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June 4, 2009

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

Re: *FINRA Regulatory Notice 09-22 Regarding Personal Securities Transactions*

Dear Ms. Asquith:

The Investment Company Institute<sup>1</sup> is writing to comment on FINRA's proposed new rule, Rule 3210, which addresses member firm oversight of personal trading by their associated persons.<sup>2</sup> The proposed rule combines certain provisions of NASD Rule 3050 and New York Stock Exchange Rule 407 and creates additional requirements intended to promote more effective oversight of personal trading by associated persons of member firms.

Oversight of personal trading activities is a core compliance obligation for investment companies, their investment advisers and principal underwriters.<sup>3</sup> Effective oversight of personal

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$10.18 trillion and serve over 93 million shareholders.

<sup>2</sup> See FINRA Regulatory Notice 09-22 (April 2009) ("Notice"), which is available at <http://www.finra.org/web.grops/industry/@ip/@reg/@notice/documents/notices/p118524.pdf>

<sup>3</sup> See, e.g., Rule 17j-1 under the Investment Company Act of 1940 (which requires all registered investment companies, their investment advisers, and their principal underwriters to adopt a code of ethics and procedures designed to detect and prevent improper personal trading and all access persons to file quarterly reports regarding their personal securities transactions); and Rule 204A-1 under the Investment Advisers Act of 1940 (which requires registered investment advisers to adopt a code of ethics setting forth a standard of business conduct and to periodically review personal securities holdings and transactions of their access persons).

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trading is of paramount importance to the Institute and its members.<sup>4</sup> At the same time, the benefits of any proposed new compliance obligations in this area should outweigh the associated costs. Therefore, we recommend that the proposed rule be modified to recognize the distinct structure of certain member firms affiliated with investment companies and to harmonize certain reporting obligations in proposed Rule 3210 with those contained in Rule 17j-1. We also recommend expressly providing member firms with the flexibility to gather personal trading information in a variety of ways. Moreover, we recommend several technical changes to streamline and make the rule practically more workable. Our comments are provided below.

### **Limited Purpose Broker-Dealers**

Proposed Rule 3210(a) prohibits any associated person, without the prior written consent of his or her employer (“employer member”) from opening at another member firm (“executing member”), or at any other financial institution<sup>5</sup> any securities account in which such associated person has a personal financial interest.<sup>6</sup> The proposed rule further requires that, as a condition to granting prior written consent, the employer member instruct an associated person to have the executing member provide duplicates of his or her account statements and confirmations to the employer member.<sup>7</sup>

We urge FINRA to pursue a more targeted supervisory approach that requires reporting of personal trading by access persons of limited purpose broker-dealers.<sup>8</sup> Specifically, the Institute recommends that for limited purpose broker-dealers whose sole purpose is to distribute mutual funds, unit investment trusts, and variable annuity contracts, duplicate account statements and confirmations be required with respect to the personal trading of their “access persons”<sup>9</sup> rather than their associated

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<sup>4</sup> See, e.g., *Report of the Advisory Group on Personal Investing* (May 9, 1994) (“Institute’s Personal Investing Report”) (report issued by a committee of senior investment company industry officials and unanimously endorsed by the Institute’s Board of Governors recommending that investment companies adopt certain substantive restrictions on personal investing activities and related compliance procedures).

<sup>5</sup> “Financial institution” is defined to include, among others, investment companies, investment advisers, and insurance companies.

<sup>6</sup> The Notice states that, as a general matter, personal financial interest would extend to an associated person’s spouse’s account. We recommend defining personal financial interest in the text of Rule 3210 as adopted. As a practical matter, doing so will make it easier for member firms to reference their authority to request an associated person’s spouse’s personal trading records, in response to employee queries.

<sup>7</sup> NASD Rule 3050 currently requires an executing member to send duplicate confirmations and account statements with respect to personal trading by associated persons of an employer member *solely on the employer member’s written request*. NYSE Rule 407 requires these documents to be sent to the employer member.

<sup>8</sup> If an employer member was concerned about the personal trading of a particular associated person, it would be permitted, as it is today, to request duplicate account statements and confirmations from executing members. See NASD Rule 3050(b)(2).

<sup>9</sup> We recommend incorporating in Rule 3210 a definition of “access person” based on Rule 17j-1’s definition of access person. See Rule 17j-1(a)(1) (generally providing that an access person is any director, officer, general partner, or employee of the fund or its investment adviser who, in connection with his or her regular functions or duties, makes, participates in, or obtains information regarding, the

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persons. Unlike associated persons of other broker-dealer firms, associated persons of these firms do not make, participate in, or obtain information regarding the purchase or sale of securities by investment companies or for private client accounts. Nor do they make any recommendations with respect to such purchases or sales. Therefore, an employer member that is a limited purpose broker-dealer that receives account statements and confirmations from its associated persons would not have a basis on which to evaluate the legitimacy of the trading activity.<sup>10</sup> Despite that, by having required the transmittal of this information, there would be a perceived obligation for compliance personnel to review this information. This review potentially would take compliance personnel's time and attention away from areas where their oversight would be better spent.<sup>11</sup> Costs that would have to be incurred to maintain these records similarly are not warranted, because the risks of personal trading based upon misuse of client information does not exist with respect to these employees. Our recommended approach also would line up more closely FINRA's personal trading requirements with those of Rule 17j-1, thereby facilitating more cost effective compliance.<sup>12</sup>

## Other Comments

### *Exceptions from Reporting Requirements*

We recommend that FINRA make any personal trading requirements consistent with existing requirements for investment company personnel, thereby avoiding unnecessary costs without corresponding benefits. As proposed, executing members would not be required to provide duplicate account statements and confirmations with respect to transactions in unit investment trusts, variable contracts, or registered open-end investment companies or to accounts that are limited to transactions in such securities, or to Monthly Investment Plan type accounts. We support these exceptions (with

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purchase or sale of certain securities by a fund, or whose functions relate to the making of any recommendations with respect to such purchases or sales). We have provided rule text to implement this recommendation in Appendix A.

<sup>10</sup> Review of personal securities holdings and transaction reports typically include, among other things, an assessment of whether the access person is trading for his account in the same securities he is trading for clients, and, if so, whether the clients are receiving terms as favorable as the access person takes for himself. As the Commission explained in the proposing release for Rule 204A-1, investment advisers and their personnel face inherent conflicts of interest when they trade securities for their own accounts and have access to information about their clients' securities transactions, which they can exploit for their own benefit. *See* Investment Advisers Act Release No. 2209 (January 20, 2004) at p. 4.

<sup>11</sup> *See, e.g.*, Rule 38a-1 under the Investment Company Act of 1940 (requiring investment companies to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund, including policies and procedures that provide for the oversight of compliance by each investment adviser, principal underwriter, administrator, and transfer agent of the fund).

<sup>12</sup> Under Rule 17j-1, access persons are required to report securities transactions on a quarterly basis to the investment company (or relevant adviser or principal underwriter). Our recommended approach also would be consistent with a recommendation in the Institute's Personal Investing Report, which provided that investment company codes of ethics require all access persons to direct their brokers to supply to a designated compliance official duplicate confirmations and account statements. *Cf.* Commissioner Elisse B. Walter, U.S. Securities and Exchange Commission, *Regulating Broker-Dealers and Investment Advisers: Demarcation or Harmonization?* (May 5, 2009) (calling for the Commission's harmonization of the supervisory responsibilities of broker-dealers and investment advisers).

one technical change)<sup>13</sup> because we do not believe that any of these types of transactions present opportunities for abuse. For the same reason, we recommend that FINRA not require reporting with respect to: (i) transactions effected for, and securities held in, any account over which the person has no direct or indirect influence or control; or (ii) transactions in direct obligations of the United States government, bankers' acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements.<sup>14</sup>

*Retain Flexibility of Executing Members' Methods for Reporting*

Proposed Rule 3210 requires an executing member to send duplicate account statements and confirmations to employer members. The Notice requests comment on the methodologies firms currently use to obtain personal trading information, and whether the proposed rule should address such information-gathering methodologies. Our members report that they gather personal trading information in a variety of ways. For example, some firms receive electronic feeds of transactions and disks of account statements. Others receive electronic feeds of transactions and have access to account statements through the Internet. Still others, particularly smaller advisers, are not set up to receive electronic feeds and instead receive hard copies of confirmations and account statements. We see no reason to limit the current flexibility, and therefore recommend expressly permitting confirmations and account statements to be received in electronic or paper form or accessed through the Internet.<sup>15</sup>

*Employer Member's Revocation of Consent*

Supplementary Material .04 provides that if an employer member does not receive duplicate account statements and confirmations required pursuant to proposed Rule 3210 in a timely manner, the employer member must revoke its consent to maintain the account, and the executing member must close the account.<sup>16</sup> An employer member not receiving confirmations or account statements may be the result of an administrative oversight or other benign circumstance. Given that, requiring that the account be closed is an unduly severe consequence. We recommend instead requiring the employer member to provide notice to the executing member and associated person and permit an opportunity to cure within a reasonable time period. If there is failure to cure, then it may be appropriate to require the account to be closed.

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<sup>13</sup> We recommend renaming the term Monthly Investment Plan as Automatic Investment Plan and defining it in the rule along the same lines as Rule 17j-1 defines Automatic Investment Plan. The automated nature of the investment (rather than its frequency) is the feature that protects against the potential for abusive trading. See Rule 17j-1(a)(11) (generally defining automatic investment plan as a program in which regular periodic purchases are made automatically in investment accounts in accordance with a predetermined schedule and allocation.) We have provided a recommended definition of this term in Appendix A.

<sup>14</sup> These reporting exceptions are based on Rule 17j-1. See Rule 17j-1(a)(4) and (d)(2).

<sup>15</sup> Rule 17j-1 does not require information regarding access persons' personal trading to be sent or received in any particular manner.

<sup>16</sup> There is no corollary to this obligation in Rule 17j-1.

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The Institute appreciates the opportunity to comment on the proposal. Any questions about regarding the comments may be directed to the undersigned at (202) 218-3563 or Ari Burstein at (202) 371-5408.

Sincerely,

/s/

Dorothy M. Donohue  
Senior Associate Counsel

cc: Robert E. Plaze, Associate Director, Office of Regulatory Policy and Investment Adviser  
Regulation  
Sarah A. Bessin, Assistant Director, Office of Investment Adviser Regulation

Division of Investment Management  
U.S. Securities and Exchange Commission

## Appendix A

### 3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

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### 3200. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS

#### 3210. Personal Securities Transactions for or by Associated Persons

(d) Notwithstanding the foregoing, this provision applies only to associated persons of limited purpose broker-dealers whose sole purpose is to distribute registered open-end investment companies, unit investment trusts, and variable annuity contracts that are access persons. An access person is any such associated person who, in connection with his or her regular functions or duties, makes, participates in or obtains information regarding, the purchase or sale of securities by those registered open-end investment companies or unit investment trusts, or whose functions relate to the making of any recommendations with respect to such purchases or sales.

Supplementary Material:

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**.03 Duplicate Account Statements and Confirmations.** – The requirement to provide to the employer member duplicate account statements and confirmations shall not be applicable to transactions in unit investment trusts and variable contracts or redeemable securities of companies registered under the Investment Company Act of 1940 or to accounts that are limited to transactions in such securities, or to Automatic Investment Plan type accounts, unless the employer member requests receipt of such duplicate account statements or confirmations. For purposes of this paragraph, “Automatic Investment Plan” means a program in which regular periodic purchases (or withdrawals) are made automatically in (or from) investment accounts in accordance with a predetermined schedule and allocation. An Automatic Investment Plan includes a dividend reinvestment plan and retirement plans under Section 401(k) of the Internal Revenue Code.