ING

ADVISORS NETWORK

By Electronic Mail

June 13, 2008

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

Re: Regulatory Notice 08-24
Supervision and Supervisory Controls

Dear Ms. Asquith:

Thank you for the opportunity to comment on Regulatory Notice 08-24 relating to Supervision and Supervisory Controls ("Proposal"). ING Advisors Network offers this comment letter on behalf of its four retail broker-dealers. [1]

We appreciate the complexity of FINRA's rule consolidation efforts and applaud FINRA's stated objectives of eliminating obsolete or duplicative requirements and making rules more clear. In the area of supervision and supervisory controls, we particularly endorse FINRA's objective of a more flexible approach to certain supervisory requirements. Rules need to be clear enough to put broker-dealers on notice of what the specific regulatory expectations are, yet flexible enough so that broker-dealers can meet those expectations without undue burden to the firms and consequent costs to investors.

With these concepts in mind, we offer the following specific comments to the Proposal.

[1] ING Advisors Network is the marketing name for a group of retail broker-dealers with a total of over 7,500 representatives. Our representatives are independent contractors and engage in the sales of general securities and packaged products. Our broker-dealers are also registered with the Securities and Exchange Commission ("SEC") as investment advisers.

Comment Time Period Should be Extended

We believe that the very short time period FINRA has given the industry is not sufficient given the importance of these particular rules. The rules are complex and, as noted below, there are significant drafting and other issues with the Proposal. We do not believe the industry can effectively respond and to all the issues or provide sufficient guidance on how they could be drafted in the time period provided.

FINRA should extend the comment period for 30 days so that it can obtain thoughtful and complete comments before filing the Proposal with the SEC. In the long run, this likely would be more expeditious than amending the Proposal after it is filed with the SEC.

Proposed FINRA Rule 3110 (Supervision)

(a) Supervisory System

Proposed rule 3110(a)(2) would require that a member's supervisory system provide for:

> The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for <u>each type of business in which it engages [for which registration as a broker/dealer is required]</u>. (emphasis added and deleted language bracketed)

We strongly urge FINRA to reconsider the proposed language. We believe the proposed drafted language has potential consequences that raise significant issues for broker-dealers, particularly independent broker-dealers.

The Proposal would drop the current language "for which registration as a broker/dealer is required." The Regulatory Notice states that this change is being made to make the provision consistent with current Rule 3010(b). Deletion of the language "for which registration as a broker/dealer is required" does <u>not</u> make the rule more consistent with current Rule 3010(b). Instead it makes it less consistent with the current Rule. This is because the language in current Rule 3010(b) is qualified. A member firm must have written supervisory procedures to supervise the:

> …types of business in which it engages <u>that are reasonably designed to achieve compliance with applicable securities laws and regulations and with the applicable Rules of NASD</u> (emphasis added)..

The qualification in current Rule 3010(b) limits its scope to the securities business of the member. Proposed Rule 3110(a)(2) does not have such limitation. While it could be

argued that the prefatory language in proposed Rule 3110(a)[2] somehow limits the scope of proposed Rule 3110(a)(2) the proposed language is at best unclear, and at worst overbroad and overreaching.

The proposed language could be read to mean that a member has some requirement to supervise activities outside of the direct securities business of the member. This is the obvious intent with respect to outside securities activities of associated persons proposed in 3110(b)(3) (see comments below). If the intent of the language is to apply also to other, non-securities businesses, such as fixed insurance, investment advisory, tax or legal business, or the like, the Proposal is overbroad, unworkable, raises jurisdiction issues, creates duplicate regulation in many instances and appears at odds with current regulatory and governmental efforts to modernize the regulatory structure and eliminate costly duplication. [3] For independent contractor broker-dealers, in which outside business activities are common, the effect of such an overbroad rule would be to essentially put the firms out of business. The broker-dealers could not afford to supervise such businesses, nor would they legally be permitted to do so in many instances.[4]

The rule needs to be redrafted so that broker-dealers have clear notice of what is expected and the rule's reach is appropriately clear.

(b) Written Procedures

(2) Review of Member's Investment Banking and Securities Business

The Proposal would require procedures for the review of all transactions relating to the investment banking or securities business of the member. Supplementary Material .06, however, allows for the member to use a risk-based approach for such review, which we believe is appropriate. The language of the two sections however seems contradictory.

We suggest that FINRA rephrase the rule to state that "the supervisory procedures required by this paragraph (b) shall include procedures reasonably designed to permit principal review of transactions relating to the securities business of the member." Such language would allow for risk-based review and for the flexibility needed for various firms' business models.

[2] The prefatory language in proposed Rule 3110(a) states that each member shall adopt and maintain a supervisory system that "…is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA and Municipal Securities Rulemaking Board (MSRB) Rules"

[3] We are concerned that FINRA has not included in these drafts any proposed changes to current Rule 3030. We believe any changes to that rule need to be considered in reviewing the subject rule proposals.

[4] Such an interpretation would also raise questions about the independent contractor status of the firms' representatives due to the level of control the firms would have over these non-securities businesses.

(3) Supervision of Outside Securities Activities

Proposed Rule 3110(b)(3) states:

> 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 written 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).

Subparagraph B goes on to exempt bank-related activities not requiring registration as a broker-dealer, with which we largely agree.

We believe that there are a number of significant issues with this proposed rule. At the outset, we note that the rule should be more clearly drafted to state that no associated person may engage in the activity without first having received prior, written approval of the member. As currently proposed, there is an argument that the associated person does not have to actually receive the written approval. Further, the rule should be placed in section (a) of the rule dealing with the requirement to have a supervisory structure (or in a separate rule altogether) and not within the section dealing with supervisory procedures. If conduct is to be prescribed, it should be in a separate rule. The general rule requiring supervisory procedures to supervise the firm's securities business would logically require procedures to address the prescribed conduct.

Far more significant is the fact that while intended to replace current Rule 3040, the proposed rule is substantially less clear. Further, the proposal is much broader than current Rule 3040 and could have wide sweeping, adverse consequences to broker-dealers. In this regard:

- The words "conduct" and "securities business" are ambiguous. Current Rule 3040 prohibits "participation in any manner" in a "securities transaction," which is far more clear language, particularly in light of the interpretations over the years. The current rule focuses on actual securities transaction-based conduct, while the proposed rule, by using the word "business" could encompass a wide variety of activities that are not transaction-specific. It is not clear what kind of conduct the Proposal is intended to address.

- The Proposal's requirement that approved outside securities "businesses" become subject to the fully panoply of proposed Rule 3110 is unclear, overbroad and unworkable. The following examples are offered:

- Outside Registered Investment Advisers ("RIAs"). In the independent contractor broker-dealer environment, it is not unusual for persons associated with the member to own an entity that is registered as an RIA. Any securities transactions for that RIA's clients, may or may not be conducted through the member. Under interpretations to current Rule 3040, the member is required to conduct a suitability review of the securities transactions away from the member, but only when the associated person "participated" in them.[5] Under the proposed rule, it could be construed that the outside RIA itself becomes part of the member's "business" and subject to the rules to have policies and procedures and supervise the entire business. RIAs are subject to a different regulatory scheme and an alternative supervisory structure. Customers of the RIA may not be customers of the member. To impose FINRA regulation on these activities would be an unwarranted expansion of jurisdiction and would submit the entity to duplicative, possibly conflicting regulation.

  With respect to outside RIAs, we urge FINRA to adopt an exemption similar to that it has proposed for bank-related securities activities.

- For large corporations that conduct a variety of businesses through various separate legal entities, the proposal could also create significant issues. In such corporations it is possible that a registered person would have corporate responsibilities over more businesses than that of the broker-dealer, but have no direct participation in securities transactions. Nevertheless, as drafted, the proposed rule could be read to suggest that all of the other businesses would be required to become the "business of the member." This is simply impractical and unnecessary.

  The proposal should clarify that firms may rely upon the supervisory structure of affiliated entities.

- By deleting the current language requiring active conduct by the associated person to notify and detail his/her proposed activities and placing the proposed rule in Proposed Rule 3110, the emphasis has shifted from prohibiting conduct of an individual to

[5] We believe that there are significant issues with existing interpretations in this area that we urge FINRA to address.

requiring supervision by the member. The current emphasis of Rule 3040 on prohibiting private securities transactions is more effective than the proposed rule focusing on supervision. A member must know about the activity before it can supervise it, and the effectiveness of Rule 3040 has been in the member's ability to prohibit the conduct more than supervise permissible activity.

- The proposed rule does not include the current exemptions for personal transactions and transactions among family members. Such exemptions should continue to apply.

(4) Review of Correspondence and Internal Communications

The proposed rule states that "(t)he supervisory procedures must ensure…." The language should be redrafted to state that "the supervisory procedures are reasonably designed to…." This language would be more in keeping with traditional concepts of supervision, and consistent with the provisions of Supplementary Material .09 which allows for a risk-based review of such communications.

We support the language in Supplementary Material .11 permitting delegation of review of correspondence and communications to unregistered persons.

(5) Review of Customer Complaints

It is not clear why there is a separate section relating to customer complaints when the proposed rule discussed immediately above requires firms to review and handle customer complaints "in accordance with firm procedures." This rule seems duplicative.

Since FINRA has appropriately proposed to delete the current requirement in NYSE Rule 401A requiring acknowledgement of a customer complaint within fifteen days, the word "acknowledge" seems unnecessary.

We strongly support FINRA's decision to omit the fifteen day language and to limit the proposal to written customer complaints for the reasons FINRA has stated.

(6) Documentation and Supervision of Supervisory Personnel

The Proposal would require firms to have "procedures prohibiting associated persons who perform a supervisory function" from certain conduct. It is unclear why firms would be required to have written procedures prohibiting certain conduct if the conduct itself is not prohibited. If there is to be prohibited conduct there should be rules specifically addressing the conduct to be prohibited. Firms

generally are required to have supervisory procedures appropriate to their business.

Further, the prohibition on a supervisor's "reporting to, or having their compensation or continued employment determined by a person or persons they are supervising," lacks clarity and raises significant difficulties, particularly for large firms or firms that are part of large corporations, notwithstanding the provisions of (c)(ii)(a). There are any number of instances in which a person may supervise some aspect of the activities of another who has the authority to affect the supervisor's compensation. These may be in the areas of finance, continuing education, registration, or other areas of the business that do not create the kinds of conflict issues that trade review might. This is far broader than the current requirements of heightened supervision of producing managers. FINRA should identify the specific concerns it has in this area and draft a rule that addresses those specific concerns.

Subparagraph (D) of this section would require firms to have:

> . . .procedures preventing the supervision required by this Rule from being lessened in any manner…due to any conflicts of interest that may be present with respect to the associated person being supervised, including the position of such person, the revenue such person generates for the firm, or any compensation that the associated person conducting the supervision may derive from the associated person being supervised.
> (Emphasis added)

The proposed language is extremely broad and is vague as to what is being prohibited. As previously noted, firms should not be required to have procedures prohibiting conduct that is not otherwise prohibited. Further, it is completely ambiguous as to what "lessened in any manner" means or what "any conflict of interest" might be involved. This provision does not put broker-dealers on reasonable notice of what conduct might violate the rule. FINRA should specifically identify the conduct to be prohibited and draft a rule prohibiting that specific conduct. The general requirement to have supervisory procedures would necessitate that broker-dealers address supervision of the prohibited conduct in their procedures.

(7) Maintenance of Written Supervisory Procedures

The Proposal retains the current requirement that firms maintain copies of its written procedures in various offices. We recommend that the rule clarify that electronic access to procedures by associated persons at those locations would comply with this requirement. Additionally, the proposed rule states that each member is responsible for communicating any amendments to its supervisory procedures "throughout its organization." This language, while currently in Rule 3010, is vague. Better language would be "to its associated persons."

(c) Internal Inspections

The proposed rule would retain the current language stating:

> Each member shall conduct a review, at least annually, of the businesses in which it engages. The review shall be reasonably designed t assist the member in detecting and preventing violations of, and achieving compliance with, applicable laws …."

The remainder of the proposed rule deals with inspections of offices. We believe that in view of the supervisory controls rule, the broad and somewhat vague language above should be deleted at this time.

Proposed section (c)(2)(A) includes the current language that "(t)he written inspection report must include, without limitation, the testing and verification" of various activities including transmittal of funds, changes of address and verification of customer address changes. These activities generally do not occur in branch offices of a broker-dealer. We believe the language "where applicable" should be used instead of "without limitation" to address this issue.

Proposed subparagraph (c)(2)(A)((iv) would require testing and verification of procedures relating to hand-delivery of checks between customers and registered representatives. It is not clear how such activity can be tested or verified.

Proposed subparagraph (c)(2)(B) requires that firm policies and procedures require a method of customer confirmation, notification or follow-up relating to transmittal of customer funds or securities, as well as the hand-delivery of checks. It is not clear what is anticipated in addition to the required account statements that customers receive.

Proposed subparagraph (c)(3)(A) would require that a firm's procedures state that a person conducting an office inspection not be "assigned" to the location or not "directly or indirectly supervised" by an associated person who is assigned to the location. This section seems to suggest that an OSJ manager may not conduct an examination of a branch to which he/she is the "assigned" OSJ principal. This would not be practical or economically feasible for broker-dealers with OSJ supervisory structures. It would also suggest that home office inspections cannot be conducted by broker-dealer employees, such as compliance or internal audit persons. Notwithstanding the provisions of subparagraph (c)(3)(B)(i), the Supplementary Material should be clarified to permit both situations.

Subparagraph (c)(3)(B) would require that a firm have procedures reasonably designed to

> Prevent the inspection from being lessened in any manner due to any conflicts of interest, including, but not limited to, economic, commercial, or financial interest in the associated persons and businesses being inspected that may be present.

This language is extremely vague and highly subjective. Taken to an extreme, the language could suggest that even home office employees could not conduct office inspections because their salaries are generated from sales by persons in the branch offices. We suggest that the subparagraph be deleted in its entirety.

Additional Comments to Supplementary Materials ("SM")

.03 One-Person OSJs

This proposed SM should be deleted as there is no apparent reason for its requirements. If the OSJ manager is a person who processes securities transactions for customers, the rules would already require that those transactions be supervised by others. The proposed SM apparently would require that because the office is registered as an OSJ, transactions that are otherwise supervised must now be supervised through "close" supervision and "on-site" supervision. The word "close" is vague and "on-site" supervision would not appear to be any more necessary for these offices than for non-OSJ branch offices that are not subject to a similar requirement, or even for other OSJ offices in which there are two or more registered persons. There is already a requirement that such OSJ offices be inspected at least annually.

For many firms who use an OSJ supervisory structure, supervision of OSJ manager production is conducted in the home office and close, on-site supervision by home office personnel would be impossible. The effect of this SM would be to eliminate any one-person OSJ. If that is the intent of the SM, it should simply state that one-person OSJs are not permitted and the industry should be given an opportunity to comment on whether such a rule is appropriate.

,04 Supervision of Multiple OSJs by a Single Principal

The SM states that there is a "general presumption" that a determination by a member to designate and assign one principal to supervise more than two OSJs is unreasonable. We believe this presumption to be unreasonable and contrary to principles-based regulation. FINRA has offered no rationale or anecdotal evidence to support the proposal. In today's world in which much of the supervision is carried out electronically, there is little reason for such a requirement or for the further proposed requirements that the OSJ principal must be physically present "on a regular and routine basis."

We object to the language that suggests that a member that decides to assign one principal to supervise more than two OSJs will be subject to "greater

scrutiny" and will have a "greater burden" to evidence the reasonableness of such structure. This appears to create a new legal standard and to apply it even where the assignment of a principal to more than two OSJs may not be the cause of any other securities rule violation.

.05 Annual Compliance Meeting

We support FINRA's allowing the annual compliance meeting to be conducted through means other than by in-person meetings. We suggest that the SM simply say that the member may conduct the meeting through electronic means as long as the member ensures that each registered person attends the entire meeting. How that is determined should be left to the broker-dealer as technology changes quickly.

,08 Transaction Review and Investigation

SM .08 (a) would require broker-dealers to have supervisory procedures to review securities transactions that are effected for the accounts of "family members" to generally prevent insider trading and fraud. We believe this requirement to be vague, extremely overbroad and inconsistent with principles-based regulation. For firms that engage in investment banking, having procedures requiring the review of accounts of family members of associated persons who may have access to non-public information may make some sense. However, even for these firms requiring procedures to review family accounts of all associated persons' family members is not reasonable. For firms that do not conduct such businesses, a required review of "family accounts" to detect insider trading or fraud in general is not feasible. How would a broker-dealer identify such conduct if it is not related to the business of the broker-dealer?

The proposed SM would essentially require firms to mandate that all associated persons "family members'" accounts be maintained at the firm with which the representative is associated. It might be possible to mandate that accounts of spouses and minor children be so maintained, but virtually impossible for accounts of other "family" members. The broker-dealer would have no idea of who the family members are and whether there are accounts located elsewhere and no way to reasonably detect if there are.

3120 Supervisory Control System[6]

The proposed new requirements for the supervisory controls annual report to management are overly burdensome and contrary to any concept of principles-based regulation or risk-based review of a firm's business. There is no apparent

[6] It would be helpful to be able to view any proposed changes to current Rule 3013 in connection with the proposed changes to this rule.

reason to require a tabulation of customer complaints in light of the information already available to FINRA. Similarly, a report on "internal investigations made to FINRA" is unnecessary. Presumably, this would include information on FINRA inquiries into customer complaints, terminations for cause, routine examinations, special examinations and branch office examinations, among other things. FINRA certainly has this information and the proposal presumes that broker-dealers' senior management is unaware of these events.

Requiring the report to enumerate compliance efforts and educational programs in specific areas of the business and including such broad topics as "antifraud and sales practices," "supervision," and "risk management" creates significant burdens and again presumes that business management is not involved in these areas on any ongoing basis. This will require firms to allocate additional resources to simply prepare reports. It should be noted that "risk management" (which is not defined in or required by any rule) in many firms currently is outside of the compliance structure.

These burdens to broker-dealers outweigh FINRA's stated purpose of providing valuable information to FINRA for its regulatory program. Much of the information is already in FINRA's possession and the rest could be obtained as circumstances warrant.

Conclusion

Again, we appreciate the opportunity to comment. We urge FINRA to consider extending the comment period and engage in discussion with industry members to address the serious concerns we have noted, and those noted by others who were able to submit comment letters in the time allotted or who would be able to submit comments if an extension of time were given. While we understand FINRA's desire to proceed expeditiously with rule consolidation, rules that are as important as the ones addressed in Regulatory Notice 08-24 deserve as much thought and consideration of how business is conducted as possible and FINRA should elicit input earlier, rather than later in the rulemaking process.

Respectfully submitted,

Kerry E. Cunningham
Head of Risk Management