

Office of the Corporate Secretary-Admin.

March 5, 2010

FINRA
Attention: Marcia E. Asquith
Office of the Corporate Secretary
1735 K Street, N.W.
Washington, D.C. 20006-1506

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FINRA
Notice to Members

Dear Ms. Asquith:

National Financial Services LLC and Fidelity Brokerage Services LLC ("Fidelity") appreciate the opportunity to comment on FINRA's Regulatory Notice 10-03, which sets forth three proposed rules: FINRA Rule 4314 (Securities Loans and Borrowings); FINRA Rule 4330 (Customer Protection – Permissible Use of Customers' Securities); and FINRA Rule 4340 (Callable Securities).

After carefully reviewing the Regulatory Notice, we submit the following comments specific to proposed FINRA Rule 4330 (Customer Protection – Permissible Use of Customers' Securities).

We generally support proposed FINRA Rule 4330(a), which continues to require a member firm to obtain a customer's written authorization prior to lending the customer's eligible margin securities, and would permit a member firm to satisfy the written authorization requirement by using a single customer-signed margin agreement/loan consent, provided that it contains a legend in bold type face placed directly above the signature line that states:

BY SIGNING THIS AGREEMENT I ACKNOWLEDGE THAT MY SECURITIES MAY BE LOANED TO YOU OR LOANED OUT TO OTHERS.

Considering the existing requirement under NYSE 402(b) and Interpretation 01, most member firms currently have similar language already contained within their margin agreement. We believe this new language and placement is relatively easy to accomplish, but hereby request that this requirement apply only to new margin agreements established, as opposed to requiring firms to repaper all existing margin customers with the new language. Given that existing margin agreements generally contain similar language already, we believe repapering existing agreements provides only minor additional benefit at best and that the benefit would pale in comparison to the tremendous cost involved in such an undertaking.

We have several comments related to proposed FINRA Rule 4330(b) (Requirements for Borrowing of Customers' Fully Paid or Excess Margin Securities).

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Proposed FINRA Rule 4330(b)(1) requires members to notify FINRA, in such manner and format as FINRA may require, at least 30 days prior to engaging in such activities. FINRA may request related information, including the written agreement authorizing such arrangements, the types of customers, the accounts used and the collateral involved in the transactions.

We generally agree with this requirement as applied going forward to member firms that do not currently have programs in place to borrow customer fully-paid or excess-margin securities. However, given that fully-paid programs have been a focus area during both routine and "sweep" FINRA examinations over the last couple of years, we do not believe there is any benefit to imposing this requirement on firms with existing programs that FINRA has already taken the opportunity to review.

Proposed FINRA Rule 4330(b)(2) imposes a new requirements that a member firm, prior to entering into a securities borrow transaction with a customer, provide the customer, in writing (which may be electronic), with a clear and prominent notice that the provisions of SIPA may not protect the customer with respect to such transaction and that the collateral delivered to the customer may constitute the only source of satisfaction of the member firm's obligation in the event the member firm fails to return the securities. In addition, a member firm would be required to provide the customer with information regarding risks associated with the transaction (e.g., the potential loss of SIPC protection as described above, a loss of voting rights, possible limitations on the ability to sell the borrowed securities); the economics of the transaction, including potential tax implications; and the member firm's right to liquidate the transaction because of a condition of the kind specified in proposed FINRA Rule 4314(b).

We agree that customers should be fully informed of the risks associated with lending their fully-paid and excess-margin securities and believe that an industry-standard risk disclosure form should be developed to help ensure consistent standards for disclosure across the industry.

FINRA has expressed concerns about limitations on the ability of the customer to sell the borrowed security. The SEC has issued guidance on ability to sell securities on loan "long," provided certain conditions are met (e.g., recall within 2 days etc.). We do not believe any distinction should be drawn between hypothecated margin securities and fully-paid or excess margin securities on loan, as long as it is reasonable to believe they can be recalled by settlement date of the sale.

Although loaned securities are no longer covered by SIPC protection, it is important to recognize that each loan of fully-paid or excess-margin securities must comply with Rule 15c3-3 of the Securities Exchange Act of 1934. Rule 15c3-3(b)(3) specifies, among

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other things, that the broker or dealer must provide to the lender collateral consisting exclusively of cash or United States Treasury bills and Treasury notes, or an irrevocable letter of credit issued by a bank as defined in Section 3(a)(6)(A)-(C) of the Act which fully secures the loan of securities.¹ Rule 15c3-3 also sets forth the requirement to mark the loan to the market not less than daily.

Proposed FINRA Rule 4330(b)(2) includes disclosure of the "economics of the transaction." We believe this should include the rate the customer will be paid by the broker or dealer to borrow the securities, which already must be disclosed to the customer as required under the standard master securities lending agreement executed between the customer and the broker or dealer. We also believe customers should be made aware of the potential for different tax treatment on the payment of dividends, while the security is on loan.

However, we are aware that FINRA has discussed applying a mark-up type analysis to this activity, which would not be analogous and we believe would be inappropriate.² First, we note unlike typical securities transactions, the customer is receiving income from the broker-dealer in these loan transactions as opposed to incurring an expense or transaction cost on a trade. This transaction is more analogous to a customer's cash balance resulting in the firm paying interest to the customer out of the interest income the firm earns off of the resulting free credit balance. In order for a customer to make an informed decision as to what firm to place a cash balance with a firm or whether to invest the cash balance, a customer only needs to know what rate they will receive. The rate earned by the firm is irrelevant to the customer's decision.

Second, there is not a one-to-one relationship between a customer's loan of securities to the firm and the firm's loans to other customers or the street. The borrowed securities are fungible with other like securities available for loan by the firm and may be effectively lent to several different counterparties at different market rates and combined with other available securities over the life of the loan. It would be impossible to definitively identify for any fully-paid stock loan customer how much spread the firm made on their particular securities just as a bank could not say how much it made on any particular deposit through its loan portfolio. Any rate provided to the customer at the time of the loan would be an average blended rate for that security. In addition, it would only be an

¹ Interpretations to Rule 15c3-3 have also set forth other types of acceptable collateral, including, securities issued by the United States Treasury, Participation Certificates and Mortgage-Backed securities guaranteed by GNMA, and negotiable bank certificates of deposit and bankers acceptances issued by banking institutions in the United States and payable to the United States.

² For example, one senior FINRA executive has indicated that that FINRA is concerned that, when borrowing fully paid for/excess margin securities from retail customers, firms are not adequately disclosing among other things the amount of revenue that firms are deriving from the on-lend of such securities.

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estimate at that moment in time as there would be no way of knowing exactly what rate that security would be lent out at initially or over the life of the loan. Because this disclosure would not provide meaningful information to assist the customer in making any loan or investment-related decision and would only be a rough estimate in any event, we do not believe it is appropriate to require firms to generate and disclose this type of information to customers that are prospective loan counterparties.

Proposed FINRA Rule 4330(b)(2) also requires a member firm to determine whether the transaction is suitable for the customer. As it relates to this requirement, we request further clarity about FINRA's views on a suitability determination with respect to stock loan transactions. If a customer is fully informed of the risks associated with the transaction, executes a master securities lending agreement with the firm which sets forth the terms and conditions of the loan, the loan is fully collateralized in accordance with Rule 15c3-3(b)(3), and there are no limitations placed upon the customer's ability to sell the loaned security or draw upon the collateral, we would like further clarification on what would make a customer unsuitable to participate.

Fundamentally, we question FINRA's implicit assumption that the loan increases rather than decreases the customer's risk position. Although the customer is foregoing SIPC protection, the customer is doing so only upon receipt of Rule 15c3-3(b)(3) qualifying collateral. Furthermore, if the collateral is placed with a separate custodian, the customer may have two counterparties standing behind the obligation to return the securities or release the collateral rather than just a single counterparty (i.e. their broker-dealer backstopped by SIPC). Although we firmly agree that each customer should be informed that they are losing SIPC coverage in making these loans, we question whether the customer is actually taking on additional risk rather than mitigating risk by doing so.

In this regard, we do not believe a customer's investment objective is applicable, as these are loans and not investments or securities purchase or sale transactions. We also do not believe a customer's net worth or net equity should be used to determine whether a customer is suitable to participate in a fully-paid or excess margin securities lending program, particularly if a customer already owns individual securities and bears the risk of those investments. Ultimately, we do not believe that customers should be excluded from the opportunity to generate additional income on their securities positions, solely based upon not meeting certain net income or equity standards, as long as the terms of these programs are fully disclosed.

We do agree with FINRA's concerns about member firms recommending that customers purchase certain hard to borrow securities for the sole purpose of lending such securities as fully-paid securities. However, such activity is already covered under NASD Conduct Rule 2310 (Recommendations to Customers – Suitability), as it relates to the purchase of

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the securities. Finally, if a FINRA believes it is necessary to establish a separate suitability determination as it relates to the lending of fully-paid or excess margin securities, we believe it should be applied at the program level and not on a transaction by transaction basis.

Although not without some risk, we believe that if structured appropriately, and member firms adhere to their Physical Possession or Control obligations set forth under Rule 15c3-3, a fully-paid or excess-margin securities lending program provides customers with a beneficial opportunity to earn income by lending brokers or dealers certain hard to borrow securities positions held long in their account. This opportunity has not typically been available to retail customers in the past. Although we agree that firms have an obligation to make customers fully aware of the risks associated with this type of activity, such risks alone should not prevent less affluent retail customers from being allowed to participate in these loan programs, nor should they impose additional suitability obligations on a member firm, unless the member firm's program has limitations on the customer's ability to sell the securities on loan.

We would like to thank FINRA for considering our comments. Please contact me at (617) 563-0312 should you have any questions concerning this letter.

Sincerely yours,

A handwritten signature in cursive script that reads "Erica M. Waters".

Erica M. Waters
Vice President – Fidelity Institutional Compliance
Fidelity Capital Markets, a division of National Financial Services LLC.