are overly broad given the limited nature of the trading activity engaged in by Traditional Proprietary Traders.

Traditional Proprietary Traders such as Hold have made large investments in their businesses and have tailored their operations specifically to fit within the exemption provided under Rule 15b9-1. Requiring such firms to apply for membership with FINRA and to be subject to the same rules and regulations as broker-dealers that carry customer accounts is an undue hardship, particularly considering Traditional Proprietary Traders are not the catalyst for such regulation.

Thank you for your consideration of our comments and suggestions. Any questions in relation to our comments may be directed to Gregory Hold at [REDACTED].

Sincerely,

*Gregory F. Hold*

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management (assuming an average of 4 senior managers per firm, 8 managers, 5 firms) of small FINRA day trading firms with significant business in China were seriously sanctioned by FINRA or otherwise.