39 Broadway, Suite 3300, New York, New York 10006-3019

Via email: rule-comments@sec.gov

October 22, 2014

RE: SR-FINRA-2014-037:
Payments to Unregistered Persons

Integrated Management Solutions USA LLC ("IMS") is pleased to comment on Proposed FINRA Rule 2040 (the Proposed Rule") regulating when members can pay transaction-based compensation to unregistered persons, together with Supplementary Material .01[1] to that rule (the "Supplementary Material" and, except where the context otherwise requires, collectively, "the Proposed Rule").[2] 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.[3] We counsel clients daily on the scope of permissible broker-dealer activities under various FINRA and SEC rules, including with respect to issues of transaction-based compensation. We believe that our regular, daily experience with FINRA's membership rules, and how they are

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1 Titled "Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act."

2 The Release accompanying the Proposed Rule also discusses several ancillary provisions in NASD and NYSE Rules that would be incorporated in, or deleted from, the Consolidated FINRA Rulebook. In addition, FINRA has proposed an amendment to FINRA Rule 8311 describing when, and under what circumstances, a member firm may pay continuing commissions to an Associated Person who is sanctioned or resigns.

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

implemented by FINRA itself, enables us to assess the impact of the Proposed Rule on FINRA members from both a regulatory and business perspective.

The Proposed Rule

The Proposed Rule was first sent out for comment in Regulatory Notice 09-69 ("RN 09-69"), with the stated objective of harmonizing FINRA's rules for payments by members to unregistered persons with the provisions of Section 15A(b)(6) of the Securities Exchange Act of 1934 and its related guidance.[4] Five years and seven response/comment letters later, FINRA has still not fully addressed industry concerns about the implementation of these particular compensation rules. This letter focuses on both the newly created and unresolved issues in two of the three subsections of the Proposed Rule. We are baffled why FINRA would issue a Proposed Rule in such an incomplete state.

(a) Proposed Rule 2040(a): The General Rule

The general rule regulating payments to unregistered persons is Proposed Rule 2040(a). Key to members' compliance with that subsection is the directive that members determine when registration as a broker-dealer is "required"[5] for certain persons to receive transaction-related compensation. To address objections by some of the commenters to RN 09-69 with this particular requirement, FINRA proposed the Supplementary Material, discussed further below.

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[4] 15 U.S.C. 78o–3(b)(6). This subsection, among other requirements, is "…designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, …and, in general, to protect investors and the public interest;…."

[5] Proposed Rule 2040(a)(1) (emphasis added).

(b) **Proposed Rule 2040(b): Payments to Retiring Representatives**

Proposed Rule 2040(b) describes when payments to retiring representatives may be made. We believe that FINRA adequately balanced theory and practical implementation in this subsection of the Proposed Rule and applaud what FINRA has done in this regard.

(c) **Proposed Rule 2040(c): Payments to Nonregistered Foreign Finders**

In response to six (of the seven) commenters' objections to FINRA's initial proposal to eliminate rules with respect to payments to unregistered foreign finders, FINRA adopted Proposed Rule 2040(c).[6] This subsection mandates that the paying firm make several determinations as to whether the foreign recipient can be paid, including, without limitation, that (1) the finder "…is not required to register…" as a U.S. broker-dealer; (2) the finder is not subject to a disqualification under FINRA's By-Laws; and (3) "…the compensation arrangement does not violate applicable foreign law."[7] Each of these requires legal determinations that most member firms are ill-equipped to resolve internally. All of these mandates will unquestionably increase compliance costs to firms, particularly when outside counsel has to be retained. Additional duties include disclosure requirements "…similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act"[8] and several record-keeping requirements.

Several questions remain unaddressed by FINRA, including whether these compliance costs justify the benefit of such foreign referral business, particularly when a member does not regularly get such referrals, as is the case with most member firms. As with Proposed Rule 2040(a), FINRA issued the Supplementary Material to provide guidance as to how a firm can

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[6] Based on NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 with technical changes. SEC Release No. 34-73210; File No. SR-FINRA-2014-037 (the "SEC Release") at pp. 23, 24, 26-30, 34-37.

[7] Proposed Rule 2040(c)(1).

[8] Proposed Rule 2040(c)(4).

determine whether a payment recipient is "required" to register as a broker-dealer, discussed further below.

Startlingly, in response to a particular comment by a prominent law firm, FINRA explicitly challenged that commenter's interpretation that one of the predecessor rules to Proposed Rule 2040(c) implied:

> …that NASD Rule 2420(c) can validly be used as confirmation that FINRA rules permit members to enter into a variety of brokerage arrangements with foreign non-members and to share fees or pay other forms of compensation without requiring the foreign firms or their personnel to register with the SEC.[9]

Whether a range of options is available to members when unregistered foreign finders are compensated is the crux of the matter. Yet, instead of a well-considered response to that issue, FINRA blithely states that it "…is considering guidance on circumstances where such arrangements may comply with FINRA rules."[10] Isn't that a critical element of the Proposed Rule? Shouldn't that have been resolved internally by FINRA before submitting the Proposed Rule to the SEC?

Determining Whether an Unregistered Recipient is "Required to be Registered"

The Supplementary Material to Proposed Rule 2040 imposes five distinct conditions[11] to substantiate that the payment to an unregistered person was made in compliance with FINRA rules. First, a member is "expect[ed]" to make the determination that registration is not required and "reasonably" support its determination. According to FINRA, there are at least three, non-exclusive methods to support that determination by,

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9 SEC Release, p. 36.

10 Id.

11 Of necessity, a firm would be required to include its procedures for payments to unregistered persons in its WSPs, raising the concern that too much detail would be a trap if the delineated procedures were not followed completely, or, a FINRA examiner interpreted "reasonably" in a manner contrary to that used by the firm.

> …among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action letter from the Commission staff[12]; or (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area.[13]

Third, the member's determination must also be reasonable under the circumstances. It should be reviewed periodically if ongoing payments are made. Finally, a member must maintain books and records that reflect the member's determination.

FINRA's mandates in the Proposed Rule are burdensome, expensive and, mostly, impractical. If a firm chooses to obtain a legal opinion, FINRA insists that counsel be "independent." That means, among other burdens, that in-house counsel is automatically disqualified from rendering such an opinion, even if that counsel is prepared and qualified, by reputation and knowledge, to issue an objective opinion. Certainly, given in-house counsel's familiarity with the firm's business could, in theory, result in the faster issuance of such an opinion letter. The additional concepts of "reputable" and "knowledgeable" in option (3), above, are so subjective that they create a no-win situation. If you were the broker-dealer client relying on such an opinion, would you be able to sleep at night knowing that FINRA (or the SEC) might subsequently determine that the independent counsel selected was neither "reputable" nor "knowledgeable"? Given the subjectivity of these "standards," there is no guaranty that choosing that option will put the issue of such payments to rest.

Perhaps a large firm would simply view these as additional costs of doing business. For small- and medium-sized firms, however, the costs of implementing these mandates are likely

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[12] Anecdotally, we are reminded by many in the industry that the turnaround time on a no-action letter request is extremely slow, so much so that the term "no-action" is an appropriate description of what actually happens when such requests are submitted.

[13] Supplementary Material .01, "Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act."

prohibitive and disproportionate to any economic benefit the firm might receive. Several of the commenters pointed out that reliance on SEC releases is impractical because they are usually too general, whereas no-action letters are usually far too fact-specific. As a practical matter, that forces a firm to seek either a no-action letter from the SEC or a legal opinion from counsel. Those options are expensive and time-consuming, but, more realistically, by the time either becomes available, the business opportunity is likely lost. Moreover, this is not a situation of market risk; if subsequent (expensive) analysis determines that the payment to the unregistered person was improper, the firm can request it be refunded.[14] What we predict will happen is that there will be inconsistent interpretations of a firm's compliance with the Proposed Rule by different FINRA examiners during the course of a routine examination, leading to possible disciplinary action(s) and more costs to the examined firm.

Industry Conditions

A lot has happened in the financial services industry since RN 09-69 was first issued in 2009. The SEC and FINRA have made many proposals in response to both the Dodd-Frank and JOBS Acts, particularly with respect to the activities of non-custodial broker-dealers. These proposals carve out or limit certain broker-dealer activities that generate transaction-based compensation from registration with FINRA. These include Crowdfunding[15]; the Six Lawyer No-Action Letter exempting merger and acquisition brokers from registration as a broker-dealer ("Unregistered M&A Brokers")[16]; and the proposed rules for Limited Corporate Finance Brokers ("LCFB"), a specialized form (as proposed) of registered broker-dealer advising sophisticated

[14] Of course, that raises a lot of practical questions, including whether a foreign finder would even want to get involved in such a transaction in the first place.

[15] SEC Release Nos. 33-9470; 34-70741; File Number S7-09-13; and RN 12-34.

[16] The "Six Lawyer Letter"; SEC No-Action Letter Jan. 31, 2014; revised February 4, 2014.

parties on capital transactions.[17] For ease of reference, these will be collectively referred to as the "Non-Custodial Broker Rules.

Inexplicably, the Proposed Rule does not even mention how it would affect the Non-Custodial Broker Rules. Could a crowdfunding firm pay finders' fees to an unregistered individual, of US or foreign citizenship? Would it even be cost effective for a crowdfunding firm to meet the obligations of the Proposed Rule? What happens to a transaction if an LCFB improperly (in hindsight) pays an unregistered person? We predict that more parties will try to make referrals to Unregistered M&A Brokers to stay away from FINRA's reach. Does that comport with FINRA's mandate to protect investors?

These problems also confirm our prior criticism of FINRA's piecemeal approach to regulating Non-Custodial Brokers, what we have previously characterized as the Balkanization of the brokerage industry. FINRA needs to take a systematic review of the reality of the business and market risks of Non-Custodial Brokers, which comprise at least 90% of FINRA's membership. Such an assessment should result in a much simpler, more rational and unified regulatory approach to the non-custodial activities of broker-dealers, including the payment of referral fees. FINRA's focus should instead be on promulgating rules that focus on risk and risk management and cost efficiency. Once that has been completed, imposing rules such as the Proposed Rule may make more business and regulatory sense.

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FINRA should be promulgating rules that promote financial intermediation. Writing rules that are confusing and difficult to implement disserves the very public that FINRA is supposed to protect. Chasing legitimate business from our shores is not in the interest of the U.S. securities industry. Regardless of whether foreign finders are paid, the execution of the

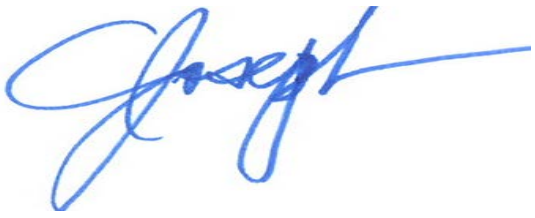
[17] Regulatory Notice 14-09.

securities transactions will still be done by FINRA-registered members and their registered representatives, in accordance with FINRA and SEC rules and regulations. The public will be protected.

Perhaps FINRA should propose a general principle to govern business conducted when a foreign finder is involved. Compensation to a foreign finder should be ordinary, necessary and reasonable. In addition, it should be lawful. Period. Prescribing expensive and impractical impediments to business flies in the face of business realities and common sense and even thwarts the will of Congress, which, in its collective wisdom, adopted such business-promoting legislation as the JOBS Act. We don't need rules that create hardships by raising more questions than currently exist. The answer to all of this may very well be that less is, indeed, more!

Thank you for the opportunity to comment on the Proposed Rule. 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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