SIFMA®
Securities Industry and
Financial Markets Association

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VIA ELECTRONIC DELIVERY (pubcom@finra.org)

Marcia E. Asquith
Senior Vice President and Corporate Secretary
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, DC 20006-1500

Re: FINRA Regulatory Notice 09-63; Discretionary Accounts and Transactions

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to comment on FINRA Regulatory Notice 09-63, which proposes to transfer NASD Rule 2510 into the Consolidated FINRA Rulebook as FINRA Rule 3260, with certain changes that take into account requirements under Incorporated NYSE Rule 408 (the "Proposal"). Although SIFMA generally supports the Proposal, SIFMA believes that the prior written authorization requirement of proposed Rule 3260(b) should not apply to individual sub-accounts in the institutional account context. In addition, while SIFMA supports FINRA's proposal to effectively maintain the exception from the prior written authorization and related requirements of proposed FINRA Rule 3260(a) for oral good-'til-canceled ("GTC") orders issued on a "not held" basis for institutional accounts, SIFMA believes that oral instructions in respect of retail customer orders should be afforded the same treatment, provided the member firm makes and keeps a record of such instruction. Finally, SIFMA believes that proposed Rule 3260(a) should not apply to SEC Rule 10b5-1 trading plans, through which securities transactions are already amply authorized and documented by contract.

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

I. Proposed Rule 3260(b) – Transactions by Agents of Customers

Proposed FINRA Rule 3260(b) would require that, before accepting orders for a customer's account from any person other than the customer, members and associated persons must obtain the customer's dated, prior written authorization granting discretionary power to such person. FINRA specifically solicits comment on the ability of members to obtain the required written authorizations from "customers in an institutional account (e.g., sub-account customers in a master account – sub-account arrangement)."[2]

Although SIFMA generally supports this proposed requirement in the retail context and believes that it is consistent with prudent business practices, SIFMA is concerned about the Rule's application in the context of a significant segment of institutional account arrangements. In particular, in those circumstances where the member firm transacts with institutional money managers (e.g., investment advisers) that have been granted discretionary trading authority by their underlying clients, the member often does not have a relationship with such underlying clients, particularly in accounts that clear and settle trades on a delivery-versus-payment (DVP) basis where the broker-dealer is not acting as a custodian.[3] Moreover, the money manager's client base changes frequently and the administration of these changes is most efficiently handled by the money managers sought out by clients in the first instance and who often are affiliated with the underlying beneficiaries. A member firm with a significant institutional client base may routinely open between 50,000 and 100,000 sub-accounts in a single year, and may have many times that number of sub-accounts on its books at any one time. An individual manager may have as few as one and as many as 3,500 such sub-account clients. If

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2 *See* Proposal at Page 5.

3 A typical arrangement is documented under the industry-accepted master investment adviser letter ("Master IA Letter"), which provides in pertinent part: "We are (check appropriate box): __ an adviser registered under the Investment Advisers Act of 1940 ("Advisers Act") and maintain the records required by the Advisers Act; or __ a non-U.S. investment adviser that is registered as such under the applicable laws of the jurisdiction(s) in which we are located. . . In either case, we act as investment adviser for a number of clients under an agreement or power of attorney to invest on their behalf, including the execution of orders to buy and sell securities and to bunch orders and average prices for those clients, provided that [broker-dealer] will make available information regarding actual prices upon request. We are fully aware of the financial position and the investment objectives and investment limitations of these clients. We are capable of independently evaluating the investment risk of the orders we place with [broker-dealer] and are exercising independent investment decisions without reliance on [broker-dealer's] recommendations or advice, if any. **In lieu of furnishing [broker-dealer] with specific evidence of our authority and other information in connection with each account in which we give an order, we agree (without limiting our obligations to [broker-dealer]) to indemnify and hold [broker-dealer] harmless in the event that any person or entity should make claim against the [broker-dealer] that the [broker-dealer's] execution of any order on the basis of our instruction was without authority or was not suitable for the account.** We represent that we have all necessary authorizations to enter into this Agreement. If a transaction is to be executed by [broker-dealer] which is not so authorized, we will notify [broker-dealer] so that [broker-dealer] may communicate directly with the client and receive the necessary authority from the client involved." (Emphasis added).

authorization at the sub-account level is required by FINRA Rule 3260(b), member firms would face significant operational and logistical challenges in identifying the underlying clients that have provided authority to institutional managers and obtaining their authorization before permitting trading activity for the benefit of those clients.

In addition, in those circumstances where an institutional master account is a retirement plan owned by a trust and the sub-accounts are held in the name of the plan for the benefit of individual plan participants, applying the written authorization requirement to the individual sub-account participants would be cumbersome and impractical. In addition to imposing significant bookkeeping requirements on member firms, it could also create legal complications for a member's relationship with the trustee and participants. Under current practice, the plan trustee communicates to the member, who can direct investments in any plan sub-accounts (the participants, the member in its discretionary advisory programs, investment managers or others). Requiring the underlying participant's signature is inconsistent with this relationship and may not be legally binding on the plan account, potentially exposing the member firm to claims by the plan trustee.

In light of the above practical and legal considerations, SIFMA believes that the prior written authorization requirement should not apply to individual sub-accounts in the institutional context. Rather, member firms should be permitted to rely on written representations such as those noted above in the Master IA Letter,[4] whereby the money manager represents to the broker-dealer that it has received discretionary trading authority from the underlying clients and indemnifies the broker-dealer for following the manager's instructions in connection with orders and transactions for those sub-accounts.

II. Proposed Rule 3260(c) – Specific Discretionary Activities; Extent Permissible

FINRA is proposing to clarify that an oral "not held" instruction provides time and price discretion on the order for a single trading session only. Specifically, proposed FINRA Rule 3260(c)(1) provides that, notwithstanding the requirements of proposed FINRA Rule 3260(a), members may exercise time or price discretion: (1) during a normal trading session, provided that such time or price discretion is only valid during that session; or (2) after the close of a normal trading session, provided that such discretion is only valid during the next normal trading session. Although not explicit in the Rule text, the Proposal states that "[s]uch limited time or price discretion may be given orally by the customer." The Proposal also notes that it has no impact on the duration of GTC orders issued on a "not held" basis for institutional accounts.

SIFMA supports FINRA's proposal to effectively maintain in proposed FINRA Rule 3260(c) the exception from the prior written authorization and related requirements of

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4 *See* note 3, *supra*.

proposed FINRA Rule 3260(a) for GTC orders issued on a "not held" basis for institutional accounts. However, SIFMA believes that retail customers should be provided with the same flexibility and that oral instructions with respect to retail customer orders should be afforded the same treatment.

SIFMA believes that, although generally required today under existing NASD Rule 2510, requiring a retail customer's oral GTC order issued on a "not held" basis to be refreshed on a daily basis is not always practical and can result in an inferior execution. A number of SIFMA members have advised that they often "work" GTC orders from retail clients over a period of several days or trading sessions. If a firm is unable to fill an order in a single trading session, under proposed Rule 3260(c)(1), it would need to contact the customer to effectively confirm the instruction. Not only is this "daily refresh" requirement an administrative burden on FINRA member firms, but it also can work to the customer's disadvantage. Indeed, the firm may not be successful in reaching the customer to gain the necessary confirmation of the "not held" instruction, which could result in missed opportunities for a favorable execution. This concern is heightened when serving customers resident in jurisdictions outside of the United States that may be in significantly different time zones.

Accordingly, SIFMA asks that FINRA consider revising proposed Rule 3260(c)(1) to provide that oral "not held" instructions from retail customers are valid for the duration of the order, provided the member creates and retains a record of such instruction. More specifically, SIFMA believes the Rule should provide that a "not held" GTC order from either a retail or institutional client that has not been executed, or that has been only partially executed, should be considered valid until it is fully executed or canceled by the client. Likewise, a market or limit day order with "not held" instructions from the customer should be valid only for the trading session during which it was entered (or the next normal trading session, if entered after the close). Redrafting the proposed Rule in this manner would provide retail customers with the same flexibility as institutional customers in this regard and would ease the administrative burden on member firms.

Finally, SIFMA believes that SEC Rule 10b5-1 trading plans[5] should be specifically excluded from the requirements of proposed Rule 3260(a). We note that, in a typical Rule 10b5-1 trading plan, a corporate executive or employee enters into an agreement with the broker-dealer administering the plan, which expressly authorizes the firm to trade on the employee's behalf. These contracts provide written instructions from the customer as to the timing and quantity of transactions to be executed, but typically do not provide discretion to a "named, natural person or persons" associated with the firm. Rather, the firm's trading desk carries out the instructions of the Rule 10b5-1 trading plan. Imposing a requirement that a specific individual be provided with discretionary authority in the Rule 10b5-1 context would require most member firms to amend their

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[5] Rule 10b5-1 creates an affirmative defense to insider trading liability where the trader can demonstrate that a transaction was entered into pursuant to a previously adopted contract, instruction or plan for selling securities.

existing Rule 10b5-1 agreements with customers. In addition, imposing supervisory approval requirements on each transaction executed pursuant to a Rule 10b5-1 trading plan would require firms to restructure their 10b5-1 trading desks, which would be a significant undertaking with no clear investor protection benefit. Indeed, SIFMA is not aware of abuses in this area and believes that imposing these requirements on the administration of Rule 10b5-1 plans is unnecessary.

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We appreciate this opportunity to submit our comments on FINRA's proposal. If you should have any questions or would like to discuss our comments, please do not hesitate to contact me at 202-962-7386 or jmchale@sifma.org.

Sincerely,

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Managing Director and Associate General Counsel
SIFMA

cc: Thomas Gira
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