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RESPONSE TO THE COMMISSION'S NOTICE OF HEARING AND ORDER REQUIRED BY THE NOVEMBER 26, 2013 FILING MADE IN ADMINISTRATIVE PROCEEDING 3-15626

INTRODUCTION

Some statements made in Section II of the Order omit facts which shed additional light on the situations at Parallax which resulted in this action. It is not surprising for a charging document to present the allegations without discussion of mitigation or exculpatory facts, but I do welcome this opportunity to provide the Commission with additional information on the conduct described in the Order.

In addition, I believe that the Commission has not considered some facts that I believe mitigate the conduct described and violations alleged. I will take this opportunity to describe specific mitigating facts, which I believe are material to the ultimate disposition of this action.

Finally, I note with interest that in other recent Commission Orders describing violations and conduct with rough similarities to the violations alleged in this Order, the Commission has opted to not personally name or personally sanction natural person respondents. Given the ramifications to a natural person of settling an action involving the violations alleged in the November 26, 2013 Order, the naming of individuals has been and will continue to be an impediment to settling the matter prior to a hearing.

STATEMENTS THAT I BELIEVE ARE NOT COMPLETE AND FULLY ACCURATE WITH RESPECT TO THE RULE 204A AND 206(4)-7 ALLEGATIONS

Section II.D.24: *Parallax failed to conduct an annual review of its policies and procedures.*

This is directly contradicted by the Commission's own statement of facts in Section II.D.23.; specifically; *"Falkenberg's first compliance memo dated April 2010 and emailed to Bott noted explicitly that the 2009 Manual needed "to be updated and made effective."* That memo does demonstrate that I reviewed the manual, which contained our compliance policies and procedures. The absence of any documentation or conclusion that the manual needed to be updated would support the statement that "Parallax failed to conduct an annual review of its policies and procedures", but the facts enumerated in the Order by the Commission itself indicates that Parallax' compliance manual was reviewed by the firm's CCO in 2010.

I believe it is significant that the Commission has not in either the examination letter issued August 31, 2011 or the Order filed November 26, 2013 referenced any specific item in the procedures adopted in 2009 that were actually deficient. While I generally share the Commission's disdain for "off-the-shelf" compliance manuals, I do question the Commission's conclusion that the manual did not materially satisfy the requirements of Rule 206(4)-7 without referencing specific deficiencies within the manual.

Section II.D.25: In this entire section, the Commission refers to the preparation of the memo documenting that the review was performed. There is not a reference to the compliance logs and blotters that were prepared and updated throughout 2010 and the rest of my time at Parallax. There is not any reference made to the reviews that were needed to be done in order to produce the narrative Part 2 of Form ADV (required by Release IA-3060) which was filed on March 30, 2011. The actual work

done on the annual review began in December 2010; the memo provided to the examiners was the compilation of my review activity.

I must dissent the inference that the Commission's Order makes in this paragraph; that the memo was put together as a sop to offer the examiners that requested this record. Had the memo been merely a piece of paper prepared to satisfy the Commission's Examination staff, I would have made certain that the compliance manual had received some form of updating and produced a memo stating everything relating to compliance at Parallax was in perfect order. An argument could be made that the Commission is prepared to personally sanction me for compiling my review work into a document that accurately and honestly depicted my awareness of the firm's compliance efforts as they stood at the end of 2010 and into the first quarter of 2011.

Section II.D.26: *"Parallax failed to establish, maintain, and enforce a written code of ethics. While Parallax's 2009 Manual contained a section titled "Code of Ethics," the ethics policy was never established, maintained or enforced."*

I do not agree with either of the sentences. In 2009, the previous compliance officers for Parallax established and implemented the manual purchased by Mr. Bott, which did contain a Code of Ethics. Parallax staff was educated and trained on the requirements within the Code of Ethics by my predecessors in 2009 and myself in 2010.

While the term "maintain" can be nebulous, a common working definition in the context of financial industry compliance is 'promptly updated when external factors (changes in regulation) or internal factors (changes in organization operations or personnel) require modification'. Conduct prohibited in the manual was prohibited by regulation and standards of business conduct well before 2009 and remains prohibited still.

The Code was absolutely enforced. I reviewed the personal trading and communication for all of Parallax' Supervised Persons and support staff. I ensured, to the best of my knowledge within the relevant time period, that Parallax was satisfying our fiduciary obligations to our clients. My knowledge may have been imperfect and I do not defend that, but I will defend the effort I expended to ensure that the clients were treated fairly. Parallax staff, registered or unregistered, adhered to a high standard of professional ethics in their business conduct. My reviews of their communication and trading did not indicate any situation which I believed at the time constituted a Material Compliance Matter or Significant Compliance Event.

In addition, Parallax failed to (a) identify and designate all access persons, (b) obtain written acknowledgments from all access persons, and (c) require all access persons to report their securities transactions and holdings as required by Advisers Act Rule 204A-1.

Item (a) references the opinion of the examiners that support staff and certain employees of TSF needed to be formally identified as access persons and treated that way, even if the persons were not employees of Parallax. During the examination, it was pointed out to the examination staff that all of the persons named by the examining staff (such as the Head Trader for Tri-Star Financial) were registered with a FINRA member brokerage firm and as such, were required to report their securities positions and holdings to their employing firm.

At the time the Commission staff performed their fieldwork, I had been the CCO for both the affiliated broker –dealer and Parallax for the previous 7 months. In the 9 months prior to that, I had access to the internal (Southwest Securities) and external statements for all of the registered and unregistered persons at both Parallax and Tri-Star Financial in my capacity as Parallax CCO and compliance consultant for Tri-Star Financial.

While the official designations may have not been made, as a practical matter, all of the persons associated with Parallax and Tri-Star Financial were reporting their holdings and transactions to me and I was reviewing them. As the reviews were taking place monthly, the reporting and reviews of what was being reported were being done more frequently than required by Rule 204A-1(b)(3)(iii). The reviews were evidenced by my initials and date of the review on the monthly account statements. The Commission staff was provided those documents during the examination.

MITIGATING FACTS IN THE CUSTODY RULE (RULE 206(4)-2) ALLEGATIONS

I generally agree with the Commission's facts describing the Custody Rule violation, as specified in Paragraphs 14-19 of the Order. There are some circumstances that related to the facts recited that I believe mitigate some of the conduct described and should be considered by the Commission prior to the ultimate resolution of this matter:

- Parallax had one on-site bookkeeper / accountant during the relevant period. This person was also the CFO and FINOP for Tri-Star Financial, and the bookkeeper / accountant for Tri-Star Advisors. Tri-Star Financial has a January 31 FYE; therefore, annual audits must be submitted to the Commission and FINRA no later than March 31 of every year as required by Rule 17a-5.
- Parallax used the CPA firm of Seidel, Schroeder & Co. to perform quarterly and annual compilations of Parallax Capital Partners. (This is also the firm that performs the Rue 17a-5 Annual Audit for the affiliated brokerage firm.) That CPA firm also prepared the K-1's sent to the limited partners and quarterly statements of the limited partner's individual balances, which were provided to the limited partners. Seidel, Schroeder & Company is a PCAOB registered CPA firm. The 2010 compilation and issuance of K-1's were done by early March 2011.
- The financial audit on Parallax Capital Partners was scheduled to begin the last week of March 2011. This changed when the Commission's Ft. Worth office announced the examination of both RIA firms and sent in their request lists. The on-site accountant, a long-term employee of Tri-Star Financial, did not believe she had sufficient time to deal with the needs of the Commission's examiners, the audit on Tri-Star Financial, and the scheduled audit of Parallax Capital Partners, while preparing the corporate tax returns, partnership tax return and assisting the outside accountants with all of that preparation. She also needed to continue recording the normal business activity for the various entities.
- I told her several times that the audit needed to get out to the limited partners by April 30, 2011. Acting under the working assumption that the Commission would begin its fieldwork on April 11, 2011 (which is what we were originally told) I was assured that the audit could be done shortly after that and be completed by the 30th.
- The Commission's staff did not begin their fieldwork until April 18, 2011. I told the staff at the time that the examination and change in schedule had impacted the timing of the Partnership audit. The response from Commission staff was fairly cavalier and can accurately be summed up as "oh well".

- Upon discovery of Mark Sloan's status as a non-PCAOB registered CPA, there was a discussion within Parallax as to how to proceed. This discussion was driven by two factors: The Partnership Agreement, which required audited financials being provided to the Limited Partner investors (which had been done since 1999), and the requirements of Rule 206(4)-2. I did not want Parallax to be in violation of the Partnership Agreement and I did not want to be in violation of the custody rule.
- I concluded that since there was going to be a Rule 206(4)-2 violation; given Mr. Sloan's status and the timing in which he and the accountant ultimately scheduled the examination, that the Partners were owed their audited financials as soon as possible. This was one of the more frustrating professional situations I have dealt with in my career.
- I offered the names of at least 3 PCAOB accountants to Bott in May 2011. PMB Helin Donovan was not selected until August. I have no idea what caused the delay.
- When the draft audit report was sent to me, I was surprised and angry to see the Level 1 designation for the CMO's. The knowledge that the audit was unacceptable in satisfying the requirements of Rule 206(4)-2 colored my opinion in allowing the audit to go out; at the time, I remained concerned about the Partnership Agreement audit requirement, as well as the Rule 206(4)-2 requirements.

With regards to the Rule 206(4)-2 requirement for the Inspected PCAOB registered CPA audit, I take full responsibility for failing to verify that Mark Sloan was eligible to satisfy the regulatory requirements for the audit. As for the issues with the timing of the audit, in many ways, that was out of the control of several relevant staff members, due to the extraordinary demands upon the firm's resources from March 1, 2011, through April 22, 2011.

Personally, I did not have the ability to force the preparation of the original audit being done more quickly. I also had no ability to sign contracts on behalf of Parallax or commit Parallax resources to hiring an Inspected PCAOB registered CPA firm quicker.

It is my belief that there can be no real assignment of blame for the late audit. In small firms such as Parallax and the affiliated brokerage firm, allocation of limited staff resources can create problems in unusual circumstances. With the broker-dealer audit, tax return deadline, K-1 deadline, the Commission examination, and Limited Partnership audit all having legal or regulatory deadlines within a 48 calendar day period, on top of the need to record the accounting entries produced by the business operations of three entities, something had to give.

In this case, the firms named in the Order faced a range of unpalatable choices: fail to comply with the Rule 17a-5 audit requirement on the broker-dealer side, fail to comply with IRS filing deadlines, not provide Commission staff records requested as part of an announced examination in a timely manner, or not complete the Partnership audit within the deadline.

With that said, I performed extensive reviews of the Limited Partnership and its financials. I was confident in the abilities of the internal accountant, noted that her numbers agreed with the compilation and that the compilation agreed to the audited financial statements. I knew that the Limited Partners were getting an audit report that presented accurate financial statements; the only item that I evaluated as deficient was the asset valuation category assigned to the CMO's. Even that is a subjective opinion shared by the Commission and I, as many of the bonds held by the Partnership, had they been offered for a bona fide sale, would have received several bids on any given day that the affiliated brokerage firm offered any given position for sale.

Faced with a choice – set that all resulted in poor outcomes, I chose what I believed at the time was the best choice I had available from the range of poor choices. My choice was to satisfy the terms of the Partnership Agreement in place for Parallax Capital Partners, LP and permit the issuance of an audit report that I believed was materially accurate in a best effort to comply with Rule 206(4)-2 with what was available at the time. That choice was made with the belief and knowledge that engaging a properly qualified CPA to issue a fully compliant report was going to happen shortly.

SIMILAR CHARGES HAVE BEEN SETTLED WITHOUT PERSONALLY NAMING INDIVIDUAL RESPONDENTS

I performed a Google search of "206(4)-7 Violation" and was able to discover several filed Settlements and other Orders. Going back to 2011, I was only able to locate four Orders from 2011 through 2013 that personally named natural person respondents. Two of those were the Order naming Parallax and me producing this response and the one filed against the affiliated advisory firm the same day. Another one involved Wunderlich from 2011 and the last involved a Utah firm that permitted a clerical employee to steal $33,000 from the dividends earned by two private funds managed by the advisor.

What stood out to me was that some of these Orders described some fairly outrageous conduct, but only named the firms and not the individual supervised persons:

File No. 3-14644 http://www.sec.gov/litigation/admin/2011/ia-3324.pdf

In a settlement order dated November 28, 2011, Asset Advisors, LLC was censured and fined $20,000 after multiple violation of Rules 206(4)-7 and 204A-1. The firm had been informally found to be deficient in complying with those rules (twice) by the Commission and failed to take adequate corrective measures. No natural persons were named or sanctioned.

File No. 3-14645 http://www.sec.gov/litigation/admin/2011/34-65838.pdf

In an Order also dated November 28, 2011, Feltl & Company, Inc. was censured, fined $50,000, ordered to hire a consultant, provide notice to its clients, disgorge $153,000, and provide a compliance certification to the Chicago Regional Office. In addition to the 206(4) – 7 violation, the firm was also found to have violated Section 206(3), Section 206(2), and Section 204A of the '40 Act. No natural persons were named or sanctioned.

File No. 3-15190 http://www.sec.gov/litigation/admin/2013/ia-3537.pdf

This Order from January 29, 2013 sanctioned IMC Asset Management, Inc. for violations of Rules 206(4)-7. The firm was censured, fined $30,000, and ordered to have a CCO hired 6 months prior to the date of the order receive training. The Order also required IMC to retain an outside compliance consultant indefinitely. No natural persons were named or sanctioned.

File No. 3-15399 http://www.sec.gov/litigation/admin/2013/ia-3637.pdf

A July 31, 2013 Order naming A.R. Schmeidler & Co., Inc. as respondent required disgorgement of slightly more than $826,000, fined the firm $175,000, censured the firm, and ordered that the firm hire an independent consultant to prevent future violations. In addition to the 206(4)-7 violation(s) cited, the firm was also found to have wilfully violated Section 206(2) of the '40 Act by failing to obtain best

execution for their clients in thousands of trades over 2 years. No natural persons were named or sanctioned.

File No. 3-15589 https://www.sec.gov/litigation/admin/2013/ia-3706.pdf

This October 28, 2014 Order of Settlement reported the Commission's settlement with GW & Wade, LLC. The Settlement required the firm to hire an independent consultant, reimburse clients for advisory fee overcharges arising from including Class C Mutual Fund positions in fee calculations, and pay a $250,000 fine. The advisory firm kept pre-signed Letters of Authorization for fund transfers on file and failed to implement their policy of excluding Class C mutual fund shares from advisory fee calculations. The respondent was found to have violated Sections 206(4) and 204A, with Rule violations of Sections 204-2, 206(4)-2, and 206(4)-7. No natural persons were named or sanctioned.

File No. 3-15616 http://www.sec.gov/litigation/admin/2013/ia-3719.pdf

This is the most recent Order, dated November 19, 2013, that settled an action involving Agamas Capital Management, LP. The respondent, a hedge fund advisor, was ordered to provide notice to the fund investors and pay a $250,000 fine. This action arose from the respondent failing to implement and enforce its own procedures on valuation of CMO's and other securities that were not widely traded. No natural persons were named or sanctioned.

After reviewing the Orders summarized above and comparing them to the Order issued naming me personally, I am reminded of the punch line to a joke originally ascribed to Abraham Lincoln: After being tarred and feathered, while being run out of town on a rail, the subject of this treatment was asked how he felt. His response was "If it weren't for the honor of the thing, I'd rather walk." I do not know the thought process that resulted in personally naming respondents in this Order compared to the thought process involved in the other Orders summarized. Not being able to discern how my conduct was more egregious than that described in the other orders, leads me to wonder if there is an objective criteria for personally naming respondents and the circumstances at Parallax which warranted that attention.

I have heard Commission attorneys mention at least twice in the last 8 months that wording on Commission Orders is fairly rigid and inflexible. That assertion is supported by the Orders I have read throughout this process, but it does appear that the Commission has a higher degree of latitude in how enforcement actions are charged. I am certainly not privy to internal Commission discussions on how matters are charged and have no knowledge of any objective standard or criteria for naming individual natural person respondents.

What I do know is that for an individual to be found in violation of certain '40 Act violations invokes other consequences for those individuals if they are FINRA members (https://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118466.pdf) or if they are involved in the issuance or sale of Private Placements (http://www.sec.gov/rules/final/2013/33-9415.pdf). While the Commission may not be concerned with the additional consequences to a natural person signing an Order describing willful violations of any provision of '40 Act Section 206, the individual respondents named in the Parallax Order and the Order filed against the affiliated advisory firm and persons, (all FINRA registered principals) certainly are. While the Commission may not have contemplated a de Jure sanction limiting future business activity or future registration applied to the persons named in this order, proceeding with an action naming the individuals could certainly create those consequences as a de Facto result.

This impedes settling the matter before proceeding to hearing. Speaking just for me, being personally named has created a mentality of "nothing or little to lose by taking my chances." In a situation where economic benefit to the individual respondent or economic harm to investors did not happen or was not measurably significant, a sanction applied to natural person respondents permanently impairing their ability to earn a livelihood in this business is not just or equitable.

SUMMARY AND CONCLUSIONS

My Conduct Described in the Hearing Order Does Not Warrant Enforcement Action

It remains my belief that had the examiners and subsequent enforcement division investigation not determined that the riskless principal trading routinely done by Parallax and the affiliated advisor was done in a manner inconsistent with Section 206(3), the remaining items would have been dealt with informally. During my regulatory career, technical deficiencies, particularly when the regulated entity took quick and decisive measures to correct the deficiency, were rarely (if ever) the subject enforcement action. Enforcement proceedings were justified when the regulator pointed out the deficiencies and corrective action was not done, whether the corrective action was promised or not. This is not the case for Parallax. Parallax took quick action to correct the deficiencies. Parallax had no prior history with the Commission.

Parallax instituted a variety of remedial actions in the 4 months between the Commission staff ending their fieldwork and the issuance of the initial examination report letter. I personally did not get the opportunity to complete the remedial actions, due to the firm owner requesting my resignation on September 12, 2011, which I provided him. I did participate in drafting an updated Code of Ethics and began work on the updated compliance procures. I did recommend several Inspected PCAOB CPA firms to re-audit the Partnership and the re-audit engagement was arranged prior to my resignation from Parallax.

During the examination and in the subsequent process, I have cooperated fully with the Commission and been forthcoming with any requests for information, explanations of Parallax operations, and have accepted responsibility for areas in which my knowledge or performance were lacking. I have not been quarrelsome or disagreeable with the Commission or any Commission staff member throughout the examination and subsequent investigation. I recognize the vital work that the Commission and other regulators do and I was fully prepared to do my part of the examination process; correct identified deficiencies and move forward with an improved compliance program.

Proceeding with enforcement action on the 204A-1 and 206(4)-7 charges, as articulated in the Order, amounts to a "zero tolerance policy" of enforcement, which is excessive and draconian. If the new regulatory standard is perfection 100% of the time, the Commission is going to find itself overwhelmed with actions involving technical deficiencies. FINRA found that this regulatory paradigm contributed to some adverse unforeseen consequences.
http://www.finra.org/web/groups/corporate/@corp/documents/corporate/p120078.pdf

The Charges Naming Me Personally Are Subjective And Open To Refutation

In looking at the 3 discrete charges, I would argue that 2 of the 3 charges are subjective and open to interpretation. For example, in evaluating the 206(4)-7 charge, what constitutes a review? What is sufficient documentation of reviews conducted? What is the threshold for updating a registrant's

compliance procedures? What is the required time frame for a review or a memo documenting the review? None of these details are addressed in the rule itself.

For the 204A violation, does the initial training done by the CCO for Parallax in 2009 when the Code was implemented not count for anything? After conducting an initial round of one on one staff training and assessment in the first quarter of 2010, would not my conclusion that the 3 supervised persons at Parallax (in addition to me) were aware of the Code and in compliance with the Code, not count as "implementation"? And, does review of the securities statements for all of Parallax' staff and all of the affiliated brokerage staff not satisfy the reporting and review requirement?

My response to the 206(4)-7 charge and the 204A charge is that I was in material compliance with the requirements of the rules. Documentation in the Commission's possession; my compliance logs, memos, and initialed, dated securities account statements demonstrate that compliance.

The Custody Rule Violation Was Not A Wilful Violation

I have offered the Commission the background on the lapse in fully complying with the Custody Rule. I believe that this was the worst mistake I made during my affiliation with Parallax. By the time I realized that Mr. Sloan was not qualified to perform the audit and that the audit could not be completed within the deadline, it was too late for me or any other person associated with Parallax to prevent the violation. There was no intent to ignore or violate the custody rule.

After the conclusion of the Commission's examination, I made my best effort to cause the issuance of a fully compliant audit. Given that this was the first year in which the Inspected PCAOB audit requirement was in place for Pooled Investment Vehicles, sanctioning a firm or individual for a late audit, without any accompanying allegations of misuse of investor assets or unwillingness by the registrant to correct the situation, appears to be an over-reaction and excessively harsh regulatory response.

Personally Naming Me and Any Other Respondent Is Excessively Punitive and Unwarranted

Based on a search of the Commission's actions under 206(4)-7 since 2011, it appears that a minority of the cases settled involve individuals that are personally named. If the purpose of this action is to permanently impair the ability of the individuals named in this action to fully participate in this business, the personal charging of individuals certainly accomplishes that. If the Commission wants this action promptly resolved in a fair and just manner, without the expenditure of additional staff resources and time, personally naming natural persons is (in my opinion) a major stumbling block to that outcome.

The firms and persons named in this action have had long careers in this business, relatively free from disciplinary history and disclosures. If the Commission wanted the situations described in this action corrected, that was completed in October 2011. If the Commission wanted to make certain that it got the attention of Parallax and management, that goal was accomplished in April 2011. While I cannot speak for any of the other persons named in this action, the naming of natural persons in this action has probably been the largest impediment to settling this matter prior to the issuance of the Order.

Final Considerations

As a practical consequence to me, the results of the 2011 examination have already had impacts upon my career and economic situation, with possibly additional impacts upon my future livelihood:

- The loss of Parallax as a client has resulted in an estimated decline to my earnings by $30,000 over the last two years. That was a natural consequence to an adverse examination result and I accept that.
- After reporting the Wells Notice on my U-4 in July 2013, a client that had hired me for a small engagement withdrew from the arrangement, which resulted in the direct loss of $500.
- I have had three discussions with existing clients since the Order was filed on November 27, 2013. These discussions have been personally embarrassing and humiliating. It is quite possible that continuing this process may cost me additional clients and have a severe impact on my future ability to earn a living in my profession.

I am uncomfortably aware of how much this sounds like the well-worn joke of the attorney defending a child accused of murdering his parents; "Your Honor, I plead for leniency for this orphan!" With that aside, I did think it important for the Commission to know that this action has already produced some real consequences for me personally. I believe that those consequences already exceed any effect the charged behavior had on any investor or client of Parallax.

On the positive side, this process has taught me some valuable lessons that I will apply for the remainder of my career:

- Being a remote CCO is not a viable option for either the firm or me.
- Stay away from SEC registered Advisory firms.
- Do not trust CPA's, other compliance professionals (including attorneys), or professional service providers to know what their professional requirements are or to be fully versed on every potential compliance landmine, no matter how sterling their reputation is.

I am not currently providing services to any SEC registered advisory firms and have no intention of doing so for the remainder of my career. It is my desire to put this process behind me as soon as possible, with as little further damage to my reputation or future that can happen.

It is likely that this document is somewhat (or perhaps completely) different from the usual attorney prepared response. It may not even be considered an acceptable response or may end up being a source of amusement among the Commission staff.

With that said I am not interested in being coy or asserting minutiae of legal point or rights available to me. What I am interested in is a fair and reasonable conclusion to this matter that permits me to function without future restriction in this business, without proceeding to a hearing. I am hoping that the Commission can take a further look at <u>all</u> of the pertinent facts and arrive at a fair and reasonable conclusion to this matter; that hope extends to the other persons and companies named in this Order and the Order filed against the related advisor. I am available to anyone at the Commission for any further discussion, anytime, by either phone [redacted] or e-mail at [redacted]

Respectfully Submitted Pro Se by,

F. Robert Falkenberg 12/5/13

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December 5, 2013