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June 13, 2008

VIA E-MAIL TO PUBCOM@FINRA.ORG

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

Re: FINRA Regulatory Notice No. 08-24
Proposed Consolidated FINRA Rules
Governing Supervision and Supervisory Controls

Dear Ms. Asquith:

The Public Investors Arbitration Bar Association ("PIABA") appreciates the opportunity to provide the Financial Industry Regulatory Authority with comments regarding the Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls.

We recognize that the proposed rules will effect important substantive and structural changes in brokerage industry supervision and that any proposed rule will be subject to SEC publication for public comment. We therefore offer our comments with the acknowledgment that PIABA will submit additional and more detailed commentary at such time as the SEC publishes the proposals.

PIABA is a bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums. Our members and their clients have a strong interest in FINRA rules which govern the arbitration process. We are also particularly interested in the rules which govern the conduct of securities firms and their representatives. These rules are in place primarily to protect the nation's investors and savers, as well as to provide a minimum industry standard upon which the public and regulators can rely.

The effort of FINRA to consolidate the rules of the NASD and the NYSE is worthwhile, and we support many of the proposals to streamline the rules and avoid the duplications of the past. However, some of these proposed rule changes go far beyond "consolidation," and create essential issues for the protection of the investing public.

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The concerns which we encourage FINRA to address prior to submission to the SEC involve areas that we perceive as important to a customer's ability to hold a broker-dealer and its associated persons responsible for improper conduct. We note that throughout the Proposed Rules there is a move away from specific rules and prescriptive provisions to a "more flexible approach to certain supervision requirements.[1]" Those of us who represent the investing public against members of the industry who violate the rules, know all too well the difficulty in proving a violation of a rule, a regulation, or a law without a clear statement of what that rule, regulation or law is. We are concerned that the term "flexible" appears to be a euphemism for "reduced" or "diminished" supervision requirements. We strenuously oppose any changes that reduce the protection of consumers or that will make proof of misconduct more difficult.

PIABA Is Opposed to "Principles-Based Regulation"

The proposed rule includes numerous references to "risk-based" review or examination. Recently there has been a great deal of discussion of "risk-based" review in the same breath as "principles based" regulation. These concepts have become popular in Europe and have recently been promoted by the Federal Reserve Chairman[2] and the Secretary of the Treasury[3], among others. To the extent that FINRA's use of the "risk-based" concept may signal a first step down the slippery slope of "principles based" rules and regulation, PIABA takes this opportunity to go on record as strongly opposing such a trend.

Given the accelerating pace of industry-wide scandals in recent years, it is our belief that more, rather than fewer, bright-line rules are needed. Unscrupulous members of the industry have had enough difficulty keeping their conduct in line with specific rules; one can hardly expect that their behavior would improve under a generic set of "principles." If the purpose of regulation is to protect the investing public, we do not see how a move toward less specificity will accomplish the purpose.

Moreover, "principles-based regulation" is entirely unsuitable and inappropriate for a self-regulatory organization like FINRA. We point out two primary reasons.

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[1] FINRA Regulatory Notice 08-24, p. 3.

[2] Remarks by Secretary Henry M. Paulson, Jr. on Blueprint for Regulatory Reform, March 31, 2008, available at http://www.ustreas.gov/press/releases/hp897.htm.

[3] Ben S. Bernanke, "Regulation and Financial Innovation" (speech, Financial Markets Conference, Federal Reserve Bank of Atlanta, Sea Island, GA, May 15, 2007), available at www.federalreserve. gov/boarddocs/Speeches/2007/20070515/default.htm

First, without clear rules by which compliance professionals can monitor and train registered representatives, supervisors, and officers of broker-dealers, compliance professionals will lose any ability to impose even superficial control over misconduct. Those being monitored can rightly say that they haven't broken any rule or crossed any bright line, and they can rightly say it is only the compliance professional's opinion that a "principle" has been violated.

Second, in enforcement by the SEC or other regulators, or in arbitration by customers who have been wronged by an industry person, the ability to prove a violation which will subject the violator to sanctions or an award of monetary compensation will be greatly diminished if the regulator or the consumer can point to no clear rule that has been violated.

Our position is in line with that of many compliance professionals. For example, in the August 6, 2007 *Securities Industry News*, one compliance professional was quoted as saying: "Our clients are compliance professionals. They do not want principles-based regulation. [The new approach] will be a significant industry shift in that most broker-dealers want to maximize profit. But clear rules are helpful for compliance professionals. If the compliance professional can no longer use the rule to instruct the broker-dealer about what to do, it will increase tension. . . . The downside is that it will be harder for compliance professionals. Compliance has a seat at the table now. I would like to think that the idea of a principles-based rules system is that you get to the underlying idea of risk, and doing the right thing. But if there are not clear rules, you wonder how far the line is going to get pushed."

Further, while it may be contended that "principles-based regulation" can work for a true governmental regulatory agency provided the agency is fully funded with adequate staff to perform the needed tasks, the same cannot be said for an SRO, where critics would say the "fox guards the henhouse." Certainly, pressure for an SRO to be lenient in enforcing rules against its own members can more easily be brought to bear than when rule enforcement is by an independent governmental regulatory agency.

Even those who favor principles based regulation recognize that, with the extent of agency capture in the United States, and the failure to properly fund independent regulators, we are not ready for such a change. As one commentator put it: ". . . a principles-based system relies on dedicated, well-funded regulators who are interested in regulating.[4]" That definition cannot apply to any self-

4 James Surowiecki, "Parsing Paulson," The New Yorker, April 28, 2008.

regulatory organization. FINRA should not be moving toward "principles based regulation" now or in the future.[5]

Risked-Based Review and Examination

The proposed rule is peppered with the terms "risk-based review," "risk-based examination" and "risk-based principles." For example, Proposed Rule 3110(b)(2) requires that all transactions related to the securities business of a firm be subject to a registered principal's review to be evidenced in writing. By itself, this is a clear and enforceable rule, and registered principals know exactly what is expected of them. However, the Supplementary Material, in paragraph .06, provides that "a member may use a risk-based review system to comply with Rule 3110(b)(2)." The term "risk-based" also appears for review of correspondence (Supplementary Material to Rule 3110, paragraph .09) and for annual examination of transfers of funds between customers and brokers or between customers and third parties (Proposed Rule 3110(c)(2)(A)(iv)).

Nowhere is the term "risk based" defined. Thus, proposed rules provide for a "risk based" standard with no meaningful direction as to the type of review, examination or principles. One obvious concern is that FINRA will view the concept of "risk-based" review of offices and "risk based" supervision of brokers with reference to the level of "risk" to the broker-dealer, as opposed to the level of "risk" to the customer.

While we support any FINRA proposal to provide greater protection to the investing public, we emphatically oppose any efforts to diminish or erode consumer protections. We view the reference to "risk-based" rules or regulation as the first step toward such erosion. We urge FINRA to establish well-defined standards which will assure that everyone will understand the rules, and there can be no question what is expected of members of the industry.

Non-Reporting of Oral Complaints

Proposed Rule 3110(b)(5) would limit the customer complaints which a firm is required to "capture, acknowledge, and respond to." Specifically, the firm

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[5] The oft-stated rationale in favor of principles based regulation is that it will improve our nation's competitive position in the capital markets. This is a doubtful proposition. Indeed, the historical success of the United States in attracting capital from investors around the world is due in large part to the perception that investors receive greater protection in our country than elsewhere. We believe the United States can retain its preeminence only by continuing to assure that our markets are the safest place in the world for investors. A move toward principles based regulation is precisely the wrong way to go.

would need to "capture, acknowledge, and respond to" written complaints only, thereby allowing firms to conceal oral complaints from customers. This proposal is purely and simply "anti-consumer" and benefits the firm and its associated persons over the customer. A better approach to this issue would be to require firms to provide the customer with a form to file a complaint. If the customer does not choose to write the complaint, the member should reduce the complaint to writing, offer its counter statement to the oral complaint, and send a copy to the customer. The firm should then be required to report the complaint along with the firm's response.

Many customers, in our experience, are unable or reluctant to put their thoughts in writing. When the financial services industry is ready to restrict their sales efforts to those persons who possess a college education or are able to demonstrate a reasonable comfort level, and an ability, to write the English language with coherence, then requiring written complaints may make some sense and be appropriate. Since the financial services industry routinely solicits customers of all education levels, and of all financial levels, the industry should make sure that even those who do not type, cannot write well, and/or are intimidated by the thought of writing a letter, are given the same ability to complain and have their complaints recorded and heard by regulators.

Moreover, it must be recognized that communications between a broker and client are almost always oral, typically conducted over the telephone. Accordingly, it may be expected that most complaints are, at least initially, communicated orally. The fact that they are communicated in this way makes them no less a complaint, nor does it make the complaint any less important to the client. Simply put, the exclusion of unwritten complaints ignores the essential character of broker-customer relations. Requiring complaints to be in writing before they are acknowledged is clearly inconsistent with FINRA's stated objective of protecting the investing public.

Proposed FINRA Rule 3110(b)(3)

Proposed Rule 3110(b)(3) provides that outside activities are subject to supervision if the firm "gives its written approval." This language may be construed to suggest that if the firm did not give written approval for outside activities, it would not have responsibility for supervision of the associated person relating to these activities. The rule should clearly state the obligation of the firm to supervise associated persons to detect and prevent unapproved activities.

An additional concern in Proposed FINRA Rule 3110 relates to the exception proposed from the general supervisory requirements of Proposed

FINRA Rule 3110 (b) for bank-related securities activities involving a "dual employee." This change would put the industry in a bifurcated claim situation. Bank employees above the registered representative level are often not registered. Therefore, any claim against the individual registered representative would need to be arbitrated through FINRA, but the "lobby broker" firm may contend that it was permitted to justifiably rely on the bank employees. In addition, a claimant could not compel the bank to arbitrate, so the claimant would also need to pursue a claim in court. This would create unacceptable additional expense and burden on the customer.

Limitation of Reporting to Firms Grossing at Least $150 Million

Former NYSE Rule 342.30 required members of the Exchange to report certain information relating to specified issues. Proposed FINRA Rule 3120(b) would retain the substantive reporting requirements of the NYSE Rule, but would only require such reporting by firms who had exceeded $150 million in gross revenues on the prior year's FOCUS reports. The Regulatory Notice, at page 10, explained the limitation as follows:

> Under the proposed rule, firms subject to the supplemental information requirement would have to include in the following year's reports a tabulation of the previous year's customer complaints and a discussion of the previous year's compliance efforts in a number of specified areas, such as trading and market activities, investment banking activities and sales practices. FINRA believes the $150 million threshold serves as an appropriate benchmark to identify those firms for which this additional information is most beneficial given the nature and complexity of the firms' activities, and by using FOCUS report data, firms can easily and readily determine whether they are subject to the enhanced information requirement.

The Regulatory Notice seems to suggest that the "supplemental information" is somehow excessive and that its reporting would be an unnecessary burden for firms with less than $150 million gross revenues. PIABA believes this is exactly the type of information that all firms, irrespective of size, should be required to report.

Retention of Correspondence and Internal Communications

Paragraph .12 of the Supplementary Material to Proposed Rule 3110 states:

> Each member shall retain the internal communications and correspondence of associated persons relating to the member's investment banking or securities business for the period of time and accessibility specified in SEA Rule 17a-4(b). The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records, and the retained records shall be readily available to FINRA, upon request.

By conforming the rule on the retention of correspondence and internal communications to that of the SEC Rule 17a-4(b), FINRA continues the retention period at just three years. This can be a significant impediment to the ability of consumers to pursue legitimate claims. While securities statutes often have limitations periods expiring in three years or less, the FINRA eligibility rule permits arbitration claims to be brought within six (6) years of the event or occurrence. Furthermore, many state statutes also have limitations periods extending to six years and possibly more when the various tolling rules are applied, and many state limitations periods have no application to arbitration. Accordingly, the document retention periods should not be reduced. To do so only makes it more difficult for a customer to prove a violation of a rule, regulation, or law.

The record retention requirement for most customer-oriented documents should be at least six (6) years. This six-year period would match the eligibility provisions for customer disputes contained in FINRA Rule 12206. In the age of electronic storage, there should be little argument over reasonably increasing the time periods for document retention. Whereas the document retention rules once posed a burden in terms of finding warehouse space, electronic storage space may be obtained at near-zero cost.

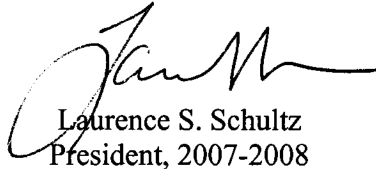
In addition, PIABA would like to see a rule requiring that these kinds of records, as well as any other customer-related documents, be made available upon request to customers and former customers within a reasonable time and at no charge.

Conclusion

PIABA appreciates the opportunity to comment on these important rule changes before they are submitted to the SEC. These changes are broad in scope and will materially affect the supervisory responsibilities of the brokerage industry. Because of the scope and importance of these changes, PIABA will continue to review these FINRA's proposals; and as noted above, we anticipate that we will have further substantive comments at the time these proposals are published by the SEC for comment.

Respectfully submitted,

PUBLIC INVESTORS ARBITRATION
BAR ASSOCIATION



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