COMMONWEALTH financial network®

VIA ELECTRONIC MAIL

October 22, 2014

Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Proposal to Adopt FINRA Rule 2040 (Payments to Unregistered Persons)
Release No. 34-73210; File No. SR-FINRA-2014-037

Commonwealth Financial Network® ("Commonwealth") welcomes the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") proposal to adopt FINRA Rule 2040 (Payments to Unregistered Persons) regarding the payment of transaction-based compensation by members to unregistered persons, and Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) (the "Proposal").

Commonwealth appreciates FINRA's desire to "provide guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related hereto." Nevertheless, we are concerned that the continued focus by both FINRA and the SEC on the payment or receipt of transaction-based compensation as the sole means to determine whether registration under Section 15(a) of the Exchange Act is required, without regard to the array of other relevant factors that should also be considered prior to making such determination, is inappropriate and inconsistent with the law. Rather, a consideration of all relevant factors should be undertaken by FINRA and the SEC prior to the adoption of any new rule that has as its purpose the means by which a firm may determine whether a person must register in accordance with Section 15(a) of the Exchange Act.

Within the Background section of the Proposal, FINRA notes that it "generally has interpreted the provisions of the NASD Non-Member Rules, through interpretive letters and other guidance, to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer", and that "Section 15(a)(1) of the Exchange Act generally requires any broker-dealer effecting transactions in securities to be registered with the SEC."

Notwithstanding prior opinions of SEC Staff that the "receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer", the interpretations and guidance provided in SEC Staff "no-action" letters are informal guidance by the Staff and possess no binding legal authority. Notably, in *SEC v. Kramer*, No. 8:09-cv-455-T-23TBM (M.D. Fla. Apr. 1, 2011), the U.S. District Court for the Middle District of Florida concluded that the SEC's reliance on past "no-action" letters was both inconsistent and, by its own admission, not legally binding. Moreover, the SEC's enforcement of the broker-dealer registration requirements in *Kramer* was denied by the

court, which found that "the Commission's proposed single-factor 'transaction-based compensation' test for broker activity (i.e., a person 'engaged in the business of effecting transactions in securities for the accounts of others') is an inaccurate statement of the law."

In *SEC v. Kramer* the court also stated that:

> "Because the Exchange Act defines neither 'effecting transactions' nor 'engag[ing] in the business,' an array of factors determines whether a person qualifies as a broker under Section 15(a). *See DeHuff v. Digital Ally, Inc.,* 2009 WL 4908581, *3 (S.D.Miss.2009) (Lee, J.). The most frequently cited factors, identified in *SEC v. Hansen,* 1984 WL 2413, *10 (S.D.N.Y.1984), consist of whether a person (1) works as an employee of the issuer, (2) receives a commission rather than a salary, (3) sells or earlier sold the securities of another issuer, (4) participates in negotiations between the issuer and an investor, (5) provides either advice or a valuation as to the merit of an investment, and (6) actively (rather than passively) finds investors."

The court further cited *SEC v. Bravata*, 2009 WL 2245649, at *2 (E.D. Mich. 2009), which stated that "the most important factor in determining whether an individual entity is a broker" is whether there is a "regularity of participation in securities transaction at key points in the chain of distribution."

As is illustrated above, the proposal to adopt new FINRA Rule 2040(a), which would prohibit "members or associated persons from, directly or indirectly, paying any compensation, fees, concessions, discounts, commissions or other allowances to any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act", based solely on the factor that the recipient receives transaction-based compensation, without regard to the array of other relevant factors that should be considered in order to form the basis for making a determination as to whether a person must register under Section 15(a) of the Act, including but not limited to whether there is a "regularity of participation in securities transaction at key points in the chain of distribution" by such person, is inconsistent with the order issued by the U.S. District Court for the Middle District of Florida.

Commonwealth therefore urges FINRA to either withdraw the Proposal or make substantial modifications to the Proposal to address the concerns outlined in this letter.

Respectfully,
COMMONWEALTH FINANCIAL NETWORK

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