3PM
THIRD PARTY MARKETERS ASSOCIATION

January 12, 2016

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

File Number: SR-FINRA-2015-054. [By electronic submission]

Dear Mr. Errett,

The Third Party Marketers Association ("3PM") strongly supports FINRA's initiative to issue a separate rule set for limited purpose firms such as third party marketers, placement agents, investment bankers and other financial advisors that advise companies on mergers and acquisitions, advise issuers on raising debt and equity capital in private placements with institutional investors, or provide advisory services on a consulting basis to companies that need assistance analyzing their strategic and financial alternatives ("Capital Acquisition Broker" or "CAB").

We applaud the steps that FINRA has taken in revisiting this proposal and incorporating the comments the industry had with respect to the original Limited Corporate Finance Broker ("LCFB") proposal issued in early 2015. In the aggregate, 3PM overwhelmingly supports FINRA's revised proposal. We would, however, like to bring the Commission's attention to the following items that should be considered in regards to this proposal. To that end, this letter will set forth our comments, suggestions and proposed amendments as applicable in the hope that we can participate in the forward-moving momentum of this initiative.

GENERAL STANDARDS (CAB RULE 010 SERIES)

Rule 016. Definitions

- **Capital Acquisition Broker (CAB)** – Although the modifications do not impact 3PM's members, we believe that the expanded definition makes sense and as such we are in agreement with the proposed change.

- **Institutional Investor –** 3PM supports FINRA's decision to incorporate "Qualified Purchasers" into the definition of an institutional investor.

MEMBER APPLICATION AND ASSOCIATED PERSON REGISTRATION (CAB RULE 100 SERIES)

Rule 116. Application for Approval of Change in Ownership, Control, or Business Operations

The application seems reasonable given the accommodation of all likely scenarios of establishing CAB member status and/or reinstating previous member status within one year following a member's conversion to CAB status.

Rule 123. Categories of Registration

3PM believes that CABs should not be subject to FINRA Rule 1230(b)(6) regarding Operations Professional registration because of the scope and nature of the examination.

3PM agrees with FINRA's decision to eliminate the limit on the principal and registration categories that would be available for persons associated with a CAB. 3PM requests FINRA's confirmation that CABs may hold all licenses previously sought and attained by their associated persons including Series 53, 4 and other licenses.

Rule 125. Continuing Education Requirements

In general, we support the requirement for CE testing to keep licensure active as well as the proposal to eliminate the requirement to hold an annual compliance meeting.

DUTIES AND CONFLICTS (CAB RULE 200 SERIES)

Rule 209. Know Your Customer

3PM is generally in agreement with Rule 209. Most 3PMs are raising capital for Reg. D products and do so by approaching an "agent" who represents the institutional investor looking to allocate capital. As such, the majority of the communication that takes place is between the "agent" and the 3PM. It is not unusual for there to be little or no communication between the 3PM and the end investor. Given this, there is often some information regarding the institutional investor which may not be obtainable due to this construct. 3PMs are not making recommendations in the traditional definition of the term, and therefore, as an example, will not have insight into the overall composition of the institutional investor's portfolio – as a retail broker would have over one of their accounts. Accordingly, we believe the rules should address some type of minimum compliance that would be appropriate in these situations. We further suggest that a demonstrable best efforts basis may be a satisfactory alternative in such instances.

3PM also seeks clarification of the statement "It also recognizes that a CAB or its associated person may look to an institutional investor's agent if the investor is represented by an agent" Specifically, clarification

as to what "look to" requires and whether this can be interpreted to mean that a CAB's responsibility under 209 is limited to learning the essential facts of the agent.

Rule 211. Suitability

3PM is generally in agreement with Rule 211, however, we still believe that the rule as proposed fails by requiring the suitability analyses to be performed before any recommendation is made. While we agree that a CAB must reasonably believe that an investment is suitable for an investor before making a recommendation, we believe that the rule does not recognize that the process of diligence is ongoing, in many cases can take several months to several years before an investment decision is made, and often does not, and should not, conclude until the deal is closed. We believe incorporation of this process is essential to Investor protections, and to the success of the rulemaking regime for CABs. We continue to believe that Rule 211 should emphasize this point and encourage RRs to periodically review their suitability analysis throughout the offering process, but no less frequently than once before the subscription agreement or relevant contract is signed and due diligence is as complete as it can be at that particular time. While this approach should apply to all recommendations, it is especially relevant in the case of the offering of Private Placements and other complex products.

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Rule 221. Communications with the Public

3PM is generally in agreement with Rule 221 and supports FINRA's removal of the prohibition on predictions or projections of performance.

Rule 240. Engaging in Impermissible Activities

3PM recommends that FINRA consider a grace period incorporated into this rule, especially in regards to unintentional activities. To this end, we recommend circulating a FAQs piece for greater education and reference of the CAB member firms during the grace period which would outline the most common misunderstandings the Commission and or FINRA may be seeing.

SUPERVISION AND RESPONSIBILITIES RELATED TO ASSOCIATED PERSONS (CAB RULE 300 SERIES)

3PM is generally in agreement with the Rule 300 series with the exception of Rule 331. We applaud FINRA for implementing modifications to the traditional supervision rule that negatively impacts a CAB's business model while not necessarily adding any substantive investor protections and replacing it with Rule 311.

Rule 331. Anti-Money Laundering Compliance Program

3PM recognizes that all financial institutions play an important role in the detection and prevention of money laundering. Further, we are in agreement with FINRA's proposal to allow CABs to conduct independent compliance tests every two years rather than annually. We do however believe that the appropriate steps need to be taken to conform the Customer ID Program (CIP) requirement of the Bank Secrecy Act to the business of a CAB. Since CABs do not hold customer accounts, cash or securities, nor do they open accounts for clients, it is often difficult for firms to obtain the depth of confidential information necessitated by the Rule. When working with Funds, most AML information is collected by the Administrator or the Fund and AML responsibilities are often delegated to these firms by the issuer. Furthermore, if FINCEN's proposal to include investment advisers in the definition of a financial institution is approved, then the investment advisers who are actually opening the accounts with the clients who are investing in their strategies will then be able to conduct a more formal review than a CAB can as an intermediary. We strongly request that the SEC work with the appropriate authorities to revisit the AML responsibilities of CABs and apply consideration to require US registered entities such RIAs to share certain data with FINRA member firms so that all registered participants may satisfy their respective compliance obligations in the most complete and accurate manner possible.

In addition, 3PM seeks the SEC's confirmation that the terms and conditions of the No-Action letters initially dated 2004 and extended by subsequent No-Action letter in January 2015 apply to CABs to the extent that customer ID is reasonable performed by a federally regulated entity under a contractual obligation.

Removal of FINRA Rule 3050 from the CAB Ruleset

3PM is in agreement with FINRA's decision to remove this Rule from the CAB Ruleset.

FINANCIAL AND OPERATIONAL RULES (CAB RULE 400 SERIES)

Rule 411. Capital Compliance

3PM believes that proposed Rule 411 should remove the minimum net capital requirement of $5,000 currently applied to CAB members. While we understand that this is outside of FINRA's authority we urge the SEC to review the calculation of net capital for CABs and modify the Rule so that the nature of a CAB's business does not cause it to have to improperly report its financial condition to FINRA.

The current net capital requirement thresholds of $250,000, $100,000, and $50,000 respectively for carrying members and introducing members are rather arbitrary in nature; however, the materiality of these dollar amounts at least substantively supports the spirit of these minimum net capital requirements which is used to protect investors from unforeseen circumstances. In theory, the broker dealer carrying or clearing that customer account would have minimally sufficient reserves to apply a remedial solution to the customer. When applying this ideology to the $5,000 net capital requirement for CABs (non-carrying and non-clearing members), it is clear that $5,000 would universally be determined as an insufficient amount to apply to any hypothetical remedial solution involving a customer. Moreover, CABs do not hold any customer accounts nor have access to them, so it is unclear what value a net capital requirement has and for what purpose it would be applicable. One may then deduce that this specific net capital requirement remains in place to ensure that all member firms remain on the grid and adhere to the general net capital requirement apparatus, and that perhaps the intention was that a well thought out resolution would be implemented down the line. The time has now finally come, and we collectively need to implement specific rules which effectively and efficiently regulate the CAB universe of member firms.

Countless hours and resources have been allocated to this $5,000 minimum net capital requirement by CABs and FINRA examiners alike. This is clearly not an effective and efficient use of our collective resources when recognizing that the minimum net capital requirement of $5,000 for CABs (non-carrying firm) does not deliver any type of investor protection nor does the role of a VAB demonstrate any basis for a minimum net capital requirements given the limited scope of the activities permitted.

3PM believes that the calculation of net capital and FOCUS reporting requirements for CAB members needs to be overhauled as the current set of calculations and data points are not directly applicable to the business conducted by CABs and as such place a significant burden on CABs without any identified protection to investors. Furthermore, this approach is simply another attempt by the SEC to standardize reporting regardless of fit, rather than make the appropriate changes required for CABs to properly assess their financial viability and the ability to protect investors.

A specific issue that illustrates this disconnect is demonstrated through the revenue generation framework relative to private placement activity. When payment is due, a CAB will book a receivable for the incentive fee owed to the firm. Often a corresponding payable will be established that would pass-through a portion of that fee to the registered representative who gets paid a commission on that fee. Both of these entries are in compliance with the SEC and GAP standards. A disconnect, however occurs in the firm's calculation of net capital. Under SEC rules, the current net capital calculation does not allow the accrued receivable to be offset by the payable that is directly related to it. Instead, the entire net commission payable is required to be recorded as aggregate indebtedness (AI), in effect requiring the CAB to double count the payable. This methodology does not adhere to GAP standards which would allow for the corresponding offset to the receivable. Furthermore, a significant number of PCAOB registered accountants believe that this is the improper way to record revenue or calculate AI. By following the SEC's mandated approach, the CAB is not accurately reflecting its true capital condition.

Rule 414. Audit

Given the nature of a CAB's business, 3PM does not believe that the provision of audited financial statements in any way enhances investor protection. We also believe that the cost of Audits, which are extremely prohibitive to small firms, need to be addressed. Given the new requirement that PCAOB Auditors must now be audited by the Board, the costs of such audits, which will be absorbed by the broker dealer community, is growing exponentially. We are confident that the underlying purpose of Dodd Frank was to address shareholder protections. A CAB has no shareholders, no public customers and as such requiring a PCAOB audit of a CAB is meaningless exercise, well outside the intention of the law. Furthermore, issues raised in the PCAOB interim inspection program simply are not relevant to CABs, and would therefore should not influence the decision to eliminate this requirement for CABs.

3PM is aware that the PCAOB Board, and not FINRA or the SEC, has the authority under Dodd Frank to exempt CABS from this requirement. Accordingly, in addition to commenting in this letter, 3PM will also communicate its findings with the PCAOB directly.

Please see the Appendix for a report entitled PCAOB Audit Oversight and Small, Non-Public Non-Custodial Broker-Dealers; Attributes-Based Analysis of the Broker-Dealer Risk Profile which supports 3PM's perspective.

Rule 436. Fidelity Bonds

3PM is in full agreement with the revisions made to Rule 436.

Rule 452. Supplemental Focus Information

3PM does not agree with FINRA proposal to subject CABs to FINRA Rule 452. While we understand that FINRA does not have the authority to set net capital rules, we do believe that FINRA does have the ability to improve the information requests made in the SSOI. 3PM also believes that the information FINRA receives from these forms are inaccurate due to the wide array of methods, timelines and fee structures applicable to CABs offering private placements.

The SSOI was clearly written under the assumption that there is consistency in the method, timeframe and fee structures that applies to both private placements and publicly traded securities. This is simply an inaccurate assumption. When FINRA was made aware of the inaccuracies, the response was that they understood the shortcomings of the reports, and it was suggested that firms use their best efforts to interpret the questions. While 3PM is not against enhanced reporting for the purpose of gleaning new insights in to a firm's financial condition, we do not believe that it is acceptable for FINRA to issue reporting requirements that do not apply to a constituency or that may distort the findings because of the interpretation of an unclearly written question. As such we think that FINRA should revisit the SSOI requirements for CABs in their current form and consider requesting appropriate information from our

constituency. To accomplish this task, we suggest convening a working committee of CABs to help write appropriate questions that accurately reflect our business model.

Removal of the Requirements of FINRA Rules 4370 and 4380

3PM is in agreement with the removal of these rules from the CAB ruleset.

SECURITIES OFFERINGS (CAB RULE 500 SERIES)

3PM is in agreement with FINRA's proposed 500 series.

INVESTIGATIONS AND SANCTIONS, CODE OF PROCEDURE AND ARBITRATION AND MEDIATION (CAB RULES 800, 900 AND 1000)

3PM supports these proposed rules.

Rule 2266. SIPC Information

While neither FINRA nor the SEC have the authority to modify SIPC rules, we urge the Commission to work with SIPC to exempt CABs from membership in SIPC.

SIPC was created under the Securities Investor Protection Act as a non-profit membership corporation. SIPC oversees the liquidation of member broker-dealers that close when the broker-dealer is bankrupt or in financial trouble, and customer assets are missing. In a liquidation under the Securities Investor Protection Act, SIPC and the court-appointed Trustee work to return customers' securities and cash as quickly as possible. Within limits, SIPC expedites the return of missing customer property by protecting each customer up to $500,000 for securities and cash (including a $250,000 limit for cash only).

SIPC is an important part of the overall system of investor protection in the United States. While a number of federal and state securities agencies and self-regulatory organizations deal with cases of investment fraud, SIPC's focus is both different and narrow: restoring customer cash and securities left in the hands of bankrupt or otherwise financially troubled brokerage firms.

In SIPC's own words, their mission directly relates to protecting customer assets. CAB firms by definition ***"do not include any broker or dealer that carries or maintains customer accounts, holds or handles customers' funds or securities, accepts orders from customers to purchase or sell securities as a principal or as an agent for the customer".*** As such, CABs are continually paying assessments on their revenues in to the SIPC fund to protect investors that will never require coverage from such an event from a CAB. This rule is not properly aligned with the business of CAB and creates significant expenses to CABs without providing any tangible benefit. In reality CABs are paying into a fund that reimburses investors for somebody else's wrongdoing which is an unfair practice. Moreover, we believe the acknowledgement of

SIPC protection on the materials of a CAB who does not maintain any customer accounts, etc. is misleading to investors and may create a false sense of additional protection.

Not addressed in the FINRA rule proposal, but underlying and possibly interfering with the overall impact of the CAB rules on BDs are the new rules being implemented by the MSRB for Municipal Advisers. While CAB proposes to implement meaningful regulations for firms operating under FINRA's rules, the adoption of the tailored rule set would cause conflicts for FINRA members who are dual registrants and are required by their business model to also be registered as a Municipal Advisor with the SEC and MSRB. The CAB proposal streamlines many of the compliance requirements for firms who opt for this regime. However, many of these same firms are also registered as Municipal Advisers, requiring them to adopt many of the policies and procedures that FINRA has clarified and even eliminated. Regulations that would be at odds specifically include CABs elimination of the annual compliance meeting requirement, some of the relief afforded by the changes made to the communications with the public and supervision rules, most notably the elimination of the requirement to perform annual inspections and to send a letter to senior management regarding the firm's supervisory controls, and the change to the AML audit requirement that CABs only perform an independent compliance test every two years rather than yearly. It is our belief that given this, some firm's may choose not to opt into the CAB ruleset unless FINRA, the MSRB and SEC can work together to find a way to eliminate these conflicts. To do so would require acknowledgement from the MSRB and SEC that while 3PMs may be MAs, our firms perform a much more limited function than many other firms operating under the same regulatory scheme. We are happy to speak with FINRA, the SEC or MSRB further on this point should there be an interest in working to resolve this issue.

3PM is pleased that FINRA chose to continue its efforts on behalf of this proposal despite the negative feedback received from the industry. After the release of the first proposal, 3PM did not believe that many FINRA members would convert their registration to this new category given the limited benefits offered. FINRA however was able to take feedback from the industry and reformulate their original proposal into one we think qualifying firms should wholeheartedly take advantage of. Not only does this proposal take a meaningful step to refining an overly burdensome regulatory scheme, but it implements significant cost savings for small firms accomplished without compromising investor protection. While we believe there is still some work to do here, we are extremely grateful to FINRA for taking the first step in the process. In fact, we believe if implemented the CAB rules may increase the number of Firm's who elect to register and thus ultimately increase investor protection through broader oversight.

If you have any questions or comments regarding any of the information contained in this letter or would like to discuss any of these comments in further detail, please feel free to contact me directly by phone at [redacted] or by email at [redacted].

Thank you in advance for your consideration.

Regards,

//DONNA DIMARIA//

Donna DiMaria
Chairman of the Board of Directors
3PM Association

//LISA ROTH//

Lisa Roth
Board of Directors
3PM Association

Appendix

3PM is an association of independent, outsourced sales and marketing firms that support the investment management industry worldwide.

3PM Members are properly registered and licensed organizations consisting of experienced sales and marketing professionals who come together to establish and encourage best practices, share knowledge and resources, enhance professional standards, build industry awareness and generally support the growth and development of professional outsourced investment management marketing.

Members of 3PM benefit from:

- Regulatory Advocacy
- Best Practices and Compliance
- Industry Recognition and Awareness
- Manager Introductions
- Educational Programs
- Online Presence
- Conferences and Networking
- Service Provider Discounts

3PM began in 1998 with seven member-firms. Today, the Association has more than 65 member organizations, as well as significant number of prominent firms that support 3PMs and participate in the Association as 3PPs, Industry Associates, Member Benefit Providers, Media Partners and Association Partners.

A typical 3PM member-firm consists of two to five highly experienced investment management marketing executives with, on-average, more than 10 years' experience selling financial products in the institutional and/or retail distribution channels. The Association's members run the gamut in products they represent. Members work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. Some firms' business is comprised of both types of product offerings. The majority of 3PM's members are currently registered with FINRA or affiliated with a broker-dealer that is a member of FINRA.

For more information on 3PM or its members, please visit www.3pm.org

LIMITED PURPOSE BDS AND RISK

Attributes-Based Analysis of SIPC Distribution Data

Updated November 7, 2014

Background

PCAOB has received comments and information from trade associations and industry representatives in various capacities regarding its interim audit program and other matters related to its expanded authority under the Dodd Frank Act. Many of these groups have sought carve-outs from the PCAOB audit requirement for introducing firms, among other firm types. In this same context, the Board received a copy of a letter written by SIPC noting the extent to which it had made distributions on behalf of introducing firms.[1]

At a meeting of the members of the PCAOB Board in January 2011, certain Board Members expressed their interest in identifying and understanding trends related to firm attributes that might facilitate a meaningful dialogue regarding risk amidst the interests of the trade groups, the facts and data shared by SIPC, and its own underlying mission to protect investors.

The original version of this report was written in March 2011 in response to the Board's request, presenting preliminary conclusions that certain firms present little or no risk based an analysis of SIPC distributions for years 2008-2010 based on dollar amount and firm attributes.

The original report, presented a meaningful rationale for PCAOB to adopt in carving out certain firms from its audit requirements.

The November update is meant to provide refreshed data, and to restate the prior conclusion, as it remains true to this date.

RISK UPDATE

This report, as update in November 2014, presents updated dated to the tables provided in the original report. It is meant to restate the conclusion that small, privately owned, non-custodial broker-dealers should be exempt from the PCAOB audit requirement.

A review of SIPC distributions demonstrates that companies with only 1 or 2 business types or attributes in the following combinations present little or no risk of insolvency for investors and will not be found among firms subject to SIPC distributions:

- PLA – Private Placement
- Other
- MFR – Mutual Funds Retailer

[1] The SIPC letter is attached as Attachment B to this update.

- VLA – Variable life insurance or annuities
- PLA and Other
- MFR and VLA

Background

There are a high number of FINRA registrants with one or two business types only in the specific combinations noted in the hypothesis.
Consider the following approximate number of firms that fall into these categories:

- 189 broker-dealers report that private placement activity is their only business line;
- 165 broker-dealers do not fall into any of the customary FINRA business lines and disclose "Other" as their only line of business. Most of these describe their business as mergers and acquisitions;
- 562 broker-dealers disclose that they engage solely in private placement agent and "other" activity, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these 916 firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and which does not have customers in the retail sense. The business activities of these firms are governed by contract, and are not 'transactional.'

Consider also the following approximate number of firms that only engage in retail sales to customers by application:

- 32 broker-dealers report that their only business line is to retail mutual funds. Out of these 32 firms, all but 3 have fewer than 25 employees;
- According to FINRA BrokerCheck reports, 20 broker-dealers offer only variable annuities. 15 of the 20 report having fewer than 50 employees;
- 79 broker-dealer firms disclose having only two business lines, mutual funds and variable annuities. Nearly 80% of them have fewer than 10 employees.

These 126 broker dealers only engage in 'application-way' business, which means that their business is limited to purchases and sales of funds and annuities accomplished through direct paper-based application to the mutual fund or annuity companies. These companies do not have custody and also do not have clearing arrangements. Rather they operate through selling agreements with the fund and annuity companies.

It is important to note that the majority of these firms are also very small firms, and many have revenue of less than $1mm/year. (see the chart below) Of the 457 firms reporting only one line of business (private placements, "other", mutual funds, or variable annuities) all but 20 are small firms (fewer than 50 employees). Of those reporting two business lines (Private placements and "other"), 96% have fewer than 50 employees. Nearly 80% of 79 BD firms with combination of only two attributes MFR and VLA have fewer than 10 employees.

Attributes	#Firms	No. with Fewer than 50 RRs	As a %	#Firms with Fewer than $1mm revenue*
PLA	189	185	98%	
Other	165	156	95%	
PLA and Other	562	546	97%	
MFR	32	29	91%	
VLA	20	15	75%	
MFR and VLA	79	75	95%	
Total:	1047	1006	96%	

* To be provided by FINRA

Summary and Conclusion

When the original report[2] was delivered in 2011, the impact of the PCAOB's program on small privately held non-custodial broker-dealers was hypothetical. Now, however, as the PCAOB audit standards come into effect, the impact on small firms is being realized[3]. Audit fees are escalating, and most importantly the pool of auditors available and affordable to small firms is diminishing rapidly.[4] Were the audits meaningful to fulfilling the mission and vision of the PCAOB, then the added costs and burdens might be acceptable. But this is not the case.

The PCAOB's mission is "to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection."

Its vision is to be a model regulatory organization. Using innovative and cost-effective tools, the PCAOB aims to improve audit quality, reduce the risks of auditing failures in the U.S. public securities market and promote public trust in both the financial reporting process and auditing profession.

In a speech made by PCAOB Board Member Jay Hanson in 2012 he set forth the board's mission in clear terms. He advised his university audience: "Never lose sight of the fact that your true clients are the investors in the companies you are auditing, not the company's CFO, or

2 The original Report is provided as an Attachment B to this update.

3 [survey detail]

4 [statistics]

the accounts receivable accountant, or even the internal auditor with whom you may be interacting day after day. When you are working long hours and dealing with difficult issues, it may be easy to forget about the public-interest mission auditors fulfill, but that mission is the only thing that distinguishes the auditor from the legions of others whose work affects the company's financial statements."

The PCAOB should follow Mr. Hanson's lead, and recognize that in the case of small privately held non-custodial broker-dealers, the "investors in the companies" being audited are NOT public investors. They are the broker-dealer principals, the owners, the CFO's themselves, and not the investors that PCAOB was charged with protecting. Oversight of the audits of these firms is nothing more than a distraction from the true objective and mission of the PCAOB.

ATTACHMENT A

SECURITIES INVESTOR PROTECTION CORPORATION
805 FIFTEENTH STREET, N. W., SUITE 800
WASHINGTON, D. C. 20005-2215
(202) 371-8300 FAX (202) 371-6728
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OFFICE OF THE GENERAL COUNSEL

November 2, 2009

BY MESSENGER

Honorable Scott Garrett
Ranking Republican, Capital Markets Subcommittee
House Financial Services Committee
U. S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Re: Investor Protection Act of 2009 Proposed Amendment

Dear Congressman Garrett:

We write to express the concern of the Securities Investor Protection Corporation ("SIPC") with respect to an amendment ("the Amendment") offered by you to the draft bill, the Investor Protection Act of 2009. Section 17(e)(1)(A) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U. S. C. §78q(e)(1)(A), requires registered securities brokers or dealers to file with the Securities and Exchange Commission ("SEC") a yearly balance sheet and income statement ("financial statement") that has been certified by a registered public accounting firm. "Registered public accounting firm" is one that is registered with the Public Company Accounting Oversight Board ("PCAOB") and is subject to its oversight and inspection. See 15 U.S.C. §§78c(59) and 7201(12). Under the proposed Amendment, only brokers or dealers providing clearing or custodial services would be required to have their financial statements audited by a PCAOB firm. "Introducing" broker-dealers, that is, brokerages that merely introduce business to other firms that provide the clearing or custodial services, would have the option of having their financial statements audited by a PCAOB firm or a non-registered independent public accountant.

Broker-dealers, known as introducing firms, may not have the financial resources or expertise to clear or complete securities transactions. Typically, they enter into clearing agreements with other broker-dealers, known as clearing firms, whereby the introducing firm "introduces" customer accounts to the clearing firm. While the introducing firm continues to service the customer accounts and has direct client contact, for example, by soliciting the opening of an account, helping to determine a customer's investment objectives, and accepting orders for the purchase or sale of securities, they rely upon the clearing firm to complete trades and to perform settlement and

custodial functions. See H. Minnerop, The Role and Regulation of Clearing Brokers, 48 The Business Lawyer 841 (May 1993). Introducing broker-dealers typically do not hold customer cash or securities. As such, there would seem to be good cause for the Amendment. Regrettably, history suggests otherwise.

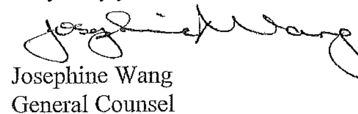
Although introducing firms should not hold customer assets, between 1995 and 2008, 52 introducing brokerage firms were placed in liquidation under the Securities Investor Protection Act, 15 U.S.C. §78aaa et seq. ("SIPA"), at a cost to SIPC of more than $137 million. A list of the firms is Attachment B hereto. Because of the direct client contact, key personnel at the brokerages have been able to acquire customer assets by conversion, unauthorized trading or other improper conduct. See, e.g., In re John Dawson & Associates, Inc., 289 B.R. 654 (Bankr. N.D. Ill. 2003) (claims of conversion and unauthorized trading by an introducing broker are customer claims under SIPA because "customer property" includes "the proceeds of any such property transferred by the debtor, including property unlawfully converted"); In re R.D. Kushnir & Co., 274 B.R. 768 (Bankr. N.D. Ill. 2002) (introducing broker employee used clearing broker computer system to make unauthorized trades in customer accounts).

An audit of the introducing brokerage by a registered public accounting firm could uncover wrongdoing and minimize or avoid losses to customers in such cases. Bernard L. Madoff Investment Securities LLC ("BLMIS") is a good example of the dire consequences if a broker, even one that clears for itself or for others, can avoid auditing by a registered accounting firm. Under an SEC exemption, Friehling & Horowitz, a three-employee accounting firm, was able to avoid oversight by the PCAOB and continue to audit BLMIS. David Friehling, the sole proprietor of the accounting firm, reportedly will plead guilty on November 3, 2009 for his role in the Ponzi scheme.

Currently, section 601(b) of the Investor Protection Act would amend section 101(a) of the Sarbanes-Oxley Act, 15 U.S.C. §7211(a), to require all companies, and not only "public companies," to be audited by accounting firms registered with the PCAOB "in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports...." This would include all brokerages -- introducing broker-dealers and clearing broker-dealers alike. Respectfully, we submit that the Amendment does not further those objectives by limiting the provision to registered brokers or dealers that provide clearing or custodial services.

A copy of this letter is being provided to Chairman Frank. If there is any additional information that we can provide, please let us know.

Very truly yours,



Josephine Wang
General Counsel

Encs.

ATTACHMENT B

[INTRODUCTION REDACTED]

Hypothesis

A review of SIPC distributions over the past 3 years will prove that companies with only 1 or 2 business types or attributes in the following combinations present little or no risk of insolvency for investors and will not be found among firms subject to SIPC distributions:

- PLA – Private Placement
- Other
- MFR – Mutual Funds Retailer
- VLA – Variable life insurance or annuities
- PLA and Other
- MFR and VLA

Background

There are a high number of FINRA registrants with one or two business types only in the specific combinations noted in the hypothesis.
Consider the following approximate number of firms that fall into these categories:

- 202 broker-dealers report that private placement activity is their only business line;
- 185 broker-dealers do not fall into any of the customary FINRA business lines and disclose "Other" as their only line of business. Most of these describe their business as mergers and acquisitions;
- 520 broker-dealers disclose that they engage solely in private placement agent and "other" activity, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these 907 firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and which does not have customers in the retail sense. The business activities of these firms are governed by contract, and are not 'transactional.'

Consider also the following approximate number of firms that only engage in retail sales to customers by application:

- 48 broker-dealers report that their only business line is to retail mutual funds. Out of these 48 firms, all but 3 have fewer than 25 employees;
- According to FINRA BrokerCheck reports, 22 broker-dealers offer only variable annuities. 16 of the 22 report having fewer than 50 employees;
- 93 broker-dealer firms disclose having only two business lines, mutual funds and variable annuities. Nearly 80% of them have fewer than 10 employees.

These 163 broker dealers only engage in 'application-way' business, which means that their business is limited to purchases and sales of funds and annuities accomplished through direct paper-based application to the mutual fund or annuity companies. These companies do not have custody and also do not have clearing arrangements. Rather they operate through selling agreements with the fund and annuity companies.

It is important to note that the majority of these firms are also very small firms, and many have revenue of less than $1mm/year. (see the chart below) Of the 457 firms reporting only one line of business (private placements, "other", mutual funds, or variable annuities) all but 20 are small firms (fewer than 50 employees). Of those reporting two business lines (Private placements and "other"), 95% have fewer than 50 employees.

Attributes	**# Firms**	**No. with Fewer than 50 RRs**	**As %**	**No. with Fewer than $1mm revenue****
PLA	202	198	98%	
Other	185	177	96%	
PLA and Other	520	513	99%	
MFR	48	46	96%	
VLA	22	16	73%	
MFR and VLA	93	74*	80%	
Total:	**1,070**	**1,024**	**96%**	

* Nearly 80% of 93 BD firms with combination of only two attributes MFR and VLA have fewer than 10 employees…data on 'MFR and VLA' BD firms with fewer than 50 employees is pending
**To be provided by FINRA

Observations and Conclusions

SIPC did not pay out for the firms with the attributes stated in our hypothesis. These findings support an exemption from the PCAOB audit requirement for firms whose business services are limited to these attributes alone or in combination.

When compiling data to test our hypothesis, we noticed several trends that may suggest other types of firms also absent among SIPC distributions and therefore possible candidates to be

carved out of PCAOB audit requirements. Further research is underway to ascertain whether or not any of these trends is worthy of such consideration.

Biography of Aliya Kaziyeva

American University graduate with major in Economics, minor in Mathematics, and 2-year work experience in Deloitte&Touche, Almaty, Kazakhstan, branch. Was accepted into the Full-time MBA program and offered an Assistantship Award at the Isenberg School of Management, University of Massachusetts. Ms. Kaziyeva is seeking a part-time job in the Western Massachusetts area starting from September, 2011. Contact at: [redacted] or [redacted].

Biography of Lisa Roth

Lisa Roth is the CEO of Keystone Capital Corporation, an independent broker-dealer based in San Diego CA. Ms. Roth is a member of the Board of the Third Party Marketers' Assoc., heads Member Advocacy for the National Association of Independent Broker-Dealers and serves on FINRA's Small Firm Advisory Board, among other industry and professional affiliations. Contact at: [redacted] or [redacted].