August 30, 2010

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

Re:File Number SR-FINRA-2010-034
Comments to FINRA Proposed Rule 4530 (Reporting Requirements)

Dear. Ms. Murphy:

Introduction

The National Society of Compliance Professionals ("NSCP") appreciates the opportunity to comment on FINRA's Proposed Rule 4530 regarding reporting requirements. The NSCP is the largest organization in the securities industry serving compliance professionals exclusively through education, certification (CSCP), publications, consultation forums, and regulatory advocacy. Since its founding in 1987, NSCP membership has grown to near 1,800 members including compliance professionals at broker-dealers, investment advisers, banks, insurance and investment companies, and hedge funds.

As reflected in its Code of Conduct and its educational and advocacy efforts on behalf of compliance professionals, the NSCP's membership shares the SEC and FINRA's goals that compliance professionals at member firms promote appropriate systems of supervision and control which, in turn, foster investor protection and public confidence in the marketplace. The NSCP's Code of Ethics Standards of Professional Conduct and Guidance for Compliance Professionals (Section 3.2) (http://www.nscp.org/media/nscp-coe.pdf), is in accordance with the relevant FINRA and SEC principles regarding supervision and a culture of compliance:

> *Compliance Professionals should encourage their firms to create and implement appropriate systems of supervision; assist their firms in the development and documenting of appropriate policies and procedures; participate in appropriate testing and monitoring of the systems of compliance; assist their firms in identifying and developing appropriate mechanisms for identifying, reporting, and responding to compliance issues; and strive to enhance the systems and culture of compliance at their firms.*

The NSCP appreciates the opportunity to comment on FINRA's Proposed Rule 4530 ("Proposed Rule"). NSCP previously commented on an earlier draft of the Proposed Rule which FINRA posted for comment in December 2008, pursuant to FINRA Regulatory Notice 08-71 (http://www.finra.org/Industry/Regulation/Notices/2008/P117455).

While we support the principles underlying the Proposed Rule and acknowledge FINRA's effort to modify certain language and provide supplemental material for the Proposed Rule that take into account comments received from NSCP and other commentators following FINRA's initial proposal, we nevertheless have serious concerns about the breadth of the language used, the lack of guidance as to its application and the administrative burden it will impose on many of our compliance officer members.

NSCP's Focus is on Issues for Compliance Professionals

NSCP supports the broad goals of recent financial reform efforts, in particular the goals of protecting retail investors and strengthening the safety and soundness of our financial markets. Nevertheless, in light of the diversity of its members as well as its special focus on encouraging the adoption of regulations that are carefully considered, appropriately focused, and accompanied by clear direction and guidance, NSCP must limit its comments to those that will most directly impact compliance professionals. For this reason, NSCP will not be commenting more generally on the merits of the various regulatory schemes under consideration by the SEC or the appropriate scope of regulation for broker-dealers as opposed to investment advisers.

Summary of Comments and Concerns

As discussed below, NSCP has concerns that FINRA has not provided sufficient guidance with respect to certain provisions of the Proposed Rule concerning a member firm's obligation to report:

- External events involving *"financial-related insurance civil litigation and arbitration"* (Proposed FINRA Rule 4530(a)(1)(A) and (G) and 4530(f))

- External events involving *"any claim for damage by a customer, broker or dealer that is financial or transactional in nature"* (Proposed FINRA Rule 4530(a)(1)(A) and(G))

- Internal conclusions ("Internal Conclusions") that an associated person or the member itself has violated any of the securities, commodities and other enumerated laws, rules, regulations or standards of conduct of a domestic or foreign self regulatory organization, including circumstances where the member concluded or *"reasonably should have concluded"* such a violation had taken place (Proposed FINRA Rule 4530(b))

With regard to reporting Internal Conclusions, we are concerned that FINRA has offered little guidance with respect to the kinds of internally discovered situations member firms need to report or exclude, apart from those already mandated under pre-existing reporting requirements.

In particular, we are concerned with how narrow the exclusionary language is that is set forth in proposed Supplemental Material 4530.01, that

> *FINRA does not expect members to report an isolated violation by the member or an associated person of the member that can be reasonably viewed as a ministerial violation of the applicable rules that did not result in customer harm and was remedied promptly upon discovery.*

Further, FINRA's suggestion in the commentary accompanying the Proposed Rule that member firms treat internal audit findings as presumptively reportable under Proposed Rule 4530(b), has the potential to undermine the internal audit process and risks the unintended consequence that member firms may over-report unrefined material or may become less self-critical in their assessment of their operations, resulting in conflict with FINRA's goal that member firms vigorously test and remediate their own activities, whenever necessary.

We also believe that without further qualification, the language of the Proposed Rule may lead firms to report immaterial external events about insurance matters related to the member firm and information about associated persons of no or little consequence to FINRA, such as de minimus fines by state insurance regulators involving ministerial oversights; such events could be deemed to be within the scope of certain terms used in the Proposed Rule.

In addition, we believe the Proposed Rule, if approved by the SEC without further clarification and guidance, will substantially increase the administrative burden on FINRA members, absorbing scarce compliance resources better spent on addressing substantive issues more central to the establishment of sound supervision and compliance. In that regard, we believe that FINRA and the SEC have underestimated the practical difficulties involved in administering the Proposed Rule as written, particularly for small firms and those with non-securities business affiliates such as banks and insurance companies, many of whose employees and agents may also be registered as associated persons of the member firm affiliate.

As presently crafted, the Proposed Rule may also lead to inconsistent and subjective practices among member firms and could well inundate FINRA with voluminous and irrelevant information which may tax FINRA's limited resources. Rather than facilitate FINRA's desire to inquire into issues, that would otherwise be overlooked under current reporting requirements, we question whether the lack of clear guidelines or reasonable exceptions might lead FINRA to receive large amounts of unfiltered data, reported by member firms in an excess of caution to avoid non-compliance. It would seem that such an outcome would frustrate rather than further the goals intended by the Proposed Rule.

Accordingly, we urge FINRA and the SEC to reconsider whether the "belt and suspenders" approach to the language in the Proposed Rule is really necessary and to provide more guidance in the Supplemental Material to the Proposed Rule, including a listing of the objective factors a firm should consider in evaluating what matters, external or internal, it should report. In addition, we urge FINRA and the SEC to provide additional examples of the kinds of external

and internal events FINRA expects its members to report (or exclude) about their firms and their associated persons, so that members can enhance their existing processes to comply with FINRA's reporting rules and provide meaningful information.

We discuss below certain provisions of the Proposed Rule that are of particular concern.

External Events Involving "Financial-Related Insurance" Litigation and Arbitration

FINRA proposes that sections 4530(a)(G) and 4530(f)(2) and (3) of the Proposed Rule provide that a member file reports and certain materials (e.g., civil complaints or arbitration claims) where the member firm or a person associated with the member is a defendant or respondent in *"any financial-related insurance civil litigation or arbitration."* In addition, section 4530(a)(1)(A) of the Proposed Rule provides that a member report circumstances where a member or a person associated with a member *"has been found to have violated any …**insurance**…laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, self-regulatory organization or business or professional organization"* (emphasis added).[1]

In response to the concerns expressed by NSCP and others about the breadth of this provision, FINRA modified its original proposed language that members file reports concerning litigation or arbitration claims involving *"insurance,"* by adding the phrase *"any financial-related insurance…"* to proposed sections 4530(a)(7) and 4530(f). FINRA did not modify the proposed

[1] Section 4530(a)(1)(A) of the Proposed Rule also provides that member firms report findings by the entities identified in the text above as to the member or an associated person where the violation relates to any ***"financial or investment related"*** law, rule, regulation or standard of conduct. Similarly, section 4530(a)(7) provides that a member firm report any civil litigation or arbitration claim where the member firm or associated person is "*the subject of any claim for damages by a customer, broker or dealer **that is financial or transactional in nature**"* (emphasis added).

Neither existing NASD Rule 3070 nor NYSE Rule 351 (the rules from which the Proposed Rule is derived) contains similar language. The Proposed Rule and commentary do not define what the phrases "financial or investment related" or "financial or transactional in nature" actually mean. The Supplemental Material for the Proposed Rule, the Form 19b-4 filing made on behalf of FINRA as to the Proposed Rule ("Form 19b-4 Filing"), and the original Regulatory Notice 08-71 proposing adoption of a Proposed Rule 4530 (November 2008), contain little commentary as to what FINRA intends by the inclusion of these phrases. Specifically, as to the highlighted language proposed in section 4530(a)(7), the Form 19b-4 Filing (at p. 7) states only that "*FINRA believes that transactional claims by customers, including contractual disputes, are relevant to its programs since they may reveal misconduct, such as an impermissible customer loan."*

Without guidance as to what is intended, or how member firms might identify events FINRA expects to be covered, the highlighted phrases are too vague to be administered with any consistency across the member firm population. Accordingly, we recommend that such language further qualified, e.g., to relate to securities activities, or that it be deleted wherever it appears in the Proposed Rule, particularly in light of the otherwise extensive amendments to the relevant sections, including the amended language that requires reporting of violations or allegations with respect to any securities or commodities laws, rules, regulations or standards of conduct.

language of section 4530(a)(1)(A), however, that a member report any findings of violations under *"insurance… laws, rules and regulations…."*

FINRA offered the following discussion about the modification and its rejection of several suggestions for further modifications in its Form 19b-4 Filing (at p. X):

> *As originally proposed in Regulatory Notice 08-71, the rule required members to report any insurance-related civil litigation or arbitration. The purpose of this proposed change was to make the provision consistent with other provisions of NASD Rule 3070 and NYSE Rule 351 that require the reporting of regulatory matters relating to insurance. Several commenters argued that the proposed requirement will result in voluminous reporting regarding insurance matters completely unrelated to securities activities (e.g., auto and health). In response, FINRA has revised the proposed rule to require the reporting of any "insurance" civil litigation or arbitration that is "financial related."*

Elsewhere in its Form 19b-4 Filing (at p. 7), FINRA discussed the modified language, without addressing commentators' concerns that the *reasons* for such a change were not at all clear:

> *In addition, the proposed rule extends the provision relating to civil litigation or arbitration matters to include the reporting of any "insurance" civil litigation or arbitration that is "financial related." Further, the proposed rule clarifies that firms are required to report any claim for damages by a customer or broker-dealer that is "financial" or "transactional" in nature. FINRA believes that transactional claims by customers, including contractual disputes, are relevant to its programs since they may reveal misconduct, such as an impermissible customer loan.*

Respectfully, FINRA's statement that the amended language *"clarifies"* what members are expected to report, without explaining why or how, or what kind of "contractual disputes" or other events FINRA thinks are relevant, does not answer the questions posed by commentators to the Proposed Rule. Moreover, even if FINRA might find it relevant to know that an associated person may have been alleged by a customer, in another context, to have offered *"an impermissible customer loan"* (the one example offered to illustrate why the change should be made), the Proposed Rule provides no guidance as to how a member firm could identify such information systematically. Where, as here, the only example cited relates to a transaction which may well be within the province of another regulator to address, FINRA's failure to consider the administrative burden placed on member firms by the Proposed Rule warrants consideration.[2]

[2] Although FINRA's Form 19b-4 Filing acknowledges that the Proposed Rule is only directed at member firms and persons associated with the member—and not affiliated entities or persons not subject to FINRA jurisdiction—it is concerning that FINRA expects to collect information about activities and transactions outside the scope of their authority to regulate.

While the proposed modification is clearly intended to narrow the original language, it does not address our (and others) concerns that FINRA is painting with far too broad a brush. We respectfully submit that implicitly excluding auto or health insurance related litigation or claims and providing no clarification of what FINRA intends the phrase *"financial related"* insurance matters to mean, is of little practical use to any member firm whose activities, affiliates, or associated persons include insurance related activities.

Administration of this provision of the Proposed Rule also raises several practical concerns which FINRA does not address. Moreover, FINRA does not appear to have considered whether the burden of distilling that information from reams of irrelevant data that might otherwise have to be collected for hundreds or even thousands of associated persons within a member firm, in order to extract and report some information, justifies such a requirement. While the volume of potential exceptions that small member firms would have to review for potential reporting would likely be far less than that generated within large firms, the burden on such small firms, which frequently have small compliance staffs, would be significant.

First, how would a member firm establish a system to collect information about events potentially within the purview of the proposed language and then exclude those which are not "*financial related?"* Is any finding that includes a financial component, and every claim that seeks a financial remedy, within the scope of the Proposed Rule? If not, how would a member firm differentiate those items FINRA does not expect to be reported from those FINRA does want to know about? How will FINRA manage the data it receives under this provision and what resources will it devote to extracting the relevant material from the extraneous? Is such an exercise, without an explanation as to the regulatory gap it purports to address, the best use of FINRA's own somewhat constrained resources?

For the foregoing reasons and notwithstanding the modifications already made by FINRA in the wake of comments to the original language proposed in Regulatory Notice 08-71, we remain concerned that these modifications and the accompanying commentary in the Form 19b-4 Filing do not offer sufficient clarity to enable member firms to effectively identify and report those matters truly relevant to FINRA. In particular, we encourage FINRA and the SEC to consider further qualifications in the text of the Proposed Rule, such as allowing member firms to exclude litigation, arbitration claims and other claims that do not involve securities activities. We also urge FINRA to provide additional guidance and examples in the Supplemental Material for the Proposed Rule as to what it reasonably expects member firms to identify and report.

Internal Conclusions of Wrongdoing Subject to Self-Reporting

FINRA proposes section 4530(b) of the Proposed Rule provides that a member self-report wrongdoing:

> *after the member has concluded or* ***reasonably should have concluded*** *that an associated person of the member or the member itself has violated any securities,*

> *insurance, commodities, financial or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization (emphasis added).*

It is clear FINRA expects member firms to self-report instances in which wrongdoing has surfaced *internally* which are not otherwise reportable under section 4530(a) of the Proposed Rule, e.g., because they are the subject of a "finding" by some external source (like a regulator, court or arbitration forum) or a complaint, civil lawsuit or arbitration claim by a customer. The problem however, is that FINRA has not sufficiently articulated any objective standards in the Proposed Rule or provided adequate guidance so as to enable member firms uniformly to know what circumstances might dictate mandatory self-reporting.[3] Nor does any of the material accompanying its proposed adoption describe what Internal Conclusions member firms are failing to disclose. It is also unclear as to whether the existing practices have contributed to any situations in which FINRA has been disabled from learning about and addressing serious wrongdoing by a member firm or associated person.[4]

In the absence of compelling justification by FINRA for more expansive self-reporting (given the unclear factual predicate for FINRA to seek more expansive self-reporting), it is important to analyze the language of the Proposed Rule carefully, particularly where, as we and many other commentators have expressed, the burden of compliance is high. NSCP respectfully submits that

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[3] Clearly, a compelling incentive already exists for member firms to self-report wrongdoing or other problematic circumstances which might be violative or about which FINRA might want to inquire. Conversely, FINRA has been patently clear that a member firm's failure to remedy and disclose a significant issue which has come to management's attention and which contributed to customer harm or seriously impaired a member firm's financial and operational responsibilities to FINRA, will have adverse consequences and be deemed an aggravating factor if FINRA concludes that there has been a violation of its rules or those of the SEC which it enforces against its members and associated persons. See e.g., FINRA Regulatory Notice 08-70 (November 2008)

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117452.pdf;

NYSE Information Memo 05-65 (September 14, 2005).

NSCP members support the principle that self-reporting and remediation should mitigate how FINRA addresses facts it concludes are violative. Our concerns with respect to the Proposed Rule however, are what standards are to be applied and how member firms can adopt the kind of systematic process necessary to comply with a mandatory reporting rule. For the reasons discussed in the text, we think the Proposed Rule as currently drafted is too vague and ambiguous to be administered properly.

[4] Of course, member firms have multiple reporting obligations to FINRA and other regulators such as the SEC with which FINRA consults, and already call for much of the objective information sought under the Proposed Rule. Examples include the litigation and arbitration claims discussed elsewhere; the circumstances related to when an employee is terminated for cause or allowed to resign,; the fact and reasons why an employee is disciplined within the proscribed terms of Proposed Rule 4530(a); where a firm detects some suspicious activity as defined under applicable anti-money laundering regulations; where a firm discovers it is out of compliance with certain net capital or other operational requirements, etc. Although it appears as if the purpose of proposed section 4530(b) is to ***supplement*** those pre-existing reporting requirements, FINRA does not address why or how these current reporting obligations are deficient.

a careful reading of the text of the Proposed Rule and all of the accompanying material, does not adequately explain precisely what must be reported or why.

The Supplemental Material pertaining to the reporting of Internal Conclusions under the Proposed Rule does not define what FINRA intends with the word *"concluded"* to mean in the context of the Proposed Rule, or who within a member organization must have *"concluded"* one of the enumerated violations that occurred. Furthermore, there is no discussion as to why FINRA added the disjunctive phrase "*reasonably should have concluded"* a violation occurred. We have grave concerns that such language could be used on a hindsight basis for FINRA to pursue a member firm or its compliance or managerial personnel, if FINRA concludes after the fact that it believes a member should have self-reported even if the member came to a contrary conclusion.[5]

The Supplemental Material at 4530.01 & .02 to the Proposed Rule offers the following guidance:

> *FINRA does not expect a member to report an isolated violation by the member or an associated person…that can reasonably be viewed as a ministerial violation of the applicable rules that did not result in customer harm and was remedied promptly upon discovery.*
>
> [Such self reporting] *is limited to situations where the member has concluded or reasonably should have concluded on its own that violative conduct has occurred.*[6]

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[5] In response to a commentator's suggestion that the requirement "be limited to conclusions reached at a senior level," FINRA did not explain what it meant by "*concluded"* or "*reasonably should have concluded,"* stating instead (Form 19b-4 Filing (at p. 20), offers only the following:

> *FINRA believes that a firm is free to determine the level of seniority required of an associated person in making a determination of a reportable internal conclusion; however, it will not be a defense to a failure to report such conduct that it was of a nature that did not merit consideration by a person of such seniority.*

[6] In a footnote in the Form 19b-4 Filing, FINRA offers the following with respect to the phrases *"concluded"* and *"reasonably should have concluded:"*

> *Proposed FINRA Rule 4530(b) was originally proposed as FINRA Rule 4530(a)(3) in Regulatory Notice 08-71 (discussed in Item II.C. of this filing). As discussed above, proposed FINRA Rule 4530(a) requires a firm to report an event after the firm "knows or should have known" of the existence of the event. To clarify the standard applicable to a firm's internal conclusion of violation, FINRA is proposing to re-designate paragraph (a)(3) as paragraph (b) of FINRA Rule 4530 and require a firm to report where it has concluded or reasonably should have concluded that the firm or an associated person has engaged in the enumerated violative conduct.*

While it may have made sense when re-drafting the Proposed Rule for FINRA to shift the provisions relating to self-reporting Internal Conclusions to section 4530(b), rather than retain in 4530(a), FINRA offers no explanation why it is proposing to substitute the *"knew or should have known"* language in 4530(a) with the language *"concluded or reasonably should have concluded"* now reflected in 4530(b). While the "knew or should have known" standard in the former 3070(a) was tethered to ten objectively verifiable events, the "concluded or reasonably should have concluded" standard in 4530(b) is linked only to a highly subjective obligation of a firm to determine whether a "violation" occurred. Thus member firms and compliance officers who may be charged with

We respectfully submit that the exception offered, i.e., a "*ministerial violation,"* conditional on both no customer harm and prompt remediation, is too unyielding to be useful, particularly in light of the fact that FINRA does not explain how or why it is critical to FINRA's mission to collect such information in the first instance. The relevant discussion in the Form 19b-4 Filing (at p. 9) offers little guidance:

> *Additionally, FINRA Rule 4530.01 excludes from the reporting requirement an isolated violation by the firm or an associated person of the firm that can be reasonably viewed as a ministerial violation of the applicable rules that did not result in customer harm and was remedied promptly upon discovery. Thus, for example, if a firm discovers a few corporate accounts that, due to a ministerial lapse, do not have a record identifying the person(s) authorized to transact business on behalf of the accounts and upon discovering the problem promptly updates the accounts with the required information, it would not be considered a reportable event for purposes of proposed FINRA Rule 4530(b). Conversely, if there is a wholesale failure by a firm to maintain such information, it would be considered a reportable event for purposes of the proposed rule.*

Although the foregoing provided an example at each end of the spectrum in terms of what FINRA expects a member ***not to report*** (a glitch affecting a *"few"* accounts) and ***to report*** (a *"wholesale failure"),* it is of little practical use. We respectfully submit that these examples do not grapple with the many situations in between these two poles that member firms encounter on a daily basis.

We therefore recommend FINRA and the SEC consider revising the proposed language in Supplemental Material 4530.01 as follows:

> *FINRA does not expect members to report an isolated violation by the member or an associated person of the member that can be reasonably viewed as a ministerial violation of the applicable rules <u>or</u> that did not result in customer harm <u>or</u> was remedied promptly upon discovery.*

We think stating these factors in the disjunctive, rather than requiring all three conditions to be met, is a reasonable approach. As evidenced in the numerous comment letters filed in response to Regulatory Notice 08-71 on the issue of self-reporting, significant concerns were expressed by NSCP and several other commentators about what kinds of matters FINRA expected member firms to self-report, and numerous questions were posed in the comment letters about what was reportable. In contrast to the two examples FINRA offers, the comment letters identified the real-world issues confronting member firms on a daily basis. Commentators fairly asked how such incidents should be treated. Without further examples or bright line factors that would enable

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administering the Proposed Rule at their firms have no insight as to whether a different standard exists as to self-reporting than with respect to external events.

member firms to develop a systematic way of addressing proposed section 4530(b), compliance is likely to lack the consistency across member firms FINRA hopes for under the Proposed Rule.

Although the Form 19b-4 Filing (at pp. 19-22) lists many of those concerns, FINRA appears to brush these concerns aside. While lengthy, FINRA's "response" to such concerns is disappointing, since it offers few objective guideposts for members to follow. In other respects, FINRA's language also contradicts the standards that member firms currently understand to be appropriate under existing regulatory guidance.

> *Several commenters believe that the proposed provisions are unnecessary, unduly burdensome, overly broad and costly. These commenters also argue that the provisions are vague and too subjective and that certain terms, such as "the member has concluded," "isolated" and "ministerial," need further clarification. For instance, one commenter asks whether internal conclusions that are equivalent to minor rule violations will have to be reported. One commenter recommends that the proposal exclude either a "ministerial" or "non-material" violation. One commenter suggests that the requirement be limited to those matters that result in "material customer harm." Another commenter recommends that the requirement be limited to matters that result in "customer harm." Some of these commenters also suggest that if FINRA opts to retain the proposed requirement, it adopt the reporting standard set forth in NYSE Information Memorandum 06-11, which provides that if a firm determines not to impose discipline against an individual, the firm need only report any recidivist or ongoing violative conduct by the individual. NYSE Information Memorandum 06-11 also provides that a firm need only report systemic firm failures involving numerous customers, multiple errors or significant dollar amounts, as well as violative conduct by the firm or its employees that has widespread or potential widespread impact to the firm, its customers or the industry.*
>
> *FINRA believes that the standard set forth in Information Memorandum 06-11 is too narrow. However, in response to the comments, FINRA has provided an example in Item II.A. of this filing of the types of reportable and non-reportable matters.*
>
> *With respect to settlements, it is not the fact that a firm has settled a matter that makes it a reportable event under FINRA Rule 4530(b), rather it is whether the firm has reached an internal conclusion or reasonably should have reached an internal conclusion that the firm or an associated person has engaged in the enumerated violative conduct. Regarding internal audit findings, FINRA believes that the existence of such findings creates a strong presumption that the matter is reportable, but that any particular finding is eligible to be viewed by the firm as non-reportable (i.e., an isolated, ministerial violation that did not result in customer harm and was remedied promptly upon discovery).*

> *Further, two commenters believe that matters subject to a firm's internal review process as required under other rules (e.g., FINRA Rule 3130 (Annual Certification of Compliance and Supervisory Processes) should be excluded from the proposed requirement. FINRA believes that firms have an obligation to meet each of their regulatory requirements (including the requirements of FINRA Rule 3130) and that the obligation to meet a regulatory requirement is not superseded based on compliance with other regulatory requirements.*
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> *Additionally, some commenters suggest that the proposed requirement may have a chilling effect on a firm's willingness to reach such conclusions or that reporting such information, which may lack qualified or total immunity, may result in defamation suits. Without opining on the issues raised by these commenters, FINRA questions the collateral effects posited by the commenters given the use of the information for FINRA internal examination and enforcement purposes and that, in any event, FINRA believes that the goals of customer protection and market integrity necessitate the reporting of such conduct to FINRA.*

For several reasons, we respectfully submit that the foregoing justification by FINRA in the Form 19b-4 Filing be carefully re-examined before adoption of the Proposed Rule in its current form.

First, FINRA's response does nothing to address concerns that the language of the Proposed Rule is too vague for member firms to understand what they are being asked to do.

Second, while FINRA disclaims the guidance set forth in NYSE *Information Memorandum* 06-11 as "*too narrow,*" it offers no alternative. [Nor does it explain what member firms failed to report under NYSE IM 06-11 so as to undermine its utility.]

Third, the proposition that member firms should consider internal audit findings as presumptively reportable turns the internal audit process on its head. A robust and candid internal audit process is a critical component of effective supervision and control. While it may be true that some audit findings, upon further review, may rise to the level of a violation of law, rule or regulation significant enough to be called to the attention of FINRA, the notion that the hundreds (and for some firms, thousands) of items representing the output routinely generated by internal audits be self-reported is quite startling.

Moreover, requiring member firms to self-report audit findings routinely would be counterproductive, completely undermining the value that such self-critical analysis and remediation brings to the supervision and control process. Similarly, requiring member firms to treat items identified during the FINRA Rule 3130 certification process as presumptively reportable, is likely to have an equally chilling effect on the self-critical analysis FINRA has sought members to engage in as part of the Rule 3130 process.

We respectfully submit that FINRA has offered nothing in the materials relating to expanded self-reporting under section 4530(b) of the Proposed Rule to support the proposition that more extensive ***mandatory*** self-reporting will lead to enhanced compliance, address any regulatory gap FINRA has not been able to close, or even provide fruitful information that might lead to inquiries FINRA has been disabled from conducting because it lacks essential information about potential wrongdoing. To affirm only as FINRA does that "*FINRA believes that the goals of customer protection and market integrity necessitate the reporting of such conduct to FINRA,"* seems an inadequate justification for a process as burdensome as the Proposed Rule is likely to become to member firms.

Conclusion

The integrity of the rule-making process rests on a rigorous and candid debate that flows from the notice and comment process. We respectfully submit that FINRA has not truly grappled with the fundamental questions raised by NSCP and other commentators.

The critical questions we believe must be answered before the Proposed Rule should be adopted are as follows.

- What purpose do the proposed amendments play that the existing rules (NASD 3070 and NYSE 351) do not address?

- What is it that FINRA expects its members to do so as to achieve compliance with the Proposed Rule if adopted?

- Why do the benefits FINRA expects to flow from the information provided outweigh the burdens it will clearly impose on its members?

For the reasons expressed above, NSCP submits that FINRA has not adequately answered these questions and should be asked to do so by the SEC prior to adoption of the Proposed Rule as currently drafted.

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NSCP appreciates the opportunity to provide comments on FINRA's Proposed Rule 4530 and hopes you find our comments useful. NSCP would be pleased to assist FINRA and the SEC in any way that it can going forward. Questions regarding our comments or requests for additional information should be directed to the undersigned at 860.672.0843.

Thank you in advance for your kind consideration.

Sincerely yours,

Joan Hinchman
Executive Director, President and CEO
NSCP

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