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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:

Cetera Financial Group, Inc. appreciates the chance to comment on the proposed rules regarding supervision in the consolidated FINRA Rulebook ("Proposed Rules")[1]. Cetera Financial Group, Inc. ("Cetera") is the holding company of four independent channel broker-dealers[2]with approximately 6,500 financial advisors and more than 600 financial institutions. Our broker-dealers conduct a retail business, and serve customers of all income levels and sophistication.

The Proposed Rules, for the most part, incorporate and clarify existing requirements. However, certain aspects of the Proposed Rules and Supplemental Materials are unclear, or contradictory.

The Conflicts of Interest Language is Overly Broad

Proposed Rule 3110(b)(6)(D) and Rule 3110(c)(3)(A) state that standards of supervision and inspection standards cannot be "reduced in any manner, due to any conflicts of interest that may be present". While we agree that the supervisory system and inspections should be reasonably designed to mitigate conflicts of interest, the proposed language exceeds the statutory framework [3] and case law.

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[1] Release No. 34-69902; File No. SR-FINRA-2013-025
[2] Cetera Advisors LLC, Cetera Advisor Networks LLC, Cetera Financial Institutions (Cetera Investment Services LLC), and Cetera Financial Specialists LLC.
[3] Section 15(b)(4)(D) of the Securities Exchange Act of 1934.

Proposed Rule 3110(b)(6)(D) lists factors that should be considered in meeting this standard such as conflicts that may arise 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". By requiring that member firms adopt procedures preventing the "standards of supervision" from being reduced "in any manner" by conflicts of interest, Rule 3110(b)(6)(D) appears to veer from settled law that supervisory procedures and systems be "reasonably" designed, to an absolute requirement that supervisory conflicts of *any* manner be prevented.

The same issues are presented by Proposed Rule 3110(c)(3)(A) which covers inspection standards. In addition, Proposed Rule 3110(c)(3)(A) requires consideration of even broader factors in determining if conflicts of interest have reduced inspection standards including, but not limited to "...economic, commercial, or financial interests in the associated persons and businesses being inspected." It is unclear whether this language is intended to prohibit an OSJ principal from conducting inspections of branch and non-branch offices designated to that OSJ Principal if he or she receives overrides from business conducted at those locations. If that is the case, further analysis should be conducted as to whether the benefits of this proposed rule outweigh its costs. Onsite inspections enhance an OSJ Principal's understanding of a branch or non-branch location, which can only serve to improve daily supervision of securities transactions.

Supplementary Material .03 Draws an Artificial Line

Supplementary Material .03 requires that a one person OSJ be designated to a senior principal who "must conduct on-site supervision of such location on a regular periodic schedule to be determined by the member". In response to comments, FINRA justified Supplementary Material .03 by stating that it allows for flexibility, while at the same time "clarifying that a reasonable supervisory structure cannot permit a principal to supervise his or her own sales activities..." We concur that self-supervision is inappropriate and support adoption of Proposed Rule 3110(b)(6)(C). However, Supplementary Material .03 goes much farther and certainly does not take into account the independent broker-dealer channel.

Many independent channel broker-dealers have field OSJ principals with personal production. To prevent the conflict of interest that arises from self-supervision, the personal production of field OSJ principals is generally supervised by home office employees of the broker-dealer. Personal production of OSJ principals varies significantly, and is often minimal. For this reason,

the home office employee principals may supervise multiple OSJ principals, utilizing technology and annual inspections to augment their supervision.

It is not clear why a one person OSJ poses a greater threat of self-supervision than an OSJ with two, three or even 20 registered representatives. Personal production of field OSJ principals is and should be supervised consistently no matter the size of the OSJ location. For example, assume a home office supervisor is responsible for supervision of the personal production of 15 OSJ principals. If five of the 15 OSJs are one-person OSJs, and ten of the 15 OSJs have one OSJ principal and one registered sales assistant, the home office supervisor would be required to perform "regular on-site supervision" of the five one-person OSJs, but would never be required to visit the ten OSJs with registered sales assistants. In this scenario, the impact of Supplementary Material .03 will be inconsistent and serve little regulatory purpose.

In contrast to other business models, independent channel broker-dealers have producing field OSJ principals. For this reason, Supplementary Material .03 unevenly and unfairly impacts independent channel broker-dealers and should be reconsidered.

The Terms in Supplementary Material .04 Remain Unclear

In response to comments requesting clarification that the terms "onsite supervisor" and "designated principal" in Supplementary Material .04 do not encompass a member's "up-the-chain" reporting structure, FINRA stated: "FINRA clarifies that, for the purposes of this provision, the two terms refer to one person – the onsite principal assigned and designated to supervise the OSJ pursuant to FINRA Rule 3110(a)(4)". While this clarification is helpful, Supplementary Material .04 should either be revised to exclude "up-the-chain" home office supervision of producing field OSJ principals as well as supervisory surveillance as a whole or more clearly address how the "physical presence" requirement applies to home office employee supervisors.

Moreover, certain sales of products by registered representatives may be supervised by home office employee principals. Generally, this is because a special registration is required to supervise that business, or because the broker-dealer has determined supervision is more consistent if centralized, such as in the case of complex products. It is not clear whether, in those instances, the home office principal would be considered a supervisor of the OSJ with the consequent "physical presence" requirement.

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The Presumption in Supplementary Material .04 Inappropriately Shifts the Burden of Proof

Supplementary Material .04 states that there is a "general presumption" that assigning one principal to supervise more than two OSJs is "unreasonable" and that if a member firm "determines to designate and assign one principal to supervise more than two OSJs, the member's determination will be subject to greater scrutiny, and the member will have a greater burden to evidence the reasonableness of such structure".

While we do not support a presumption that an onsite principal can reasonably supervise more than two OSJs, we think Supplementary Material .04 inappropriately shifts the burden of proof by stating that this structure is *per se* unreasonable. It is not clear why this is justified given that the standard of proof in a FINRA disciplinary proceeding is a relatively modest "preponderance of the evidence" standard.[4]

Risk Based Reviews (3110(b)(2) and Supplementary Material .06)

Proposed Rule 3110(b)(2) states that a member firm's supervisory procedures must require written evidence that a registered principal has reviewed "all transactions relating to the investment banking or securities business of the member", but notes in Supplementary Material .06 that a member may use a "risk-based review system to comply with Rule 3110(b)(2)". In its commentary FINRA describes a "risk-based" review as "...a review methodology based on a reasonable sampling of information in which the sample is designed to discern the degree of overall compliance..." and notes that it is appropriate "in limited circumstances". This description of a "risk-based" review does not take into account the central role of sophisticated technology in transaction and account level reviews.

As with the use of a lexicon in e-mail review, most firms use technology to perform risk-based but comprehensive reviews of all transactions. Whether the software is developed internally or by a vendor, based on the nature of its business, a member firm determines parameters that would cause a trade to be flagged for more intensive review, such as missing customer

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[4] See *Wall Street West, Inc. v. SEC*, 718 F.2d 973, 974 (10th Cir. 1983); *Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982).

information, or information that does not conform to the suitability requirements for a particular product. While all transactions are ultimately reviewed and approved or rejected, the use of technology allows the supervisor to focus attention on those transactions that require greater scrutiny. Because FINRA declined to remove the word "all" from proposed rule 3110(b)(2) it is unclear if use of technology to review transactions conforms to the requirements of the Proposed Rules.

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Thank you in advance for consideration of our comments. . Should you have any questions, please contact me at 913.789.8691 or at [redacted]

Sincerely,

Nina Schloesser McKenna
General Counsel

Cc: Patricia Albrecht, Assistant General Counsel, FINRA