

**Compliance**

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April 8, 2011

**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: SEC Release No. 34-64080; File No. SR-FINRA-2011-13; Proposed Operations  
Professional Registration**

Dear Ms. Murphy:

Charles Schwab & Co, Inc. (Schwab) appreciates the opportunity to comment on proposed new FINRA Rule 1230 and 1250 ("Proposed Rule"), commonly referred to as "Operations Professional Registration."

Schwab commends FINRA for making some meaningful modifications to the Proposed Rule based on member commentary solicited via Regulatory Notice 01-25, notably:

- Removing "capturing" from Proposed Rule 1230(b)(6)(B)(xiii) related to business requirements for sales and trading systems.
- Inclusion of a "materially" threshold in Proposed Rule 1230(b)(6)(A)(iii) related to persons with authority or discretion to commit a member's capital and clarification of what constitutes "materially" via proposed Supplementary Material .06., Scope of Operations Professional Requirement.
- Extending the proposed implementation period to one year.

Schwab agrees with FINRA that certain employees and associated persons of member firms play an integral role in the securities business of a member firm and shares FINRA's express goal "...that investor protection mechanisms are in place in all areas of a member's business that could harm the member, a customer, the integrity of the marketplace, or the public."<sup>1</sup>

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<sup>1</sup> SR-FINRA 2011-013 at page 4.

While sharing this goal, Schwab believes the Proposed Rule requires further revision and clarification, for the reasons noted herein.

### **Scope of Covered Persons and Covered Functions**

Schwab believes that the Proposed Rule requires further clarification to appropriately identify “Covered Persons”<sup>2</sup> by clearly articulating the functions, responsibilities or activities considered as “Covered Functions.”

The “Covered Functions” list provided in Proposed Rule 1230(b)(6)(B)(i) through (xvi) is simply a topical list of activities inherent in broker-dealer operations, technology and financial management. The Proposed Rule should be revised to identify specific functions, responsibilities or activities related to the “Covered Functions” that would prompt “Operations Professional” registration.

For example, the express language of “Covered Function” 1230(b)(6)(B)(vi) includes merely “...account statements[.]” without qualification, specificity or context. Account statements include information compiled from a wide array of sources; information may come from various departments within a broker-dealer and third-party service providers, who may or may not be affiliated with the broker-dealer (“third-party service providers”). Merely stating “account statements” fails to provide guidance on what functions, responsibilities or activities related to the compilation and/or production of account statements would require supervisors, managers or other persons responsible for approving or authorizing work related to “account statements” to register as an Operations Professional.

For example; many brokerage accounts include cash management features such as a linked checking account, linked debit card(s), linked credit card(s), online bill pay, payroll check deposit, etc. Typically, these cash management features are provided via agreements with other financial institutions and transactional information related to these cash management services is included in the brokerage “account statement.” Consistent with existing regulatory guidance in NASD Notice to Members 05-48, Responsibilities When Outsourcing Activities to Third-Party Service Providers, associated persons of the member firm oversee, supervise and monitor the third-party service provider’s performance of the noted activities. In addition, the non-member financial institutions would certainly employ supervisors, managers and others who supervise, manage or are responsible for ensuring the accuracy of the transactional information provided to the member for inclusion on the brokerage “account statement.” Based on the express language of the Proposed Rule and FINRA’s guidance in the Proposed Rule filing that:

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<sup>2</sup> “Covered Persons” refers to persons required to register as Operations Professionals pursuant to Proposed Rule 1230(b)(6)(A)(i) through (iii).

[t]he proposed registration category is function based so persons are not shielded from the requirements based on their job title or employment by an entity other than a member[.],<sup>3</sup>

the Proposed Rule would appear to require that the member register as an Operations Professional not only the associated persons of the member firm but also the supervisors, managers and others employed by non-member financial institutions.

Further, based on the Proposed Rule filing guidance that:

FINRA would consider any senior manager in the chain of command responsible for a covered function to be subject to the proposed rule, up to and including the Principal Operations Officer[.],<sup>4</sup>

the entire “chain of command” at the non-member financial institution would be required to register as Operations Professionals with the member.

Another example related to the “Covered Function” of account statements and “Trade Confirmation,”<sup>5</sup> is Covered Function 1230(b)(6)(B)(x), “Approval of pricing models used for valuations.” Broker-dealers typically use Exchanges and third-party service providers for pricing and valuations. The Exchanges and third-party service providers employ supervisors, managers or others responsible for the review and approval of their pricing information and models. The express language of Proposed Rule 1230 would appear to require that the broker-dealer register as an Operations Professional the supervisors, managers and others employed by the Exchanges and other third-party service providers.

Once again, the entire management “chain of command” at the Exchange(s) and other third-party service providers would be required to be registered as Operations Professionals with the member.

Revisions identifying specific functions, responsibilities or activities would be consistent with FINRA’s (and its predecessor entities) historical approach of identifying the specific responsibilities, typically in the investment banking or securities business of a member, that would require registration.

In addition, current registration rules specifically indicate that registration is required for person(s) associated with a member,<sup>6</sup> a standard that should also be applied in the Proposed Rule.

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<sup>3</sup> SR-FINRA-2011-013 at page 51

<sup>4</sup> SR-FINRA-2011-013 at page 28.

<sup>5</sup> Also included in covered function 1230(b)(6)(B)(vi)

<sup>6</sup> FINRA Rule 1021(a), All Principals Must Be Registered, specifying investment banking or securities business, and (b), Definition of Principal, specifying “[p]ersons associated with a member.” See also FINRA Rule 1031(a), All Representatives Must Be Registered, specifying investment banking or securities

Schwab recognizes that FINRA repeatedly asserts in the Rule Proposal that “FINRA already views the persons treated as covered persons in the covered functions, and indeed all non-clerical persons reporting to such covered persons, as associated persons irrespective of the proposed rule.”<sup>7</sup> However, due to lack of specificity regarding the functions, responsibilities or activities related to the “Covered Functions” and, therefore, the potential broad, sweeping nature of the “Covered Functions,” Schwab does not believe all “Covered Persons” potentially captured by the Proposed Rule are and should be considered associated persons of the member.<sup>8</sup>

FINRA’s jurisdiction generally extends to any *securities activity* by a FINRA member firm or associated person that is governed by Exchange Act or FINRA’s rules.<sup>9</sup> Further, Exchange Act and SEC rules require FINRA to regulate the conduct of “*securities persons*,” partners, officers, control persons or certain employees of the member firm.<sup>10</sup>

The Proposed Rule, as written, appears to exceed FINRA’s statutory authority and jurisdictional boundaries to cover individuals at third-party service providers who do not engage in activities requiring registration as a broker or dealer. If it is not the SEC’s intention, through this Proposed Rule, to expand FINRA’s authority and jurisdiction to regulate third-party service providers and individuals, who are not currently deemed a “person associated with a broker or dealer” as defined in the Exchange Act, Schwab recommends that Proposed Rule 1230(b)(6)(A) be amended to define as “Covered Persons” only *associated persons* of the member and recommends the following specific revision to Proposed Rule 1230(b)(6)(A):

Each of the following persons *associated with a member* shall be required to register with FINRA as an Operations Professional.

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business and (b), Definition of Representative, specifying “[p]ersons associated with a member...” See also FINRA Rule 1032 (a) through (i), Categories of Representative Registration., FINRA Rule 1041(a), All Assistant Representatives – Order Processing Must Be Registered, and FINRA Rule 1050(a), Registration of Research Analysts. Each rule specifies person or persons “associated with a member” who meet the definition of representative and/or perform specific functions.

<sup>7</sup> SR-FINRA-2011-013 at page 52. See also pages 7, 27 and 52.

<sup>8</sup> Under FINRA’s By-Laws, “associated person of a member” is defined as: “(1) a natural person who is registered or has applied for registration under the Rules of the Corporation; (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the Corporation under these By-Laws or the Rules of the Corporation; and (3) for purposes of Rule 8210 any other person listed in Schedule A of Form BD of a member.”

<sup>9</sup> See Exchange Act 15(A)(b).

<sup>10</sup> Exchange Act 19(g)(2); SEC Rule 19g2-1

Schwab is not suggesting that a member's obligation to supervise third-party service providers is limited to its employees. As stated above and in Schwab's commentary in response to FINRA's request for comment on the Proposed Rule in Regulatory Notice 10-25:

Schwab recommends that Rule 1230(b)(6)(A)(ii) be amended to reflect consistency with the guidance provided in NASD NTM 05-48 and that "covered persons," as defined in Rule 1230(b)(6)(A)(ii), ***be refined to only consider associated persons*** of the member responsible for overseeing, supervising or monitoring the third-party service provider's performance.<sup>11 12</sup>

Sweeping employees of third party service providers into a class of associated and registered persons requires more than simply FINRA's assertions that such individuals are associated persons. The Proposed Rule must be grounded in sound analysis of FINRA rules, Exchange Act and SEC rules. Such an analysis would also serve to allay concerns of unexpected or unintended interpretations, applications and consequences of the Proposed Rule and respectfully requests that FINRA provide such analysis.

#### **Non-Day-One Professionals Grace Period**

Schwab believes that non-Day-One Professionals associated with self-clearing firms should also be provided the 120 day grace period to pass the Operations Professional examination. Any such grace-period should be provided consistently to clearing, self-clearing and non-clearing member firm personnel.

Schwab appreciates the opportunity to provide comments on FINRA's Proposed Rule and believes its suggestions and recommendations will continue to allow FINRA to meet its commitment to the SEC "...to establish a new system to enhance the oversight and professional requirements of personnel performing back-office functions at broker-dealer firms. "Back-office" personnel typically perform critical custody, accounting, transfer agency and account maintenance functions....Under the new regime, certain back-office personnel would be subject to licensing and education requirements as well as enhanced oversight."<sup>13</sup>

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<sup>11</sup> Schwab comment letter, page 2.

<sup>12</sup> Schwab also believes FINRA may have misunderstood Schwab's commentary in response to FINRA's request for comment as FINRA's Rule Proposal filing states (bold added) "Given a member's obligation to supervise any outsourced activity, numerous commenters stated that it should be sufficient for FINRA to confine application of the proposed registration and examination requirements to **"employees"** of the member." SR-FINRA-2011-013 at page 50 and footnote 122 attributing the referenced to Schwab, among other commenters. As noted, Schwab's commentary specifically stated "associated persons of the member."

<sup>13</sup> The Securities and Exchange Commission Post-Madoff Reforms (December 7, 2009) at Page 3. Available at <http://www.sec.gov/spotlight/secpostmadoffreforms.htm>

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Schwab thanks the Staff for consideration of the points raised in this letter and welcomes any further discussions or questions. Please feel free to contact me at (415) 667-0866.

Sincerely,

Bari Havlik  
SVP and Chief Compliance Officer  
Charles Schwab & Co., Inc.