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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 and FINRA Regulatory Notice 08-25, Books and Records

Dear Ms. Asquith:

LPL Financial Corporation ("LPL")<sup>1</sup> appreciates the opportunity to comment on the above-referenced FINRA Regulatory Notices, which propose new rules governing supervision and supervisory controls and books and records. Specifically, FINRA is proposing to adopt new rules for the FINRA consolidated rulebook, based in part on existing NASD and NYSE Rules.

LPL supports FINRA's efforts to develop a consolidated rulebook that not only seeks to harmonize and streamline existing rules, but also gives consideration to the diversity of firms subject to FINRA regulation. We also agree that rewriting the existing supervision and supervisory control rules to reflect more flexible, principles-based regulation is necessary in the current global market environment, and can be accomplished while still preserving FINRA's core mission of investor protection and market integrity. Overall, LPL believes that the amendments proposed thus far are a positive first step toward that end, but we respectfully suggest, however, that several provisions require further consideration and modification to fully achieve the goals of the consolidated rulebook. Our specific comments are described below.

<sup>&</sup>lt;sup>1</sup> LPL Financial is one of the nation's leading diversified financial services companies and the largest independent broker/dealer supporting more than 11,000 financial advisors nationwide. It has offices in Boston, Charlotte, Chicago, Los Angeles, San Diego and West Palm Beach.

### I. Supervisory System: Proposed Rule 3110(a)(2)

In proposing Rule 3110(a)(2), FINRA seeks to amend NASD Rule 3010 (a)(2) that requires firms to designate "an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required." The proposed rule change would eliminate the phrase "for which registration as a broker/dealer is required". LPL respectfully opposes the proposal and suggests that the language of the existing rule should remain. In LPL's opinion, this amendment would cause confusion and undue burden on firms that provide services and products that are non-securities related.

It would appear to be beyond FINRA's jurisdiction to require a principal designation for supervising non-securities related activities. FINRA currently conducts no oversight of insurance or investment advisory businesses, which are generally subject to the jurisdiction and oversight of the SEC and states that maintain their own rules and registration/licensing examination requirements.

Additionally, NASD Rule 1021 outlining registration requirements notes that principal registrations are required for investment banking or securities activities only. Furthermore, this rule specifically restricts individuals who are not engaged in these activities from maintaining licenses, "A member shall not maintain a principal registration with the Association for any person (1) who is no longer active in the member's investment banking or securities business..." For the reasons stated above, FINRA should maintain the language in current NASD Rule 3010(a)(2).

## II. OSJ and Non-OSJ Principals: Proposed Rule 3110(a)(4)

Proposed Rule 3110(a)(4) would require that each OSJ and each non-OSJ branch office designate one or more appropriately registered principals with authority to carry out the supervisory responsibilities assigned to that office by the member. In addition, the Supplemental Material in .03, and .04 specify that a producing registered representative cannot supervise his or her own activities.

These provisions do not take into account the business and supervisory structure of independent member firms, but appear to be more tailored to "wirehouses", which typically consist of a branch office with a producing manager, a compliance manager and a regional compliance manager or director. Independent member firms usually structure their supervisory functions within field OSJs, with home office staff acting as supervisory and surveillance personnel. At LPL, for example, field OSJs conduct supervisory functions, but are also producing managers. To separate the two functions, we would need over 3,300 new staff in the field.

Furthermore, LPL's home office supervision staff acts as the supervisory personnel for our approximately 3,300 OSJs. Supplemental Material .04 presumes that a determination by a member to designate one principal to supervise more than two OSJs is an "unreasonable" determination. If a member exceeds this ratio, the firm would "be subject to greater scrutiny, and

[the firm would] have a greater burden to evidence the reasonableness of such structure." To avoid this extra scrutiny (and comply with the spirit of the rule), LPL would need to not only add staff to the field offices, but disband the home office supervision structure. Such a radical departure from our current practice would impose an undue burden and enormous cost on firms that follow a business model similar to LPL.

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

Proposed FINRA Rule 3110(b)(2) seeks "to retain the requirement in NASD Rule 3010(d)(1) requiring principal review, evidenced in writing, of all transactions", but Supplementary Material .06 states that members "may use a risk-based review system to comply."<sup>3</sup>

LPL seeks clarification of this apparent conflict, and respectfully recommends that the proposed rule adopt the risk-based standard, consistent with traditional concepts of reasonable supervision.

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

We believe that Proposed Rule 3110(b)(3) needs additional clarification and revision. We are concerned that the Proposed Rule seeks to broaden the member firm's responsibility for separately registered outside activities by including approved activities "within the scope of the member's business..." We do not believe it is appropriate to subject all outside business activities to all of the requirements set forth in Proposed Rule 3110.

Many member firms permit their financial advisors to engage in investment advisory services through their own investment advisor entity. The level and type of activity permitted by member firms varies and procedures are developed accordingly. Subjecting all investment advisory activity to Proposed Rule 3110 is a significant departure from the guidance previously provided by FINRA and included in NASD Notice to Members 94-44 and 96-33. For example, given the potential breadth of the term "securities business", it is possible that the guidance under these notices limiting certain firm supervision only in the event that a financial advisor participates in the execution of a securities transaction for advisory clients (e.g., by placing orders) will be lost. We believe this long-standing existing guidance should remain in effect and urge FINRA to incorporate explicitly the guidance into the proposed rule.

Clarification as to the status of NASD Rule 3030 is needed as well. For firms that permit financial advisors to conduct outside business activities that do not require registration as a broker-dealer, the proposed amendment appears to represent a significant expansion of NASD Rules 3030 and 3040 with jurisdictional implications. As discussed above in our comments

<sup>&</sup>lt;sup>2</sup> FINRA Notice 08-24 at page 26.

<sup>&</sup>lt;sup>3</sup> FINRA Notice 08-24 at page 5 and 26. Existing NASD Rule 3010(d)(1) requires a "... review and endorsement by a registered principal in writing, on an internal record, of all transactions ..."

Ms. Marcia E. Asquith June 13, 2008 Page 4 of 4

regarding Proposed Rule 3110(a)(2), many outside businesses are subject to the jurisdiction of other regulatory authorities – each of which has its own rules, requirements and examinations governing those activities. Imposing yet another regulatory overlay for member firms that permit financial advisors to engage in these types of activities away from the broker/dealer entity is redundant and at odds with current regulatory and governmental efforts to modernize the regulatory structure and eliminate costly duplication.

### V. Internal Inspections: Proposed Rule 3110(c)

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 that 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." We believe that this requirement, as written, is excessively broad, susceptible to misinterpretation, and should be removed entirely. LPL urges FINRA to adopt a rule requiring procedures reasonably designed to avoid conflicts.

# VI. <u>Approval and Documentation of Changes in Account Name or Designation:</u> Proposed Rule 4515

Currently NASD Rule 3110(j) requires principal approval of changes in account names or designations. Proposed FINRA Rule 4515 would expand this requirement by obligating the registered principal to approve these changes in writing *prior to the execution* of an order. To ensure that those written approvals are received prior to execution of an order, such accounts would need to be restricted until written approval from the registered principal was received. This requirement would create undue delay and market risk and require operational and procedural changes for implementation. We would suggest restricting purchases and permitting immediate liquidations (with a mechanism to stop funds from going out of the account) until the change to the account is approved by a principal.

#### VII. Conclusion

LPL appreciates the opportunity to comment, and we thank you for your consideration of our comments. Should you have any questions, please contact me at (617) 897-4340.

Stephanie L. Brown

Sincerely