Pershing

AN AFFILIATE OF THE BANK OF NEW YORK MELLON

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April 27, 2009

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

RE: Regulatory Notice 09-03 Concerning Proposed Consolidated FINRA Rules Governing Financial Responsibility and Related Operational Rules

Dear Ms. Asquith:

Pershing LLC ("Pershing") appreciates the opportunity to comment on the above referenced proposal and supports efforts to harmonize legacy NYSE and NASD rules into a Consolidated FINRA Rulebook. We would like to thank FINRA for its continued thoughtful approach towards harmonization and for seeking the feedback of its membership throughout the harmonization process. We have tailored our comments to those provisions of Proposed FINRA Rule 4311 where we believe assistance from FINRA is required to maximize the benefit to the industry, to reduce the potential for unintended consequences or to provide further clarification.

Proposed Rule 4311(b)(4)

The proposed rule sets forth specific due diligence requirements for a carrying firm ("CF") to undertake regarding a prospective Introducing Firm ("IF"). It is our position that a CF's due diligence requirements should be limited to confirming that a prospective IF relationship is appropriate from a commercial perspective and does not pose undue credit risk or liability to the CF. Furthermore, a more prudential approach would avoid setting a false expectation that a CF is responsible for oversight or monitoring of the IF's activities and compliance responsibilities.

Specifically, the proposed rule states that "each carrying firm shall conduct appropriate due diligence with respect to any new introducing firm relationship, including but not limited to inquiry into the introducing firm's business mix and customer account activity; proprietary and customer positions; FOCUS and similar reports; audited financial statements and complaint and disciplinary history".

We agree that it is appropriate for a CF to perform a level of due diligence on prospective IF clients to confirm that the IF is well suited to the service model and product offerings of the CF. For example, the CF should review the IF's customer and proprietary account positions and balances (e.g. margin concentrations), as well as, information relating to the IF's financial

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wherewithal and business mix to confirm that the IF does not pose undue credit, financial or balance sheet risk to the CF.

However, we respectfully disagree with the proposed rule, insofar as it sets forth specific certain review requirements, including customer activity, complaint and disciplinary history. While it may be the case that many of the proposed items for review comprise part of a CF's due diligence review, a more prudential approach would allow CFs the ability to craft the most effective review of IFs with different business models. For instance, an institutional IF requires a review of information different from a predominantly retail focused IF. In addition, it may not be possible to review a static list of specific requirements for non-US IFs, since the regulatory structure, available information and requirements differ in foreign jurisdictions.

We also suggest that the rule be carefully worded so it cannot be misconstrued to imply that the CF is, or should be, responsible to take further steps to proactively determine the appropriateness of IFs activities or compliance profile, which could lead to the potential for unintended consequences. It is our concern that the current proposed rule can be interpreted in a manner that the CF becomes a default "gatekeeper" to the marketplace by determining whether to extend its services to an IF based upon its due diligence evaluations. Instead, we believe that the industry's regulatory authorities have the ultimate responsibility for, and are in the best position to provide the oversight and control mechanisms to ensure that investors are provided with the appropriate protections as it relates to the compliance responsibilities of IFs[1]. We would welcome the opportunity to work with FINRA to confirm that it has access to all of the information needed to perform this oversight and would offer to provide additional information through INSITE (or other existing mechanisms) to enhance those efforts.

We recommend that the current language in NYSE 382/04 ("Member Organizations should carefully weigh the capital and other regulatory and practical consequences of the assumption of the functions enumerated in Rule 382"), should carry forward to proposed Rule 4311, in lieu of the language currently proposed in Rule 4311(b)(4). The more prudential approach afforded by the current language, affords the CF the flexibility to conduct due diligence most appropriate in light of information available and in consideration of the firm's business model without leading to unintended consequences.

<u>Proposed Rule 4311(b)(1), 4311.01 and 4311(d)</u>

Proposed Rule 4311(b)(1) states a CF "shall submit to FINRA for approval any material changes to an approved carrying agreement before such changes become effective." Rule 4311.01 defines material changes as changes to the allocation of responsibilities, parties to the agreement, or liability of the parties, and termination clauses. We are unclear whether this language is

[1] We do not intend to infer that a CF would not take appropriate actions to report matters through existing, required legal mechanisms if any substantive facts regarding an IF, its representatives or its activities became known to them during the course of a relationship and such information was not otherwise publicly known or available.

intended to require prior approval if either the IF or CF chooses to exercise their right to terminate. Further, we are requesting clarification on whether the cited language would require FINRA's approval prior to the date of termination, or the end of the termination timeframes set forth in the clearing agreement itself.

We respectfully assert that a prior approval requirement could stand in the way of either party achieving what it deems appropriate, not only for its own protection, but also from a commercial, service and business perspective. We understand that this language may have been referring to whether or not the retention of a deposit, at the time of termination, would cause a net capital deficiency for the IF. If this was the intention, we request that the language more explicitly reflect this intent to avoid misinterpretation.

Section 4311(d) indicates that "the customer shall be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities there-under." We are uncertain on the intended definition of "material" in this section. If this is intended to include termination, we respectfully assert that the IF, who has the primary relationship with the customer, should be responsible for communicating with the customer about such changes.

Furthermore, there are existing mechanisms designed to provide clients notice of such changes. Examples of this include the conversion communications made pursuant to Notice to Members 02-57, as well as, customers' positive consent to open and transfer their account to another firm. In these situations, the CF is already required to send a notice outlining the responsibilities of the CF and IF relative to the new account opened pursuant to 4311(d). Adding further notification requirements may lead to unintended investor confusion or alarm regarding the status of their accounts.

We believe that the CF should only communicate directly with the customer regarding changes in those limited circumstances when it provides services to the client through contract (i.e. opening of a margin account) and that the proposed new rule be amended to reflect this.

<u>Proposed Rules 4311(g)(1)(A) and (h)(2)</u>

This proposal requires that both copies of customer complaints and the list of reports supplied to the IF should be provided to the IF's designated examining authority (or its appropriate regulatory agency or authority). Through prior discussions with FINRA, we understand that this requirement would apply to a non-US IF[2]. We appreciate that this may be designed to provide greater transparency in today's global marketplace, however, we believe that there are some practical issues that need to be considered. For instance, a number of non-US regulatory authorities are not accustomed to this process and may not be prepared for the receipt of such

[2] While similar language exists in NYSE 382(e)(3), we doubt the applicability relative to non-US IFs was contemplated as non-US IFs were not prevalent in the marketplace at that time.

information. As a provider of services to IFs in the global marketplace, we would suggest that the parties would be best served if FINRA could review this matter with the International Organization of Securities Commissions (IOSCO) and the World Federation of Exchanges prior to implementation. Prior notice to the potential recipients of this information, accompanied by explanatory materials would serve to reduce the unintended consequences that may result from this new process. Perhaps an industry committee tailored towards such matters could assist with the implementation of this proposed requirement. Pershing welcomes the opportunity to explore this matter further with FINRA and to provide some examples where this could prove problematic if not carefully implemented.

<u>Proposed Rule 4311(a)(1), (a)(2) and (i)</u>

These sections focus on requirements for "clear thru" relationships. We are uncertain as to whether the above "clear-thru" provisions are intended to apply to non-US IFs in the same way they would apply to member firms. Given that Pershing provides services to a number of non-US IFs, we hope to gain a greater understanding of the applicability to non-US IFs, including a discussion of whether additional INSITE or other reporting information would prove beneficial.

In closing, we wish to mention that we understand IF to mean a bank or broker-dealer, or foreign equivalent. In the event that this is incorrect, we invite FINRA to provide additional clarification.

We greatly appreciate the opportunity that we have been afforded to submit this letter. As always, Pershing looks forward to working with FINRA to achieve productive, positive results. We await your response and the chance to gain clarification on the provisions cited above. Thank you again for your consideration.

Very truly yours,

Claire Santaniello
Managing Director and Chief Compliance Officer

cc: Marc Menchel