Public Investors Arbitration Bar Association

Via On-line submission

July 20, 2011

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

Re: File Number SR-FINRA-2011-028
Proposed Rule Change to Adopt the Consolidated FINRA Supervision Rules

Dear Ms. Murphy:

The Public Investors Arbitration Bar Association ("PIABA") appreciates the opportunity to provide the Commission with comments regarding the Proposed Consolidated FINRA Supervision Rules. PIABA is a bar association comprising attorneys who represent investors in securities arbitrations. Our members and their clients have a strong interest in FINRA rules which govern the conduct of securities firms and their representatives, with a goal of providing investor protection.

PIABA does support the adoption of consolidated rules governing supervision. PIABA appreciates that FINRA has made it clear in the supplementary materials to the rules that firms are required to design a supervisory system which includes supervision for all of the firm's business lines irrespective of whether they require broker-dealer registration. This is particularly important given that so many firms are one-stop shops, offering investors all sorts of services. Investors must be protected, especially when the firms themselves do not make it clear that the various services being offered come with varying levels of regulatory protections.

PIABA also supports the inclusion of clear guidance regarding the supervision of offices of supervisory jurisdiction (OSJs) and non-OSJ branch offices. The supplementary materials to the rules make it clear that a principal who is engaging in sales cannot supervise his own conduct. The supplementary materials also make it clear that on-site principals must have a physical presence on a regular and routine basis in the offices the principal is supervising. Both of these provisions add clarity to the current rules.

Notwithstanding that the proposed rules are a move in a positive direction in some aspects, there are certain aspects of the rules that still raise concerns. FINRA initially published the proposed rules for comment in May 2008. At that time, PIABA took the opportunity to voice concerns about certain aspects of the

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proposed rules. While FINRA has addressed certain of our concerns in the current regulatory notice, it has essentially dismissed them. Accordingly, we will set forth those concerns once more at this time.

The concerns which we raise involve areas that we perceive as important to providing firms and their brokers clear rules regarding permissible and impermissible conduct. When disregarded, the rules should provide customers the ability to hold a broker-dealer and its associated persons responsible for improper conduct. In its initial release, FINRA indicated that it believed the proposed rules reflected "a more flexible approach to certain supervision requirements."[1] Those of us who represent the investing public against members of the industry who violate the rules, know all too well the difficulty in proving a violation of a rule, a regulation, or a law without a clear statement of what that rule, regulation or law is. We are concerned that the term "flexible" appears to be a euphemism for "reduced" or "diminished" supervision requirements. We strenuously oppose any changes that reduce the protection of investors or that will make proof of misconduct more difficult.

PIABA Is Opposed to "Principles-Based Regulation"

PIABA believes a strong, uniform fiduciary duty will make significant progress towards protecting investors' interests. The rule, however, includes numerous references to "risk-based" review. There has been a great deal of discussion of "risk-based" review in the same breath as "principles-based" regulation. These concepts have become popular in Europe and have been promoted by the Federal Reserve Chairman[2] and the former Treasury Secretary[3], among others. However, in the wake of the financial crisis, it became clear that principles-based regulations were ineffective. In a recent speech, current Treasury Secretary, Tim Geithner, warned, "The United Kingdom's experiment in a strategy of 'light touch' regulation to attract business to London away from New York and Frankfurt ended tragically. That should be a cautionary note for other countries deciding whether to try to take advantage of the rise in standards in the United States."[4]

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[1] FINRA Regulatory Notice 08-24, p. 3.

[2] Ben S. Bemanke, "Regulation and Financial Innovation" (speech, Financial Markets Conference, Federal Reserve Bank of Atlanta, Sea Island, GA, May 15, 2007), available at www.federalreserve.gov/boarddocs/Speeches/2007/20070515/default.htm.

[3] Remarks by Secretary Henry M. Paulson, Jr. on Blueprint for Regulatory Reform, March 31, 2008, available at http://www.forbes.com/2008/03/31/treasury-paulson-regulation-biz-cx_bw_0331paulsontext.html.

[4] Remarks by Treasury Secretary Tim Geithner to the International Monetary Conference, June 6, 2011, available at http://www.treasury.gov/press-center/press-releases/Pages/tg1202.aspx.

To the extent that FINRA's use of the "risk-based" concept may signal a first step down the slippery slope of "principles based" rules and regulation, PIABA takes this opportunity to go on record as strongly opposing such a trend.

Given the accelerating pace of industry-wide scandals in recent years, it is our belief that more, rather than fewer, bright-line rules are needed. Unscrupulous members of the industry have had enough difficulty keeping their conduct in line with specific rules; one can hardly expect that their behavior would improve under a generic set of "principles." If the purpose of regulation is to protect the investing public, we do not see how a move toward less specificity will accomplish the purpose.

Moreover, "principles-based regulation" is entirely unsuitable and inappropriate for a self-regulatory organization like FINRA. We point out two primary reasons.

First, without clear rules by which compliance professionals can monitor and train registered representatives, supervisors, and officers of broker-dealers, compliance professionals will lose any ability to impose even superficial control over misconduct. Those being monitored can rightly say that they haven't broken any rule or crossed any bright line, and they can rightly say it is only the compliance professional's opinion that a "principle" has been violated.

Second, in enforcement by the Commission or other regulators, or in arbitration by customers who have been wronged by an industry person, the ability to prove a violation which will subject the violator to sanctions or an award of monetary compensation will be greatly diminished if the regulator or the consumer can point to no clear rule that has been violated.

Our position is in line with that of many compliance professionals. For example, in the August 6, 2007 Securities Industry News, one compliance professional was quoted as saying: "Our clients are compliance professionals. They do not want principles-based regulation. [The new approach] will be a significant industry shift in that most broker-dealers want to maximize profit. But clear rules are helpful for compliance professionals. If the compliance professional can no longer use the rule to instruct the broker-dealer about what to do, it will increase tension. ... The downside is that it will be harder for compliance professionals. Compliance has a seat at the table now. I would like to think that the idea of a principles-based rules system is that you get to the underlying idea of risk, and doing the right thing. But if there are not clear rules, you wonder how far the line is going to get pushed."

Further, while it may be contended that "principles-based regulation" can work for a true governmental regulatory agency provided the agency is fully funded with adequate staff to perform the needed tasks, the same cannot be said for an SRO, where critics would say the "fox guards the henhouse." Certainly, pressure for an SRO to be lenient in enforcing rules against its own members can more easily be brought to bear than when rule enforcement is by an independent governmental regulatory agency.

Even those who favor principles based regulation recognize that with the extent of agency capture in the United States, and the failure to properly fund independent regulators, we are not ready for such a change. As one commentator put it: " ... a principles-based system relies on dedicated, well-funded regulators who are interested in regulating."[5] That definition cannot apply to any self-regulatory organization. FINRA should not be moving toward "principles based regulation" now or in the future.[6]

Risked-Based Review

The proposed rule is peppered with the term "risk-based review." For example, Proposed Rule 3110(b)(2) requires that all transactions related to the investment banking or securities business of a firm be subject to a registered principal's review to be evidenced in writing. By itself, this is a clear and enforceable rule and registered principals know exactly what is expected of them. However, the Supplementary Material, in paragraph .07, provides that "a member may use a risk-based review system to comply with Rule 3110(b)(2)." The term "risk-based" also appears for review of correspondence (Supplementary Material to Rule 3110, paragraph .08) and for annual examination of transfers of funds between customers and brokers or between customers and third parties (Proposed Rule 3110(c)(2)(B)).

Nowhere is the term "risk based" defined. Thus, proposed rules provide for a "risk based" standard with no meaningful direction as to the type of review. One obvious concern is that FINRA will view the concept of "risk-based" review of offices and "risk based" supervision of brokers with reference to the level of "risk" to the broker-dealer, as opposed to the level of "risk" to the customer.

While we support any FINRA proposal to provide greater protection to the investing public, we emphatically oppose any efforts to diminish or erode consumer protections. We view the reference to "risk-based" rules or regulation as the first step in such erosion. We urge FINRA to establish well-defined standards which will ensure that everyone will understand the rules, and there can be no question what is expected of members of the industry.

Non-Reporting of Oral Complaints

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[5] James Surowiecki, "Parsing Paulson," The New Yorker, April 28, 2008.

[6] The oft-stated rationale in favor of principles based regulation is that it will improve our nation's competitive position in the capital markets. This is a doubtful proposition. Indeed, the historical success of the United States in attracting capital from investors around the world is due in large part to the perception that investors receive greater protection in our country than elsewhere. We believe the United States can retain its preeminence only by continuing to assure that our markets are the safest place in the world for investors. A move toward principles based regulation is precisely the wrong way to go.

Proposed Rule 3110(b)(5) would limit the customer complaints which a firm is required to "capture, acknowledge, and respond to." Specifically, the firm would need to "capture, acknowledge, and respond to" written complaints only, thereby allowing firms to conceal oral complaints from customers. This proposal is purely and simply "anti-consumer" and benefits the firm and its associated persons over the customer. In response to PIABA's concerns, FINRA stated that "the proposed rule change does not include oral complaints because they are difficult to capture and assess, whereas members can more readily capture and assess written complaints."[7] However, because something is difficult is not a sufficient justification for not providing investor protection.

PIABA had suggested that in the case where an oral complaint is made, that the firms be required to provide the customer with a form to file a complaint. If the customer does not choose to write the complaint, the member should reduce the complaint to writing, offer its counter statement to the oral complaint, and send a copy to the customer. The firm should then be required to report the complaint along with the firm's response. FINRA has stated that it "encourages members to provide customers with a form or other format that will allow customers to detail their complaints in writing" and goes on to remind firms that "the failure to address any customer complaint, written or oral, may be a violation of FINRA Rule 2010."[8] FINRA's response to PIABA's raised concerns is internally inconsistent. If firms are required to address an oral complaint under Rule 2010, then clearly they must "capture and assess" the oral complaint to do so. Consequently, reporting the oral complaint they have "addressed" cannot be too "difficult" for them.

Many customers, in our experience, are unable or reluctant to put their thoughts in writing. Since the financial services industry routinely solicits customers of all education levels, and of all financial levels, the industry should make sure that even those who do not type, cannot write well, and/or are intimidated by the thought of writing a letter, are given the same ability to complain and have their complaints recorded and heard by regulators. Moreover, it must be recognized that communications between a broker and client are almost always oral, typically conducted over the telephone. Accordingly, it may be expected that most complaints are, at least initially, communicated orally. The fact that they are communicated in this way makes them no less a complaint, nor does it make the complaint any less important to the client. Simply put, the exclusion of unwritten complaints ignores the essential character of broker-customer relations. Requiring complaints to be in writing before they are acknowledged is clearly inconsistent with FINRA's stated objective of protecting the investing public.

Limitation of Reporting to Firms Grossing at Least $150 Million

Former NYSE Rule 342.30 required members of the Exchange to report certain information relating to specified issues to senior management. Proposed FINRA Rule 3120(b) would retain the substantive reporting requirements of the NYSE Rule, but would only require such reporting by firms who had exceeded

[7] SEC Release No. 34-64736, pg. 45.
[8] Id.

$150 million in gross revenues on the prior year's FOCUS reports. As FINRA explained in the initial proposal, and has restated in this proposal, "the additional information required of members with more than $150 million in gross revenue will prove to be valuable information for FINRA's regulatory program, in addition to being valuable compliance information for the senior management of the firm."[9]

FINRA has failed to offer a rationale as to why this information would not be just as relevant to firms grossing less than $150 million. PIABA believes this is exactly the type of information that all firms, irrespective of size, should be required to report.

Retention of Correspondence and Internal Communications

Paragraph .11 of the Supplementary Material to Proposed Rule 3110 sets forth the record retention period applicable to correspondence and internal communications. FINRA has conformed the rule to that of the SEC Rule 17a-4(b), thereby continuing the retention period at just three years. In its prior letter, PIABA had suggested that it would be more appropriate for the record retention rule to conform, at a minimum, with the eligibility provisions for customer disputes contained in FINRA Rule 12206, which is six years. To reduce the record retention rules to a shorter time period only makes it more difficult for a customer to prove a violation of a rule, regulation, or law. In the age of electronic storage, there should be little argument over reasonably increasing the time periods for document retention. Whereas the document retention rules once posed a burden in terms of finding warehouse space, electronic storage space may be obtained at near-zero cost.

In addition, PIABA would like to see a rule requiring that these kinds of records, as well as any other customer-related documents, be made available upon request to customers and former customers within a reasonable time and at no charge.

Family Member and Other Accounts

The proposed rules contain provisions designed to prevent and detect insider trading. In determining which accounts would receive heightened scrutiny, proposed rule 3110(d)(3)(A) defines "covered account" as "any account held by the spouse, child, son-in-law, or daughter-in-law of a person associated with the member where such account is introduced or carried by the member." This definition is unduly narrow. It should include the associated person's parents, siblings, mother-in-law and father-in law, as well as any life partner.

Conclusion

PIABA appreciates the opportunity to comment on these important rule changes. These changes are broad in scope and will materially affect the

[9] Id. at pg. 64.

supervisory responsibilities of the brokerage industry. PIABA requests that the Commission review the concerns raised herein, and take the necessary steps to provide greater investor protection.

Respectfully submitted,
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