August 17, 2015

By Electronic Mail to *pubcom@finra.org*

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20549-1090

Re: FINRA Regulatory Notice 15-22: Revised Proposal to Adopt a Consolidated FINRA Rule Regarding Discretionary Accounts and Transactions

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to FINRA's request for comment on Regulatory Notice 15-22 ("RN 15-22" or the "Proposal"), a proposed rule regarding member firms' supervisory requirements for discretionary accounts and transactions.[2] The Proposal would be adopted in the Consolidated FINRA Rulebook[3] as new FINRA Rule 3260 (Discretionary Accounts and Transactions by Persons Other Than the Customer) ("Proposed Rule 3260").

SIFMA applauds FINRA's continued efforts to streamline the Consolidated FINRA Rulebook by grouping together rules that apply to similar subject matter and eliminating obsolete or duplicative rules. SIFMA appreciates the staff's work to move this and other proposals forward as part of the rule consolidation process. With respect to the Proposal, SIFMA supports FINRA's goal of preventing unauthorized and excessive trading in discretionary accounts by member firms and their associated persons. Notwithstanding

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[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. 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 http://www.sifma.org.

[2] *See generally* RN 15-22 (June 2015), available at http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory_Notice_15-22.pdf (last visited Aug. 17, 2015).

[3] *See generally* Information Notice 03-12-08 (Rulebook Consolidation Process) (Mar. 12, 2008), available at https://www.finra.org/sites/default/files/NoticeDocument/p038121.pdf (last visited Aug. 17, 2015).

this support, SIFMA strongly recommends several changes to the Proposal to better align its costs with its investor protection benefits.

I. BACKGROUND

SIFMA appreciates FINRA's efforts to incorporate into RN 15-22 previous comments submitted by SIFMA and others in connection with FINRA's initial proposal to adopt Proposed Rule 3260 in November 2009 (the "Initial Proposal").[4]

The Initial Proposal would have transferred and reorganized under Proposed Rule 3260 the requirements currently under NASD Rule 2510 (Discretionary Accounts), with certain changes that take into consideration requirements under Incorporated NYSE Rule 408 (Discretionary Power in Customers' Accounts) and NYSE Rule Interpretation 408 (Discretionary Power in Customers' Accounts) (collectively, "NYSE Rule 408"). Specifically, the Initial Proposal contained the following core elements:

- Proposed Rule 3260(a) would have grouped together the various requirements (such as trade-by-trade approval and review of accounts) applicable to member firms and their associated persons that have discretionary power over a customer's account.

- Proposed Rule 3260(b) would have reflected the requirements of NYSE Rule 408(a) regarding accepting orders for a customer's account from someone other than the customer.[5]

- Proposed Rule 3260(c) would have provided certain exceptions to the requirements of Proposed Rule 3260(a) in connection with member firms taking the following actions:

    - Exercising time and price discretion;

    - Effecting bulk exchanges at net asset value of money market mutual funds using negative response letters;

    - Effecting redemptions of money market mutual funds for

[4] *See generally* Regulatory Notice 09-63 (Discretionary Accounts and Transactions) ("RN 09-63"), available at https://www.finra.org/sites/default/files/NoticeDocument/p120369.pdf (last visited on Aug. 17, 2015). Comments filed in connection with RN 09-63 are available at https://www.finra.org/industry/notices/09-63 (last visited Aug. 17, 2015).

[5] NYSE Rule 408(a) prohibits member firms from accepting an order for a customer's account from a person other than the customer without first obtaining (i) the customer's written consent, (ii) the signature of the person(s) authorized to exercise discretion in the account, and (iii) the date such discretionary authority was granted.

payment of securities purchases; and

- Effecting transactions to satisfy an indebtedness to the firm.

Each of the exceptions of Proposed Rule 3260(c) was subject to certain conditions. The Initial Proposal also would have added supplementary material to Proposed Rule 3260 and deleted NYSE Rule 408 from the Consolidated FINRA Rulebook.[6]

II. OVERVIEW OF RN 15-22

As a revised proposal, RN 15-22 is substantially similar to RN 09-63. There are, however, several notable differences, such as:

- Clarification that "[t]he signature and approval requirements of proposed FINRA Rule 3260(a) may be satisfied through the use of 'electronic' means."[7] In regards to electronic signatures, FINRA notes:

  > FINRA will consider a valid electronic signature to be any electronic mark that clearly identifies the signatory and is otherwise in compliance with the Electronic Signatures in Global and National Commerce Act (E-Sign Act), the guidance issued by the [Securities and Exchange Commission (the "SEC")] relating to the E-Sign Act, and the guidance provided by FINRA through its interpretative letters, which address electronic approval processes generally.[8]

- An exclusion from the requirements of Proposed Rule 3260(a) for "fee-based only accounts, including accounts that are charged only a flat fee or a fee based on assets under management."[9]

- A requirement that member firms "obtain a wet signature or a copy of a wet signature, such as a scanned or faxed copy of a wet signature," of the named natural person(s) authorized to exercise discretion in the account (the

[6] FINRA explained in RN 09-63 that NYSE Rule 408 would be rendered obsolete by Proposed Rule 3260 and other applicable rules. *See* RN 09-63 at 6.

[7] RN 15-22 at 4.

[8] *Id*. (Internal citations omitted.)

[9] *Id*.

"Authorized Person Signature Requirement").[10] Where written authorization is granted to a natural person, member firms must obtain the authorized person's prior dated manual signature.[11] Where the authorization is granted to an entity, member firms must obtain the prior dated manual signature of a natural person authorized to act on behalf of the entity.[12]

- Clarification that Proposed Rule 3260(b) does not require member firms "to look through an intermediary (*e.g.*, an investment adviser) to the underlying beneficial owners where the intermediary…is identified as the firm's customer."[13] In such cases, the investment adviser, not its underlying clients, "ordinarily would be considered the firm's customer."[14]

- A requirement that member firms "update accounts established prior to the effective date of [Proposed] Rule 3260 whenever they update the account information in the course of their routine and customary business."[15]

- New requirements concerning the treatment of customers' free credit balances, sweep programs, bulk transfers of customers' accounts and change of broker-dealer of record.

In RN 15-22, FINRA explains that the regulatory objective of Proposed Rule 3260 is to address concerns arising from discretionary accounts related to "opportunities for firms to compromise the interest of customers by engaging in activities such as unauthorized and excessive trading."[16] To this end, FINRA seeks to harmonize current NASD and NYSE Rules to eliminate duplication, streamline regulations, and establish appropriate requirements for exercising discretionary authority over customer accounts. FINRA also "aims to bring clarity and consistency to FINRA rules ***without imposing any significant additional burden on member firms or undermining investor protection.***"[17]

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[10] *Id*. at 5. In RN 15-22, FINRA uses the terms "wet signature" and "manual signature" interchangeably. If FINRA determines to proceed with a non-electronic signature requirement, for purposes of clarity, SIFMA recommends that FINRA use a single, clearly defined term in its final rule.

[11] *Id.* at 5.

[12] *Id*.

[13] *Id*. at 6.

[14] *Id*.

[15] *Id*. at 15.

[16] *Id*.

[17] *Id*. (Emphasis added.)

III. Executive Summary

In this section of the comment letter, SIFMA summarizes some of its general comments on the Proposal. A detailed discussion of each of these issues is included in the various sections of this comment letter.

- ***Proposed Rule 3260(b)'s Authorized Person Signature Requirement Should Be Eliminated*:** SIFMA believes that the signature requirement for authorized persons under Proposed Rule 3260(b) raises significant operational, cost, regulatory, and other concerns with no discernible investor protection benefit. The requirement will be particularly burdensome in the registered investment adviser context by disrupting longstanding industry practices. The additional requirement that an authorized person's signature must be manual conflicts with the legal, regulatory, and industry move toward automated processes, including electronic signatures.

- ***Proposal's Requirement to Update Existing Accounts Should Be Replaced with a Going-Forward Requirement or Tied to the Update Requirements of Rule 17a-3*:** SIFMA believes that the Proposal's update requirement will result in a significant administrative undertaking for member firms, the costs of which ultimately will be borne by investors. Moving to an update requirement that applies on a going-forward basis to new accounts opened after the effective date of the Proposal will better align the costs of the Proposal with its investor protection benefits.

- ***Rule 10b5-1 Plans Should Be Specifically Exempted from the Requirements of Proposed Rule 3260(a)*:** SIFMA believes that the significant cost of compliance with Proposed Rule 3260(a) is unwarranted in the Rule 10b5-1 plan context in light of the reduced risk of unauthorized or excessive trading.

- ***Proposed Rule 3260(c)(1)(C) Should Include Orphaned Accounts and Certain Assets Held Directly*:** SIFMA believes that Proposed Rule 3260(c)(1)(C) should include additional bulk transfer via negative consent scenarios, including accounts that have become "orphaned" in scenarios not currently covered by Proposed Rule 2360(c)(1)(C). This recommended change is consistent with the FINRA's policy goals of ensuring customer access to their account as well as the trading markets. In addition, SIFMA believes that Proposed Rule 3260(c)(1)(C) should permit firms to transfer, via negative consent, mutual funds and 529 plan assets and accounts held directly (*i.e.*, not at an introducing broker's clearing firm) to assist efficient introducing broker monitoring of numerous supervisory obligations.

- ***<u>Proposed Supplementary Material 3260.04 Should Conform to the Language of SEC Guidance that Provides Flexibility to Firms Changing Sweep Program Products when Effecting a Bulk Transfer of Customer Accounts via Negative Consent</u>*:** In its Frequently Asked Questions regarding the Financial Responsibility Rules for Broker Dealers,[18] the SEC Division of Trading and Markets provided guidance regarding changes to a Sweep Program contemporaneous with a bulk transfer pursuant to the existing Bulk Transfer guidance RN 15-22 seeks to codify and amend, FINRA Notice to Members 02-57 ("NTM 02-57").[19] SIFMA believes that the language of Proposed Supplementary Material 3260.04 should include the language "to the extent practicable," which the SEC included in its guidance and SIFMA understands to provide necessary flexibility in the context of negative consent transfer of customer accounts.

- ***<u>FINRA Should Consider the Application of NYSE Information Memo 05-11 Regarding Bank Sweep Data Disclosures to Mutual Funds in Proposed Rule 3260(c)(1)(E)(v)</u>*:** SIFMA respectfully requests that FINRA consider the appropriateness of disclosure requirements that may makes sense for bank sweep products, but are less applicable or inapplicable to money market funds, such as "interest rate" disclosures.

- ***<u>The Balance Record Retention Period of Proposed Supplementary Material 3260.06 Should Align with Federal Record Retention Requirements</u>*:** SIFMA recommends that Proposed Supplementary Material 3260.06 Record Retention be amended to measure the record retention period from the creation of the detailed individual customer balances required by Proposed Rule 3260(c)(1)(E)(vi), consistent with SEC Rule 17a-4.

IV. PROPOSED RULE 3260(b)'S AUTHORIZED PERSON SIGNATURE REQUIREMENT SHOULD BE ELIMINATED

The Authorized Person Signature Requirement raises significant operational, cost, regulatory, and other concerns. Compliance with the Authorized Person Signature Requirement will force many member firms to develop, implement, and maintain new systems and procedures or significantly revise existing ones. For customer accounts that are advised by registered investment advisers, the Authorized Person Signature

[18] Division of Trading and Markets: Response to Frequently Asked Questions Concerning the Amendments to Certain Broker Dealer Financial Responsibility Rules ("FRR FAQs") (Mar. 6, 2014), available at https://www.sec.gov/divisions/marketreg/amendments-to-broker-dealer-financial-responsibility-rule-faq.htm (last visited on Aug. 17, 2015).

[19] NTM 02-57 (Sept. 2002), available at http://www.finra.org/sites/default/files/NoticeDocument/p003486.pdf (last visited on Aug. 17, 2015).

Requirement will disrupt longstanding industry practices. The significant new costs for member firms ultimately will be borne by the customers they serve, with no discernible investor protection benefit.

SIFMA is unaware of any investor protection benefits that reasonably can be expected to result from the Authorized Person Signature Requirement. Unfortunately, FINRA did not delineate in RN 15-22:

- A basis for the imposition of the Authorized Person Signature Requirement;
- An explanation of why the Proposal added a new requirement that the authorized person's signature must be "manual" or "wet;" or
- A substantive analysis of the potential costs and investor protection benefits of the manual signature requirement and an ultimate conclusion that the benefits outweigh the costs.

On balance, SIFMA believes that the costs of the Authorized Person Signature Requirement far outweigh any assumed, potential benefits. Accordingly, SIFMA strongly believes that the Authorized Person Signature Requirement should be eliminated from Proposed Rule 3260(b).

A. *The Signature Requirement Is New for Most Firms and Broad in Scope*

Although NYSE Rule 408(a) requires the signature of authorized persons, FINRA acknowledges in RN 15-22 that Proposed Rule 3260(b)'s Authorized Person Signature Requirement "may impose additional obligations" on FINRA member firms that are not subject to NYSE rules.[20] According to the membership directory section of NYSE's website, NYSE had fewer than 200 member firms as of August 1, 2015.[21] As of May 2015, FINRA had over 4,000 member firms.[22] For each of the many FINRA members that are not also NYSE members, Proposed Rule 3260(b)'s signature requirement for authorized persons will be new.

In addition to being a new requirement for most FINRA member firms, the Authorized Person Signature Requirement will apply broadly across each firm's customer base. Proposed Rule 3260(b) imposes the Authorized Person Signature Requirement on member firms with respect to each "person who is authorized to place orders in a customer's account, not just a person who has discretionary power over a customer's

[20] RN 15-22 at 6.

[21] *See* https://www.nyse.com/markets/nyse/membership (last visited Aug. 1, 2015).

[22] *See* https://www.finra.org/newsroom/statistics (last visited Aug. 1, 2015).

account."[23] In the Proposal, FINRA states that the Authorized Person Signature Requirement will be triggered in the following situations:

1. An investment adviser, other than an associated person, engaged in investment adviser discretionary activities in a customer's account;

2. Any person, other than an associated person, granted non-investment adviser discretionary authority by a customer of the member firm, such as a family member;

3. Any person, including an associated person, engaged in non-discretionary trading in a customer's account; or

4. Transactions by member firms or associated persons in fee-based accounts exempted from Proposed Rule 3260(a).[24]

The Authorized Person Signature Requirement will apply to a broad and significant number of circumstances in which persons other than the customer are authorized to place orders for the customer's account, including investment advisers, registered representatives, family members, and others who engage in discretionary and non-discretionary trading in the account.

B. *The Authorized Person Signature Requirement Conflicts with Current Industry Practices*

Where an entity, such as a registered investment adviser, is authorized to place orders in a customer's account, a requirement to further obtain a signature of a natural person who is authorized to act on behalf of the entity is impractical and does not align with current industry practices. Customers typically authorize member firms to take instruction from an authorized entity, not specific individuals at the authorized entity. The authorized entity is responsible for determining and providing to the member firm the employees authorized to act on specific accounts. Authorized entities may be large and have numerous employees who may change over time. It would be impractical for member firms to collect and routinely update signatures of specific individuals at these firms. At least in the investment adviser context, the Authorized Person Signature Requirement would represent a fundamental shift away from current industry practices.

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[23] RN 15-22 at 5. By contrast, the requirements of NYSE Rule 408(a), as well as FINRA Rule 4512, apply only to accounts for which a person other than the customer has been granted *discretionary authority*.

[24] *Id*. FINRA explains that non-discretionary trading authority exists where a "person is authorized to place an order in the customer's account, but the person must obtain the customer's approval prior to placing the order." *Id*. at n. 17.

1. Investment Advisers

The Authorized Person Signature Requirement is unnecessary in the investment adviser context for two reasons: (1) excessive trading concerns generally do not materialize in the investment adviser context and (2) investment advisers are highly regulated.

a. Excess Trading Concerns Do Not Exist in the Investment Adviser Context

Concerns about excessive trading generally do not exist in the investment adviser context because investment advisers do not receive transaction-based compensation. FINRA applies this logic under Proposed Rule 3260(a) in providing a carve-out for "fee-based only accounts, including accounts that are charged only a flat fee or a fee based on assets under management."[25] The Proposal also provides a carve-out under Proposed Rule 3260(b) for investment advisers in certain limited circumstances: where the investment adviser is a customer of the member firm but its underlying clients are not.[26] By way of example, FINRA explains that the carve-out would apply where an investment adviser opens a master account and associated sub-accounts at a member firm, the sub-accounts clear and settle trades on a delivery-versus-payment (DVP) basis, and the member firm does not act as custodian for the underlying clients.[27] This carve-out appears to be limited to this one example. Because concerns about excessive trading generally do not exist in the investment adviser context, a broader exclusion from the requirements of Rule 3260(b) is warranted for accounts advised by investment advisers.

b. Investment Advisers Are Highly Regulated

The highly regulated nature of the investment adviser relationship alleviates the need for a signature requirement. SIFMA understands that FINRA's purpose in imposing the Authorized Person Signature Requirement may be to potentially increase the accountability of authorized persons by requiring them to manually sign their name. Investment advisers, however, are specifically in the business of taking on precisely this accountability, and are therefore heavily regulated. Investment advisers are registered with their state securities authority and/or SEC; they sign detailed agreements with custodians and with investors spelling out their authority and responsibilities; and they are held to a fiduciary standard. Imposing a signature requirement would not add to their regulatory and fiduciary accountability. In fact, after a diligent search of published academic research and regulatory publications by FINRA and other regulatory and academic organizations,

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[25] RN 15-22 at 4. Proposed Rule 3260(a) states that "[t]he requirements of this paragraph (a) shall not apply to accounts that are only fee-based."

[26] RN 15-22 at 6.

[27] *Id*.

SIFMA has not found any support for the notion that manual signatures increase the accountability of signors.

C. *The Authorized Person Signature Requirement Raises Significant Operational, Cost, Regulatory, and Other Concerns with No Discernible Investor Protection Benefits*

1. The Requirement Applies to Both New & Existing Accounts

The Authorized Person Signature Requirement applies to both new and existing accounts. Member firms will need to review all existing accounts to identify accounts in which a person other than the customer is authorized to place orders on either a discretionary or non-discretionary basis, review each identified account's documentation to see whether there is a record of the authorized person's manual signature, and if not, try to contact the authorized person to obtain their manual signature as quickly as possible.[28] Proposed Rule 3260(b) prohibits the member firm from accepting any orders from the authorized person until a record of the authorized person's manual signature has been obtained. Orders placed by an otherwise properly authorized person may be delayed while the member firm attempts to obtain the authorized person's signature. In some cases, this delay may last several days or weeks or longer, causing harm to the customer's economic interests.

For new accounts, member firms will need to amend or create new systems and procedures to identify accounts for which an authorized person's signature must be obtained under Proposed Rule 3260(b). In many cases, member firms will need to change account applications and certain other forms because the manual signature of an authorized person currently is not requested as part of the account opening process.

2. Accounts Advised by Investment Advisers

The Authorized Person Signature Requirement will be particularly burdensome for member firms with customer accounts that are advised by investment advisers. Many member firms are dually-registered investment advisers, have investment adviser affiliates, or have investment adviser customers who custody their or their client accounts with the member firm. In each case, Proposed Rule 3260(b) would require that member firms obtain the signature of "a natural person authorized to act on behalf of the entity" for each account advised by the investment adviser.[29] As explained in Section IV.B of this

[28] With respect to current industry practice for accounts advised by investment advisers, third person authorizations typically are provided at the firm level, not at the individual level. Accordingly, in the vast majority of cases, firms currently do not possess a record of the manual signature of a person authorized to act on behalf of the investment adviser as a part of the customer's account documentation.

[29] RN 15-22 at 5.

comment letter, the Authorized Person Signature Requirement conflicts with current industry practices in the investment adviser context.[30]

The Proposal is unclear as to whether member firms must obtain the signature of the individual at the investment adviser who makes trading decisions for the underlying customer account, or an individual at the investment adviser serving in a supervisory capacity in relation to the persons who make trading decisions for client accounts. Even if member firms need to obtain the signature of a single person authorized to act on behalf of an investment adviser, this task would be burdensome. The member firm would need to ensure that the signature is obtained from an appropriate person, include a record of the individual's manual signature for each account advised by that investment adviser, and continually assess whether the signor remains a person authorized to act on behalf of the investment adviser. If the signor leaves the investment adviser or otherwise is no longer authorized to act on behalf of the investment adviser, the member firm would need to identify an appropriate signor and re-paper each of the affected accounts.

If member firms must obtain the manual signature of each person at the investment adviser who makes trading decisions for underlying customer accounts, the Authorized Person Signature Requirement would become exponentially more burdensome.

3. Costs of the Requirement Will Be Borne by Investors

The costs of compliance with the Authorized Person Signature Requirement ultimately will be borne by investors. Investors will bear the additional costs associated with inevitable delays in the execution of orders in cases where member firms receive

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[30] As a separate but related matter, Proposed Rule 3260(b) requires that firms obtain the customer's "signed, dated prior written authorization" to each person placing orders for the customer's account. This requirement will disrupt current industry practices for dually registered sponsors of wrap fee investment advisory programs, where a member firm acts as both the program sponsor and the executing broker-dealer. In many cases, wrap fee program sponsors do not obtain a client signature on a document that authorizes, by name, each investment manager trading for the client's account. Instead, advisory client agreements may permit fee-based clients, at and after account opening, to select specific investment managers orally, followed by a written "playback" from the sponsor to the client confirming the client's selection. Additionally, in some advisory programs, the client may authorize the *sponsor* to select the specific investment manager(s) for the client's account. Certain advisory programs may also have a "default replacement" feature that allows the sponsor to replace an investment manager by notifying affected clients in writing of the termination and the sponsor's recommended "default" replacement manager. The client can accept the designated replacement manager by negative consent after a specified period of time, in which event the assets are automatically moved to the new manager.

In light of the foregoing, SIFMA is concerned that FINRA's proposed application of the prior written authorization requirement to fee-based accounts under Proposed Rule 3260(b) will have disruptive effects on wrap fee program sponsors and the investment advisory programs they sponsor. On balance, SIFMA believes that the increased costs and operational challenges arising from such disruption will outweigh any potential investor protection benefits of the requirement.

orders from an authorized person but have not yet obtained a record of the authorized person's manual signature. These costs will be significant because immediately upon the effectiveness of Proposed Rule 3260, there undoubtedly will be a backlog of accounts at each member firm related to the Authorized Person Signature Requirement.

FINRA has not articulated any potential benefits that justify the significant operational and cost burdens that would be incurred by member firms and their customers as a result of the Authorized Person Signature Requirement. Moreover, SIFMA was not able to identify any apparent benefit to investor protection that would be furthered by the requirement. Accordingly, SIFMA strongly believes that FINRA should not impose any signature requirement – wet or otherwise – for authorized persons under Proposed Rule 3260(b).

D. *The Purpose of the Authorized Person Signature Requirement Is Outside of the Scope of Proposed Rule 3260*

The Authorized Person Signature Requirement should be removed from Proposed Rule 3260(b) because its underlying purpose is to affect the conduct of third parties who have been granted written authorization for a customer's account. As a rule containing supervisory requirements of member firms and their associated persons, Proposed Rule 3260 is not an appropriate location for the Authorized Person Signature Requirement.

Proposed Rule 3260 will be located in the Rule 3200 Series (Responsibilities Relating to Associated Persons) of the Consolidated FINRA Rulebook, a section of the supervision rules that includes existing requirements relating to influencing or rewarding employees of others,[31] telemarketing,[32] borrowing from or lending to customers,[33] designation of accounts,[34] and outside business activities of registered persons.[35] All of these rules govern the conduct and business arrangements of persons associated with member firms. The Authorized Person Signature Requirement, however, is a recordkeeping obligation that aims to affect the conduct of persons not associated with a member firm, such as a customer's family member with a Power of Attorney, and, therefore, Proposed Rule 3260 does not appear to be the appropriate location for such a requirement.

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[31] *See* FINRA Rule 3220.

[32] *See* FINRA Rule 3230.

[33] *See* FINRA Rule 3240.

[34] *See* FINRA Rule 3250. This rule prohibits a member firm from carrying an account on its books in the name of a person other than that of the customer, except that accounts may be designated by a number or symbol.

[35] *See* FINRA Rule 3270.

If FINRA disagrees with SIFMA's recommendation that the Authorized Person Signature Requirement be eliminated from Proposed Rule 3260(b), the requirement should at least be moved to a different section of the Consolidated FINRA Rulebook.

E. *Current FINRA Rule 4512 Is Not an Appropriate Benchmark for the Imposition of the Authorized Person Signature Requirement*

SIFMA believes most of its comments regarding Proposed Rule 3260(b)'s Authorized Person Signature Requirement apply with equal force to current FINRA Rule 4512 and, therefore, SIFMA recommends that FINRA eliminate the manual signature requirement of Rule 4512(a)(3). As described below, manual signature requirements are inconsistent with the industry's move towards automated and electronic processes, which only serves to increase costs for member firms and the investors they serve.[36]

SIFMA urges FINRA to use caution in determining whether to retain Proposed Rule 3260(b)'s Authorized Person Signature Requirement because it would apply to a larger number of accounts, and therefore have broader negative impacts, than the manual signature requirement of current Rule 4512(a)(3). As an internal requirement for a member firm's discretionary accounts, Rule 4512(a)(3)'s manual signature requirement is relatively less burdensome than that of Proposed Rule 3260(b) because Rule 4512 applies to a much smaller universe of accounts and authorized persons.

F. *Electronic Signatures Should Be Permitted for Compliance with the Authorized Person Signature Requirement*

SIFMA strongly believes that the Authorized Person Signature Requirement should be eliminated from Proposed Rule 3260(b), especially with respect to accounts advised by investment advisers. Even with individual authorized persons, the Authorized Person Signature Requirement is unnecessarily burdensome and should be eliminated. If FINRA deems it necessary to impose a signature requirement for authorized persons, however, SIFMA strongly recommends that FINRA permit member firms to obtain electronic signatures to comply with the Authorized Person Signature Requirement. This would allow member firms to use the same systems and procedures to comply with the signature requirements of both sections (a) and (b) of Proposed Rule 3260. Electronic signatures are a legally valid, binding method of obtaining signatures that the industry has fully embraced.

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[36] In connection with the adoption of Rule 4512, FINRA did not identify any specific benefit to investor protection that would result from the manual signature requirement of Rule 4512(a)(3). *See generally*, Regulatory Notice 08-25 (May 2008), available at https://www.finra.org/sites/default/files/NoticeDocument/p038507.pdf (last visited Aug. 17, 2015); Notice of Filing of Proposed Rule Change to Adopt FINRA Rules Regarding Books and Records in the Consolidated FINRA Rulebook, Securities Exchange Act Release No. 63181 (Oct. 26, 2010), 75 FR 67155 (Nov. 1, 2010) (SR-FINRA-2010-052); and Regulatory Notice 11-19 (April 2011), available at https://www.finra.org/sites/default/files/NoticeDocument/p123548.pdf (last visited Aug. 17, 2015).

In contrast, manual signature requirements are antiquated and contradict recent trends of moving towards more electronic processes, raising additional operational and cost concerns without adding any discernible investor protection benefits.

1. The Manual Signature Requirement Is Out of Step with the Legal, Regulatory, and Industry Move Toward Automation

a. The E-Sign Act

Congress enacted the E-Sign Act in 2000 to promote the use of electronic contract formation, signatures, and recordkeeping in interstate and international commerce.[37] Section 101 of the E-Sign Act provides that "a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form."[38] Among other things, the E-Sign Act establishes legal equivalence between pen-and-ink signatures and electronic signatures. The E-Sign Act reflects Congress' intent to support the interests of business and government to achieve greater efficiency through electronic transactions.[39]

The Authorized Person Signature Requirement is inconsistent with the E-Sign Act because it forces securities market participants to revert back to paper-based transactions.

Furthermore, section 104 of the E-Sign Act suggests that FINRA lacks the authority to specify signature standards for contractual agreements between private parties. Section 104 provides that nothing in that statute "limits or supersedes any requirement by a Federal regulatory agency, self-regulatory organization, or State regulatory agency that *records be filed with such agency or organization* in accordance with specified standards or formats."[40] This section evidences an effort by Congress to preserve the ability of a regulatory agency and self-regulatory organization ("SRO"), such as FINRA, to specify

[37] *See* Pub.L. 106-229, 114 Stat. 464 (June 2000).

[38] 15 U.S.C. § 7001 (2015).

[39] In enacting the law, Representative Sessions stated that the E-Sign Act "will allow Americans to benefit from the efficiencies resulting from advances in technology." 146 Cong. Rec. H4347 (daily ed. June 14, 2000) (statement of Rep. Sessions). Further, it was Congress' intent that the E-Sign Act apply to "electronic records, signatures and agreements governed by the Securities Exchange Act of 1934 and all electronic records, signatures and agreements used in financial planning, income tax preparation, and investments." 146 Cong. Rec. S5281, S5283 (daily ed. June 16, 2000) (Explanatory Statement of S. 761, "The Electronic Signature in Global and National Commerce Act," submitted by Sen. Abraham).

[40] 15 U.S.C. § 7004(a) (2015). (Emphasis added.) The E-Sign Act also preserves agencies' authority to set standards for the integrity, accuracy, and accessibility of electronic records and the authentication of electronic signatures. *See* OMB Guidance on Implementing the Electronic Signatures in Global and National Commerce Act (E-SIGN) (Mar. 1, 2001), available at https://www.whitehouse.gov/sites/default/files/omb/assets/omb/memoranda/esign-guidance.pdf (last visited Aug. 17, 2015).

standards and formats of records, but only with respect to *records filed with the agency or organization*.

It is reasonable to infer that such authority to specify standards and formats of records was not preserved in all other contexts. If Congress wanted to preserve an SRO's, such as FINRA's, authority to require non-electronic signatures in all contexts, Congress would have said so in the statutory language. A basic tenant of statutory construction is that "a legislature says in a statute what it means and means in a statute what it says there. . . ."[41] As required under Proposed Rule 3260(b), records of the manual signature of authorized persons do not need to be filed with FINRA. Furthermore, such signatures ordinarily would arise in connection with private contracts among member firms and their customers, investment advisers and their clients, and other contractual relationships between the customer and third parties, such as family members with Powers of Attorney. For these agreements between private parties, it appears that the E-Sign Act removed FINRA's authority to require manual signatures.

b. Regulatory Trend of the SEC, FINRA, and Other Financial Regulatory Organizations – Electronic Signatures & Automated Processes

The Authorized Person Signature Requirement runs contrary to the decades-old regulatory trend of the SEC, FINRA, and other financial regulatory organizations of moving towards electronic signatures and other electronic processes.[42] For example, the SEC adopted amendments to its broker-dealer record preservation rule (SEC Rule 17a-4)[43] in 1997 to allow for the use of electronic storage systems.[44] The SEC stated that the amendments were "a recognition of technological developments that will provide economic as well as time-saving advantages for broker-dealers by expanding the scope of recordkeeping options . . . ."[45]

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[41] *See Rice v. Rehner***,** 463 U.S. 713, 732 (1983).

[42] The SEC began to mandate electronic filings through its Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR") in 1993. *See* SEC, Electronic Filing and the EDGAR System: A Regulatory Overview (Oct. 3, 2006), available at https://www.sec.gov/info/edgar/regoverview.htm (last visited Aug. 17, 2015) (EDGAR was implemented "to benefit electronic filers, enhance the speed and efficiency of SEC processing, and make corporate and financial information available to investors, the financial community and others in a matter of minutes.").

[43] *See generally* 17 C.F.R. § 240.17a-4 (2015).

[44] Adopting Release, Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934, Securities Exchange Act Release No. 38245 (Feb. 5, 1997), 62 FR 6469 (Feb. 12, 1997).

[45] *Id.* at 6469.

The NASD, the predecessor organization to FINRA, joined the SEC in permitting the use of electronic recordkeeping processes at least as early as 1997. At that time, the NASD provided guidance that member firms could utilize electronic signatures to meet the signature requirements of NASD Rule 3110(c)(1)(C).[46] In part, the NASD based its decision to permit the use of electronic signatures on the fact that the SEC had issued a number of releases that approved the use of electronic storage systems "to store and maintain certain broker-dealer records in electronic format or form, and the acceptance of electronic media to obtain certain client or customer approvals."[47]

In 2000, the Commodity Futures Trading Commission ("CFTC") adopted a new rule to allow the use of electronic signatures in lieu of manual signatures for certain purposes, including where CFTC rules require registrants to obtain a signature of a customer, commodity pool participant, or advisory client.[48] In the same year, the Federal Deposit Insurance Corporation ("FDIC") issued a Bulletin on Digital Signatures.[49] After stating that "[t]he future is increasingly pointing to the use of digital documents and digital signatures," the bulletin listed issues for financial institutions to consider when deploying digital signature technology.[50] The FDIC also stated that "[d]igital signature technology is the electronic equivalent of a written signature on written documents."[51]

After the passage of the E-Sign Act in 2000, the SEC issued guidance regarding the electronic storage requirements of Rule 17a-4(f).[52] The SEC stated that it "encourages the use of technological innovation when both broker-dealers and investors will benefit."[53] The SEC further stated that it "continues to be interested in exploring ways in which

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[46] NASD Interpretive Letter to Laura Moret, American Express Financial Corporation (Nov. 26, 1997), available at https://www.finra.org/industry/interpretive-letters/november-26-1997-1200am-0 (last visited Aug. 17, 2015). NASD Rule 3110(c)(1)(C) required member firms to maintain, for each customer account opened after January 1, 1991, the signature of the registered representative introducing the account and the signature of the member or partner, officer, or manager who accepts the account. Proposed Rule 3260(a) contains a similar supervisory approval requirement and expressly permits it to be satisfied with electronic signatures.

[47] *Id*.

[48] *See* Adopting Release, Use of Electronic Signatures of Customers, Participants and Clients of Registrants, 65 FR 12469 (Mar. 9, 2000). *See also* 17 C.F.R. § 1.4 (2015).

[49] *See* FDIC Bulletin on Digital Signatures (Sept. 30, 2000), available at https://www.fdic.gov/regulations/information/fils/banktechbulletin.html (last visited Aug. 17, 2015).

[50] *Id*.

[51] *Id*.

[52] Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), Securities Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001).

[53] 66 FR at 22917.

technology can be used to create efficiencies without sacrificing the Commission's regulatory objectives."[54] With respect to the use of electronic storage media to comply with the SEC's recordkeeping requirements, the SEC identified increased productivity and cost savings as the benefits of the use of electronic storage systems.[55]

In 2001 and 2002, the NASD determined that automated systems could be used to satisfy NASD Rule 3110(c)(1)(C)'s requirement that member firms maintain, for each customer account, the signature of the registered principal who approved the account application.[56] For example, in an interpretive letter to Charles Schwab & Co. Inc. in 2002, the NASD concluded that NASD Rule 3110(c)(1)(C)'s principal review signature requirement would be satisfied where an automated system used to approve account applications "notes the date, time, and identity of the registered principal who has approved the criteria" used by the system for each approved application.[57]

More recently, in January 2014, the Federal Housing Administration ("FHA") announced that it was granting authority to lenders to accept electronic signatures on documents associated with mortgage loans, such as origination, servicing, and loss mitigation documents.[58] Prior FHA policy allowed for electronic signatures only on third party documents such as contracts and other documents not controlled by the lender. In a statement in conjunction with the announcement, FHA Commissioner Carol Galante stated that the expanded use of electronic signatures "bring[s] our requirements into alignment with common industry practices" and "allow[s] for greater efficiency in the home-buying and loss mitigation process."[59] On August 5, 2015, it was reported that the Consumer Financial Protection Bureau ("CFPB") is urging the mortgage industry to switch to an

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[54] *Id.* at n. 15. The SEC's regulatory objectives include considering the "public interest" and protecting investors. *See, e.g.,* Securities Exchange Act § 3(f) and SEC, The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, available at http://www.sec.gov/about/whatwedo.shtml (last visited Aug. 17, 2015) (stating "[t]he mission of the U.S. Securities and Exchange Commission is to protect investors . . . .").

[55] 66 FR at 22917.

[56] *See* NASD Interpretive Letter to Jeffrey W. Kilduff, Esp., O'Melveny & Myers, LLP (Jul. 5, 2001), available at https://www.finra.org/industry/interpretive-letters/july-5-2001-1200am (last visited Aug. 17, 2015) and NASD Interpretive Letter to Selwyn Notelovitz, Global Compliance (Jun. 4, 2002), available at https://www.finra.org/industry/interpretive-letters/june-4-2002-1200am (last visited Aug. 17, 2015).

[57] *See* NASD Interpretive Letter to Selwyn Notelovitz, Global Compliance (Jun. 4, 2002), available at https://www.finra.org/industry/interpretive-letters/june-4-2002-1200am (last visited Aug. 17, 2015).

[58] Press Release: FHA to Accept More Documents with Electronic Signatures (Jan. 30, 2014), available at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2014/HUDNo.14-011 (last visited Aug. 17, 2015).

[59] *Id*.

electronic closing process.[60] Richard Cordray, Director of the CFPB, stated that electronic mortgage closings are "the direction industry is intending and wanting to go. This is the future."[61]

Even under the current Proposal, "[t]he signature and approval requirements of proposed FINRA Rule 3260(a) may be satisfied through the use of 'electronic' means."[62] FINRA states that it "will consider a valid electronic signature to be any electronic mark that clearly identifies the signatory and is otherwise in compliance with the [E-Sign Act]," SEC guidance related to the E-Sign Act, and FINRA interpretive guidance.[63]

The move towards automated and electronic processes by the financial industry and its governing rules and regulations is clear. This trend is driven by increased efficiency and the reduction in costs to member firms and the investors they serve that result from continued technological innovation. By imposing a manual signature requirement under section (b) of Proposed Rule 3260, the Proposal is out of step with this trend and ultimately will cause economic harm to investors without any appreciable investor protection benefits.

2. The Manual Signature Requirement Raises Additional Operational and Cost Concerns and Reduces Investor Protection

As stated above, SIFMA believes that the Authorized Person Signature Requirement will create significant operational and compliance burdens and increased costs for investors without adding any discernible investor protection benefits, particularly with respect to customer accounts advised by investment advisers. These burdens and costs will increase by multiples if the signature requirement is required to be a manual signature.

A prospective customer can open a brokerage account through a member firm's website using an electronic signature. If the manual signature requirement of Proposed Rule 3260(b) goes into effect, an authorized person on the same account will need to print an authorization form, manually sign the form, and mail or scan and e-mail the signed form to the member firm. The member firm will then need to process the form, including identifying the account with which the signature form is associated and saving the signature form with the other documentation for the account.

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[60] *See* Rachel Witkowski, CFPB Urges Industry to Quickly Adopt Electronic Closing (Aug. 5, 2015), available at http://www.americanbanker.com/news/law-regulation/cfpb-urges-industry-to-quickly-adopt-electronic-closings-1075891-1.html (last visited Aug. 17, 2015).

[61] *Id*.

[62] RN 15-22 at 4.

[63] *Id.*

Using electronic signatures would streamline and speed up this process while manual signatures will slow the process. Using electronic signatures offers a variety of benefits to member firms, their customers, and authorized persons for customer accounts. For all of the parties involved, electronic signatures ensure the integrity of documents, provide enhanced tracking and audit trail capabilities, increase scale to accommodate high volumes of documents, and reduce costs.

Available electronic signature technologies provide a "signing" experience similar to manual signatures. For example, existing technologies allow for the signor to type her full name into a text box or draw her signature using a mouse, stylus, or touch screen device, capturing the digital equivalent of a handwritten signature. Thus even assuming that manual signatures increase the accountability of signors, such increased accountability could be achieved with electronic signatures that provide a similar signing experience. FINRA should evaluate available electronic signature technologies and permit member firms to comply with the Authorized Person Signature Requirement using all such technologies that meet FINRA's objectives with the signature requirement.

3. Proposed Rule 3260(b) Goes Beyond the Scope of FINRA's Rule Consolidation Process by Imposing a New Manual Signature Requirement

The Authorized Person Signature Requirement goes beyond the scope of FINRA's rule consolidation process because the NASD and NYSE rules being consolidated into Proposed Rule 3260 did not contain a manual signature requirement for authorized persons of customer accounts. NASD Rule 2510 does not require the signature of authorized persons. Indeed, just like NASD Rule 2510, the Initial Proposal did not contain any signature requirement for authorized persons. While NYSE Rule 408(a) does require the signature of authorized persons, the rule does not require that such signatures be "manual" or "wet." Instead, NYSE Rule 408(a) provides flexibility to member firms to obtain the signatures of authorized persons by electronic means. Additionally, NYSE Rule 408 applies only where discretionary authority has been granted, whereas Proposed Rule 3260(b) applies in both discretionary and non-discretionary contexts.

In FINRA's March 2008 Information Notice announcing its rule consolidation process, FINRA stated that it sought to harmonize and streamline existing rules while giving "consideration to the rapidly evolving nature of the securities business and the broad diversity of firms subject to FINRA regulation."[64] By inserting the manual signature

[64] Information Notice 03-12-08 (Rulebook Consolidation Process) (Mar. 12, 2008) at 1, available at http://www.finra.org/sites/default/files/NoticeDocument/p038121.pdf (last visited Aug. 17, 2015).

requirement in Proposed Rule 3260(b) in connection with the current Proposal, FINRA is going beyond mere consolidation of existing rules.[65]

If FINRA believes that manual signature requirements are necessary for investor protection purposes, SIFMA recommends that FINRA engage in a comprehensive rulemaking process to identify each FINRA rule in which such a requirement is appropriate and provide an analysis of the justification for the requirement.

V. The Proposal's Requirement to Update Existing Accounts Should Be Replaced with a Going-Forward Requirement or Tied to the Update Requirements of Rule 17a-3

A. *The Scope of the Update Requirement is Ambiguous*

SIFMA believes that the Proposal is unclear regarding member firms' obligation to update account documentation under Proposed Rule 3260. For example, the text of Proposed Rule 3260 attached to RN 15-22 as Appendix A does not contain proposed language regarding the Proposal's requirement that member firms "update accounts established prior to the effective date of proposed FINRA Rule 3260 whenever they update the account information in the course of their routine and customary business."[66] In addition, the discussion of the "update requirement" in RN 15-22 is located at the end of Section H of the Proposal, a section which describes the Supplementary Material of Proposed Rule 3260.

SIFMA requests that FINRA clarify the scope of the Proposal's update requirement. Will the Proposal apply solely to customer accounts opened after the effective date of the Proposal or will member firms be required to update existing customer accounts in light of all aspects of the Proposal? For purposes of this letter, SIFMA will assume that the Proposal's update requirement would apply to the requirements of Proposed Rule 3260 as a whole.

B. *Update Requirement Should Only Apply on a Going-Forward Basis*

SIFMA recommends that the update requirement be replaced with a requirement that applies on a going-forward basis to new accounts opened after the effective date of the Proposal. FINRA should eliminate the update requirement as proposed because it would impose a significant administrative undertaking for member firms. Requiring member firms to re-paper the vast number of accounts falling within the scope of the Proposal would result in an increase of costs to member firms and the investors they serve, who ultimately bear these costs.

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[65] Notably, the Initial Proposal did not contain the Authorized Person Signature Requirement.

[66] RN 15-22 at 15.

While the potential costs of the update requirement undoubtedly are significant, SIFMA believes the investor protect benefits are, at best, unclear. FINRA indicates that the Proposal is primarily motivated by a desire to protect investors from unauthorized and excessive trading.[67] FINRA, however, already has a number of rules that address the dangers of unauthorized and/or excessive trading in customer accounts: FINRA Rule 2090 (Know Your Customer), FINRA Rule 2111 (Suitability), FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade), and FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices).

As proposed and adopted, Rule 4512 contains an update requirement that appears to be identical to that of Proposed Rule 3260. During the notice-and-comment process for Rule 4512, FINRA stated that the update requirement was necessary "to promote greater consistency and uniformity of account record information."[68] FINRA also stated at that time that it did "not believe that limiting the update requirements in [proposed Rule 4512] to the account updating requirements under [Exchange Act] Rule 17a-3 would achieve this purpose."[69]

Beyond investor protection considerations, the benefits of greater consistency and uniformity of account record information do not justify the significant cost difference between the update requirement as proposed and a requirement applied on a going-forward basis. By applying the update requirement on a going-forward basis, the investor protection benefits of Proposed Rule 3260 would be better aligned with its cost.

As an alternative to a going-forward requirement, FINRA could achieve its objective of consistency and uniformity of account record information by tying Proposed Rule 3260's update requirement to the requirements of SEC Rule 17a-3 for account information related to suitability determinations.[70] In pertinent part, Rule 17a-3 requires that for every account held by a natural person and for which the member firm has within the past three years been required to make a suitability determination, the member firm obtain certain information concerning the customer (*e.g.*, employment status, annual income, net worth, investment objectives for the account).[71] Rule 17a-3 provides that "[f]or accounts in existence on the effective date of this section, the member, broker or dealer must obtain this information within three years of the effective date of the

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[67] *See* RN 15-22.

[68] Notice of Filing of Proposed Rule Change to Adopt FINRA Rules Regarding Books and Records in the Consolidated FINRA Rulebook, Securities Exchange Act Release No. 63181 (Oct. 26, 2010), 75 FR 67155, 67159 (Nov. 1, 2010) (SR-FINRA-2010-052).

[69] *Id*.

[70] *See* 17 C.F.R. § 240.17a-3 (2015).

[71] 17 C.F.R. § 240.17a-3(a)(17)(i)(A).

section."[72] This rule effectively imposes an update requirement based on a three-year cycle. By imposing a substantially different update requirement under Proposed Rule 3260, FINRA will reduce the consistency and uniformity of account record information for accounts already subject to Rule 17a-3.

SIFMA urges FINRA to use caution when it considers imposing additional recordkeeping requirements for member firms that differ from existing SEC rules. In cases where FINRA moves away from requirements under existing SEC rules, FINRA should identify and explain its justification for doing so.

If FINRA deems it necessary to impose Proposed Rule 3260's update requirement as proposed, clarification is needed. For example, SIFMA requests confirmation that Proposed Rule 3260's update requirement is triggered only by member firm action, not customer action. SIFMA is concerned that the update requirement, as described in the Proposal, may be triggered in cases where the customer independently updates account information by way of electronic access to the account through a member firm's website. In such cases where the member firm takes no affirmative action to update account information, the update requirement should not be triggered.

Additionally, SIFMA seeks clarification on the types of events in the course of a member firm's routine and customary business where Proposed Rule 3260's update requirement would be triggered. As proposed, the update requirement's uncertain terms subject member firms to unwarranted and unnecessary regulatory risk.

VI. Rule 10b5-1 Plans Should Be Specifically Exempted from the Requirements of Proposed Rule 3260

SIFMA believes that Rule 10b5-1 plans should be expressly excluded from Proposed Rule 3260(a) because of the significant compliance and operational burdens that would be imposed. Rule 10b5-1 plans typically do not provide discretion to a named natural person, yet Proposed Rule 3260(a) requires exactly that – the customer's written authorization must be provided to a "named natural person or persons."[73] Imposing a requirement that a specific individual be provided with discretionary authority in the Rule 10b5-1 plan context would require most member firms to amend their existing Rule 10b5-1 agreements with customers. Additionally, Proposed Rule 3260(a)'s supervisory approval requirement for each transaction executed pursuant to a Rule 10b5-1 plan would require many member firms to restructure their 10b5-1 trading desks.

Rule 10b5-1 plans should be expressly excluded from Proposed Rule 3260(a)'s requirements because concerns about unauthorized and excessive trading do not warrant

[72] *Id*.

[73] RN 15-22 at 3.

the significant costs of compliance with the rule in this context. A Rule 10b5-1 plan is a written agreement providing trading instructions from a public company director, officer, employee or other person who may come into possession of material, non-public information about the company or its stock, to the broker-dealer administering the plan.[74] The plan creates a pre-established buying or selling program in a limited purpose brokerage account that will be in effect for a specified period of time.[75] Once a person has adopted a plan, she typically will not exercise any subsequent influence over the plan's scheduled transactions.[76] While these plans may not prescribe the precise details of each securities transaction, the plans do not provide meaningful "discretion" to the administering broker-dealer. Instead, the member firm's trading desk must carry out the instructions of the Rule 10b5-1 plan subject to limited flexibility with regard to the price and timing, and in some cases share volume, of the securities transactions contemplated in the plan. Because of the limited nature of member firms' discretion in this context, the requirements of Proposed Rule 3260 should not apply to member firms in connection with administering Rule 10b5-1 plans.

The Proposal, moreover, already contains exclusions from the requirements of Proposed Rule 3260(a) for limited discretion provided to member firms in similar contexts. Specifically, the limited flexibility provided by a Rule 10b5-1 plan to the administering broker-dealer is similar to the exception under Proposed Rule 3260(c)(1)(A) (Temporary Time or Price Discretion), which provides an exception to the requirements of Proposed Rule 3260(a) for a customer's authorization to exercise time or price discretion.[77] Despite the similarity, broker-dealer activities pursuant to Rule 10b5-1 plans will not qualify under Proposed Rule 3260(c)(1)(A) because the exception is limited to the grant of discretion for

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[74] *See generally* 17 CFR § 240.10b5-1 (2015). Rule 10b5-1 defines when a purchase or sale constitutes trading "on the basis of" material non-public information for purposes of insider trading charges under Section 10(b) of the Securities Exchange Act (and its implementing regulation, Rule 10b-5). The rule also provides an affirmative defense to an insider trading charge by specifying that a person's purchase or sale is not "on the basis of" material non-public information when the person, before becoming aware of the information, entered into a binding contract to purchase or sell the security or adopted a written trading plan.

[75] Generally the administering broker-dealer will have a relationship with the public company itself and will manage all of the Rule 10b5-1 plans of the company's directors, officers and employees. Further, each of these accounts likely will only transact in the securities of the public company with which the individual accountholder is affiliated, to the exclusion of all other securities.

[76] Rule 10b5-1 states that the plan must either (i) specify the date, amount of securities, and prices for the securities transactions, (ii) include a written formula or other program for determining the date, amount of securities, and prices for the securities transactions, or (iii) "not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales." 17 C.F.R. § 240.10b5-1(a)(1)(i)(B).

[77] *See* Proposed Rule 3260(c)(1)(A)(i).

a single "normal trading session."[78] In contrast, Rule 10b5-1 plans generally have an effective period of multiple months or years.

Proposed Rule 3260(c)(1)(A) also contains an exception to the requirements of Proposed Rule 3260(a) where a member firm exercises time or price discretion for an "institutional account" pursuant to valid good-'til-canceled instructions issued on a "not held" basis.[79] This exception applies without time limits but is only available for "institutional accounts," as defined under Rule 4512(c).[80] Although the individuals who utilize Rule 10b5-1 plans typically are sophisticated senior executives of publicly traded companies, in most cases they will not qualify as institutional accounts for purposes of the exception under Proposed Rule 3260(c)(1)(A)(ii).

In light of the fact that unauthorized and excessive trading concerns do not exist in the Rule 10b5-1 plan context, the compliance and operational burdens associated with re-papering most of the existing Rule 10b5-1 plans as well as restructuring administering broker-dealers' trading desks are unnecessary. Furthermore, the Proposal already contains exclusions for limited time and price discretion in contexts similar to Rule 10b5-1 plans. For these reasons, SIFMA believes that Rule 10b5-1 plans should be expressly excluded from the requirements of Proposed Rule 3260(a).

VII. Institutional Account Definition Should Include All Accounts Advised by Professional Money Managers

SIFMA believes that all accounts that are advised by a professional money manager, such as an investment adviser or trust company, should be excluded from Proposed Rule 3260(a)'s requirements. The Proposal contains "an exception to the requirements of proposed FINRA Rule 3260(a) for a firm that exercises time or price discretion for [institutional] accounts pursuant to valid good-'til-canceled instructions issued on a 'not-held' basis, without time limitations."[81] Proposed Rule 3260(c)(1)(A)(ii) incorporates by reference Rule 4512(c)'s definition of "institutional account."[82] As proposed, the exception would apply to an investment adviser's firm account(s) but likely would not apply to its sub-accounts. The exception under Proposed Rule 3260(c)(1)(A)(ii) should apply to these additional accounts because in both situations a professional is making a determination regarding the manner of trading.

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[78] RN 15-22 at 6.

[79] *See* Proposed Rule 3260(c)(1)(A)(ii).

[80] Under Rule 4512(c), the term "institutional account" includes that account of (i) a bank, savings and loan association, insurance company or registered investment company; (ii) an SEC-registered or state-registered investment adviser; and (iii) any other person with total assets of at least $50 million.

[81] RN 15-22. *See* Proposed Rule 3260(c)(1)(A)(ii).

[82] *See* note 80, *supra*.

VIII. PROPOSED RULE 3260(c)(1)(C) – BULK ACCOUNT TRANSFER OF "ORPHANED" ACCOUNTS

A. *Proposed Rule 3260(c)(1)(C) – Inclusion of Orphaned Account Negative Consent Transfer*

SIFMA greatly appreciates FINRA's efforts in codifying and expanding its guidance regarding the bulk transfer of customer accounts via negative consent between introducing brokers and clearing firms in certain situations. In RN 15-22, FINRA outlined a request for information regarding "orphaned" account scenarios. There are several scenarios, outlined below, where accounts are left at a clearing firm after the introducing broker responsible for servicing the account has severed its relationship with that clearing firm.[83] These "orphaned"[84] accounts generally no longer have access to the services of a registered representative, which significantly limits an accountholder's access to her account and the trading markets. As such, SIFMA recommends that clearing firms have the flexibility to transfer these orphaned accounts via negative consent to another broker-dealer on its platform with qualified and licensed staff able to provide accountholders with service and access to their account as well as the trading markets.

B. *Orphaned Account Scenarios*

There are a variety of ways an account may remain at a clearing firm after the introducing broker with which the account was associated severed its relationship with that clearing firm. First, the new clearing firm to which the introducing broker transferred its

[83] An introducing broker may sever its clearing relationship with a clearing firm for a variety of reasons, including, but not limited to: moving all of its accounts to another clearing firm; divesting itself of a business line and moving the accounts associated with that business line to another introducing broker; merging with another introducing broker; and experiencing operational difficulties and transferring all of its accounts to a new introducing broker that has a clearing relationship that is different from the original introducing broker. SIFMA understands that the current Proposed Rule 3260(c)(1)(C) includes some, but not all of these scenarios. For example, where an introducing broker is moving from one clearing firm to another outside the context of operational stress or business line divestiture.

[84] SIFMA notes that there is a material difference between an "orphaned" account and an "abandoned" account in common usage. Generally, firms use the term "abandoned" to classify an account for the purposes of state unclaimed property laws. All 50 states and the District of Columbia have adopted unclaimed property laws that require the reporting and remittance ("escheatment") of various types of intangible property (generally, any obligation to pay money to another person) after such property has remained unclaimed by the owner for a specified period of time (generally, three to five years after the property becomes due and payable to the owner). If a state's unclaimed property laws apply to a certain type of property, then the "holder" of that property has certain obligations, including (i) to attempt to return the property to the rightful owner (this is called "due diligence"); and (ii) if the owner cannot be located, to report and remit the property to the state. For further information, please see SIFMA's 2015 Whitepaper on Unclaimed Property here: http://www.sifma.org/issues/item.aspx?id=8589952727.

accounts may reject certain types of assets contained within the account. These asset types may include, but are not limited to, the following:

- Mutual funds that the new clearing firm does not service due to the lack of a dealer, networking, and/or omnibus agreement(s) with the fund family;
- Foreign securities where the clearing firm does not have custody support for that geographic area;
- Certain annuity products;
- Certain low- priced securities;
- Certain non-transferrable assets which cannot move from their current custody location (*e.g.*, DTC frozen securities,[85] proprietary products); and
- Direct to Fund accounts where the dealer of record is named as the clearing firm.

Second, the new clearing firm may not accept certain account types. These account types may include, but are not limited to, the following:

- The account of foreign residents in jurisdictions that the new clearing firm does not serve;
- Qualified Plan Accounts not serviced by the provider at the new clearing firm; and
- Accounts with features inconsistent with the new clearing firm's margin policies.

Third, accounts may remain with a clearing firm due to the action or inaction of a client as it relates to a request to move that customer's account. These instances may include the following:

- Clients who have responded in the negative to the negative response letter, but have not provided transfer instructions to a new broker-dealer; and
- Clients who have not responded to an affirmative consent request to move an account (*e.g.*, instances where conversions were completed via the Automated

[85] *See generally*, Investor Bulletin: DTC Chills and Freezes, SEC Office of Investor Education and Advocacy (May 2012), available at https://www.sec.gov/investor/alerts/dtcfreezes.pdf (last visited Aug. 17, 2015).

Account Transfer (ACAT) process and the customer does not return a completed, signed ACAT form).

In these instances, the customer's account remains in the custody of the original clearing firm. However, the introducing broker responsible for servicing the account no longer has an agreement with the clearing firm. Therefore, the customer associated with the orphaned account generally does not have access to a registered representative that can service her account or provide the accountholder access to the markets.

C. *Due Diligence, New Introducing Broker Identification, and Consumer Privacy*

RN 15-22 inquired as to the level of due diligence clearing firms may perform on prospective introducing broker and information regarding the privacy of consumer financial information in connection with the negative transfer of orphaned accounts. As it relates to due diligence on a prospective introducing broker, as the prospective introducing broker in the orphaned account negative transfer scenario has an existing clearing relationship with the clearing firm, the clearing firm would have performed extensive analysis of this introducing broker prior to establishing the clearing relationship and on an ongoing basis during the course of that relationship. Further, as a function of a clearing firm's ongoing due diligence, clearing firms necessarily have an intimate understanding of an introducing broker's operation and activities, including, but not limited to, the type of business in which an introducing broker engages, the client base of the introducing broker (*e.g.,* retail, institutional, online), the type of accounts an introducing broker services, the types of assets an introducing broker generally offers its clients, and the risk profile of an introducing broker.

As it relates to the identification of a new introducing broker, if permitted to transfer orphaned accounts via negative consent, in certain cases the most direct approach to providing a client access to a registered representative that can service her account or provide the accountholder access to the markets would be to allow the clearing broker to transfer the account to a broker-dealer under common control with the clearing firm. Often times clearing firms have affiliated divisions that provide services to self directed investors. The use of such an affiliated service provider could address FINRA concerns related to due diligence of prospective introducing brokers. Alternatively, a clearing firm could use its understanding of the previous introducing broker to approach other unaffiliated introducing brokers on its platform with an analogous structure and profile to gauge the new introducing broker's ability and willingness to receive a group of orphaned accounts.[86] Elements a clearing firm might consider include, but are not limited to, the following:

[86] Generally, orphaned accounts of an introducing broker are not a single account, but a group of accounts with an attribute that prevents the transfer of the group of accounts.

- **Similar Business Model:** the new introducing broker has a substantially similar business model in size (measured by number of representatives or number of transactions) and business (*e.g.*, retail vs. institutional) to the previous introducing broker.

- **Client Service Capabilities:** the new introducing broker supports the same customer interface as the previous introducing broker. For example, if the customer accounts are web-based, the new introducing broker should have web-based capability

- **Product Offering:** the new introducing broker services products/lines that might fit the new customers. For example, an introducing broker with a large options business might be a good landing spot for orphaned customers who do mainly engage in options trading.

- **Capacity:** the new introducing broker has, or will hire, representatives to service the new accounts, and has a plan for the integration of the new customers into its supervisory and compliance structure.

- **Geography:** the new introducing broker has a customer base in the same geographic area as the previous introducing broker, and an understanding of that geographic area's customers.

- **Capital:** the new introducing broker is sufficiently capitalized to take on new customers.

Once identified, a clearing firm could approach an introducing broker to discuss the potential of that introducing broker would receive and service a specific group of orphaned accounts. The clearing firm could potentially share non-personally identifiable account profile information, which may include account type, as well as position and balance information. This sharing of information is generally necessary in several of the currently permissible negative consent account transfers where the introducing broker or clearing firm is experiencing financial or operational difficulties,[87] is going out of business[88] or where an introducing broker has gone out of business.[89] The transfer of these orphaned accounts would depend on the new introducing broker's willingness and capability to service these orphaned accounts, and incorporate these orphaned accounts into its compliance and supervisory structure.

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[87] Proposed Rule 3260(c)(1)(C)(i)(b).

[88] Proposed Rule 3260(c)(1)(C)(i)(c).

[89] Proposed Rule 3260(c)(1)(C)(i)(e).

With respect to the privacy of consumer financial information, the information shared with a new introducing broker in the transfer of an orphaned account to it via negative consent would not differ from currently permissible scenarios regarding the negative consent transfer of customer accounts. In an orphaned account negative consent transfer scenario, as well as all other negative consent scenarios, the receiving broker-dealer is a registered broker-dealer with an obligation to protect consumer information pursuant to, among numerous other requirements, SEC Regulation S-P. Further, in the negative response letter used to transfer an account pursuant to Proposed Rule3260(c)(1)(C), the customer would receive, among other disclosures, "a statement regarding the firm's compliance with SEC Regulation S-P (Privacy of Consumer Financial Information) in connection with the transfer or change in broker-dealer of record."[90] Finally, the introducing broker receiving an orphaned account as a new customer would inform the new customer of its privacy policies and compliance with applicable privacy rules and laws, including Regulation S-P.

D. *SIFMA Recommendation on Negative Consent Transfer of Orphaned Accounts*

SIFMA recommends that FINRA expand Proposed Rule 3260(c)(1)(C) to include the use of negative consent to permit a clearing firm to transfer an orphaned customer account to a broker-dealer on its clearing platform with registered representatives licensed to service that account. The transfer of an orphaned account via negative consent in these scenarios is a fundamentally consumer friendly expansion of the scenarios where firms are able to use negative consent to move a customer account. Such transfers are consistent with the policy goals of mitigating risks to investors and costs to firms that could result if firms were required to obtain individual transfer instructions and to help minimize interruptions to customers' access to their accounts and the trading markets. Communications to orphaned accountholders transferred via negative consent would make clear that the accountholder is free to transfer its account to another broker-dealer or liquidate its assets in an account and receive the proceeds at any time.

Importantly, orphaned account scenarios do not raise concerns regarding registered representatives driving or influencing the eventual location of an account. Accounts do not become orphaned opportunistically. At the same time, orphaned accounts create significant operational friction, and leave the orphaned accountholder in an operational 'limbo' without the attention and service of an assigned registered representative. As such, SIFMA believes that the ability of clearing firms to use negative consent in the context of orphaned accounts is a consumer-friendly and reasonable expansion of the scenarios where firms can use negative consent to move customer accounts from one firm to another.

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[90] Proposed Rule 3260(c)(1)(C)(iii)(e).

IX. Proposed Rule 3260(c)(1)(C) – Bulk Account Transfer of Certain Mutual Funds and 529 Plans Held Directly

SIFMA believes FINRA staff should consider including in Proposed Rule 3260(c)(1)(C) the consolidation of certain existing accounts held at mutual fund companies into identically registered new brokerage accounts held at an introducing broker's clearing firm as an additional acceptable scenario where a firm may use negative consent to effect the bulk transfer of accounts.

As background, introducing brokers are constantly pursuing opportunities to reduce operational risk, increase supervisory oversight, more effectively comply with governing laws, regulations and rules, leverage straight-through processing efficiencies, strengthen investment professional productivity, and enhance service to investors.

A long-standing practice of investment professionals affiliated with introducing brokers which challenges this pursuit is investment professionals direct investors to transact and maintain mutual funds using the mutual fund companies' platforms (commonly referred to as "direct mutual funds") rather than directing investors to use the introducing brokers' clearing firm platforms where the majority of the introducing brokers' other assets (as well as mutual funds) are transacted and maintained on behalf of investors. Separately, 529 plan assets are often held directly with a fund selected by a state to manage that state's 529 plan because introducing brokers could not hold the account through their clearing firms. However, now that clearing firms are able to allow introducing brokers to hold their customers 529 accounts on their platforms, the same benefits noted below apply and thus the reason that the use of negative consent should be expanded.

Investors and accounts held directly at the fund company facilitate easier account transfer between introducing broker. Specifically, the process of transferring an investor and account at an introducing broker's clearing firm to another introducing broker's clearing firm involves completing new documentation and a transfer of assets which is most commonly accomplished via the ACAT process. The ACAT documentation must be routed for approval through the existing introducing broker which controls the investor and account relationship. Conversely, transferring an investor and account held direct at a mutual fund company from one introducing broker to another introducing broker merely necessitates a Change of Broker/Dealer of Record form which requires no authorization or involvement from the existing introducing broker.

The use of multiple processing platforms can make the introducing brokers' compliance and supervisory obligations more challenging, create processing inefficiencies, and hinder optimal benefit to the investor. In addition, it provides investment professionals with an advantage when an investment professional leaves a firm.

In view of these challenges, many introducing brokers prohibit or severely limit investors and accounts held directly at mutual fund companies. Further, introducing brokers generally seek to consolidate investors and accounts held directly at fund companies onto their clearing firm platforms in order to realize the following benefits for introducing brokers and their investors:

- Simplified sales practice monitoring and trend analysis across the entire account base;
- Ease in maintaining books and records, including mandatory mailings required by SEC Rule 17a-3;
- More consistent supervisory principal review and oversight;
- Use of the clearing firm's compliance, supervisory, anti-money laundering and risk management tools across the entire account base, including the identification of mutual fund switches and mutual funds eligible for pricing discounts;
- More accurate management of the investors' accounts and assets;
- Efficient and accurate application of mutual fund pricing discounts (*i.e.*, breakpoints);
- Enhanced ability to respond to regulatory inquiries;
- More time for service to investors;
- Faster response times to requests from investors;
- Reduced manual work related to supporting mutual fund business;
- Consistent reporting for all asset types;
- Single point of contact for support and problem resolution;
- Streamlined service requests and account maintenance;
- Consolidated reporting on account statements and tax statements (*i.e.*, across multiple mutual fund companies and across multiple asset classes, including equities, options, bonds, exchange traded funds and alternative investments);
- Streamlined access to consolidated account information;

- Access to a broader array of products;
- Efficient computation of Required Minimum Distributions for retirement accounts; and
- With respect to 529 accounts, the movement of the customer's account from the mutual fund company's platform to the clearing firm platform would preserve the limited access to only the investment options authorized by the 529 Plan sponsor (*e.g.*, customers would not have a normal brokerage account that offered additional investment products).

For introducing brokers and investors to effectively realize the above-listed benefits, SIFMA respectfully request that introducing brokers be permitted to consolidate existing investors and accounts held at mutual fund companies into identically registered new brokerage accounts held on their clearing firm platforms via the bulk transfer process outlined in Proposed Rule 3260(c)(1)(C) accompanied by the introducing brokers' Fee Schedule and the Disclosure required by FINRA Rule 4311.

As it relates to a potential difference in fees between the custody and maintenance of mutual funds and 529 assets held direct and the custody and maintenance of those assets and accounts at the receiving broker-dealer, FINRA could draft Proposed Rule 2360(c)(1)(C) to limit the negative consent transfer of such assets and accounts to instances where the customer will not face additional fees on the assets held at the delivering broker-dealer following the transfer of these assets and accounts to the receiving broker-dealer. For example, if a mutual fund had no transaction fee when mutual funds held directly were purchased or liquidated, the receiving broker-dealer would not be permitted to charge a transaction fee to buy more shares or liquidate shares of that fund at the receiving broker-dealer.

X. PROPOSED SUPPLEMENTARY MATERIAL 3260.04 – CONTEMPORANEOUS BULK TRANSFER AND SWEEP PROGRAM CHANGES

Proposed Supplementary Material 3260.04 addresses the investment of customer free credit balances in products available in the receiving firm's Sweep Program in connection with a bulk transfer of customer accounts pursuant to Proposed Rule 3260(c)(1)(C). SIFMA requests that the language of Proposed Supplementary Material 3260.04 precisely track the interpretive guidance the SEC Division of Trading and Markets' provided in its FRR FAQs. From an operational perspective, it is essential that the 30-day negative consent period of the bulk transfer of accounts at the firm level and changes to the products contained in the Sweep Program available to that account via negative consent occur contemporaneously. As defined in SEC Rule 15c3-3(a)(17):

> The term Sweep Program means a service provided by a broker or dealer where it offers to its customer the option to automatically transfer free credit balances in the securities account of the customer to either a money market mutual fund product as described in §270.2a–7 of this chapter or an account at a bank whose deposits are insured by the Federal Deposit Insurance Corporation.

In practical terms, a Sweep Program is an operationally efficient mechanism that automatically converts free credit balances to cash equivalent money market funds or FDIC insured bank deposits. A Sweep Program also efficiently funds the purchase of a security for an account through the automatic liquidation or redemption of the cash equivalent product in the Sweep Program. Sweep Programs are essential to the operational management of a customer account at a broker-dealer. Broker-dealers, unlike banks, are not designed to hold customer free credits as cash deposits. Generally, a broker-dealer invests customer free credit balances in cash equivalent securities, such as a money market fund, or places customer free credit balances in an FDIC insured bank deposit product awaiting a customer's instruction (*e.g.*, an instruction to purchase a security purchase). These cash equivalents offer a modest return in exchange for stability and on-demand liquidity.

When a customer account is transferred from one clearing firm to another the specific cash equivalent products contained within the previous clearing firm's Sweep Program often differ from the specific products offered in the new clearing firm's Sweep Program. However, the cash-equivalent products in Sweep Programs are substantially similar in character from an asset perspective. Absent the operational flexibility to change the products available in a Sweep Program concurrent with the bulk transfer of that account via negative consent, a customer may experience a number of negative consequences including, but not limited to, the following:

- The customers' free credit balances can remain uninvested when the account exits the Sweep Program of the previous clearing firm;

- Customers may not have access to the check writing or debit card features on accounts;

- For ERISA accounts, the account may not transfer from the previous clearing firm as it is potentially a "prohibited transaction" to maintain customer free credit balances, and thereby uninvested, for an extended period of time;[91] and

[91] Generally, pursuant to the Internal Revenue Code ("Code") Section 4975 requirements, deviating from a customer's direction and holding ERISA-governed "plan assets" in cash or as free credit balances may raise a number of issues under the prohibited transaction rules of both ERISA and the Code.

- The potential for reduced SIPC coverage for free credit balances that exceed coverage thresholds.

Separate from the potential negative impacts to customers, firms also face significant operational challenges where the transfer of an account and change of a Sweep Program option are out of step. These operational challenges include, but are not limed to, the following:

- Holding dollar for dollar reserves against customer free credit balances pursuant to Rule 15c3-1; and

- Maintaining an account in operational 'limbo' where the account has transferred but is not fully accessible to the customer, a non-standard manual process which requires additional firm resources.

Further, in 2013, SIFMA extensively discussed the bulk transfer of customer accounts pursuant to NTM 02-57 and the investment of customer free credit balances in a receiving firm's Sweep Program in the context of Rule 15c3-3(j)(2). These discussions resulted in questions 14-16 in the FRR FAQs. FAQ 15 specifically permits firms reliance on negative response letters used to effect the bulk transfer of customer accounts to *immediately* invest customer free credit balances in a Sweep Program offered at the receiving firm:

> **Question 15.**
>
> [F]ollowing the bulk transfer of customers' accounts to a receiving firm in accordance with FINRA NTM 02-57, the receiving firm may immediately invest customers' free credit balances in products (either a money market mutual fund or an FDIC-insured bank deposit account) offered through a Sweep Program at the receiving firm. In such circumstances, may the receiving firm also rely on the negative response letters that were used to effect the bulk transfer of customers' accounts as permitted by FINRA NTM 02-57 (for bulk transfers that occur on or after March 3, 2014) without being deemed in violation of paragraph (j)(2)(ii) of Rule 15c3-3?
>
> **Answer 15:**
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> Under the circumstances described above, the staff will not object to the receiving firm relying on the negative response letters that were used to effect the bulk transfer of customers' accounts as permitted by FINRA NTM 02-57 (for bulk transfers that occur on or after March 3, 2014), provided that the negative response letter used to effect the bulk transfer of such accounts, in addition to satisfying the requirements outlined in FINRA

> NTM 02-57, contains the information and disclosures required by paragraphs (j)(2)(ii)(A)(1) and (2), and (j)(2)(ii)(B)(1) of Rule 15c3-3 and: (1) if the customers' free credit balances are invested in a different money market mutual fund at the receiving firm than the one available through the Sweep Program of the delivering firm, the negative response letters also must comply with the disclosure and notice requirements of NASD Rule 2510(d)(2); and (2) if the customers' free credit balances were previously invested in a product (either a money market mutual fund or an FDIC-insured bank deposit account) in the Sweep Program of the delivering firm, the receiving firm must reinvest customers' free credit balances in a substantially similar product in its Sweep Program to the extent practicable.[92]

SIFMA understands this guidance to offer necessary flexibility to make changes to the products contained in a Sweep Program in the context of bulk transfer of customer accounts. As such, SIFMA requests Proposed Supplementary Material 3260.04 precisely track the interpretive guidance the SEC Division of Trading and Markets' regarding changes to the products available in a Sweep Program in the context of bulk transfers of customer accounts. Specifically, in the context of negative consent changes to the products available in a Sweep Program contemporaneous with the bulk transfer of accounts pursuant to Proposed Rule 3262(c)(1)(C), Proposed Supplementary Material 3260.04 requires, among other things, that "the customers' free credit balances were previously invested in a substantially similar product in the Sweep Program of the member delivering the accounts."[93] SIFMA believes that this requirement, as currently constructed, is inconsistent with the SEC guidance in FRR FAQ 14 in that it does not include the meaningful phrase "the extent practicable."[94] SIFMA believes customer accounts involved in a bulk transfer pursuant to Proposed Rule 3260(c)(1)(C) are best served by a smooth operational transition from one firm's Sweep Program to another, for the reasons outlined above. SIFMA understands the SEC's "to the extent practicable" language to provide necessary flexibility in the context of negative consent transfer of customer accounts from one firm to another in certain scenarios.

XI. PROPOSED RULE 3260(c)(1)(E)(v) – NEW DATA DISCLOSURES

As it relates to the use of customer free credit balances and Sweep Programs, Proposed Rule 3260(c)(1)(E)(v) requires that a firm "posts on its website applicable bank and money market mutual fund interest rates and information regarding any conflicts of interest relating to its Sweep Program with prominent notice of the availability of such

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[92] *See* note 18, *supra*.

[93] Proposed Supplementary Material 3260.04(a).

[94] *See* note 18, *supra*.

information, and regularly updates applicable interest rates." SIFMA notes that the requirements of Proposed Rule 3260(c)(1)(E)(v), arising from the guidance of NYSE Information Memo 05-11 related to bank sweep products, expand the product scope of these disclosure to money market funds.

SIFMA respectfully requests that FINRA consider the appropriateness of disclosure requirements that may makes sense for bank sweep products, but are less applicable or inapplicable to money market funds. For example, NYSE Information Memo 05-11 and the current text of Proposed Rule 3260(c)(1)(E)(v) requires a firm to post an "interest rate" related to a money market mutual fund. SIFMA believes that this rule section, should it be adopted, be amended to require a "rate of return" for money market funds and an interest rate for bank sweep products.

XII. Proposed Supplementary Material 3260.06 – Balance Record Retention Period

Proposed Rule 3260(c)(1)(E)(vi) outlines the following requirement in the context of the treatment of free credit balances in a Sweep Program, "[a] member may transfer free credit balances held in a customer's securities account to a product in the member's Sweep Program or transfer a customer's interest in one product in a Sweep Program to another product in a Sweep Program, provided that,"[95] among other things, "where the member maintains customer bank sweep balances on an omnibus basis with an affiliated bank, the member maintains detailed individual customer balances on its books and records on behalf of the bank and the member's customers."[96]

Proposed Supplementary Material 3260.06 Record Retention includes the following requirement: "[f]or purposes of paragraph (c)(1)(E)(vi) of this Rule, members shall maintain records of individual customer balances on their books and records and preserve such records for at least six years after the date the account is closed."[97]

SIFMA believes that the requirement to keep balance records for six years after the closing of an account is inconsistent with the current federal record retention requirements. Pursuant to SEC Rule 17a-4(e)(5), firms must retain documents covered by SEC Rule 17a-3(a)(17) for "at least six years after the earlier of the date the account was closed or the date on which the information was replaced or updated."[98] SIFMA understands Rule 17a-3(a)(17) to generally include customer account information, but to not include specific account balances. Separately, SIFMA understands that pursuant to Rule 17a-4(a), firms

[95] Proposed Rule 3260(c)(1)(E).

[96] Proposed Rule 3260(c)(1)(E)(vi).

[97] Proposed Supplementary Material 3260.06.

[98] 17 CFR 240.17a-3(a)(17).

"shall preserve for a period of not less than six years, the first two years in an easily accessible place"[99] records firms are required to make pursuant to, among other things, Rule 17a-3(a)(3), which requires the creation of "[l]edger accounts (or other records) itemizing separately as to each cash and margin account of every customer and of such member, broker or dealer and partners thereof, all purchases, sales, receipts and deliveries of securities and commodities for such account and all other debits and credits to such account."[100] SIFMA understands the six year period of Rule 17a-4(a) to begin from the creation of the document, not the closure of the account. As such, SIFMA recommends that Proposed Supplemental Material 3260.06 Record Retention be amended to measure the record retention period from the creation of the detailed individual customer balances required by Proposed Rule 3260(c)(1)(E)(vi), consistent with Rule 17a-4.

XIII. Conclusion

SIFMA appreciates the opportunity to comment on the Proposal. SIFMA commends FINRA for using the feedback received in connection with the Initial Proposal. SIFMA believes that by addressing the comments included in this letter, FINRA will improve the Proposal by better aligning its costs and investor protection benefits.

If you have any questions or require further information, please contact Stephen Vogt, Assistant Vice President & Assistant General Counsel, SIFMA, at (202) 962-7393 (svogt@sifma.org), or Kevin Zambrowicz, Managing Director & Associate General Counsel, SIFMA, at (202) 962-7386 (kzambrowicz@sifma.org).

Very truly yours,

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[99] 17 CFR 240.17a-4(a).

[100] 17 CFR 240.17a-3(a)(3).