July 29, 2013

By Electronic Mail (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: **FINRA Supervision Rule Proposal (File No. SR-FINRA-2013-025)**

Dear Ms. Murphy:

The Compliance and Regulatory Policy Committee of the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the proposed consolidated Financial Industry Regulatory Authority ("FINRA") rules governing supervision (the "Proposal").[2] Specifically, among other things, FINRA is proposing to adopt new FINRA Rules 3110 (Supervision) and 3120 (Supervisory Control System) to replace NASD Rules 3010 and 3012, respectively. We agree with much of the Proposal, and we appreciate the changes that FINRA has made since its 2011 proposal. As more fully discussed below, we have several suggestions that we believe will further improve the Proposal.

I. Introduction

SIFMA appreciates FINRA's extensive efforts to obtain input from its member firms regarding amendments to the supervision rule. Several revisions included in the Proposal respond to prior industry comments and provide valuable feedback to the industry, including:

[1] 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"). More information about SIFMA is available at http://www.sifma.org.

[2] *See* Notice of Filing of Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook; Release No. 34-69902 (July 1, 2013), 78 Fed. Reg. 40792 (July 8, 2013) (the "Rule Filing Notice"). The full rule filing (the "Rule Filing") is available at: http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p286229.pdf.

- Modifying the proposal to require that supervisory procedures be communicated to relevant persons;

- Eliminating the requirement that associated persons verify annually that they have reviewed their firm's written supervisory procedures;

- Clarifying that the terms "on-site supervisor" and "designated principal" are not intended to encompass "up-the-chain" reporting structure - the two terms refer to one person;

- Modifying the reporting obligations relative to internal investigations to reduce the burden;

- Eliminating risk management from the additional content requirements under proposed FINRA Rule 3120; and

- Stating that "supplementary material is part of the rule" and the location of language within the Supplementary Material does not affect "the weight or significance" of a provision.

II. Addressing Conflicts of Interest under Proposed FINRA Rule 3110(b)(6)(D) and Proposed FINRA Rule 3110(c)(3)(A)

Proposed FINRA Rule 3110(b)(6)(D) and proposed FINRA Rule 3110(c)(3)(A) require members to establish procedures to prevent "standards of supervision" and "inspection standards," respectively, from being "reduced in any manner due to conflicts of interest that may be present." As noted in our comment letter on SR-FINRA-2011-028, SIFMA fully supports the objectives of these proposals, and agrees that conflicts of interest relating to the compensation of the supervisor and the subject of that supervision should not needlessly compromise the effectiveness of supervisory procedures. However, SIFMA believes that the proposed rules may be interpreted in a manner that appears to suggest that the phrase "reduce in any manner" means that the risk-based standards of supervision and the "reasonable design" of the supervisory system are being replaced by a different standard that requires firms to prevent all conflicts of interest rather than to mitigate and control them. Although this may not be the intent of the rule proposals, SIFMA suggests that modest modifications to both rules will avoid unnecessary ambiguity and burden without diminishing the effectiveness of these rules.

A. Proposed FINRA Rule 3110(b)(6)(D)

Proposed FINRA Rule 3110(b)(6)(D) states that a member's written supervisory procedures must include:

> "procedures preventing the standards of supervision required pursuant to paragraph (a) of this Rule from being reduced in any manner, due to any conflicts of interest that may be present with respect to the associated person being supervised, including the position of such person, the revenue such person generates for the firm, or any compensation that the

associated person conducting the supervision may derive from the associated person being supervised.

1. Ambiguity of "Standards of Supervision"

We are concerned that the phrase "standards of supervision" in proposed FINRA Rule 3110(b)(6)(D) is ambiguous. Neither proposed Rule 3110(a), nor the Supplementary Material, define "supervisory standards." Nor is it a term that FINRA used in NASD Rule 3110. SIFMA assumes that the "standards of supervision" are based on the "reasonably designed" supervisory system prescribed by the rule. Therefore, we suggest that FINRA Rule 3110(b)(6)(D) replace "standards of supervision" with the well-known phrase "supervisory system" in order to avoid potential confusion in implementing this proposed rule.

2. Mitigation of Conflicts Relating to Supervision

In our prior comment letter, SIFMA stated that, read literally, proposed FINRA Rule 3110(b)(6)(D) could be interpreted to require that unless member firms eliminated any and all conflicts of interest that could impact supervision, then they otherwise would be violating the rule itself. Consequently, we suggested that the proposed rule be modified to state that members must establish supervisory procedures that are "reasonably designed to prevent conflicts of interest from impeding effective supervision." In its response, FINRA stated that rule 3110(b) is governed by the "reasonably designed standard" as opposed to a "strict liability" standard which seemed to be implied.[3]

However, FINRA also stated that the firm's conflicts of interest procedures must "address how the member will prevent these conflicts from reducing in any manner the standards of supervision for its supervisory personnel."[4] This appears to require the prevention of all conflicts rather than mitigating and controlling potential conflicts of interest relating to supervision, the latter being consistent with a "reasonably designed" supervisory system. We believe the proposed rule should reinforce the notion that mitigation of conflicts of interest should be embedded in the reasonable design of an effective supervisory system rather than what

[3] *See* 78 Fed. Reg. 40806 (stating "FINRA disagrees with this strict liability argument and declines to eliminate the provision. The reasonably designed standard that applies to the supervisory procedures required throughout proposed FINRA Rule 3110(b) does not recognize a strict liability obligation requiring identification and elimination of all conflicts of interest. Rather, the reasonably designed standard recognizes that while a supervisory system cannot guarantee strict compliance, the system must be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a member's business. Accordingly, a member's conflict of interest procedures should reflect a member's sound, common sense identification of potential conflicts of interest, based on factors unique to the member's business, and address how the member will prevent these conflicts from reducing in any manner the standards of supervision for its supervisory personnel.") (footnotes omitted).

[4] *Id.*

appears to be a new requirement to establish a separate set of procedures that prevent all potential conflicts of interest within a supervisory system.[5]

Thus, we recommend that the proposed rule language refer to "procedures reasonably designed to prevent …" rather than "procedures preventing …" and that the phrase "in any manner" be deleted. Coupled with our suggestion above regarding "standards of supervision," the rule would state *[deletions in brackets, additions underlined]*:

> "… procedures [preventing] reasonably designed to prevent the [standards of supervision] supervisory system required pursuant to paragraph (a) of this Rule from being reduced [in any manner] …"

Our suggestion prevents any misunderstanding regarding the procedures that need to be maintained under proposed FINRA Rule 3110(b)(6)(D), and is consistent with FINRA's view that the proposed rule imposes a reasonableness standard and not a strict liability one.

B. Proposed FINRA Rule 3110(c)(3)(A)

Proposed FINRA Rule 3110(c)(3)(A) uses the same "reducing in any manner" language relative to conflicts of interest in a firm's internal inspections. The proposed rule states that a member firm must:

> "prevent the inspection standards required pursuant to paragraph (c)(1) of this Rule [3110], from being reduced in any manner due to any conflicts of interest that may be present, including but not limited to, economic, commercial, or financial interests in the associated persons and businesses being inspected …"

SIFMA previously commented that proposed rule Rule 3110(c)(3)(A) appears to require members to prevent and eliminate conflicts of interest, no matter how slight, in the context of conducting its internal inspections. We therefore suggested that the proposed rule be modified to require that "inspection standards" be reasonably designed to prevent conflicts of interest from impeding effective inspections.

In its response, FINRA stated that the proposed "standard does not require the elimination of all possible conflicts of interest ... [r]ather, the proposed provision is intended to

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[5] Firm identification and management of conflicts of interest is currently the subject of a FINRA sweep examination of fourteen large firms and includes consideration of conflicts of interest related to compensation and product sales. The stated goal of the sweep is "to better understand industry practices, and to identify both good policies and potential problem areas . . . . [to] helps us determine whether FINRA should issue guidance to the industry or consider other steps to improve how conflicts are addressed." *See* Remarks by Richard Ketchum to the Consumer Federation of America Consumer Assembly, March 14, 2013, available at: http://www.finra.org/Newsroom/Speeches/Ketchum/P222651.

SIFMA believes that any regulatory action regarding conflicts of interest, including rulemaking regarding establishment of conflict of interest procedures, should be informed by the results of the conflict of interest sweep examination, consistent with the stated objectives of the sweep.

address conflicts of interest that would cause diminished inspection standards for a location that, in turn, could result in a failure to detect violative conduct committed at that location."[6] SIFMA appreciates this interpretive guidance from FINRA.

However, SIFMA is concerned with a further statement by FINRA that the undefined "standards" of internal inspections are not governed by a "reasonable standard" because the "proposed requirement does not pertain to a member's supervisory procedures, which a member must 'reasonably design' to achieve compliance with applicable federal laws and regulations and SRO rules, but instead defines a standard around which inspections must be conducted."[7] In addition, FINRA stated that the term "reduced in any manner" "does not have a fixed interpretation, but rather should be considered within the context of proposed FINRA Rule 3110(c)(1)'s reasonably designed inspection standards."[8]

Based on this response, SIFMA is uncertain about the intent of the "inspection standard" under proposed FINRA Rule 3110(c)(3)(A). Proposed FINRA Rule 3110(c)(3)(A) requires that member firms must "prevent" their inspection standards from being reduced "in <u>any</u> manner" due to any conflicts of interest that may be present. FINRA stated that this means that the proposed rule is not subject to a "reasonably designed" standard. However, FINRA also stated that this proposed rule does not impose a strict liability standard and the phrase "reduced in any manner" "does not have a fixed interpretation."

Since proposed FINRA Rule 3110(c)(3)(A) states that a member firm's inspection standards must, unequivocally, not be reduced "in any manner" due to <u>any</u> conflicts of interest that may be present, and this standard is <u>not</u> subject to a "reasonable design" standard, then we are unclear as to what standard is being imposed. Since FINRA stated in its response that the proposed rule does not impose a strict liability standard, then the proposed rule should be revised to make clear what the alternative standard is. SIFMA recommends that FINRA make clear that inspection standards should be reasonably designed to prevent conflicts of interest from impeding effective inspections. We therefore request that FINRA make this change which would appear as follows *[deletions in brackets, additions <u>underlined</u>]*:

> "For each inspection conducted pursuant to paragraph (c), a member must: (A) [prevent the] <u>employ</u> inspection standards <u>reasonably designed to prevent</u> [required pursuant to paragraph (c)(1) of this Rule, from being reduced in any manner due to] any conflicts of interest that may be present, including but not limited to, economic, commercial, or financial interests in the associated persons and businesses being inspected, <u>from impeding effective inspections</u> …"

[6] 78 Fed. Reg. at 40808.

[7] *Id.*

[8] 78 Fed. Reg. at 40807 at note 79.

III. Scope of Covered Accounts

A. Proposed Rule 3110(d)(3)(A)(i)

As stated in our prior comments to SR-FINRA-2011-028, SIFMA is supportive of the objectives of proposed Rule 3110(d). Based on a long history of federal legislation and SRO regulation, member firms have established reasonably designed procedures and risk-based reviews relating to the supervision of employee personal trading that is based on accounts where the employee has a direct beneficial interest, discretionary authority to make investment decisions, or has outside accounts required to be reported under NYSE Rule 407 and NASD Rule 3050. SIFMA also recognizes the importance of reporting and reviewing accounts of an associated person's immediate family members when these well-established conditions are present or when the family member lives in the same household with, or has a financial dependency on, the associated person.

However, FINRA is proposing to expand the definition of "covered accounts" with respect to family members, under proposed Rule 3110(d)(3)(A)(i), well beyond existing NYSE and SEC requirements to any "covered accounts" that the member firm is introduced to or holds, as follows:

> "The term 'covered account' for each member shall include: any account held by the spouse, domestic partner, child, parent, sibling, son-in-law, daughter-in-law, father-in-law, or mother-in-law of a person associated with the member where such account is introduced or carried by the member;"

SIFMA does not object to the proposed additional categories of family members to include parents, siblings, fathers-in-law, mothers-in-law and domestic partners if the existing conditions (*i.e.*, beneficial interest in, control over, authority to make investment decisions) apply to such accounts held at the member firm or when a family member lives in the same household with, or has a financial dependency on, an associated person. SIFMA is concerned that omitting these well-established conditions, thereby replacing the nexus of the associated person's ability to influence with the instance of familial relation – and expanding the scope of accounts to include all such accounts held at the member firm – will raise significant implementation issues, including impacting legitimate privacy expectations of these individuals. The expansion of the rule would require member firms to identify, track and supervise accounts in which investment activities are completely independent from the associated person, and do so merely because that family member maintains an account at the member firm. We view this aspect of the proposal to be a "sea change" from existing regulation rather than a harmonization of current rules and request that FINRA adopt a final rule that will more closely follow existing NYSE and SEC requirements in the interests of consistency and practicality.

B. NYSE Requirements

There is a long regulatory history relating to the review of employee trading and related accounts, and this guidance has been reasonably relied upon by member firms. In Information Memo 89-17, the NYSE clarified its intent in requiring family member accounts to be reviewed under Rule 342.21(a) and confirmed the reviews would be substantially facilitated and more meaningful if family member accounts were limited to those introduced or carried by a member for an employee's spouse; children and children's spouses provided that they *reside in the same household* with, or are *financially dependent* upon, the employee; as well as any related individual over whose account the employee has control; or any other individual over whose account the employee *controls* and to whose *financial support* the employee materially contributes. SIFMA understands that member firms since 1989 have established supervisory procedures and supervisory systems based on these conditions, and that FINRA has not to date provided any guidance that such procedures and systems are not reasonably designed. It has not been made clear why these conditions do not meet regulatory expectations relating to review of employee trading.

C. SEC Requirements

It is also instructive to compare SEC rules that require supervision of personal trading to proposed Rule 3110(d). In particular, SEC Rule 17j-1 under the Investment Company Act of 1940 and Rule 204A-1 under the Investment Advisers Act of 1940 (collectively referred to as "Code of Ethics rules") require an investment adviser's "access persons" to report, and the firm to review, personal securities transactions and holdings. The reporting requirements are limited to reportable securities in which the access person has a direct or indirect beneficial ownership.

Beneficial ownership is determined by cross-reference to Rule 16a-2 under the Securities Exchange Act of 1934 ("Exchange Act"). A beneficial owner under Rule 16a-2 is one who has a direct or indirect pecuniary interest in a security, or in other words, an opportunity to profit from the security (or account). There is a presumption of indirect pecuniary interest in securities held by a person's immediate family, but only when sharing the *same household*, and the provision notes this presumption may be rebutted.

In addition, the reporting requirements under the Code of Ethics rules include express exceptions. For example, access persons need not report transactions made in accounts over which they have no direct or indirect influence (*e.g.*, a "blind trust" discretionarily managed by another adviser) or made pursuant to automatic investment plan (*e.g.*, a dividend reinvestment plan).

The Code of Ethics rules were adopted by the SEC in 2004, a year following the adoption of rules requiring investment companies and investment advisers to have compliance programs to address conflicts of interest including personal trading.[9] SIFMA believes the relatively recent

[9] The SEC adopted Rule 204A-1 and amendments to Rule 17j-1 in July 2004. The year prior, in December 2003, the SEC adopted Rule 204(4)-7 and Rule 38a-1.

adoption of the Code of Ethics rules, which limit the required reporting and review of family member accounts to when certain factors are present such as residing in the same household, serves to effectively ratify the similar approach adopted for broker-dealers by the NYSE approximately 15 years earlier in Information Memo 89-17.

D. Implementation and Privacy Considerations

As noted above, proposed Rule 3110(d)(A)(3)(i) would lead to an unprecedented requirement for associated persons to report the accounts of family members introduced or carried by a member firm even when the associated person has no beneficial interest in, control over or authority to make investment decisions in that account and the family member does not reside in the same household as the associated persons or is not financially dependent. In many cases, an associated person may not be aware of whether a family member has an account with his/her firm unless the aforementioned longstanding conditions for inclusion are present. Furthermore, as proposed, the rule would require an associated person of a carrying firm to determine and report family member accounts held with his/her firm even if the accounts are introduced by an unaffiliated correspondent broker-dealer and there is no further nexus between the associated person and the account holder other than familial relationship. This would necessarily require the member firm to establish procedures requiring their associated persons to request and receive highly sensitive information from family members either in the form of account numbers and/or personally identifiable information such as social security numbers that firms could use to identify the accounts. The implementation and privacy-related considerations associated with such an expansion of the "covered accounts" definition lead SIFMA to believe the expansion is both impracticable and inappropriate.

Personal financial information such as personal account holdings and transactions are understandably viewed as highly confidential, perhaps even as much among family members as with the general public. While we are not aware that this reporting and review of family member accounts would be a violation of federal, state, or foreign privacy laws or regulations, it might well be, especially considering the proposed wide scope of holders of a covered account will affect a significantly increased number of foreign persons in many different countries. Regardless of whether privacy laws would be violated, it is likely that family members may refuse to provide the information, strongly object to reviews of their accounts, or even move accounts to an unaffiliated broker-dealer in order to avoid the intrusion. It also will be the case that, in certain instances, associated persons are estranged from or otherwise do not have a relationship with family members covered by the proposed rule. The costs of implementing this change are potentially quite significant, including developing procedures where the associated person's requests for information go unheeded, and the firm then needs to obtain that information itself.

In addition, several member firms have indicated that family member accounts and transactions are not only reviewed through automated account surveillance programs but are also directly reviewed each month or quarter by an associated person's manager or assigned registered principal. Personal information of this nature is not only viewed as sensitive among family members but also between co-workers and the additional disclosure required by the

expanded definition of "covered accounts" would likely result in employee dissatisfaction and could result in inappropriate disclosure of personal customer information.

There would also be potentially significant resources expended in obtaining and tracking the disclosure of accounts from associated persons and implementing their review through established systems for account monitoring and insider trading surveillance such as information barrier restrictions and preclearance for access persons. Challenges to identifying and maintaining a record of covered accounts would include the fact that family relationships change and accounts are opened and closed with regularity. The resources necessary to manage the additional disclosures required by an expanded definition of "covered accounts" could be better directed at monitoring and surveillance of accounts which fulfill the long-standing conditions required under current rules, which are characterized by the well-precedented nexus of an ability to influence (*i.e.*, beneficial interest in, control over, authority to make investment decisions, same household or financial dependence).

E. Adopt a Rule Consistent with Existing Requirements

Accordingly, SIFMA urges FINRA to retain the general and long-standing conditions required under current rules for the reporting and review of family member accounts when adopting proposed Rule 3110(d)(3)(A)(i). In the absence of these conditions (*e.g.*, direct control, beneficial interest, or authority to make investment decisions), accounts of family members should only be reported and reviewed when the family member resides in the same household or is financially dependent on the associated person. We do not believe there has been a showing that the existing regulatory standards are insufficient or that including these additional familial relationships in the definition of "covered accounts" will improve member firms' surveillance to an extent that significantly outweighs the substantial additional costs and burdens that would be imposed not just on member firms but on family members whose activities are not related to the member firm, its business or its associated persons. In addition, we believe FINRA should consider adding exclusions for certain account types from Rule 3110(d)(3)(A) such as those available under the Code of Ethics rules including for discretionarily managed accounts and dividend reinvestment plans.

IV. Review of Electronic Internal Communications

Proposed FINRA Rule 3110(b)(4) would require FINRA members to have procedures to review incoming and outgoing written (including electronic) correspondence and internal communications relating to the members' investment banking and securities businesses.

A. Proposed Supplementary Material .07 and Internal Communications

Proposed FINRA Rule 3110(b)(4) states, in pertinent part, that a member firm's "supervisory procedures must require the review of … internal communications to properly identify those communications that are of a subject matter that require review under FINRA and MSRB rules and federal securities laws."

Further, in pertinent part, proposed Supplementary Material .07 states:

> "By employing risk-based principles, a member must decide the extent to which additional policies and procedures for the review of … internal communications that are not of a subject matter that require review under FINRA and MSRB rules and federal securities laws are necessary for its business and structure."

We ask that FINRA clarify that member firms do not need to review every internal communication that relates to a member's investment banking and/or securities businesses.

We raised this concern in our comment letter on SR-FINRA-2011-028. In response to our prior comment, FINRA said that it:

> "has modified proposed FINRA Rule 3110(b)(4) and Supplementary Material .07 to more precisely reflect the guidance in Regulatory Notice 07-59 that a member must have supervisory procedures to provide for the member's review of its internal communications to properly identify communications that are of a subject matter that require review under FINRA or MSRB rules and the federal securities laws and that, by employing risk-based principles, the member must decide the extent to which additional policies and procedures for the review of additional internal communications are necessary for its business and structure. These modifications reflect FINRA's intent, as noted in the Initial Filing, to codify Regulatory Notice 07-59's guidance regarding the supervision of electronic communications."[10]

We appreciate the modifications made by FINRA to recognize the risk-based differences between internal and external communications. However, SIFMA does not believe proposed Supplementary Material .07 adequately reflects the guidance in Regulatory Notice 07-59. Regulatory Notice 07-59 provides considerably detailed guidance regarding the review of internal communications and, most importantly, makes clear that not all internal electronic communications regarding a member firm's securities and/or investment banking businesses must be reviewed. The combination of proposed FINRA Rule 3110(b)(4) and Supplementary Material .07 still, in our view, is ambiguous as to whether firms are required to review all internal communications that relate to a member's investment banking and/or securities businesses since, notwithstanding the allowance for risk-based review, firms are still required to properly identify internal communications that are of a subject matter that require review under FINRA and MSRB rules and federal securities laws. Therefore, in order to resolve this ambiguity, we suggest that FINRA modify proposed Supplementary Material .07 to expressly state that FINRA Rule 3110(b)(4) does not require that firms review every internal communication, as follows *[deletions in brackets, additions <u>underlined</u>]*:

[10] 78 Fed. Reg. at 40804.

> "By employing risk-based principles, a member must decide the extent to which additional policies and procedures for the review of: …(b) internal communications that are not of a subject matter that require review under FINRA and MSRB rules and federal securities laws are necessary for its business and structure. Through the use of risk-based principles, Firms can determine the extent to which the review of their internal communications is necessary."

B. Proposed Supplementary Material .08

Proposed Supplementary Material .08 would note that merely opening a communication is not sufficient review. Instead, a FINRA member would have to identify the communication reviewed, the identity of the reviewer, the date of review, and the actions taken by the member as a result of any significant regulatory issues identified during the review.

In our comment letter on SR-FINRA-2011-028, we suggested that FINRA clarify that members do not need to maintain a record of the required documentation (*i.e.*, identity of reviewer, date of review, etc.) for communications that are reviewed through electronic review systems or lexicon-based screening tools and do not generate review alerts. In the Rule Filing, FINRA declined this suggestion stating that "the required documentation is necessary to demonstrate that the communication was actually reviewed."[11]

We believe there is potential conflict between FINRA's position that electronic review systems are permissible and its position that firms must keep a record of the required documentation when an electronic review system does not generate a review alert. We request that FINRA confirm our position that lexicon-based screening tools are a risk-based means of identifying communications for review, and when no hit or alert is generated by the electronic surveillance tool, there is no need to document a reviewer, his/her date of review, or actions taken for purposes of Supplementary Material .08. We suggest that FINRA further modify proposed Supplementary Material .08 to require member firms that employ electronic review systems to retain documentation to reasonably demonstrate such electronic review, as follows *[deletions in brackets, additions underlined]*:

> "For those communications reviewed by a natural person, the evidence of review required in Rule 3110(b)(4) must be recorded either electronically or on paper and must clearly identify the reviewer, the internal communication or correspondence with the public that was reviewed, the date of review, and the actions taken by the member as a result of any significant regulatory issues identified during the review. [Merely opening a communication is not sufficient review.] For those communications subjected to electronic review, the member must maintain documentation reasonably sufficient to demonstrate the parameters of such review."

[11] *Id.*

V. Communicating Written Supervisory Procedures

Proposed FINRA Rule 3110(b)(7) states that each member firm is "responsible for promptly communicating its written supervisory procedures and amendments to all associated persons to whom such written supervisory procedures and amendments are relevant based on their activities and responsibilities." While SIFMA does not object to the language of proposed FINRA Rule 3110(b)(7), SIFMA believes that written supervisory procedures should only be distributed to persons with responsibilities under the written supervisory procedures.

FINRA rejected SIFMA's prior comment that written supervisory procedures only be disseminated to supervisory personnel, and FINRA makes clear in the Rule Filing its view that the term "relevant" refers to associated persons beyond supervisory personnel. FINRA's decision appears premised on its view, as expressed in the Rule Filing, that "all associated persons are deemed to have knowledge of and are subject to a member's supervisory procedures and amendments."[12]

We are not aware of any support for FINRA's statement that all associated persons are deemed to have knowledge of their firms' supervisory procedures. At many firms, written supervisory procedures are intended solely for supervisors while other documents (*e.g.*, compliance policies) are intended for the broader audience of all associated persons. In fact, at many firms, there are written supervisory procedures that firms do not want every person to be aware of (*e.g.*, how employee correspondence and trading are reviewed) because the broad dissemination may undermine their effectiveness or cause confusion. Therefore, SIFMA suggests that FINRA permit firms the flexibility to determine who should receive which portions of their written supervisory procedures, if any, and not unnecessarily interpret the language of proposed FINRA Rule 3110(b)(7) to include non-supervisory personnel.

VI. Review of All Transactions

Proposed FINRA Rule 3110(b)(2) requires member firms' written supervisory procedures to "include procedures for the review by a registered principal, evidenced in writing, of **all** transactions relating to the investment banking or securities business of the member" (emphasis added). Proposed Supplementary Material .06 states that a member firm "may use a risk-based review system to comply with Rule 3110(b)(2), which requires the review by a registered principal, as evidenced in writing, of all transactions relating to the investment banking or securities business of the member."

SIFMA requests that FINRA confirm that "risk-based review system" as described in proposed Supplementary Material .06 does not require that "all" transactions are reviewed by a principal; rather, a "risk-based review system" means that a member firm's supervisory systems must take into account "all" transactions, but under such "risk-based review system," only a sample of transactions may in fact be reviewed by a principal.

[12] 78 Fed. Reg. 40806-07.

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SIFMA appreciates the opportunity to provide comments on proposed consolidated FINRA Rules 3110 and 3120 governing supervision and supervisory control requirements. If you have any questions or require further information, please contact Kevin Zambrowicz, at (202) 962-7386 (kzambrowicz@sifma.org), or outside counsel Michael Wolk at (202) 736-8807 (mwolk@sidley.com) or Michael Trocchio at (202) 736-8070 (mtrocchio@sidley.com).

Very truly yours,

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