February 3, 2012

VIA ELECTRONIC MAIL

Ms. Lourdes Gonzalez
Assistant Chief Counsel for Sales Practices
Division of Trading and Markets
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Supplemental Letter regarding SR-FINRA-2009-28; Filing of Amendment No. 1 to Proposed Rule Change to Adopt FINRA Rule 2231 (Customer Account Statements) in the Consolidated FINRA Rulebook

Dear Lourdes,

On behalf of the Securities Industry and Financial Markets Association,[1] I want to thank you and your colleagues for speaking with us last fall regarding the referenced FINRA rule filing. This letter is to follow up on our conversation and supplement our August 24, 2011 comment letter on the proposal.[2] Except with respect to Section II of this letter, "Transmission of Statements to Other Persons or Entities," through which we revise our comments regarding proposed Supplementary Material .02 of Rule 2231, we wish to reiterate all of our comments from the August 2011 Letter, as if repeated verbatim herein. In particular, we cannot overemphasize our point that FINRA should take this opportunity to clarify that member firms are not required to deliver account statements to an address known to be incorrect because it was returned to the member after two consecutive attempts to deliver, provided that firms follow the procedures otherwise applicable under abandoned property laws and any applicable requirements of SEC Rule 17Ad-17.

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[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

[2] *See* Letter to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, from James T. McHale, Managing Director and Associate General Counsel, SIFMA, dated August 24, 2011 (hereinafter "August 2011 Letter").

I. Exclusions for Passive Activity

As stated in our August 2011 Letter, SIFMA fully supports and appreciates the intent of FINRA's proposed exclusions from the monthly reporting obligation for certain passive activities enumerated in proposed Rule 2231(c)(2) and notes that these changes would help bring the Rule into better alignment with industry practices. We also noted, however, that FINRA did not propose to exclude "pre-authorized and regularly scheduled investments in and redemptions from registered investment companies *and related distributions* from the account (*e.g.*, required minimum distributions from certain tax qualified accounts)." Although Rule 10b-10(b) allows for the use of quarterly statements in lieu of trade-by-trade confirmations for certain securities transactions pursuant to "periodic plans" or "investment company plans," as defined in the Rule, any "related distribution" from the account would not appear to be covered by this provision. For example, in a situation where a customer requests periodic distributions from the sale of securities, the broker-dealer would have relief from sending clients trade-by-trade confirmations or monthly statements where the securities transactions are done pursuant to a periodic plan or investment company plan, but it appears the firm still would be required to send monthly statements to report the distribution of the *proceeds* of the sale to the client, even though such distributions were also part of the client's instructions.[3] In other words, the reporting of these "related distributions from the account" may not effectively be pre-empted by Rule 10b-10(b), thus necessitating the last category of relief requested in our August 2011 Letter in order for the firm to send statements on a quarterly basis with respect to that activity.

II. Transmission of Statements to Other Persons or Entities

Proposed Supplementary Material .02, Transmission of Customer Account Statements to Other Persons or Entities, provides that "[e]xcept as required to comply with NASD Rule 3050 and Incorporated NYSE Rule 407, a member may not address and/or send account statements or other communications relating to a customer's account to other persons or entities, unless (a) the customer has provided written instructions to the member to send such statements or communications to such person or entity; *and* (b) the member continues to send such statements or communications, monthly or quarterly as applicable in accordance with this Rule, directly to the customer either in paper format or electronically as provided in Supplementary Material .03 below." (Emphasis added.)

Although SIFMA appreciates that FINRA has clarified that members are not required to obtain the written consent of the customer before sending duplicate statements and other communications pursuant to NASD Rule 3050 and NYSE Rule 407, SIFMA believes this exception should be broadened under the same logic to permit members to send duplicates to an employer that is a Registered Investment Company or Registered Investment Adviser, both of which are also required to obtain this information about their associated persons' personal

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[3] Distribution of cash proceeds out of an account presumably would be viewed as "account activity," thus triggering the monthly statement delivery requirement of proposed FINRA Rule 2231(a).

securities dealings pursuant to Rule 17j-1 under the Investment Company Act of 1940 and the provisions of an investment adviser's code of ethics as required by Rule 204A-1 under the Investment Advisers Act of 1940, respectively.

In addition, as noted in our August 2011 Letter, SIFMA is very concerned about the impact of proposed Supplementary Material .02 (b), which was added through Amendment No. 1 to the proposal, and that would require members to continue to send account statements or other account communications to the customer directly, even when the customer has provided written instructions to send such account documentation to a third party. We believe that the approach of Incorporated NYSE Rule 409(b) has served both the investing public and the industry quite well and SIFMA is unaware of any problems in this area that would justify such a substantial and costly expansion of account statement delivery obligations. The cost burdens associated with this new requirement would be particularly severe for member firms where customers have not elected to receive electronic account communications.[4]

It appears that the proposed new requirement to obtain instruction from – and in all cases provide copies of statements to the underlying customer – is an attempt to align the requirements of the new FINRA rule with the SEC's position under Rule 10b-10 in connection with the use of an account statement in lieu of an immediate trade confirmation. Additionally, it appears that these more stringent requirements arise from a concern that the expansion of the application of Incorporated NYSE Rule 409(b) beyond situations where a non-member person holds power of attorney over a customer's account might result in some harm to the customer. For the reasons discussed below, SIFMA asserts that the first apparent rationale for these stringent requirements is unnecessary and the latter rationale can be controlled without the imposition of significant burdens and costs on clearing firms and in a manner that meets the needs of customers that have requested statements not be delivered to them directly.

FINRA has specifically stated in proposed Supplementary Material .01 that members remain subject to any conditions imposed by the SEC or its Staff relating to the delivery of periodic account statements in lieu of the delivery of immediate transaction confirmations. Generally, Rule 10b-10 requires that confirmations be sent to the customer herself or himself but there are circumstances under which the customer can direct that confirmations be sent to a third-party. However, the requirements under Rule 10b-10 are more restrictive than those under Incorporated NYSE Rule 409(b) related to customer account statements. In 1994, when the SEC adopted amendments to Rule 10b-10, the SEC noted the differences in the requirements between the

[4] We note that one firm estimates that 500,000 of 5 million (or 10%) of customer statements are sent to an address other than the legal address of record for the account. This same firm indicates that only 11% of the approximately 5 million accounts it custodies have opted to receive statements electronically. Accordingly, this new requirement could increase statement mailings by 89% for this 10% subset of accounts for both the monthly and quarterly statements cycle. This would translate to increased overall annual statement delivery costs of 8.9% (10% *89%). The firm with 5 million customer accounts sends an average of 34 million statements annually. Therefore, this would add an estimated additional 3 million statements per year, at an estimated additional cost of $2.3 million.

rules, but did not invalidate or "abrogate" the NYSE rule.[5] Rather, the Commission indicated that "substitution of quarterly statements for the immediate confirmation is optional. No broker-dealer is required in the first instance to include all relevant trade information in a quarterly statement"[6] but, if broker-dealers choose to substitute an account statement for an immediate confirmation by including the confirmation information on the statement, then the more stringent requirements of the Commission's policy under Rule 10b-10 would apply. The two "rules" have co-existed without conflict since 1994.

In one regard, however, proposed FINRA Rule 2231 goes beyond Incorporated NYSE Rule 409(b) by permitting the delivery of account statements to third-parties not holding a formal power of attorney for the customer, provided the customer has provided written instructions to the member to send statements to such person or entity and the member continues to deliver the statements directly to the customer. SIFMA agrees that the class of persons to whom delivery can be made should be expanded beyond those persons who have technical legal authority over the affairs of the customer. However, SIFMA does not agree that the best way to control for potential fraudulent activity that may be present when statements are delivered to someone other than the customer is to require statements also be sent to the customer in all instances. As we noted in our August 2011 Letter, imposing an obligation to send sensitive customer information to the customer's address in all cases may in fact increase the risk of breaches of customer confidentiality and worse yet potential fraudulent account activity. For example, an elderly customer living in a nursing home may wish to send account statements and information directly to his or her attorney, as opposed to the nursing home or other permanent residence. Similarly, member firms routinely receive requests from customers in foreign jurisdictions where mail delivery is not secure to send their statements to a trusted agent, in lieu of the customer's address.[7] Permitting the customer in these examples to suppress delivery of statements to his or

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[5] *See generally* Securities Exchange Act Release No. 34962 (November 10, 1994), 59 FR 59612 (November 17, 1994).

[6] *Id* at note 36.

[7] We note that this aspect of FINRA Statements proposal has the potential to intersect with FINRA's Supervision rule proposal, which had been filed with the SEC last year for approval, but was later withdrawn. *See* Securities Exchange Act Release No. 65477 (October 4, 2011), 76 FR 62890 (October 11, 2011). Specifically, in jurisdictions where mail delivery is not secure and poses security concerns for the customer, the customer often will appoint a local agent to receive his or her mail. Though cited as an acceptable reason for a "hold mail" request in Proposed Rule 3150, these arrangements are not by definition "hold mail" arrangements as the mail is actually delivered to the customer's agent as requested, for further delivery to the client. We note that, while such parties represent trusted "locations" for receipt of mail (as evidenced by the client instruction), such parties do not generally hold a power of attorney ("POA") over the account. We maintain that such arrangements should be permitted with written customer instruction as it would pose substantial issues in terms of managing customer expectations, as well as posing substantial implementation challenges if such arrangements could only be established under a formal POA arrangement. If a customer instruction to hold mail for an acceptable reason is enough to suppress the delivery of statements entirely, a similar instruction by a customer to deliver mail directly to a third-party for legitimate and acceptable reasons should also be sufficient. Under such circumstances as described in the example, requiring that duplicates be sent to the account holder would, in most instances, frustrate the purposes underlying the customer's instruction.

her address of record would enhance security of the account by greatly reducing the possibility that the account information would be intercepted by an unknown third party.

SIFMA believes that a customer should be able to designate any third party to receive account statements in lieu of the customer receiving them directly, so long as member firms have reasonable controls around such delivery. The appropriate controls should be different for written designations that are specific to the delivery of account statements and those that are more generally authorized through the operation of a legal document such as a power of attorney or a court order of guardianship or conservatorship. In many cases, such legal authority as exists under a power of attorney is not even exercised until such time as the customer can no longer act for him or herself. Member firms should be able to rely on the authority granted in such legal documents to deliver account statements directly to the person holding the power of attorney and not to the customer, yet Proposed Rule 2231 as currently drafted would appear to require that the customer himself provide such instruction in writing to the member firm in all cases. SIFMA also believes that such designations to deliver account statements to third parties do not always need to be made in writing, but agrees that controls should be different for written and oral delivery instructions. Such controls should be consistent with those required under FINRA Rule 3012 with regard to the processing of customer address changes.

Finally, SIFMA is concerned that the phrase "other communications relating to a customer's account" is overly broad. This language could encompass myriad operational communications with third parties (such as custodians, issuers and transfer agents, counterparties to trades, banks in connection with disbursement and deposits and a member firm's own vendors) where firms need to send "communications" about a customer's account in order to provide the services requested for the customer. Members, of course, are permitted as a privacy matter to engage in these types of communications without specific authorization from the customer for each communication. SIFMA does not believe that FINRA intends to capture these types of communications, and, therefore, respectfully requests that FINRA strike from the proposed Rule the phrase "or other communications relating to a customer's account," as well as the two other references to "other communications" in proposed Supplementary Material .02.

Accordingly, in light of the above comments, SIFMA respectfully requests that FINRA revise Supplementary Material .02 to read as follows:

> "Except as required to comply with NASD Rule 3050, Incorporated NYSE Rule 407, Rule 17j-1 under the Investment Company Act of 1940, and the provisions of an investment adviser's code of ethics as required by Rule 204A-1 under the Investment Advisers Act of 1940, a member may not address or send account statements to other persons or entities, unless (a) the customer has provided written instructions to the member to send such statements to such person or entity; or (b) the member continues to send such statements, monthly or quarterly as applicable in accordance with this Rule, directly to the customer either in paper format or electronically as provided in Supplementary Material .03 below. The "written instructions" referred to in Supplementary Material .02(a) above need not be addressed specifically to the member

> firm, but may be provided for generally pursuant to a power of attorney (other than to a member or a member's associated persons) or court order. When a member relies upon Supplementary Material .02(b) above to send statements to other persons or entities, the member must adhere to all applicable privacy requirements under state and federal law and implement reasonable controls, consistent with NASD Rule 3012(a)(2)(B)(ii), for notification to the customer that statements are being sent to a third party, such as by indicating this fact on the duplicate statements that are delivered to the customer."

These simple changes would permit member firms to continue to honor the requests of their customers to direct account communications to a trusted adviser or attorney-in-fact and avoid the additional costs and potential account security concerns associated with sending account communications to the customer's address of record, even when the customer has designated a third party to receive them.

However, if FINRA proceeds with seeking approval for Supplementary Material .02 as proposed without change from that filed in Amendment No. 1 to this rule filing, SIFMA strongly urges FINRA to make clear that the Rule only has prospective application and does not apply retroactively, thereby permitting firms to continue to rely on oral instructions provided by customers under the current regulatory regime prior to the Rule's effective date. This would avoid the burdensome exercise of reviewing and "remediating" existing accounts for which written instructions to address account statements and other account communications to a third party may not have been received, or for which duplicate statements are not sent to customers who have provided written instructions that their statements be sent to third parties in their place, both in reliance upon and in accordance with Incorporated NYSE Rule 409(b). SIFMA firmly believes that imposing such a regulatory cost on member firms is not warranted in this case where no evidence has been presented that the current regulatory regime has been anything less than effective.

III. <u>Employee Retirement Plans</u>

During our conference call, one of the SEC staff members asked about ERISA coverage, the different types of employee retirement plans, and the frequency requirements for the sending of account statements to plan participants. The following information is by no means a comprehensive analysis of ERISA or the noted retirement plans, but hopefully will be helpful to you and your colleagues as you consider the FINRA Account Statement proposal.

ERISA Coverage

ERISA generally covers plans established by private employers. ERISA specifically excludes certain types of plans, including:

- Government sponsored plans

- Plans offered by churches that do not elect to be covered by ERISA

- Tax deferred annuity plans under Internal Revenue Code ("IRC") section 403(b) where there is minimal employer involvement. These plans allow only employee elective deferrals and are, in effect, payroll practices that the DOL does not consider plans for purposes of ERISA.

Plan Types

The following outlines the plan types discussed in the proposed "employer sponsored retirement plan" exclusion from our August 2011 Letter:

1. <u>401(a) and (k) Plans</u>. IRC section 401(a) plans can be sponsored by private employers, churches or governmental employers. 401(k) plans are a specific type of defined contribution 401(a) plan. Government entities can no longer sponsor a 401(k) plan, but may continue to sponsor such plans enacted before the change in the law. Private employer and grandfathered government entity sponsored 401(k) plans are subject to ERISA.

2. <u>403(b) Plans</u>. IRC section 403(b) plans are sponsored by private IRC section 501(c)(3) organizations and governmental public education organizations. The plans may be subject to ERISA if the sponsor is a private entity.

3. <u>457 Governmental Plans</u>. 457(b) and (f) plans are sponsored by government and tax-exempt entities. Government 457(b) and (f) plans are exempt from ERISA. 457(b) and (f) plans sponsored by tax-exempt organizations are generally subject to ERISA but are usually structured to be exempt from most of ERISA's substantive provisions.

4. <u>408(k) (SEP) and 408(p) (SIMPLE) IRA Plans</u>. These plans are sponsored by private employers and government entities. 408(k) and 408(p) plans sponsored by government entities are not subject to ERISA. 408(k) and 408(p) plans sponsored by private entities are generally subject to ERISA, but exempt from many of ERISA's substantive and reporting and disclosure requirements.

5. <u>415(m) Plans</u>. These plans are sponsored by government entities and are, therefore, exempt from ERISA.

6. <u>Deferred compensation plans offered by taxable private employers</u>. These plans offered by private employers are generally subject to ERISA but are usually structured to be exempt from most of the substantive and reporting and disclosure requirements of ERISA.

We believe a quarterly reporting structure is used by both ERISA and ERISA exempt plans. We are unaware of any requirements covering ERISA exempt plans that would require a more frequent reporting basis than quarterly. We reiterate the importance of a standardized quarterly reporting approach under FINRA rules for both recurring and non-recurring transactions in employer sponsored retirement plan accounts. This relief is necessary not only to conform to current industry practice, but also to avoid a confusing reporting regime where quarterly statements are received for transactions subject to Rule 10b-10(b) and monthly statements are received for non-recurring transactions, such as would be the case for allocation changes among plan investment options. A quarterly statement that provides a holistic view of the activity in the plan participant's account combined with immediate confirmation of transactions not subject to Rule 10b-10(b) makes for a straightforward informative communication regime that more easily lends itself to customer identification of discrepancies in the customer account.

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We appreciate the opportunity to submit our supplemental comments regarding FINRA's proposal. Should you have any questions, please feel free to contact me at (202) 962-7386 or jmchale@sifma.org.

Sincerely,

Managing Director and
Associate General Counsel

cc:

Mr. Marc Menchel, FINRA
Ms. Patrice Gliniecki, FINRA
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