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Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F Street N.E.
Washington, D.C.20549-1090

Re: SR-FINRA 2013-025, FINRA Consolidated Supervision Rules

Dear Secretary Murphy:

I have reviewed Securities and Exchange Commission Notice of a Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook (Release No. 34-69902), File No. SR-FINRA-2013-025 and now submit my comments. I will summarize the proposed rule changes and then address whether they are in accord with Title IX (Investor Protection and Securities Reform Act of 2010) of the Dodd-Frank Wall Street and Consumer Protection Act ("Dodd-Frank") and ultimately serve the principal objective of Dodd-Frank's Title IX in enhancing investor protection for the smaller and non-institutional investor. These are the investors who are without sufficient independent and in depth resources to give themselves the reasonable assurance that they are protected from fraud and the systemic flaws that periodically occur and which can cause significant investor loss unless proactively prevented by the SEC, FINRA, and other regulators.

I will then add my personal recommendations that hopefully may have both relevance and materiality to the informed dialogue that is now taking place with respect to these important rules because supervision is always key to investor protection. Principally, it is the undersigned's recommendation that reasonable assurance of sound supervisory practices can only exist if both supervision and internal inspections are subject to independent compliance audits.

I. Summary of The Proposed Consolidated Rules

The consolidated supervision rules address the following topical areas: (1) Supervision and Supervisory Control Systems (FINRA Rule 3110 and 3120); ((2) Branch Offices and Offices of

Supervisory Jurisdiction ("OSJ"); (FINRA Rule 3110); (3) Standards for Reasonable Review (FINRA 3110); Trade Review and Investigation (FINRA Rule 3110); Customer Complaints (FINRA Rule 3110); Tape Recording of Registered Persons by Certain Firms (FINRA Rule 3170) and Customer Mail (FINRA Rule 3150).

A. FINRA Rules 3110, 3120, and 3150

1. Supervisory Structure

Proposed FINRA Rule 3110(a) requires member firms to designate a registered principal to supervise each type of business in which the firm is engaged regardless of whether registration is required for that type of activity.

B. OSJ's and Branch Offices

Offices of Supervisory Jurisdiction ("OSJ") and/or branches have to have a registered principal to supervise the activity within the principal office or branch including but not limited to giving final approval to the opening of new accounts, order taking and execution, market making, structuring of public offerings and private placements, protection of customer funds and securities and review of customer trades. Each location including the principal office must operate under or within an OSJ and have a designated registered principal present. Generally multiple OSJ's cannot operate under one registered principal and a supervisor cannot supervise his or her own activities or supervise those persons who make the determination as to the supervisor's compensation.

Flexibility is provided for under appropriate and demonstrable circumstances. By way of example a dual employee of both a banking organization and broker-dealer is exempt from the broker-dealer's supervision provided there is written assurance of bank supervision of the securities activities including compliance with the anti-fraud provisions of the securities laws and the bank gives notice of the employee's violation to the broker-dealer.

II. Implementation

A. Supervision

Proposed Rule 3110(b) requires each member to establish, maintain and enforce written supervisory procedures. There must be by a registered principal a risk based review of all types of transactions engaged in and evidenced in writing including all investment banking and securities business. There is mandated supervision of outside business activities in that it must be disclosed and is subject to the firm's prior written approval before the employee engages in outside investment banking or securities activities. There is now such supervision irrespective of whether the activity is compensated or the activity is of such a nature to trigger licensing and/or registration in the securities business.

FINRA proposed Rule 3110(b) (6) requires documentation of the supervision of supervisory personnel "to address potential abuses in connection with the supervision of supervisors" i.e., "the leaks at the top." There is a general prohibition of self-supervision or supervision of someone who determines the compensation for the supervisor. Conflicts and other factors that tend to diminish supervision must be addressed and documented under the Rule.

B. Supervisory Procedures

Proposed FINRA Rule 3110 (b) (4) provides for the review of incoming and outgoing correspondence, emails and all internal communications. Further both in effecting securities transactions and the inspection process there must be transaction reviews. Also pursuant to the Insider Trading Securities Enforcement Act of 1988 (ISTEFA) every broker-dealer has to establish written procedures reasonably designed to prevent misuse of inside information and insider trading. Firms that provide "investment banking services" must provide FINRA within (10) days of learning of an event raising an insider trading issue with reports of insider trading investigations. The insider trading reviews that the firms engage in irrespective of a precipitating event must include reviews of the firm trading account, and the accounts of the firm personnel and family members.

Proposed FINRA Rule 3120 (Supervisory Control System) requires testing and verification requirements for the supervisory system. This entails the submission to senior management of a report annually for firms reporting $150 million or more in gross revenues and includes tabulations of customer complaints and discussion of the past years' compliance efforts in relation to and not exclusively sales practices, investment banking, trading and market activity.

FINRA Rule 3150 is a standalone mail holding rule. Mail can only be held in accordance with written instructions of the customers.

C. Inspections

The inspection process is to test and provide reasonable assurance of the firm's compliance and supervisory procedures. The inspection process on an on-going basis, must monitor the securities activities of the firm or activities that relate to its key supervisory and compliance procedures and this is set forth in the Consolidated Rules.

Proposed FINRA Rule 3110 (c) provides for internal inspections and included within the scope of such inspections are the transmittal of funds and securities, the holding of mail, trade review, and the change of addresses and investment objectives. Those persons conducting the inspection must be from outside of the office subject to the inspection. They must not be part of the supervisory process for the location and/or someone at the location. The Rule gives explicit recognition to not allowing the supervision or inspection process to be lessened by

conflicts. There are heightened office inspections where managers, supervisors, and branch office managers generate twenty percent (20%) of the revenues.

Non-branch office inspections must occur at least once in three (3) years. In regard to firms with gross revenues of $150 million or more a report must be submitted to senior management that includes addressing customer complaints and FINRA inquires/investigations.

The inspection process entails testing and verification of the member firm's policy for safeguarding customer funds and securities including, specifically transmittal of funds between registered representatives and customers and third parties, maintenance of books and records, address or other changes resulting in a change of beneficial interests and investment objectives, and validation of customer account information by direct customer confirmation.

A. Annual Compliance Meetings and Firm Culture

Proposed FINRA Rule 3110(a)(7) provides for annual compliance meetings that includes webcasts, video conferences, interactive classroom settings, telephone conferences, and other electronic means to broaden the audience and sustain an informed dialogue. Each registered person must attend the meeting.

B. Customer Complaints and Hiring Process

FINRA Rule 3110 (b) (5) addresses Customer Complaints. Firms must acknowledge complaints in writing and respond to all customers when a complaint is made. The Rule does not however, give specific content to the forms and methods of the claims process. Further the hiring process also requires background checks and inquiries regarding firm employment as a registered representative. This necessarily entails a prospective employee's complaint and disciplinary history.

III. Title IX of Dodd-Frank, Investor Protection

In evaluating the proposed consolidated rules on supervision the primary considerations now have to come from Title IX of Dodd-Frank, Investor Protection. The statutes overriding objective of protecting the public investor by "identifying emerging risks;" "determining where gaps . . . in supervision exist" and "facilitating dispute resolution" permeate not only oversight by multiple regulators but the supervisory structure and culture of compliance for every financial service organization. The macro and fiduciary goals for the regulatory framework also serve as a model for the exercise of professional and supervisory responsibility in the financial services industry. In all respects the high point of any organization must be interconnected to the base.

Section 918 of Dodd Frank provides for the enhanced authority of the Commission to require "investor disclosures before purchase of investment products and services." Section 919(a) is a direction to the GAO to conduct a study of the securities underwriter's and analyst's functions in consultation with the SEC and FINRA. Section 919 (a) and (b) requires a study on

improving access to information on investment advisors and broker-dealers and a further study on financial planners with emphasis being placed on their designations.

Section 921 prohibits the enforcement of pre-dispute arbitration clauses now giving the customer the option to always have his or her day in Court, presumably to assure the public investor they have a free choice between an industry forum and the courts. Section 933, in essence, relaxes the scienter-fraud standard for material misrepresentations or omissions to one of engaging in such conduct knowingly or by "recklessly failing" to meet appropriate standards.

The foregoing signifies to the undersigned that the Federal Securities Laws will be making conduct actionable and according to investors recourse not merely on a showing of actual fraud but as a result of a disregard for professional and industry standards i.e., constructive fraud that should be further expanded to include liability for professional negligence. The goal would be to think of and treat brokers not as sales persons but as financial service professionals.

Section 942 addresses improving disclosures with respect to asset back securities and while specific to asset based securities is demonstrable of Congressional intent to enhance disclosure for all investors in relation to all investment products. Section 989 (a) heightens standards for the investor protection of seniors especially with respect to misleading designations.

Also key to viable supervision is effective regulatory and self-regulatory oversight of the financial services industry which experience teaches involves ongoing and cooperative interaction between the SEC, FINRA, State Securities Regulators and most especially the Industry Compliance Professionals in (a) the inspection process i.e. exit interviews; (b) the handling of customer complaints; (c) maintaining internal discipline; (d) responding to regulatory inquiries, investigations, and Wells Notices and (e) effecting internal compliance reforms when firms and/or their personnel have violated or about to violate the federal and state securities laws. There must be open communication channels so the industry can responsibly interact with the regulators to the positive end of protecting investors.

Section 961 requires a report on the SEC's rule making processes and in respect to the instances where the Court's overturn SEC rules. Section 964 in comparable fashion addresses SRO oversight. Section 989 (a) addresses senior investor protection and the misleading designations by way of example, that sometimes takes place to overstate professional status by calling oneself a financial planner when in fact the individual has no special training or experience.

The new Consolidated FINRA Supervision Rules are consistent with Title IX but should be expanded as outlined below for greater efficacy.

IV. Recommendations In Regard to the Consolidated Rules and to Further Enhanced Supervision

The key to supervision and supervisory structure, as is true for any aspect of the regulatory framework for our capital markets; and as was and is noted by a distinguished state securities regulator is the "main street investor." To fulfill the objective of protecting the "main street investor" I think the points of emphasis have to be the interests of the "retail investor" that is expressed in the primary focus of Title IX of Dodd-Frank. The rules must be tested for efficacy based on the risk based considerations in respect to the following topical areas:

(1) Supervisory Depth

(2) Avoidance of Supervisory Conflicts

(3) Suitability in respect to all securities recommendations both as to the security and the activity to be or is engaged in respect to the investment product the public customer has or will have in his or her account. This will always include a written information base for the recommendation and accurate documentation regarding the "retail investor's" capacity for financial risk and investment objectives. All new account forms should be signed by the customer before trades in the account will be permitted.

(4) Trade Review to determine best execution contemporaneously and within reasonable intervals of trade activity and for the purpose of assessing patterns.

(5) Trade Review for the purpose to "red flag" insider trading.

(6) Product suitability and the customer qualification process in respect to the specific public customer.

(7) Prevention of unauthorized trading and the virtual elimination of all de facto discretion except limited time and price discretion, appropriate in special circumstances.

(8) Monitoring for churning in accordance with defined turn over ratios, in and out trading, and ratios of commissions and markups to account profits and losses.

(9) Systemic Problems: Compliance audits distinguishable from the internal inspection process conducted by objectively independent professionals especially with respect to start up firms with more limited resources, and engaged in or through which their customers engage in high risk activities should now be made mandatory. Independent Compliance Audits will further enhance loss prevention.

(10) Compliance meetings should take place more frequently than on an annual basis as cultures of compliance can only be established by collective and repetitive effort.

(11) Defined Responsibilities and Non-Deligable Duties: Good faith and reasonable basis certifications by a registered principal and compliance professional with respect to (a) ongoing supervision; (b) the inspection process; (c) compliance audits and (d) claims handling will heighten consciousness of supervisory responsibility.

(12) Customer Complaints. In respect to customer complaints mere written acknowledgement and response will not be deemed sufficient but must include an internal process of good faith, adequate, and objective review that will include legal evaluation where appropriate; trade reversal and cancellation; good faith pre-arbitration and/or litigation discussion, negotiation and bona fide settlement offers when the situation warrants. Variation of the American Rule on fee shifting where the broker-dealer pays for the customer's litigation and arbitration expenses if good faith and objectively sound procedures of supervision, compliance, inspection, and claims handling are not followed should be a mandatory requirement

With respect to the topical areas identified above, my further explanation to the recommendations to enhance the proposed rules and supervisory responsibility in the best interests of investors intended to be protected by Title IX, are as follows:

(1) The Consolidated Rules provide for supervisory depth and avoidance of supervisory conflict by requiring supervision for each type of firm activity; supervision for all OSJ's and branch locations; and linkage to the highest levels of supervision of the principal office, OSJ's branches, and non-branch offices. There are risks specifically related to non-branch offices and the potential conflicts that arise from supervising the supervisors. While the rules do provide for non-branch supervision by a registered principal there is risk by reason of size, location, and resources that needs to be addressed by more frequent inspections and audits of non-branch offices and their personnel.

Further while the realities will allow risk gaps this can and should now be overcome by outside licensed, and independent vendor organizations that can provide monitoring of on-going activity and the internal inspection process as well as independent compliance audits. Independent compliance audits, however,should take place for all firms, and more frequently for firms that do have risk gaps because they are start-ups or physically dispersed. They may have legally sufficient resources but in fact have more limited personnel and financial resources and cannot achieve the highest level of attention and care for the public customer.

All supervisory, inspection, and compliance audit reports should be signed off on by a registered principal and/or compliance professional with the express

representation of the registered principal and compliance professional (in addition to the independent compliance auditor's signature representation) that to their knowledge and good faith belief the scope of the audit was as represented; the compliance and exceptions to it are as stated; and the report is true and correct. Failure to have a good faith and reasonable basis for the representation will and should trigger both civil liability and regulatory consequences. The foregoing should be comparable to the signature requirement for all pleadings and court papers submitted pursuant to the Federal Rules of Civil Procedure ("FRCP").

(2) In respect to the supervision of investor suitability for products and activity in a public customer account there should be a more personalized process including initial and face to face meetings and informed consent confirmed in writing in respect to the account and attendant activity. The firm should make available investor education facilities for types of products, activities, and services that will be provided to the public customer. All new account forms will have to be signed off on by the customer plus a new account acknowledgment letter consisting of *non-boiler plate disclosures specific to the individual customer* also will have to be signed by the customer, in respect to the contemplated products, services, and activities.

A firm and its associated persons compliance with the *Know Your Customer and Suitability* Rules should not merely be subject to ongoing monitoring and internal inspections but subject to independent compliance audits certified as described by the firm's registered principal, compliance professional, and independent compliance auditor. Pre-inspection and pre audit written plans have to be prepared and identify the risks and loss prevention procedures that must be subject to inspection and audit including but not limited to *Know Your Customer and Suitability* Rule Compliance.

(3) Best execution and insider trading reviews also must be subject to on-going monitoring, internal inspections certified by registered principals and compliance professionals. Audits must include auditing procedures addressing best execution and insider trading and also must be certified to by the independent auditor as well as the registered principal and compliance professional. Just like there are gradations of accounting inquiries, testing and reports in respect to compilations, reviews, and independent audit reports there can and should be gradations with respect to contemporaneous monitoring, inspections, and independent compliance audits. Subjects such as customer disclosure and qualification for individual customers in respect to the *Know Your Customer* and *Suitability* Rules; product suitability, and trade review for both best execution, insider trading, and churning are critical. These subjects should be subject to both internal checking as well as outside and independent verification on a repeat basis.

Other areas for monitoring, inspection, and audit are unauthorized trading and abuse of discretion and trade authorization, elder abuse and high risk customer churning and excessive trading at and to the customer's expense and detriment and making trade confirmations and activity letters less mechanical and more meaningful for the customers is essential. Internal examination on a regular basis and outside independent audits need to be in place to make the best supervisory practices a reality.

(4) Investor claims handling on a professional basis is in the best interest of public investors and requires significantly more than written acknowledgement and response to the customer and should also be subject to the *tri parte* supervisory and compliance process of ongoing monitoring by claims professionals, inspections, and/or reviews and audits. Where required there should be legal evaluation and opinion, all with a view to making bona fide offers of resolution and settlement if justified. In the event the firms do not have a bona fide and competent claims process in place not only should the firm be subject to reimburse the customer for reasonable arbitration and litigation fees and costs but subject to administrative sanction (monetary or otherwise) if the firm knowingly or "recklessly fails" to establish such a process or handle the claim.

Fair payouts rather than statistical efficiency should be the operative principle. My recommendation would be to reimburse customers for legal fees and costs where there is not merely reckless failure in claims handling but professional malpractice in claims handling as well.

In respect to mandated and certainly more enhanced customer claims handling; the broader possibilities of professional liability insurance for the financial services professional will increase investor compensation for losses they should not have incurred but for the intentional, reckless, (and/or negligent) disregard of professional and industry standards as well as present a new dimension of supervision through the insurance underwriting process. The risk level of the firm and its activities including its prevention and mitigation procedures and practices will be more fully evaluated and improved by the insurance underwriting process.

A firm that can establish sound loss prevention and mitigation practices and procedures so as to have professional liability insurance coverage should receive a positive credit in respect to its supervision and compliance if the firm's or its associated person's conduct is called in question. Pursuant to Section 20(a) of the Securities and Exchange Act of 1934 ("the 34 Act") a firm and/or its principals and/or supervisors have the opportunity to avoid liability by showing they acted in good faith and did not induce directly or indirectly the conduct in issue. A showing of sound supervisory and compliance procedure meets the foregoing burden set by the 34 Act. Claims history and handling should also be transparent. Even if claims are not accrued as liabilities in

specific amounts there should be full disclosure including the nature and full amount of the claims for all firms.

I appreciate the Commission and its staff's consideration of my comments and the opportunity to participate in this informed dialogue on such an important subject for investor protection.

Respectfully,

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