3PM
THIRD PARTY MARKETERS ASSOCIATION

May 16, 2014

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street – Suite 600
Alexandria, VA 22314-3412

RE: Establishing Professional Qualification Requirements for Municipal Advisors
Regulatory Notice 2014-08

Dear Mr. Smith:

The Third Party Marketers Association ("3PM") supports MSRB's initiative to establish a separate professional requirement for the recently created market participant profile of Municipal Advisor, which is outlined in the MSRB's Regulatory Notice 2014-08.

While we understand the need for comprehensive and current registration requirements, we caution that there is a critical disconnect in the initial approach of MSRB's Regulatory Notice 2014-08 - Establishing Professional Qualification Requirements for Municipal Advisors. Primarily, we believe the definition of Municipal Advisor extends beyond what is necessary because as written it would effectively require certain professionals who are already licensed, to be subject to another, duplicative, regime. Placement Agents who introduce alternative investment managers to public pensions are already required to be registered with FINRA as registered representatives of broker-dealers. These placement agents are already properly registered in the scope of their business activities as General Securities Representatives because they are participating in private securities transactions. The scope of their qualifications and training includes municipal securities.

According to the SEC's Final Rule regarding Release No. 34-70462; File No. S7-45-10, "As discussed in the Proposal, until the passage of the Dodd-Frank Act, the activities of municipal advisors were largely unregulated, and municipal advisors were generally not required to register with the Commission or any other federal, state, or self-regulatory entity with respect to their municipal advisory activities.", it is clear to see the identification of municipal market participants which the MSRB is targeting for these professional qualification requirements. These municipal market participants are involved with the issuance of municipal securities and related matters.

The placement agents serving the U.S. alternative asset management industry are registered with broker-dealers regulated by the SEC and FINRA, and all of the placement agent firms operate in an environment of rigorous compliance oversight and controls. All U.S. placement agents must be registered with FINRA as General Securities Representatives by passing the Series 7 exam which contains a significant amount of content on municipal securities and related rules. In addition, all General Securities Representatives are required to complete Continuing Education requirements on a recurring

frequency which tests foundational and updated content knowledge.

As outlined in FINRA's General Securities Representative Qualification Examination – Content Outline, the municipal securities content for the Series 7 examination is one of the top 2 focus topics for questions accounting for approximately 20% of the exam:

Subject area	**Approximate number of**	**Percentage of exam**
Options	50	20%
Municipal Securities	50	20%
Packaged Securities	20	8%
Direct participation programs	15	6%
Corporate Securities	15	6%
Securities industry regulations	15	6%
Exchange operation / NYSE	15	6%
Economics and securities analysis	15	6%
Margins	10	4%
US government securities	15	6%
Retirement plans and taxation	15	6%
Customer Accounts	15	6%

This data clearly supports the historical framework of proper qualification requirements being in place for placement agents who introduce alternative investment managers to public pensions. These market participants should not be required to meet additional professional qualification requirements which are not relevant to their business activities.

To overcome this disconnect, we strongly recommend that the MSRB focus on the relevant regulatory precedent set by FINRA in 2009 regarding the Series 79 – Limited Representative Investment Banking. Following the SEC's approval, Rule 1032 (i) effectively developed a qualification examination for this category. Individuals who were registered as General Securities Representatives (Series 7) and engaged in the member firm's investment banking business as described in Rule 1032 (i) were provisioned with a grandfathering clause to the new registration category which was given a timeframe of six months from the effective date of the Rule.

FINRA's goal of establishing a special limited license category was effectively implemented by providing market participants who were already properly licensed and conducting business activity within the scope of the special license category with a transitional "Opt-In" Period as outlined in FINRA Regulatory Notice 09-41. This transitional period applied to both General Securities Representatives and General Securities Principals in supervisory roles.

FINRA is also currently considering comments to Regulatory Notice 14-09 which would create a separate registration category for limited purpose firms, such as placement agents, that offer securities to

"Qualified Investors". Please see the appendix for a copy of 3PM's comments to FINRA Regulatory Notice 14-09. Whether as a registrant under FINRA's new regulatory scheme for limited purpose firms, or as broker-dealers who act as placement agents under the existing rules and regulations, we believe that the rule set(s) are adequately broad to encompass all broker-dealer activities, including municipal activities, and do not require redundant rules, regulations and licenses.

The MSRB's current proposal for professional qualification requirement is to be applied to the newly created profile of Municipal Advisor which parallels the aforementioned scenario. The MSRB's goal is to establish special professional qualification requirements for Municipal Advisors and those who are charged with supervising them. For those market participants, specifically General Securities Representatives and General Securities Principals, the MSRB should provide a transitional "Opt-In" period for the new professional qualifications proposed which follows the precedent and allows proper exemption to qualified and registered individuals.

The Commission rightly provides exemptive relief to market participants who are already registered with another national regulatory authority such as the SEC and the NFA, as one of the directives of the Municipal Advisor initiative is to ensure that all market participants which are conducting business activities relevant within the municipal securities industry are properly registered with a minimum of one national regulatory authority. This avoids duplicity in the layered regulatory framework which we all operate within while mitigating the practice of double-dipping market participants for fees and registration costs.

We strongly suggest that the MSRB and the Commission should extend this logical methodology to dedicated placement agents who are already registered with FINRA, the SEC and potentially other national regulatory authorities such as the NFA. This would allow the proposal of establishing professional requirements to target the specific market participants who are truly responsible for attaining and maintaining these professional proficiencies in knowledge and practice in the municipal securities arena, while ensuring that properly registered placement agents are not unfairly burdened with additional examination requirements which are not testing the proficiency of their skill sets which is in selling Reg D investment opportunities.

Placement agents who interface with public pensions have been incorrectly bucketed into the category of Municipal Advisors based on the fact that they may introduce pre-vetted investment managers and opportunities to these public pensions. Placement agents do not act in any fiduciary capacity to these public pensions, but rather serve as an informational channel that assists public pensions in identifying potential allocation targets. This construct is materially distinct from the description that the MSRB publically acknowledges on their website regarding the role of municipal advisors which reads as follows:

Municipal advisors act in a fiduciary capacity for issuers.

- Placement Agents do not act in a fiduciary capacity for issuers.

The strategic services offered by municipal advisors may include development of comprehensive financing plans; analysis and monitoring of client portfolios; advice on potential financing solutions and new financial products; and recommendations for tracking and achieving on-budget performance.

- Placement Agents do not offer these services.

Municipal advisors also provide advice on conditions of a new issue, such as structure, timing, marketing, fairness of pricing, terms and bond ratings.

- Placement Agents do not provide advice of any nature to prospective investors.

During the transaction, municipal advisors represent the interests of state and local governments in negotiations with underwriters, rating agencies, banks and others involved. Municipal advisors also assist state and local governments with preparing disclosure documents, including official statements and continuing disclosure documents.

- Placement Agents do not represent or engage in negotiations with underwriters or the other aforementioned counterparties.

It is critical that the MSRB consider that the SEC's final rule, as aforementioned, **provides exemptions provided under the rule which are based on the activities of the [Municipal] advisor *rather than the type of market participant.*** Placement Agents do not interface with public pensions regarding municipal securities, and do not advise public pensions or municipalities regarding portfolio construction, and do not need to have a specific level of understanding of municipal securities instruments as they do not directly relate to a placement agent's activities.

In addition to an examination for Municipal Advisor Representatives, the MSRB is also adding a new registration classification for Municipal Advisor Principals. We once again refer you to the arguments stated above and remind the MSRB that all Municipal Advisors that are already registered as representatives with FINRA are also supervised by the appropriately registered FINRA Principal.

Given that most placement agents who are also MAs are small firms, it is important to recognize the additional burdens the MSRB's proposed rules would place on these small firms. Not only will individuals in our firms have to sit for an examination, but sometime in the future, supervisors will also be required to sit for a MA Principal examination. We believe that this is unnecessary given the fact that we are already registered with FINRA, as both Representatives and Principals, for all of our private placement activities. Those of us who conduct municipal activities carry a specific municipal license, a general securities license, and (or are supervised by someone with) a principal license.

In addition to the registration examinations, it is unreasonable to believe that the MSRB will also be implementing new continuing education requirements for MAs which will further burden small firms who are already registered and subject to continuing education requirements. While this is not covered in Notice 2014-08, we believe that the entire picture must be taken into account to judge the addition impact on small firms.

We further believe that the MSRB's decision to design only one examination that would cover material relevant to all Municipal Advisors is faulty. As articulated earlier in this letter, the definition of Municipal Advisor is extremely broad in that it covers a number of constituencies whose business models vary dramatically from one another. Given this reality, Municipal Advisors will be required to learn material relating to one another's businesses that will be used solely for the purpose of passing the MA qualification examination and never in the course of our day-to-day business operations. This

requirement is time consuming and irrelevant to the MSRBs mission of investor protection is putting an undue burden on the small firms that are already licensed through FINRA.

Questions posed by the MSRB

The MSRB requested comment concerning the following issues:

- **Should all individuals engaged in municipal advisory activities demonstrate a minimum level of competence by taking and passing a general qualification examination?**

  While we believe that all individuals engaged in municipal advisory activities demonstrate a minimum level of competence by taking and passing a qualification examination, we do not believe that this necessary entails that a new examination be written or administered. We believe that the MSRB has the responsibility to understand the specific activities undertaken by different types of Municipal Advisors, such as placement agents, and then to assess whether or not there are any existing examinations that cover these activities. We are confident that the MSRB will determine that placement agents are adequately licensed under the FINRA examination regime. Unless a gap exists, we do not believe a new examination should be required. In this instance, 3PM firmly believes that any of its members offering securities to Municipalities are already covered by FINRA's rules and their qualifying examinations. As such it is unnecessary for the MSRB to write a new examination for placement agents and subject our members to yet another qualifying examination. We believe that the MSRB's efforts should be focused on those Municipal Advisors that currently do not fall under the purview of existing regulatory authorities and that have not passed any type of qualifying examination.

- **Is the one-year grace period sufficient time for municipal advisor representatives to study and take (and, if necessary retake) the municipal advisor representative qualification examination?**

  Given the fact that placement agents who are required to sit for the municipal advisor representative examination will need to learn a great deal of material that is irrelevant to our business activities, and the fact that most of our constituents are small businesses and require all of their representatives focused of generating new business, we do not feel that one year is sufficient time for representatives to study and take and if necessary retake the qualification examination.

- **Do dealers believe the current 90-day apprenticeship requirement for municipal securities representatives is beneficial?**

  Since all of our members have been conducting business for several years, we do not believe that a 90-day apprenticeship requirement is necessary. An apprenticeship might be worthwhile for individuals that have never before worked in the industry, however, 3PM members are seasoned professionals with experience working in the financial services arena.

- **Would there be any negative consequences if the current municipal securities representative apprenticeship requirement were eliminated?**

No. It is the responsibility of each firm to ensure that their employees are properly trained to carry out their roles and are supervised in their activities.

- **Would dealers realize any cost savings if the current municipal securities representative apprenticeship requirement were eliminated?**

  Yes, it is likely that firms will realize some cost savings although we are not experienced in this area to specifically comment on how this would be achieved.

- **Is there a benefit to having an apprenticeship period for municipal advisor representatives?**

  No.

- **How should economic analysis apply to proposed new registration classifications and the establishment of a basic qualification examination?**

  Economic analysis should be used on a firm level to assess the time required for individuals to learn, study and sit for (and re-take if necessary) the new qualifying examination. It should also be used to quantify the lost opportunities firms will face while their employees are focusing on the qualification examination rather than on new business generation. The analysis should also take into account the Principal examination which will be forth coming as well as any new continuing education requirements that will be proposed in subsequent rules.

  We also believe that economic cost-benefit analysis should be performed because of the anticipated high costs to MSRB for implementation of what we believe to be, with respect to placement agents, a redundant or worse an irrelevant examination. Costs the MSRB will likely experience include convening industry groups to assess the need for qualification exams, the cost of MSRB staff to establish qualifying examinations and to test their efficacy as well as the time and effort of other MSRB staff such as the Office of General Counsel and senior staff members such as Lynnette Kelly who have taken the time to seek industry input on the examination. The time and effort taken up by this comment process and the time of the Board of Directors to debate this proposal is also, very likely, a significant expense.

  Costs such as the implementation of the examination process should also be considered and applied not only to the regulatory perspective, but to the firm assessment as well since a portion of these costs will be passed on the firms whose employees will have to take a Representative and Principal examination and will likely have continuing education requirements as well.

  Once the cost is determined, it should be then compared to the benefit the industry will gain – i.e. investor protection - by having MAs take the qualification examinations.

  We believe that in the case of placement agents, who are already covered by FINRA rules and examinations, the benefit will be little. As such, the cost of this undertaking for constituents who are already registered with other Regulatory Authorities will far out-weigh any possible benefits that will be achieved through this process.

Overall, 3PM applauds the thoughtful approach the MSRB has taken towards rulemaking. From the outset, the MSRB has been sensitive to constituencies that are already subject to regulatory oversight and whenever possible has taken the steps to harmonize their new rules with existing rules. Furthermore, given that most of 3PM's constituents are small firms, we also truly appreciate the MSRB's sensitivity to the burdens faced by small firms and that where ever possible you have worked to minimize the impact any new rules have on small firms. We ask only that you take these initiatives one step further and apply them to this rule proposal.

3PM strongly believes that the current regulatory qualification framework in place regarding the specific business activity of placement agents satisfies the regulatory qualification standards which apply directly to a placement agent's business activity, and as such that any new and additional professional qualification requirements would be unduly applied to placement agents who currently satisfy several professional qualification requirements and are required to maintain these levels of professional qualification through continuing education. As such, we strongly recommend that the MSRB seeks to reconcile to current disconnect by reconsidering their position on the grandfathering provision for General Securities Representatives and General Securities Principals who are only focused on private securities transactions and NOT focused on municipal securities transactions.

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 (585) 203-1480 or by email at donna.dimaria@tesseracapital.com.

Thank you in advance for your consideration.
Regards,

Donna DiMaria
Chairman of the 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 35 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

3PM
THIRD PARTY MARKETERS ASSOCIATION

April 28, 2014

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

Re: Regulatory Notice 14-09

Dear Ms. Asquith,

The Third Party Marketers Association ("3PM") 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 (Limited Corporate Financing Broker or "LCFB").

While we applaud the steps that FINRA has taken to move this initiative forward by establishing a working group of industry participants and undertaking a revised rule set, we believe that the proposed rule set requires amendments and changes in order to effectively address the nuances related to the constituency of LCFBs, in order to provide a clear roadmap for regulators, including regulatory examiners in their oversight efforts, and to afford appropriate investor protections.

To that end, this letter we 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.

Rule 016. Definitions

Because the LCFB does not engage individual consumers in the same manner as full service BDs, the term "customer" does not fit in the vernacular of an LCFB. For regulators, regulatory field examiners and industry participants seeking to draft internal working procedures that both conform to regulations and address their business and operating needs, use of the term presents a fundamental obstacle.

In discussion with FINRA staff members we have ascertained that point (f) in the definition of a "LCFB" is intended to bring the institutional investors we work with into the definition of "customers". We feel, however that the way in which point (f) is written is unclear and leaves room for interpretation. Point (f) states that a LCFB is any broker that engages in any one or more of the following activities - qualifying,

identifying or soliciting potential institutional investors. FINRA asserts that this clause should be read to mean that an "institutional investor" is receiving corporate financing services from a LCFB and is thus a "customer". The definition, however, could be interpreted to mean that qualifying, identifying or soliciting potential institutional investors is a service that benefits the manager, fund sponsor or issuer not the "institutional investor". Rather than force the definition into existing terms, we believe a more sound approach involves clear new definitions tailored to the business of an LCFB.

We propose that the term "customer" be eliminated from the LCFB rules. In its place, we recommend the following terms:

- **"Issuer"** – A Manger, Fund Sponsor, GP, Offerer or other similar person or organization that engages the services of a LCFB.

- "**Investor**" – any person, whether a natural person, corporation, partnership trust, family office or otherwise, that commits or is solicited to commit money or capital to the Issuer.

- **"Qualified Investor"** – We propose substituting the term "Qualified Investor" for "Institutional Investor" and utilizing the current definition of "Institutional Investor" as defined in FINRA Rule 2210 with some modifications. One such modification should include allowing Qualified Purchasers, as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 [15 U.S.C. 80a–2 (a)(51)(A)], to be included in the definition of "Qualified Investors". While we recognize FINRA's concerns with lowering the threshold of "Institutional Investor" to "accredit investors", we see Qualified Purchasers as a prudent and reasonable standard for the following reasons:

    - It would provide a standard consistent with the highest requirements of alternative investment funds themselves mandated by the SEC - (3(c)(7) funds versus 3(c)(1) funds – and by extension other private placements and alternative investments; and

    - It would reduce ambiguity and inconsistency with SEC rules both where third party marketers and placement agents conduct business directly with Investors and indirectly through consultants, wealth managers and other investment advisors who serve as Intermediaries for the actual legal and beneficial investors.

- **Intermediary** – a Federally regulated entity that is compensated by an Investor to act on its behalf by engaging in any one of the following activities:

    - Advise the investor regarding its investment policy
    - Determine a target asset allocation

- Provide education on new investment opportunities
- Qualify, identify and select investment managers to handle mandates consistent with the Investors target allocations and risk tolerance

We believe these definitions clearly describe the counterparties involved in LCFB and provide a meaningful foundation and common vernacular for industry participants, regulators, regulatory examiners and investors alike. We believe these definitions effectively remove ambiguity and ensure the consistent application of rules as they are intended. Furthermore, by using terminology that more accurately reflects the business of a LCFB, we would eliminate any inconsistencies or uncertainty that currently exists in the proposed definitions.

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

While FINRA has eliminated the need for members changing their status to a LCFB to file a CMA /NMA, firms would still be required to file a request to amend to their membership agreement. We believe that any firm opting into the LCFB category should be permitted to do so without a fee. We further believe that firms should have the ability to change their status back to that of a full broker dealer without the expense of transition or the need to file a CMA for at least the first year of the category's availability. We believe by making the transition period less complex and costly, FINRA will help to facilitate a broader adoption of the new rule set while allowing LCFB's to put these resources towards the revision of their compliance program.

Rule 123. Categories of Registration

3PM proposes that FINRA waive the S99 examination requirement for small firms who have a registered principal assigned to the covered functions outlined in the rule. We believe that the requirements of Rule 1230 should only apply to unregistered individuals handling any of the covered functions outlined.

Rule 125. Continuing Education Requirements

FINRA is waiving the RE requirement for LCFB, but is reserving the right to require firms to take educational courses if mandated. We would not be opposed to the requirement for additional training so long as the training is applicable to the LCFB's business and relevant from an industry perspective. In general, we support the requirement for CE testing to keep licensure active, but propose a two-year frequency which we believe to be more reasonable.

Rule 209. Know Your Customer

We encourage FINRA to consider redrafting the Know Your Customer requirements in the context of our proposed definitions to reinforce clarity and consistency.

3PM believes that regulators including exam personnel and the industry alike will require an understanding of the constituents if the rulemaking is to be effective. As such, 3PM believes that the term "customer" must be removed in order for the sake of relevance. For this reason, consistent with our proposed definitions above, we propose the following general guidelines for Rule 209:

- ***"Knowing you Issuer"*** standard should require the LCFB to conduct a full and thorough risk-based, due diligence review of an entity or person (Issuer) that engages the LCFB, consistent with a reasonable basis suitability review.

- ***"Knowing your Investor or Intermediary"*** " standard should require the LCFB to conduct thorough risk-based, due diligence review of the investor or intermediary that is reviewing the offering, again consistent with the reasonable basis review. This would include ensuring that the intermediary meets all applicable licensing standards, business and experience standards, among other reviews.

Rule 211. Suitability

We believe that Rule 211 is essential to providing meaningful, defining requirements for LCFBs. Because of the unique nature in which LCFBs conduct their business, we believe that Rule 211 must be properly crafted so that regulators, including regulatory examiners, and industry personnel alike will find a common ground, and a far more effective regulatory regime. We believe that the Rule as currently drafted does not adequately capture aspects of the suitability process that are inherent to LCFBs, and, importantly, that it does not adequately provide for investor protections.

We believe the rule as proposed fails in two primary regards:

1) by requiring the suitability analyses to be performed before any recommendation, and
2) by defining suitability in terms applicable to retail investors.

To remedy these issues, we propose that the Rule be redrafted as generally described below:

Regarding the timing of the suitability analysis, we encourage FINRA to recognize that the process of diligence related to offerings ranging from private placements offered to Investors and Qualified Investors, to placements, mergers and acquisitions of businesses of all sizes is ongoing 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 LCFBs. We encourage FINRA to redraft Rule 211 to require that the suitability analysis be complete by the time the subscription agreement or relevant contract is signed in recognition of the actual ongoing work performed by a LCFB, and, most importantly, to protect Investors in the non-institutional circumstances. With regard to the suitability requirements themselves, we again revert to our proposed definitions, suggesting as follows:

- The LCFB should be required to perform reasonable basis suitability analysis regarding each "**Issuer"** by which it is engaged.

- The LCFB should be required to perform a reasonable basis suitability analysis regarding each **"Intermediary**" with which it does business. The LCFB will perform no look-through to the underlying investor so long as the suitability review of the Intermediary, demonstrates that the Intermediary is qualified to recommend suitable securities to their clients and represents that their clients are Qualified Purchasers and thus "**Qualified Investors**".

- The LCFB should be required to perform Investor-Specific suitability analysis as per FINRA Rule 2111 for every **"Investor"** with which it directly conducts business (not through an Intermediary").

- The LCFB should be required to perform a suitability analysis similar to that required by the institutional investor exemption as per Rule 2111 for every "**Qualified Investor**" for which it directly conducts business (not through an intermediary). The requirement for a "**Qualified Investor**" to provide an affirmative indication of independent judgment should be waived.

Rule 221. Communications with the Public

While the LCFB proposal did remove two of the three communication categories covered by Rule 2210, Retail Communications and Correspondence, these are categories that by definition would not apply to a LCFB who can only work with institutional investors. Accordingly, the changes to the Rule did not make the rule more relevant to the members who may decide to register as a LCFB than it was before. LCFBs are still subject to the same provisions of Rule 2210 covering institutional communications as we were before which we believe do not accurately reflect how LCFB firms operate in a real life setting.

3PM proposes that FINRA revise Rule 2210 and specifically the general content standards to meet the realities of representing Issuers. Proposed modifications should include a realistic approach to setting fair and balanced content standards for communications and marketing materials as well as an expansion of the exemptive provisions for our new definition of "**Qualified Investors**", especially those that are professional allocators or use the services of investment consultants.

Rule 240. Engaging in Impermissible Activities

As proposed, FINRA may impose severe penalties on a LCFB if the firm engages in any activities that require the firm to be registered as a broker or dealer under the Exchange Act. To ensure an evenhanded approach, modification would include explicit language outlining a defined remedial period and process for any unintentional activities of an LCFB until the practical application has played out which will likely illuminate these areas of the Rule framework which warrant additional precision. Egregious and intentional disregard of an LCFB would still fall into the enforceable realm of FINRA authority.

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. While we believe that extending the independent test requirement from annually to bi-annually is appropriate for LCFBs, we also suggest that FINRA consider amending the Customer ID Program (CIP) requirements to conform to the business of a LCFB. Specifically, 3PM recommends that LCFB's should be required to implement a CIP as follows:

- For all Issuers and Intermediaries with which the LCFB does business
- For all Investors when there is no Intermediary involved.

Rule 411. Capital Compliance

3PM believes that proposed Rule 411 should remove the minimum net capital requirement of $5,000 currently applied to the LCFB members. Furthermore, FINRA should assist the LCFB community in working with the SEC to correct the calculation of net capital for LCFBs so that the nature of our business does not cause us have to improperly report our financial condition to the FINRA. Additionally, we suggest that FINRA overhaul the current Supplemental Statement of Income ("SSOI") content by convening a working committee of LCFBs to help write appropriate questions that accurately reflect our business model. Further details regarding specific components of the proposal are described below.

- ***Net Capital Requirement*** - 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 in part to protect the customer should a scenario unfurl which causes damage to an investor. In theory, the broker dealer carrying or clearing that customer account would have minimally sufficient reserves to apply to a remedial solution for the customer. When applying this ideology to the $5,000 net capital requirement for LCFBs (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. 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. This time has now finally come, and we collectively need to implement specific rules which effectively and efficiently regulate the LCFB universe of member firms.

Countless hours and resources have been allocated to this $5,000 minimum net capital requirement by LCFBs 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 LCFBs (non-carrying firm) does not deliver any type of investor protection.

- ***FOCUS Reports and Calculation of Net Capital -*** 3PM believes that the calculation of net capital and FOCUS reporting requirements for LCFB members need to be overhauled as the current set of calculations and data points are not directly applicable to the business conducted by LCFBs. We believe that this approach is simply another attempt by both FINRA and the SEC to standardize reporting regardless of fit rather than make the appropriate changes required for LCFBs to properly assess their financial viability and 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 LCFB 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 LCFB 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 LCFB is not accurately reflecting its true capital condition.

- ***Supplemental Statement of Income ("SSOI") -*** In an attempt to gather new information and intelligence, FINRA implemented the SSOI. The SSOI incorporated new questions and data requests regarding the financial condition of member firms. While the goal of this exercise was worthwhile, we believe that the results FINRA receives from these forms are inaccurate due to the wide array of methods, timelines and fee structures applicable to LCFBs 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.

Rule 414. Audit

3PM believes 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. The rule requiring PCAOB audits was initially intended to cover firms working with public entities, not small, broker dealers like those that are covered by the LCFB rule set. Furthermore, the PCAOB interim inspection program findings simply are not relevant to LCFBs, and would therefore would not be found in the audits of our firms.

We believe that FINRA should work with other Authorities and Government Agencies, in this case the PCAOB, to help carve out small broker dealers, specifically LCFBs from this new oversight requirement. 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 feels that Rule 4360 is not applicable to LCFBs and should be omitted from the rule set. Continuing to subject LCFBs to this Rule does not make sense and offers no protection to the LCFB or investors.

The LCFB proposal did not make any changes to Rule 4360 and as such LCFBs are still required to obtain a fidelity bond. A fidelity bond insures a firm against intentional fraudulent and dishonest acts committed by employees and registered representatives under certain specified circumstances. In cases of theft of customer funds, a fidelity bond generally will indemnify a firm for covered losses sustained in the handling of customers' accounts. Since, by definition, an LCFB is not permitted to hold or handle customer funds or securities, this rule is irrelevant to LCFBs. Under the current rules, LCFBs are required to secure costly insurance policies that would protect us and our customers from bankruptcy. While in theory the idea is sound, in practice if an LCFB was ever sued for wrongdoing, the fidelity bond policy would not cover our firms or provide the bankruptcy protection the Rule was designed to provide. Since

this rule does offer any type of protection, LCFBs are wasting capital on premiums that could alternatively be used to support business operations.

Additional Rules Not Covered in the LCFB Rule Set

3PM believes that LCFBs should be exempt from membership in SIPC. Furthermore, while we understand that FINRA was not the authority that mandated compliance with SIPA, we do believe that FINRA is in a position to assist the LCFB community in its mission to seek relief from this irrelevant requirement.

Rule 2266. SIPC Information

The proposed rule set did not make mention about Rule 2266 and whether or not this Rule applied to LCFBs. 3PM would however like to make clear our thoughts on the relevancy of this Rule to LCFB firms.

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. LCFB 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, LCFB 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 LCFB. This rule is not properly aligned with the business of LCFB and creates significant expenses to LCFBs without providing any tangible benefit. In reality LCFBs are paying into a fund that reimburses investors for somebody else's wrongdoing which is an unfair practice.

Questions posed by FINRA

FINRA particularly requested comment concerning the following issues:

- **Does the proposed rule set provide sufficient protections to customers of an LCFB? If not, what additional protections are warranted and why?**

  We believe it is FINRA's intent and consistent with investor protections in general, to offer the greatest level of protection to the individual or entity making the capital commitment or investment. In our language, as proposed above, this is the Investor. We believe that by changing the definitions that apply to LCFBs as we have proposed, FINRA would address the fundamental confusion and inconsistencies that exist in the current rulebook and close any loopholes that are open to interpretation as to who is actually a LCFB's "customer". Further, we believe that the suitability rules must be amended to better reflect the business those firms offering private placements actually engage in. This would ensure that reasonable basis and investor level suitability are considered ongoing requirements timed to the purchase of an investment rather than to the recommendation.

- **Does the proposed rule set appropriately accommodate the scope of LCFB business models? If not, what other accommodations are necessary and how would customers be protected?**

  We do not believe that the current rule set as written is relevant to the LCFB business model for the reasons articulated above is our discussion on the proposed rule set for LCFBs.

- **Is the definition of "limited corporate financing broker" appropriate? Are there any activities in which broker-dealers with limited corporate financing functions typically engage that are not included in the definition? Are there activities that should be added to the list of activities in which an LCFB may not engage?**

  We believe that definition of LCFB is appropriate.

- **Are there firms that would qualify for the proposed rule set but that would choose not to be treated as an LCFB? If so, what are the reasons for this choice?**

  We believe that firms may forego the new registration category until details regarding the NMA/CMA process are better defined. In particular, the cost of switching registration types and potential enforcement may outweigh the benefits gained by changing categories. For this reason, we request that consideration be given to preliminarily offering the LCFB registration as a category (in lieu of "Other") subjecting the relevant portion of a firm's business to the new rules, as opposed to requiring an all-or-none decision. This would facilitate an orderly transition

for firms, lessen the learning curve for examiners, and generally reduce the margin for unintended consequences.

- **What is the likely economic impact to an LCFB, other broker-dealers and their competitors of adoption of the LCFB rules?**

  3PM does not believe that this rule will have a meaningful economic impact on the LCFBs that are eligible to operate under this proposed rule set. We are not convinced that firms will adopt the rules unless and until LCFB registration eliminates costly and, we would argue irrelevant, financial audits and reporting, AML Independent Testing, and SIFMA registration.

- **FINRA welcomes estimates of the number of firms that would be eligible for the proposed rule set.**

  The below information was excerpted from a report presented to PCAOB in early 2013. While the data may not be as current as we would like, we believe numbers reflect a viable estimate of the firms that would be eligible to register as a LCFB.

  FINRA, defines a small firm is any firm with 150 or fewer licensees, or registered representatives. FINRA is comprised of approximately 4400 firms of which 85% are categorized as small firms. A significant percentage of small broker-dealers that have only 2 or fewer business lines, have less than $1mm in annual revenue, and/or engage in business lines such as private placements, mergers and acquisitions, and other such business lines which would fall under the category of LCFB.

  These types of small broker-dealers are readily identifiable using BrokerCheck, FINRA's public resource for broker-dealer background reviews, or through its central data depository (CRD) with the following acronyms:

    - Other
    - PLA – Private Placement
    - PLA and Other

  Of the 4400 FINRA broker-dealers registered, the statistics reveal the following:

  - 191 broker-dealers report that private placement activity is their only business line;
  - 174 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;
  - 541 broker-dealers disclose that they engage solely in private placement agent and "other"

activities, again describing the other activity as mergers, acquisitions and placement agent or third party marketing services.

Cumulatively, these 906 firms represent a class of broker-dealer that does not open securities or investment accounts, does not carry or introduce assets or securities, and does not have customers in the retail sense. The business activities of these firms are governed by contract and are not 'transactional.' As such, we would conclude that they would fall under the definition of a LCFB.

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. Of the 457 firms reporting only one line of business (private placements or "other") all but 13 are small firms (fewer than 50 employees). Of those reporting two business lines private placements and "other", 98% have fewer than 50 employees.

Attributes	# Firms	# with Fewer than 50 RRs	As %
PLA	191	188	98%
Other	174	164	94%
PLA and Other	541	528	98%
Total or Average	**906**	**880**	**97%**

- **Proposed LCFB Rule 123 would limit the principal and representative registration categories that would be available for persons associated with an LCFB. Are there any registration categories that should be added to the rule? Are there any registration categories that are currently included in the proposed rule but that are unnecessary for persons associated with an LCFB?**

3PM does not believe that the Rule 123 should limit the principal and registration categories that would be available for persons associated with a LCFB. We believe that there are other registration categories that could apply to a LCFB that are not included in the proposed rule set. For example,

- LCFB firms that are registered as a broker dealer with the ability to engage in investment advisory services would also need to hold the Series 65 or 66 registrations.
- Some LCFBs may be required under state requirements to hold the Series 63 registration
- LCFB firms that are distributing mutual funds may have associated persons holding the Series 6 and 26 registrations
- LCFB firms may be acting as a solicitor for direct participation programs and may have associated persons holding the Series 22 and 39 registrations

- LCFB firms offering private placements whereby the Issuer is a CTA may be required to have associated person who hold the Series 3, 30, 31 or 32 registrations
- LCFB firms offering private placements whereby the Issuer's strategy involves options may hold the Series 4 and 42
- LCFB firms may have associated persons holding the Series 14 examination

As such we believe that FINRA should not restrict the principal and representative registration categories for persons associated with a LCFB.

- **Should principals and representatives that hold registration categories not included within LCFB Rule 123 be permitted to retain these registrations?**

  3PM believes that principals and representatives should be able to continue to retain their registrations so long as they continue to stay current with their CE requirements. We believe that prohibiting a principal or representative from maintaining a registration because it was not within LCFB 123 would be penalizing a professional for choosing to engage in a regulatory scheme that was more relevant to their current business operations. The financial industry has long been categorized by inventive and driven people who often change firms or focus several times throughout their careers. We believe allowing a LCFB to maintain additional registrations would be no different than someone who changed roles in a firm and continued to maintain registrations used in a previous role.

- **Does an LCFB normally make recommendations to customers to purchase or sell securities? Should an LCFB be subject to rules requiring firms to know their customers (LCFB Rule 209) and imposing suitability obligations (LCFB Rule 211) to an LCFB?**

  We believe that there are firms that would otherwise qualify as a LCFB that make recommendations to customers. We believe that our recommendations regarding the fundamental definitions of counterparties and their respective roles in suitability address concerns that may exist or arise from recommendations of this type.

- **Does the SEC staff no-action letter issued to Faith Colish, et al., dated January 31, 2014,9 impact the analysis of whether a firm would become an LCFB? Is it likely that some limited corporate financing firms will not register as a broker consistent with the fact pattern set forth in the no-action letter, or will they register as an LCFB?**

In general, 3PM members conduct a business that is very different than the business conducted by Faith Colish et al. As such we do not believe that this would be a reason for any of our constituents to choose not to register as a LCFB.

3PM does not believe that many FINRA members meeting the definition of this rule will convert their registration to this category. Our reasoning is that there are just not enough meaningful changes to the rule which would make it more conducive to the business of LCFBs. LCFBs are currently spending a great deal of time and resources following rules that are not appropriate or applicable to our businesses. These are resources that can alternatively be applied to making meaningful enhancements to our business and compliance operations.

While we are pleased that FINRA took on this initiative and convened a working industry group to address the issue, the feedback solicited from this group was only related to the definition of an LCFB not the underlying rule set. We believe that FINRA should have taken the initiative at least one step further and worked together with the industry to write a meaningful and relevant rule set rather than the one presented which did little more than remove the sections of rules that already did not apply to us. We only hope that all of the industry feedback received will not dissuade FINRA from revisiting this proposal and this time listening to what the industry has to say. 3PM stands ready to participate in any further initiatives regarding this proposal and looks forward to a day when LCFBs have a rule set that appropriately addresses our business model.

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 (212) 209-3822 or by email at donna.dimaria@tesseracapital.com.

Thank you in advance for your consideration.

Regards,

Donna DiMaria
Chairman of the 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 35 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

PCAOB Audit Oversight and Small, Non-Public Non-Custodial Broker-Dealers

Attributes-Based Analysis of the Broker-Dealer Risk Profile

January 2013

Report Objectives

Since its inception, the PCAOB has exerted diligent efforts to carry out its mission of investor protection. When Dodd Frank expanded the scope of PCAOB authority to include oversight of the audits and auditors of broker-dealers, the broker-dealer community responded with recommendations for exclusions of certain types of broker-dealers. While forging ahead with an interim audit program, Board members have continued to express their interest in identifying and understanding trends related to broker-dealer attributes, facilitating a meaningful dialogue regarding risk, and possibly leading to exclusions.

This brief report will present data and information to support exemption of certain classes of small and limited purpose broker-dealers from the PCAOB audit requirement. It presents an update to data previously shared in March 2011, and asserts that broker-dealers of limited size and/or with limited business purposes present little or no risk relative to the scope of PCAOB responsibilities to protect investors. To best ensure that risk is adequately considered, the report includes an analysis of SIPC distributions through 2012 based on dollar amount and broker-dealer attributes.

Data presented in this report may lead to other useful trend analyses, including the consideration of excluding other types of firms, such as introducing firms, firms with minimum net capital of $5,000, or firms with less than $1mm in annual revenue.

Background

To FINRA, a small firm is any firm with 150 or fewer licensees, or registered representatives. FINRA is comprised of approximately 4400 firms of which approximately 85% are categorized as small firms. But 'small' is relative. To a research analyst, a small cap company is one with $300 million to $2 billion in market capitalization. The JOBS Act, designed to lower the regulatory burdens for small companies intending to go public applies to companies with less than $1billion in revenues. By stark contrast, many of the smallest broker-dealers are scattered along a broad spectrum of characteristics and attributes much smaller than any of these standards.

Low Risk Broker-Dealers Based on FINRA Data

Significant percentages of small broker-dealers have only 2 or fewer business lines, have less than $1mm in annual revenue, and/or engage in business lines that do not inherently indicate high percentages of risk, such as 'application way' mutual funds, variable annuities,

private placements, mergers and acquisitions, and other such business lines. Many of these firms operate under a minimum net capital requirement of $5,000.

Small broker-dealers characterized by business lines are readily identifiable using BrokerCheck, FINRA's public resource for broker-dealer background reviews, or through its central data depository (CRD) with the following acronyms:

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

Of the 4400 FINRA registered broker-dealers, the statistics reveal the following:

- **191** broker-dealers report that private placement activity is their only business line;
- **174** 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;
- **541** 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 **806** 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:

- **39** broker-dealers report that their only business line is retail sales of mutual funds. Out of these 39 firms, **all but 3 have fewer than 25 employees**;
- **21** broker-dealers offer only variable annuities. **16 of the 21 report having fewer than 50 employees**;
- **87** broker-dealer firms disclose having only two business lines, mutual funds and variable annuities. **82% of these companies have fewer than 10 employees**.

The **147** broker dealers described above engage solely in 'application-way' business, which means that their business is limited to purchases and sales of funds and/or annuities accomplished through direct paper-based application to the mutual fund or annuity companies. These companies do not have custody of customer funds or securities, and also do not have clearing arrangements (they are not 'introducing'). Rather they operate through selling agreements with mutual fund and annuity companies, which are themselves regulated by the SEC.

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"), 98% have fewer than 50 employees.

Attributes	# Firms	No. with Fewer than 50 RRs	As %
PLA	191	188	98%
Other	174	164	94%
PLA and Other	541	528	98%
MFR	39	37	95%
VLA	21	16	76%
MFR and VLA	87	82*	94%
Total or Average	**1,053**	**1,015**	**96%**

* Nearly 80% of 87 BD firms with combination of only two attributes MFR and VLA have fewer than 10 employees.

Low Risk Broker-Dealers Based on SIPC Data

SIPC weighed in against a statutory exemption for broker-dealers during Congressional deliberations regarding the PCAOB's scope of authority over broker-dealer audits. Later, in response to the request by broker-dealer trade associations and others encouraging PCAOB to carve out introducing broker-dealers from its audit scope, SIPC again wrote to PCAOB in favor of an all-inclusive audit program, citing statistics regarding its payouts related to introducing broker-dealer liquidations in particular.

While SIPC payouts may be used as a measure of risk, even SIPC has never undergone consideration of liquidation coverage for the types of small broker-dealers discussed in this report.

In this context, a review of SIPC distributions for the past 5 years 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. In fact, no broker-dealer with 2 or fewer business lines, including those listed below has every been represented on SIPC bankrolls:

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

Low Risk Broker-Dealers Based on PCAOB Data

PCAOB's interim audit program preliminary results, reported August 2012, reveal certain material weaknesses in BD audit programs. While the findings appear proportionately significant, the results are less worrisome in the context of small broker-dealers as summarized in the table below:

Finding	**Description**	**Application to Small and Limited Purpose Broker-Dealers**
Supplemental Report on Material Inadequacies	21 of 23 did not adequately test for controls related to safeguarding securities	Not applicable to non-custodial broker-dealers
Exemption from Provisions of Customer protection Rule	All 14 audits of BDs claiming exemptions to 15c3-3 did not fully comply with conditions of the exemption	Not applicable to non-custodial broker-dealers
Customer Protection Rule	2 of the 9 audits of BDs required to maintain a customer reserve failed to properly verify and disclosure the appropriate restrictive provisions	Not applicable to non-custodial broker-dealers
Net Capital Rule	7 of 23 audits failed to sufficiently test the minimum net capital computation	Not materially significant to broker-dealers with $5,000 minimum net capital
Consideration of Risks of Material Misstatements Due to Fraud	13 of 23 audits did not incorporate adequate assessments of risks of material misstatement	Subject to FINRA reviews, requirements
Related Party Transactions	10 of 23 audits did not adequately test existence and/or sufficiency of procedures related to material third party transactions	Subject to FINRA reviews, requirements
Revenue Recognition	15 of 23 audits did not adequately test occurrence, accuracy and completeness of revenue	Not materially applicable to firms with <$1mm annual revenue
Establishing a Basis for Reliance on Records and Reports	12 of 23 audits did not evidence adequate procedures for reliance on third parties used in the audit process	Not applicable to the accounting firms most likely to perform the audits of small broker-dealers
Fair Value	6 of 9 audits involving valuations did not adequately test valuation	Not applicable to non-custodial

Finding	Description	Application to Small and Limited Purpose Broker-Dealers
measurements	practices	broker-dealers
Evaluation of Control Deficiencies	4 of 23 audits did not evidence sufficient evaluation of identified errors for determination of control weakness	Subject to FINRA reviews, requirements
Financial Statement Disclosures	7 of 23 audits did not evidence adequate tests of accuracy and completeness of financial statement disclosures	Subject to FINRA reviews, requirements
Auditor Independence	2 audits revealed inadequate procedures to test auditor independence	Subject to discussion

This summary data can be interpreted to mean that many of the PCAOB interim inspection program findings simply are not relevant, and therefore would not be found, in the audits of small broker dealers. Of those with a degree of relevance, most would be apparent as a result of the regulatory initiatives carried out by FINRA, which incorporate considerable depth in routine inspections of broker-dealer financial data. FINRA reviews include ongoing assessments of FOCUS filings carried out at both the district and national levels, and FINRA performs routine onsite inspections according to a risk-based cycle. These inspections include reviews of financial data, and cover all registered broker-dealers.

Summary

In its November 2012 Standing Advisory Group (SAG) meeting, the PCAOB SAG members considered important current initiatives, including the auditor's reporting model, PCAOB's standard setting agenda, and consideration of outreach or research regarding the auditor's approach to detecting fraud. In each discussion, in small group settings, audits of broker-dealers were considered and discussed as a specific agenda item. When PCAOB staffers reported summaries from their breakout groups in the large public meeting session, it was apparent that SAG members were receptive to the exclusion of certain types of broker-dealers based on risk. Among other comments, SAG members recommended excluding:

- Wholly owned non-public BDs
- BDs deemed to be low risk based on business model, net capital or ownership structure
- Small, non-public, non-custodial BDs
- BDs that are not issuers

Each of these considerations is consistent with the recommendation of this paper that broker-dealers in any of the following categories should be excluded:

- Non-custodial, non-public BDs with 2 or fewer business lines, including but not limited to the following:
    - MFR
    - VLA
    - PLA
    - 'Other'

Important to the practical implementation of this recommendation, each of the attributes listed above is based on data and information routinely reported to FINRA and/or the SEC. As such, this data is readily available from a reliable regulatory source.

By excluding BDs based on these attributes, the PCAOB will have trimmed its auditor oversight by a measurable degree (approximately 1,400 firms) without compromising its mission.