Patricia Albrecht
Associate General Counsel

Direct: [redacted]
Fax: (202) 728-8264

November 12, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FINRA-2013-025 – Rebuttal

Dear Ms. Murphy:

On July 1, 2013, FINRA filed with the Securities and Exchange Commission ("SEC" or "Commission") SR-FINRA-2013-025, a proposed rule change to adopt the consolidated FINRA supervision rules. The Commission published the proposed rule change for comment in the *Federal Register* on July 8, 2013.[1] The Commission received 572 comment letters in response to the Proposing Release, with 555 commenters using a form comment letter ("Letter Type A"), and 17 other commenters filing individual letters.

On October 2, 2013, FINRA filed Partial Amendment No. 1 to the proposed rule change and a letter responding to comments.[2] On October 22, 2013, the Commission published in the *Federal Register* a notice and order to solicit comments on Partial Amendment No. 1 from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act" or "SEA") to determine whether to approve or disapprove the proposed rule change, as modified by Partial Amendment No. 1.[3] The

---

1 *See* Securities Exchange Act Release No. 69902 (July 1, 2013), 78 FR 40792 (July 8, 2013) (Notice of Filing of File No. SR-FINRA-2013-025) (the "Proposing Release").

2 *See* Letter from Patricia Albrecht, Associate General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, SEC, dated October 2, 2013 ("FINRA's Response to Comments"); *see also* Partial Amendment No. 1 to SR-FINRA-2013-025, available on finra.org.

3 *See* Securities Exchange Act Release No. 70612 (October 4, 2013), 78 FR 62831 (October 22, 2013) (Notice of Filing of Partial Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove File No. SR-FINRA-2013-025).

Commission received three comment letters in response to this notice.[4] This letter responds to the comments received and responds to any assertion that the proposed rule change, as amended, would not meet the statutory requirements for approval.

1. Support for Changes to Proposal

FSI expressed strong support for the proposed rule change, as modified by Partial Amendment No. 1, applauding FINRA "for acknowledging and addressing the issues raised by FSI and other commenters." In addition, FSI stated that the revised proposal "will ensure that investors are protected by the robust supervision programs implement by firms, and that firms can continue to effectively utilize their supervisory structures and procedures under clear regulatory requirements."

2. Applicability of Proposal to Mutual Fund Underwriters

ICI raised issues specific to their concerns that the revised proposal does not take into account the unique business of mutual fund underwriters. As detailed further below, ICI raised many of these issues in its comments to the Proposing Release.

A. Regulatory Scheme

ICI suggested that the proposed consolidated supervision rules propose a "one-size-fits-all" regulatory scheme that is inconsistent with FINRA's recent initiatives to (1) define, for regulatory purposes, categories of broker-dealers that conduct a limited business and do not process or handle customer funds or securities and (2) assess the economic impact of existing and future rules.

FINRA disagrees with ICI's characterization of the proposed rule change. The proposed supervision rules are designed to provide sufficient flexibility for members to structure their supervisory systems and procedures in a manner that reflects their different business models, sizes, and resources. In this regard, the proposed consolidated (and current) supervision rules require each member to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules.[5] In addition, as stated in FINRA's Response to

---

4 Letter from Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, SEC, dated October, 17, 2013 ("ICI"); Letter from David T. Bellaire, Esq., Executive Vice President & General Counsel, Financial Services Institute, to Elizabeth M. Murphy, Secretary, SEC, dated October 28, 2013 ("FSI"); Andrea Seidt, President and Ohio Securities Commissioner, North American Securities Administrators Association, Inc., to Elizabeth M. Murphy, Secretary, SEC, dated November 5, 2013 ("NASAA").

5 *See* proposed FINRA Rule 3110(a) (and current NASD Rule 3010(a)); *see also Notice to Members* 99-45 (June 1999) (NASD Provides Guidance On Supervisory Responsibilities).

Comments, the proposed rules apply a risk-based approach or similar flexibility for specified aspects of a member's supervisory procedures to allow firms the ability to establish their supervisory programs in a manner that reflects their business models,[6] such as members with limited broker-dealer activities.

With respect to economic impacts, as further detailed in FINRA's Response to Comments, the proposed rule change strives to minimize the membership's burden and cost of complying with the consolidated supervision rules, as consistent with their purposes.[7] FINRA has responded to pertinent industry and public comments throughout the rulemaking process, and has tailored the proposed rules to reduce economic impact concerns while maintaining rigorous investor protections. Moreover, FINRA has committed to review the proposed consolidated supervision rules within an appropriate period after their implementation to determine whether they are achieving their intended purpose and whether they are having unintended effects.[8]

B. Branch Office Definition and Inspection Requirements

Proposed FINRA Rule 3110(e)'s definition of "branch office" specifically excludes some locations from being considered a branch office, including an associated person's primary residence, if specific conditions are met.[9] However, proposed FINRA Rule 3110(e)(2)(B) provides that if any excluded location, including an associated person's residence, is responsible for supervising the activities of a member's associated persons at one or more non-branch locations, the location is considered a branch office.[10] FINRA Rule 3110(c) requires, among other things, each member to inspect at least annually (on a calendar-year basis) every office of supervisory jurisdiction ("OSJ") and any branch office that supervises one or more non-branch locations.

ICI continues to request that FINRA revise proposed FINRA Rule 3110(e)(2)(B) to exclude from the definition of "branch office" the homes of regional distributors and wholesalers of mutual fund underwriters. Specifically, ICI suggested in its comments to the Proposing Release that FINRA revise the provision to include the statement that "[t]he provisions of this subparagraph (2)(B) shall not apply to any location that qualifies for the exclusion in subparagraph (2)(A) if such location is used exclusively by an associated person of a member whose business qualifies for the exemption in SEA Rule 15c3-3(k)(1)."[11] In a related comment,

---

6 FINRA's Response to Comments, *supra* note 2, at 5.

7 *Id.* at 4.

8 *Id.* at 6.

9 *See* proposed FINRA Rule 3110(e)(2)(A)(ii).

10 *See* proposed FINRA Rule 3110(e)(2)(B).

11 *See* Letter from Tamara K. Salmon, Senior Associate Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated July 29, 2013 ("ICI Comment Letter to the Proposing Release"), at 5-7 (discussing "branch office" definition).

ICI continues to request that FINRA not subject such home offices to the inspection requirements for supervisory branch offices and non-branch locations. Specifically, in its comments to the Proposing Release, ICI questioned the regulatory or public purpose to be served by FINRA presuming that all members should conduct an inspection of each home of a regional distributor or wholesaler at least every three years in accordance with proposed FINRA Rule 3110.13 (General Presumption of Three-Year Limit for Periodic Inspection Schedules) relating to non-branch locations.[12]

FINRA addressed these comments in FINRA's Response to Comments and declined to make the changes, specifically noting that the branch office definition is being transferred unchanged from current NASD Rule 3010(g) and that inspections are a crucial component of detecting and preventing regulatory and compliance problems of associated persons working at unregistered offices.[13] ICI, however, indicated that FINRA's previous response did not sufficiently address its concerns regarding the treatment as branch offices of such personal residences that are not held out to the public and do not conduct a public securities business.

FINRA, however, continues to support proposed FINRA Rule 3110's branch office definition and related inspection requirements. ICI's request to exclude from the branch office definition the homes of regional distributors and wholesalers of mutual fund underwriters based on the exemption provided in SEA Rule 15c3-3(k)(1) would be over-broad as that exemption would extend beyond mutual fund underwriters. In addition, as ICI acknowledged in its comments to the Proposing Release, supervisory activities occur at these home offices.[14] Given the supervisory activities occurring at such locations, FINRA does not believe an exclusion from the branch office definition is appropriate for regional distributors working from home offices. Such exclusion would undermine the core principle underlying the registration of branch offices and OSJs that recognizes the critical nature of locations where supervision is occurring. Moreover, FINRA believes that the proposed annual inspection cycle in FINRA Rule 3110(c)(1)(A) remains appropriate for home offices of regional distributors where supervisory activities are occurring. In addition, FINRA believes that home offices of regional distributors or wholesalers that are not registered branch office locations and from which no supervision is occurring, should remain subject to the proposed periodic inspection cycle in FINRA Rule 3110(c)(1)(C). FINRA believes that proposed FINRA Rule 3110.13, while establishing a general presumption that inspections of non-branch locations should be conducted every three years, provides members flexibility to establish either a shorter or longer periodic inspection schedule. If a member chooses an inspection schedule longer than three years, the member must

---

12 *See id.* at 7-11 (discussing inspection requirements).

13 *See* FINRA's Response to Comments, *supra* note 2, at 25 and 33.

14 *See* ICI Comment Letter to the Proposing Release, *supra* note 11, at 7 (noting that such supervisory activities "consist of providing the wholesalers the tools of the trade [sales literature, presentations, and prospectuses], approving travel and expense reports, holding conference calls, mentoring the wholesalers and monitoring their activities, and reviewing management reports").

document in its written supervisory and inspection procedures the factors used in determining why a longer periodic inspection cycle is appropriate for that location.

C. Review of Transactions

Proposed FINRA Rule 3110(b)(2) (Review of Member's Investment Banking and Securities Business) requires a member to include procedures for the review by a registered principal, evidenced in writing, of all transactions relating to the member's investment banking or securities business.[15] ICI stated that a member should not be required to have supervisory procedures for the review of transactions if it does not have any customer transactions due to the member's business (*e.g.*, mutual fund underwriting). ICI raised this same issue in its comments to the Proposing Release,[16] and FINRA responded that, if mutual fund underwriters do not effect transactions, they would have no review obligations pursuant to proposed FINRA Rule 3110(b)(2).[17] Moreover, if a member does not engage in any transactions relating to its investment banking or securities business, it would be sufficient under proposed Rule 3110(b)(2) for the member to acknowledge in its supervisory procedures that it does not engage in any such transactions and that it must have supervisory policies and procedures in place before doing so.

D. Supervision of Supervisory Personnel

Proposed FINRA Rule 3110(b)(6)(C) requires a member to have procedures prohibiting its supervisory personnel from supervising their own activities and reporting to, or having their compensation or continued employment determined by, a person the supervisor is supervising (subject to a limited exception based on a member's size or a supervisory personnel's position within the firm). Proposed FINRA Rule 3110.10 (Supervision of Supervisory Personnel) indicates that the exception provided in proposed FINRA Rule 3110(b)(6)(C) generally will arise in instances where there is a sole proprietor in a single-person firm or where a supervisor holds a very senior executive position.

ICI requested that FINRA revise proposed FINRA Rule 3110(b)(6)(C) to permit an associated person of a mutual fund underwriter member to supervise, for limited purposes or limited periods of time, another associated person who determines the supervisor's compensation or continued employment, noting that unique relationships within a mutual fund complex may cause such situations. ICI made this same suggestion in its comments to the Proposing

---

15 Proposed FINRA Rule 3110(b)(2) transfers the provision in NASD Rule 3010(d)(1) requiring principal review, evidenced in writing, of all transactions, into the consolidated rulebook with clarification that such review includes all transactions relating to the member's investment banking or securities business. *See also* proposed FINRA Rule 3110.05 (Risk-based Review of Member's Investment Banking and Securities Business) (permitting a member to use a risk-based system to review these transactions).

16 ICI Comment Letter to the Proposing Release, *supra* note 11, at 11.

17 FINRA's Response to Comments, *supra* note 2, at 13-14.

Release.[18] FINRA responded by revising proposed FINRA Rule 3110.10 to delete the term "only" to clarify that the provision's list of examples of situations where the exception would generally apply is non-exclusive; FINRA specifically noted that a member may still rely on the exception in other instances where it cannot comply because of its size or the supervisory personnel's position within the firm, provided the member documents the factors used to reach its determination and how the supervisory arrangement with respect to the supervisory personnel otherwise complies with proposed FINRA Rule 3110(a).[19]

ICI indicated that FINRA's previous response did not sufficiently address the concerns or examples raised in its comments to the Proposing Release. ICI's comments to the Proposing Release stated that, for mutual fund underwriters, it was not uncommon for a registered person on the member's senior management business team to be supervised by another associated person for whom the senior management member determines compensation or continued employment. In addition, ICI provided an example where a registered person with a Series 24 license supervises, "for a limited purpose (*e.g.*, review of advertising or marketing material produced by the adviser that will be used by a FINRA member), a more senior person who only has a Series 7 license."[20]

In response, FINRA re-emphasizes that the revisions to proposed FINRA Rule 3110.10's list of examples where a member would need to rely on the exception is non-exclusive. In addition, the provision includes a situation where a registered person is one of several of the member's most senior executive officers (or similar positions). Thus, ICI's first example may fall within proposed FINRA Rule 3110.10's list of examples. With respect to ICI's second example, FINRA notes that the application of proposed FINRA Rule 3110(b)(6)(C) is not generally based on the type of license that the individual holds or that person's seniority. Based on the limited facts presented, FINRA would need additional information to better understand ICI's second example regarding the application of proposed FINRA Rules 3110(b)(6)(C) and 3110.10. FINRA, however, continues to support the principle set forth in proposed FINRA Rule 3110(b)(6)(C) that supervisory personnel must not report to, or have their compensation or continued employment determined by, a person they are supervising unless the firm complies with the permitted exception.

E. Communications Review

i. Risk-based Review of Internal Communications

Proposed FINRA Rule 3110(b)(4) requires a member to, among other things, have supervisory procedures to review the member's internal communications to properly identify communications that are of a subject matter that require review under FINRA rules and federal securities laws. Proposed FINRA Rule 3110.06 (Risk-based Review of Correspondence and

---

18 *See* ICI Comment Letter to the Proposing Release, *supra* note 11, at 11-13.

19 FINRA's Response to Comments, *supra* note 2, at 22.

20 *See* ICI Comment Letter to the Proposing Release, *supra* note 11, at 12.

Internal Communications) requires a member, by employing risk-based principles, to decide the extent to which additional policies and procedures for the review of internal communications that fall outside of such subject matters are necessary for its business and structure.

ICI requested that FINRA amend the proposed provisions to make clear that a firm is not required to review all internal communications. ICI raised this same issue in its comment letter to the Proposing Release,[21] and FINRA responded by confirming that, consistent with existing guidance in *Regulatory Notice* 07-59, the proposed provisions do not require the review of every internal communication.[22] Although ICI acknowledged this clarification, ICI continues to request that FINRA amend the provisions. FINRA, however, believes that its guidance set forth in *Regulatory Notice* 07-59, as codified in proposed FINRA Rule 3110.06, addresses this concern.

ii. Evidence of Review of Communications Using Electronic Reviewing Tools

Proposed FINRA Rule 3110.07 (Evidence of Review of Correspondence and Internal Communications) provides that merely opening a communication is not sufficient review. Instead, a member must identify what communication was 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.

ICI requested that FINRA not require members to retain proposed FINRA Rule 3110.07's specified information fields for communications reviewed through electronic review systems or lexicon-based screening tools if those messages do not generate review alerts. ICI repeated the request from its comment letter to the Proposing Release that FINRA amend the provision to permit a member to rely on electronic surveillance tools if a member has reasonably designed controls in place to ensure that the screening tools are subject to review and are operating as intended.[23]

As ICI acknowledged, FINRA previously clarified that, "with respect to communications reviewed by electronic surveillance tools that are not selected for further review, it would be

---

21 *See id.* at 14.

22 *See* FINRA's Response to Comments, *supra* note 2, at 15 (citing to *Regulatory Notice* 07-59 (December 2007) (Supervision of Electronic Communications: FINRA Provides Guidance Regarding the Review and Supervision of Electronic Communications)). In addition, FINRA noted that proposed FINRA Rule 3110.06 is consistent with *Regulatory Notice* 07-59's guidance regarding the review of internal communications that, "with the exception of the enumerated areas requiring review by a supervisor, members may decide, employing risk-based principles, the extent to which review of any internal communications is necessary in accordance with the supervision of their business." *See id.* (quoting *Regulatory Notice* 07-59 (December 2007), at 3, 9).

23 *See* ICI Comment Letter to the Proposing Release, *supra* note 11, at 15-16.

sufficient to demonstrate compliance with proposed FINRA Rule 3110.07 if the electronic surveillance system has a means of electronically recording evidence that those communications have been reviewed by that system."[24] In addition, FINRA noted that the failure to record and retain such information, such as the identity of the reviewer, could be inconsistent with a member's record retention obligations required under FINRA and SEC rules.[25] Taking these requirements into consideration, FINRA declines to make ICI's suggested change, though FINRA notes that it would be permissible to use an electronic surveillance or reviewing tool that, with respect to communications that do not generate alerts, only captures the specified information fields to the extent necessary to comply with applicable FINRA and SEC rules.

FINRA also re-emphasizes that, consistent with previous guidance discussing the use of any automated supervisory systems or tools to discharge supervisory duties, the use of electronic surveillance tools to review communications represents a direct exercise of supervision by the supervisor (including any use of such tools by the supervisor's delegate to review communications). In addition, the supervisor remains responsible for the discharge of supervisory responsibilities in compliance with the rule and is responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed.[26] Furthermore, as noted in *Regulatory Notice* 07-59, members utilizing automated tools or systems in the course of their supervisory review of electronic communications must have an understanding of the limitations of such tools or systems and consider what, if any, further supervisory review is necessary in light of such limitations.[27]

F. Insider Trading Transaction Review and Reporting

Proposed FINRA Rule 3110(d)(1) requires a member to have supervisory procedures to review securities transactions that are effected for a member's or its associated persons' accounts, as well as any other "covered account," to identify trades that may violate the provisions of the Exchange Act, its regulations, or FINRA rules prohibiting insider trading and manipulative and deceptive devices. The proposed rule also requires members to promptly conduct an internal investigation into any such trade to determine whether a violation has

---

24 *See* FINRA's Response to Comments, *supra* note 2, at 17.

25 *See id.* at 16 (citing to proposed FINRA Rule 3110.09 (Retention of Correspondence and Internal Communications) and SEA Rule 17a-4(b)(4) (requiring, among other things, that a broker-dealer's retained communications records include any approvals of communications sent)).

26 *See Regulatory Notice* 07-53 (November 2007) (Deferred Variable Annuities) (discussing use of automated supervisory systems).

27 *See Regulatory Notice* 07-59 (December 2007).

occurred. Finally, firms engaged in "investment banking services," as defined in the rule, are required to report information regarding these investigations to FINRA.[28]

i. Definition of Investment Banking Services

ICI asserted that mutual fund underwriters should be excluded from the definition of "investment banking services" in proposed FINRA Rule 3110(d) so that mutual fund underwriters would not be required to submit reports to FINRA of internal investigations. ICI raised this concern in its comments to the Proposing Release.[29] In response, FINRA declined to categorically exclude mutual fund underwriting activity from the definition of "investment banking services" given its limited use for the purposes of proposed FINRA Rule 3110(d).[30] ICI stated that FINRA disregarded its concerns and "underestimate[s] the costs and burdens associated with members being required to establish, maintain, implement, and review on an ongoing basis policies and procedures to comply with each rule FINRA adopts, even those rules that do not apply to the member's business."[31]

FINRA has not disregarded or failed to take into account the potential costs and burdens to firms associated with adopting policies and procedures and systems to ensure compliance with the rule. In fact, FINRA addressed them in FINRA's Response to Comments.[32] All broker-dealers, including mutual fund underwriters, are subject to the policies and procedures required by Exchange Act Section 15(g) and to those required by proposed FINRA Rule 3110(d). ICI apparently does not object to these requirements. Rather, ICI's objection is to the inclusion of mutual fund underwriters in the proposed definition of "investment banking services," a

---

28 Proposed FINRA Rule 3110(d)(3)(B) defines the term "investment banking services" to include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer, or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

29 ICI Comment Letter to the Proposing Release, *supra* note 11, at 18-20. The Committee of Annuity Insurers raised a similar point in its comment letter regarding firms that serve as principal underwriters of variable annuities or are involved in the sale of variable annuities and other similar products such as mutual funds and 529 plans. *See* Clifford Kirsch and Eric A. Arnold, Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers, to Elizabeth M. Murphy, Secretary, SEC, dated July 29, 2013.

30 FINRA's Response to Comments, *supra* note 2, at 31.

31 FINRA notes that ICI has made no attempt to quantify the costs or burdens or to provide any specificity on what the costs and burdens of the reporting requirement itself would be.

32 *See* FINRA's Response to Comments, *supra* note 2, at 31-32.

definition that applies only to the requirement to report internal investigations to FINRA. As noted above, the reporting obligation is triggered only after an internal investigation has been initiated, and FINRA continues to believe, as stated in FINRA's Response to Comments, that the primary costs and burdens associated with the proposed rule change would arise in developing and implementing policies and procedures for reviewing transactions and conducting investigations, not in reporting those investigations to FINRA.[33] FINRA also believes that the type of "investment banking services" in which a firm engages, and the relative level of risk of insider trading those activities present, may be a factor in assessing the reasonableness of such a firm's procedures; however, FINRA does not believe it should affect the analysis of whether a firm engaged in "investment banking services" has a reporting obligation once potentially violative trades have already been identified and internal investigations have begun.

ii. Incorporating NYSE Guidance as Supplementary Material

ICI requested that FINRA more formally incorporate guidance from NYSE Information Memo 06-06[34] into the rule's supplementary material to address the scope of the rule's investigation and reporting requirements. The specific provisions cited by ICI include statements from NYSE IM 06-06 clarifying that NYSE Rule 342.21 does not specify the manner in which firms should identify and investigate trades but rather sets forth broad requirements that leave firms the flexibility to put in place a process that satisfies the requirement to have procedures in place that are reasonably designed to identify potentially violative trades, "which should include establishing guidelines or criteria for taking reasonable follow-up steps to determine which trades are potentially violative trades and, therefore, merit further review via an internal investigation." The guidance explicitly recognizes that "not every trade subjected to a firm inquiry or review will result in a reportable internal investigation." The guidance also emphasizes that a firm's procedures be written and be reasonably designed to identify potential violative trades, while recognizing that "different areas of the firm may be susceptible to different types of violative conduct or trading abuses."

FINRA addressed these issues in its Response to Comments and does not believe it is necessary to adopt the guidance from NYSE IM 06-06 as supplementary material.[35] In addition, FINRA amended the rule language to include the phrase "reasonably designed" to "acknowledge more clearly that firms with different business models may adopt different procedures and practices." In FINRA's Response to Comments, FINRA noted that, "[a]s emphasized throughout the Proposing Release, firms are permitted to take a risk-based approach to monitoring transactions that takes into account a firm's specific business model, which would include the type of underwriting activity performed by the firm." FINRA also noted that, "[i]n fulfilling their obligations, firms may determine that certain departments or employees pose a greater risk and examine trading in those accounts accordingly." There is no implied obligation on firms as to how best to conduct the reviews. Regarding firms such as mutual fund

---

33 *See id.* at 32.

34 *See* NYSE Information Memo 06-06 (Feb. 17, 2006) ("NYSE IM 06-06").

35 *See* FINRA's Response to Comments, *supra* note 2, at 31-32.

underwriters specifically, FINRA stated that it "would expect that firms with underwriting activity limited to mutual funds may adopt significantly different review procedures than a firm engaged in more traditional investment banking activity."

FINRA agrees with the guidance from NYSE IM 06-06 that not all reviews will result in an internal investigation. FINRA also agrees that, as part of implementing a firm's risk-based approach to these requirements, a firm's procedures should include establishing guidelines or criteria for taking reasonable follow-up steps to determine which trades are potentially violative trades and, therefore, merit further review via an internal investigation. Similar to the guidance set forth in NYSE IM 06-06, FINRA does not expect that every trade highlighted in an exception or other report would require a firm to conduct an internal investigation. However, as noted in NYSE IM 06-06, FINRA would similarly expect that "firms that utilize such reports will maintain additional written procedures that set forth guidelines or criteria for reasonable follow-up steps for determining which trades initially highlighted merit further review."

G. Additional Content Requirements

Proposed FINRA Rule 3120 (Supervisory Control System) requires a member that reported $200 million or more in gross revenue (total revenue less, if applicable, commodities revenue) on its FOCUS reports in the prior calendar year to include additional content in the required report it submits to senior management. The required additional content includes a tabulation of the reports pertaining to the previous year's customer complaints and internal investigations made to FINRA. Also, the report must include a discussion of the preceding year's compliance efforts, including procedures and educational programs, in each of the following areas: (1) trading and marketing activities; (2) investment banking activities; (3) antifraud and sales practices; (4) finance and operations; (5) supervision; and (6) anti-money laundering.

ICI requested that FINRA revise the $200 million gross revenue threshold triggering additional reporting obligations to recognize the business and capital structure of mutual fund underwriters by either revising the definition of "gross revenue" to exclude a mutual fund underwriter's 12b-1 revenue or exclude limited purpose broker-dealers from the additional content requirements. ICI raised this issue in its comment letter to the Proposing Release.[36] FINRA responded by revising the proposed rule to clarify that a member's report must include the additional content, to the extent applicable to the member's business.[37] Although ICI acknowledged this clarification, ICI continued to request that FINRA revise proposed FINRA Rule 3120 as originally requested to avoid mutual fund underwriters from triggering the proposed rule's additional content requirement.

---

36 *See* ICI Comment Letter to the Proposing Release, *supra* note 11, at 22-24.

37 FINRA's Response to Comments, *supra* note 2, at 34.

As FINRA previously noted, the additional content requirements, which are drawn from Incorporated NYSE Rule 342.30 (Annual Report and Certification), provide valuable information for FINRA's regulatory program and will be valuable compliance information for a firm's senior management. In addition, some content requirements relate to regulatory obligations, such as supervision and anti-money laundering, that apply to all member firms, regardless of their business activities.[38] Rather than addressing these points, ICI suggested that FINRA revise proposed FINRA Rule 3120 to avoid having 12b-1 fees (characterized by ICI as pass-through revenues) counted as the member's gross revenue for purposes of calculating the additional content requirements' $200 million threshold. However, ICI does not indicate how a mutual fund underwriter's gross revenue calculation, which may vary depending on the amount of 12b-1 fees, is different from other members with gross revenue calculations that may vary significantly depending on the amount and nature of revenue received. Accordingly, FINRA re-emphasizes and continues to support its rationale for requiring each member meeting the specified threshold to provide the additional content, to the extent applicable to its business.

3. Issues Previously Addressed Through Rulemaking Process

Another commenter, NASAA, while generally supporting FINRA's rulebook consolidation efforts, remained concerned that the revised proposal does not: (1) require a member to capture, acknowledge, and respond to oral complaints; (2) include previously proposed supplementary material requiring a member's supervisory system to include supervision of all of a member's business lines irrespective of whether they require broker-dealer registration; (3) include NASD Rule 3012's provision requiring members to impose heightened supervisory requirements for producing managers meeting a specified revenue threshold; and (4) expand from three years to six years the proposed record retention period for correspondence and internal communications. These comments raise issues that FINRA has analyzed and addressed previously as part of the rulemaking process.[39] FINRA continues to support its analysis of these issues as set forth in the Proposing Release and FINRA's Response to Comments.

NASAA also raised concerns regarding FINRA's decision to delete previously proposed supplementary material that would have required a registered principal at a one-person OSJ to be under the effective supervision and control of another appropriately registered principal. NASAA, however, stated that "the harm that may have resulted from its removal is remediated by further changes designed to make it clear that self-supervision is inappropriate, and we encourage FINRA to continue to follow up on its commitment to continue to examine the unique challenges posed by One-Person OSJs." Based on prior comments and concerns raised on the Proposing Release, FINRA continues to believe that it was the best course to eliminate the proposed supplementary material from the proposed rule. FINRA will continue to monitor one-person OSJs for possible conflicts of interest or sales practice violations and may determine to

---

38 *See id.*

39 *See., e.g.,* Proposing Release, *supra* note 1; FINRA's Response to Comments, *supra* note 2.

address the matter further as part of a retrospective review process following an appropriate period after implementation of proposed FINRA Rule 3110.

* * * * *

If you have any questions, please contact me at [redacted].

Sincerely,

Patricia Albrecht