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July 20, 2011

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

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

Re: File Number SR-FINRA-2011-028
Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook

Dear Ms. Murphy:

Charles Schwab & Co., Inc. ("Schwab") appreciates the opportunity to comment on FINRA's proposals relating to the FINRA supervision and supervisory control rules. We support FINRA's efforts to clarify and streamline certain supervisory requirements and appreciate the modification of several provisions of the initial rule proposal in light of comments received.

While many of the proposed rules support the objectives of providing more streamlined, clear and flexible supervisory requirements, several of the proposals significantly expand the jurisdiction of FINRA and impose new supervisory obligations on member firms. As discussed below, Schwab does not believe certain of these changes are warranted.

Supplementary Material .01

Proposed Supplementary Material .01 to Rule 3110, states that for "a member firm's supervisory system required by Rule 3110(a) to be reasonably designed to achieve compliance with Rule 2010, it must include supervision for all of the member's business lines *irrespective of whether they require broker-dealer registration*." Schwab believes this represents a problematic extension of supervisory rules to non-securities activities that FINRA has not historically regulated, raising significant jurisdictional concerns.

FINRA justifies this expansion by asserting that the commercial honor and just and equitable principles of trade provisions of Rule 2010 reach into every aspect of a member firm's business activities, even those that do not require registration as a broker-dealer. FINRA's argues that because 3110(a) requires member firms to have supervisory systems reasonable designed to achieve compliance with FINRA rules, and at least one of its rules, FINRA Rule 2010, applies to non-securities business activities, a member's supervisory system must include supervision of business lines that do not require broker-dealer registration. Leveraging broad application of Rule 2010, a principles based ethics rule, FINRA is attempting to expand application of its supervisory rules, and its own enforcement and examination jurisdiction, into business activities for which it has no explicit oversight authority.

Member firms may engage in business activities within the broker-dealer entity that do not require registration as a broker-dealer. Many of these activities, such as investment advisory or insurance businesses, are regulated by other governmental and regulatory authorities, each with rules and regulations mandating defined compliance and oversight controls. Today, FINRA does not have the explicit authority to regulate, examine and enforce compliance with these non-broker dealer rules.[1] The application of FINRA supervisory obligations to these activities would allow FINRA to test and challenge the adequacy of supervisory procedures and the discharge of supervisory obligations against laws, rules and regulations that FINRA does not currently oversee and has no experience regulating. This approach would create unnecessary duplicative and potentially inconsistent regulation over non-broker dealer activities and impose an additional layer of regulatory oversight for firms conducting such activities within a broker-dealer entity.

The basis for such an expansion of jurisdiction is not clear and does not appear to be warranted. In the absence of explicit statutory authority to regulate business lines that do not require broker-dealer registration, Supplementary Material .01 should be eliminated.

3110(b)(4) and Supplementary Material .08

Proposed Rule 3110(b)(4) expands the scope of existing FINRA rules requiring supervisory procedures for the review of external correspondence with the public by applying the supervisory requirement to internal communications. While Schwab agrees that there are circumstances where supervision of internal communications is appropriate, the regulatory requirements and risks underlying such supervision are different from and more limited than the regulatory requirements and risks underlying the member's obligation to supervise external correspondence. We believe reference to internal communications in 3110(b)(4) should be removed.

There are limited instances where NASD/FINRA rules specifically require the review of internal communications. For example, NASD Rule 2711(b)(3)(A) requires a member's

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[1] See, for example, SEC Study on Enhancing Investment Adviser Examinations, January 2011, p.37 - 38 noting that the Exchange Act does not provide FINRA with express authority to enforce compliance with the Advisers Act, and indicating that an amendment to the Exchange Act would be required to allow FINRA to examine dual registrants for compliance with the Advisers Act.

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legal and compliance department to be copied on communications between non-research and research departments concerning the content of a research report. We believe those rules stand on their own merits in establishing a member's obligations with respect to internal communications and their supervision. An additional supervisory rule governing internal communication is not necessary in these instances.

With respect to supervision of internal communication in support of other regulatory obligations, we agree that member firms should take a risk based approach in tailoring their supervisory procedures and controls to include monitoring and supervision of internal communications where warranted. However, this risk based approach to supervision is already embodied in a member firm's general obligations to establish, maintain and enforce written procedures and establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations. There is no need to call out in a rule a specific requirement to engage in a risk based assessment to determine the extent to which a firm should monitor internal communications. The existence of the prior guidance provided by Regulatory Notice 07-59 regarding supervision of electronic communication is helpful and appropriate, but should not be the basis for new rulemaking regarding supervision of internal communications.

3110(b)(5)

Proposed Rule 3110(b) (5) incorporates the NYSE Rule 401A requirement that firms capture, acknowledge and respond to complaints. As we noted in our comment letter to FINRA, we support the proposal to limit the requirement to written complaints; however, we believe the NYSE requirement to "acknowledge" complaints imposes a new and unnecessary burden on former NASD only firms, and should be eliminated.

While FINRA recognizes that this is a new requirement for many FINRA members, they assert, without explanation, that "the investor protection that this provision would provide outweighs any potential compliance burdens." The additional investor protection benefit associated with "acknowledging" a complaint, however, is not apparent, particularly where the rule already requires members to respond to each and every complaint. The requirement to provide a response, which in and of itself is a form of acknowledgment, is the core investor protection component of the complaint rule. Schwab believes that developing and implementing an appropriate infrastructure to send an acknowledgement of receipt for each complaint received requires an allocation of resources better focused on investigating and responding to complaints.

3110(b)(6) and 3110(c)(3)(A)

Schwab supports proposed Rule 3110(b)(6)(C) replacing the detailed requirements associated with supervising "producing managers" in NASD Rule 3012 with clear, direct and flexible supervisory standards.

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Proposed Rule 3110(b)(6)(D) introduces a new requirement that member firms implement procedures preventing standards of supervision "from being reduced in any manner, due to conflicts of interest that may be present with respect to the associated person being supervised. . . . ." This new conflict of interest procedures requirement is unnecessary and creates a strict liability standard that is inconsistent with existing supervisory rules.

The general supervisory obligations stated in proposed Rules 3110(a) and (b) address conflict of interest issues by requiring member firms to establish and maintain systems of supervision, and establish, maintain and enforce supervisory procedures regarding business activities and associated persons "reasonably designed to achieve compliance." These fundamental supervisory obligations require member firms to identify, assess and mitigate conflicts of interest in the design of their systems of supervision, and embed in their supervisory controls and procedures checks and balances to mitigate the impact of potential conflict of interests on the execution of supervision. There is no need for a separate rule regarding supervision of conflicts of interest – management of conflicts of interest is at the core of existing firm supervisory obligations.

The new rule also appears to heighten the supervisory standard applicable to member firms from a reasonable basis standard ("reasonably designed to achieve compliance") to a strict liability standard ("procedures preventing the standards of supervision . . .from being reduced in any manner"). FINRA rejected comments suggesting that the "reasonably designed" standard should be incorporated into the new rule, stating that such a change would suggest an "impermissible relaxation of the standards around which the rule is designed." We don't believe it fair, appropriate or practical to design this rule around a strict liability standard. While we believe the rule is unnecessary, if it is retained, the standard for the newly required procedures to mitigate conflicts of interest should be a reasonableness standard, consistent with the language of existing SEC and FINRA supervisory rules.

FINRA has proposed a similar strict conflict of interest standard for internal inspections in Proposed Rule 3110(c)(3)(A). For the reasons set forth above, we believe existing supervisory rules render this requirement unnecessary, but if retained, the standard should be reflected as a reasonableness standard.

3110 (b)(7) and Supplementary Material .13

As we previously commented to FINRA, The last sentence of proposed Rule 3110(b) (7) states that each member is responsible for communicating amendments to supervisory procedures "throughout its organization." Because it is not appropriate to broadly communicate written supervisory procedures or amendments "throughout" the organization, particularly in a broadly diversified financial services firm where an amendment may only be relevant to a limited business or set of associated persons, the quoted language should be changed to "to relevant supervisory personnel." FINRA noted this comment but declined to make this change, without explanation.

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FINRA also added Supplementary Material .13 which clarifies that members may electronically amend and distribute written supervisory procedures provided certain conditions are met, including requirements that the firm "verify at least once each calendar year through electronic tracking, written certifications or other means that associated persons have reviewed the member's written supervisory procedures." The Supplementary Material creates an extensive new recordkeeping and tracking obligation for members that choose to distribute supervisory materials electronically. While we believe it appropriate that member firms maintain records of the distribution of supervisory procedures to relevant supervisory personnel, the electronic communication of these procedures should not require verification and certification of review.

Supplementary Material .05

Proposed Supplementary Material .05 creates (1) a general presumption that a principal will not be designated and assigned to supervise more than one OSJ; and (2) a general presumption that a determination by a member to designate and assign one principal to supervise more than two OSJs is unreasonable. A decision to assign one supervisor to more than two OSJs will be subject to "greater scrutiny" and the member will have a "greater burden to evidence the reasonableness of such structure." Schwab believes the creation of these negative presumptions is not necessary or appropriate and that they should be eliminated.

Existing supervisory rules contemplate a flexible standard that require member firms to create appropriate supervisory systems that are tailored to each firm's unique business and organizational structure and technology and resource capabilities. Such capabilities, include surveillance, trading and communication systems, and centralized supervisory, compliance and oversight support functions, which, coupled with regularly scheduled visits, may reasonably support the supervision of multiple OSJs by one designated principal. The proposed presumption that such a structure is not reasonable effectively requires member firms to implement a particular supervisory organization that FINRA has determined to be "reasonable" and creates a significant hurdle for member firms considering implementation of alternative supervisory structures that may reflect a more effective allocation of resources. The basis for the negative presumptions set forth in Supplementary Material .05 has not been established, particularly in light of evolving supervisory tools, technology and capabilities. We do not believe the proposed negative presumptions are appropriate and may operate to limit development and design of more effective supervisory models.

3110(d)(3)(A)(i), Covered Account

Schwab believes including adult children and son-in-law or daughter-in-law of associated persons in the definition of "covered account" is overly broad and impractical. Associated persons may not be aware of and may be unable to obtain information regarding the

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accounts of their adult children and their spouses. Adult children and their spouses are under no obligation to provide associated persons of member firms or other member firm personnel information related to their accounts introduced or carried by the member. Absent an obligation by the adult children and their spouses to provide such information to associated persons of member firms or member firm personnel, Schwab believes the challenges of identifying such accounts and meaningfully applying this requirement would be significant and, in many circumstances, impossible.

While the Rule filing indicates that "[t]he revised language is based, in large part, on the obligations established by the NYSE in Information Memo 88-21 (July 28, 1988) regarding the accounts of certain family members of persons associated with a member and accounts in which the associated person has an interest or has the power, directly or indirectly, to make investment decisions[,]" the Rule filing fails to recognize that NYSE Member Firm Regulation subsequently issued Information Memo 89-17, Regulatory Initiatives, Clarification of "Family Member" Definition and Report Filing Reminder." The Information Memo stated (excerpt):

> The July Information Memo stated that "[f]or purposes of this rule [Rule 342], 'family member' accounts include accounts of husbands, wives, children, sons-in-law, daughters-in-law and any household relative of employees, where such accounts are introduced or carried by an employee's member or member organization." Comments received by the Exchange from member organizations have suggested that monitoring of relevant accounts would be substantially facilitated and be more meaningful if the definition of "employee ... or family member" was revised in certain limited areas. In order to address this comment and clarify the Exchange's intent in requiring "employee or family member" accounts to be reviewed, the term has been revised to include accounts introduced or carried by a member or member organization of the following:
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> - an employee's spouse;
> - children of employees and the children's spouses, provided that they reside in the same household with, or are financially dependent upon the employee; and
>
> - any other related individual over whose account the employee has control; and
> - any other individual over whose account the employee has control and to whose financial support the employee materially contributes.

Schwab believes the more limited definition of "covered account" articulated in NYSE Information to 89-17 to be consistent with the historical NYSE rule, and more reasonable and practical to implement, while continuing to achieve the underlying policy objectives of the proposed Rule. Schwab strongly recommends that FINRA consider adopting the NYSE's definition of "covered accounts" with its subsequent modifications.

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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 to discuss them in more detail.

Very truly yours,

Scott Cook
Senior Vice President Compliance
Charles Schwab & Co., Inc.