

VIA ELECTRONIC MAIL

September 15, 2010

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

RE: File Number SR-FINRA-2010-034 – Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 4530 (Reporting Requirements) in the Consolidated FINRA Rulebook

Dear Ms. Murphy:

On July 30, 2010, the Securities and Exchange Commission (SEC) filed for comment FINRA's proposal to adopt FINRA Rule 4530 in the Consolidated FINRA Rulebook (Proposed Rule)¹. The Proposed Rule seeks to adopt NASD Rule 3070 as FINRA Rule 4530, subject to certain amendments, and to delete paragraphs (a) through (d) of Incorporated NYSE Rule 351 and Incorporated NYSE Rules 351.10 and 351.13. The Proposed Rule change also would add a supplementary material section to proposed FINRA Rule 4530.

The Financial Services Institute (FSI)² welcomes this opportunity to comment on the Proposed Rule. We note that this Proposed Rule is substantially similar in nature to the rule proposal set forth in Regulatory Notice 08-71³, which FSI commented on through a January 16, 2008 comment letter.⁴ While we are encouraged to see that FINRA responded to several aspects of our comment letter, we have serious concerns about certain aspects of the Proposed Rule. Specifically, we are concerned with the scope of the Proposed Rule, the monetary reporting thresholds set forth in section 4530(a)(1)(G) and 4530(a)(1)(H), the unintended consequences of section 4530(b) of the Proposed Rule, the duplicative reporting requirements, and requirements related to reporting on formerly associated persons. These concerns are outlined below in more detail.

Background on FSI Members

FSI represents independent broker-dealers (IBD) and the independent financial advisors that affiliate with them. The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive

¹ Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 4530 (Reporting Requirements) in the Consolidated FINRA Rulebook at <http://sec.gov/rules/sro/finra/2010/34-62621.pdf> and <http://sec.gov/rules/sro/finra/2010/34-62621-ex5.pdf>. The Proposed Rule was filed in the Federal Register on August 9, 2010, 75 Fed. Reg. 47863 (Aug. 9, 2010) <http://www.federalregister.gov/articles/2010/08/09/2010-19505/selfregulatory-organizations-financial-industry-regulatory-authority-inc-notice-of-filing-of>

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 123 Broker-Dealer member firms that have more than 188,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 14,500 Financial Advisor members.

³ Regulatory Notice 08-71, FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Reporting Requirements, available at <http://www.finra.org/Industry/Regulation/Notices/2008/P117455>

⁴ FSI Comment Letter in response to Regulatory Notice 08-71, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p117738.pdf>

financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.⁵ These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.⁶ Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments on the Proposed Rule

As stated above, FSI has serious concerns about certain aspects of the Proposed Rule. Specifically, we have concerns with scope of the Proposed Rule, the monetary reporting thresholds set forth in section 4530(a)(1)(G) and 4530(a)(1)(H), the unintended consequences of section 4530(b), the duplicative reporting requirements of the Proposed Rule, and requirements related to reporting on formerly associated persons. These concerns are outlined below in more detail.

- **Scope of the Proposed Rule is Overly Broad** - We believe that the Proposed Rule represents a significant expansion of the scope of the existing reporting requirements. For example, Section 4530(a)(1)(A) of the Proposed Rule expands broker-dealer reporting obligations well beyond the securities business of broker-dealer firms by including

⁵ Cerulli Associates at <http://www.cerulli.com/>.

⁶ These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

violations of any "insurance, commodities, financial or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, self-regulatory organization or business or professional organization."⁷ Events involving foreign regulatory bodies are also added to the reporting obligations of Sections 4530(a)(1)(C), (D) and (F). In addition, Section 4530(a)(1)(G) would require the reporting of insurance related civil litigation or arbitration matters that meet the reporting thresholds outlined in the Proposed Rule. In effect, these sections expand FINRA's reach to include matters over which it does not currently have jurisdiction. We oppose any attempt on FINRA's part to extend its jurisdiction beyond the broker dealer activities it is authorized by the Securities and Exchange Commission (SEC) to regulate.

We appreciate, and generally agree with FINRA's comment that "[t]his [new insurance, commodities, financial or investment-related reporting] . . . assists FINRA in identifying and investigating firms, offices and associated persons that may pose a regulatory risk."⁸ However, we believe that FINRA does not currently have the jurisdiction to require broker-dealers to report this type of information to them.

Ultimately, we believe that the scope of the Proposed Rule will place an undue and unenforceable burden on IBD firms. Accordingly, we urge the SEC to scale back the scope of the Proposed Rule by eliminating reporting requirements for activities outside the scope of FINRA's current jurisdiction.

- **Reporting Thresholds are Too Low** – Proposed Rule 4530(a)(1)(G) and 4530(a)(1)(H)(2) provide that each member firm should promptly report to FINRA if the member:

"is a defendant or respondent in any securities_ or commodities-related civil litigation or arbitration, is a defendant or respondent in any financial-related insurance civil litigation or arbitration, or is the subject of any claim for damages by a customer, broker or dealer that is financial or transactional in nature, [which] and such civil litigation, arbitration or claim for damages has been disposed of by judgment, award or settlement for an amount exceeding \$15,000. However, when the member is the defendant or respondent or is the subject of any claim for damages by a customer, broker or dealer, then the reporting to [the Association] FINRA shall be required only when such judgment, award[,] or settlement is for an amount exceeding \$25,000; or [(8) is the subject of any claim for damages by a customer, broker, or dealer which is settled for an amount exceeding \$15,000. However, when the claim for damages is against a member, then the reporting to the Association shall be required only when such claim is settled for an amount exceeding \$25,000;] (Emphasis added)

Or,

is" an associated person of the member is the subject of any disciplinary action taken by the member [against any person associated with the member] involving suspension, termination,

⁷ Section 4530(a)(1)(A)

⁸ *Id.*

the withholding of [commissions] compensation or of any other remuneration in excess of \$2,500, [or] the imposition of fines in excess of \$2,500[,] or is otherwise disciplined in any manner [which] that would have a significant limitation on the individual's activities on a temporary or permanent basis.
(Emphasis added)

While "FINRA believes that the current dollar thresholds continue to be consistent with the purposes of the rule,"⁹ we believe that the reporting thresholds should be increased and adjusted to reflect a reasonable rate of inflation over the 14-year period since NASD Rule 3070 was originally adopted. Therefore, we recommend that the Proposed Rule be amended to reflect the following reporting thresholds:

- Proposed Rule 4530(a)(1)(G)
 - Thirty thousand dollars (\$30,000) for financial advisors;
 - Fifty thousand dollars (\$50,000) for broker-dealers.
 - Proposed Rule 4530(a)(1)(H)(2)
 - Five thousand dollars (\$5,000) for financial advisors.
- **Issues with Section 4530(b)** – Section 4530(b) of the Proposed Rule provides that:

"Each member shall promptly report to FINRA, but in any event not later than 30 calendar days, 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."

- **Reporting of Internal Findings Inappropriately Requires Firms to Reach Legal Conclusions**

Proposed FINRA Rule 4530(b) was originally proposed as FINRA Rule 4530(a)(3) in Regulatory Notice 08-71. Section 4530(a) of the Proposed Rule 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 re-designated paragraph (a)(3) as paragraph (b) of FINRA Rule 4530 and requires 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.

We believe that this reporting requirement obligates broker-dealer firms to reach legal conclusions as to whether they or their financial advisors engaged in violative conduct. Since regulators, broker-dealers, financial advisors, and the courts frequently disagree about whether a given set of facts involves a violation, we believe the Proposed Rule will frequently place broker-dealers in the perilous position of being second-guessed by FINRA, a plaintiff's attorney representing a financial advisor whose activity was reported to FINRA by the broker-dealer, or both.

⁹ See page 15, <http://sec.gov/rules/sro/finra/2010/34-62621.pdf>

In our response to Regulatory Notice 08-71, we voiced concerns about a firm's obligation to report any internal conclusion and indicated that they may very well lead broker-dealers to choose not to reach such conclusions in the course of their internal review processes. We noted that when NASD Rule 3012 and 3013 were proposed, broker-dealers expressed concern that NASD would use the reports and review processes contemplated by those rules as a roadmap for disciplinary action against a firm or financial advisor. NASD officials assured firms that the NASD would not do so, and that broker-dealers would be given latitude to resolve deficiencies uncovered during the annual review. In response to this point, in the Proposed Rule release FINRA stated that it "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."¹⁰

We believe the Proposed Rule's requirement to report internal conclusions represents a dramatic and unexplained shift in FINRA's approach to self-policing. As a result, we believe the reporting requirements will have a chilling effect on a broker-dealer's internal review processes and, thus, undermine investor protection. Therefore, we urge FINRA to eliminate the requirement to report internal conclusions and findings as required by Section 4530(b) of the Proposed Rule.

- **Reasonably Should Have Known Provision**

In the 2008 version of Proposed FINRA Rule 4530, the "reasonably should have concluded" provision of Proposed Rule 4530(b) was not present. The inclusion of this clause represents a substantial expansion on the scope of items that a firm is obligated to report to FINRA. As discussed above, we believe that this will force broker-dealers into the perilous position of being second-guessed by FINRA, a plaintiff's attorney representing a financial advisor whose activity was reported to FINRA by the broker-dealer, or both. The benefit of hindsight in determining if an item should have been reported will work to the detriment of investors and market integrity. It appears that the inclusion of this provision will ultimately server FINRA's enforcement division with an additional tool in penalizing member firms who have failed to have the foresight to see how an internal issue may develop and play out.

We urge the SEC to remove the "reasonably should have concluded" provision from Proposed Rule 4530(b).

"Each member shall promptly report to FINRA, but in any event not later than 30 calendar days, 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."

¹⁰ See page 18, <http://sec.gov/rules/sro/finra/2010/34-62621.pdf>

- **Duplicative Reporting Requirements** – Section 4530(e) of the Proposed Rule provides as follows:

“[(d)] (e) Nothing contained in this Rule shall eliminate, reduce[,] or otherwise abrogate the responsibilities of a member or person associated with a member to promptly [file with full disclosure,] disclose required [amendments to] information on the Forms BD, [Forms] U[-]4 [and] or U[-]5, as applicable, [or] to make any other required filings[, and] or to respond to [NASD] FINRA with respect to any customer complaint, examination[,] or inquiry. In addition, members are required to comply with the reporting obligations under paragraphs (a), (b) and (d) of this Rule, regardless of whether the information is reported or disclosed pursuant to any other rule or requirement, including the requirements of the Forms BD or U4. However, a member need not report an event otherwise required to be reported under paragraphs (a) or (b) of this Rule if the member discloses the event on the Form U5, consistent with the requirements of that form.”

In the Proposed Rule filing with the SEC, FINRA notes that “[w]hile information disclosed on the Forms BD and U4 are not subject to this exception [granted to information reported on a U5] at this time, FINRA will work toward the goal of eliminating duplicative reporting of information disclosed on those forms.” Regulatory Notice 08-71 also represented that FINRA was working to eliminate duplicative reporting of information. Moreover, in 1995, the NASD made this same commitment without resulting progress on the initiative or reducing duplicative reporting requirements.¹¹

Accordingly, we believe that FINRA should take advantage of its current opportunity to act, and should draft the rules to reduce duplicative reporting rather than pushing it off to a later date. Firms should not be required to report the same information to different areas within FINRA. FINRA should assess its current systems and aid its members in reducing reporting requirements. As a result, we urge FINRA to eliminate the requirement for member firms to report information that has already been reported via Forms BD and U4.

- **Ministerial Violation Related to Qualified Immunity**

In our response to Regulatory Notice 08-71, we asked that if FINRA decided to retain the internal findings reporting obligations that they adopt the guidance provided by NYSE Information Memo 06-11 into the Supplementary Material of Proposed Rule 4530. This Information Memo further clarifies the reporting obligations of a broker-dealer. We recommended that FINRA provide reporting firms with qualified immunity to encourage accurate reporting without the repercussions associated with a good faith report that is later determined to be based on an incorrect legal conclusion.

In response to this request, in its rule filing with the SEC, FINRA indicated that in its opinion the guidance provided by NYSE Information Memo 06-11 was too narrow. FINRA did not expand upon this conclusion. However, the rule filing provides that “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

¹¹ See Exchange Act Release No. 34-35956, 60 FR 36841 (July 18, 1995): “Further, upon implementation of the redesigned CRD which will provide more ready access to registration information, the NASD will undertake to review the proposed reporting rule to determine whether certain of the duplicative requirements may be eliminated. To the degree that such modifications are feasible, the NASD would intend to delete such provisions from the proposed rule.”

ministerial violation of the applicable rules that did not result in customer harm and was remedied promptly upon discovery.”¹² It further provides the following examples, “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).”¹³ It goes on to provide that “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.” However, outside of these two examples the Proposed Rule and the related rule filing do not expand on what “an isolated, ministerial violation that did not result in customer harm and was remedied promptly upon discovery”¹⁴ truly is. In an effort for member firms to have a clear and accurate understanding of what is and is not reportable, we suggest that FINRA expressly define what is and what is not a “ministerial violation.”

- **Reporting on Former Associated Persons** – Supplementary Material .07 to the Proposed Rules provides that a broker-dealer must report under Sections 4530(a), (b) and (d) events “relating to a former associated person if the event occurred while the individual was associated with the” firm. In our comment letter in response to Regulatory Notice 08-71, we indicated that this requirement would prove difficult, if not impossible to comply with if the financial adviser is no longer affiliated with the broker-dealer firm. This is because the firm would have no leverage over or recourse against the financial adviser who is not affiliated with them. In response to this comment, in its rule filing with the SEC, FINRA asserts that “firms should report the information in their custody, possession, or control or to which they have knowledge and provide an explanation in the appropriate reporting system fields of the information that they were unable to obtain due to circumstances beyond their control, with the understanding that firms cannot intentionally avoid becoming aware of a reportable event.”¹⁵

While we appreciate FINRA addressing our concern, we believe that the issue has not been rectified. In an effort to have FINRA obtain the information it is seeking, and to reduce the burden on firms reporting on former associated person, we suggest that Supplementary Material .07 of the Proposed Rule be amended to conform to the record retention requirements of Sections 17a-3 and 17a-4 of the Securities Exchange Act of 1934.¹⁶ Accordingly, we suggest that the reporting period for formerly associated persons be capped at three years and suggest the following language for Supplementary Material .07:

“For purposes of paragraphs (a), (b) and (d) of this Rule, members should report an event relating to a former associated person if the event occurred **within the past three years of the associated person’s affiliation with the member and** while the individual was associated with the member.” (Added language in bold)

Conclusion

¹² See page 7, <http://sec.gov/rules/sro/finra/2010/34-62621.pdf>

¹³ See page 7, <http://sec.gov/rules/sro/finra/2010/34-62621.pdf>

¹⁴ See page 18, <http://sec.gov/rules/sro/finra/2010/34-62621.pdf>

¹⁵ See page 21, <http://sec.gov/rules/sro/finra/2010/34-62621.pdf>

¹⁶ Records to be preserved by certain exchange members, brokers and dealers, 17 C.F.R. § 240.17a-4(e)(1), referencing Records to be made by certain exchange members, brokers and dealers, 17 C.F.R. § 240.17a-3(a)(12).

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to achieve further efficiency in the reporting process while maintaining investor protection.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 202 379-0943.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dale E. Brown". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Dale E. Brown, CAE
President & CEO