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May 13, 2011

Via E-mail to pubcom@finra.org

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

Re: FINRA Regulatory Notice 11-14 Proposed Rule 3190 (Use of Third-Party Service Providers)

Dear Ms. Asquith:

Wells Fargo Advisors ("WFA") appreciates this opportunity to comment briefly on FINRA's Regulatory Notice 11-14 concerning the use of third-party service provides, oftentimes referred to as "outsourcing." Providing clarity concerning obligations of member firms is frequently helpful and worthwhile. In this instance, however, WFA suggests that FINRA may need to make some adjustments to actually achieve the clarity the industry will need in order to comply. WFA particularly notes that some of its proposed requirements for clearing firms will create a two-tier system without any clear and supportable rationale. WFA respectfully files this brief comment letter to encourage FINRA to modify the proposal.

WFA consists of brokerage operations that administer almost $1 trillion in client assets. It accomplishes this task through 15,088 full-service financial advisors in 1,100 branch offices in all 50 states and 4,569 licensed financial specialists in 6,610 retail bank branches in 39 states.[1]

[1] WFA is a non-bank affiliate of Wells Fargo & Company ("Wells Fargo"), a diversified financial services company providing banking, insurance, investments, mortgage, and consumer and commercial finance across the United States of America and internationally. Wells Fargo has $1.2 trillion in assets and more than 278,000 team members across 80+ businesses. Wells Fargo's brokerage affiliates also include HD Vest Financial Services with 5,100

Supervisory Rules Cover Third-Party Providers

Currently, firms are required to establish and maintain supervisory procedures and systems under Rule 3010 and 3012. FINRA Rule 3010 states "Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Final responsibility for proper supervision shall rest with the member." Proposed Rule 3190 requires firms to have supervisory procedures, including due diligence measures, to ensure compliance with applicable securities laws and regulations. The proposed rule does not establish a new concept of supervisory responsibilities for the firm and, in fact, appears redundant with our current obligations. Under the proposed rule to register operations personnel,[2] third-party providers are construed as "other associated persons" and firms are held responsible for their work product and actions. It is important that FINRA provide clarity concerning how this rule is designed to work with proposed Rule 1230.

Differential Treatment of Clearing Firms Unnecessary

Proposed Rule 3190 sets out a number of general requirements for member firms that desire to enter into outsourcing arrangements. The rule provides generally that a member firm's use of a third-party service provider to perform functions or activities related to the member firm's business as a regulated broker-dealer does not relieve the firm of its obligation to comply with applicable securities laws and regulations. The rule also prohibits a member firm from delegating its supervisory responsibilities for functions or activities performed by a third-party service provider. Additionally, proposed FINRA Rule 3190(b) requires that a member firm include in these supervisory procedures an ongoing due diligence analysis of each current or prospective third-party service provider to determine, at a minimum, whether:

> (1) the third-party service provider is capable of performing the activities being outsourced; and
> (2) with respect to any activities being outsourced, the member firm can achieve compliance with applicable securities laws and regulations.

This section and 3190(a) focus on what is critical about any third party arrangement that a member may have—that the member is equipped with the tools reasonably designed to ensure compliance with the rules and to supervise those activities, no matter who carries out the activity

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independent advisors and First Clearing LLC which provides clearing services to 98 correspondent clients and WFA. For the ease of discussion, this letter will use WFA to refer to all of those brokerage operations.

[2] *File No. SR-FINRA-2011-013, Proposed Rule Change to Establish a Registration Category, Qualification Examination and Continuing Education Requirements for Certain Operations Personnel, Federal Register / Vol. 76, No. 53 15012 (March 18, 2011)(*Proposed Rule 1230)

on behalf of the member. Such an interpretation will be critical to making the proposed rule more workable and enforceable.

FINRA takes the outsourcing rules to another level when it singles out clearing and carrying firms for additional and heightened treatment of outsourcing arrangements. The justification for this additional scrutiny is "the additional responsibilities of a clearing or carrying member firm to protect customer funds and securities . . . ."[3] Specifically, proposed FINRA Rule 3190(c) requires a clearing or carrying member firm to vest an associated person of the firm with the authority and responsibility for the following activities:

(1) the movement of customer or proprietary cash or securities;
(2) the preparation of net capital or reserve formula computations; and
(3) the adoption or execution of compliance or risk management systems.

While all could agree that the movement of customer or proprietary cash or securities is the one area in which fraud or errors could occur, that fact alone does not make it clear additional requirements should apply to clearing firms. A better approach would be for FINRA to design a system that all firms can follow related to these important activities.

It is important to note that clearing firms take instructions from introducing firms. Certain responsibilities related to customer verification, funds availability, etc., are allocated by contract between the clearing firms and introducing firms. Accordingly, any additional requirements should only apply to the portion of the asset movement that is within the control of the clearing firm. Clearing firms should not have to vest authority in an associated person for activity and conduct that is solely under the control of an otherwise registered broker-dealer.

FINRA also would require that clearing firms have procedures that require the firm to take prompt corrective action when necessary to have the outsource firm comply with securities regulations. In addition, clearing firms must also approve the transfer of any duties by the outsourcing firm to any sub-vendor. The concept that the clearing firm must approve the transfer of "any" duties to a sub-vendor appears overbroad. In an outsourced entity, there are countless steps and processes that may go into the overall performance of the outsourced activity. Establishing a rule that a firm must give prior approval to the transfer of any of those activities could be both cumbersome and burdensome. If FINRA insists that such approval take place, the rule should focus on only certain "material" duties that an outsourcing firm might transfer to a sub-vendor or, referencing the standard used elsewhere, on duties that if not performed would prevent compliance with laws or prevent the fulfillment of supervisory obligations. By limiting and detailing the duties that need such approval, FINRA may create a rule that is more manageable while simultaneously addressing the critical concerns that may exist with the transfer of essential or material duties to sub-vendors.

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[3] Rule Proposal at P.4.

Affiliates Should Be Treated Differently

In crafting the outsourcing proposal, FINRA fails to make any allowances for work sent to a firm's affiliate.[4] Since the rule requires that a firm do a "due diligence" analysis of a third party vendor, in essence this definition asks that affiliates, subsidiaries or parent firms submit to scrutiny by a member firm. In this increasingly interconnected world, it would seem that the rules should allow for a different standard when the third party performing the outsourced work is an affiliate or parent of the member firm. The parent of a member firm and its affiliates have every incentive to ensure that both of its subsidiary companies are fully compliant regulatory citizens. It would seem wasteful and duplicative to expect that an affiliate would spend time and money to determine that a co-affiliate of the parent company needs separate vetting by the member firm. More importantly, it seems to put the cart before the horse to have the member firm conduct due diligence on its parent. From a cost-benefit standpoint, it would appear that a member firm should be able to rely upon the policies and procedures of its parent or affiliate. Especially firms with other regulated affiliates (regardless of regulatory body) should be able to adopt procedures reasonably designed to achieve compliance and to determine the level of due diligence required. This reliance would be appropriate particularly where the member is unaware of any facts indicating the parent or affiliate lack systems, policies or procedures to ensure compliance with securities regulations.

Duty to Review Sub-Vendors Needs Reconsideration

While FINRA has proposed Rule 3190 to codify its prior notices concerning outsourcing, as mentioned briefly above, there is a tremendous amount of uncertainty that arises from a provision requiring that the member conduct due diligence of the sub-vendors of the outsourced firm. A practical reality is that the member firm simply may not have information concerning all of the sub-vendors used by an outsourcing firm. There are situations in which all of the sub-vendors may not be known 120 days or more into an arrangement. In addition, there should be a strong materiality standard that applies to the work done by sub-vendors of the outsource firm before the due diligence and other obligations apply. While it is unclear from the rule, there additionally should be an interpretation of the rule that exempts a firm from having to perform due-diligence on certain regulated entities such as DTC or Euroclear or having to provide notice if it changes to such vendors. As part of the definition of materiality, one should consider how far down the sub-vendor level the due diligence responsibility should flow. It should be sufficient for the member firm to review the first level vendor's "vendor due diligence process." If the member firm is comfortable with the level of diligence used by the first level vendor, there is no need to review sub-vendors. Without more guidance, the duty to review the activities of sub-vendors could quickly become a confusing and costly process of searching for sub-vendors and sub sub-vendors and then conducting the appropriate due diligence. It is likely that a period of 9 months to identify sub-vendors is preferred.

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[4] In the supplementary material of the proposal, clarifying language states that the term "'third-party service provider (including any sub-vendor)'shall include any person controlling, controlled by or under common control with a member firm, unless otherwise determined by FINRA." *FINRA Regulatory Notice 11-14 at p.11 (March 29, 2011)*

Review of Posting Entries Needs More Flexible and Risk-Based Standard than Next Business Day Review

As a part of the specific duties that the proposed rule places on clearing and carrying firms, the proposed rule would prohibit the outsourcing of authority or responsibility for "the movement of customer or proprietary cash or securities."[5] In the supplementary notes, however, FINRA explains that:

> The provisions of paragraph (c)(1) of this Rule do not preclude a designated third-party service provider (including any sub-vendor) from posting items to a member's books or records, provided that the member reviews each posting prior to the close of the business day following the posting.[6]

One can support FINRA's view that there should be a mechanism where a third-party can post items to a member's books and records subject to a review by the member. Requiring that review prior to the close of the next business day following the closing is inflexible and may not be the best solution. At the outset, FINRA should acknowledge that existing and ordinary supervisory controls would include a review of postings to a firm's books and records, regardless of the type of activity. This review takes place irrespective of the firm structure (introducing versus clearing broker for example) or whether the activity is outsourced. FINRA appears to acknowledge that there is not a simple calendar consideration driving this review of the posting of items. By making the requirement for the review "the close of the business day following the posting," FINRA creates a scenario where almost 96 hours or more could pass before a posting by a third party gets a review. Since it appears that the important aspect of the supplementary notes is the review by the member, we suggest that the rule be modified to allow firms flexibility in conducting that review. A firm should be able to take a risk-based analysis that flexibly blends the lapsed time period and materiality of the entry to determine when a review of the posting takes place. By making this change, FINRA will create a system that can adjust according to circumstances in accomplishing the required review while still adhering to the underlying purpose of the provision.

Conclusion

By codifying into a rule its guidance on outsourcing, FINRA has made an important step to clarify the requirements associated with outsourcing. The comments in this letter ideally will allow FINRA to make adjustments to the rule that will allow member firms to comply in a manner that is both cost-effective and beneficial to the industry at large.

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[5] Proposed FINRA Rule 3190(c)(1)

[6] *FINRA Regulatory Notice 11-14 at p.11 (March 29, 2011)*

If you have any questions regarding this comment letter, please do not hesitate to contact me.

Sincerely,

Ronald C. Long
Director of Regulatory Affairs