FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

June 26, 2014

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-72193; File No. SR-FINRA-2014-006

Dear Ms. Murphy:

On January 31, 2014 the Financial Industry Regulatory Authority (FINRA) filed a proposed rule change to amend rule provisions addressing per share estimated valuations for unlisted direct participation program (DPP) and real estate investment trust (REIT) securities.[1] The Proposed Rule would modify the requirements relating to the inclusion of a per share estimated value for unlisted DPP and REIT securities on a customer account statement under NASD Rule 2340 (Customer Account Statements) and modify the requirements applicable to members' participation in a public offering of DPP or REIT securities under NASD Rule 2310 (Direct Participation Programs). On March 12, the Financial Services Institute[2] (FSI) submitted a comment letter raising concerns with certain aspects of the proposed rule change.[3] On May 20, 2014, the SEC published an order to institute proceedings to determine whether to approve or disapprove the proposed rule change.[4] FSI appreciates the opportunity to provide additional input on this important proposal.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered

[1] Notice of Filing of Proposed Rule Change Relating to per Share Estimated Valuations for Unlisted DPP and REIT Securities, 79 Fed. Reg. 9,535 (Feb. 19, 2014).

[2] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 100 broker-dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 37,000 financial advisor members.

[3] See Letter from David T. Bellaire, Esq., (Mar, 12, 20140), *available at* http://www.sec.gov/comments/sr-finra-2014-006/finra2014006-16.pdf.

[4] Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPP and REIT Securities, 79 Fed. Reg. 30,217 (May 27, 2014).

investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64 percent of all practicing registered representatives – operate in the IBD channel.[5] These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[6] Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments

FSI continues to strongly support regulators' efforts to increase transparency and investor protection through effective disclosure and other measures. While some elements of the proposed rule change are likely to effectively achieve these goals, other aspects of the rule threaten to be counter-productive and introduce severely negative unintended consequences. Specifically, the proposed language allows firms to include a per share estimated value of unlisted DPP or REIT securities provided the account statement includes required disclosures, is developed in a manner reasonably designed to ensure it is reliable, and "the member has *no reason to believe* [emphasis added] that the per share estimated value is unreliable." This "no reason to believe" standard raises significant concerns due to its breadth and vagueness. We expand upon these concerns below:

- **The Standard is Broad, Vague, and Impractical:** Under the proposed rule text, member firms are not required to include a per share estimated value of an unlisted DPP or REIT security in a customer account statement. However, if a per share estimated value is included, it must

[5] Cerulli Associates at http://www.cerulli.com/.

[6] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisers.

have been "developed in a manner reasonably designed to ensure that it is reliable, the member has no reason to believe that the per share estimated value is unreliable, and the account statement provides the [required disclosures]."[7] A standard for broker-dealers to have "no reason to believe" is broad, vague, and lacks precedent. We agree with other commenters who have suggested that such a standard may place an affirmative on-going duty of inquiry in pursuit of proving a negative.[8] Therefore, we believe that, if approved as proposed, FINRA's rule would place an unreasonable obligation on broker-dealers to monitor and confirm the reliability of valuations received by clearing firms or another third-party on an on-going basis. This duty to inquire would require conducting exhaustive searches and investigations regarding the valuation provided. This is a function and responsibility that has not traditionally been placed on FSI members, and would introduce significant costs. Based solely upon the proposed rule language, it is unclear what type of information would trigger the "no reason to believe" standard's threshold. It is not clear whether it can ever be met even with the most extensive and thorough review of available information. Such a standard does not take into account the breadth and volume of information available through the internet and other sources, nor the reliability of the sources of information.

- **The Standard Will Lead to Less Transparency:** FSI member firms join FINRA in its desire to increase the transparency of these securities. However, the result of such a vague and unworkable standard is that firms will choose to display per share estimated values as "not priced" to reduce the risk of litigation. This runs counter to FINRA's goals with the proposed rule change, and is an unintended consequence of the rule's language.

- **The Vagueness of the Standard May Make FSI Members Vulnerable to Unmitigated and Unsubstantiated Claims:** Because of the vagueness of the standard, firms will be second guessed with regard to the reliability of the valuations provided to investors in their client account statements at the time the valuation is provided. As a result, firms may become vulnerable to claims that information existed at the time an estimated valuation was provided and that firms should have known of that information. Additionally, Plaintiffs may bring complaints based upon information that may have been available at the time of the valuation but that firms found unreliable.

- **FSI Suggests that FINRA Change the Proposed Language:** FSI suggests that FINRA apply a standard that allows broker-dealers to rely upon valuations provided by clearing firms and other independent third-parties. One approach supported by FSI and advanced by the Investment Program Association (IPA) would allow firms to refrain from including a per share estimated value for a DPP or REIT security on an account statement if the member has reason to believe the value is no longer accurate based upon disclosure in the issuer's periodic reports of an other-than-temporary material change in the value of the underlying assets or investments of the DPP or REIT subsequent to the date of valuation.[9] Another acceptable approach would allow firms to rely upon clearing firms and other independent third-parties if the valuations are conducted using FINRA's proposed "Net Investment" or "Independent Valuation" methodologies. Either of these approaches would ensure more robust investor protections while providing customers with the information they need to make fully informed

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[7] Notice of Filing of Proposed Rule Change Relating to per Share Estimated Valuations for Unlisted DPP and REIT Securities, 79 Fed. Reg. at 9,536.

[8] Letter from Thomas F. Price, Managing Director, Securities Industry and Financial Markets Association (SIFMA), (Mar. 12) at 5, *available at* http://www.sec.gov/comments/sr-finra-2014-006/finra2014006-8.pdf.

[9] Letter from Mark Goldberg, Chairman, Investment Program Association (IPA), (Mar. 12, 2014), at 18, *available at* http://www.sec.gov/comments/sr-finra-2014-006/finra2014006-15.pdf.

decisions and avoid the unintended consequences likely to result if FINRA's proposed rule language is not revised.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with FINRA and the SEC on this and other important regulatory efforts.

Thank you for your consideration of our comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

David T. Bellaire, Esq.
Executive Vice President & General Counsel