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June 13, 2008

BY EMAIL TO: pubcom@finra.org

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

Re: FINRA Regulatory Notice 08-24
Supervision and Supervisory Controls

Dear Ms. Asquith:

Charles Schwab & Co., Inc. ("Schwab") appreciates the opportunity to comment on FINRA's proposals relating to the FINRA supervision and supervisory control rules. We support FINRA's goal to provide firms with greater flexibility to tailor their supervisory procedures to reflect their business, size and organizational structure. We also support and commend FINRA for their efforts to clarify and streamline certain supervisory requirements.

While many of the proposed changes support the objectives of providing more streamlined, clear and flexible supervisory requirements, several of the proposed rules significantly expand the jurisdiction of FINRA and impose new supervisory obligations on member firms. As discussed below, Schwab does not believe certain of these changes are warranted.

3110(a)(2)

Proposed FINRA Rule 3110(a)(2) proposes an amendment to NASD Rule 3010 to require the designation of appropriately registered principals to supervise each type of business in which the member firm engages, regardless of whether registration as a broker-dealer is required. The extension of the principal designation requirement beyond business activities requiring registration represents a broad expansion of member firm supervisory obligations and FINRA's jurisdiction. Schwab does not believe this expansion is necessary or appropriate.

Although FINRA cites consistency with Rule 3010(b) as the basis for this amendment, the language of proposed Rule 3110(a)(2) is broader than that of Rule 3010(b), which requires supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations and NASD rules. If a business activity does not implicate securities laws and rules regulated by FINRA, the language of Rule 3010(b) does not require supervisory procedures for that activity.

Member firms may engage in business activities within the broker-dealer entity that do not require registration as a broker-dealer. Many of these activities, such as investment advisory or insurance businesses, are regulated by other governmental and regulatory authorities, each with rules and regulations mandating defined compliance and oversight controls. The application of FINRA supervisory and designated principal obligations to these activities would allow FINRA to test the adequacy of supervisory procedures and the discharge of supervisory obligations against laws, rules and regulations that FINRA does not currently oversee. In addition, this approach would create unnecessary duplicative regulation over non-broker dealer activities that would penalize firms conducting such activities within the broker-dealer entity. The basis for such an expansion of jurisdiction is not clear and does not appear to be warranted.

The requirement that a firm designate appropriately registered principals to supervise non broker-dealer business activities also creates licensing issues. This new requirement appears to represent an exception to Rule 1021(a), which prohibits firms from maintaining registrations for individuals who are not actively engaged in the management of the member's securities business. It is also unclear what licenses these individuals would hold. Existing principal licenses are designed for individuals supervising securities activities. There is no apparent benefit to requiring a manager of a non-broker-dealer business to obtain securities licenses that are largely irrelevant to their business activities. Even if FINRA introduced a separate registration program for designated principals of non broker-dealer business activities, it is not clear that such an alternative registration structure would be meaningful, given the variety of business activities that may be conducted within the broker-dealer.

3110(b)(3)

Proposed Rule 3110(b)(3), "Supervision of Outside Securities Activities," would replace NASD Rule 3040 and require associated persons to obtain member firm approval for any outside business activities relating to securities or investment banking. The proposed Rule would require that if a member firm gives its written approval, the activity would fall within the scope of the member firm's business and need to be supervised accordingly. Proposed Rule 3110(b)(3) provides an exception from the general supervisory requirements for certain bank related securities activities, provided the member firm receives specific written assurances regarding the bank's policies and procedures.

While the supervisory obligations required under NASD Rule 3040 are limited to defined “private securities transactions,” proposed Rule 3110(b)(3) more broadly covers “outside business activities relating to securities and investment banking.” In imposing a duty to supervise these approved outside business activities, the proposed Rule introduces an ongoing supervisory obligation that currently does not exist in either NASD Rule 3030 or Rule 3040. The basis for this expansion of supervisory obligations is not clear, and creates practical compliance concerns. Access to books, records and customer information regarding these outside activities may be limited by law or policy, restricting a member firm’s ability to supervise the activity effectively. In addition, the outside business activities relating to securities or investment banking would generally occur within a separately regulated entity with primary responsibility for all supervisory and compliance controls over all of its businesses and associated persons. The creation of a secondary level of supervision by the approving member firm would add duplication and potential confusion to the supervisory structure. To address these concerns, we respectfully suggest that the proposed Rule address only private securities transactions as defined in NASD Rule 3030.

In addition, we believe it would be appropriate for FINRA to confirm that the definition of investment banking and securities business for purposes of the proposed Rule is the definition set forth in Article 1(u) of the FINRA By-Laws, and that the proposed obligation to supervise approved outside business activities would not extend to activities conducted in entities that are not registered broker dealers, such as investment advisors.

If the proposed Rule broadly covers supervision of approved outside business activities, we suggest that the exception covering bank-related securities activities of dual employees be extended to securities activities of associated persons in other regulated entities, whether affiliated or not. Depending on the definition of the activities covered, such regulated entities might include insurance companies and investment advisors, as well as broker-dealers. It is appropriate for member firms and FINRA to reasonably rely on regulated entities to implement appropriate compliance and supervisory controls over their business activities consistent with the laws and regulations applicable to those activities and tested by their regulators. We do not believe it necessary to obtain assurances regarding policies and procedures from these regulated entities, or to require members to independently assess the adequacy of such policies and procedures. It is reasonable and appropriate for the member firm and FINRA to rely on the efficacy of the regulatory requirements and oversight structure applicable to that regulated business.

3110(b)(4) and Supplementary Material .09

Although proposed Rule 3110(b)(4) purports to streamline the substance of NASD Rule 3010(d), the addition of internal communications to FINRA's rule governing supervision of written correspondence significantly expands and complicates supervisory requirements for member firms.

NASD Rule 3010(d) sets forth member firm obligations with respect to supervisory review of written and electronic correspondence relating to investment banking or securities business, and does not reference internal communications. Proposed Rule 3110(b)(4) would add a new requirement that firms maintain procedures for review of both written and electronic internal communications relating to the member's investment banking or securities business. Supplementary principles .09 allows a member firm to use risk based principles to determine the extent to which additional policies and procedures are required for correspondence and internal communications that fall outside of the subject matters listed in 3110(b)(4).

Taken together, the proposed Rule and supplementary material can be read to create a new affirmative obligation for member firms to supervise all written and electronic internal communications relating to investment banking and securities activities. Compliance with this new requirement would require a substantial investment in systems, processes and human resources to identify, review, categorize and document supervision of a wide variety of internal communications, including e-mail, internal systems with a communication component, hard copy memos, internal faxes and written presentations. It is not clear that this result is FINRA's intent. If it is, a more detailed assessment of the costs and benefits associated with this change is required. Absent an assessment showing a justification for heightened supervisory obligations associated with internal communications, we believe the proposed Rule should remain consistent with NASD Rule 3010(b) and address supervision of correspondence only.

3110(b)(5)

Proposed Rule 3110(b)(5) incorporates the NYSE Rule 401A requirement that firms capture, acknowledge and respond to complaints. We support the proposal to limit the requirement to written complaints; however, we believe the NYSE requirement to "acknowledge" complaints imposes a new and unnecessary burden on former NASD only firms. Developing and implementing an appropriate infrastructure to send an acknowledgement of receipt for each complaint received will require a reallocation of resources better focused on investigating and responding to complaints. Because firms are obligated to respond to the complaint, it is not clear that there is a significant benefit to customers to send an acknowledgement in advance of the response.

3110(b)(6)

Schwab supports proposed Rule 3110(b)(6)(C) replacing the detailed requirements associated with supervising “producing managers” in NASD Rule 3012 with clear, direct and flexible supervisory standards.

However, proposed Rule 3110(b)(6)(D) introduces a new requirement regarding supervisory procedures and conflicts of interest that is vague, ambiguous and unnecessarily expansive. The proposed Rule requires member firms to implement procedures to prevent supervision “from being lessened in any manner . . . due to conflicts of interest that may be present with respect to the associated person being supervised. . . .” There is no clear standard stated in the proposed Rule and the language is subject to a broad range of possible interpretations. Without clarity, it will be very difficult for a member firm to establish and test procedures that meet the requirements of the new Rule. The vagueness of the Rule 3110(b)(6)(D) also raises concerns regarding its interpretation and application in an examination or enforcement proceeding.

We believe that the general supervisory obligations stated in proposed Rules 3110(a) and (b) address conflict of interest issues by requiring a system of supervision and supervisory procedures regarding business activities and associated persons “reasonably designed to achieve compliance.” These fundamental supervisory obligations require member firms to identify, assess and mitigate conflicts of interest in the design and implementation of reasonable systems of supervision. There is no need for a separate rule regarding supervision of conflicts of interest.

We respectfully suggest proposed Rule 3110(b)(6)(D) be eliminated.

3110 (b)(7)

The last sentence of proposed Rule 3110(b)(7) states that each member is responsible for communicating amendments to supervisory procedures “throughout its organization.” Because it is not appropriate to broadly communicate written supervisory procedures or amendments “throughout” the organization, particularly in a broadly diversified financial services firm where an amendment may only be relevant to a limited business or set of associated persons, the quoted language should be changed to “to relevant supervisory personnel.”

3110(c)

Proposed 3110(c)(2)(A) states “the written inspection report must also include, without limitation, the testing and verification of the members policies and procedures, including supervisory policies and procedures relating to “(iii) Supervision of supervisory personnel.”

The language in proposed Rule 3110(c)(2)(A)(iii) regarding “supervision of supervisory personnel” replaces language that limited the inspection reporting requirement to “supervision of customer accounts serviced by branch office managers.” While we understand and agree with FINRA’s general position that supervisors should not supervise their own activities, the proposed language is unnecessarily broad.

Proposed Rule 3110(c)(2)(A)(iii) would potentially expand the inspection and related reporting responsibility to include inspection of supervisory personnel beyond the scope of the supervisory activities performed by the branch office manager. For example, there may be personnel responsible for supervising certain activities undertaken by the branch office manager who work in a separate location from the branch. While those centralized supervisors would ultimately be subject to inspection, the timing of the inspection of the centralized supervisors may not coincide with the inspection of the branch office manager subject to the centralized supervision. Therefore, it would not be practical to include the results of testing of the centralized supervisory personnel in the branch office location inspection report.

We believe the original language requiring the inspection report to include “Supervision of customer accounts serviced by branch office managers” should be retained.

Proposed Rule 3110(c)(2)(B) and (C) should be removed from 3110(c) and moved into a separate section within 3110 on customer confirmation, as the information in these paragraphs does not pertain to internal inspection requirements.

Proposed Rule 3110(c)(2)(D) requires members to identify in its supervisory procedures those activities enumerated in paragraphs 3110(c)(2)(A)(i)-(v) in which it does not engage. Current NASD Rule 3010(a) requires member to establish and maintain a system to supervise the activities of the member’s associated persons which is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. The value and purpose of stating in a member’s supervisory procedures that it does not engage in one or more of the activities enumerated in proposed Rule 3110(c)(2)(A)(i)-(v) is unclear. Further requiring member firms to state in supervisory procedures that before a member can engage in those activities it must establish supervisory policies and procedures is unnecessary as the requirement to do so is addressed in current Rule 3010(a) and proposed Rule 3110(a). We believe proposed Rule 3110(c)(2)(D) should be revised to state “If the OSJ, branch office or non-branch location being inspected does not engage in all of the activities enumerated in paragraphs (c)(2)(A)(i) through (c)(2)(A)(v), the inspection report must identify those activities in which the office does not engage.”

Proposed Rule 3110(c)(3) states that “each member must have procedures that are reasonably designed to:

- (A) ensure that the person conducting an inspection pursuant to paragraph (c)(1) is not an associated person assigned to the location or is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the location...”

The proposed Rule language is not practical or necessary. Certain business locations contain multiple business units. The language in Proposed Rule 3110(c)(3) would disqualify inspection personnel based in a location from inspecting other business units in that same location, even if the inspection personnel report to individuals outside the supervisory chain of command of those other businesses. We do not believe that there is any conflict requiring disqualification if the inspection personnel report to individuals outside of the supervisory chain of command of the business units subject to inspection.

We believe proposed Rule 3110(c)(3) should be revised to require that each member have procedures that are reasonably designed to ensure that the person conducting an inspection pursuant to paragraph (c)(1) is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the office of supervisory jurisdiction, branch or non-branch subject to inspection.

Proposed Rule 3110(c)(3)(B) states that each member must have procedures that are reasonably designed to “prevent the inspection from being lessened in any manner due to any conflicts of interest, including but not limited to, economic, commercial, or financial interests in the associated persons and businesses being inspected that may be present.”

The proposed Rule language is vague and impractical. For example, an internal inspector who is also a shareholder of their employing broker-dealer’s stock would have a conflict of interest. This conflict of interest, by itself, should not render an individual ineligible to conduct an inspection. This is just one of many possible conflicts of interest, large or small, that an internal inspector may have. The rule proposal would require firms to undertake an extensive analysis of conflicts of interest for inspection personnel. The outcomes of such an analysis would be subject to interpretation and judgment. While a firm may believe they have made a reasonable determination, FINRA examiners may disagree with that determination and impose penalties. Further guidance would be needed on how to measure the extent of inspections being “lessened in any manner” due to any conflicts of interest.

Rule 3110(d) and Supplementary Material .04

Schwab supports the proposal to retain the definitions of “branch office” and “office of supervisory jurisdiction” in existing Rule 3010(g).

Proposed Supplementary Material .04 creates (1) a general presumption that a principal will not be designated and assigned to supervise more than one OSJ; and (2) a general presumption that a determination by a member to designate and assign one principal to supervise more than two OSJs is unreasonable. A decision to assign one supervisor to more than two OSJs will be subject to "greater scrutiny" and the member will have a "greater burden to evidence the reasonableness of such structure." Schwab believes the creation of these negative presumptions is not necessary or appropriate and should be eliminated.

Member firms are required to maintain supervisory systems reasonably designed to achieve compliance with applicable securities laws and regulations. These supervisory systems must be tailored to a firm’s business and organization structure, including technological and resource capabilities. Such capabilities, including surveillance, trading and communication systems, and centralized supervisory, compliance and oversight support functions, may reasonably support the supervision of multiple OSJs by one designated principal. The proposed presumption that such a structure is not reasonable creates a significant hurdle for member firms to overcome. The basis for the negative presumption has not been established, particularly in light of evolving supervisory tools and capabilities. We do not believe the proposed negative presumptions are appropriate and may operate to limit development and design of more effective supervisory models. In addition, while it may be relevant to document the assessment of these factors in the relevant supervisory procedures, we do not believe it necessary to also document that assessment in the inspection procedures of the member firm.

Rule 3120

Proposed Rule 3120(b) adopts NYSE Rule 342.30 reporting requirements, adds report content standards and imposes NYSE reporting obligations on all member firms that report \$150 million or more in gross revenues on their FOCUS reports. This reporting obligation is new for former NASD only member firms and will require allocation of additional resources towards compiling and reporting the required information. We do not believe the introduction of this new reporting obligation is necessary in light of existing Rules 3012 and 3013, which provide for communication and reporting of substantially similar information. We also do not believe that the imposition of a new senior management reporting requirement on former NASD only member firms is justified based on an assertion that the reporting was “a valuable tool for the NYSE regulatory program.” Further, as a general matter, we do not agree that a revenue threshold is an appropriate trigger for a compliance reporting obligation.

Supplementary Material – 08

Schwab believes proposed Supplementary Material .08, expanding NYSE Rule 342.21 and extending the rule to former NASD only member firms, is unnecessary and burdensome. We believe that the Section 15 (f) of the Securities Exchange Act of 1934 (ITSFEA) together with existing NASD Rules prohibiting insider trading and manipulative and deceptive devices and the associated interpretative materials (e.g. NTM 91-45, 89-5) adequately and appropriately address member firm's responsibilities to supervise and investigate employee transactions for possible insider trading.

In addition, if such a transaction is deemed to be a violation of the Exchange Act and/or FINRA rules prohibiting insider trading, reporting would occur pursuant to NASD Rule 3070(a)(1) and, for registered personnel, on Form U4 (or Form U5 depending on the circumstances).

Because ITSFEA and existing NASD supervisory and reporting rules adequately address insider trading concerns, we do not believe that the application of NYSE reporting obligations to former NASD only member firms is warranted.

Absent complete withdrawal of the proposed Supplementary Material .08, Schwab recommends that FINRA propose only .08(a)(1) and (2) and provide clarification on what constitutes an "internal investigation" and the definition of "family members" for the purposes of the Supplementary Material.

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Thank you for your consideration of the points we have raised in this letter. Please feel free to contact me at (415) 636-3540 to discuss them in more detail.

Sincerely,



Bari Havlik
SVP and Chief Compliance Officer
Charles Schwab & Co., Inc.