September 1, 2010

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

Re: Release No. 34-62621; File No. SR-FINRA-2010-34; Proposed Amendments to FINRA Reporting Requirements

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the referenced proposal, in which FINRA seeks the Securities and Exchange Commission's ("SEC") approval to adopt FINRA Rule 4530 and related Supplementary Material governing member firms' reporting obligations.[2] Proposed FINRA Rule 4530 effectively would replace existing NASD Rule 3070 and Incorporated NYSE Rule 351. Although SIFMA has a number of concerns with the Proposal, the substance of which we raised previously in response to *Regulatory Notice* 08-71 (the "Notice"), we are particularly concerned by an entirely new proposed standard applicable to member firms' reporting of internal conclusions, which was not proposed as part of the Notice. We also believe FINRA should provide additional examples of the application of the self-reporting exception for "isolated, ministerial violations" and should create a *de*

[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] Securities Exchange Act Release No. 62621 (July 30, 2010), 75 *Federal Register* 47863 (August 9, 2010) (hereinafter, the "Proposal").

minimus exception for such reporting generally. Finally, we wish to renew our earlier recommendation that FINRA should completely eliminate the duplicative reporting required under proposed Rule 4530(e) and Forms U4, U5 and BD.

I. Reporting Internal Conclusions – A Flawed Standard

SIFMA is seriously concerned that proposed FINRA Rule 4530(b) significantly departs from existing requirements by requiring firms to report "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 ours.) We strongly believe that a requirement to report internal findings of a firm should only exist if a firm ***has concluded*** that it or an associated person has violated the applicable laws, rules, regulations or standards of conduct noted above, consistent with the existing requirement under NYSE Rule 351.

In the context of a firm's internal findings, the "*reasonably should have concluded*" standard is far too subjective and would be subject to inconsistent application by member firms and FINRA alike. A reading of existing NASD Rule 3070 makes clear that the matters subject to reporting under that Rule generally are triggered by the actions of a third party or by the occurrence of an objective, knowable event (*e.g.*, certain types of customer complaints, being named as a defendant or respondent in certain proceedings, or the settlement of certain claims).[3] The "*should have known*" standard makes sense in these contexts, where the reportable events are objective facts. Such language, however, does not fit logically in the context of a member's internal "findings," which are often highly subjective interpretations. Applying this standard also would raise such difficult interpretive questions as to the precise date when a member should have discovered a violation that went undetected. As a result, it is highly unlikely that the standard would be applied consistently across member firms and quite conceivably among the FINRA staff themselves.[4]

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[3] *See* NASD Rule 3070(a)(2), (3), (7) and (8).

[4] We note that industry comment was never directly solicited regarding this new standard for reporting internal conclusions. When FINRA initially sought comment on proposed Rule 4530, it indicated that it was "based in large part on NASD Rule 3070, taking into account NYSE Rule 351." However, it should be noted that NASD Rule 3070 does not have, and to our knowledge never has had, a requirement to report internal conclusions of a member firm. While NYSE Rule 351 does require reporting of internal conclusions, it does not include a "*should have known*" or "*reasonably should have concluded*" standard. Until FINRA filed the Proposal with the SEC, it was clear that FINRA intended to incorporate the NYSE requirement into Rule 4530 without grafting on a "*should have known*" or "*should have reasonably concluded*" standard. Both the Notice and rule text published along with the Notice included only a requirement to report when a (…continued)

Finally, SIFMA is concerned that this standard could be used on a hindsight basis for FINRA to pursue member firms or their personnel, if FINRA concluded, after the fact, that a member firm should have self-reported even if the member came to a contrary conclusion.

For the above reasons, SIFMA respectfully requests that FINRA amend the Proposal to remove the "*reasonably should have concluded*" language from proposed Rule 4530(b).

II. Ministerial Violation Exception – Clearer Guidance Needed

As stated in many of the comment letters filed in response to the Notice on the issue of self-reporting, significant concerns and numerous questions were raised by SIFMA and others about what kinds of matters FINRA expected member firms to self-report. SIFMA continues to believe that proposed Rule 4530(b) and Supplementary Material .01 together provide insufficient guidance on what matters are reportable and that FINRA should provide a number of examples or bright-line factors in the Rule or Supplementary Material itself. In addition, SIFMA believes that FINRA should adopt a *de minimus* reporting exception, based on the nature and magnitude of the matter to be reported in relation to a member firm's overall size and business.

In this regard, SIFMA generally supports the approach advocated by the National Society of Compliance Professionals ("NSCP") in their comment letter on this Proposal.[5] SIFMA recommends that FINRA and the SEC consider revising the language in proposed Supplementary Material .01 to Rule 4530 as follows:

> *FINRA does not expect a member 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* ***or*** *that did not result in customer harm* ***or*** *that is de minimus, when considered in the context of a firm's overall size and business.*

As noted by NSCP, we believe that stating these factors in the disjunctive, rather than requiring all three conditions to be met, is a reasonable approach. Our proposed language differs from that of NSCP's proposed language only in that we believe a *de minimus* exception should apply in lieu of an exception for violations that are remedied promptly

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(continued…)

firm "has concluded" that it violated the applicable legal requirements. Without any detailed justification for this significant change, FINRA inserted into the Proposal the "reasonably should have concluded" language.

[5] *See* Letter from Joan Hinchman, Executive Director, President and CEO, NSCP to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated August 30, 2010.

upon discovery. We understand that FINRA may well have an interest in learning about significant violations even if promptly resolved.

III. Reporting of Audit and Internal Control Findings – A Chilling Effect

SIFMA is also concerned with statements in FINRA's rule filing regarding the potential reporting of internal audit and internal controls program findings. Specifically, in response to comments on the Notice, FINRA states in the Proposal that the existence of an internal audit finding "creates a strong presumption that the matter is reportable" and that matters subject to the firm's internal control processes under FINRA Rule 3130 are also subject to being reported as internal findings under Rule 4530(b).[6]

SIFMA believes that the "strong presumption" posited by FINRA could significantly impede a firm's ability to diagnose the cause of a problem transparently and to self-correct. To the extent a firm becomes aware of a potential issue through its control processes, we submit that prudent public policy would support a firm's management having the benefit of (i) candid, transparent escalation of an issue, (ii) thoroughly evaluating the facts and any corrective action, and (iii) considering the matter's impact, all *before* reaching a conclusion that a violation has occurred warranting a report.

Furthermore, in the event FINRA were to construe the obligation as having been "discovered" at the time of an exception report, a firm would be unable to have completed a meaningful self-evaluation of the facts within the 30-day time frame proposed in the Rule. Requiring a report within 30 days under these circumstances would subject a firm to FINRA scrutiny before the firm has even had an opportunity to remediate the situation, a result fundamentally at odds with the view that the compliance function within FINRA member firms should be the first line of defense.

Finally, we note that requiring firms to report findings that stem from these programs may prompt some firms to dilute their internal audit and internal control findings. This surely would not be in the public interest.

Accordingly, SIFMA requests that FINRA amend its rule filing to withdraw or clarify these statements regarding the reporting of internal audit and internal controls program findings.

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[6] Proposal at 47867.

IV. Duplicative Reporting Obligations – Proposed Rule 4530(e)

Finally, SIFMA is concerned that FINRA has only partially addressed the duplicative reporting obligations under proposed Rule 4350, on the one hand, and Forms U4, U5, and BD, on the other. In the Notice, FINRA proposed to require members to report pursuant to Rule 4530, regardless of whether the information also had to be reported on Forms U4, U5 or BD. In response to industry concern about duplicate reporting, FINRA is now proposing an exception for matters reported on Form U5.[7] Duplicate reporting continues to be required, however, for matters otherwise reportable on the Form U4 or Form BD. We do not believe that there is any public policy reason that would require duplicate reporting of the same information on two different forms and we fail to understand why FINRA is distinguishing between matters reportable on a Form U5 versus matters reportable on a Form U4 or Form BD.[8] Indeed, the Proposal is silent as to why FINRA is drawing this distinction. Accordingly, SIFMA recommends that, if a matter is reported on a Form U4 or Form BD, that it not also be required to be reported under proposed Rule 4530.

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[7] *See* Proposed FINRA Rule 4530(e). While FINRA is proposing relief for matters appearing on a Form U5, it did not revise Supplementary Material .07, which appears to indicate that those matters need to be reported under FINRA Rule 4530 ("members should report an event relating to a former associated person if the event occurred while the individual was associated with the member.")

[8] Under existing NASD Rule 3070(b), firms must report within ten business days of the triggering event, whereas Forms U4 and BD have a 30-day reporting requirement. While the different timing requirements could arguably support the requirement of duplicate reporting, this distinction will be eliminated with the adoption of FINRA 4530, which will impose a requirement to report within 30 days.

SIFMA appreciates the opportunity to provide comments on FINRA's proposal regarding reporting requirements. We would be pleased to discuss the proposed Rule and our comments in greater detail with the SEC and its staff. If you have any comments or questions, please do not hesitate to contact me at 202-962-7386 or jmchale@sifma.org.

Sincerely,

/s/ James T. McHale

James T. McHale
Managing Director and Associate General Counsel
SIFMA

cc: Katherine A. England