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August 3, 2009

BY EMAIL TO: pubcom@finra.org

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
173 K Street, NW
Washington, D.C. 20006-1506

RE: **FINRA NTM 09-34: Investment Company Securities**

Dear Ms. Asquith:

LPL Financial Corporation ("LPL")[1] appreciates the opportunity to comment on the above-referenced Regulatory Notice, which seeks input on proposed FINRA Rule 2341 (the "Proposed Rule"). The Proposed Rule, if adopted, would incorporate and replace NASD Rule 2830, with certain revisions to:

- require member firms to make new disclosures to investors regarding the receipt of cash compensation;
- make a minor change to the recordkeeping requirements for non-cash compensation;
- eliminate a condition regarding discounted sales of investment company securities to dealers; and
- codify past FINRA staff interpretations regarding the purchases and sales of exchange-traded funds ("ETFs").

LPL acknowledges the substantial amount of work that has been undertaken by FINRA staff members to create a new consolidated rulebook. It is a herculean task, and we commend FINRA's thoughtful dedication to the effort. With respect to the Proposed Rule, we are pleased to convey our agreement with the proposed change to the recordkeeping requirements for non-cash compensation. Moreover, we have no objection to FINRA's proposed changes that eliminate the condition regarding discounted sales of investment company securities to dealers.

[1] LPL Financial is one of the nation's leading diversified financial services companies and the largest independent broker/dealer supporting more than 12,000 financial advisors nationwide. LPL Financial has offices in Boston, Charlotte, Chicago, Los Angeles, San Diego and West Palm Beach.

Finally, we have no comment to the proposal that would codify past FINRA staff interpretations regarding the purchases and sales of ETFs. We believe that each of these revisions will serve to clarify existing rules and processes and would serve enhancing consumer protection and our industry as a whole.

We would, however, like to provide you with our specific comments and concerns regarding proposed FINRA Rule 2341(l)(4), which would forbid a broker-dealer from accepting sales charges or service fees from any "offeror" unless such sales charges or service fees are described in a current prospectus. As discussed in detail below, we respectfully disagree with the adoption of this rule, as it indirectly seeks to regulate the disclosure requirements of investment companies by imposing rules with which member firms would have difficulty complying. Proposed FINRA Rule 2341(l)(4) also imposes significant new disclosure requirements on broker-dealers that offer investment company securities. While we agree with certain of these proposed disclosure requirements, we provide below our suggested improvements to these new requirements.

I. Investment Company Prospectus Disclosure Requirements

The Proposed Rule indirectly seeks to modify disclosure requirements for investment companies that pay cash compensation to member firms. Under current NASD Rule 2830(l)(4), member firms are prohibited from accepting cash compensation from an investment company unless the investment company discloses the compensation in its prospectus. However, the Proposed Rule alters this requirement by only requiring prospectus disclosure of "sales charges and service fees" paid by the investment company rather than all cash compensation. More importantly, the Proposed Rule provides that if the investment company does not make sales charges and service fees available on exactly the same terms to all broker-dealers, then the prospectus must disclose the specific arrangements with each broker-dealer, identified by name.

A. Prospectus Disclosure Requirements Outside of FINRA Jurisdiction

LPL fundamentally opposes the adoption of these new indirect prospectus disclosure requirements. While broker-dealers such as LPL are certainly able to comply with the current NASD requirement that cash compensation paid by an investment company to a member firm be clearly disclosed in the prospectus, it would be impossible for a broker-dealer to comply with the new requirement that specific details of any "special" arrangements be disclosed. As an example, LPL does not have visibility into the arrangements made between our investment company partners and their other broker-dealer relationships. It would therefore prove impossible for LPL to know whether or not our compensation arrangements with a particular investment company should be characterized as "special." The only way for a broker-dealer to ensure that it is compliant with this Proposed Rule would be to renegotiate its contracts with every investment company on its platform to add provisions requiring the investment company to warrant that it has and will continue to make accurate prospectus disclosures of all of its special compensation arrangements.

LPL views these expanded prospectus disclosure requirements as an attempt by FINRA to regulate the mutual fund industry through indirect means. We believe that regulation of

investment company obligations is more properly imposed by the U.S. Securities and Exchange Commission (the "SEC"), which has direct jurisdiction over the investment company industry. The SEC has the authority to require investment companies to make the necessary prospectus disclosures that detail "special" arrangements with broker-dealers and service agents. This, in turn, would allow broker-dealers to rely upon their existing contractual warranties that the issuer's prospectus is accurate and complete.

B. Proposed Rule is Potentially Anti-Competitive, Discriminatory and Unnecessary

LPL believes that requiring investment companies to disclose their financial arrangements with each of their broker-dealer partners would create an anti-competitive environment forcing the financial services industry towards fee standardization.[2] This trend may result in negative consequences such as a reduction in the number and quality of services provided by broker-dealers or a limitation on the technology that broker-dealers, as service agents, are willing or able to provide. Ultimately, fee standardization could serve to curtail any future innovations in products or services, which would most certainly be detrimental to our industry as a whole.

Furthermore, LPL believes that the Proposed Rule is discriminatory towards one particular product. The Proposed Rule would only apply to investment company securities and would not require other investment instruments distributed through broker-dealers to disclose similar information. These enhanced disclosure obligations solely related to investment company securities will put investment companies at a competitive disadvantage when negotiating with other market participants who could easily compare the fees provided to other agents for similar, although not identical, services. Moreover, if enacted, investment companies and broker-dealers will be subject to enhanced scrutiny for their payment methodology for only this one particular product type. This heightened focus upon special financial arrangements could lead to a desire on the part of broker-dealers to focus on its more valuable investment company relationships, ultimately leading to reduced market choice for consumers seeking mutual fund investments.

LPL believes that much of the information the Proposed Rule seeks to disclose is already conveniently available to consumers and that further disclosure would merely provide duplicative and often confusing information. Most broker-dealers currently disclose revenue sharing payments received from product sponsors on their websites. In addition, investment companies often disclose similar information in their statements of additional information.

Furthermore, by providing information related to what investment companies pay, as opposed to what broker-dealers receive, consumers could be misinformed as to the potential conflict of interest that the Proposed Rule attempts to mitigate. The fact that an investment company pays compensation to different broker-dealers under different terms (e.g., Investment Company A pays 3% to Broker-Dealer Y, but only pays 2% to Broker-Dealer Z) is not of consequence to the consumer. We believe an end consumer should be far more concerned by the differential compensation that a broker-dealer receives within a particular product type (e.g.,

[2] Indeed, such fee disclosure may raise anti-trust concerns as each industry participant would have complete information concerning their competitor's pricing.

Broker-Dealer X receives 2% from Investment Company A and 3% from Investment Company B for selling a similar mutual fund). While we understand that the FINRA seeks to defuse conflicts of interest that may currently exist in the industry, we do not believe that the Proposed Rule, as drafted, achieves this goal.

C. Definitions are Ambiguous and Need Clarification

The Proposed Rule fails to address lingering ambiguities with respect to certain key defined terms. For instance, the decidedly vague term "special cash compensation," long since used in the existing NASD Rule 2830 is now to be replaced by "special sales charges or service fee arrangements." This new term is not defined anywhere in the body of the rule. Rather, FINRA attempts to explain the meaning of this term in proposed Supplementary Material 0.2, providing that "[f]or purposes of this provision, "special sales charge or service fee arrangement" means an arrangement under which a member receives greater sales charges or service fees than other members selling the same investment company securities." This attempted definition over-simplifies the relationships shared by broker-dealers and investment companies. By saying that a sales charge or fee is "special" simply by virtue of the fact that the member receives more charges or fees than other members selling the same security, FINRA fails to acknowledge the many scenarios that could explain such a differential in compensation. This simplistic language will lead to questions as to the intent of the definition and will serve only to confuse the end investor.

The term "revenue-sharing payments" is another term that is poorly defined by the Proposed Rule. In fact, "revenue sharing" is not even discussed in the body of the rule, and is only mentioned in Supplementary Material .01. There, it states that [f]or purposes of this Rule, "cash compensation" includes cash payments commonly known as "revenue sharing" which are typically paid by the investment company's adviser or another affiliate of the investment company in connection with the sale and distribution of the investment company's securities." In a footnote to the Regulatory Notice, FINRA notes that revenue-sharing can take many forms, including "the form of other cash payments, such as an offeror helping to pay the costs of a firm's annual sales meeting." This is a stark change to the current industry standard, where an offeror's contribution towards the cost of a firm's annual sales meeting has generally been treated as a form of non-cash compensation and not as revenue-sharing.

We believe that for a term so critical in nature, the industry would be best served by a clear definition that is developed and incorporated into the rule itself. Furthermore, if changes to the industry standard are to be made, we believe this should be done explicitly within the rule so that all parties are on firm notice and able to respond accordingly.

II. New Broker-Dealer Disclosure Requirements

The Proposed Rule would impose new disclosure requirements on any member firm that receives cash compensation in addition to standard sales charges and service fees paid in connection with the sale of mutual funds. These new requirements would require member firms to:

- Disclose that information about a fund's fees and expenses may be found in the fund's prospectus;

- Disclose, if applicable, that:

    - The member firm receives cash payments from an offeror, other than sales charges or service fees disclosed in the prospectus fee table;
    - The nature of any such payments received in the last 12 months; and
    - The name of each offeror that made such cash payment, listed in descending order based upon the amount of compensation received from each offeror; and

- Provide a reference to a web page or toll-free number containing updated information, which must be updated on a semi-annual basis.

These disclosures would be required to be made to customers at the time the customer account is opened, would need to be updated on a semi-annual basis and must be made in writing. With respect to any accounts existing when the Proposed Rule becomes effective, these disclosures would be required to be made by the later of (a) 90 days after the effective date or (b) the time the customer first purchases shares of an investment company after the effective date.

LPL finds these new disclosure requirements acceptable in concept. We applaud the transparency that is afforded through proper disclosure about a fund's fees and expenses and effective communication of cash payments that are received from an offeror. However, we feel that requiring that the nature of any cash payments received "in the last 12 months" is overly burdensome and the cost of implementation of this rule would exceed its benefits. Rather than requiring this "rolling" 12 month requirement, we suggest that FINRA modify this provision to require disclosure of the payments received by the broker-dealer during the prior [fiscal] year.

Furthermore, the Proposed Rule requires that these disclosures be updated on a semi-annual basis. Given our suggestion above that broker-dealers provide disclosure of payments made during the prior fiscal year, we believe it makes more sense that updates to these disclosures be made on an annual basis, rather than a semi-annual basis.

FINRA has noted in Regulatory Notice 09-34 that it seeks comment on how information about these cash payments should be disclosed to investors. Given the widespread availability of electronic communication, LPL strongly suggests that these disclosures be made to investors through electronic means such as website postings. This would be consistent with the SEC's recent rules such as the recently adopted summary prospectus rule and Form ADV delivery requirements.

III. Cost Implications and Implementation Period

Finally, as discussed above, LPL would like to note the significant cost implications for all broker-dealers that would be triggered by the adoption of proposed FINRA Rule 2341(l)(4) as currently drafted. Indirectly regulating investment company disclosures through broker-dealer distribution and servicing mechanisms will require substantial resources from the broker-dealer

community. In addition, building the proper operational infrastructure to accommodate additional continuous off cycle customer reporting obligations will require considerable time and capital commitments.

Therefore, should the Proposed Rule be adopted, LPL would strongly urge FINRA to incorporate an adoption period of no less than twenty-four months to give member firms the appropriate time to renegotiate contracts, update electronic disclosures and revise customer documentation.

IV. Conclusion

LPL appreciates the opportunity to comment, and we thank you for your consideration of our concerns. Should you have any questions, please contact me at (617) 897-4340.

Sincerely,

Stephanie L. Brown
Managing Director, General Counsel