

**Compliance**

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BY EMAIL TO: [pubcom@finra.org](mailto:pubcom@finra.org)

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 11-14  
Proposed New FINRA Rule 3190 Third-Party Service Providers

Dear Ms. Asquith:

Charles Schwab & Co., Inc. ("Schwab") appreciates the opportunity to comment on proposed new FINRA Rule 3190 ("Proposed Rule"), which seeks to clarify the scope of a firm's obligations and supervisory responsibilities for functions or activities outsourced to a third-party service provider. Schwab understands that FINRA is working toward a consolidated rulebook and concurs with the need for the new manual to address the subject of outsourcing. Schwab acknowledges the benefit of codifying the guidance provided in NTM 05-48<sup>1</sup> by rule adoption. However, we are concerned that the Proposed Rule and the accompanying text of Regulatory Notice 11-14<sup>2</sup> may create confusion regarding the standards to be applied to existing arrangements and add unnecessary new requirements.

**NASD Notice to Members 05-48**

Since the NASD dissemination of NTM 05-48, member firms have relied upon its principles-based guidance in structuring engagements with third-party service providers and related systems of supervision. We believe the flexible standards enunciated in NTM 05-48 have proven to be readily tailored to a diverse range of engagements and have accomplished their purpose. We suspect that any subsequent problems caused by third-party service providers are more likely attributable to a failure by members to adhere to its guidelines rather than any perceived shortcomings in the guidance itself.

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<sup>1</sup> NASD Notice to Members 05-48 (July 2005) (Members Responsibilities When Outsourcing Activities to Third-Party Service Providers) ("NTM 05-48").

<sup>2</sup> FINRA Regulatory Notice 11-14 (March, 2011)(the "Notice")

### **Scope of Covered Functions**

Schwab believes the scope of covered functions and activities in Proposed Rule 3190(a)(1) should be amended to adopt verbatim the “covered activities” language in NTM 05-48, which applies to activities and functions “that, *if performed directly by members, would be required to be the subject of a supervisory system and written supervisory procedures pursuant to Rule 3010.*” The Proposed Rule, as it is currently written, states that it is intended to apply to a member’s use of a third-party service provider to perform functions or activities “*related to the member’s business as a regulated broker-dealer.*” Schwab is concerned that the scope of the Proposed Rule could be misconstrued to apply to nearly any function or activity related to a member’s business. For example, the outsourcing of ancillary business functions like human resources could be construed as related to the member’s business as a regulated broker-dealer, and trigger notification or other requirements under the Proposed Rule.

### **Restrictions Applicable to Clearing or Carrying Members**

For the reasons detailed below, Schwab recommends the deletion of Proposed Rule 3190(c) and Supplementary Material .02 in their entirety. Proposed Rule 3190(c) requires a clearing or carrying member to vest an associated person of the member “with the *authority* and responsibility” for movement of customer or proprietary cash or securities; the preparation of net capital or reserve formula computations; and the adoption or execution of compliance or risk-management systems. The Notice indicates that these provisions impose heightened requirements for firms when outsourcing these enumerated activities. These obligations are, however, duplicative of the general prohibition in Rule 3190(a)(1), which states that “no member shall delegate its responsibilities for, or control over, *any* functions or activities performed by a third-party service provider....” Further, proposed Rule 3190(a)(2) states that “[p]ursuant to its obligations under FINRA rules, a member shall establish and maintain a supervisory system and written procedures for *any* functions or activities performed by a third-party service provider....”

Schwab believes that simply adding “authority” to the language of proposed Rule 3190(c) does not substantively change a member’s obligations imposed under proposed Rule 3190(a)(1) and (a)(2). Therefore, proposed Rule 3190(c) appears superfluous and may create confusion concerning what is allowed under the rule as a whole.

### **Notification by Clearing or Carrying Members**

Schwab objects to the notification procedures specified in proposed Rule 3190(e) on the grounds that they are unnecessary and unduly burdensome. Under these provisions of the Proposed Rule, clearing firms would be required to notify FINRA within 30 calendar days of entering into a covered outsourcing agreement. The required written notice would include information on the function or functions being performed by the third-

party service provider (including any sub-vendor); the identity and location of the third-party service provider/sub-vendor; the identity of the third-party service provider's/sub-vendor's regulator; and a description of any affiliation between the member and the third-party service provider/sub-vendor.

FINRA does not articulate any cost-benefit considerations or sufficient necessity for clearing firms to provide it with the notification called for under the Proposed Rule. It is unclear why firms must establish yet another process for notifying FINRA of new outsourcing arrangements without an articulated need. This is particularly true since FINRA currently has ready access to details regarding third-party service provider arrangements when its examiners invariably solicit such information during annual Financial and Operations Principal ("FINOP") examinations.

In the event FINRA intends to retain the notification requirements in proposed Rule 3190(e), Schwab suggests that either all members be required to file such notices, or alternatively, if the claimed benefits pertain only to clearing firms, then the scope of outsourced activities subject to such notice be limited only to clearing functions.

Finally, if FINRA intends to proceed with Proposed Rule 3190 in its current form, Schwab suggests that, at a minimum, it be amended only to apply to arrangements entered into after the effective date.

Schwab thanks FINRA staff for consideration of the points raised in this letter and welcomes any further discussions or questions.

Sincerely,



Bari Havlik  
SVP and Chief Compliance Officer  
Charles Schwab & Co., Inc.