

Books and Records

FINRA Requests Comment on a Proposed New Rule Requiring Carrying/Clearing Member Firms to Maintain and Keep Current Certain Records in a Central Location

Comment Period Expires: December 9, 2011

Executive Summary

FINRA is requesting comment on a proposed new rule that would require each carrying or clearing member firm to maintain and keep current certain records in a central location to facilitate a more rapid and orderly transfer of customer accounts to another broker-dealer as well as a more orderly liquidation in the event the member firm can no longer continue to operate due to financial or operational problems.

The text of proposed FINRA Rule 4516 (Readily Identifiable and Accessible Records) is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- ▶ Marshall J Levinson, Vice President, Member Regulation, at (646) 315-8453; and
- ▶ Adam H. Arkel, Assistant General Counsel, Office of General Counsel, at (202) 728-6961.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by December 9, 2011.

October 2011

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management

Key Topics

- ▶ Books and Records

Referenced Rules & Notices

- ▶ FINRA Rule 4370
- ▶ FINRA Rule 4523
- ▶ NASD Rule 1160
- ▶ NASD Rule 3110
- ▶ SEA Rule 15c3-3
- ▶ SEA Rule 17a-3
- ▶ SEA Rule 17a-4

Member firms and other interested parties can submit their comments using the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments as they are received.¹

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.²

Background & Discussion

If a carrying or clearing member firm can no longer continue to operate due to financial or operational problems, it is essential that regulators be able to take prompt action to protect investors. Regulators may need, among other things, to identify a clearing firm that would be able to take all customer accounts of the liquidating member firm in an expedited manner. In order for regulators to act in a timely fashion, certain documents and information must be readily identifiable and accessible. To aid in this process, FINRA believes it is critical that a carrying or clearing member firm maintain and keep current certain documents and information in one central location.³

To that end, FINRA is proposing new FINRA Rule 4516. Paragraph (a) of the new rule would require that, unless otherwise permitted by FINRA, in writing, each carrying or clearing member firm must maintain, and keep current, in a manner readily identifiable as such, records containing the information set forth in paragraph (b) of the rule at an area within its principal office that the member firm must specially designate. For purposes of compliance with the new rule, member firms may maintain the records in electronic form.⁴ Specifically, under paragraph (b) of the rule, the records must contain the following:

1. description of all accounts and ranges on the general ledger including the names of the associated persons assigned primary and supervisory responsibility for each such account pursuant to Rule 4523(b);
2. mapping of the general ledger accounts and ranges to the trial balance, including a list of all affiliated accounts;
3. description of all mission critical systems as defined in FINRA Rule 4370(g),⁵ including recordkeeping systems and the names of contact persons for each;
4. list of all bank accounts, authorized signatories, copies of executed agreements with such banks and “no lien” letters where applicable;
5. identification of all accounts and ranges on the stock record;
6. identification of all foreign and domestic control locations pursuant to SEA Rule 15c3-3 with the names of contact persons at each institution;
7. copies of all executed subordination agreements and nonconforming subordination agreements;
8. copies of all executed agreements with any clearing agencies, clearing banks and custodians;
9. copies of all executed agreements relating to the outsourcing of any significant activities or functions that are critical to the transfer of customer accounts and the liquidation of the member firm; and
10. most recent copy of the member firm’s business continuity plan.

The proposed rule requires that these records be immediately available to and accessible by representatives or designees of FINRA, the SEC and Securities Investor Protection Corporation (SIPC). Further, a member firm subject to the rule would be required to enter into an agreement with any clearing agency, clearing bank or custodian with which the member firm does business that requires, upon the commencement of a liquidation of the member firm, that any electronic systems provided to the member firm by the clearing agency, clearing bank or custodian will be made available, on a read only basis, to representatives or designees of FINRA, the SEC and SIPC.⁶

The rule would require that all records maintained pursuant to the rule must indicate the date the records were last updated. Lastly, the rule would also require that all member firms subject to the rule must designate a contact person responsible for maintaining and keeping current the records required under the rule. The member firm would be required to report the contact information for the designated contact person to FINRA and to update the contact information pursuant to NASD Rule 1160.⁷

Request for Comment

While FINRA is interested in receiving comments on all aspects of proposed FINRA Rule 4516, FINRA seeks specific comment on whether any adjustments are appropriate as to the list of records that would be subject to the proposed requirement as set forth in paragraph (b) of the rule, and as to the anticipated costs of compliance with the proposed rule.

The comment period expires December 9, 2011.

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. *See* Section 19 of the Securities Exchange Act of 1934 (SEA) and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. The inability to locate certain documents and information was identified as a concern in connection with the Lehman Brothers Inc. liquidation during the recent credit crisis. *See, e.g., In re Lehman Brothers Inc., Trustee's Preliminary Investigation Report and Recommendations* (August 25, 2010), pages 112 *et seq.* (Trustee's Report).
4. The proposed rule provides that if the member firm maintains the records by means of electronic storage media, such records must be uniquely tagged and appropriately indexed so as to be readily identifiable as such and accessible from the member firm's principal office. Member firms are reminded that they remain subject to the books and records requirements set forth in SEA Rules 17a-3 and 17a-4 and NASD Rule 3110.
5. FINRA Rule 4370(g) defines "mission critical system" as "any system that is necessary, depending on the nature of a member's business, to ensure prompt and accurate processing of securities transactions, including, but not limited to, order taking, order entry, execution, comparison, allocation, clearance and settlement of securities transactions, the maintenance of customer accounts, access to customer accounts and the delivery of funds and securities."
6. FINRA is including this provision in large part based on the experience of the Lehman liquidation. *See, e.g., Trustee's Report*, pages 60-63, 91-92 and 124-25.
7. NASD Rule 1160 requires, among other things, each member firm to (1) report to FINRA all contact information required by FINRA; (2) update its required contact information promptly, but in any event not later than 30 days following any change in such information; and (3) review and, if necessary, update its required contact information within 17 business days after the end of each calendar year.

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Attachment A

Below is the text of proposed FINRA Rule 4516.

FINRA Rule 4516. Readily Identifiable and Accessible Records

- (a) Unless otherwise permitted by FINRA, in writing, each carrying or clearing member shall maintain, and keep current, in a manner readily identifiable as such, records containing the information set forth in paragraph (b) of this Rule at an area within its principal office that the member shall specially designate. If the member maintains such records by means of electronic storage media, the records shall be uniquely tagged and appropriately indexed so as to be readily identifiable as such and accessible from the member's principal office.
- (b) Pursuant to paragraph (a) of this Rule, each carrying or clearing member shall maintain and keep current records containing the following:
 - (1) Description of all accounts and ranges on the general ledger including the names of the associated persons assigned primary and supervisory responsibility for each such account pursuant to Rule 4523(b);
 - (2) Mapping of the general ledger accounts and ranges to the trial balance, including a list of all affiliated accounts;
 - (3) Description of all mission critical systems as defined in Rule 4370(g), including recordkeeping systems and the names of contact persons for each;
 - (4) List of all bank accounts, authorized signatories, copies of executed agreements with such banks and "no lien" letters where applicable;
 - (5) Identification of all accounts and ranges on the stock record;
 - (6) Identification of all foreign and domestic control locations pursuant to SEA Rule 15c3-3 with the names of contact persons at each institution;
 - (7) Copies of all executed subordination agreements and nonconforming subordination agreements;
 - (8) Copies of all executed agreements with any clearing agencies, clearing banks and custodians;
 - (9) Copies of all executed agreements relating to the outsourcing of any significant activities or functions that are critical to the transfer of customer accounts and the liquidation of the member; and
 - (10) Most recent copy of the member's business continuity plan.

- (c) Every record maintained pursuant to this Rule shall be immediately available to and accessible by representatives or designees of FINRA, the SEC and SIPC.
- (d) All members subject to this Rule shall enter into an agreement with any clearing agency, clearing bank or custodian with which the member does business that requires, upon the commencement of a liquidation of the member, that any electronic systems provided to the member by the clearing agency, clearing bank or custodian will be made available, on a read only basis, to representatives or designees of FINRA, the SEC and SIPC.
- (e) All records maintained pursuant to this Rule shall indicate the date such records were last updated.
- (f) All members subject to this Rule shall designate a contact person responsible for maintaining and keeping current the records required pursuant to this Rule. The member shall report the contact information for such person to FINRA and shall update such information pursuant to NASD Rule 1160.