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June 13, 2008

BY EMAIL TO: pubcom@finra.org

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

Re: FINRA Regulatory Notice 08-24
Supervision and Supervisory Controls Amendments

Dear Ms. Asquith:

Janney Montgomery Scott LLC ("Janney") appreciates the opportunity to comment on the above-referenced FINRA Regulatory Notice, which proposes new rules governing supervision and supervisory controls. Specifically, FINRA is proposing to adopt new Rules 3110 and 3120 for the new FINRA consolidated rulebook, based in part on existing NASD Rules 3010 and 3012, and NYSE Rule 342. Janney is pleased to offer comments on this critical industry rule change and we hope that FINRA will give due consideration to our comments. Our specific comments are as follows:

Designation of a Registered Principal over Each Type of Business: Proposed Rule 3110(a)(2)

In Proposed Rule 3110(a)(2), FINRA seeks to amend the terms of existing NASD Rule 3010 to require firms to designate an appropriately registered principal with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages regardless of whether registration as a broker-dealer is required to conduct the business. Although FINRA justifies the proposal as "consistent" with the current rule, the language of the proposed rule is broader as it appears to apply the registered principal designation requirement beyond securities activities requiring registration as a broker-dealer.

Existing NASD Rule 3010(b) is limited in scope to those types of businesses for which registration as a broker-dealer is required. Indeed, FINRA's existing license scheme, where certain principal licenses are required for specific types of activity (e.g., Series 4 for Options; Series 9/10 or 24 for Branch Office Management), is designed to

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meet the objectives of existing rule 3010(a)(2), that is, a supervisor should demonstrate a certain level of knowledge about a particular subject to supervise related activity.

Janney conducts business activities that do not require registration as a broker-dealer. Therefore, the proposed amendment represents an expansion of the current rule that implicates several practical and jurisdictional concerns. For example, Janney engages in, among others, investment advisory, futures, and insurance business. Typically, such businesses are not subject to FINRA oversight by FINRA, but would fall under the jurisdiction of other regulatory authorities (e.g., OCC, SEC, CFTC, state regulators) – each of which has its own rules, requirements and examinations governing those activities. Imposing yet another regulatory overlay for member firms that engage in these types of activities within the broker-dealer entity is redundant, potentially conflicting, and at odds with current regulatory and governmental efforts to modernize the regulatory structure and eliminate costly duplication.

In addition to the regulatory duplication, the proposed rule change raises practical registration issues. For example, it is unclear which "principal" license in particular would be required to supervise the types of Janney businesses described above. Because the Series 24, 9/10 and 4 are designed for broker-dealer professionals, it is illogical to require principals of non-regulated businesses to qualify and obtain a license under the current supervisory principal regime that is largely irrelevant to his or her business activities. Management over such businesses is best left to the determination by firms as to the requisite experience and qualifications. In light of the forgoing, Janney believes the proposed change to 3110(a)(2) is unnecessary and that the language contained in existing NASD rule 3010(a)(2) should carry forward without amendment.

Review of Member's Investment Banking and Securities Business: Proposed Rule 3110(b)(2)

FINRA states in the Regulatory Notice that proposed Rule 3110(b)(2) seeks "to retain the requirement in NASD Rule 3010(d)(1) requiring principal review" and at the same time "clarify that such review shall include all transactions relating to the investment banking and securities business of the member firm." Under the proposal:

> The supervisory procedures required by this paragraph (b) shall include procedures by a registered principal, evidenced in writing, of all transactions relating to the investment banking or securities business of the member.

a. Incorporate Risk-Based Language within Text of Rule

Janney appreciates that FINRA provides for firms to be flexible in utilizing a "risk-based" approach to the review of securities and investment banking transactions

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as set forth in Supplementary Material .06 to the proposed rule. We understand that the intent of proposed Rule 3110(a) and (b) is that no business line is to be excluded from having supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations. However, as drafted, the Rule appears to suggest that a registered principal would have to review all transactions for every business engaged in investment banking or securities activities, a result that appears inconsistent with the risk-based approach outlined in the Supplementary Material. We therefore respectfully suggests that FINRA insert the "risk-based" language within the text of the rule and eliminate the word "all" to avoid potential confusion regarding the scope of the transactional review of procedures that firms must implement under the proposed Rule.

b. Investment Banking Transactions

Janney also believes that FINRA should reconsider requiring the written supervisory review of investment banking transactions, even if done on a risk-based basis. We believe that such a review would be duplicative of existing supervisory systems applicable to the investment banking business. Securities and investment banking businesses are inherently different. Any supervisory review for these businesses should, therefore, not be subject to a one-size-fits-all approach. The investment banking business tends to consist of discrete transactions involving a team of bankers, capital markets professionals, internal and/or external counsel and other specialists all involved in the consummation or execution of a transaction. This is far different from the execution of a securities transaction.

Moreover, the requirement to have a written record documenting the supervisory review of an investment banking "transaction" is unnecessarily bureaucratic. As FINRA is aware, many member firms have adopted a supervisory structure consisting of a "commitments committee" or similar group that reviews and approves all investment banking transactions or certain kinds of transactions, depending upon the nature of the deal. For example, a firm may have a commitments committee review and approve all initial public offerings, common stock underwritings, and high-yield debt underwritings, while employing a more streamlined review process for other transactions such as high-grade corporate debt shelf underwritings or Rule 144A offerings. The FINRA proposal fails to take into account a member's existing supervisory structure under Rule 3010(a) to conduct, review and approve investment banking transactions, and would add an unnecessary and duplicative supervisory sign-off. Janney requests that FINRA specifically exclude investment banking transactions from proposed Rule 3110(b)(3). At a minimum, we request that FINRA acknowledge that the documentation requirement under the Rule can be met by other existing supervisory processes.

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Supervision of Outside Securities Activities: Proposed Rule 3110(b)(3)

FINRA proposes to delete existing NASD Rule 3040 and replace it with Proposed Rule 3110(b)(3), which would state that:

> Unless a member provides prior written approval, no associated person may conduct any investment banking or securities business outside the scope of the member's business. If the member gives such approval, such activity is within the scope of the member's business and shall be supervised in accordance with this Rule, subject to the exceptions set forth in subparagraph (B) ["Dual Employees"].

Janney supports FINRA's efforts to simplify and make less prescriptive existing NASD Rule 3040. Unfortunately, as drafted, the current proposal is much broader than NASD 3040, and unless modified, could have wide-sweeping adverse consequences to broker-dealers. Janney's comments and suggested modifications are as follows:

a. *Clarify that Passive Investments Are Covered by the Rule*

As proposed, the rule's use of the word "conduct" may be construed to exclude an associated person's passive investment in an outside private securities transaction. Janney believes that the interests of investors and member firms are better served if associated persons notify and seek approval from their firms for passive investments in outside private securities transactions (e.g., hedge funds, private equity funds). Therefore, Janney respectfully requests that FINRA modify this language to clarify that passive investments continue to be covered by the scope of the rule.

b. *Distinction Between Passive Investment and Selling Away*

Janney does not believe it is necessary for a firm, once it has notice of, and gives approval for, outside private securities transactions, to subject <u>all</u> such investments to all of the supervisory rules set forth in Proposed Rule 3110. Rather, Janney believes FINRA should draw a distinction between "passive investments" and situations where the representative receives compensation related to the outside private securities transactions (e.g., "selling away"). In the case of passive investments, FINRA should permit member firms to design their own policies and procedures relating to prior approval, potential conflicts of interest, and other potential sales practices issues which would not need to satisfy the full scope of requirements under proposed rule 3110. If "passive investments" are considered within the scope of firms' business, future litigation involving the passive investment could be extended to firms even if firms previously notified all parties in writing from the outset that the Firm is not involved in the investment.

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We do agree with FINRA that such supervision is required where the representative conducts an outside securities or investment banking transaction and receives compensation for such a transaction.

Moreover, in light of Proposed Rule 3110(b)(3), Janney requests that FINRA clarify the status of existing NASD Rule 3030 (Outside Business Activities of Associated Persons). We believe that outside business activities such as serving on the board of directors of a for-profit or not for profit corporation is not an "outside private securities transaction" since it is not the conducting of "investment banking and securities activities" and thus would not be within the ambit of the proposed rule 3110(b)(3). Janney also would like to confirm whether FINRA intends to adopt Rule 3030 within the new consolidated rulebook. Firms have developed policies and procedures relating to outside business activities and will need to determine how Proposed Rule 3110(b)(3) affects, if at all, existing NASD Rule 3030. We hope that FINRA does not intend to incorporate the requirements of that rule within the supervisory obligations under proposed new rule 3110, as such a modification would likely result in a prohibition on outside business activities.

Review of Correspondence and Internal Communications: FINRA Rule 3110(b)(4)

Proposed FINRA Rule 3110(b)(4) and accompanying Supplementary Materials .09-.12 would require appropriate procedures for the review of correspondence and internal communications. Although FINRA states that the proposal is intended to incorporate the substance of NASD Rule 3010(d), by combining external correspondence with internal communications, the proposal appears to impose potentially new and confusing requirements on the review of internal communications. In addition, certain language in Supplementary Material .09 creates ambiguity around the well-established practice of risk-based review of communications.

a. Proposed Rule 3110 (b)(4): Review of Correspondence and Internal Communications

Existing NASD rules and recent guidance generally distinguish between the review of incoming and outgoing correspondence with the public and internal communications. NASD NTM 07-59, for example, sets forth different standards for the review of external and internal electronic communications.

By combining external correspondence with internal communications, Proposed Rule 3110(b)(4) unnecessarily confuses the established separate standards of review for these communications. The proposal seems to state that supervisory procedures for all communications must ensure that the member properly handles customer complaints, customer instructions, and various other customer-related procedures -- all of which are more appropriately addressed in the review of customer, rather than internal, communications. Janney

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submits that communications with the public and internal communications present very different levels and types of risk, which should be reflected in any risk-based approach to supervision.

Janney therefore recommends that FINRA move the provisions of the Proposed Rule concerning internal communications to a separate rule or a separate section of Proposed Rule 3110. Janney also requests that FINRA explicitly recognize the guidance in NASD NTM 07-59 (Electronic Communications Guidance), which established clear and accepted industry practices for the review and supervision of electronic communications.

b. Supplementary Material .09

Although the Proposed Rule contemplates a risk-based approach to the review of correspondence and internal communications, it is unclear what is intended by the highlighted language in the following sentence: "a member may decide the extent to which *additional* policies and procedures for the review of....correspondence with the public and internal communications *that fall outside of the subject matters listed in Rule 3110(b)(4)* are appropriate for its business and structure (emphasis added)."

Because a risk-based approach contemplates that each member firm will address additional subject matters that pose unique risks to that firm in accordance with the supervision of their business, this language creates unnecessary ambiguity. Moreover, the Supplementary Material does not affirmatively state that a risk-based approach would be permissible in such circumstances (even though this does appear to be the intent of the Rule).

Janney therefore recommends that FINRA *replace* the first sentence of Supplementary Material .09 with an affirmative statement that firms may take a risk-based approach to the review of communications. FINRA could adapt some of the language from the Electronic Communication Guidance, as follows:

> Members generally may decide by employing risk-based principles the extent to which the review of [electronic] communications, both internal and external, is necessary in accordance with the supervision of their business. However, members must have policies and procedures for the review by a supervisor of employees' incoming and outgoing [electronic] communications that are of a subject matter that require review under SRO rules and federal securities laws. . . .

c. Supplementary Material .10

Supplementary Material .10 expressly states that merely opening a communication is not sufficient evidence of review. Although this language is established guidance and Janney does not dispute the point, FINRA's guidance in this section does not appear to be consistent with the broader goal of principles-based regulation, particularly when the guidance is placed in a section on evidence of review. In other areas, FINRA has not prescribed a specific required level of review. For example, while supervisors sign off on trade runs and order tickets, firms have

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latitude to determine how to evidence their review. Janney therefore recommends that FINRA delete this sentence.

d. Supplementary Material .11

Janney strongly supports the modifications permitting the delegation of correspondence and internal communication review functions to non-registered personnel, provided that appropriate controls are in place to ensure non-registered personnel have sufficient knowledge, experience and training to perform the reviews.

Janney is concerned, however, that Supplementary Material .11 could be interpreted to require a supervisor/principal to evidence the review of all delegated functions to demonstrate overall supervisory control. Janney recommends that FINRA clarify the reasonable and appropriate standards for demonstrating overall supervisory control with respect to delegated functions.

Supervision of Supervisory Personnel: Proposed Rule 3110(b)(6)

Proposed FINRA Rule 3110(b)(6) combines the recordkeeping provisions of NASD Rule 3010(b)(3) with the requirements for supervising associated persons who perform supervisory functions currently contained in NASD Rule 3012(A)(2). The new requirements adopt two clearly-stated prohibitions that would apply to the supervision of <u>any</u> associated person in a supervisory role, not only to supervisors who conduct customer account activity. This proposed rule is considerably more broad than the current NASD rules, reflecting FINRA's encouraging efforts to de-emphasize specific compliance mandates in favor of principles-based regulation. As discussed below, however, the proposed language set forth in paragraph (D) creates a standard for written supervisory procedures that is not sufficiently clear to enable firms to implement it, and would be better addressed as guidance in a separate Regulatory Notice.

a. Rule 3110(b)(6)(D) – Conflicts of Interest

Paragraph (D) of the Proposed Rule is highly problematic. Though clearly well-intended, this proposed new language would significantly expand the standards regarding conflicts of interest set in Paragraph (C) by requiring firms to implement procedures to "prevent" the effective supervision of supervisors from being "lessened in any manner" by "any conflicts of interest that may be present" with respect to <u>any</u> supervisor. For the reasons stated below, Janney respectfully requests that FINRA withdraw Paragraph (D) from the Proposed Rule, or alternatively modify the language as recommended herein.

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As a threshold matter, the rule proposal would create an unrealistic standard in that it would require firms to develop written supervisory procedures that "prevent" a particular circumstance from occurring, including one that relates to the supervision of a conflict of interest. In addition, this broadly-stated mandate, presented without further guidance, uses ambiguous language – "lessened in any manner" – which we believe will impede a member's ability to establish and test written supervisory procedures. The preamble to Regulatory Notice 08-24 uses similarly unhelpful language in requiring firms to "prevent[] the diminution of supervision . . . to detected non-compliant conduct due to conflicts of interest." We believe that such ambiguous language could lead to second-guessing by FINRA after a supervisory breakdown occurs without giving members the guidance they need to prevent violations from occurring in the first place.

Indeed, in light of existing NASD Rules 3010(a) and (b) and their proposed equivalents, FINRA Rules 3110(a) and (b)(1), Janney questions whether Paragraph (D) is necessary at all. Proposed FINRA Rule 3110(a) maintains the current NASD requirement for members to establish and maintain a supervisory system that is reasonably designed to achieve compliance with all applicable laws, rules and regulations. Proposed FINRA Rule 3110(b)(1) requires that this system be maintained and enforced with written supervisory procedures. Together, these requirements already impose an obligation upon members that would include a process to identify and mitigate potential conflicts of interest. In an effort to meet these obligations, Janney has implemented controls and corporate governance mechanisms to minimize the presence of conflicts in our supervisory systems and to identify and effectively address these conflicts when they inevitably occur. Finally, we believe that Proposed Rule 3110(b)(6)(3)(C), as stated above, speaks directly to conflicts of interest in supervision.

Janney fully supports FINRA's continued efforts to enhance its members' conflicts of interest policies and procedures. However, for the reasons stated above, we believe the proposed language is problematic and should be deleted. Alternatively, Janney recommends FINRA modify the language to clarify that firms' policies and procedures must be reasonably designed to prevent effective supervision of supervisors from being damaged by conflicts.

Transaction Review and Investigation:
Supplementary Material .08

FINRA also proposes to adopt Supplementary Material .08, which incorporate with some modification the NYSE Rule 342.21 requirement that member firms' insider trading procedures specifically include a review of trades affected in firm proprietary accounts, or for accounts of

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employees or family members for potential insider trading violations. [1] The Supplementary Material would also require member firms to promptly conduct internal investigation into transactions the firm identifies as having violated insider trading regulations.

Additionally, and perhaps most significantly, the Supplementary Material would also require member firms that engage in "investment banking services" as that term is defined in the consolidated research analyst rules, to provide FINRA with various written "reports" regarding such investigations. These include: (i) a quarterly report addressing the progress of each open investigation; (ii) a written report within 10 business days of initiation of internal investigation disclosing, among other things, the securities, trades employees and employee family members under reviews; and (iii) a written report within 15 business days of completion of internal investigation disclosing the results of the investigation, including any internal disciplinary actions and regulatory referrals.

Janney supports incorporating within the FINRA consolidated rulebook the NYSE Rule 342.21. Janney also generally supports adoption of the current NYSE Rule 351(e) quarterly reporting requirements.

Janney strongly opposes, however, requiring firms to further provide FINRA with additional reports upon the commencement and conclusion of any internal investigations. These additional reports are unnecessary and unduly burdensome to member firms in light of the quarterly reporting requirement. Indeed, we note that NYSE's Risk Assessment Unit previously reviewed industry practice and issued comprehensive guidance in NYSE Information Memo 06-06 for reporting requirements relating to Rule 342.21(b) internal investigations, which included among other things the types of internal investigations covered and reportable under the rule. Janney believes that the guidance reflected therein is sufficient and should serve as the benchmark for the Supplementary Material.

Finally, and more generally, Janney believes it would be extremely beneficial for FINRA to articulate the interaction between the Rule proposal and certain Incorporated NYSE Incorporated Rules that have been designated as Non-Exclusive Common Rules under the 17d-2 Agreement – rules for which both FINRA and NYSE bear responsibility when performing their respective regulatory functions. Because 17d-2 Agreement provides for sharing of information between FINRA and NYSE with respect to reports and other documents, we would hope that dual member firms would not be subject to separate reporting requirements regarding internal investigations once the FINRA rulebook is completed.

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[1] As noted by FINRA, "the ITSFEA requires every broker-dealer to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by the broker-dealer or any associated person of the broker-dealer." *Regulatory Notice at p. 9, citing* Exchange Act Section 15(f). Janney believes this language is helpful to understanding the scope of the requirement and should be carried over to the supplementary material.

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Internal Inspections: Proposed Rule 3110(c)

a. *FINRA Should Adopt the Risk-Based Inspection Scheme Permitted under NYSE Rules 342.24 and 342.25*

Proposed FINRA Rule 3110(c)(1)(A) would require a member firm to conduct an annual inspection of any location that meets the definition of "office of supervisory jurisdiction" under proposed FINRA Rule 3110(d)(1) or any branch office that supervises one or more non-branch locations. Janney supports proposed new FINRA Rule 3110(c). We respectfully request, however, that FINRA incorporate within the consolidated rulebook the risk-based inspection scheme permitted by current NYSE Rules 342.24 and 342.25.

Under these NYSE rules, firms may, upon application to, and approval by, the NYSE, obtain an exemption from the annual inspection requirement for branch offices if the firm can demonstrate that it has policies and procedures that provide for a systemic risk-based surveillance of its branch offices. In effect, NYSE member firms have been able, since 2006, to forego an annual inspection of all of their branch office locations if they meet the requirements set forth in NYSE Rule 342.24 and .25.

Janney is particularly concerned that the definition of OSJ in proposed Rule 3110(d)(1) is broad enough to cover a number of smaller offices, or satellites, where one part of the definition is technically met. This would be the case, for example, in connection with a location that performs no other functions that would cause it to be considered an OSJ other than approving new accounts, and has the majority of its supervision occurring through a parent office. This definition, combined with the provisions of proposed Rule 3110(c)(1)(A), would virtually eliminate the risk-based approach to inspections of satellite locations that has been approved by the NYSE specifically, and more generally by the SEC. Janney can find no such regulatory rationale for such a change. .

Incorporating the NYSE Rules 324.24 and. 25 into the FINRA rulebook should be done for several reasons. First, the SEC considered and already approved the use of a risk-based approach to branch office inspections since they approved NYSE Rules 342.24 and .25 in June 2006. The NYSE then issued guidance to its member firms in June 2006 with respect to the process for requesting certain offices be exempt from the annual inspection requirement and the factors that the NYSE will consider in reviewing the application.

Since then, a number of NYSE member firms have applied for, and received approval from, the NYSE to conduct risk-based inspections of their branch offices. These firms have already revised their branch office inspection programs in line with the NYSE approval. Reversing such approval will result in additional costs to the firms since they will need to expand to be put back into the annual inspection program. Specifically, such reversal will force these firms to bear significant additional costs in the form of increased headcount and commensurate staff training as well as a dramatic rise in travel and travel-related expenses. In today's

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challenging economic environment, and with travel associated costs rising exponentially, we urge FINRA staff to consider carefully the sizeable negative financial effect failure to incorporate this program will have on members, especially in light of the recognized benefits and reasonableness of the program.

Second, permitting a risk-based inspection program for locations that meet the definition of supervisory branch offices or OSJs is consistent with FINRA's approach to risk-based testing in Rule 3012. FINRA has recognized previously that risk-based testing of policies and procedures is appropriate for its member firms, and this principle should be applied to inspections of supervisory branch offices and OSJs.

Third, the criteria used by the NYSE to approve a risk-based approach to branch office inspections is equally valid for FINRA member firms. NYSE Information Memo 06-47 requires that in making a risk-based assessment to exempt specific branch offices from the annual inspection requirement, a firm review the "business profile" of the office (e.g., size of the office, number of customers, volume of transactions), the regulatory history of the office (e.g., number of customer complaints, Financial Consultants on special supervision or subject to disciplinary actions), operational factors (e.g., number of errors, account designation changes), the branch office manager, and the history of the branch office. Offices subject to the exemption were also monitored by the member firm for "red flags" on an ongoing basis. In addition to these prudent requirements, we note that NYSE Rule 342.25(c) does require annual inspections for most types of offices that meet FINRA's definition of "OSJ," including offices with 25 or more registered individuals and any branch office designated as exercising supervision over another branch office.

A risk-based inspection rule such as NYSE Rule 342.24 and .25 allows firms to effectively direct attention to those regulatory risk areas that need closer investigation during the course of each inspection cycle. Risk-based scheduling allows for better-focused and more productive on-site examination efforts, gives firms flexibility in developing and modifying its branch office inspection program, and results in time savings and reduction in mandatory field work, which then leads to an increase in examiner preparation and training time. Indeed, the SEC, in approving the NYSE's rule proposal, stated that it "appropriately balances the needs for firms to survey and inspect their branch offices with the need to provide firms with some flexibility to adapt branch office inspections according to changing circumstances."[2]

We also note that the risk-based inspection program adopted by the NYSE contains effective measures specifically tailored to prevent firms from applying the exemption inappropriately. As part of the application to the NYSE, firms were required to detail the risk criteria to be applied, how often the criteria was to be updated, and provide a list of offices the firm was going to visit in the first year of the program. The SEC likewise noted that the NYSE

[2] *See* NYSE Rule 342.24 and 342.25 Approval Order, 71 FR at 37523.

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Rules, "contain appropriate limitations on a firm's ability to apply the exemption from the requirement to inspect branch offices every year."[3]

Finally, since the SEC has already considered and approved a risk-based approach to branch office inspections, we believe that they would also approve these rules being incorporated into the FINRA rulebook. Accordingly, we request that FINRA incorporate the risk-based internal office inspection scheme contained in NYSE Rule 342.24 and .25 into the FINRA rulebook.

b. Requiring Firms to Maintain Procedures that Prevent an Inspection from Being "Lessened in any Manner" is Unreasonable

In seeking to make the inspection provisions less prescriptive, FINRA has proposed eliminating the heightened office inspection provisions of NASD Rule 3010(c)(3), which must be implemented where a branch office manager and the person conducting the inspection report to the same person and generally require members to have in place procedures that are reasonably designed to avoid conflicts of interest "that serve to undermine complete and effective inspection because of the economic, commercial or financial interest that the branch office manager's supervisor holds in the associated persons and the businesses being inspected." In its place, FINRA proposes to adopt, through FINRA Rule 3110(c)(3), inspection requirements that would require each member to have procedures that both ensure that each location is inspected by someone who is not an associated person of, or supervised by someone at, that location and "prevent the inspection from being lessened in any manner due to any conflicts of interest."

Janney supports FINRA's intent to remove the specific heightened inspection requirements and replace them with a more principles-based approach designed to prevent generally conflicts of interest from harming the effectiveness of internal inspections. However, for reasons similar to those set forth in Part VIII(b) of this letter, we submit , that the conflict of interest standard expressed in proposed Rule 3110(c)(3)(B), like that in proposed Rule 3110(b)(6)(C), is vague, overly broad and not reasonable in light of the purpose of FINRA's internal inspection rules.

The inspection provisions, as set forth in current NASD Rule 3010(c)(1), and proposed FINRA Rule 3110(c)(1), require that members conduct reviews that assist in "detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable … rules." Janney agrees that this requirement contemplates a member's duty to reasonably safeguard its internal inspection system from conflicts of interest. However, we are concerned that creating an expectation in the rulebook that members have (and can enforce) procedures that

[3] *See* NYSE Rule 342.24 and 342.25 Approval Order, 71 FR at 37523.

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"prevent" any conflict that may "lessen in any manner" the inspection is a standard that is overreaching and too easily susceptible to misinterpretation.

For the above reasons, Janney urges FINRA to withdraw section 3110(c)(3)(B) from the Proposed Rule, relocate subparagraph (i) to paragraph (A), and eliminate any remaining references to paragraph (B). Alternatively, Janney urges FINRA to adopt language that provides more guidance to firms in implementing procedures reasonably designed to prevent the effectiveness of the inspection from being damaged by conflicts.

c. *FINRA Should Eliminate the Negative Presumption in Supplementary Material .15*

Janney generally supports proposed Rule 3110(c)(1)(C) as an adequate method to provide supervision for non-branch offices as it reasonably permits member firms to establish a "periodic schedule" for inspection of non-branch offices by considering identified relevant factors. Further, the flexibility of the proposed Rule is consistent with a risk-based approach to regulation and recognizes the varied sizes, structures and access to resources of member firms.

Janney recommends, however, that FINRA eliminate the related Supplementary Material .15. We believe that the following language of .15 runs contrary to the flexibility inherent in proposed Rule 3110(c)(1)(C):

> In establishing a non-branch location inspection schedule, there is a general presumption that a non-branch location will be inspected at least every three years, even in the absence of any indicators of irregularities or misconduct (i.e., "red flags").

If implemented, the presumption would effectively *require* member firms to establish a three year non-branch inspection cycle, thereby eviscerating the reasonable discretion otherwise allowed in proposed Rule 3110(c)(1)(C).

For many member firms, the "presumption" would necessitate allocating valuable resources to non-branch inspections even when the relevant factors do not warrant a 3-year cycle. Non-branch offices, by their definition under proposed Rule 3110 (d)(2)(A)(i)-(iii), are a limited class of offices whose activities generally carry - as compared to branches - less potential for harm to the public investor and less potential risk to the member firms. As such, FINRA should not attempt to create a presumption that will impose *de facto* an inspection cycle on them similar to that imposed on branch offices.

Branch Office and OSJ Definitions and Standards for Review of Offices: Proposed Rule 3110(d) and Supplementary Material .04

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Janney recognizes the importance of member firms providing adequate supervision of OSJs and branch offices in order to ensure compliance with all relevant laws and regulations. We support the proposal to retain the definitions of "branch office" and "office of supervisory jurisdiction" in existing Rule 3010(g).

Proposed Supplementary Material .04, however, goes beyond existing rules in creating: (1) a general presumption that a principal will not be designated and assigned to supervise more than one OSJ; and (2) a general presumption that a determination by a member to designate and assign one principal to supervise more than two OSJs is unreasonable. The latter presumption will subject any member determination assigning one supervisor to more than two OSJs to "greater scrutiny" and the member will have a "greater burden to evidence the reasonableness of such structure."

Janney believes that the introduction of negative presumptions addressing the reasonableness of certain supervisory structures is unnecessary, inappropriate, and should be eliminated. As a threshold matter, such presumptions run counter to the stated objective of the Regulatory Notice to rewrite the supervisory rules "to provide firms with greater flexibility to tailor their supervisory and supervisory control procedures to reflect their business, size and organization structure." The presumptions disregard technology-driven methods of supervision that allow for robust and comprehensive supervision of an OSJ by a designated principal who is not physically present at the location. Enhancements in surveillance, trading and communication systems increasingly allow for effective remote supervision. The presumptions do not consider the varied sizes and resources of member firms that support designated principals in the discharge of their supervisory obligations. These resources may include compliance, control, operations or oversight functions dedicated to supervisory monitoring and support. While the factors outlined in Supplementary Material .04 (a) through (e) are relevant considerations in designating principals to supervise multiple OSJs, a member firm should not be required to overcome negative presumptions and heightened scrutiny to implement an otherwise reasonable supervisory structure.

Janney recommends that the Supplementary Material be reframed as a statement of factors to be considered in creating a supervisory structure over multiple OSJs, without the negative presumptions. Janney further recommends that the language in .04(d) be clarified. As drafted, the language stating that OSJ locations should be "in sufficiently close proximity" is ambiguous. Geographic distance, means of travel and travel time are all variables that could be relevant to a determination of "sufficiently close proximity." For example, is a two hour plane trip between OSJs adequate as opposed to a three hour car or train trip? To eliminate the vague terms and wide breadth of interpretation, Janney recommends the following language: ".04(d) whether the principal is able to be physically present at each OSJ office location on a regular and routine basis; and..."

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Supervisory Control System: Proposed Rule 3120

Proposed FINRA Rule 3120 retains NASD Rule 3012's testing and verification requirements, including the requirement to prepare and submit to the firm's senior management a report at least annually summarizing the test results, significant identified exceptions, and any additional or amended supervisory procedures. FINRA is also proposing to require firms that report $150 million or more in gross revenue on their FOCUS reports to include certain content requirements (modified from NYSE Rule 342.30) in the annual report. In addition, FINRA has recommended that NYSE Rule 354 relating to delivery of the annual report to control persons be eliminated.

Proposed FINRA Rule 3120(b)(1) would require that the report include a tabulation of reports pertaining to customer complaints and internal investigations made to FINRA during the preceding year. Proposed Rule 3120(b)(2) would require a discussion of the preceding year's compliance efforts, including procedures and education programs in the areas specified.

Janney is appreciative that some of the content included in NYSE Rule 342.30 is proposed to be streamlined and reduced, and that the requirement to provide the report to control persons is being removed. Nevertheless, Janney strongly believes that the legacy NYSE Rule 342.30 report should have been eliminated in light of subsequent regulatory developments.

Specifically, Janney believes that that FINRA's proposal to apply certain content requirements in NYSE Rule 342.30 is redundant with the requirements of NASD Rules 3012 (proposed Rule 3120(a)) and 3013. The wording in the introductory paragraph of proposed Rule 3120(b)(2), for example, is almost identical with the language in NASD IM-3013, which requires one or more meetings between the firm's CEO and CCO to discuss matters pertaining to the certification, the member's compliance efforts, and compliance problems and plans for emerging business areas.

Notably, when NASD Rule 3013 was first proposed, industry representatives recommended that NASD adopt the NYSE annual report requirement in lieu of a certification and yearly meeting. At the time, NASD rejected this approach, reasoning that the CEO certification and CEO meeting of Rule 3013 would "enhance investor protection by ensuring that senior management focuse[d] increased attention on their firm's compliance and supervisory systems, and by fostering regular interaction between business and compliance officers.[4] NASD augmented, however, the requirements relating to the CEO meeting to more "closely parallel" the language in

[4] NASD News Release, September 23, 2004.

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NYSE 342.30[5] by requiring that the discussion cover compliance efforts, identify and address significant compliance problems and plans for emerging business areas.

The industry is appreciative of FINRA efforts to streamline and reduce some of the content included in NYSE Rule 342.30 and eliminate the delivery of the annual report to Control Persons pursuant to NYSE Rule 354. In light of the Rule 3013 requirements and history, [6] JANNEY members are disappointed that FINRA did not choose to eliminate in its entirety the NYSE annual report requirements. For dual member firms, the report requirement is cumbersome and time-consuming, replicating much of the processes implemented under NASD Rules 3012 and 3013. For NASD-only firms meeting the gross revenue threshold that will now be required to prepare an annual report, the proposed rule represents a significant expansion of their current obligations – increasing costs without any substantial additional mitigation of risks. Several large firms estimate that today it takes approximately 160 hours to prepare this report alone. Accordingly, JANNEY respectfully requests that FINRA eliminate the annual report requirement, and rely on existing proposed Rule 3120(a) and NASD Rule 3013.

Again, Janney appreciates the opportunity to comment on these proposed rules.

Sincerely,

Mary P. Glancey
First Vice President

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[5] See letter to SEC from Phil Shaikun, dated March 8, 2004, which stated that "NASD believes that those mandated meetings present practical and important opportunity to discuss more broadly the quality of compliance, including such areas as resources, risk and deficiencies. Accordingly, NASD is amending the proposal to require that the CEO and CCO also discuss during their meetings the member's compliance efforts to date and that they further identify and address significant compliance problems and plans for emerging business areas. These enumerated topics in the amendment closely parallel the requirements in NYSE Rule 342.30."

[6] In fact, many firms have implemented regular meetings and reviews with business heads – not just the CEO – covering the same topics, namely compliance efforts, significant compliance problems and plans for emerging business areas.