

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
 WASHINGTON, D.C. 20549
 Form 19b-4

File No.* SR - 2010 - * 059

Amendment No. (req. for Amendments *)

Proposed Rule Change by Financial Industry Regulatory Authority
 Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☒ Amendment * ☐ Withdrawal ☐

Section 19(b)(2) * ☒ Section 19(b)(3)(A) * ☐ Section 19(b)(3)(B) * ☐

Rule

Pilot ☐ Extension of Time Period
 for Commission Action * Date Expires *

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Adopt FINRA Rule 4360 (Fidelity Bonds) in the Consolidated FINRA Rulebook

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * Erika Last Name * Lazar
 Title * Counsel
 E-mail * erika.lazar@finra.org
 Telephone * (202) 728-8013 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 11/10/2010

By Patrice Gliniecki
 (Name *)

Senior Vice President and Deputy General Counsel

(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Patrice Gliniecki,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information (required)

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change (required)

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt NASD Rule 3020 (Fidelity Bonds) with certain changes into the consolidated FINRA rulebook as FINRA Rule 4360 (Fidelity Bonds), taking into account Incorporated NYSE Rule 319 (Fidelity Bonds) and its Interpretation.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Upon Commission approval and implementation by FINRA of the proposed rule change, the corresponding NASD and Incorporated NYSE rules will be eliminated from the current FINRA rulebook.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on April 16, 2009, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 365 days following Commission approval.

¹ 15 U.S.C. 78s(b)(1).

3. **Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

(a) Purpose

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),² FINRA is proposing to adopt NASD Rule 3020 as FINRA Rule 4360 (Fidelity Bonds), taking into account NYSE Rule 319 (and its Interpretation).³ Proposed FINRA Rule 4360 would update and clarify the fidelity bond requirements and better reflect current industry practices. Unless otherwise noted below, the provisions in NASD Rule 3020 would transfer, subject only to non-substantive changes, as part of proposed FINRA Rule 4360.

NASD Rule 3020 and NYSE Rule 319 (and its Interpretation) generally require members to maintain minimum amounts of fidelity bond coverage for officers and employees, and that such coverage address losses incurred due to certain specified events. The purpose of a fidelity bond is to protect a member against certain types of losses, including, but not limited to, those caused by the malfeasance of its officers and employees, and the effect of such losses on the member’s capital.

² The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

³ For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

General Provision

NASD Rule 3020(a) generally provides that each member required to join the Securities Investor Protection Corporation (“SIPC”) that has employees and that is not a member in good standing of one of the enumerated national securities exchanges must maintain fidelity bond coverage; NYSE Rule 319(a) generally requires member organizations doing business with the public to carry fidelity bonds. Like NASD Rule 3020, proposed FINRA Rule 4360 would require each member that is required to join SIPC to maintain blanket fidelity bond coverage with specified amounts of coverage based on the member’s net capital requirement, with certain exceptions.

NASD Rule 3020(a)(1) requires members to maintain a blanket fidelity bond in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America. Under NYSE Rule 319(a), the Stockbrokers Partnership Bond and the Brokers Blanket Bond approved by the NYSE are the only bond forms that may be used by a member organization; NYSE approval is required for any variation from such forms. Proposed FINRA Rule 4360 would require members to maintain fidelity bond coverage that provides for per loss coverage without an aggregate limit of liability. Members may apply for this level of coverage with any product that meets these requirements, including the Securities Dealer Blanket Bond (“SDBB”) or a properly endorsed Financial Institution Form 14 Bond (“Form 14”).⁴

⁴ Since 1982, firms electing to acquire coverage through the FINRA-sponsored Insurance Program (“Sponsored Program”) have been provided with the SDBB. It is the “default” insurance for FINRA members in that when a firm completes the application for the Sponsored Program, they are applying for the SDBB.

Most fidelity bonds contain a definition of the term “loss” (or “single loss”), for purposes of the bond, which generally includes all covered losses resulting from any one act or a series of related acts. A payment by an insurer for covered losses attributed to a “single loss” does not reduce a member’s coverage amount for losses attributed to other, separate acts. A fidelity bond with an aggregate limit of liability caps a member’s coverage during the bond period at a certain amount if a loss (or losses) meets this aggregate threshold. FINRA believes that per loss coverage without an aggregate limit of liability provides firms with the most beneficial coverage since the bond amount cannot be exhausted by one or more covered losses, so it will be available for future losses during the bond period.

Under proposed FINRA Rule 4360, a member’s fidelity bond must provide against loss and have Insuring Agreements covering at least the following: fidelity, on premises, in transit, forgery and alteration, securities and counterfeit currency. The proposed rule change modifies the descriptive headings for these Insuring Agreements, in part, from NASD Rule 3020(a)(1) and NYSE Rule 319(d) to align them with the headings in the current bond forms available to broker-dealers. FINRA has been advised by insurance industry representatives that the proposed rule change does not substantively change what is required to be covered by the bond.⁵

In addition, proposed FINRA Rule 4360 would eliminate the specific coverage provisions in NASD Rule 3020(a)(4) and (a)(5), and NYSE Rule 319(d)(ii)(B) and (C), and (e)(ii)(B) and (C), that permit less than 100 percent of coverage for certain Insuring

⁵ For example, previous versions of the SDBB and Form 14 included a separate Insuring Agreement for misplacement; however, in the current versions of the bonds, this coverage is included in both “on premises” and “in transit” coverage.

Agreements (i.e., fraudulent trading and securities forgery) to require that coverage for all Insuring Agreements be equal to 100 percent of the firm's minimum required bond coverage. Members may elect to carry additional, optional Insuring Agreements not required by proposed FINRA Rule 4360 for an amount less than 100 percent of the minimum required bond coverage.

Like NASD Rule 3020(a)(1)(H) and NYSE Rule 319.12, proposed FINRA Rule 4360 would require that a member's fidelity bond include a cancellation rider providing that the insurer will use its best efforts to promptly notify FINRA in the event the bond is cancelled, terminated or "substantially modified." Also, the proposed rule change would adopt the definition of "substantially modified" in NYSE Rule 319 and would incorporate NYSE Rule 319.12's standard that a firm must immediately advise FINRA in writing if its fidelity bond is cancelled, terminated or substantially modified.⁶

FINRA is proposing to add supplementary material to proposed FINRA Rule 4360 that would require members that do not qualify for a bond with per loss coverage without an aggregate limit of liability to secure alternative coverage. Specifically, a member that does not qualify for blanket fidelity bond coverage as required by proposed FINRA Rule 4360(a)(3) would be required to maintain substantially similar fidelity bond coverage in compliance with all other provisions of the proposed rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by proposed FINRA Rule 4360(a)(3).

⁶ NYSE Rule 319 defines the term "substantially modified" as any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of the rule.

The member would be required to retain such correspondence for the period specified by Exchange Act Rule 17a-4(b)(4). FINRA has been advised by insurance industry representatives that the proposed alternative coverage requirement is necessary for firms that, for example, have had a covered loss paid by an insurer within the past five years or firms that may present certain risk factors that would prevent an insurer from offering per loss coverage without an aggregate limit of liability.

Minimum Required Coverage

NASD Rule 3020 requires fidelity bond coverage for officers and employees of a member. Under NASD Rule 3020(e), the term “employee” or “employees” means any person or persons associated with a member firm (as defined in Article I, paragraph (rr) of the FINRA By-Laws) except: (1) sole proprietors, (2) sole stockholders and (3) directors or trustees of a member who are not performing acts coming within the scope of the usual duties of an officer or employee. Under NYSE Rule 319(a), any member organization doing business with the public must maintain fidelity bond coverage for general partners or officers and its employees.⁷

Proposed FINRA Rule 4360, similar to NASD Rule 3020 and NYSE Rule 319, would require each member to maintain, at a minimum, fidelity bond coverage for any person associated with the member, except directors or trustees of a member who are not

⁷ Under NYSE Rule Interpretation 319/02 (Additional Coverages), the required coverage of the Brokers Blanket Bond must apply, through rider or otherwise, as applicable to: all domestic and foreign guaranteed and non-guaranteed affiliates, subsidiaries and branches; bearer instruments if the member organization handles such securities; limited partners of a member firm if they are also employees; and the partners, officers and employees or person acting in a similar capacity of electronic data processing agencies in their activities on behalf of the member organizations.

performing acts within the scope of the usual duties of an officer or employee. As further detailed below, the proposed rule change would eliminate the exemption in NASD Rule 3020 for sole stockholders and sole proprietors.

The proposed rule change would increase the minimum required fidelity bond coverage for members, while continuing to base the coverage on a member's net capital requirement. To that end, proposed FINRA Rule 4360 would require a member with a net capital requirement that is less than \$250,000 to maintain minimum coverage of the greater of 120 percent of the firm's required net capital under Exchange Act Rule 15c3-1 or \$100,000. The increase to \$100,000 would modify the present minimum requirement of \$25,000. FINRA believes this increase is warranted since the NASD and NYSE fidelity bond rules have not been materially modified since their adoption - over 30 years ago - and \$25,000 in 1974 (the year the NASD rule was adopted) is equal to approximately \$110,000 today (adjusted for inflation). Although members may experience a slight increase in costs for their premiums under the proposed rule change, FINRA believes that the proposed amendments to the fidelity bond minimum requirements are necessary to provide meaningful and practical coverage for losses covered by the bond.

Under proposed FINRA Rule 4360, members with a net capital requirement of at least \$250,000 would use a table in the rule to determine their minimum fidelity bond coverage requirement. The table is a modified version of the tables in NASD Rule 3020(a)(3) and NYSE Rule 319(e)(i). The identical NASD and NYSE requirements for members that have a minimum net capital requirement that exceeds \$1 million would be retained in proposed FINRA Rule 4360; however, the proposed rule would adopt the

higher requirements in NYSE Rule 319(e)(i) for a member with a net capital requirement of at least \$250,000, but less than \$1 million.⁸

Under the proposed rule, the entire amount of a member's minimum required coverage must be available for covered losses and may not be eroded by the costs an insurer may incur if it chooses to defend a claim. Specifically, any defense costs for covered losses must be in addition to a member's minimum coverage requirements. A member may include defense costs as part of its fidelity bond coverage, but only to the extent that it does not reduce a member's minimum required coverage under the proposed rule.

Deductible Provision

Under NASD Rule 3020(b), a deductible provision may be included in a member's bond of up to \$5,000 or 10 percent of the member's minimum insurance requirement, whichever is greater. If a member desires to maintain coverage in excess of the minimum insurance requirement, then a deductible provision may be included in the bond of up to \$5,000 or 10 percent of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount based on the member's minimum required coverage must be deducted from the member's net worth in the calculation of the member's net capital for purposes of Exchange Act Rule 15c3-1. Where the member is a

⁸ For example, NASD Rule 3020 requires a small clearing and carrying firm (i.e., one subject to a \$250,000 net capital requirement) to obtain \$300,000 in coverage. The same firm, had it been designated to NYSE, would have needed \$600,000 in coverage. FINRA believes the increased coverage requirements are appropriate given the larger number/amount of claims that can be satisfied at these levels.

subsidiary of another member, the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Under NYSE Rule 319(b), each member organization may self-insure to the extent of \$10,000 or 10 percent of its minimum insurance requirement as fixed by the NYSE, whichever is greater, for each type of coverage required by the rule. Self-insurance in amounts exceeding the above maximum may be permitted by the NYSE provided the member or member organization certifies to the satisfaction of the NYSE that it is unable to obtain greater bonding coverage, and agrees to reduce its self-insurance so as to comply with the above stated limits as soon as possible, and appropriate charges to capital are made pursuant to Exchange Act Rule 15c3-1. This provision also contains identical language to the NASD rule regarding net worth deductions for subsidiaries.

Proposed FINRA Rule 4360 would provide for an allowable deductible amount of up to 25 percent of the fidelity bond coverage purchased by a member. Any deductible amount elected by the firm that is greater than 10 percent of the coverage purchased by the member⁹ would be deducted from the member's net worth in the calculation of its net capital for purposes of Exchange Act Rule 15c3-1.¹⁰ Like the NASD and NYSE rules, if the member is a subsidiary of another FINRA member, this amount may be deducted

⁹ FINRA notes that a member may elect, subject to availability, a deductible of less than 10 percent of the coverage purchased.

¹⁰ NASD Rule 3020 bases the deduction from net worth for an excess deductible on a firm's minimum required coverage, while proposed FINRA Rule 4360 would base such deduction from net worth on coverage purchased by the member.

from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Annual Review of Coverage

Consistent with NASD Rule 3020(c) and NYSE Rule 319.10, proposed FINRA Rule 4360 would require a member (including a firm that signs a multi-year insurance policy), annually as of the yearly anniversary date of the issuance of the fidelity bond, to review the adequacy of its fidelity bond coverage and make any required adjustments to its coverage, as set forth in the proposed rule. Under proposed FINRA Rule 4360(d), a member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), would be used as the basis for determining the member's minimum required fidelity bond coverage for the succeeding 12-month period. The "preceding 12-month period" includes the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond. This would give a firm time to determine its required fidelity bond coverage by the anniversary date of the bond.

Similar to NASD Rule 3020(c)(2), proposed FINRA Rule 4360 would allow a member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement to use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member would not be permitted to carry less minimum fidelity bond coverage in its second year than it carried in its first year.

Exemptions

Based in part on NASD Rule 3020(a), proposed FINRA Rule 4360 would exempt from the fidelity bond requirements members in good standing with a national securities exchange that maintain a fidelity bond subject to the requirements of such exchange that are equal to or greater than the requirements set forth in the proposed rule.¹¹

Additionally, consistent with NYSE Rule Interpretation 319/01, proposed FINRA Rule 4360 would continue to exempt from the fidelity bond requirements any firm that acts solely as a Designated Market Maker (“DMM”),¹² floor broker or registered floor trader and does not conduct business with the public.

Proposed FINRA Rule 4360 would not maintain the exemption in NASD Rule 3020(e) for a one-person firm.¹³ Historically, a sole proprietor or sole stockholder member was excluded from the fidelity bond requirements based upon the assumption

¹¹ In general, the notification provisions of the corresponding exchange rules (i.e., cancellation rider and notification upon cancellation, termination or substantial modification of the bond) require notification to the respective exchange rather than to FINRA. Accordingly, the practical effect for a firm that avails itself of the proposed exemption is that such firm must maintain a fidelity bond subject to the same or greater requirements as in proposed FINRA Rule 4360; however, such firm would be exempt from the requirement that FINRA be notified of changes to the bond and would alternatively comply with the notification provisions of the respective exchange.

¹² See Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (Order Approving File No. SR-NYSE-2008-46). In this rule filing, the role of the specialist was altered in certain respects and the term “specialist” was replaced with the term “Designated Market Maker.”

¹³ A one-person member (that is, a firm owned by a sole proprietor or stockholder that has no other associated persons, registered or unregistered) has no “employees” for purposes of NASD Rule 3020, and therefore such a firm currently is not subject to the fidelity bonding requirements. Conversely, a firm owned by a sole proprietor or stockholder that has other associated persons has

that such firms were one-person shops and, therefore, could not obtain coverage for their own acts. FINRA has determined that sole proprietors and sole stockholder firms can and often do acquire fidelity bond coverage, even though it is currently not required, since all claims (irrespective of firm size) are likely to be paid or denied on a facts-and-circumstances basis. Also, certain coverage areas of the fidelity bond benefit a one-person shop (e.g., those covering customer property lost in transit).

FINRA understands that changes to a firm's fidelity bond policy, in coordination with insurance providers, may be impacted by bond renewal cycles and changes required by the insurance industry. FINRA will consider such factors in establishing an implementation date for the proposed rule change upon approval by the SEC.

As noted above, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 365 days following Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁴ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will update and clarify the

“employees” for purposes of NASD Rule 3020, and currently is, and will continue to be, subject to the fidelity bonding requirements.

¹⁴ 15 U.S.C. 78o-3(b)(6).

requirements governing fidelity bonds for adoption as FINRA Rule 4360 in the Consolidated FINRA Rulebook.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In July 2009, FINRA published Regulatory Notice 09-44 (FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Fidelity Bonds) requesting comment on the proposed rule change. The comment period expired on September 14, 2009. Thirteen comment letters were received in response to the Regulatory Notice. A copy of the Regulatory Notice is attached as Exhibit 2a to this rule filing. A list of the commenters, and copies of the comment letters, are attached as Exhibit 2b to this rule filing.¹⁵

As originally proposed in Regulatory Notice 09-44, FINRA Rule 4360 provided that any member that is required to be a member of SIPC must maintain fidelity bond coverage with the SDBB, unless they are unable to obtain this coverage, in which case they may use the Form 14. Several commenters noted that only a limited number of insurance carriers offer the SDBB, the standard form of which provides per loss (i.e., per event) coverage without an aggregate limit of liability, and requested that FINRA provide

¹⁵ All references to commenters under this Item are to the commenters as listed and defined in Exhibit 2b.

flexibility with respect to bond forms under the proposed rule.¹⁶ These commenters suggested that limiting the bond form requirement to the SDBB restricts competition among insurance carriers, limits the potential of broker-dealers to secure superior coverage at more favorable terms and is likely to result in unfair pricing of such policies, raising costs for firms. The commenters further noted that the proposal creates an uneven playing field in that it promotes certain underwriters and products to the disadvantage of others that offer commensurate coverage, such as a properly endorsed Form 14. One commenter suggested that FINRA amend the proposed rule to set forth the parameters of the preferred bond form instead of prescribing a particular product.¹⁷

Many commenters noted that an aggregate limit of liability is standard in the industry and important to most underwriters because it quantifies and controls the underwriter's maximum exposure to loss during the bond period.¹⁸ Further, the commenters noted that without an aggregate limit of liability, members' premium costs are likely to increase. Certain commenters believe that a bond with a "restoration of the aggregate" option is the equivalent of "per event" coverage.¹⁹

In response to the comments, FINRA made certain changes to the original proposal. Specifically, FINRA has amended the proposed rule to remove the requirement that a member maintain fidelity bond coverage with the SDBB, and alternatively with the Form 14. As detailed in the Purpose section of this rule filing, the proposed rule would

¹⁶ FFS, Gallagher, HBHA, ISO, Kwiecinski, SFAA and Travelers.

¹⁷ SFAA.

¹⁸ FFS, Kwiecinski, SFAA and Travelers.

¹⁹ Kwiecinski and SFAA.

require a member to maintain blanket fidelity bond coverage with a bond that would provide for per loss coverage without an aggregate limit of liability (e.g., the SDBB or a properly endorsed Form 14). FINRA believes the amendments to the proposal address the issues noted by the commenters while maintaining the aims of the proposed rule to provide blanket per loss fidelity bond coverage unrestricted by an aggregate limit of liability. As noted in detail in the Purpose section of this rule filing, FINRA believes that a member's fidelity bond coverage should not include an aggregate limit of liability because it is important that a member's coverage not be eroded by covered losses within the bond period, thus exposing a member to future losses with a reduced bond limit.

Additionally, FINRA has amended its original proposal for alternative coverage in the supplementary material to the proposed rule to provide that a member that does not qualify for blanket fidelity bond coverage as required by proposed FINRA Rule 4360(a)(3) must maintain substantially similar fidelity bond coverage in compliance with all other provisions of the proposed rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by proposed FINRA Rule 4360(a)(3). The member would be required to retain such correspondence for the period specified by Exchange Act Rule 17a-4(b)(4).

One commenter agreed with FINRA's proposal to increase the minimum bond limit requirement because losses often exceed the current minimum bond requirements, which exposes firms' net capital and, in some cases, results in a SIPC liquidation

proceeding.²⁰ Other commenters noted that the proposed increased minimum requirements remain inadequate.²¹ According to one commenter, the proposed minimum fidelity bond requirements do not meet comparable limits of liability set for any other insurable exposure in the commercial marketplace and, when registered representatives steal from clients, the losses frequently range from \$250,000 to \$5 million or more.²²

Certain other commenters opposed the increase in the minimum bond requirement arguing that it will have a disproportionately negative effect on small firms, including small firms that engage in certain business areas that require a higher net capital amount.²³ Two commenters requested that FINRA provide specific data to justify why the increased minimum fidelity bond requirements are necessary.²⁴ One commenter suggested that the expansion of the definition of “branch office” will increase fees for securing fidelity bond coverage.²⁵

FINRA does not propose to make any changes to the proposed minimum requirements set forth in Regulatory Notice 09-44. As stated above in the Purpose section of this rule filing, FINRA believes the increase in the minimum fidelity bond requirements is warranted since the NASD and NYSE fidelity bond rules have not been materially modified since their adoption over 30 years ago; members that have

²⁰ Travelers.

²¹ First Asset and Gallagher.

²² Gallagher.

²³ FGS, First Asset, HBHA and PCI.

²⁴ First Asset and Schrinier.

²⁵ First Asset.

maintained minimum coverage of \$25,000 have had claims that exceed this amount; and notwithstanding a slight increase in premium costs for certain members under the proposed rule change, the proposed amendments are necessary to provide meaningful and practical coverage for losses covered by the bond. With respect to the comment regarding the “branch office” definition, FINRA notes that the proposed fidelity bond rule does not implicate the definition of “branch office.” Irrespective of FINRA’s definition of “branch office,” the insurance provider makes the determination as to whether the number of branch offices associated with a member is a relevant criterion in assessing a member’s fidelity bond coverage and premiums. FINRA neither imposes a requirement that insurance providers use branch offices as a factor in evaluating a member’s qualifications to obtain fidelity bond coverage nor does it require them to use its current definition of branch office to make this determination.

One commenter suggested that the proposed rule require notification to FINRA in the event that the member has experienced a loss or losses that have exhausted its fidelity bond coverage.²⁶ FINRA did not make any changes to the proposal in this respect because a bond without an aggregate limit of liability by its terms cannot be exhausted.

Two commenters suggested that FINRA incorporate an exemption into the proposed rule for firms that are a subsidiary of a larger parent organization.²⁷ According to the commenters, parent organizations of members typically purchase their own fidelity bonds, include the member subsidiary as an insured under that program, and provide

²⁶ Kwiecinski.

²⁷ Kwiecinski and Travelers.

substantially greater coverage than the minimum requirements under the proposed rule. Moreover, the commenters believe that the premiums paid for the FINRA bond are an unnecessary expense since the coverage already exists. The commenters also noted that, in many cases, a duplication of coverage complicates loss settlements where the bonds of both the member firm and its parent organization are affected by a single loss.

FINRA notes that neither the current fidelity bond rule nor the proposed fidelity bond rule precludes a member from being part of its parent organization's fidelity bond coverage as long as the coverage under the parent's bond provides equal to or greater coverage than the member's minimum required coverage under the rule. The parent organization's bond must contain a rider that provides for the subsidiary broker-dealer's coverage by enumerating the requirements of the FINRA rule and providing for, at a minimum, the subsidiary's minimum required coverage. Accordingly, FINRA does not propose to amend the proposed rule in this respect as it is unnecessary.

Two commenters urged FINRA to maintain an exemption from the fidelity bond requirements for one-person firms.²⁸ The commenters noted that FINRA could be requiring coverage that is not available in the marketplace, since the alter ego concept applies to fidelity bond claims for these entities.

As noted above in the Purpose section of this rule filing, many one-person firms currently maintain fidelity bond coverage notwithstanding the exemption in NASD Rule 3020, and claims are likely to be paid based on a facts-and-circumstances analysis, not on a firm's size or structure. As such, FINRA is not proposing any changes to the original proposal in this respect.

²⁸ SFAA and Travelers.

One commenter noted that the proposed rule serves no purpose to investors of the financial markets in its application to small firms that do not hold customer funds, execute transactions in securities on public markets, or engage in trading or underwriting (e.g., a firm that solely provides corporate financial advisory services for fee income).²⁹ FINRA believes that all members of SIPC should maintain fidelity bond coverage. FINRA does not agree with the commenter's assessment, since any firm could be the target of malfeasance of one of its employees. Thus, FINRA is not proposing to incorporate an exemption for these small firms.

One commenter encouraged FINRA to incorporate a requirement for an insuring agreement for Computer Theft.³⁰ FINRA did not amend the proposal to add this insuring agreement at this time; however, FINRA understands that this coverage is already included in most basic riders obtained by members at no extra cost, so a member will likely obtain this coverage automatically as part of its fidelity bond coverage.

One commenter supported increased deductible thresholds; however, the commenter suggested deleting the haircut provision because the proposed rule may discourage a firm from pursuing or accepting higher deductibles if it has to take a haircut in its net capital computation for deductibles over 10 percent.³¹ Another commenter suggested that the annual review requirement is duplicitous and unnecessary and that the

²⁹ Akin Bay.

³⁰ Travelers.

³¹ Travelers.

proposed rule should speak solely to minimum bond requirements for members.³² The commenter noted that fidelity bond reviews should be triggered by changes in a firm's net capital requirement and not subject to an annual requirement, since the firm would likely review how any changes in net capital affect all aspects of the firm when such changes occur. FINRA did not make any amendments to the proposal in these areas as these concepts have not been substantively amended from the legacy NASD rule, and FINRA believes that they are achieving their intended purposes.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.³³

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. Regulatory Notice 09-44 (July 2009)

Exhibit 2b. Comments received in response to Regulatory Notice 09-44 (July 2009).

³² IBI.

³³ 15 U.S.C. 78s(b)(2).

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2010-059)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 4360 (Fidelity Bonds) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt NASD Rule 3020 (Fidelity Bonds) with certain changes into the consolidated FINRA rulebook as FINRA Rule 4360 (Fidelity Bonds), taking into account Incorporated NYSE Rule 319 (Fidelity Bonds) and its Interpretation.

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),³ FINRA is proposing to adopt NASD Rule 3020 as FINRA Rule 4360 (Fidelity Bonds), taking into account NYSE Rule 319 (and its Interpretation).⁴ Proposed FINRA Rule 4360 would update and clarify the fidelity bond requirements and better reflect current industry practices. Unless otherwise noted below, the provisions in NASD Rule 3020 would transfer, subject only to non-substantive changes, as part of proposed FINRA Rule 4360.

³ The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

⁴ For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

NASD Rule 3020 and NYSE Rule 319 (and its Interpretation) generally require members to maintain minimum amounts of fidelity bond coverage for officers and employees, and that such coverage address losses incurred due to certain specified events. The purpose of a fidelity bond is to protect a member against certain types of losses, including, but not limited to, those caused by the malfeasance of its officers and employees, and the effect of such losses on the member's capital.

General Provision

NASD Rule 3020(a) generally provides that each member required to join the Securities Investor Protection Corporation ("SIPC") that has employees and that is not a member in good standing of one of the enumerated national securities exchanges must maintain fidelity bond coverage; NYSE Rule 319(a) generally requires member organizations doing business with the public to carry fidelity bonds. Like NASD Rule 3020, proposed FINRA Rule 4360 would require each member that is required to join SIPC to maintain blanket fidelity bond coverage with specified amounts of coverage based on the member's net capital requirement, with certain exceptions.

NASD Rule 3020(a)(1) requires members to maintain a blanket fidelity bond in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America. Under NYSE Rule 319(a), the Stockbrokers Partnership Bond and the Brokers Blanket Bond approved by the NYSE are the only bond forms that may be used by a member organization; NYSE approval is required for any variation from such forms. Proposed FINRA Rule 4360 would require members to maintain fidelity bond coverage that provides for per loss coverage without an aggregate limit of liability. Members may apply for this level of coverage with any product that

meets these requirements, including the Securities Dealer Blanket Bond (“SDBB”) or a properly endorsed Financial Institution Form 14 Bond (“Form 14”).⁵

Most fidelity bonds contain a definition of the term “loss” (or “single loss”), for purposes of the bond, which generally includes all covered losses resulting from any one act or a series of related acts. A payment by an insurer for covered losses attributed to a “single loss” does not reduce a member’s coverage amount for losses attributed to other, separate acts. A fidelity bond with an aggregate limit of liability caps a member’s coverage during the bond period at a certain amount if a loss (or losses) meets this aggregate threshold. FINRA believes that per loss coverage without an aggregate limit of liability provides firms with the most beneficial coverage since the bond amount cannot be exhausted by one or more covered losses, so it will be available for future losses during the bond period.

Under proposed FINRA Rule 4360, a member’s fidelity bond must provide against loss and have Insuring Agreements covering at least the following: fidelity, on premises, in transit, forgery and alteration, securities and counterfeit currency. The proposed rule change modifies the descriptive headings for these Insuring Agreements, in part, from NASD Rule 3020(a)(1) and NYSE Rule 319(d) to align them with the headings in the current bond forms available to broker-dealers. FINRA has been advised

⁵ Since 1982, firms electing to acquire coverage through the FINRA-sponsored Insurance Program (“Sponsored Program”) have been provided with the SDBB. It is the “default” insurance for FINRA members in that when a firm completes the application for the Sponsored Program, they are applying for the SDBB.

by insurance industry representatives that the proposed rule change does not substantively change what is required to be covered by the bond.⁶

In addition, proposed FINRA Rule 4360 would eliminate the specific coverage provisions in NASD Rule 3020(a)(4) and (a)(5), and NYSE Rule 319(d)(ii)(B) and (C), and (e)(ii)(B) and (C), that permit less than 100 percent of coverage for certain Insuring Agreements (i.e., fraudulent trading and securities forgery) to require that coverage for all Insuring Agreements be equal to 100 percent of the firm's minimum required bond coverage. Members may elect to carry additional, optional Insuring Agreements not required by proposed FINRA Rule 4360 for an amount less than 100 percent of the minimum required bond coverage.

Like NASD Rule 3020(a)(1)(H) and NYSE Rule 319.12, proposed FINRA Rule 4360 would require that a member's fidelity bond include a cancellation rider providing that the insurer will use its best efforts to promptly notify FINRA in the event the bond is cancelled, terminated or "substantially modified." Also, the proposed rule change would adopt the definition of "substantially modified" in NYSE Rule 319 and would incorporate NYSE Rule 319.12's standard that a firm must immediately advise FINRA in writing if its fidelity bond is cancelled, terminated or substantially modified.⁷

FINRA is proposing to add supplementary material to proposed FINRA Rule 4360 that would require members that do not qualify for a bond with per loss coverage

⁶ For example, previous versions of the SDBB and Form 14 included a separate Insuring Agreement for misplacement; however, in the current versions of the bonds, this coverage is included in both "on premises" and "in transit" coverage.

⁷ NYSE Rule 319 defines the term "substantially modified" as any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of the rule.

without an aggregate limit of liability to secure alternative coverage. Specifically, a member that does not qualify for blanket fidelity bond coverage as required by proposed FINRA Rule 4360(a)(3) would be required to maintain substantially similar fidelity bond coverage in compliance with all other provisions of the proposed rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by proposed FINRA Rule 4360(a)(3). The member would be required to retain such correspondence for the period specified by Exchange Act Rule 17a-4(b)(4). FINRA has been advised by insurance industry representatives that the proposed alternative coverage requirement is necessary for firms that, for example, have had a covered loss paid by an insurer within the past five years or firms that may present certain risk factors that would prevent an insurer from offering per loss coverage without an aggregate limit of liability.

Minimum Required Coverage

NASD Rule 3020 requires fidelity bond coverage for officers and employees of a member. Under NASD Rule 3020(e), the term “employee” or “employees” means any person or persons associated with a member firm (as defined in Article I, paragraph (rr) of the FINRA By-Laws) except: (1) sole proprietors, (2) sole stockholders and (3) directors or trustees of a member who are not performing acts coming within the scope of the usual duties of an officer or employee. Under NYSE Rule 319(a), any member organization doing business with the public must maintain fidelity bond coverage for general partners or officers and its employees.⁸

⁸ Under NYSE Rule Interpretation 319/02 (Additional Coverages), the required coverage of the Brokers Blanket Bond must apply, through rider or otherwise, as applicable to: all domestic and foreign guaranteed and non-guaranteed affiliates,

Proposed FINRA Rule 4360, similar to NASD Rule 3020 and NYSE Rule 319, would require each member to maintain, at a minimum, fidelity bond coverage for any person associated with the member, except directors or trustees of a member who are not performing acts within the scope of the usual duties of an officer or employee. As further detailed below, the proposed rule change would eliminate the exemption in NASD Rule 3020 for sole stockholders and sole proprietors.

The proposed rule change would increase the minimum required fidelity bond coverage for members, while continuing to base the coverage on a member's net capital requirement. To that end, proposed FINRA Rule 4360 would require a member with a net capital requirement that is less than \$250,000 to maintain minimum coverage of the greater of 120 percent of the firm's required net capital under Exchange Act Rule 15c3-1 or \$100,000. The increase to \$100,000 would modify the present minimum requirement of \$25,000. FINRA believes this increase is warranted since the NASD and NYSE fidelity bond rules have not been materially modified since their adoption - over 30 years ago - and \$25,000 in 1974 (the year the NASD rule was adopted) is equal to approximately \$110,000 today (adjusted for inflation). Although members may experience a slight increase in costs for their premiums under the proposed rule change, FINRA believes that the proposed amendments to the fidelity bond minimum requirements are necessary to provide meaningful and practical coverage for losses covered by the bond.

subsidiaries and branches; bearer instruments if the member organization handles such securities; limited partners of a member firm if they are also employees; and the partners, officers and employees or person acting in a similar capacity of electronic data processing agencies in their activities on behalf of the member organizations.

Under proposed FINRA Rule 4360, members with a net capital requirement of at least \$250,000 would use a table in the rule to determine their minimum fidelity bond coverage requirement. The table is a modified version of the tables in NASD Rule 3020(a)(3) and NYSE Rule 319(e)(i). The identical NASD and NYSE requirements for members that have a minimum net capital requirement that exceeds \$1 million would be retained in proposed FINRA Rule 4360; however, the proposed rule would adopt the higher requirements in NYSE Rule 319(e)(i) for a member with a net capital requirement of at least \$250,000, but less than \$1 million.⁹

Under the proposed rule, the entire amount of a member's minimum required coverage must be available for covered losses and may not be eroded by the costs an insurer may incur if it chooses to defend a claim. Specifically, any defense costs for covered losses must be in addition to a member's minimum coverage requirements. A member may include defense costs as part of its fidelity bond coverage, but only to the extent that it does not reduce a member's minimum required coverage under the proposed rule.

Deductible Provision

Under NASD Rule 3020(b), a deductible provision may be included in a member's bond of up to \$5,000 or 10 percent of the member's minimum insurance requirement, whichever is greater. If a member desires to maintain coverage in excess of the minimum insurance requirement, then a deductible provision may be included in the

⁹ For example, NASD Rule 3020 requires a small clearing and carrying firm (*i.e.*, one subject to a \$250,000 net capital requirement) to obtain \$300,000 in coverage. The same firm, had it been designated to NYSE, would have needed \$600,000 in coverage. FINRA believes the increased coverage requirements are appropriate given the larger number/amount of claims that can be satisfied at these levels.

bond of up to \$5,000 or 10 percent of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount based on the member's minimum required coverage must be deducted from the member's net worth in the calculation of the member's net capital for purposes of Exchange Act Rule 15c3-1. Where the member is a subsidiary of another member, the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Under NYSE Rule 319(b), each member organization may self-insure to the extent of \$10,000 or 10 percent of its minimum insurance requirement as fixed by the NYSE, whichever is greater, for each type of coverage required by the rule. Self-insurance in amounts exceeding the above maximum may be permitted by the NYSE provided the member or member organization certifies to the satisfaction of the NYSE that it is unable to obtain greater bonding coverage, and agrees to reduce its self-insurance so as to comply with the above stated limits as soon as possible, and appropriate charges to capital are made pursuant to Exchange Act Rule 15c3-1. This provision also contains identical language to the NASD rule regarding net worth deductions for subsidiaries.

Proposed FINRA Rule 4360 would provide for an allowable deductible amount of up to 25 percent of the fidelity bond coverage purchased by a member. Any deductible amount elected by the firm that is greater than 10 percent of the coverage purchased by

the member¹⁰ would be deducted from the member's net worth in the calculation of its net capital for purposes of Exchange Act Rule 15c3-1.¹¹ Like the NASD and NYSE rules, if the member is a subsidiary of another FINRA member, this amount may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

Annual Review of Coverage

Consistent with NASD Rule 3020(c) and NYSE Rule 319.10, proposed FINRA Rule 4360 would require a member (including a firm that signs a multi-year insurance policy), annually as of the yearly anniversary date of the issuance of the fidelity bond, to review the adequacy of its fidelity bond coverage and make any required adjustments to its coverage, as set forth in the proposed rule. Under proposed FINRA Rule 4360(d), a member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), would be used as the basis for determining the member's minimum required fidelity bond coverage for the succeeding 12-month period. The "preceding 12-month period" includes the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond. This would give a firm time to determine its required fidelity bond coverage by the anniversary date of the bond.

Similar to NASD Rule 3020(c)(2), proposed FINRA Rule 4360 would allow a member that has only been in business for one year and elected the aggregate

¹⁰ FINRA notes that a member may elect, subject to availability, a deductible of less than 10 percent of the coverage purchased.

¹¹ NASD Rule 3020 bases the deduction from net worth for an excess deductible on a firm's minimum required coverage, while proposed FINRA Rule 4360 would base such deduction from net worth on coverage purchased by the member.

indebtedness ratio for calculating its net capital requirement to use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member would not be permitted to carry less minimum fidelity bond coverage in its second year than it carried in its first year.

Exemptions

Based in part on NASD Rule 3020(a), proposed FINRA Rule 4360 would exempt from the fidelity bond requirements members in good standing with a national securities exchange that maintain a fidelity bond subject to the requirements of such exchange that are equal to or greater than the requirements set forth in the proposed rule.¹²

Additionally, consistent with NYSE Rule Interpretation 319/01, proposed FINRA Rule 4360 would continue to exempt from the fidelity bond requirements any firm that acts solely as a Designated Market Maker (“DMM”),¹³ floor broker or registered floor trader and does not conduct business with the public.

¹² In general, the notification provisions of the corresponding exchange rules (i.e., cancellation rider and notification upon cancellation, termination or substantial modification of the bond) require notification to the respective exchange rather than to FINRA. Accordingly, the practical effect for a firm that avails itself of the proposed exemption is that such firm must maintain a fidelity bond subject to the same or greater requirements as in proposed FINRA Rule 4360; however, such firm would be exempt from the requirement that FINRA be notified of changes to the bond and would alternatively comply with the notification provisions of the respective exchange.

¹³ See Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (Order Approving File No. SR-NYSE-2008-46). In this rule filing, the role of the specialist was altered in certain respects and the term “specialist” was replaced with the term “Designated Market Maker.”

Proposed FINRA Rule 4360 would not maintain the exemption in NASD Rule 3020(e) for a one-person firm.¹⁴ Historically, a sole proprietor or sole stockholder member was excluded from the fidelity bond requirements based upon the assumption that such firms were one-person shops and, therefore, could not obtain coverage for their own acts. FINRA has determined that sole proprietors and sole stockholder firms can and often do acquire fidelity bond coverage, even though it is currently not required, since all claims (irrespective of firm size) are likely to be paid or denied on a facts-and-circumstances basis. Also, certain coverage areas of the fidelity bond benefit a one-person shop (e.g., those covering customer property lost in transit).

FINRA understands that changes to a firm's fidelity bond policy, in coordination with insurance providers, may be impacted by bond renewal cycles and changes required by the insurance industry. FINRA will consider such factors in establishing an implementation date for the proposed rule change upon approval by the SEC.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 365 days following Commission approval.

¹⁴ A one-person member (that is, a firm owned by a sole proprietor or stockholder that has no other associated persons, registered or unregistered) has no "employees" for purposes of NASD Rule 3020, and therefore such a firm currently is not subject to the fidelity bonding requirements. Conversely, a firm owned by a sole proprietor or stockholder that has other associated persons has "employees" for purposes of NASD Rule 3020, and currently is, and will continue to be, subject to the fidelity bonding requirements.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁵ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will update and clarify the requirements governing fidelity bonds for adoption as FINRA Rule 4360 in the Consolidated FINRA Rulebook.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In July 2009, FINRA published Regulatory Notice 09-44 (FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Fidelity Bonds) requesting comment on the proposed rule change. The comment period expired on September 14, 2009. Thirteen comment letters were received in response to the Regulatory Notice. A copy of the Regulatory Notice is attached as Exhibit 2a to this rule filing. A list of the commenters, and copies of the comment letters, are attached as Exhibit 2b to this rule filing.¹⁶

¹⁵ 15 U.S.C. 78o-3(b)(6).

¹⁶ All references to commenters under this Item are to the commenters as listed and defined in Exhibit 2b.

As originally proposed in Regulatory Notice 09-44, FINRA Rule 4360 provided that any member that is required to be a member of SIPC must maintain fidelity bond coverage with the SDBB, unless they are unable to obtain this coverage, in which case they may use the Form 14. Several commenters noted that only a limited number of insurance carriers offer the SDBB, the standard form of which provides per loss (i.e., per event) coverage without an aggregate limit of liability, and requested that FINRA provide flexibility with respect to bond forms under the proposed rule.¹⁷ These commenters suggested that limiting the bond form requirement to the SDBB restricts competition among insurance carriers, limits the potential of broker-dealers to secure superior coverage at more favorable terms and is likely to result in unfair pricing of such policies, raising costs for firms. The commenters further noted that the proposal creates an uneven playing field in that it promotes certain underwriters and products to the disadvantage of others that offer commensurate coverage, such as a properly endorsed Form 14. One commenter suggested that FINRA amend the proposed rule to set forth the parameters of the preferred bond form instead of prescribing a particular product.¹⁸

Many commenters noted that an aggregate limit of liability is standard in the industry and important to most underwriters because it quantifies and controls the underwriter's maximum exposure to loss during the bond period.¹⁹ Further, the commenters noted that without an aggregate limit of liability, members' premium costs

¹⁷ FFS, Gallagher, HBHA, ISO, Kwiecinski, SFAA and Travelers.

¹⁸ SFAA.

¹⁹ FFS, Kwiecinski, SFAA and Travelers.

are likely to increase. Certain commenters believe that a bond with a “restoration of the aggregate” option is the equivalent of “per event” coverage.²⁰

In response to the comments, FINRA made certain changes to the original proposal. Specifically, FINRA has amended the proposed rule to remove the requirement that a member maintain fidelity bond coverage with the SDBB, and alternatively with the Form 14. As detailed in the Purpose section of this rule filing, the proposed rule would require a member to maintain blanket fidelity bond coverage with a bond that would provide for per loss coverage without an aggregate limit of liability (e.g., the SDBB or a properly endorsed Form 14). FINRA believes the amendments to the proposal address the issues noted by the commenters while maintaining the aims of the proposed rule to provide blanket per loss fidelity bond coverage unrestricted by an aggregate limit of liability. As noted in detail in the Purpose section of this rule filing, FINRA believes that a member’s fidelity bond coverage should not include an aggregate limit of liability because it is important that a member’s coverage not be eroded by covered losses within the bond period, thus exposing a member to future losses with a reduced bond limit.

Additionally, FINRA has amended its original proposal for alternative coverage in the supplementary material to the proposed rule to provide that a member that does not qualify for blanket fidelity bond coverage as required by proposed FINRA Rule 4360(a)(3) must maintain substantially similar fidelity bond coverage in compliance with all other provisions of the proposed rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by proposed FINRA Rule 4360(a)(3). The member would be

²⁰ Kwiecinski and SFAA.

required to retain such correspondence for the period specified by Exchange Act Rule 17a-4(b)(4).

One commenter agreed with FINRA's proposal to increase the minimum bond limit requirement because losses often exceed the current minimum bond requirements, which exposes firms' net capital and, in some cases, results in a SIPC liquidation proceeding.²¹ Other commenters noted that the proposed increased minimum requirements remain inadequate.²² According to one commenter, the proposed minimum fidelity bond requirements do not meet comparable limits of liability set for any other insurable exposure in the commercial marketplace and, when registered representatives steal from clients, the losses frequently range from \$250,000 to \$5 million or more.²³

Certain other commenters opposed the increase in the minimum bond requirement arguing that it will have a disproportionately negative effect on small firms, including small firms that engage in certain business areas that require a higher net capital amount.²⁴ Two commenters requested that FINRA provide specific data to justify why the increased minimum fidelity bond requirements are necessary.²⁵ One commenter suggested that the expansion of the definition of "branch office" will increase fees for securing fidelity bond coverage.²⁶

²¹ Travelers.

²² First Asset and Gallagher.

²³ Gallagher.

²⁴ FGS, First Asset, HBHA and PCI.

²⁵ First Asset and Schrinier.

²⁶ First Asset.

FINRA does not propose to make any changes to the proposed minimum requirements set forth in Regulatory Notice 09-44. As stated above in the Purpose section of this rule filing, FINRA believes the increase in the minimum fidelity bond requirements is warranted since the NASD and NYSE fidelity bond rules have not been materially modified since their adoption over 30 years ago; members that have maintained minimum coverage of \$25,000 have had claims that exceed this amount; and notwithstanding a slight increase in premium costs for certain members under the proposed rule change, the proposed amendments are necessary to provide meaningful and practical coverage for losses covered by the bond. With respect to the comment regarding the “branch office” definition, FINRA notes that the proposed fidelity bond rule does not implicate the definition of “branch office.” Irrespective of FINRA’s definition of “branch office,” the insurance provider makes the determination as to whether the number of branch offices associated with a member is a relevant criterion in assessing a member’s fidelity bond coverage and premiums. FINRA neither imposes a requirement that insurance providers use branch offices as a factor in evaluating a member’s qualifications to obtain fidelity bond coverage nor does it require them to use its current definition of branch office to make this determination.

One commenter suggested that the proposed rule require notification to FINRA in the event that the member has experienced a loss or losses that have exhausted its fidelity bond coverage.²⁷ FINRA did not make any changes to the proposal in this respect because a bond without an aggregate limit of liability by its terms cannot be exhausted.

²⁷

Kwiecinski.

Two commenters suggested that FINRA incorporate an exemption into the proposed rule for firms that are a subsidiary of a larger parent organization.²⁸ According to the commenters, parent organizations of members typically purchase their own fidelity bonds, include the member subsidiary as an insured under that program, and provide substantially greater coverage than the minimum requirements under the proposed rule. Moreover, the commenters believe that the premiums paid for the FINRA bond are an unnecessary expense since the coverage already exists. The commenters also noted that, in many cases, a duplication of coverage complicates loss settlements where the bonds of both the member firm and its parent organization are affected by a single loss.

FINRA notes that neither the current fidelity bond rule nor the proposed fidelity bond rule precludes a member from being part of its parent organization's fidelity bond coverage as long as the coverage under the parent's bond provides equal to or greater coverage than the member's minimum required coverage under the rule. The parent organization's bond must contain a rider that provides for the subsidiary broker-dealer's coverage by enumerating the requirements of the FINRA rule and providing for, at a minimum, the subsidiary's minimum required coverage. Accordingly, FINRA does not propose to amend the proposed rule in this respect as it is unnecessary.

Two commenters urged FINRA to maintain an exemption from the fidelity bond requirements for one-person firms.²⁹ The commenters noted that FINRA could be requiring coverage that is not available in the marketplace, since the alter ego concept applies to fidelity bond claims for these entities.

²⁸ Kwiecinski and Travelers.

²⁹ SFAA and Travelers.

As noted above in the Purpose section of this rule filing, many one-person firms currently maintain fidelity bond coverage notwithstanding the exemption in NASD Rule 3020, and claims are likely to be paid based on a facts-and-circumstances analysis, not on a firm's size or structure. As such, FINRA is not proposing any changes to the original proposal in this respect.

One commenter noted that the proposed rule serves no purpose to investors of the financial markets in its application to small firms that do not hold customer funds, execute transactions in securities on public markets, or engage in trading or underwriting (e.g., a firm that solely provides corporate financial advisory services for fee income).³⁰ FINRA believes that all members of SIPC should maintain fidelity bond coverage. FINRA does not agree with the commenter's assessment, since any firm could be the target of malfeasance of one of its employees. Thus, FINRA is not proposing to incorporate an exemption for these small firms.

One commenter encouraged FINRA to incorporate a requirement for an insuring agreement for Computer Theft.³¹ FINRA did not amend the proposal to add this insuring agreement at this time; however, FINRA understands that this coverage is already included in most basic riders obtained by members at no extra cost, so a member will likely obtain this coverage automatically as part of its fidelity bond coverage.

One commenter supported increased deductible thresholds; however, the commenter suggested deleting the haircut provision because the proposed rule may discourage a firm from pursuing or accepting higher deductibles if it has to take a haircut

³⁰ Akin Bay.

³¹ Travelers.

in its net capital computation for deductibles over 10 percent.³² Another commenter suggested that the annual review requirement is duplicitous and unnecessary and that the proposed rule should speak solely to minimum bond requirements for members.³³ The commenter noted that fidelity bond reviews should be triggered by changes in a firm's net capital requirement and not subject to an annual requirement, since the firm would likely review how any changes in net capital affect all aspects of the firm when such changes occur. FINRA did not make any amendments to the proposal in these areas as these concepts have not been substantively amended from the legacy NASD rule, and FINRA believes that they are achieving their intended purposes.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

³² Travelers.

³³ IBI.

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2010-059 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2010-059. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10

a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-059 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁴

Florence E. Harmon

Deputy Secretary

³⁴ 17 CFR 200.30-3(a)(12).

EXHIBIT 2b

Alphabetical List of Written Comments

1. Email from Howard M. Bernstein, Insurance Services Office, Inc. ("ISO") (September 11, 2009)
2. Letter from Robert J. Corne, Howe Barnes Hoefer & Arnett, Inc. ("HBHA") (September 14, 2009)
3. Letter from Robert J. Duke, The Surety & Fidelity Association of America ("SFAA") (September 14, 2009)
4. Letter from Perry Even, Arthur J. Gallagher & Co. ("Gallagher") (September 9, 2009)
5. Letter from John F. Hahn, The Travelers Companies, Inc. ("Travelers") (September 14, 2009)
6. Letter from Robert L. Hamman, First Asset Financial Inc. ("First Asset") (August 4, 2009)
7. Email from Steve Klein, Farmers Financial Solutions, LLC ("FFS") (September 13, 2009)
8. Email from Daniel Kwiecinski ("Kwiecinski") (September 12, 2009)
9. Email from Donald J. Lemek, Isaak Bond Investments, Inc. ("IBI") (August 12, 2009)
10. Email from Daniel R. Levene, Pointe Capital, Inc. ("PCI") (August 6, 2009)
11. Email from Robert Mann, First Georgetown Securities, Inc. ("FGS") (August 29, 2009)
12. Letter from James B. Rybakoff, Akin Bay Company LLC ("Akin Bay") (September 11, 2009)
13. Email from Doug Schriner ("Schriner") (August 26, 2009)

Dear Sir/Madam:

Insurance Services Office, Inc. ("ISO"), as a significant supplier of insurance products to the financial services industry, is pleased to offer our comments in regard to the adoption of NASD Rule 3020 as FINRA Rule 4360.

By way of introduction to our company, ISO is the leading provider of insurance information to the property and casualty insurance industry. In that capacity, we develop policy forms, endorsements, rate manuals and loss costs (rates) for use by our insurance company customers. We also provide our customers with statistical services for the reporting, aggregating and trending of premium and loss information. These products are provided for most property and casualty lines of business, including the fidelity and crime line of insurance. Specifically, the ISO Financial Institution Securities Brokers And Dealers policy is written for FINRA member firms

With regard to the proposed adoption of FINRA Rule 4360, we generally support the changes being made. However, in Supplementary Material, 01. Alternative Coverages, we note FINRA's proposed designation of its proprietary Securities Dealer Blanket Bond as the benchmark for coverage and refers only to Financial institution Bond Form 14 (published by the Surety And Fidelity Association of America ("SFAA")) as the primary acceptable alternative if companies are unable to qualify for the FINRA form. We believe that our product deserves equal mention as our form also complies with FINRA guidelines and is available to members unable to obtain the Blanket Bond. Proposed Rule 4360, as currently written, creates an uneven playing field in that it promotes the SFAA and its product to the exclusion of other coverage options and restricts competition in the marketplace as the ISO policy form and independent company forms (substantially similar to the ISO policy form) would be precluded from being written on member firms. Therefore, we urge FINRA to permit the use of ISO's Financial Institution Securities Brokers And Dealers policy, the SFAA's Form 14 as well as other similar forms of coverage manuscripts by independent insurers or which are otherwise available in the marketplace.

We appreciate the opportunity to comment on the Proposed Rule and are available to answer any questions you may have regarding our response.

Sincerely,

Howard M. Bernstein, Esq.

Law Department
Insurance Services Office, Inc.
545 Washington Blvd.
Jersey City, New Jersey 07310-1686
Tel: (201) 469-2991
Fax: (201) 748-1431
E-Mail: HBernstein@iso.com

Howe Barnes
Hoefer & Arnett, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506
Tel: 202-462-1100
Fax: 202-462-1101
www.hba.com

September 14, 2009

Marcia E. Asquith
Office of Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Regulatory Notice 09-44 – Fidelity Bonds

Dear Ms. Asquith:

Upon reviewing Regulatory Notice 09-44 (the "Notice"), management of Howe Barnes Hoefer & Arnett, Inc. has two concerns regarding the implications of the changes identified in the Notice. The areas of concern include the availability of the Securities Dealer Blanket Bond ("SDBB") through our insurance carrier and the premiums associated with the SDBB as compared to the Financial Institutions Form 14 Bond.

We have contacted our current insurance carrier, Travelers, in order to determine the differences between the SDBB and our current coverage provided under the Form 14 Bond. We were informed that Travelers does not currently offer the SDBB but that aside from the "per event" interpretation that is presented by FINRA in the Notice, there does not appear to be a difference between the two types of bonds. The fact that a nationally recognized carrier such as Travelers does not offer the SDBB leads us to have concerns about our ability to properly market a bid to multiple carriers in order to obtain the coverage that best fits our needs. If, as we have been told by FINRA, the SDBB is only available through FINRA's relationship with a specific carrier, there is some concern as to the "one pricing schedule fits all" model that appears to be utilized under the program. Our management's concern is that as a result, certain smaller firms such as Howe Barnes, due to the nature of our business which includes market making and equity underwriting which require higher net capital requirements, will be categorized with larger, more complex firms that have more inherent risk built into their businesses.

A second concern would be that the premium associated with the SDBB, when compared to the premium for the Form 14 Bond, may be higher due to that lack of carriers offering the product. Since it does not appear that we will have the ability to compare bids from multiple carriers, the premiums are in all likelihood going to be higher through simple supply and demand economics. We attempted to obtain an estimate of the increase that we would be facing by reaching out to the contacts that were provided in the Notice but were

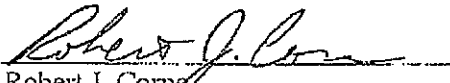
Marcia E. Asquith
FINRA
September 14, 2009
Page 2

informed that an estimate for our situation could not be obtained in time for us to respond within the Notice's deadline for comments.

We appreciate the opportunity to present our concerns regarding the Notice prior implementation. If you have any questions regarding our response, please contact Robert Corne at (312) 655-2710.

Sincerely,

HOWE BARNES HOFFER & ARNETT, INC.

By 
Robert J. Corne
Vice President and CFO

cc: James D. Nolan Jr.

The Surety & Fidelity Association of America

1101 CONNECTICUT AVENUE, NW, SUITE 800, WASHINGTON, DC 20036 TEL: (202) 463-0600 – FAX: (202) 463-0606

website: <http://www.surety.org>
E-mail: information@surety.org

LYNN M. SCHUBERT
President

EDWARD G. GALLAGHER
General Counsel
LENORE MAREMA
Vice President of Government Affairs
ROBERT J. DUKE
Director of Underwriting / Assistant Counsel
BARBARA FINNEGAN REIFF
Director-Regulatory Affairs
ALAN CLARK, A.C.A.S., M.A.A.A.
Actuary

September 14, 2009

Via Electronic Mail

Ms. Marcia E. Asquith
Office of Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

**Re: Regulatory Notice 09-44 ("Notice")
Proposed Consolidated FINRA Rule Governing Fidelity Bonds**

Dear Ms. Asquith:

The Surety & Fidelity Association of America ("SFAA") is a trade association of companies that are licensed to provide surety and fidelity bonds. The vast majority of fidelity bonds that are obtained by financial institutions such as securities dealers are provided by SFAA members. SFAA also develops various standard fidelity forms and riders that are available for use by our members. The Financial Institution Bond, Standard Form No. 14 ("Form 14"), developed by SFAA, is intended to insure against fidelity, forgery and theft risks for broker dealer and securities firms. Thus, we have a significant interest in FINRA's proposed rule regarding fidelity bonds as set forth in proposed rule 4360 (the successor to NASD rule 3020).

Prescription of a particular product

Under the proposal, rule 4360(a) is amended to stipulate the Securities Dealer Blanket Bond as the preferred form. We have two concerns regarding this revision. First, insurers can only offer and use insurance forms that have been filed and approved by state insurance departments. This filing process can be laborious and limits an insurer's ability to introduce new products to the market quickly. Therefore, by prescribing a particular product, the rule significantly limits competition among insurers and restricts broker dealers' options only to those insurers that have the particular product filed and approved with the state insurance departments. Second, the discussion in the Notice states that the Securities Dealer Blanket Bond is preferred because such form provides coverage on a "per event" basis and the Form 14 provides coverage on a "per year" basis. This is not accurate. The Form

Marcia E. Asquith
September 14, 2009
Page 2

14's Single Loss Limit is on a per occurrence basis similar to "per event" coverage. A "Single Loss" is defined as all covered loss resulting from any one act or series of related acts. A payment for loss attributed to an act or related acts does not reduce the Single Loss Limit of Liability for losses attributed to other acts. The Form 14 is subject to an Aggregate Limit of Liability, which limits the insurer's aggregate loss. However, if a loss reduces the remaining aggregate limit, the insured is able to purchase a restoration of the aggregate. Thus, with the restoration of the aggregate, the Form 14 effectively provides "per event" coverage. Finally, we question whether it is appropriate that the rules prescribe the use of a particular product developed by a for-profit entity with which FINRA has an apparent business relationship. (See Endnote 5 of the Notice.) If FINRA desires certain parameters of coverage, it should prescribe those parameters in the rules, rather than prescribing a particular product by name.

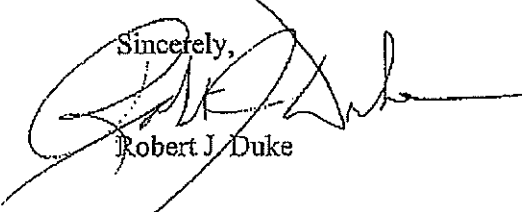
Scope of employee dishonesty coverage

The Notice states that rule 4360 no longer maintains the exception in NASD Rule 3020 for a one-person firm. The Notice states that such firms "can and often do acquire fidelity bond coverage." We agree that a broker dealer should have fidelity coverage for its employees if it is owned by one individual. Such a bond, however, will not and should not insure the owner against his or her own dishonesty. Although burglary, theft and forgery coverages may be available and necessary, we do not know of a fidelity bond that currently provides coverage for losses caused by the dishonesty of the owner of a one-person firm. In fact, the form of a Securities Dealer Blanket Bond that we have seen covers loss resulting directly from the dishonest acts of an "Employee," and sole owners are not included within the definition of "Employee." There are sound underwriting reasons that the dishonest acts of the sole owner do not come within the scope of fidelity coverage. The underwriting of a fidelity bond is based, in part, on the strength of the internal controls of the insured. An owner of a business usually is not subject to the internal controls applicable to the business' employees. In addition, the owner is the alter ego of the insured, and one cannot insure against one's own intentional acts.

The changes proposed by FINRA indicate that it may be requiring coverage that may not be available in the market. Section 4360 deletes the requirements for coverage of "officers and employees" and replaces it with a broader requirement of coverage "for any person associated with the member" The proposal also deletes the definition of "employee," which explicitly did not include sole proprietors and sole stockholders in the definition. Does FINRA expect coverage of loss caused by the dishonesty of persons in addition to those that are covered under current forms: employees, officers and registered representatives?

We would be happy to work with FINRA to develop parameters of fidelity bond coverage that protect the interests of FINRA and the public, would be available in the market and provide for the greatest competition among insurers. Thank you for your consideration.

Sincerely,



Robert J. Duke



Arthur J. Gallagher & Co.

Insurance Brokers of California, Inc

September 9, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 2006-1506

Re: FINRA Rule Governing Fidelity Bonds

We are providing comments regarding the Notice to Members 09-44, relative to FINRA rules governing Fidelity Bonds. By way of introduction, our office of Arthur J. Gallagher & Co (Gallagher) has, since 1991, specialized in providing insurance and risk management services to broker dealers. We currently have over 40 broker dealer clients of varying sizes, with approximately 40,000 registered representatives covered under programs we broker and administer. During those past 18 years, we have worked with the management and staff at Marsh, Seabury & Smith. We hold them in high regard and consider them friends and colleagues.

We are writing today regarding two aspects of your proposed rules which: 1) requires that broker dealers purchase a blanket fidelity bond, if available; and 2) requires that broker dealers obtain minimum fidelity bond limits of liability relative to a their net capital.

(1) Requirement that broker dealer's purchase a blanket fidelity bond, if available

It is not accurate to assert that a blanket bond is fundamentally better than a Form 14, Financial Institution bond. The terms and riders attached to either bond will determine the adequacy or superiority of the coverage. Requiring broker dealers to purchase one form over another, could remove the potential for a broker dealer to secure superior insurance coverage at more favorable terms from an insurer which may only offer a Form 14, but with favorable riders, and thus, better coverage.

Gallagher currently has several broker dealers which have purchased robust fidelity coverage issued on a Form 14 and not a blanket bond. These Form 14 policies were obtained from alternative insurance markets (other than the FINRA sponsored program) and are endorsed to afford broader coverage than the blanket bond referenced in this Notice to Members. For instance, each of the above referenced Form 14 bonds does not have policy aggregates, the same as with blanket bonds. There are certain other standard coverages provided automatically in the blanket bond which must be endorsed onto a Form 14 in order to meet the same level of coverage. However, a properly endorsed Form 14 can meet or exceed the terms available in an unmodified blanket bond.

15 Enterprise, Suite 200
Aliso Viejo, CA 92656
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License # 0726293
Website: www.ajg.com



Arthur J. Gallagher & Co.

Insurance Brokers of California, Inc

Page 2
FINRA

(2) Requirement that broker dealers obtain minimum fidelity bond limits relative to their net capital

FINRA has proposed increasing the minimum fidelity limits from \$25,000 to \$100,000. As in the past, the determination of the required limits of liability is based on a percentage of a firm's net capital requirement. The Notice to Members states in part: "Historically, firms that have maintained minimum coverage of \$25,000 have had claims that exceed this amount."

We find this an amazing understatement. Though theft by a registered representative is not a frequent event, it is a common occurrence. When such thefts do occur, reps rarely steal as little as \$100,000. In our experience, when registered reps steal from clients, the losses frequently range from \$250,000 to \$5 million or more.

If fidelity bonds are intended to protect public customers, we are hard pressed to understand why FINRA has set such a low limit of coverage over the years. Even now, we believe the current proposed minimum limit does not meet the exposure. Having spoken to many executives in both the brokerage and insurance industries over the years, we have never found anyone with knowledge of this risk who believes these minimums are adequate. It should be recognized that these minimums do not meet any comparable limits of liability set for any other insurable exposure in the commercial marketplace.

It is an irony that a large broker dealer can financially withstand the repayment to customers of a theft in excess of its fidelity bond limit. However, an overwhelming majority of small firms would not have the capital to pay a large fidelity claim unless they had purchased fidelity coverage well above the minimums established by FINRA under this proposed rule change.

We are sensitive to the fact that small firms need to contain costs. However, it should be clearly understood that the economy of this purchase will confirm disaster to clients whose life fortune have been taken by a registered representative of such small firm who purchase only the minimum limits.

We believe that everyone in the broker dealer community should be concerned about protecting the reputation and public trust in this industry. Events like the catastrophic, headline grabbing Madoff and Stanford scandals may never be contained by any insurance program. But the vast majority of historically predictable acts of fraudulent conversions of client's funds can be contained with fidelity bonds with proper terms and limits.



Arthur J. Gallagher & Co.

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FINRA

Insurance Brokers of California, Inc

We also believe management of broker dealers should be concerned for their own self-interest regarding this issue. It has been very common that reps who have started stealing from clients move from one broker dealer to another. We have seen long running schemes, hidden from their supervisors, which have spanned as many as four separate broker dealers. These reps, when found out, have often admitted that they moved from the broker dealers because of fear of discovery. In such instances, whenever any of those broker dealers fail to purchase adequate limits and also have limited assets, the remaining broker dealers will be under pressure to pay restitution greater than their proportioned liability.

Medium to large broker dealers should be particularly concerned about this. We have observed a common pathology in these fraud schemes perpetrated by registered representatives. In numerous instances in which a rep, while stealing from clients, moved from a small firm to a large broker dealer. Once found out they explained, "I moved to the larger firm, so if I was caught, my clients would get their money back."

It is our experience that in such events, the larger broker dealers find themselves under intense pressure from customers and regulators to make restitution to all clients, even for theft done when the registered representative was at another firm which had inadequate fidelity bond limits.

For these reasons we recommend that FINRA reevaluate their proposed rules regarding Fidelity Bond requirements.

Sincerely,

A handwritten signature in cursive script that reads "Perry Even".

Perry Even
Area Senior Vice President
Professional Liability Division
Arthur J. Gallagher & Co.



John F. Hahn
2nd Vice President
Practice Leader – FI Bonds
Bond and Financial Products
One Tower Square S203A
Hartford, CT 06183
phone 860.277.1952
fax 860.277.3932
JHahn@travelers.com

September 14, 2009

Ms. Marcia E. Asquith
Senior Vice President and Corporate Secretary
FINRA
1735 K Street, NW
Washington DC 20006-1500

RE: Request For Comments – Regulatory Notice 09 – 44 Proposed Consolidated
FINRA Rule Governing Fidelity Bonds

Dear Ms. Asquith:

Travelers provides many specialty insurance products to members of the financial institution industry including FINRA regulated firms. We are pleased to have an opportunity to review and comment on the proposed rule change noted above.

Our first comment deals with the change guiding firms to the Securities Dealers Bond as the FINRA required bond form. From what we understand, the insurance market is currently limited to only two underwriters who have elected to provide this bond. Most of the other underwriters who provide financial institution bond coverage to FINRA members do not have this product in their portfolio and are limited to the Form 14 which is the industry standard for broker-dealers. This change will put these other underwriters at a distinct competitive disadvantage. We suspect one reason why there may be such little support for this form in the broader insurance market is due to its significant breadth of coverage and very low premium. Travelers encourages FINRA to continue to focus the bonding requirement on the Form 14, which is broadly available in the market, with the Securities Dealers Bond as an alternative instead of the preferred solution.

The rule change could also be perceived as driving FINRA members to one of two programs - one of which is sponsored by FINRA. Not only does this focus the business on the two underwriters offering the form, it also focuses a significant portion of the business on the two distributors of these financial institution bonds. This change in the rule has the potential of disrupting local relationships with insurance producers who have other business relationships with the FINRA member unless these producers are willing to "wholesale" the business through the exclusive distributors as intermediaries.

If the Securities Dealers Bond is the preferred form of coverage, it is very different from other financial institution bonds. Among other features, there is the absence of an aggregate limit of liability. This is the "per year" coverage described in the Regulatory Notice 09 – 44. The aggregate limit is important to most underwriters as it quantifies and controls the underwriter's maximum exposure to loss during the bond period. The Regulatory Notice enables firms to satisfy the rule with a Form 14 "which is otherwise consistent with the requirements of the proposed rule". Travelers would appreciate some clarification on what this means. Does that mean the Form 14 cannot have an aggregate limit? If that is the case, our opinion is that this will diminish the appetite of the underwriters who currently provide Form 14's. For those that elect to continue without an aggregate limit, securing adequate premium is likely to increase the cost of the protection.

Travelers concurs with the change increasing the minimum bond limit requirements. This is clearly in the public's interest and in the spirit of investor protection. Our experience shows many of the smaller firms seem to be guided by the regulatory required (minimum) limit versus a more comprehensive assessment of their exposure to loss in their bond limit selection. We do see losses that exceed the current bond limit which exposes the firm's net capital. In some cases the scale of the loss in excess of the bond's limit makes the firm the subject of a SIPC liquidation proceeding.

The Minimum Required Coverage provisions of the proposed rule seem to be relaxed for the limit required for the Securities (Insuring Agreement E) limit. In our opinion, that agreement's limit should be equivalent to the amount required for Fidelity due to the significant loss potential of that coverage. Premium savings for reducing that limit would not be significant. In addition, we encourage FINRA to incorporate a requirement for a limit on Computer Theft equivalent to Fidelity. Additional premium is nominal; and in our opinion, this insuring provision is likely to be the subject of increasing loss activity. Without this protection, the firm's net capital is fully exposed to loss.

We welcome the proposed change deleting the reference to "Fraudulent Trading" as a required insuring agreement. While the Form 14 and the Securities Dealers Bond do not exclude losses involving trading where the Fidelity insuring agreement applies, there is no coverage referred to as "Fraudulent Trading". It is our observation that this has been the cause of confusion from time to time when an examiner was reviewing a regulated firm's insurance program for compliance.

Travelers is pleased to see an increase in the maximum permissible deductible thresholds. When a firm has underwriting issues, the underwriter will generally require some increase in deductible. If the underwriter is unable to increase it above a predetermined maximum, that may have consequences in its willingness to provide coverage. However, the proposed rule provides a very strong disincentive for firms to accept or pursue these higher deductibles should the firm have to take a haircut in its net capital computation for deductibles which exceed 10% of the bond limit. For this

reason, Travelers encourages the deletion of this latter net capital computation requirement.

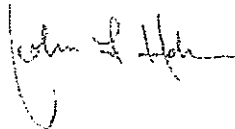
We strongly encourage FINRA to consider an additional exception in the proposed rule when the firm is an element of a larger, diversified financial services parent. The parent's financial intuition bond program will in almost all cases cover the FINRA regulated subsidiary as an additional insured with a substantial limit of liability that is a multiple of the minimum bond limit requirement. However, the parent also is subject to a deductible reflecting the scope of their operations and appetite for self-insuring risk. With the appropriate parental commitment to the subsidiary to which the FINRA bond requirements apply, we feel this treatment provides a greater degree of investor protection and is in the public's interest.

In the proposed exemption changes, Travelers strongly recommends that one-person firms should continue to be exempt from the rule as in NASD Rule 3020. The alter ego concept applies to claims, specifically fidelity claims for these entities. If the owner/principal is the perpetrator of a loss, proceeds from the claim resolution would flow to the perpetrator without this exemption. This puts the underwriter in an untenable position. We expect that most underwriters will have a fundamental issue with this change.

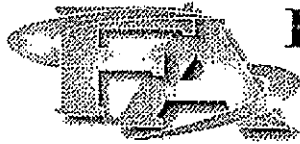
Lastly, if there are changes in the rule, it is likely there will need to be revisions in underwriting rating methodology to address limit and deductible changes. After rates are revised by underwriters subsequent to an actuarial review, the changes must be filed with and approved by the state insurance departments. This process does not always move on a timeline underwriters can control. Accordingly, we request that this process be contemplated in the determination of the effective date of the new rule.

Travelers appreciates the opportunity to provide our input into this process.

Respectfully,



John F. Hahn



**FIRST ASSET
FINANCIAL Inc.**

Member SIPC ♦ FINRA

Robert Hamman, President

110 East Iron Ave.
Salina, KS 67401
(785) 825-5050
Fax (785) 823-9207

August 4, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Regulatory Notice 09-44

Dear Ms. Asquith:

Please re-consider the proposal to quadruple the minimum requirement for the fidelity bond requirement of FINRA.

The minimum requirement will affect small broker dealers disproportionately. First Asset is a small broker dealer. The timing for such a proposed change could not be made at a worse time than now. With business down over 50%, small broker dealers are struggling to stay profitable, yet FINRA wishes to raise premium significantly for the required Fidelity Bond expense (up to four times greater assuming the premium is proportional to the coverage).

It is mentioned in the Regulatory Notice on page 3 that "Historically, firms that have maintained minimum coverage of \$25,000 have had claims that exceed this amount." It is highly likely that the same will be true of \$100,000 coverage. When things go "wrong" they "really go wrong." However, in talking with our state securities representatives, they have stated that a fidelity claim is "rarely made." Given this statement it appears that the "fidelity bond" benefits insurance companies far more than benefiting investors by increasing premium income without payouts.

FINRA recently expanded the definition of "branch office," which caused smaller firms to register locations that were not previously registered as branch offices under the "old" definition. This increased fidelity bonding fees as the structure increases the bonding premium by 60% with 6 or more branches. The implementation of this proposed increase in minimum amount would be a second cost increase in addition to the branch "increase" that is not addressed or considered in this Notice.

Without statistics to verify that there are significant claims, FINRA appears to have no justifiable basis to increase the amount of the fidelity bond.

Please reconsider this proposal and let it expire without implementation.

Sincerely,

Robert L. Hamman
President

A handwritten signature in dark ink, appearing to read 'Robert L. Hamman'. The signature is fluid and cursive, with the first name 'Robert' being more prominent and the last name 'Hamman' following in a similar style.

Regulatory Notice

09-44

Fidelity Bonds

July 2009

FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Fidelity Bonds

Comment Period Expires: September 14, 2009

Executive Summary

As part of the process to develop a new consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on a proposed consolidated FINRA rule governing fidelity bond requirements.

The text of the proposed rule is set forth in Attachment A. Examples of estimated fidelity bond premiums for different-sized firms under the proposed rule are set forth in Attachment B.

Questions concerning this *Notice* may be directed to:

- Susan DeMando Scott, Associate Vice President, Financial Operations Policy, at (202) 728-8411; or
- Erika L. Lazar, Senior Attorney, Office of General Counsel, at (646) 315-8512.

Action Requested

FINRA encourages all interested parties to comment on the proposed rule. Comments must be received by September 14, 2009.

Members 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, N.W.
Washington, D.C. 20006-1506

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topic(s)

- Fidelity Bonds

Referenced Rules & Notices

- NASD Rule 3020
- NYSE Rule 319 and Its Interpretation
- SEA Rule 15c3-1

September 13, 2009

Ms. Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-15061

Re: Comments to FINRA Regulatory Notice 09-44

Dear Ms Asquith,

Farmers Financial Solutions ("FFS") appreciates the opportunity to comment on Regulatory Notice 09-44 and participate in the discussion concerning the proposed consolidated FINRA Rule governing Fidelity Bonds.

We would note that proposed FINRA Rule 4360 would require that firms secure a "blanket bond" unless they are unable to secure such coverage, either because the Firm may have had a claim paid during the past five years or because the Firm is required to carry more than \$5 million in fidelity coverage. In such instances the Firm only has the option of a "Form 14 Bond". If adopted the proposed rule would in effect mandate, regardless of price, that certain Firms would have to purchase a "blanket bond" without the option of weighing the cost and coverage provided by a "Form 14 Bond".

Without any criticism of the FINRA sponsored insurance program, given the limited availability of "blanket bonds" from multiple carriers, the proposed Rule raises questions that such a requirement would in fact further reduce the competitive environment and could potentially result in unfair pricing of such policies. At the same time the proposed rule also fails to recognize that "Form 14 Bonds" are very flexible and may be structured in ways as to provide additional coverage that would otherwise match the coverage provided by the "blanket bond".

Clearly all Firms must carefully consider their individual business models, and may elect to carry higher limits using a "Form 14 Bond" to ensure liability per year. Other Firms may elect to cover smaller limits but want to ensure coverage for every event. To mandate one type of coverage over another does not permit Firms the flexibility to purchase coverage that would best match their individual business models and risk tolerance.

Lastly, if mandated to purchase a "blanket bond" certain Firms may actually purchase the minimum coverage and forgo the alternative of a "Form 14 Bond" that ultimately may provide higher coverage and protection for the public.

As such, we would prefer that the current NASD Rule 3020 be adopted under FINRA Rule 4360 and that Firms continue to have the choice of coverage and the ability to obtain competitive bids for either a "blanket bond" or "Form 14 Bond".

Thank you for the opportunity to provide comment and participate in Rules process.

Sincerely,

Steve Klein
Chief Compliance Officer
Farmers Financial Solutions, LLC

To Whom this May Concern:

This response is in regard to the proposed consolidated FINRA rule governing fidelity bonds (Regulatory Notice 09-44). While I concur that the current rules require updating, I do have some concerns with the proposed rule. Specifically, please consider the following:

1. It appears that all firms subject to the proposed rule are required to purchase the "Securities Dealer Blanket Bond" unless the firm is unable to obtain this coverage. The rule, however, does not define a "Securities Dealer Blanket Bond". Presumably, it is referencing the bond offered by Seabury and Smith as part of the FINRA sponsored program.

First, I believe the rule needs to specifically define "Securities Dealer Blanket Bond". Second, while some firms may find the Seabury and Smith program the "easiest" route to this compliance obligation, the fact that it must be purchased through Seabury (unless "unable to obtain this coverage" – another undefined term) is unreasonable and not in the best interest of the insurance marketplace or the member firms. Under the current program, a member firm has no choice as to the underwriting paper. It is my understanding that Seabury continues to use National Union as the insurer. National Union, as part of the AIG family, is currently A rated by AM Best with a negative outlook. As the purchase of the Bond is to protect the balance sheet of the member firm, flexibility should be given to purchase a bond from an insurer of their choice. There are numerous companies providing this coverage (not necessarily on a per event basis, but with multiple aggregates effectively accomplishing the same thing) on a broader overall basis, including potentially broader coverage on bonds issued by Insurers that are A+ or even A++ rated.

The member firm should have a choice as to its compliance product. Under the proposed rule, the program administrator/insurer could increase pricing (due to adverse experience or otherwise) or change coverage terms and member firms would have no choice but to accept them. Additionally, the program administrator in its own "Transparency and Disclosure" information statement on the current Application states that it is an agent of National Union and not the member firms insurance broker. They also note that they receive commission in the amount of 23% of the premium (this is more than two times industry norms). Given the unique nature of this coverage type as well as the complexities often associated with settling claims under these policies, member firms should be allowed their choice of intermediary (notably a broker that will act in their best interest, have an understanding of the product, market alternatives and have expertise in settling claims of this type) without the need to pay the administrative fees of Seabury who is an agent of the Insurer and providing no "value added" services to the member firm.

2. The proposed wording requires that the member firm must purchase fidelity bond coverage for any person associated with the member, except certain directors or trustees. The rule should define "associated with the member". While it is reasonable to

assume that this includes the traditional definition of "employee" under a policy of this type as well as "registered representatives", there are others that may need to be covered (or not covered). Today, it is not unusual to have the mail room outsourced to a third party. This third party has potential access to all of the firm's assets. Are they to be covered? What about a janitorial firm? What about an outside investment consultant? These classes of individuals are not typically covered (and in fact are expressly excluded) under a bond of this type. It seems that the "associated" definition should specifically state who must be covered under the bond and as respects their own firm, it could be part of the member's annual review to determine who is appropriate for any expanded coverage.

3. FINRA believes that all firms should carry "per event" coverage. While this a reasonable statement in theory, in practice its value is nominal. Additionally, this requirement virtually eliminates the ability to secure this coverage from any carrier other than the FINRA sponsored program.

Most insurers, for their own balance sheet quantification or for reinsurance purposes, issue policies with an ultimate cap as to liability. In theory, a "per event" form could pay for multiple repeated losses throughout the policy term and provides an unlimited limit of liability. Most insurers today, provide both a "Single Loss" limit of liability and an "Annual Aggregate" limit of liability. A "double" the "Single Loss" annual aggregate limit of liability is readily available in today's marketplace. This provides the same coverage as a "per event" policy with two maximum policy limit loss events.

Based upon the very broad definition of "Single Loss" (or similarly "event" in a non-aggregated form) under most policies, it would highly unusual to experience two or more separate and unrelated acts (particularly at the "Single Loss" maximum) resulting in multiple losses under a given policy in a policy year. Further bolstering this thought is that even in the event of one loss over a five year period, a member firm no longer qualifies for the FINRA program. A reasonable marketplace alternative to the "per event" requirement is to simply require a higher overall annual aggregate limits for those under an aggregated form. The rule could be such that for a member firm requiring \$5MM in coverage (Single Loss Limit), the Annual Aggregate must be a minimum of \$10MM. This would address FINRA's concern and broaden the breadth of options to member firms.

4. Under the Notification of Change section, FINRA requires notice for cancellation, termination or substantial modification of the fidelity bond. I suggest that you add "exhaustion" to this provision requiring member firms (in those cases where an aggregate form is being used) to advise FINRA where they have experienced a loss or losses that have exhausted the coverage.

5. The phrase "unable to obtain" the Securities Dealer Blanket Bond needs to be further defined. The eligibility requirements under the FINRA program are clear. Are those the sole reasons a member firm is "unable to obtain" a Securities Dealer Blanket Bond?

What if the member firm is unable to obtain a Securities Dealer Blanket Bond at what they perceive to be a reasonable cost from the program? What if the member firm is unable to obtain a Securities Dealer Blanket Bond on a coverage basis they require as the FINRA program only allows "automatic riders"? What if the member firm is unable to obtain a Securities Dealer Blanket Bond from a carrier that meets the minimum financial solvency requirements as dictated by their risk management department?

6. The proposed rule allows for certain exemptions from the fidelity bonding requirement. As you aware, many member firms are wholly or majority owned by substantially larger parents (i.e. insurance companies). The parent organizations of these member firms typically purchase their own fidelity bonds and include the member firm subsidiary as an insured under that program. These programs typically contemplate substantial limits (often in excess of \$100 million) and often provide coverage substantially greater than what is required under the proposed rule. FINRA should consider an exemption for any member firm that can evidence coverage under another fidelity bond program providing substantively the same coverage as required hereunder. Many of these parents have surplus or net worth in the billions far exceeding the nominal limits required under the current and proposed FINRA rule. A further qualification for this exception could include a minimum surplus requirement of \$500 million or \$1 billion.

The current and proposed fidelity bond requirement for firms meeting the qualifications noted above is a duplication of coverage and potentially complicates loss settlement in a situation where both the member firm and parent firm's bonds are affected by a single loss. Additionally, the premium for the FINRA bond is an unnecessary expense as the coverage already exists. I would expect an objection from FINRA on the basis that the policy limits are now potentially shared with other entities. That would be true, however, based upon the nominal limits required by FINRA relative to those carried by firms meeting this standard, substantially more coverage exists. Additionally, through the required inclusion of the Notification of Change rider, FINRA could require the member firm to secure its own coverage in the event it is notified that the Parent Company's limits are impaired.

7. Today, outside of the FINRA sponsored program, member firms satisfy the current rule through the purchase of a policy (bond) from one of numerous insurers. The majority of these insurers provide true insurance to the member firm and meaningful risk transfer. One of the leading providers of this coverage, however, will only consider providing the FINRA required compliance coverage to those types of firms identified in Item 6 above utilizing an indemnity or hold harmless agreement (between the member firm, its parent and the insurer), effectively converting the insurance policy to one of self insurance with the policy being merely a front to satisfy FINRA. In the interest of a member firms transparent compliance with this fidelity bond requirement, the proposed rule should address the legitimacy of this practice. Please note that this would become a non-event if an exemption as indicated in Item 6 is implemented.

Thank you for your consideration and I look forward to your response.

To Whom It May Concern:

In the proposed FINRA Rule 4360, there is a similar requirement that is under the current NASD rule concerning an "annual review".

This portion of the rule is duplicitous and unnecessary. The rule should contain the required minimum coverage for each type of broker-dealer and, that, in and of itself, is enough. If the broker-dealer has the required coverage, who cares how often they review the coverage? It seems to me that the person, typically a Financial Operations licensed employee, who files the FOCUS would know when and if their net capital requirement changes? Any firm, such as ours, would immediately communicate to the Principal(s) of any change in net capital requirements and would then review how that effects the firm. I am unaware of firms that have a change in net capital requirements so often that this annual review would be necessary. Unless there is an alternative method that I have not calculated in my 15 years in practice? And if this is the case, then only those types of firms should have this requirement. Our net capital requirements haven't changed since the net capital rules were changed in the nineties but I have to do an annual review? Why?

Whether or not a firm does an "annual review," especially for this rule, is beside the point. The point is whether or not they have the minimum coverage in place. If a firm follows the rule but the "annual review" part, have they hurt the investor? No they have not, and that really should be the point in every rule for our industry.

This technicality in the rule, and others like it, promotes a "gotcha" attitude by regulators that does nothing to protect the investor and it continues to take time away from important items that small firms should be doing such as reviewing suitability, investigating proper investments for clients, et c.

I hope we can make compliance more efficient and effective going forward by eliminating these unneeded technical aspects in the regulations, of which this is a prime example, so that both regulators and firms can concentrate on the items that are important in protecting investors.

Thanks for letting me respond.

Sincerely,
Don

*Donald J. Lemek
Vice President of Operations
Isaak Bond Investments, Inc.
303-623-7500 phone
303-623-4252 fax*

With all due respect, this is a great example of the inconsistent application of the rules, wherein there is a tremendously greater impact (economically) on the smaller firms than on the larger firms. For the most part, the larger firms will face little or no financial impact from the proposed rule, while smaller firms may see increases of in excess of 100% for their premiums. Please consider revising this rule to apply uniformly in its impact.

Daniel R. Levene
President/Chief Compliance Officer

Pointe Capital, Inc.
4800 T-Rex Avenue
Suite 100
Boca Raton, FL 33431

(561) 208-4460
(561) 300-3471 (Fax)

I oppose changing the rule. This will increase costs for small firms, without material benefit to anyone.

Robert Mann
First Georgetown Securities, Inc.

AKIN BAY COMPANY LLC
780 THIRD AVENUE
NEW YORK, NEW YORK 10017-2024

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September 11, 2009

FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

Attention: Marcia E. Asquith
Office of the Corporate Secretary

Re: FINRA Regulatory Notice 2009-44- Comments of Akin Bay Company LLC

Dear Sirs:

We welcome the opportunity to comment upon FINRA's proposals for change in the Fidelity Bond requirements which are the subject of Regulatory Notice 2009-44. First, a few facts: Akin Bay Company (then a New York partnership) registered as a broker/ dealer with the Securities and Exchange Commission, and became a member firm of FINRA's predecessor, the National Association of Securities Dealers, Inc., in 1992. From inception, we have maintained the same business model- we do not engage in brokerage, trading or underwriting; we have no customer accounts; we handle no client funds. Our sole business is providing corporate financial advisory services to small to medium sized, (mostly) privately held businesses, for fee income. (Our founders, retired partners of a leading New York City law firm, believed it essential to conducting such a business lawfully that the firm register as a broker/ dealer, even if they intended never to actually engage in brokerage, trading or underwriting. We continue to agree with that belief.) From inception, we have, as required, maintained a fidelity bond, at increasing premium cost, covering up to \$25,000 in customer losses, although we have no retail (or wholesale, for that matter) customers. No claim has ever been made under any such fidelity bond under which Akin Bay's customers were insured.

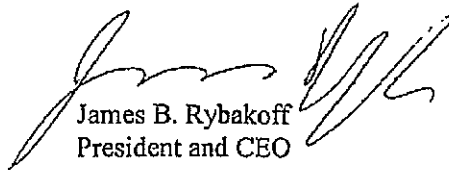
While we understand the reasons set forth in Regulatory Notice 2009-44 for the proposed changes in fidelity bond requirements as a matter of general application, we believe it fair to say that they will increase our operating expenses (already increasing as a result of increases in our CRD Annual Assessment, as well as in our annual SIPC fees), and impose other administrative burdens, without in our case-or those of member firms similarly situated- any concomitant benefit to our clients, to the financial markets or to the protection of investors.

MEMBER: FINRA, MSRB AND SIPC

AKIN BAY COMPANY LLC
Financial Industry Regulatory Authority
September 11, 2009

The firm at present has only two professionals, and has never in the past had more than four. Compared to our executing (or introducing) broker/ dealer counterparts, we are and intend to remain quite small. Thus in our own particular case- and, we add, those who are also broker/dealers but follow a business model such as ours, where we do not hold customer funds, execute transactions in securities on public markets, or engage in trading or underwriting- we respectfully submit that no useful purpose is served for investors or the financial markets by either the increased costs and administrative burdens which attend the proposals in Regulatory Notice 2009-44 or, for that matter, continuing imposition on Akin Bay of the requirement to maintain a fidelity bond in excess of the minimum amount- \$25,000 - which we have historically maintained. Respectfully submitted,

Very truly yours,



James B. Rybakoff
President and CEO

This appears to be a solution to a non-existent problem. If the insurance carrier is unhappy with the risk, the carrier should address the coverage and premiums on a case by case basis. If FINRA is unhappy with the coverage, they should show cause on a case by case basis and support their views with facts that are specific to the business activities involved and the experience in the marketplace given the safeguards and supervision exercised versus required. Just because it costs us more for a cup of coffee today, doesn't mean we should pay more napkins. The relationships are not direct. The risks are generally better managed and we pay a fair price to FINRA to supervise those risks already.

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

Text of Proposed New FINRA Rule (Marked to Show Changes from NASD Rule 3020; NASD Rule 3020 to be Deleted in its Entirety from the Transitional Rulebook)

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4300. OPERATIONS

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[3020]4360. Fidelity Bonds

(a) [Coverage Required]General Provision

(1) Each member required to join the Securities Investor Protection Corporation [who has employees and who is not a member in good standing of the American Stock Exchange, Inc.; the Boston Stock Exchange; the Midwest Stock Exchange, Inc.; the New York Stock Exchange, Inc.; the Pacific Stock Exchange, Inc.; the Philadelphia Stock Exchange, Inc.; or the Chicago Board Options Exchange] shall[:]

[(1) M]maintain [a] blanket fidelity bond coverage[, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America, covering officers and employees] which provides against loss and has Insuring [a]Agreements covering at least the following:

(A) Fidelity

(B) On Premises

(C) In Transit

[(D) Misplacement]

[(E)D] Forgery and Alteration [(including check forgery)]

[(F)E] Securities [Loss (including securities forgery)]

[(G)E] [Fraudulent Trading] Counterfeit Currency

[(H)2] The fidelity bond must include a [C]cancellation [R]rider

providing that the insurance carrier will use its best efforts to promptly notify [the National Association of Securities Dealers, Inc.] FINRA in the event the bond is cancelled, terminated or substantially modified.

(3) A member's fidelity bond must provide for per loss coverage without an aggregate limit of liability.

(b) Minimum Required Coverage

[(2)1] A member with a net capital requirement of less than \$250,000 must [M]maintain minimum fidelity bond coverage for all [i]Insuring [a]Agreements required [in this] by paragraph (a) of this Rule of [not less than \$25,000;] the greater of (A) 120% of the member's required net capital under SEA Rule 15c3-1 or (B) \$100,000. A member with a net capital requirement of \$250,000 or more must maintain minimum fidelity bond coverage for all Insuring Agreements required by paragraph (a) of this Rule in accordance with the following table:

[(3) Maintain required minimum coverage for Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration insuring agreements of not less

than 120% of its required net capital under SEC Rule 15c3-1 up to \$600,000.

Minimum coverage for required net capital in excess of \$600,000 shall be determined by reference to the following table:]

Net Capital Requirement under SE[C]A Rule 15c3-1	Minimum Coverage
<u>250,000 – 300,000</u>	<u>600,000</u>
<u>300,001 – 500,000</u>	<u>700,000</u>
<u>[\$6]500,00[0]1 – 1,000,000</u>	<u>[75]800,000</u>
1,000,001 – 2,000,000	1,000,000
2,000,001 – 3,000,000	1,500,000
3,000,001 – 4,000,000	2,000,000
4,000,001 – 6,000,000	3,000,000
6,000,001 – 12,000,000	4,000,000
12,000,001 [–] and above	5,000,000

(2) At a minimum, a member must maintain fidelity bond coverage for any person associated with the member, except directors or trustees who are not performing acts within the scope of the usual duties of an officer or employee.

(3) Any defense costs for covered losses must be in addition to the minimum coverage requirements as set forth in paragraph (b)(1) of this Rule.

[(4) Maintain Fraudulent Trading coverage of not less than \$25,000 or 50% of the coverage required in paragraph (a)(3), whichever is greater, up to \$500,000;]

[(5) Maintain Securities Forgery coverage of not less than \$25,000 or 25% of the coverage required in paragraph (a)(3), whichever is greater, up to \$250,000.]

[(b)Ⓒ] Deductible Provision

[(1) A deductible provision may be included in the bond of up to \$5,000 or 10% of the minimum insurance requirement established hereby, whichever is greater.]

[(2) If a member desires to maintain coverage in excess of the minimum insurance requirement then a deductible provision may be included in the bond of up to \$5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount described in subparagraph (1) above must be deducted from the member's net worth in the calculation of the member's net capital for purposes of SEC Rule 15c3-1. Where the member is a subsidiary of another Association member the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.]

A provision may be included in a fidelity bond to provide for a deductible of up to 25% of the coverage purchased by a member. Any deductible amount elected by the member that is greater than 10% of the coverage purchased by the member must be deducted from the member's net worth in the calculation of its net capital for purposes of SEA Rule 15c3-1. If the member is a subsidiary of another FINRA member, this amount may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

([c]d) Annual Review of Coverage

(1) [Each]A member, including a member that signs a multi-year insurance policy,[other than members covered by subparagraph (2),] shall, annually [review,] as of the yearly anniversary date of the issuance of the fidelity bond, review the adequacy [thereof] of its coverage and make any required adjustments, as set forth in paragraphs (d)(2) and (d)(3) of this Rule. [by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subparagraphs (a)(2), (3), (4) and (5).]

(2) A member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), shall be used as the basis for determining the member's required minimum fidelity bond coverage for the succeeding 12-month period. For the purpose of this paragraph, the "preceding 12-month period" shall include the 12-month period that ends 60 days

before the yearly anniversary date of a member's fidelity bond. [Each member which has been in business for one year shall, as of the first anniversary date of the issuance of its original bond, review the adequacy thereof by reference to an amount calculated by dividing the highest it experienced during its first year by 15. Such amount shall be used in lieu of required net capital under SEC Rule 15c3-1 in determining the minimum required coverage to be carried in the member's second year pursuant to subparagraphs (a)(2), (3), (4) and (5). Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.]

(3) A member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement may use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member shall not carry less minimum bonding coverage in its second year than it carried in its first year. [Each member shall make required adjustments not more than sixty days after the anniversary date of the issuance of such bond.]

[(4) Any member subject to the requirements of this paragraph (c) may apply for an exemption from the requirements of this paragraph (c). The application shall be made pursuant to Rule 9610 of the Code of Procedure. The exemption may be granted upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that results in a

lower net capital requirement. The NASD may issue an exemption subject to any condition or limitation upon a member's bonding coverage that is deemed necessary to protect the public and serve the purposes of this Rule.]

[(d)]e) Notification of Change

[Each]A member shall [report the cancellation, termination or substantial modification]immediately advise FINRA in writing if its [of the] fidelity bond is cancelled, terminated or substantially modified[to the Association within ten business days of such occurrence].

[(e) Definitions]

[For purposes of fidelity bonding the term “employee” or “employees” shall include any person or persons associated with a member firm (as defined in Article I, paragraph (q) of the By-Laws) except:]

[(1) Sole Proprietors]

[(2) Sole Stockholders]

[(3) Directors or Trustees of member firms who are not performing acts coming within the scope of the usual duties of an officer or employee.]

[(f) Exemptions]

(1) The requirements of this Rule shall not apply to:

(A) members that maintain a fidelity bond as required by a national securities exchange, registered with the SEC under Section 6 of the Exchange Act, provided that the member is in good standing with such national securities exchange and the fidelity bond requirements of such exchange are equal to or greater than the requirements of this Rule; and

(B) members whose business is solely that of a Designated Market Maker, Floor broker or registered Floor trader and who does not conduct business with the public.

(2) Any member may apply for an exemption, pursuant to the Rule 9600 Series, from the requirements of paragraphs (d)(2) and (d)(3) of this Rule. An exemption may be granted, at the discretion of FINRA, upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that would result in a lower net capital requirement.

• • • Supplementary Material: -----

.01 Definitions. For purposes of this Rule, the term "substantially modified" shall mean any change in the type or amount of fidelity bonding coverage, or in the exclusions to which the bond is subject, or any other change in the bond such that it no longer complies with the requirements of this Rule.

.02 Alternative Coverage. A member that does not qualify for blanket fidelity bond coverage as required by paragraph (a)(3) of this Rule shall maintain substantially similar fidelity bond coverage in compliance with all other provisions of this Rule, provided that the member maintains written correspondence from two insurance providers stating that the member does not qualify for the coverage required by paragraph (a)(3) of this Rule. The member must retain such correspondence for the period specified by SEA Rule 17a-4(b)(4).

* * * * *

**Text of Incorporated NYSE Rule and NYSE Rule Interpretation
to be Deleted in their Entirety from the Transitional Rulebook**

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Incorporated NYSE Rule

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[Rule 319. Fidelity Bonds]

Entire text deleted.

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NYSE RULE INTERPRETATION

[Rule 319 Fidelity Bonds]

Entire text deleted.

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