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Via email rule-comments@sec.gov

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RE: File Number SR-FINRA-2010-042

Integrated Management Solutions ("IMS") is pleased to have the opportunity to comment on FINRA's proposed Rule 4160 (the "Rule") requiring a member, upon notice by FINRA, to remove custody or record ownership of both proprietary and customer assets held at a non-member financial institution when such non-member, upon FINRA staff's request, fails promptly to provide FINRA with written verification of assets maintained by the member at such financial institution. By way of background, IMS is one of the largest providers of financial accounting and compliance consultants to the securities industry, providing such services to about 100 FINRA members. We believe that this perspective enables us to assess the impact of the Rule on FINRA member firms.

FINRA's Explanation of the Rule and Its Implementation

The Rule is so impractical and ill-conceived that a fuller explanation of FINRA's rationalizations for promulgating it is necessary. FINRA has proposed the Rule, in theory, "…to effectively detect fraud and protect investors." Hampered by only having authority over its members, FINRA has proposed a means to facilitate its independent verification of assets held for a member or its customers at a non-member financial institution. Disingenuously acknowledging "jurisdictional constraints," the Rule requires a member, at FINRA's request, to remove assets held in custody by a non-member after the non-member has failed to provide "prompt" asset verification to FINRA. FINRA has promulgated the Rule without any allegations of current harm in the *status quo* to members or FINRA's enforcement of U.S. securities laws.

FINRA baldly, and naively, claims that such enforcement against members "… would [result in] significant incentive on the part of non-member financial institutions to promptly comply with staff requests for asset verification in order to continue to retain members' proprietary or customer assets. Similarly, members would seek to assure that non-member financial institutions maintaining their proprietary or customer assets comply with such requests to avoid having to transfer assets to another institution."

FINRA's notice then suggests that it could have also mandated an alternative enforcement mechanism by requiring members to enter into a written contract with any non-member financial institution maintaining custody or record ownership of its proprietary or customer assets that would obligate the institution to comply with FINRA staff's requests for verification. Instead, FINRA has chosen to "…strongly encourage a member to enter into such a contract." Then, it unrealistically shifts the burdens of FINRA's asset verification problem to members by stating that "…the member could seek appropriate remedies against the institution…" for breach of contract if the non-member did not provide FINRA with the information it seeks. Of course, FINRA can't be bothered to explain to members what it believes are "appropriate remedies," nor does it even consider whether this would damage customer and/or financial institutional relationships, and at what cost. To aid in the implementation of the Rule, Supplementary Material .02 (Member Obligations Under SEA Rule 15c3-3) purportedly clarifies that nothing in the Rule "…shall be construed as altering in any manner a member's obligations under SEA Rule 15c3-3."

Overall Comment

The Rule ignores existing SEC Rules regarding asset verification, established asset verification procedures, long-standing norms of international law and business realities. Instead, the Rule is solely of benefit to, and for the convenience of, FINRA.

There are many assets that are difficult to verify because, although they are legitimate investments, they are not traded on any exchange or not deposited at a financial institution. This would include, without limitation, many private equity investments, hedge fund investments and private placements. We surmise that many of the assets that FINRA apparently has trouble verifying (and FINRA has provided no indication of the magnitude of its so-called asset verification problem) will likely be held by non-member financial institutions outside of the United States. Tellingly, FINRA ignores this troublesome feature of its Rule by simply not mentioning the issue at all. FINRA inexplicably seems to believe that it can gloss over the international implications of the Rule.

Presumably, FINRA's new-found zeal for asset verification was prompted by the Madoff "Ponzi scheme." Madoff perpetrated his fraudulent scheme by maintaining two sets of books for his firm, with the set of books used to defraud investors apparently never shown to FINRA during its examinations. There was no way for FINRA to verify assets without access to legitimate books and records and without knowing that the assets should have existed. Had the Rule been in effect when the books and records of Madoff's firm were being examined, FINRA would still have been unable to uncover the fraud earlier. In fact, only Madoff's voluntary admissions uncovered the fraud.

This is a poorly thought-out Rule with serious unintended consequences if it takes effect. We urge FINRA to obtain more input from members as well as discuss with accountants and other professionals better ways to accomplish FINRA's objectives. The supposed benefit of the Rule is far outweighed by the harm it will likely cause both domestically and internationally, as well as to members.

Assets Affected

The Rule applies to both proprietary and customer assets. It totally disregards the nature of those assets, some of which are unquestionably locally-based, such as real estate, or investments in foreign-domiciled assets, such as a foreign partnership. Some assets are simply not subject to easy verification, such as interests in partnerships and trusts, regardless of domicile. Other assets are required by local law to be held in the country of origination and sometimes, at a designated institution in that country. Yet other assets are peculiarly local, such as real estate. As we stated previously, other such categories of assets difficult to verify include, without limitation, many private equity investments, hedge fund investments and private placements. The Rule does not differentiate among classes of assets or the reason for their custody at a non-member financial institution or why they are not held at any financial institution. Shockingly, FINRA blithely ignores whether such mandated disclosures would result in a violation of foreign laws, or, more seriously, subject those who make such disclosures to sanctions in such foreign jurisdictions.

In addition, there is no differentiation between assets that have value for net capital purposes and other assets. Certainly the harsh proscription of the Rule should not apply to proprietary assets that are not allowable for net capital purposes anyway.

Asset Verification Options

Other established procedures exist for asset verification. The Rule ignores SEC Rule 17a-13, in effect since 1971, which requires quarterly security counts by certain exchange members and broker-dealers. Those procedures have worked. We recognize that even though it is hard to confirm certain assets, alternative procedures have been established to implement that rule's goals. Nor does the Rule acknowledge the many techniques developed by the accounting profession over the years to verify the existence of assets, including, without limitation, assets whose existence are difficult to confirm. It appears that FINRA does not want to be troubled by the admittedly time-consuming nature of these alternative, but established and field-tested, procedures.

Unwarranted Burden on Members

In addition, FINRA does not fully acknowledge the unwarranted burdens it is putting on its members under the Rule. The Rule fails to consider what happens if a particular asset can't be re-located from its country of origin or readily moved to another financial institution as a matter of law. Ostensibly "…mindful of the potential challenges of an asset transfer," the notice proposes the adoption of Supplementary Material .01

(Asset Transfers), which provides that any member required to transfer assets under the Rule shall do so "…within a reasonable period of time." FINRA suggests, but explicitly does not require at this time, that members enter into a contract with a non-member institution that requires asset verification by FINRA. Among other fundamental flaws, it ignores the possibility that such a provision might violate the law where such non-member is domiciled. FINRA gives no consideration that the Rule might damage existing contractual relationships between a financial intermediary and its customers and/or other financial institutions by imposing such onerous asset verification requirements. Nor is there any acknowledgement of the financial, relationship and reputational damage that would result if a member is forced to litigate to enforce such a contractual provision. Such litigation would likely have to be brought in the jurisdiction of the non-member, even if the contract contains U.S. venue and choice of law provisions, and regardless of such provisions, all litigation is expensive, time-consuming and burdensome.

Regulation in a Time of Globalization

Few will dispute that as global commerce has expanded, securities transactions have become increasingly international in scope and generally promote the free flow of capital and the efficient allocation of world resources. Global securities transactions serve the U.S. interest in providing equal access to our capital markets by investors, encouraging investment by both U.S. and non-U.S. citizens through the U.S. financial services sector and fostering global cooperation. The same considerations apply when foreign-source investments are made in the U.S. But, of course, global transactions also carry risks, perhaps the most significant being the need to prevent the United States from being used as a base for fraudulent securities transactions, including where U.S. or foreign investors are defrauded outside the U.S. These risks, of course, raise issues of how to best protect U.S. interests, while preserving access to U.S. capital markets. Regrettably, however, the Rule creates more problems than it solves with respect to managing risks.

What FINRA is attempting to do through the Rule is indirectly extend the extraterritorial application of the U.S. securities laws. In tacit recognition of the legal limitations of U.S. securities laws, as well as doctrines of foreign sovereignty and comity, the Rule attempts to circumvent those long-standing, well-established doctrines by attempting to shift the responsibility for asset verification onto FINRA members prospectively.

The Extraterritorial Application of U.S. Securities Laws

The Rule is a disingenuous attempt by FINRA to circumvent well-established law that the Securities Exchange Act of 1934 (the "Act") does not, by its terms, grant the SEC extraterritorial jurisdiction. Congress has not re-visited the issue of extraterritoriality despite many amendments to the Act since 1934. However, recently, in Morrison v. National Australia Bank Ltd., a unanimous U.S. Supreme Court ruled squarely that U.S. securities laws only apply to purchases and sales of securities in the United States, despite approximately more than forty years of court decisions to the contrary.[1]

[1] In Morrison v. National Australia Bank Ltd., 561 U. S. ____, 130 S. Ct. 2869 (June 24, 2010), the U.S. Supreme Court held that foreign investors who bought shares of a foreign issuer listed on a foreign exchange could not sue that issuer in U.S. courts over conduct by its U.S. subsidiary (the so-called "f-cubed" problem), regardless of domestic conduct or effect. The Supreme Court exhaustively analyzed prior precedent, the "intent" of Congress and statutory language and overruled long precedent established in various lower courts that had applied the "conduct" and/or

Significantly, Morrison involved what would probably have been held to be a violation of U.S. securities had the litigants been U.S. parties. The Court held that a presumption against extraterritoriality was warranted:

> The results of judicial-speculation-made-law—divining what Congress would have wanted if it had thought of the situation before the court—demonstrate the wisdom of the presumption against extraterritoriality. 130 S. Ct. 2869, 2881.

The effect of Morrison is not only to limit the threat of claims by foreign investors in U.S. courts, but also the reach of U.S. regulators.

The likely international ramifications of Morrison were anticipated by other countries. Eighteen amicus briefs were submitted, including by the Governments of Australia, U.K. and France, among others. The various Government briefs asked the Court to adopt a standard for liability under §10(b) that would acknowledge the fundamental policies of: (1) the sovereignty of other nations; (2) the development of sophisticated regulation governing the issuance and trading of securities within numerous markets; (3) the globalization of capital markets; (4) the increasing interdependence of national economies; and (5) the principles of comity and international relations.

The Court explicitly incorporated the sovereignty policy concerns of foreign governments in its Morrison opinion, including recognition of differing standards of disclosures:

> The probability of incompatibility with the applicable laws of other countries is so obvious that if Congress intended such foreign application "it would have addressed the subject of conflicts with foreign laws and procedures." [Citation omitted.] Like the United States, foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction. And the regulation of other countries often differs from

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"effects" tests. Instead, it held that "…we think that the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States." 130 S. Ct. 2869, 2884.

> ours as to what constitutes fraud, what disclosures must be made, what damages are recoverable, what discovery is available in litigation, what individual actions may be joined in a single suit, what attorney's fees are recoverable, and many other matters. [Citations omitted.] 130 S. Ct. 2869, 2885 (emphasis added).

The Rule is even more egregious because it applies in all situations FINRA decides it applies, regardless of whether FINRA is concerned about possible securities law violations and in total disregard of prior well-established law and the doctrines of sovereignty and comity. It also ignores the laws and regulations in effect in countries whose regulatory regimes and securities laws do not mirror American law. The Rule shreds prior, long-standing recognition of the public policy of another nation state.

Unintended Consequences of Extending Extraterritoriality

The Rule compels a member to withdraw assets from a jurisdiction where the member does not provide FINRA with "prompt" written verification of assets held by a non-member in that jurisdiction. As FINRA's Statement of Purpose acknowledges, "[w]hile FINRA currently may request such independent verification, it generally cannot compel a financial institution that is not a member to comply with the request because FINRA's rules apply only to members."

FINRA has promulgated the Rule without any recognition that compliance may require the violation of the laws of another country. It also disregards the Supreme Court holding in Morrison, supra, even though that decision was announced prior to FINRA's issuance of the Rule. Sadly, it is to be expected that high-handedly ignoring well-established deference to the interests of foreign nations will not enhance international cooperation and may even subject foreign nationals to allegations that they have violated the secrecy and other laws of their own nations. What the Rule really does is threaten long-term American interests. What if the non-member is enjoined or prohibited from complying with FINRA's asset verification request under foreign law? What if there pending litigation between the member and non-member when the FINRA request is made?

FINRA's assertion of what amounts to extraterritorial jurisdiction can lead to the promulgation and/or activation of blocking statutes by impacted nations. That would have an immediate negative effect on global securities markets in at time of global economic uncertainty. It would also create barriers to harmonizing securities laws where there is a communality of interest among nations. There is already significant global hostility to what is perceived as the U.S. forcing its norms, laws and regulations on other countries by fiat; the Rule reinforces that assessment. After Morrison, one can legitimately question whether other nations will resist U.S. jurisdictional assertions even if foreign conduct is found to have a substantial effect within the United States. While the impact of Morrison is assessed, both in the U.S. and abroad, forcing members to comply with FINRA information requests that are likely to be disruptive globally is a terrible burden for FINRA to place on its members.

The Rule is not limited to situations where the SEC and/or FINRA suspect that actual violations of US securities laws have occurred, e.g., insider trading. Nor is the Rule triggered by a suspicion of improper practices or misappropriation of assets by a FINRA member. Instead, all that is required is a simple request by FINRA's Staff simply because assets and records are located at a non-member's facilities in a foreign country. This is regulation simply for the expediency of the regulators.

Alternatives

Alternatives are available to provide FINRA with the information it seeks. No need has been established nor justification provided to change the traditional rules under which the SEC has obtained cooperation for information other than FINRA's regulatory convenience. The SEC has entered into a number of cooperative arrangements, including bilateral agreements with securities regulators of other countries. Accountants have developed a variety of techniques over the years to obtain asset verification; the Rule ignores all these options. Greater study is needed to determine the necessity of the Rule before it adversely affects global relationships.

If FINRA is so concerned about whether asset holdings of customers are not properly reflected on the books and records of the broker-dealers from whom customers may have received statements of account, FINRA or the SEC should establish a separate bureau to which a customer could send a copy of the received statement and that separate bureau could randomly verify a small sampling of the reported holdings on various customers' statements against the comparable books and records of their broker-dealers. This technique need not cost a great deal of money. Certainly, it would cost a miniscule fraction of the damage that Madoff, Gruttadauria and similar scandals have caused.

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In sum, the Rule is poorly thought out. It will probably have a very negative global impact, including among countries that have previously cooperated on information exchanges with the U.S. Viable, proven alternatives are available but have been ignored. This is the worst type of regulation, promulgated without any assessment of harm to members, U.S. markets or enforcement of U.S. securities laws.   The Rule exists only for the convenience of regulators.

Thank you for the opportunity to comment on this matter.

Should you have any further questions, feel free to call Howard Spindel at 212-897-1688 or Cassondra E. Joseph at 212-897-1687, or by e-mail at **hspindel@intman.com or cjoseph@intman.com,** respectively**.**

Very truly yours,

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