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August 17, 2015

VIA E-MAIL TO PUBCOM@FINRA.ORG
Marcia E. Asquith
Senior Vice President and Corporate Secretary
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Request for Comment on Proposed Amendment to Rules Governing Discretionary Accounts and Transactions

Dear Ms. Asquith:

Vanguard[1] appreciates the opportunity to comment on FINRA's proposed amendments to FINRA rules governing discretionary accounts and transactions.[2] Vanguard commends FINRA for its ongoing efforts to enhance investor protection by updating standards designed to prohibit excessive and unauthorized trading in a customer's account in which the firm, or an associated person of the firm, exercises discretion. While Vanguard generally supports the proposal, we are submitting this comment letter to propose several important modifications to the draft of the rule and to request a clarification of its application.

I. BROADENING THE EXCEPTION TO PROPOSED RULE 3260(a)

Vanguard respectfully requests that the exception in subsection (a) of draft Rule 3260 (relating to fee-based accounts) be expanded. FINRA should except from the member firm's supervisory obligations set forth in subsection (a) certain client accounts receiving fee-based discretionary advice from an advisory affiliate of the broker-dealer in situations where the

[1] Offering more than 150 U.S. registered mutual funds and headquartered in Valley Forge, Pennsylvania, The Vanguard Group, Inc. ("Vanguard") manages approximately $3 trillion in mutual fund assets on behalf of fund investors. Vanguard Marketing Corporation ("VMC"), a Vanguard subsidiary, is an SEC registered broker-dealer and member of FINRA. VMC offers brokerage services through its Vanguard Brokerages Services operating division, and provides marketing and distribution services for the Vanguard funds and certain 529 and annuity programs. Vanguard Advisers, Inc. ("VAI"), a Vanguard subsidiary, is an SEC registered investment advisor. VAI offers investment advisory services to a wide variety of clients, including Vanguard Personal Advisor Services™ through which it provides both nondiscretionary advice services and ongoing discretionary managed account services.
[2] *See* Regulatory Notice 15-22 (June 2015) ("Notice").

broker-dealer may also receive transaction-based compensation in connection with executing transactions in the managed accounts. We believe that the policy rationale underlying subsection (a) of the proposed rule is not implicated in advisory services where the broker-dealer is acting merely as a custodian of the advisory clients' accounts, has no meaningful input into the advisor's recommendations, and does not share its transaction-based compensation with the advisor or any individual associated person.[3] In particular, Vanguard requests that the following new exception be made part of the text of subsection (a) of the rule:

> "The requirements of this paragraph (a) shall also not apply where:
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> (i) A separate advisory entity, and not the member firm, is solely responsible for supervising the discretionary authority exercised in a customer's account;
> (ii) Such separate advisory entity exercising discretion receives only fee-based compensation for its exercise of discretionary authority; and
> (iii) The member firm does not share any transaction-based compensation derived from the advisory entity's exercise of discretionary authority with the advisory entity or any of the member firm's associated persons who are natural persons."

Vanguard believes that such advisory services are constructed in a manner fundamentally different from advisory services offered by traditional dually registered firms where the entity with discretion is the same as the entity receiving transaction-based compensation. These circumstances mitigate the policy concerns underlying the draft proposal.

FINRA has already stated its intention to exclude fee-based only accounts from the requirements of proposed Rule 3260(a).[4] According to the Notice, "FINRA does not believe that the concerns relating to excessive trading apply to fee-based only accounts, and thus approval of individual trades and excessive trading restrictions are unnecessary."[5] If the criteria set forth in the paragraph above are satisfied, Vanguard similarly believes that the policy concerns underlying the proposal are not implicated in situations where an advisory service receives only fee-based compensation for its management of client portfolios, even though some of those accounts may also generate transaction-based compensation for the member firm.

First, if there is a true separation between the fee-based advisory entity (that controls all aspects of the discretionary advice) and the member firm receiving transaction-based compensation, the member firm has no control or authority over the purchase or sale recommendations rendered. Further, the advisory entity will not have an incentive to recommend trades in particular securities on the basis of the transaction-based compensation to

[3] In situations where an advisory entity and its affiliated broker-dealer share a common pool of employees, the investment advisor representatives of the advisory entity may also be registered representatives of the broker-dealer. Under the current draft of the proposed rule, a broker-dealer serving as a custodian for assets of managed clients of the affiliated investment advisor would be required to comply with subsection (a) of proposed Rule 3260 by virtue of having employees licensed with both firms. It is within the context of this type of licensing regime that Vanguard seeks the requested exception.
[4] *See* Notice, p. 4.
[5] *See id.*

be paid because it will not share in any of that compensation. The investment advisor representatives of the advisory entity (who may be associated persons of the member firm) will also have no incentive to excessively trade in clients' accounts because the member firm will not share its transaction-based compensation with them. Moreover, the fee-based advisory entity (which is likely a highly regulated investment advisor or bank subject to a fiduciary duty) will be required to supervise the advice rendered under its applicable regulatory regime, and its supervision of that advice would be subject to the jurisdiction of the regulatory authority responsible for overseeing the fee-based advisory entity.[6] Given that this situation is consistent with the policy rationale underlying the exception and that an extensive regulatory environment applies to advisory entities, Vanguard requests that the Rule 3260(a) exception be extended as set forth above.

II. CLARIFYING AND REFINING THE "WET" SIGNATURE REQUIREMENT

Where a customer has authorized another person (including an entity) to place an order on the customer's behalf, the proposed rule would require that member firms obtain the prior dated manual signature of the person granted authority in accounts.[7] FINRA explains that this requirement is satisfied by obtaining "wet" signatures or copies of wet signatures.[8] As a preliminary matter, Vanguard requests that FINRA clarify the signature requirement for entities granted such authority. Particularly in situations where an advisory entity is an affiliate of the member firm and offers a discretionary service to the member's clients, it is unnecessary to require the advisory entity to submit endless signatures to "perfect" the grant of authority for each particular client signing up for the discretionary service. Such a time-consuming and repetitive process clearly does nothing to prevent unauthorized or excessive trading, as each client will have designated the same entity to be the discretionary advisor when enrolling in the service. Since the proposed rule is unclear on this point, Vanguard seeks guidance from FINRA that a single signature of a natural person authorized to act on behalf of the affiliated advisory entity will suffice under the rule.

Moreover, it is perplexing that FINRA would seek to require the abandonment of e-signatures, particularly in light of their wide-scale adoption by the industry. In the fifteen years since the passage of the Electronic Signatures in Global and National Commerce Act,[9] businesses have created a variety of formats for capturing electronic acceptance of contractual liability, conveying key risk information and obtaining consent. These tools are fast and convenient to use, and the investing public has moved beyond merely being "comfortable" with electronic signatures to actually demanding that firms provide alternatives to paper agreements and manual processes.

FINRA has not explained its rationale for requiring wet signatures or provided any justification for imposing the burden of a manual, paper-based signature requirement instead of

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[6] *See, e.g.,* SEC Rule 206(4)-7, 17 C.F.R. 275.206(4)-7 (2003) (requiring investment advisors to adopt and implement written policies and procedures, to annually audit such policies and procedures and to designate a CCO).
[7] *See* Notice, p. 5.
[8] *See id.*
[9] 15 U.S.C.A. § 7001 (et. seq.) (2000).

allowing e-signatures. Nor has it pointed to any defects with e-signature processes. The imposition of a wet signature requirement, by definition, entails FINRA mandating a switch to manual processes which are inherently subject to higher rates of error. Additionally, manual processes may result in clients experiencing unnecessary delays in the conduct of their accounts. Given that technology continues to evolve and provide even better methods of securing electronic consent (for example, it is not uncommon to use a stylus pen or even a finger to "sign" an actual signature on an electronic device), and given the wholesale adoption of existing and emergent e-signature functionality by members firms, Vanguard respectfully urges that FINRA abandon the "wet" signature requirement.

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Vanguard appreciates the opportunity to comment on FINRA's proposed changes to the rule on discretionary accounts and transactions. If you would like to discuss these comments further, please do not hesitate to contact Sandra Burke at (610) 503-4017 or James Creel at (610) 669-1219.

Very truly yours,

/s/ Brian McCarthy

Brian McCarthy
Principal