

VIA ELECTRONIC DELIVERY (pubcom@finra.org)

August 18, 2015

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

**RE: FINRA Regulatory Notice 15-22; Proposed FINRA Rule 3260
– Discretionary Accounts and Transactions by Persons Other
Than the Customer**

Dear Ms. Asquith:

FOLIOfn Investments, Inc. (“Folio” or the “Firm”)¹ welcomes the opportunity to express its views on the Financial Industry Regulatory Authority’s (“FINRA”) revised proposal to adopt FINRA Rule 3260 (“Proposed Rule”) outlined in Regulatory Notice 15-22 (“Revised Proposal”) as part of the Consolidated FINRA Rulebook, taking into account the requirements of NASD Rule 2510 and NYSE Rule 408. Folio supports FINRA’s efforts to not only reiterate its existing policies and rule requirements relating to discretionary accounts, but also modernize its approach. We strongly believe, however, that the Revised Proposal should be modified so as to more fully embrace the benefits and enhanced efficiency of electronic signatures and the march toward a more mobile and technologically savvy society. Further, the Revised Proposal should more fully address and take into account the burdens the Proposed Rule will place on firms like Folio that do not facilitate the types of activities that are more likely to give rise to the concerns to be addressed by the Proposed Rule and currently are required to comply only with NASD Rule 2510.

I. Discretionary Transactions by Member Firms and Their Associated Persons (Proposed FINRA Rule 3260(a))**A. Exercise of Discretion by Associated Persons**

As currently drafted in the Revised Proposal, discretionary activities by “an associated person of a firm who is granted non-broker-dealer and non-

¹ Folio is an online only self-clearing broker-dealer that generally does not provide investment advice or recommend or solicit securities transactions and does not assign any registered sales people to specific customer accounts. Folio’s customers are self-directed individuals (and their common investing vehicles such as trusts), as well as clients of independent, unaffiliated registered investment advisors (“RIAs”) and introducing broker-dealers who use Folio’s clearing platform to execute securities transactions and custody their clients’ assets.

investment adviser discretionary authority by a customer of the firm, such as a family member who has given a power of attorney to the associated person” would be subject to a higher standard of review and approval by a member firm under paragraph (a) of the Proposed Rule than, for example, by a third party RIA acting on behalf of the same account holder. Forcing what generally is an informal/personal relationship into a rigid review and approval structure such as that proposed merely because an account holder (1) determined to establish an account with a particular member firm, (2) has a personal relationship with a person in the financial services industry, and (3) the person with whom the account holder has a personal relationship is an associated person of the member firm that holds the customer account is presumptive and overbroad. The fact that the associated person has access to and may act with discretionary authority on an account does not make the account more or less susceptible to the activities that the Proposed Rule is designed to protect against, absent an incentive such as compensation.

The Proposed Rule should be narrowly construed to ensure member firms adequately review and supervise the activities of associated persons and prevent the facts and circumstances that FINRA is appropriately concerned about, such as manipulative and/or deceptive activities. Folio believes proposed FINRA Rule 3260(a) should be revised so that it applies only where an associated person of a member firm is a registered representative that recommends securities or solicits securities transactions on behalf of the firm and is compensated based on such recommendations and solicited transactions. Narrowing the scope of the Proposed Rule in such a way would be consistent with the exclusion under the rule for flat-fee accounts. Under both circumstances, FINRA’s concerns regarding manipulative and deceptive trading would be unlikely to arise as, presumably, the associated person would receive no compensation directly related to the trading activities.² Accordingly, Folio does not believe the issues that would give rise to FINRA’s concerns would be present, and thus a higher standard of review and approval would be unwarranted.

B. Surveillance

In addition to the suggestion above that the scope of the rule be limited to only apply where an associated person is incentivized to engage in certain activities, Folio believes that member firms also should continue to have the ability to take a risk-based approach in defining their supervisory procedures.

² Folio acknowledges and appreciates that there are a variety of compensation arrangements in the industry. The idea here would be to ensure that the associated person’s compensation is not directly or indirectly linked to his or her trading activities in an account. This would be true where the associated person is not a registered representative that recommends securities or solicits securities transactions on behalf of a firm and compensated directly for those activities, but also where an associated person is compensated for those activities with respect to other client accounts, but not for the accounts with respect to which the individual exercises discretionary authority.

For example, the Folio platform is not specifically designed to facilitate anything close to day trading or high frequency trading. Associated persons may be, from time to time, authorized to access client accounts to administratively implement client picked and pre-approved strategies or trades, but the Firm has no people, registered or otherwise, that are paid on commissions or who on a regular basis as part of their defined job enter orders for clients. The design Folio's platform is for self-directed clients (or an authorized person, including an RIA) to enter orders online. The Firm's supervisory oversight of its business activities should be based on the Firm's view of its risk and operations, which may be different from another firm that has commission-paid sales personnel that are permitted to act in the capacity of unregistered investment advisors for friends, family and other types of unaffiliated third parties.

C. Exception for Fee-Based Accounts

As noted above, the Revised Proposal excludes fee-based only accounts from the requirements of proposed FINRA Rule 3260(a). Folio agrees with the approach of excluding such accounts, but believes that the text of the Proposed Rule should be further clarified to not only expressly exclude "fee-based" accounts, but also "flat fee" accounts or transaction types and other arrangements where compensation is not directly or indirectly linked to the transactions executed in the customer account.³ Further, we believe it is important to clarify that a de minimis number of commission transactions in an account or a system of charging after a determined number of trades does not convert the account to a discretionary account for purposes of the Proposed Rule.

II. Transactions by Agents of Customers (Proposed FINRA Rule 3260(b))

A. Discretionary Activity Consistent with Customer's Prior Written Authorization

Proposed FINRA Rule 3260(b) prescribes certain information and documentation that member firms would be required to obtain prior to accepting an order for a customer's account from a person other than the customer, including a third party RIA (referred to herein as "Customer Agent"), which will be burdensome for both investors and many member firms with no countervailing benefit. In particular, the requirement to determine that an "order is consistent with [the Customer Agent's] authority as specified in the prior written authorization" will significantly impact firms such as Folio that traditionally offer only online, self-directed accounts. If implemented, the policy would have the effect of making such member firms, in essence, supervisors or

³ In the second full paragraph on page 4 of the Revised Proposal, there is clarifying language that includes flat fee and asset-based fees in the term "fee-based." Folio believes that this clarifying language should be incorporated into the text of the Proposed Rule.

regulators of the activities of third party RIAs and their relationships with their clients by requiring firms to make a legal determination as to whether an order being placed is consistent with the RIA's authority, notwithstanding the fiduciary obligations owed by the advisor to the underlying client and the total lack of knowledge that a clearing firm that provides only custody and execution services has with respect to the services that the advisor is or will be providing. In the absence of a formal advisory relationship that has a long history of being documented such as that between an RIA and her advised client, it would require firms to also "counsel" Customer Agents that are in a less formal arrangement to establish documentation sufficient for the member firm to rely upon for legal authorization. These are simply not oversight functions that properly should be placed on member firms. Folio acknowledges FINRA's concerns relating to unauthorized trading in client accounts, but posits that the requirements of existing NASD Rule 2510 adequately addressed those concerns and that a policy that would require member firms to gather and review agreements between customers and Customer Agents is unnecessary, overly burdensome and, in fact, not feasible for firms to comply with.

While FINRA acknowledges that it is proposing the standards incorporated in the NYSE Rule 408, which it characterizes as "more stringent" and offering a "heightened standard of protection" there is no evidence that such an approach is beneficial to investors or warranted, given member firms' long history of complying with NASD Rule 2510. Further, FINRA acknowledges that the Proposed Rule will impose additional burdens on member firms that are not also NYSE members, but provides no specific justification for the increased burden. As a member firm that is not also a NYSE member firm, Folio respectfully requests that FINRA reconsider the proposed approach of adopting the requirements set forth in NYSE Rule 408 and determine whether, based on FINRA's experience with NASD Rule 2510, whether the additional burdens imposed on firms are outweighed by any benefit to investors.

B. Electronic versus Manual Signature

In addition to our comments above relating to the requirement for member firms to confirm that an order from a Customer Agent is consistent with the agent's authority, Folio is further concerned about (1) the requirement for manual signatures and (2) the requirement for such signatures to be captured from Customer Agents as opposed to account holders.

Folio provides each account holder with a unique authorization access tool that allows the account holder to grant to another person who has established a "membership" at Folio to access the account holder's account with various levels of authority.⁴ Pursuant to that process, an account holder must either, (1)

⁴ For more information on Folio's authorized access settings, visit <https://www.folioinvesting.com/folioinvesting/help/account-settings/>.

obtain the unique user identification associated with the Customer Agent from the Customer Agent, log-in to the Folio system and self-permission the Customer Agent onto their account or (2) acknowledge that a RIA has opened an account with Folio on his behalf in one of several ways. In both cases, the Customer Agent also must have a relationship with Folio and have been reviewed consistent with Folio's AML/CIP policies and procedures. Accordingly, Customer Agents are known to Folio in the same way customers are known to the Firm. Under such circumstances, a requirement to obtain the Customer Agent's signature offers no additional protection, but imposes additional burdens on the Customer Agent (and, as a result, perhaps the account holder in the form of an increased cost of service) and Folio. At the very least, as Customer Agents are permitted to agree to and sign paperwork electronically, they should be able to convey a receipt of discretionary authority over a customer account in the same manner.

We believe the Proposed Rule should be expanded to permit, just as it does for scanned or faxed copies of wet signatures, any method of electronic signature that is permitted under the E-Sign Act, including electronic clicks, script signatures, signing using one's finger or computer mouse or similar tool. Numerous industry participants (member firms, investors and their agents) have come to rely on the benefits, protections and efficiencies afforded them as a result of electronic signing tools. A proposed rule that reverts the industry back a decade seems inapposite to that progress and inconsistent with the wishes and interest of participants, including investors.

Further, to the extent FINRA believes that a wet signature or a copy of a wet signature provides a greater level of assurance that the person who manually signed a document is in fact the person purporting to have signed it (although, Folio strongly disagrees with this perspective), it would seem prudent to not only require a wet signature from the Customer Agent, but also from the customer himself. The Proposed Rule, however, expressly permits the customer signature to be electronic while requiring a manual signature only from the Customer Agent. As noted above, Folio believes FINRA's goal of protecting account holders from unauthorized trading will be better accomplished if electronic signatures are permitted from both the customer as well as the Customer Agent. The more prudent approach, however, would be the one Folio takes - requiring the person with authority to establish credentials with the Firm that will be used to exercise discretion and then accepting electronic signatures.

III. Temporary Time or Price Discretion (Proposed FINRA Rule 3260(c)(1)(A))

Lastly, Folio does not believe that the exception for valid good-till-cancelled orders should be restricted to institutional accounts. In a computerized world it is desirable and advantageous for a retail customer to enter, and the rule should

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allow, any order that contains sufficient, objectively measurable details such that a simple computer program can execute the instruction as written. An order with sufficient detail that remains open until cancelled or executed (whether or not for a security that trades infrequently) should not require a grant to or exercise of discretion by an associated person of a member firm. For example, when entering an order for a security with lower ADTV, a retail customer may want to take advantage of contra-side interest when it becomes available rather than being required to enter a new order each day on the chance that there is sufficient contra-side interest at a price that would support an execution. Similarly, at the time an investor purchases a debt security that has an automatic rollover or payout feature, the investor may want to indicate what she would like to have happen upon payout or rollover upon maturity, which could be 1 to 3 years away. These actions are administrative in nature, directed by the retail customer, objectively measurable and simply implemented by the member firm; they were not intended by an investor to be governed by a grant of discretionary authority to a member firm and should not be treated as such. Standing written instructions have been accepted and recognized for years by institutional investors and retail investors should have the same ability to make an investment decision once (with the appropriate disclosure) that can be change at any time prior to the event, and have their brokerage firm comply with that investment decision.

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We appreciate this opportunity to submit our comments on FINRA's Revised Proposal. If you should have any questions or would like to discuss our comments, please do not hesitate to contact me at (703) 245-5705 or hoganm@folioinvesting.com or Erica A. Green at (703) 245-4848 or greene@folioinvesting.com.

Sincerely,



Michael J. Hogan
President and Chief Executive Officer