

Notices

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Disciplinary and Other FINRA Actions

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Definition of Public Arbitrator

SEC Approves Rule Change to Amend the Definition of Public Arbitrator in the Arbitration Codes for Customer and Industry Disputes

Effective June 9, 2008

Executive Summary

Effective June 9, 2008, FINRA will add an annual revenue limitation to the definition of public arbitrator, set forth in the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes. The amendment, which was approved by the Securities and Exchange Commission, will ensure that individuals with ties to the securities industry may not serve as public arbitrators in FINRA arbitrations.¹

The text of the amendment is set forth in Attachment A. The amendment will apply to arbitrator lists sent out according to Rules 12403 or 13403 on or after June 9, 2008, and to arbitrators appointed by the Director of Arbitration according to Rules 12406(c), 12411(c), 13406(c) or 13411(c) on or after June 9, 2008, when an insufficient number of names remain on the consolidated list.

Questions concerning this *Notice* should be directed to Barbara L. Brady, Vice President and Director of Neutral Management, at (212) 858-4352 or barbara.brady@finra.org; or Mignon McLemore, Assistant Chief Counsel, FINRA Dispute Resolution, at (202) 728-8151 mignon.mclemore@finra.org.

May 2008

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal

Key Topic(s)

- Arbitration
- Code of Arbitration Procedure
- Dispute Resolution
- Public Arbitrator

Referenced Rules & Notices

- NASD Rule 12100(u)
- NASD Rule 13100(u)

Background

For most disputes, FINRA maintains three types of arbitrator rosters: public, non-public and chairperson.² When investors file a dispute against member firms or their associated persons in FINRA's arbitration forum, the investors are entitled to have their cases heard by an arbitration panel consisting of either a single public arbitrator or a majority public panel consisting of two public arbitrators, one of whom is the chairperson, and one non-public arbitrator, depending on the amount of the claim.³

Under Rule 12100(p) of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Rule 13100(p) of the Code of Arbitration Procedure for Industry Disputes (Industry Code) (hereinafter, Rules 12100(p) and 13100(p)), a person is classified as a non-public arbitrator if he or she:

- (1) is or, within the past five years, was:
 - (A) associated with, including registered through, a broker or a dealer (including a government securities broker or dealer or a municipal securities dealer);
 - (B) registered under the Commodity Exchange Act;
 - (C) a member of a commodities exchange or a registered futures association; or
 - (D) associated with a person or firm registered under the Commodity Exchange Act;
- (2) is retired from, or spent a substantial part of a career engaging in, any of the business activities listed in paragraph (p)(1);
- (3) is an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional work, in the last two years, to clients who are engaged in any of the business activities listed in paragraph (p)(1); or
- (4) is an employee of a bank or other financial institution and effects transactions in securities, including government or municipal securities, and commodities futures or options, or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities.

The criteria for public arbitrators are set forth in Rules 12100(u) and 13100(u). Under these rules, an individual will be classified as a public arbitrator if he or she is qualified to serve as an arbitrator and:

- (1) is not engaged in the conduct or activities described in paragraphs (p)(1)-(4);
- (2) was not engaged in the conduct or activities described in paragraphs (p)(1)-(4) for a total of 20 years or more;
- (3) is not an investment adviser;
- (4) is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from any persons or entities listed in paragraphs (p)(1)-(4);

- (5) is not employed by, and is not the spouse or an immediate family member of a person who is employed by, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business;
- (6) is not a director or officer of, and is not the spouse or an immediate family member of a person who is a director or officer of, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business; and
- (7) is not the spouse or an immediate family member of a person who is engaged in the conduct or activities described in paragraphs (p)(1)-(4). For purposes of this rule, the term immediate family member means:
 - (A) a person's parent, stepparent, child, or stepchild;
 - (B) a member of a person's household;
 - (C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or
 - (D) a person who is claimed as a dependent for federal income tax purposes.

Discussion

FINRA has amended Rules 12100(u) and 13100(u) to add a revenue limitation to the definition of public arbitrator to ensure that individuals with significant ties to the securities industry may not serve as public arbitrators in FINRA arbitrations. Specifically, the rule excludes individuals from the public arbitrator roster who are attorneys, accountants or other professionals whose firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in paragraph (p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees and consulting fees. The rule will enhance FINRA's public arbitrator roster by removing from the pool of public arbitrators those individuals whose firms receive a significant amount of compensation for providing services on matters closely related to those that arbitrators consider during arbitration proceedings.

The following example shows how FINRA will apply the rule.⁴ In the example, a public arbitrator is an accountant whose firm has been retained by a broker-dealer to review account statements and other documents in preparation for an arbitration relating to unauthorized trading in a customer's account.

In Year 1, the accountant's firm receives \$35,000 in annual revenue from the broker-dealer for rendering these services. Revenue earned under the rule is calculated after the year ends. Thus, the accountant could continue to serve as a public arbitrator in Year 2, because in the past year, the revenue that the accountant's firm received from the broker-dealer for professional services related to a customer dispute did not exceed \$50,000.

In Year 2, the accountant's firm receives \$45,000 in annual revenue from the broker-dealer for rendering the same types of services. Because the revenue that the accountant's firm received from the broker-dealer for professional services related to a customer dispute did not exceed \$50,000 in either Year 1 or Year 2, the accountant may continue to serve as a public arbitrator in Year 3.

In Year 3, the accountant's firm receives \$61,000 in annual revenue from the broker-dealer for rendering the same types of services. Under the rule, the accountant could no longer be classified as a public arbitrator, because the revenue that the accountant's firm received from the broker-dealer for professional services related to a customer dispute exceeded \$50,000 in Year 3.⁵

In Year 4, the accountant's firm receives \$20,000 in annual revenue from the broker-dealer for rendering the same types of services. Under the rule, the accountant continues to be ineligible to be classified as a public arbitrator, because the revenue that the accountant's firm received from the broker-dealer for professional services related to a customer dispute exceeded \$50,000 in Year 3 (one of the past two years). After the end of Year 5, if the accountant firm's revenue has not exceeded \$50,000 in Year 5, the arbitrator should update his or her arbitrator disclosures, so that staff may consider the past two years' revenue and all other applicable criteria to determine whether the arbitrator is again eligible to be classified as a public arbitrator.

Updating Arbitrator Disclosures

FINRA has distributed a survey to all arbitrators on the active roster asking them to update their disclosures in light of the above amendment to the definition of public arbitrator. Arbitrators who do not respond by the deadline will be made inactive for future appointments until they have responded, and those who do not respond within a reasonable period thereafter may be removed permanently. After the surveys are returned and reviewed, arbitrators' disclosure records will be updated to reflect their proper classification under the amendment.

As the two-year period is a rolling window of time, arbitrators are reminded to update their disclosures whenever there is a change in their circumstances that affects their classification.

Parties should be aware that the amendment to the public arbitration definition applies to lists generated on or after effective date, and to arbitrators appointed on or after the effective date. Arbitrators who have been included on a list sent to parties or who are already serving on panels may continue to serve even if their classification would otherwise change due to the amendment. These arbitrators will retain their former classification for purposes of these ongoing cases. This will avoid disruption to cases and allow parties to continue with the arbitrators they have selected to hear their cases. Therefore, challenges for cause based solely on an arbitrator's reclassification will not be granted. Challenges for cause still may be made based upon the disqualification and removal criteria in Rules 12408 and 12410 and Rules 13408 and 13410.

Effective Date Provisions

The amendment will become effective on June 9, 2008; and will apply to arbitrator lists sent out according to Rules 12403 or 13403 on or after June 9, 2008, and to arbitrators appointed by the Director of Arbitration according to Rules 12406(c), 12411(c), 13406(c) or 13411(c) on or after June 9, 2008, when an insufficient number of names remain on the consolidated list.

Endnotes

- 1 Exchange Act Release No. 57492 (March 13, 2008), 73 Federal Register 15025 (March 20, 2008) (File No. SR-NASD-2007-021).
- 2 See Rules 12400(b) and 13400(b). There also is a specialized roster of experienced employment arbitrator for use in intra-industry disputes involving statutory employment discrimination. See Rule 13802.
- 3 See Rules 12401, 12402 and 12403. See also Rules 13401, 13402 and 13403 for panel composition rules governing intra-industry disputes (not involving any parties who are investors). For intra-industry disputes, depending on the nature of the dispute, panels may consist of all public arbitrators, all non-public arbitrators or a majority of public arbitrators.
- 4 The examples are meant to be illustrative only, and should not be viewed as an exhaustive list of circumstances to which the rule would apply.
- 5 The accountant may be eligible to serve as a non-public arbitrator, provided he or she meets the criteria of Rules 12100(p) and 13100(p).

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ATTACHMENT A

New language is underlined; deletions are in brackets.

**Code of Arbitration Procedure for Customer Disputes
and
Code of Arbitration Procedure for Industry Disputes**

* * *

Customer Code**12100(u). Public Arbitrator**

The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and:

(1) – (4) No change;

(5) is not an attorney, accountant, or other professional whose firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in paragraph (p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees;

(6) is not employed by, and is not the spouse or an immediate family member of a person who is employed by, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business;

[(6)] (7) is not a director or officer of, and is not the spouse or an immediate family member of a person who is a director or officer of, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business; and

[(7)] (8) is not the spouse or an immediate family member of a person who is engaged in the conduct or activities described in paragraphs (p)(1)-(4). For purposes of this rule, the term immediate family member means:

(A) a person’s parent, stepparent, child, or stepchild;

(B) a member of a person’s household;

(C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or

(D) a person who is claimed as a dependent for federal income tax purposes.

{Remainder of rule – no change.}

* * *

Industry Code

13100(u). Public Arbitrator

The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and:

(1) – (4) No change;

(5) is not an attorney, accountant, or other professional whose firm derived \$50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in paragraph (p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees;

(6) is not employed by, and is not the spouse or an immediate family member of a person who is employed by, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business;

[(6)] (7) is not a director or officer of, and is not the spouse or an immediate family member of a person who is a director or officer of, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business; and

[(7)] (8) is not the spouse or an immediate family member of a person who is engaged in the conduct or activities described in paragraphs (p)(1)-(4). For purposes of this rule, the term immediate family member means:

(A) a person’s parent, stepparent, child, or stepchild;

(B) a member of a person’s household;

(C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or

(D) a person who is claimed as a dependent for federal income tax purposes.

{Remainder of rule – no change.}

* * *

Financial Responsibility

Proposed Consolidated FINRA Rules Governing Financial Responsibility

Comment Period Expires: June 13, 2008

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 set of financial responsibility rules (the proposed rules). Proposed FINRA Rules 4110, 4120, 4130, 4140 and 4521 would be new, consolidated rules based in part on existing NASD and Incorporated NYSE Rules² and would govern members' financial responsibility requirements. Proposed FINRA Rules 9557 and 9559 would revise NASD Rules 9557 and 9559, respectively, and would afford members served with a notice under the financial responsibility rules an expedited appeal process. (In addition, FINRA would make conforming revisions to Section 4(g) of Schedule A to the FINRA By-Laws.)

The text of the proposed rules is set forth in Attachment A. The chart in Attachment B summarizes the applicability of the proposed rules to member firms.

Questions regarding this *Notice* should be directed to:

- Kris Dailey, Vice President, Risk Oversight & Operational Regulation, at (646) 315-8434;
- Susan M. DeMando, Associate Vice President, Financial Operations Policy, at (202) 728-8411; or
- Adam H. Arkel, Assistant General Counsel, Office of General Counsel, at (202) 728-6961.

May 2008

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topic(s)

- Financial Responsibility
- Capital Compliance

Referenced Rules & Notices

- NASD Rule 3130
- NASD IM-3130
- NASD Rule 3131
- NASD Rule 9557
- NASD Rule 9559
- NYSE Rule 312
- NYSE Rule 313
- NYSE Rule 325
- NYSE Rule 326
- NYSE Rule 328
- NYSE Rule 416
- NYSE Rule 418
- NYSE Rule 420
- NYSE Rule 421(2)
- SEA Rule 15c3-1
- SEA Rule 15c3-3
- Section 4(g) of Schedule A to FINRA By-Laws

Action Requested

FINRA encourages all interested parties to comment on the proposed rules. Comments must be received by June 13, 2008. Comments received after the close of the comment period will not be considered, although interested parties will have further opportunity to comment when the proposals resulting from this *Notice* process are filed with the SEC for approval.

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

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

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

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

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.³

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the Federal Register.⁴

Background

The financial responsibility rules play a crucial role in achieving member firms' compliance with their capital requirements. For that reason, FINRA has placed high priority on expeditiously developing the unified set of proposed rules for inclusion in the Consolidated FINRA Rulebook. Currently, both NASD and NYSE Rules contain provisions governing financial responsibility. The proposed rules would incorporate many of these provisions but would streamline and reorganize the provisions. In addition, many provisions have been tiered to apply only to those firms that clear or carry customer accounts or that operate pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) (referred to as "(k)(2)(i) members").⁵ The more significant changes are described below.

Discussion

A. Proposed FINRA Rule 4110 (Capital Compliance)⁶

1. Authority to Increase Capital Requirements

Proposed FINRA Rule 4110(a), based primarily on NYSE Rule 325(d), would enable FINRA to prescribe greater net capital requirements for carrying, clearing and (k)(2)(i) member firms, or require any such member to restore or increase its net capital or net worth, when deemed necessary for the protection of investors or in the public interest. The authority to act under the proposed rule would reside with FINRA's executive vice president charged with oversight for financial responsibility (or his or her written officer delegate) (referred to as "FINRA's EVP"). To execute such authority, FINRA would be required to issue a notice pursuant to Proposed FINRA Rule 9557 (referred to as a "Rule 9557 notice"). Proposed FINRA Rule 9557, much like NASD Rule 9557, would afford a member opportunity for an expedited hearing pursuant to Proposed FINRA Rule 9559. (See Section F of this *Notice*, below.)

Proposed FINRA Rule 4110(a) would be a new provision for FINRA members that are not Dual Members (referred to as "non-NYSE members") that are carrying, clearing or (k)(2)(i) member firms. However, it would not apply to introducing firms or to firms with limited business models (together, referred to as "non-clearing firms"). (For example, introducing firms and firms that engage exclusively in subscription-basis mutual fund transactions, direct participation programs, or mergers and acquisitions activities would not be subject to the provision.) In this regard, certain Dual Members that currently are subject to NYSE Rule 325(d)—namely those NYSE member firms that are not carrying, clearing or (k)(2)(i) members (referred to as "NYSE non-clearing firms")—would no longer be subject to the provision. All member firms that are subject to the provision would have an opportunity to request an expedited hearing if they receive a Rule 9557 notice, which would be a new procedural right not available under NYSE Rule 325(d).

The NYSE staff historically has employed NYSE Rule 325(d) in limited circumstances, and FINRA anticipates that it would apply Proposed FINRA Rule 4110(a) in similar fashion. Under the proposed rule, FINRA's EVP could require a carrying, clearing or (k)(2)(i) member firm to comply with increased capital requirements in extraordinary circumstances, such as where unanticipated systemic market events (*e.g.*, recent events that have caused stress in the credit markets) threaten the member firm's capital, or where the member firm maintains an undue concentration in illiquid products. In such instances, FINRA's EVP may, for example, find it appropriate, in the public interest, to raise the applicable "haircut" (that is, to increase the percentage of the market value of certain securities or commodities positions by which the member must reduce its net worth) or treat certain assets as non-allowable in computing net capital.

2. *Suspension of Business Operations*

Proposed FINRA Rule 4110(b)(1) is based in part on NASD Rule 3130(e) and would provide that, unless otherwise permitted by FINRA, a member firm must suspend all business operations during any period of time in which it is not in compliance with Securities Exchange Act (SEA) Rule 15c3-1. This requirement is consistent with current law. However, the proposed rule would expressly permit a member to effect liquidating transactions upon customer direction and proprietary transactions in circumstances where the subject transactions are reasonably expected to increase the member's net capital or reduce its risk.

As with NASD Rule 3130(e), Proposed FINRA Rule 4110(b)(1) is self-operative (that is, a firm would automatically be required to comply with the provision without any direction from FINRA). Notwithstanding that the proposed provision is self-operative, FINRA may issue a Rule 9557 notice directing a member that is not in compliance with SEA Rule 15c3-1 to suspend all or a portion of its business. Upon receipt of a Rule 9557 notice, the firm would have the right to request an expedited hearing. Neither the fact that FINRA may issue a Rule 9557 notice nor the right to an expedited hearing would be a defense in any subsequent disciplinary proceeding with respect to a member firm's non-compliance with Proposed FINRA Rule 4110(b)(1).

3. *Withdrawal of Equity Capital*

To further the goal of financial stability, Proposed FINRA Rule 4110(c)(1) would prohibit a member from withdrawing equity capital for a period of one year, unless otherwise permitted by FINRA in writing. FINRA anticipates that approvals for the early withdrawal of equity capital would be granted on a limited basis.

Proposed FINRA Rule 4110(c)(2) would apply only to carrying, clearing and (k)(2)(i) member firms and would prohibit any such member, without the prior written approval of FINRA, from withdrawing capital, paying a dividend or effecting a similar distribution that would reduce the member's equity, where such withdrawals, payments or reductions in the aggregate, in any rolling 35-calendar-day period, on a net basis, would exceed 10 percent of the member's excess net capital. This provision is based in part on NYSE Rule 312(h) and SEA Rule 15c3-1(e). While it would be a new requirement for non-NYSE members that are carrying, clearing or (k)(2)(i) members, it would not apply to non-clearing firms. In this regard, NYSE non-clearing firms that currently are subject to NYSE Rule 312(h) would no longer be required to comply with the provision. FINRA further notes that the 10 percent limit set forth in Proposed FINRA Rule 4110(c)(2) is intended as a *de minimis* exception; NYSE Rule 312(h) does not include such an exception.

4. *Sale-and-Leasebacks, Factoring, Financing, Loans and Similar Arrangements*

To ensure the permanency of net capital in contemplated sale-and-leaseback, factoring, financing and similar arrangements, Proposed FINRA Rule 4110(d)(1)(A) would provide that no carrying, clearing or (k)(2)(i) member may consummate a sale-and-leaseback arrangement with respect to any of its assets, or a sale, factoring or financing arrangement with respect to any unsecured accounts receivable, where any such arrangement would increase the member's tentative net capital by 10 percent or more, without the prior written authorization of FINRA.

Proposed FINRA Rule 4110(d)(1)(A) is based on NYSE Rule 328(a), but would apply only to carrying, clearing and (k)(2)(i) members. While the provision would be new for non-NYSE members that are carrying, clearing or (k)(2)(i) members, it would not apply to non-clearing firms. In this regard, NYSE non-clearing firms that currently are subject to NYSE Rule 328(a) would no longer be required to comply with the provision. Moreover, unlike NYSE Rule 328(a), Proposed FINRA Rule 4110(d)(1)(A) includes a *de minimis* exception by permitting a member to consummate, without FINRA's prior authorization, a sale-and-leaseback arrangement with respect to any of its assets, or a sale, factoring or financing arrangement with respect to any unsecured accounts receivable where the arrangement would not increase the member firm's tentative net capital by 10 percent or more.

Proposed FINRA Rule 4110(d)(1)(B), which is also based on NYSE Rule 328(a), would provide that no carrying member may consummate any arrangement concerning the sale or factoring of customer debit balances, irrespective of amount, without the prior written authorization of FINRA. The provision would be new for non-NYSE members that are carrying members.

Proposed FINRA Rule 4110(d)(2) is based on NYSE Rule 328(b), but also would apply only to carrying, clearing and (k)(2)(i) members. The provision would require FINRA's prior approval for any loan agreement entered into by such a member, the proceeds of which exceed 10 percent of the member's tentative net capital and that is intended to reduce the deduction in computing net capital for fixed assets and other assets that cannot be readily converted into cash under SEA Rule 15c3-1(c)(2)(iv). Because the provision would apply only to carrying, clearing and (k)(2)(i) members, NYSE non-clearing firms would be relieved from current requirements under NYSE Rule 328(b). In addition, unlike NYSE Rule 328(b), the proposed rule would include a *de minimis* exception.

Proposed FINRA Rule 4110(d)(3) provides that any member that is subject to paragraphs (d)(1)(A), (d)(1)(B) or (d)(2) of Proposed FINRA Rule 4110 would be prohibited from consummating, without FINRA's prior written authorization, any arrangement pursuant to those paragraphs if the aggregate of all such arrangements would exceed 20 percent of the member's tentative net capital.

Proposed FINRA Rule 4110(d)(4) implements a requirement of the SEC's net capital rule and therefore would apply to all members. It provides that any agreement relating to a determination of a "ready market" for securities based upon the securities being accepted as collateral for a loan by a bank under SEA Rule 15c3-1(c)(11)(ii) must be submitted to, and be acceptable to, FINRA before the securities may be deemed to have a "ready market."

5. *Subordinated Loans, Notes Collateralized by Securities and Capital Borrowings*

Proposed FINRA Rule 4110(e) is based in part on current NYSE Rule 420 and would address the requirements for subordinated loans and loans made to general partners of members that are partnerships or to LLC participants of certain members that are LLCs.

- ▶ Proposed FINRA Rule 4110(e)(1) would implement Appendix D of SEA Rule 15c3-1 and require that all subordinated loans or notes collateralized by securities must meet such standards as FINRA may require to ensure the continued financial stability and operational capability of a member, in addition to meeting those standards specified in Appendix D of SEA Rule 15c3-1.⁷ Appendix D of SEA Rule 15c3-1 requires that all subordination agreements must be found acceptable by the Examining Authority before they can become effective.
- ▶ Proposed FINRA Rule 4110(e)(2) would require that, unless otherwise permitted by FINRA, each member whose general partner or LLC participant (whose LLC agreement has provisions that operate to grant the LLC participant rights analogous to those of a general partner in a partnership) enters into any secured or unsecured borrowing, the proceeds of which will be contributed directly to the capital of the member, must, in order for the proceeds to qualify as capital acceptable for inclusion in computation of the member's net capital, submit to FINRA for approval a signed copy of the loan agreement. The loan agreement must have at least a 12-month duration and provide non-recourse to the assets of the member firm. Moreover, because a general partner's interest or certain LLC participant's interest may allow the lender to reach into the assets of the broker-dealer, FINRA is requiring a provision in the loan agreement that will estop the lender from having that right.

B. Proposed FINRA Rule 4120 (Regulatory Notification and Business Curtailment)

1. Regulatory Notification

Proposed FINRA Rule 4120(a) is based on current NYSE Rule 325(b), but would apply only to carrying, clearing and (k)(2)(i) members. The proposed rule would require any such member promptly, but in any event within 24 hours, to notify FINRA when certain specified financial triggers are reached. This would be a new notification requirement for non-NYSE members that are carrying, clearing or (k)(2)(i) members; it would not, however, apply to non-clearing firms. Accordingly, NYSE non-clearing firms would no longer be subject to the requirements.

2. Restrictions on Business Expansion

Proposed FINRA Rule 4120(b) is based on NASD Rule 3130(c) and NYSE Rule 326(a) and addresses circumstances under which a member would be prohibited from expanding its business.

Proposed FINRA Rule 4120(b)(1), which is self-operative, would apply only to carrying, clearing and (k)(2)(i) members, and requires any such member, unless otherwise permitted by FINRA, to refrain from expanding its business during any period in which any of the conditions described in Proposed FINRA Rule 4120(a)(1) continue to exist for the specified time period. While NASD Rule 3130(c) includes comparable provisions, the requirement would now be self-operative for non-NYSE members that are carrying, clearing or (k)(2)(i) members. Proposed FINRA Rule 4120(b) also provides that FINRA may issue a Rule 9557 notice directing any such member not to expand its business, in which case the member would have the right to request an expedited hearing. Neither the fact that FINRA may issue a Rule 9557 notice nor the right to an expedited hearing would be a defense in any subsequent disciplinary proceeding with respect to a member's non-compliance with Proposed FINRA Rule 4120(b)(1).

Unlike the self-operative nature of paragraph (b)(1), Proposed FINRA Rule 4120(b)(2) authorizes FINRA, for any financial or operational reason, to restrict any member's ability to expand its business by the issuance of a Rule 9557 notice. In all such cases, the member would have the right to request an expedited hearing. This same provision currently exists in NASD Rule 3130(c)(2).

3. *Reduction of Business*

Proposed FINRA Rule 4120(c) is based on NASD Rule 3130(d) and NYSE Rule 326(b) and addresses circumstances under which a member would be required to reduce its business.

Proposed FINRA Rule 4120(c)(1), which is self-operative, would apply only to carrying, clearing and (k)(2)(i) members, requiring that any such member, unless otherwise permitted by FINRA in writing, to reduce its business to a point enabling its available capital to exceed the standards set forth in Proposed FINRA Rule 4120(a)(1) when any of the enumerated conditions continue to exist for the specified time period. While NASD Rule 3130(d) includes comparable provisions, the requirement would now be self-operative for non-NYSE members that are carrying, clearing or (k)(2)(i) members. Proposed FINRA Rule 4120(c)(1) also provides that FINRA may issue a Rule 9557 notice directing any such member to reduce its business, in which case the member would have the right to an expedited hearing. Neither the fact that FINRA may issue a Rule 9557 notice nor the right to an expedited hearing would be a defense in any subsequent disciplinary proceeding with respect to a member's non-compliance with Proposed FINRA Rule 4120(c)(1).

Unlike the self-operative nature of paragraph (c)(1), proposed FINRA Rule 4120(c)(2) authorizes FINRA, for any financial or operational reason, to require any member firm to reduce its business by the issuance of a notice in accordance with Rule 9557. In all such cases, the member firm would have the right to request an expedited hearing. This same provision currently exists in NASD Rule 3130(d)(2).

C. Proposed FINRA Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties)

Proposed FINRA Rule 4130 would be substantially identical to NASD Rule 3131 except that the proposed rule would reflect FINRA as the designated examining authority and make other conforming revisions. The proposed rule would apply only to certain firms that are subject to the Treasury Department's liquid capital requirements.

D. Proposed FINRA Rule 4521 (Notifications, Questionnaires and Reports)

Drawing in part on NASD IM-3130 and Rule 3150 and NYSE Rules 325(b)(2), 416 and 421(2), Proposed FINRA Rule 4521 would address FINRA's authority to request certain information from members to carry out its surveillance and examination responsibilities. As further described below, many of the provisions would apply only to carrying, clearing and (k)(2)(i) members.

- ▶ Proposed FINRA Rule 4521(a) would provide that each carrying, clearing or (k)(2)(i) member must submit to FINRA such financial and operational information regarding the member or any of its correspondents as FINRA deems essential for the protection of investors and the public interest. The provisions would be new for certain non-NYSE members that are carrying, clearing or (k)(2)(i) members. (FINRA notes that NASD Rule 3150 (Reporting Requirements for Clearing Firms) currently requires most carrying and clearing members to submit such data to FINRA.) The proposed rule would impose a late fee of \$100 for each day that a requested report is not timely filed, up to a maximum of 10 business days.
- ▶ Proposed FINRA Rule 4521(e) would require each carrying, clearing or (k)(2)(i) member to notify FINRA in writing no more than 48 hours after its tentative net capital, as computed pursuant to SEA Rule 15c3-1, has declined 20 percent or more from the amount reported in its most recent FOCUS Report or, if later, the most recent such notification filed with FINRA. This would be a new requirement for non-NYSE members that are carrying, clearing or (k)(2)(i) members.
- ▶ Proposed FINRA Rule 4521(f) would require that, unless otherwise permitted by FINRA in writing, member firms carrying margin accounts for customers must submit, on a settlement-date basis: (1) the total of all debit balances in securities margin accounts; and (2) the total of all free credit balances contained in cash or margin accounts. This would be a new requirement for non-NYSE member firms that carry margin accounts.

E. Proposed FINRA Rule 4140 (Audit)

The proposed rules would incorporate FINRA's existing authority under NASD Rule 3130 and NASD IM-3130 and NYSE Rule 418 to request an audit or an agreed-upon procedures review under certain circumstances. The proposed rule would impose a late fee of \$100 for each day that a requested report is not timely filed, up to a maximum of 10 business days.

F. Proposed FINRA Rule 9557 (Procedures for Regulating Activities Under Rules 4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) and Proposed FINRA Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series)

NASD Rules 9557 and 9559 address service of notice to member firms that are experiencing financial or operational difficulties and the related hearing procedures. The proposed rules would make a number of conforming revisions to NASD Rules 9557 and 9559 in light of several of the proposed financial responsibility rules (Proposed FINRA Rules 4110, 4120 and 4130). The proposed rules also would set forth new provisions to afford members with an appeals process that is more expedited than that currently provided under NASD Rules 9557 and 9559. For instance:

- Proposed FINRA Rule 9557(d) would provide that the requirements referenced in a Rule 9557 notice served upon a member are immediately effective. Under the proposed rule, a timely request for a hearing would *stay the effective date for 10 business days* after the service of the notice or until a written order is issued (whichever period is less), unless it is determined that such a stay cannot be permitted with safety to investors, creditors or other member firms;
- to ensure an expedited process, Proposed FINRA Rule 9557(e) would require a member to file with the Office of Hearing Officers any written request for a hearing *within two business days* after service of the Rule 9557 notice;
- Proposed FINRA Rule 9559(d)(2) would provide that the Chief Hearing Officer must select as panelists current or former members of the FINRA Financial Responsibility Committee;
- Proposed FINRA Rule 9559(f)(1) would provide that, after a respondent subject to a Rule 9557 notice files a written request for a hearing with the Office of Hearing Officers, the hearing must be held *within five business days of such filing*; and
- Proposed FINRA Rule 9559(o)(4) would provide that, *within two business days of the date of the close of the hearing*, the Office of Hearing Officers must issue a written order that reflects the Hearing Panel's summary determinations. The Hearing Panel's written order would be effective when issued. The Office of Hearing Officers would be required to issue a written decision in connection with its order *within seven days* of the issuance of the Hearing Panel's written order.

Endnotes

- 1 The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE (Incorporated NYSE Rules). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see *FINRA Information Notice, March 12, 2008* (Rulebook Consolidation Process).
- 2 For convenience, the Incorporated NYSE Rules are referred to as the “NYSE Rules.”
- 3 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 4 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 5 For purposes of this *Notice* and the proposed rules, firms “operating” pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) is not meant to include firms that have *elected* the exemption but do not operate as such. FINRA’s records currently indicate that approximately seventy firms would be considered (k)(2)(i) members for purposes of the proposed rules.
- 6 The proposed rules may be renumbered as part of the final Consolidated FINRA Rulebook.
- 7 See SEA Rule 15c3-1d. Note that the proposed Supplementary Material would require that, for purposes of Proposed FINRA Rule 4110(e)(1), the member must assure itself that any applicable provisions of the Securities Act of 1933 and/or state Blue Sky laws have been satisfied, and may be required to submit evidence thereof to FINRA prior to approval of the subordinated loan agreement. See Proposed FINRA Rule 4110.01.

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ATTACHMENT A

Below is the text of Proposed FINRA Rules 4110, 4120, 4130, 4140, 4521, 9557 and 9559, and FINRA By-Laws Schedule A, Section 4. With respect to Proposed FINRA Rules 9557 and 9559 and FINRA By-Laws Schedule A, Section 4, new language is underlined; deletions are in brackets.

Rule 4110. Capital Compliance

(a) When necessary for the protection of investors or in the public interest, FINRA may, at any time or from time to time with respect to a particular carrying or clearing member or all carrying or clearing members or a member or members operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), pursuant to authority exercised by FINRA's Executive Vice President charged with oversight for financial responsibility, or his or her written officer delegate, prescribe greater net capital or net worth requirements than those otherwise applicable, including more stringent treatment of items in computing net capital or net worth, or require such member to restore or increase its net capital or net worth. In any such instance, FINRA shall issue a notice pursuant to FINRA Rule 9557.

(b) (1) Unless otherwise permitted by FINRA, a member shall suspend all business operations during any period in which it is not in compliance with applicable net capital requirements set forth in SEA Rule 15c3-1, provided however, that such member may effect:

(A) liquidating transactions upon customer direction; and/or

(B) proprietary transactions in circumstances where the subject transactions are reasonably expected to increase the member's net capital or reduce its risk.

(2) FINRA may issue a notice pursuant to FINRA Rule 9557 directing a member that is not in compliance with applicable net capital requirements set forth in SEA Rule 15c3-1 to suspend all or a portion of its business.

(c) (1) Any equity capital contributed by a member may not be withdrawn for a period of one year, unless otherwise permitted by FINRA in writing.

(2) A carrying or clearing member or a member operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) shall not, without the prior written approval of FINRA, withdraw capital, pay a dividend or effect a similar distribution that would reduce such member's equity, where such withdrawals, payments or reductions in the aggregate, in any 35 rolling calendar day period, on a net basis, exceeds 10% of its excess net capital.

(d) Sale-And-Leasebacks, Factoring, Financing, Loans and Similar Arrangements

(1) (A) No carrying or clearing member or member operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) shall consummate a sale-and-leaseback arrangement with respect to any of its assets, or a sale, factoring, or financing arrangement with respect to any unsecured accounts receivable, where any such arrangement would increase the member's tentative net capital by 10% or more, without the prior written authorization of FINRA.

(B) No carrying member shall consummate any arrangement concerning the sale or factoring of customer debit balances, irrespective of amount, without the prior written authorization of FINRA.

(2) Any loan agreement entered into by a carrying or clearing member or a member operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), the proceeds of which exceed 10% of such member's tentative net capital and which is intended to reduce the deduction in computing net capital for fixed assets and other assets which cannot be readily converted into cash under SEA Rule 15c3-1(c)(2)(iv), must be submitted to and be acceptable to FINRA, prior to such reduction becoming effective.

(3) Members subject to paragraphs (d)(1)(A), (d)(1)(B) or (d)(2), shall not consummate any arrangement pursuant to such paragraph(s) if the aggregate of all such arrangements outstanding would exceed 20% of such member's tentative net capital, without the prior written authorization of FINRA.

(4) Any agreement relating to a determination of a "ready market" for securities based upon the securities being accepted as collateral for a loan by a bank under SEA Rule 15c3-1(c)(11)(ii), must be submitted to and be acceptable to FINRA before the securities may be deemed to have a "ready market."

(e) Subordinated Loans, Notes Collateralized by Securities and Capital Borrowings

(1) All subordinated loans or notes collateralized by securities shall meet such standards as FINRA may require to ensure the continued financial stability and operational capability of the member, in addition to those specified in Appendix D of SEA Rule 15c3-1.

(2) Unless otherwise permitted by FINRA, each member partnership whose general partner, or each member LLC whose LLC participant is granted rights analogous to those of a general partner in a partnership, enters into any secured or unsecured borrowing, the proceeds of which will be contributed directly to the capital of the member, shall submit the following for approval in order for such proceeds to qualify as capital acceptable for inclusion in computation of the net capital of the member:

A signed copy of the loan agreement which must:

- (A) have at least a 12 month duration; and
- (B) provide non-recourse to the assets of the member.

Additional documents may be required, the nature of which will vary, depending upon the legal status of the lender e.g. an individual, bank, estate, trust, corporation, partnership, etc.

• • • **Supplementary Material:** — — — — —

.01. For purposes of paragraph (e)(1), the member shall assure itself that any applicable provisions of the Securities Act of 1933 and/or State Blue Sky laws have been satisfied and may be required to submit evidence thereof to FINRA prior to approval of the subordinated loan agreement.

Rule 4120. Regulatory Notification and Business Curtailment

(a) Notification

(1) Each carrying or clearing member or a member operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), shall promptly, but in any event within 24 hours, notify FINRA in writing if its net capital falls below the following percentages:

(A) the member's net capital is less than 150 percent of its minimum dollar net capital requirement or such greater percentage thereof as may from time to time be designated by FINRA;

(B) the member is subject to the aggregate indebtedness requirement of SEA Rule 15c3-1, and its aggregate indebtedness is more than 1,000 percent of its net capital;

(C) the member elects to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1(a)(1)(ii), and its net capital is less than the level specified in SEA Rule 17a-11(c)(2);

(D) the member is approved to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1e, and

(i) its tentative net capital as defined in SEA Rule 15c3-1(c)(15) is less than 50 percent of the early warning notification amount required by SEA Rule 15c3-1(a)(7)(ii), or

(ii) its net capital is less than \$1.25 billion;

(E) the member is registered as a Futures Commission Merchant pursuant to the Commodity Exchange Act, and its net capital is less than 120% of the minimum risk-based capital requirements of Commodity Exchange Act Rule 1.17; or

(F) the member's deduction of capital withdrawals, which it anticipates making, whether voluntarily or as a result of a commitment, including maturities of subordinated liabilities entered into pursuant to Appendix D of SEA Rule 15c3-1, during the next six months, would result in any one of the conditions described in paragraph (a)(1)(A)-(E) of this Rule.

(b) Restrictions on Business Expansion

(1) Except as otherwise permitted by FINRA in writing, a member that carries customer accounts, clears transactions, or operates pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) shall not expand its business during any period in which any of the conditions described in paragraph (a)(1) continue to exist for more than 15 consecutive business days, provided that such condition(s) has been known to FINRA or the member for at least five consecutive business days. FINRA may issue a notice pursuant to FINRA Rule 9557 directing any such member not to expand its business; however, FINRA's authority to issue such notice does not negate the member's obligation not to expand its business in accordance with this paragraph (b)(1).

(2) No member may expand its business during any period in which FINRA restricts the member from expanding its business for any financial or operational reason. In any such instance, FINRA shall issue a notice pursuant to FINRA Rule 9557.

(3) For purposes of paragraph (b) of this Rule, the term "expansion of business" may include:

(A) net increase in the number of registered representatives or other producing personnel;

(B) exceeding average capital commitments over the previous three months for market making or block positioning;

(C) initiation of market making in new securities or any new proprietary trading or other commitment in securities or commodities in which a market is not made (other than riskless trades associated with customer orders);

(D) exceeding average commitments over the previous three months for underwritings;

(E) opening of new branch offices;

(F) entering any new line of business or deliberately promoting or expanding any present lines of business;

(G) making unsecured or partially secured loans, advances, drawings, guarantees or other similar receivables; and

(H) such other activities as FINRA deems appropriate under the circumstances, in the public interest or for the protection of investors.

(c) Reduction of Business

(1) Except as otherwise permitted by FINRA in writing, a member that carries customer accounts, clears transactions, or operates pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) is obligated to reduce its business to a point enabling its available capital to exceed the standards set forth in paragraph (a)(1)(A)-(F) of this Rule, when any of the following conditions continue to exist for more than 15 consecutive business days, provided that such condition(s) has been known to FINRA or the member for at least five consecutive business days:

(A) the member's net capital is less than 125 percent of its minimum dollar net capital requirement or such greater percentage thereof as may from time to time be designated by FINRA;

(B) the member is subject to the aggregate indebtedness requirement of SEA Rule 15c3-1, and its aggregate indebtedness is more than 1,200 percent of its net capital;

(C) the member elects to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1(a)(1)(ii), and its net capital is less than one percentage point below the level specified in SEA Rule 17a-11(c)(2);

(D) the member is approved to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1e, and

(i) its tentative net capital as defined in SEA Rule 15c3-1(c)(15) is less than 40 percent of the early warning notification amount required by SEA Rule 15c3-1(a)(7)(ii), or

(ii) its net capital is less than \$1 billion;

(E) the member is registered as a Futures Commission Merchant pursuant to the Commodity Exchange Act, and its net capital is less than 110% of the minimum risk-based capital requirements of Commodity Exchange Act Rule 1.17; or

(F) the member's deduction of capital withdrawals, including maturities of subordinated liabilities entered into pursuant to Appendix D of SEA Rule 15c3-1, scheduled during the next six months, would result in any one of the conditions described in paragraph (c)(1)(A)-(E) of this Rule.

FINRA may issue a notice pursuant to FINRA Rule 9557 directing any such member to reduce its business to a point enabling its available capital to exceed the standards set forth in paragraph (a)(1)(A)-(F) of this Rule; however, FINRA's authority to issue such notice does not negate the member's obligation to reduce its business in accordance with this paragraph (c)(1).

(2) A member must reduce its business as directed by FINRA for any financial or operational reason. In any such instance, FINRA shall issue a notice pursuant to FINRA Rule 9557.

(3) For purposes of paragraph (c) of this Rule, the term "business reduction" shall mean reducing or eliminating parts of a member's business in order to reduce the amount of capital required, which may include:

- (A) promptly paying all or a portion of free credit balances to customers;
- (B) promptly effecting delivery to customers of all or a portion of fully paid securities in the member's possession or control;
- (C) introducing all or a portion of its business to another member on a fully disclosed basis;
- (D) reducing the size or modifying the composition of its inventory and reducing or ceasing market making;
- (E) closing of one or more existing branch offices;
- (F) collecting unsecured or partially secured loans, advances, drawings, guarantees or other similar receivables;
- (G) accepting no new customer accounts;
- (H) restricting the payment of salaries or other sums to partners, officers, directors, shareholders, or associated persons of the member;
- (I) effecting liquidating transactions only;
- (J) accepting only unsolicited customer orders; and
- (K) such other activities as FINRA deems appropriate under the circumstances in the public interest or for the protection of investors.

• • • **Supplementary Material:** — — — — —

.01. The following are examples of the conditions under which FINRA may exercise its discretion pursuant to paragraphs (b)(2) or (c)(2) above:

(a) The member has experienced a substantial change in the manner in which it processes its business, which, in the view of FINRA, increases the potential risk of loss to customers and other members;

(b) The member's books and records are not maintained in accordance with the provisions of SEA Rules 17a-3 and 17a-4;

(c) The member is not in compliance, or is unable to demonstrate compliance, with applicable net capital requirements;

(d) The member is not in compliance, or is unable to demonstrate compliance, with SEA Rule 15c3-3 (Customer Protection – Reserves and Custody of Securities);

(e) The member is unable to clear and settle transactions promptly; or

(f) The member's overall business operations are in such a condition, given the nature of its business that, notwithstanding the absence of any of the conditions enumerated in paragraphs (a) through (e), a determination of financial or operational difficulty should be made.

.02. The rule contemplates that any restrictions or conditions imposed on a carrying or clearing member's business under this Rule may require that member to restrict the business activities of one or more correspondent firms for which the member clears, insofar as such business would be handled by such carrying or clearing member.

Rule 4130. Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties

(a) Application — For purposes of this Rule, the term “member” shall be limited to any member of FINRA registered with the Commission pursuant to Section 15C of the Exchange Act that is not designated to another self-regulatory organization by the Commission for financial responsibility pursuant to Section 17 of the Exchange Act and SEA Rule 17d-1. Further, the term shall not be applicable to any member that is subject to Section 402.2(c) of the rules of the Treasury Department, or is otherwise exempt from the provisions of said rule.

(b) Each member subject to Section 402.2 of the rules of the Treasury Department shall comply with the capital requirements prescribed therein and with the provisions of this Rule.

(c) A member, when so directed by FINRA shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist for more than 15 consecutive business days:

(A) the member’s liquid capital is less than 150 percent of the total haircuts or such greater percentage thereof as may from time to time be prescribed by FINRA;

(B) the member’s liquid capital minus total haircuts is less than 150 percent of its minimum dollar capital requirement; or

(C) the deduction of ownership equity and maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A) or (B) of this subparagraph (1); or

(2) FINRA restricts the member for any other financial or operational reason.

(d) A member, when so directed by FINRA, shall forthwith reduce its business:

(1) To a point at which the member would not be subject to a prohibition against expansion of its business as set forth in paragraphs (c)(1)(A), (B), or (C) of this Rule if any of the following conditions continue to exist for more than 15 consecutive business days:

(A) the member's liquid capital is less than 125 percent of total haircuts or such greater percentage thereof as may from time to time be prescribed by FINRA;

(B) the member's liquid capital minus total haircuts is less than 125 percent of its minimum dollar capital requirement; or

(C) the deduction of ownership equity and maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A) or (B) of this subparagraph (1); and

(2) As required by FINRA when it restricts a member for any other financial or operational reason.

(e) A member shall suspend all business operations during any period of time when the member is not in compliance with applicable liquid capital requirements as set forth in Section 402.2 of the rules of the Treasury Department. FINRA staff may issue a notice to such member directing it to suspend all business operations; however, the member's obligation to suspend all business operations arises from its obligations under Section 402.2 of the rules of the Treasury Department and is not dependent on any notice that may be issued by FINRA staff.

(f) Any notice directing a member to limit or suspend its business operations shall be issued by FINRA staff pursuant to FINRA Rule 9557.

Rule 4140. Audit

(a) FINRA's Executive Vice President charged with oversight for financial responsibility, or his or her written officer delegate, may at any time, due to concerns regarding the accuracy or integrity of a member's financial statements, books and records or prior audited financial statements, direct any member to cause an audit to be made by an independent public accountant of its accounts, or cause an examination to be made in accordance with attestation, review or consultation standards prescribed by the AICPA. Such audit or examination shall be made in accordance with such requirements as FINRA may prescribe.

(b) Any member failing to file an audited financial and/or operational report or examination report under this Rule in the prescribed time shall be subject to a late fee as set forth in Schedule A to the By-Laws.

* * * * *

Rule 4521. Notifications, Questionnaires and Reports

(a) Each carrying or clearing member or a member operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) shall submit to FINRA, or its designated agent, at such times as may be designated, or on an ongoing basis, in such form and within such time period as may be prescribed, such financial and operational information regarding the member or any of its correspondents as FINRA deems essential for the protection of investors and the public interest.

(b) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file reports pursuant to paragraph (a) of this Rule, a late fee as set forth in Schedule A to the By-Laws.

(c) For purposes of this Rule, any report filed pursuant to this Rule containing material inaccuracies shall be deemed not to have been filed until a corrected copy of the report has been resubmitted.

(d) Every member approved by the SEC pursuant to SEA Rule 15c3-1 to use the alternative method of computing net capital contained in Appendix E to that Rule shall file such supplemental and alternative reports as may be prescribed by FINRA.

(e) Each carrying or clearing member or a member operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) shall notify FINRA in writing, no more than 48 hours after its tentative net capital as computed pursuant to SEA Rule 15c3-1, has declined 20 percent or more from the amount reported in its most recent FOCUS Report or, if later, the most recent such notification filed with FINRA. For purposes of this paragraph, “tentative net capital as computed pursuant to SEA Rule 15c3-1” shall exclude withdrawals of capital previously approved by FINRA.

(f) (1) Unless otherwise permitted by FINRA in writing, members carrying margin accounts for customers are required to submit, on a settlement date basis, the information specified in paragraphs (f)(2)(A) and (f)(2)(B) of this Rule as of the last business day of the month. If a member has no information to submit, a report should be filed with a notation thereon to that effect. Reports are due as promptly as possible after the last business day of the month, but in no event later than the sixth business day of the following month. Members shall use such form as FINRA may prescribe for these reporting purposes.

(2) Each member carrying margin accounts for customers shall submit reports containing the following customer information:

(A) Total of all debit balances in securities margin accounts; and

(B) Total of all free credit balances in all cash accounts and all margin accounts.

(3) For purposes of this Rule:

(A) Only free credit balances in cash and margin accounts shall be included in the member's report. Balances in short accounts and in Special Memorandum Accounts (as defined in Section 2.2 of Regulation T under the Exchange Act) shall not be considered as free credit balances.

(B) Reported debit or credit balance information shall not include the accounts of other organizations that are FINRA members, or of the associated persons of the member submitting the report where such associated person's account is excluded from the definition of customer pursuant to SEA Rule 15c3-3.

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9557. Procedures for Regulating Activities Under Rules 4110, [3130] 4120 and 4130 [3131] Regarding a Member Experiencing Financial or Operational Difficulties¹

(a) Notice of Requirements and/or Restrictions

FINRA [NASD] staff may issue a notice directing a member to comply with the provisions of Rule 4110, 4120 or 4130 or restrict its business activities, either by limiting or ceasing to conduct those activities consistent with Rule 4110, 4120 or 4130, if FINRA [NASD] staff has reason to believe that a condition specified in Rule 4110, 4120 [3130] or 4130 [Rule 3131] exists.

(b) Service of Notice

FINRA [NASD] staff shall serve the member subject to a notice issued under this Rule by facsimile, overnight courier or personal delivery. Papers served on a member by overnight courier or personal delivery shall conform to paragraphs (a)(1) and (3) and (b)(2) of Rule 9134. Papers served on a member by facsimile shall be sent to the facsimile number listed in the member's contact questionnaire submitted to FINRA [NASD] pursuant to Article 4, Section III of the FINRA [NASD's] By-Laws, except that, if FINRA [NASD] staff has actual knowledge that an entity's contact questionnaire facsimile number is out of date, duplicate copies shall be sent to the entity by overnight courier or personal delivery in conformity with paragraphs (a)(1) and (3) and (b)(2) of Rule 9134. Service is complete upon sending the notice by facsimile, mailing the notice by overnight courier or delivering it in person, except that, where duplicate service is required, service is complete upon sending the duplicate service.

(c) Contents of Notice

A notice issued under this Rule shall state the specific grounds and include the factual basis for the FINRA [NASD] action. The notice shall specify the nature of the requirements and/or restrictions being imposed, the effective date of the requirements and/or restrictions [state when the NASD action will take effect] and, where applicable, [explain what the respondent must do to avoid] the conditions for avoiding [such action] or terminating such requirements and/or restrictions. The notice shall state that the respondent may file a written request for a hearing with the Office of Hearing Officers pursuant to Rule 9559. The notice also shall inform the respondent of the applicable deadline for filing a request for a hearing and shall state that a request for a hearing must set forth with specificity any and all defenses to the FINRA [NASD] action.

¹ The draft text is marked to show changes between NASD Rule 9557 and proposed FINRA Rule 9557.

In addition, the notice shall explain that, pursuant to Rules 8310(a) and 9559(n), a Hearing Officer or, if applicable, Hearing Panel, may approve, modify or withdraw any and all requirements and/or restrictions [sanctions or limitations] imposed by the notice, and may impose any other fitting sanction.

(d) Effective Date of the Requirements and/or Restrictions

The requirements and/or restrictions referenced in a notice issued and served under this Rule are immediately effective. A timely request for a hearing shall stay the effective date for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less), unless FINRA's Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate) determines that such a stay cannot be permitted with safety to investors, creditors or other members. Such a determination by the Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate) cannot be appealed. An extension of the stay period is not permitted. [The restrictions referenced in a notice issued and served under this Rule shall become effective seven days after service of the notice, unless stayed by a request for a hearing pursuant to Rule 9559.]

(e) Request for a Hearing

A member served with a notice under this Rule may file with the Office of Hearing Officers a written request for a hearing pursuant to Rule 9559. A request for a hearing shall be made within two business days after service of a notice under this Rule [before the effective date of the notice, as indicated in paragraph (d) of this Rule]. A request for a hearing must set forth with specificity any and all defenses to the FINRA [NASD] action.

(f) Failure to Request Hearing

If a member does not [timely] request a hearing within the time period specified in paragraph (e) of this Rule, [the] any requirements and/or restrictions [specified in the notice shall become effective seven days after service of the notice. The restrictions] specified in the notice shall remain in effect until the head of the FINRA [NASD] department or office that issued the notice or, if another FINRA [NASD] department or office is named as the party handling the matter on behalf of the issuing department or office, the head of the FINRA [NASD] department or office that is so designated, reduces or removes the requirements and/or restrictions pursuant to paragraph (h) of this Rule.

(g) [Order to] Enforcement of [Sanctions] Notice or Decision

[If NASD staff determines that a] A member that has failed to comply with any requirements and/or restrictions imposed by a decision or an effective notice under this Rule shall be automatically and immediately suspended [that have not been stayed, NASD staff shall issue an order imposing the sanctions set forth in the decision or notice and specifying the effective date and time of such sanctions]. The [order shall inform the] member [that it] may apply for relief from the suspension [sanctions imposed by the order] by filing a written request for a hearing before the Office of Hearing Officers under Rule 9559. The procedures delineated in this Rule shall be applicable, except that a request for a hearing regarding a suspension under this paragraph does not stay the effectiveness of the suspension.

(h) Additional Requirements and/or Restrictions or the Reduction or Removal of Requirements and/or Restrictions

(1) Additional Requirements and/or Restrictions

If a member continues to experience financial or operational difficulty specified in Rule 4110 or 4120 [3130] or 4130 [3131], notwithstanding an effective notice[, order] or decision under this Rule, FINRA [NASD] [S]staff may impose additional requirements and/or restrictions by [issuing] servicing an additional notice under paragraph (b) of this Rule. The additional notice shall inform the member that it may apply for relief from the additional requirements and/or restrictions by filing a written request for a hearing before the Office of Hearing Officers under Rule 9559. The procedures delineated in this Rule shall be applicable to such [a] additional notice.

(2) Reduction or Removal of Requirements and/or Restrictions

If FINRA [NASD] staff determines that any requirements and/or restrictions previously imposed under this Rule should be reduced or removed, FINRA [NASD] staff shall serve a written notice on the member pursuant to Rule 9134.

(i) Notice to Membership

FINRA [NASD] shall provide notice of any final FINRA [NASD] action taken pursuant to this Rule in the next Regulatory Notice [to Members] Disciplinary and Other FINRA [NASD] Action Section.

9559. Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series²

(a) Applicability

The hearing procedures under this Rule shall apply to a member, person associated with a member, person subject to FINRA's [NASD's] jurisdiction or other person who is served with a notice issued under the Rule 9550 Series and who timely requests a hearing. For purposes of this Rule, such members or persons shall be referred to as respondents.

(b) Computation of Time

Rule 9138 shall govern the computation of time in proceedings brought under the Rule 9550 Series, except that intermediate Saturdays, Sundays and Federal holidays shall be included in the computation in proceedings brought under Rules 9556 through 9558, unless otherwise specified.

(c) Stays

(1) Unless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown, a timely request for a hearing shall stay the effectiveness of a notice issued under Rules 9551 through 9556[7], except that the effectiveness of a notice of a limitation or prohibition on access to services offered by FINRA [NASD] or a member thereof under Rule 9555 with respect to services to which the member or person does not have access shall not be stayed by a request for a hearing.

(2) A timely request for a hearing shall stay the effectiveness of a notice issued under Rule 9557 for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less), unless FINRA's Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate) determines that a notice under Rule 9557 shall not be stayed. Where a notice under Rule 9557 is stayed by a request for a hearing, such stay shall remain in effect only for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less) and shall not be extended.

(3) A timely request for a hearing shall not stay the effectiveness of a notice issued under Rule 9558, unless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown.

² The draft text is marked to show changes between NASD Rule 9559 and proposed FINRA Rule 9559.

(d) Appointment and Authority of Hearing Officer and/or Hearing Panel

(1) For proceedings initiated under Rules 9553 and 9554, the Chief Hearing Officer shall appoint a Hearing Officer to preside over and act as the sole adjudicator for the matter.

(2) For proceedings initiated under Rules 9551, 9552, 9555, 9556, 9557 and 9558, the Chief Hearing Officer shall appoint a Hearing Panel composed of a Hearing Officer and two Panelists. The Hearing Officer shall serve as the chair of the Hearing Panel. For proceedings initiated under Rules 9551, 9552, 9555, 9556 and 9558, [T]the Chief Hearing Officer shall select as Panelists persons who meet the qualifications delineated in Rules 9231 and 9232. For proceedings initiated under Rule 9557, the Chief Hearing Officer shall select as Panelists current or former members of the FINRA Financial Responsibility Committee.

(3) Rules 9231(e), 9233 and 9234 shall govern disqualification, recusal or withdrawal of a Hearing Officer or, if applicable, Hearing Panelist.

(4) A Hearing Officer appointed pursuant to this provision shall have authority to do all things necessary and appropriate to discharge his or her duties as set forth under Rules 9235 and 9280.

(5) Hearings under the Rule 9550 Series shall be held by telephone conference, unless the Hearing Officer orders otherwise for good cause shown.

(6) For good cause shown, or with the consent of all of the parties to a proceeding, the Hearing Officer or, if applicable, the Hearing Panel may extend or shorten any time limits prescribed by this Rule other than those relating to Rule 9557.

(e) Consolidation or Severance of Proceedings

Rule 9214 shall govern the consolidation or severance of proceedings, except that, where one of the notices that are the subject of consolidation under this Rule requires that a hearing be held before a Hearing Panel, the hearing of the consolidated matters shall be held before a Hearing Panel. Where two consolidated matters contain different timelines under this Rule, the Chief Hearing Officer or Hearing Officer assigned to the matter has discretion to determine which timeline is appropriate under the facts and circumstances of the case. Where one of the consolidated matters includes an action brought under a Rule [9558] that does not permit a stay of the effectiveness of the

notice or where the Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate), in the case of Rule 9557, or Hearing Officer, in the case of Rule 9558(d), determines that a request for a hearing shall not stay the effectiveness of the notice, the limitation, prohibition, condition, requirement, restriction, or suspension specified in the notice shall not be stayed pending resolution of the case [unless the Chief Hearing Officer or Hearing Officer assigned to the matter orders otherwise for good cause shown. Where one of the consolidated matters includes an action brought under Rule 9555 with respect to services to which the member or person does not have access, the effectiveness of a notice of a limitation or prohibition on access to services offered by NASD or a member thereof shall not be stayed pending resolution of the case]. Where one of the consolidated matters includes an action brought under Rule 9557 that is stayed for up to ten business days, the requirement and/or restriction specified in the notice shall not be further stayed.

(f) Time of Hearing

(1) A hearing shall be held within five business days after a respondent subject to a notice issued under Rule 9557 files a written request for a hearing with the Office of Hearing Officers.

~~(1)2~~ A hearing shall be held within 14 days after a respondent subject to a notice issued under Rules 9556 [through] and 9558 files a written request for a hearing with the Office of Hearing Officers.

~~(2)3~~ A hearing shall be held within 60 days after a respondent subject to a notice issued under Rules 9551 through 9555 files a written request for a hearing with the Office of Hearing Officers.

~~(3)4~~ The timelines established by paragraphs (f)(1) [and] through (f)(2)3 confer no substantive rights on the parties.

(g) Notice of Hearing

The Hearing Officer shall issue a notice stating the date, time, and place of the hearing as follows:

(1) At least two business days prior to the hearing in the case of an action brought pursuant to Rule 9557.

~~(1)2~~ At least seven days prior to the hearing in the case of an action brought pursuant to Rules 9556 [through] and 9558, and

([2]3) At least 21 days prior to the hearing in the case of an action brought pursuant to Rules 9551 through 9555.

(h) Transmission of Documents

(1) Not less than two business days before the hearing in an action brought under Rule 9557, not less than seven days before the hearing in an action brought under Rules 9556 [through] and 9558, and not less than 40 days before the hearing in an action brought under Rules 9551 through 9555, FINRA [NASD] staff shall provide to the respondent who requested the hearing, by facsimile or overnight courier, all documents that were considered in issuing the notice unless a document meets the criteria of Rule 9251(b)(1)(A), (B) or (C). A document that meets such criteria shall not constitute part of the record, but shall be retained by FINRA [NASD] until the date upon which FINRA [NASD] serves a final decision or, if applicable, upon the conclusion of any review by the [Securities and Exchange Commission] SEC or the federal courts.

(2) Not less than two business days before the hearing in an action brought under Rule 9557, three days before the hearing in an action brought under Rules 9556 [through] and 9558, and not less than 14 days before the hearing in an action brought under Rules 9551 through 9555, the parties shall exchange proposed exhibit and witness lists. The exhibit and witness lists shall be served by facsimile or by overnight courier.

(i) Evidence

Formal rules of evidence shall not apply to a hearing under this Rule Series. Rules 9262 and 9263 shall govern testimony and the admissibility of evidence.

(j) Additional Information

The Hearing Officer or, if applicable, the Hearing Panel may direct the Parties to submit additional information.

(k) Record of Hearing

Rule 9265 shall govern the requirements for the record of the hearing.

(l) Record of Proceeding

Rule 9267 shall govern the record of the proceeding.

(m) Failure to Appear at a Pre-Hearing Conference or Hearing or to Comply with a Hearing Officer Order Requiring the Production of Information

Failure of any respondent to appear before the Hearing Officer or, if applicable, the Hearing Panel at any status conference, pre-hearing conference or hearing, or to comply with any order of the Hearing Officer or, if applicable, Hearing Panel requiring production of information to support any defense to the notice that respondent has raised, shall be considered an abandonment of the respondent's defense and waiver of any opportunity for a hearing provided by the Rule 9550 Series. In such cases, the notice issued under the Rule 9550 Series shall be deemed to be final FINRA [NASD] action. The Hearing Officer or, if applicable, the Hearing Panel may permit the hearing to go forward as to those parties who appear and otherwise comply with this Rule.

(n) Sanctions, Costs and Remands

(1) The Hearing Officer or, if applicable, the Hearing Panel may approve, modify or withdraw any and all sanctions, requirements, restrictions or limitations imposed by the notice. The Hearing Officer or, if applicable, the Hearing Panel also may impose any other fitting sanction, pursuant to Rule 8310(a).

(2) The Hearing Officer or, if applicable, the Hearing Panel may impose costs pursuant to Rule 8330.

(3) The Hearing Officer or, if applicable, the Hearing Panel may remand the matter to the department or office that issued the notice for further consideration of specified matters.

(o) Timing of Decision

(1) Proceedings initiated under Rules 9553 and 9554

Within 60 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision and provide it to the National Adjudicatory Council's Review Subcommittee.

(2) Proceedings initiated under Rules 9556 [through] and 9558

Within 21 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision that reflects the views of the Hearing Panel, as determined by majority vote, and provide it to the National Adjudicatory Council's Review Subcommittee.

(3) Proceedings initiated under Rules 9551, 9552 and 9555

Within 60 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision that reflects the views of the Hearing Panel, as determined by majority vote, and provide it to the National Adjudicatory Council's Review Subcommittee.

(4) Proceedings initiated under Rule 9557

(A) Written Order

Within two business days of the date of the close of the hearing, the Office of Hearing Officers shall issue a written order that reflects the Hearing Panel's summary determinations, as decided by majority vote, and shall serve the Hearing Panel's written order on the Parties and provide a copy to each FINRA member with which the respondent is associated. The Hearing Panel's written order under Rule 9557 is effective when issued. The Hearing Panel's written order will be followed by a written decision explaining the reasons for the Hearing Panel's summary determinations, as required by paragraphs (o)(4)(B) and (p) of this Rule.

(B) Written Decision

Within seven days of the issuance of the Hearing Panel's written order, the Office of Hearing Officers shall issue a written decision that complies with the requirements of paragraph (p) of this Rule and shall serve the Hearing Panel's written decision on the Parties and provide a copy to each FINRA member with which the respondent is associated.

(5) If not timely called for review by the National Adjudicatory Council's Review Subcommittee pursuant to paragraph (q) of this Rule, the Hearing Officer's or, if applicable, the Hearing Panel's written decision shall constitute final FINRA [NASD] action. For decisions issued under Rules 9551 through 9556 and 9558, [T]the Office of Hearing Officers shall promptly serve the decision of the Hearing Officer or, if applicable, the Hearing Panel on the Parties and provide a copy to each FINRA [NASD] member with which the respondent is associated.

([5]6) The timelines established by paragraphs (o)(1)-([4]5) confer no substantive rights on the parties.

(p) Contents of Decision

The decision, which for purposes of Rule 9557 means the written decision issued under paragraph (o)(4)(B) of this Rule, shall include:

- (1) a statement describing the investigative or other origin of the notice issued under the Rule 9550 Series;
- (2) the specific statutory or rule provision[s that were] alleged to have been violated or providing the authority for the FINRA action;
- (3) a statement setting forth the findings of fact with respect to any act or practice the respondent was alleged to have committed or omitted or any condition specified in the notice;
- (4) the conclusions of the Hearing Officer or, if applicable, Hearing Panel regarding the alleged violation or condition specified in the notice [as to whether the respondent violated any provision alleged in the notice];
- (5) a statement of the Hearing Officer or, if applicable, Hearing Panel in support of the disposition of the principal issues raised in the proceeding; and
- (6) a statement describing any sanction, requirement, restriction or limitation imposed, the reasons therefore, and the date upon which such sanction, requirement, restriction or limitation shall become effective.

(q) Call for Review by the National Adjudicatory Council

(1) For proceedings initiated under the Rule 9550 Series (other than Rule 9557), [T]he National Adjudicatory Council's Review Subcommittee may call for review a proposed decision [issued] prepared by a Hearing Officer or, if applicable, Hearing Panel [under the Rule 9550 Series] within 21 days after receipt of the decision from the Office of Hearing Officers. For proceedings initiated under Rule 9557, the National Adjudicatory Council's Review Subcommittee may call for review a written decision issued under paragraph (o)(4)(B) of this Rule by a Hearing Panel within 14 days after receipt of the written decision from the Office of Hearing Officers. Rule 9313(a) is incorporated by reference.

(2) If the Review Subcommittee calls the proceeding for review within the prescribed time, a Subcommittee of the National Adjudicatory Council shall meet and conduct a review not later than 40 days after the call for review. The Subcommittee shall be composed pursuant to Rule 9331(a)(1). The Subcommittee may elect to hold a hearing or decide the matter on the basis of the record made before the Hearing Officer or, if applicable, the Hearing Panel. Not later than 60 days after the call for review, the Subcommittee shall make its recommendation to the National Adjudicatory Council. Not later than 60 days after receipt of the Subcommittee's recommendation, the National Adjudicatory Council shall serve a final written decision on the parties via overnight courier or facsimile. The National Adjudicatory Council may affirm, modify or reverse the decision of the Hearing Officer or, if applicable, the Hearing Panel. The National Adjudicatory Council also may impose any other fitting sanction, pursuant to Rule 8310(a), and may impose costs, pursuant to 8330. In addition, the National Adjudicatory Council may remand the matter to the Office of Hearing Officers for further consideration of specified matters.

(3) For good cause shown, or with the consent of all of the parties to a proceeding, the Review Subcommittee, the National Adjudicatory Council Subcommittee or the National Adjudicatory Council may extend or shorten any time limits prescribed by this Rule other than those relating to Rule 9557.

(4) The National Adjudicatory Council's written decision shall constitute final FINRA [NASD] action.

(5) The National Adjudicatory Council shall promptly serve the decision on the Parties and provide a copy of the decision to each FINRA [NASD] member with which the respondent is associated.

(6) The timelines established by paragraphs (q)(1)-(5) confer no substantive rights on the parties.

(r) Notice to Membership

FINRA [NASD] shall provide notice of any final FINRA [NASD] action in the next Regulatory Notice [to Members] Disciplinary and Other FINRA [NASD] Action Section.

(s) Application to Commission for Review

The right to have any action pursuant to this Rule reviewed by the [Securities and Exchange Commission] SEC is governed by Section 19 of the [Securities] Exchange Act. The filing of an application for review by the [Securities and Exchange Commission] SEC shall not stay the effectiveness of final FINRA [NASD] action, unless the [Securities and Exchange Commission] SEC otherwise orders.

* * * * *

FINRA By-Laws Schedule A, Section 4

Section 4 — Fees

(a) through (f) No Change.

(g) (1) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file reports, as designated by this paragraph ("Designated Reports"), a fee of \$100 for each day that such report is not timely filed. The fee will be assessed for a period not to exceed 10 business days. Requests for such extension of time must be submitted to FINRA at least three business days prior to the due date; and

(2) Any report filed pursuant to this Rule containing material inaccuracies or filed incompletely shall be deemed not to have been filed until a corrected copy of the report has been resubmitted.

(3) List of Designated Reports:

(A) SEC Rule 17a-5 — Monthly and quarterly FOCUS reports and annual audit reports; [and]

(B) SEC Rule 17a-10 — Schedule I[.];

(C) FINRA Rule 4140 — any audited financial and/or operational report or examination report required pursuant to FINRA Rule 4140; and

(D) FINRA Rule 4521(a) — any financial or operational information or report required pursuant to FINRA Rule 4521(a).

(h) No Change.

* * * * *

ATTACHMENT B

Proposed FINRA Rule #	Proposed FINRA Rule Requirement/Topic	Applies to...
4110	Capital Compliance	
4110 (a)	Authority to increase capital requirements	Carrying, clearing and (k)(2)(i) member firms
4110(b)	Suspension of business operations	All firms
4110(c)(1)	Withdrawal of equity capital	All firms
4110(c)(2)	Withdrawal of equity capital	Carrying, clearing and (k)(2)(i) member firms
4110(d)(1)(A)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Carrying, clearing and (k)(2)(i) member firms
4110(d)(1)(B)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Carrying member firms
4110(d)(2)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Carrying, clearing and (k)(2)(i) member firms
4110(d)(3)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Member firms subject to 4110(d)(1)(A), 4110(d)(1)(B) or 4110(d)(2)
4110(d)(4)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	All firms
4110(e)(1)	Subordinated loans, notes collateralized by securities and capital borrowing	All firms
4110(e)(2)	Subordinated loans, notes collateralized by securities and capital borrowing	All firms that are partnerships or LLCs whose LLC participant is granted rights analogous to a general partner in a partnership

Proposed FINRA Rule #	Proposed FINRA Rule Requirement/Topic	Applies to...
4120	Regulatory Notification and Business Curtailment	
4120(a)	Regulatory notification	Carrying, clearing and (k)(2)(i) member firms
4120(b)(1)	Restrictions on business expansion	Carrying, clearing and (k)(2)(i) member firms
4120(b)(2)	Restrictions on business expansion	All firms
4120(c)(1)	Reduction of business	Carrying, clearing and (k)(2)(i) member firms
4120(c)(2)	Reduction of business	All firms
4130	Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties	Certain firms subject to the Treasury Department's liquid capital requirements
4140	Audit	All firms
4521	Notifications, Questionnaires and Reports	
4521(a), (b) and (e)	Notifications, questionnaires and reports	Carrying, clearing and (k)(2)(i) member firms
4521(c)	Notifications, questionnaires and reports	All firms subject to 4521(a), (b), (d), (e) and (f)
4521(d)	Notifications, questionnaires and reports	Members subject to the SEC's requirements for broker-dealers that are part of consolidated supervised entities (approved to use Appendix E of SEA Rule 15c3-1 for computing net capital)
4521(f)	Notifications, questionnaires and reports	Firms carrying margin accounts

Supervision and Supervisory Controls

Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls

Comment Period Expires: June 13, 2008

Executive Summary

As part of the process of developing a new, consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on proposals relating to the FINRA supervision and supervisory control rules (the proposed rules). The proposed rules would re-write certain provisions of the existing supervision and supervisory control rules in a manner that provides firms with greater flexibility to tailor their supervisory and supervisory control procedures to reflect their business, size and organizational structure.

The text of the proposed rules is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- ▶ Patricia Albrecht, Assistant General Counsel, Office of General Counsel (OGC), at (202) 728-8026;
- ▶ Brant Brown, Associate General Counsel, OGC, at (202) 728-6927; or
- ▶ Kosha Dalal, Associate Vice President and Associate General Counsel, OGC, at (202) 728-6903.

May 2008

Notice Type

- ▶ Request for Comment
- ▶ Consolidated FINRA Rulebook

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

Key Topic(s)

- ▶ Branch Offices
- ▶ Correspondence
- ▶ Offices of Supervisory Jurisdiction
- ▶ Private Securities Transactions
- ▶ Registration
- ▶ Supervision
- ▶ Supervisory Control Systems

Referenced Rules & Notices

- ▶ NASD IM-1000-4
- ▶ NASD Rule 3010
- ▶ NASD IM-3010-1
- ▶ NASD Rule 3012
- ▶ NASD Rule 3040
- ▶ NASD Rule 3110
- ▶ NYSE Rule 342
- ▶ NYSE Rule 343
- ▶ NYSE Rule 351
- ▶ NYSE Rule 354
- ▶ NYSE Rule 401
- ▶ NYSE Rule 407

Action Requested

FINRA encourages all interested parties to comment on the proposals. Comments must be received by June 13, 2008. Comments received after the close of the comment period will not be considered, although interested parties will have further opportunity to comment when the proposals resulting from this *Notice* process are filed with the SEC for approval.

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

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

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

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

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the Federal Register.³

Background & Discussion

A. Background

NASD Rule 3010 (Supervision) requires a firm to establish a supervisory system and corresponding written procedures to supervise its businesses and associated persons' activities. NASD Rule 3012 (Supervisory Control System) requires a firm to have supervisory control procedures that test and verify that a firm's supervisory procedures are reasonably designed to achieve compliance with the applicable securities laws and regulations and NASD rules and, where necessary, amend or create additional supervisory procedures. NASD Rule 3012 also requires specific procedures to supervise producing managers (*i.e.*, persons with supervisory obligations who also service customer accounts) and to review and monitor certain specific activities (*e.g.*, transmittals of funds and securities, customer changes of address and investment objectives).

NYSE Rule 342 (Offices—Approval, Supervision and Control) and its related supplementary material and interpretations impose similar supervisory requirements. However, NYSE Rule 342 and its related material also contain a number of detailed requirements that are not included in the NASD supervision rules.

As part of the consolidation, FINRA is proposing to adopt new FINRA Rules 3110 and 3120 regarding supervision and supervisory controls, respectively.⁴ Although the proposed rules are based in large part on NASD Rules 3010 and 3012, as further detailed below, they differ in some respects. Among other things, the proposed rules:

- reflect a more flexible approach to certain supervision requirements;
- relocate certain provisions in NASD Rule 3012 to Proposed FINRA Rule 3110 (Supervision) in an effort to group all provisions relating to supervisory systems together;
- re-write supervisory requirements to make them clearer;
- delete NASD Rule 3040 (Private Securities Transactions of an Associated Person), regarding the supervision of associated persons' outside securities activities, as a separate rule and relocate a revised rule for such supervision within Proposed FINRA Rule 3110;
- codify FINRA staff guidance in such areas as supervision of electronic communications;
- incorporate—on a tiered basis—certain provisions from NYSE rules, such as requiring heightened compliance reporting for some firms as set forth in NYSE Rule 342; and
- eliminate obsolete or duplicative requirements.

B. Proposed FINRA Rule 3110 (Supervision)

Proposed FINRA Rule 3110 is based on requirements in NASD Rule 3010 and NYSE Rule 342 relating to, among other things, supervisory systems, written procedures, internal inspections and review of correspondence. Proposed FINRA Rule 3110 also would incorporate provisions in other NASD rules that pertain to supervision, including NASD Rules 3012 and 3040.

The proposed changes are described below:

1. *Proposed FINRA Rule 3110(a): Supervisory System*

Proposed FINRA Rule 3110(a), which addresses a member firm's supervisory systems, would replace NASD Rule 3010(a) and makes two notable changes. NASD Rule 3010(a)(2) currently requires a firm to designate an appropriately registered principal(s) with authority to supervise each type of business in which the firm engages that requires registration as a broker-dealer.

FINRA proposes to amend this provision to require the designation of an appropriately registered principal(s) with authority to supervise each type of business in which the firm engages, regardless of whether registration as a broker-dealer is required for that activity. This amendment is consistent with NASD Rule 3010(b) that currently requires a firm to have supervisory procedures for all business activities in which it engages.⁵

In addition, FINRA proposes to move those provisions in NASD Rule 3010(a)(3) setting forth certain factors a firm should consider in designating locations as offices of supervisory jurisdiction (OSJs) into Supplementary Material with no substantive changes.

2. *Proposed FINRA Rule 3110(b): Written Procedures*

FINRA proposes to consolidate various provisions and rules that currently require written procedures into Proposed FINRA Rule 3110(b). Provisions from NASD Rule 3010(d)(1) relating to the supervision of registered representatives, NASD Rule 3040 relating to the supervision of outside securities activities and NYSE Rule 401A relating to review of customer complaints would be incorporated within Proposed FINRA Rule 3110(b). In addition, Supplementary Material would be added to clarify or expand guidance in this area. NASD Rule 3010(b)(2) (Tape Recording of Conversations) would be reconstituted as a separate standalone rule.

Highlights of the proposal are as follows:

a. Proposed FINRA Rule 3110(b)(1): General Requirements

FINRA is proposing to retain the requirement in NASD Rule 3010(b)(1) requiring each member firm to establish, maintain and enforce written procedures to supervise the types of business in which it engages.

b. Proposed FINRA Rule 3110(b)(2): Review of Member's Investment Banking and Securities Business

FINRA is proposing to retain the requirement in NASD Rule 3010(d)(1) requiring principal review, evidenced in writing, of all transactions, but relocating the provision into a separate paragraph (Proposed FINRA Rule 3110(b)(2)). FINRA is also proposing to amend the provision to clarify that such review include all transactions relating to the investment banking and securities business of the member firm. In addition, FINRA is proposing to add new Supplementary Material clarifying that the review of such transactions may be risk-based.

c. Proposed FINRA Rule 3110(b)(3): Supervision of Outside Securities Activities

FINRA is proposing to delete NASD Rule 3040 and replace it with new streamlined provisions in Proposed FINRA Rule 3110(b)(3) that require an associated person to obtain the member firm's prior written approval before engaging in any outside investment banking or securities business, regardless of whether the associated person receives any compensation, as set forth in NASD Rule 3040. If the member firm gives its written approval, the activity is within the scope of the member firm's business and must be supervised in accordance with Proposed FINRA Rule 3110. The proposed provision would bring uniformity to the supervisory requirements regarding outside securities activities recognizing that such activity, once approved by the member firm, becomes the business of the member firm and must be supervised accordingly (with the exception of bank-related securities activity conducted pursuant to an exemption from broker-dealer registration in accordance with federal law, discussed below).

To address the concerns surrounding the functional regulation of banks and broker-dealers, FINRA is proposing an exception from the general supervisory requirements of Proposed FINRA Rule 3110(b) for bank-related securities activities of a dual employee⁶ to the extent such securities activities fall within any of the statutory or regulatory exemptions from registration as a broker or dealer. To rely on the exception, the member firm must receive written notice of and approve such securities activities. However, to guard against fraud committed by persons who conduct securities activities in a broker-dealer

and a bank, a member firm would not be able to approve a dual employee to engage in investment banking or securities business in a bank unless the member firm has written assurance that:

- the bank, or a supervised bank affiliate, will have a comprehensive view of the dual employee's securities activities;
- the bank or the supervised bank affiliate employs policies and procedures reasonably designed to achieve compliance with the anti-fraud provisions of the federal securities laws; and
- the bank or the supervised bank affiliate will promptly notify the member firm of any violation of the policies and procedures by the dual employee.⁷

FINRA is also proposing additional rule text and Supplementary Material addressing a firm's obligations to reevaluate its reliance on a bank's or supervised bank affiliate's anti-fraud policies and procedures after receiving notice that a dual employee has violated those policies and procedures.

d. Proposed FINRA Rule 3110(b)(4): Review of Correspondence and Internal Communications

Proposed FINRA Rule 3110(b)(4) generally incorporates the substance of NASD Rule 3010(d) requiring appropriate procedures for the review of correspondence, but has been streamlined.

e. Proposed FINRA Rule 3110(b)(5): Review of Customer Complaints

NYSE Rule 401A (Customer Complaints) specifically requires firms to "capture, acknowledge, and respond to" all written and oral customer complaints. FINRA is proposing to incorporate NYSE Rule 401A within Proposed FINRA Rule 3110(b)(5), but limit the requirement to include only written (including electronic) customer complaints. Written customer complaints are more easily documented and retained. In contrast, oral complaints are more difficult to capture and assess, and they raise competing views as to the substance of the complaint being alleged; consequently, oral complaints do not lend themselves as effectively to an examination program as written complaints. FINRA encourages all customers to document their complaints in writing.

f. Proposed FINRA Rule 3110(b)(6): Documentation and Supervision of Supervisory Personnel

Proposed FINRA Rule 3110(b)(6) is based largely on existing provisions in NASD Rule 3010(b)(3) and includes certain provisions presently found in NASD Rule 3012. FINRA is proposing to delete the prescriptive provisions in NASD Rule 3012 concerning the supervision of producing manager's customer account activity, including the requirement to impose heightened supervision when any producing manager's revenues rise above a specific threshold, and replace them with a new provision in Proposed FINRA Rule 3110(b)(6) that would address potential abuses in connection with the supervision of supervisors.

The proposed rule would require member firms to have procedures:

- prohibiting supervisory personnel from supervising their own activities or from reporting to, or having their compensation or continued employment determined by, someone they are supervising; and
- preventing the diminution of supervision, in terms of its nature, scope and response, to detected non-compliant conduct due to any conflicts of interest that may be present, such as the associated person's position, the amount of the revenue generated by such person or any other factor that would present a conflict.

Under the proposal, a member firm that, because of the firm's size or a supervisor's very senior position within the firm, could not prohibit a supervisor from supervising his or her own activities or reporting to someone he or she is supervising would have to document why it could not do so and have a supervisory arrangement that otherwise complies with Proposed FINRA Rule 3110(a).

3. *Proposed FINRA Rule 3110(c): Internal Inspections*

Proposed FINRA Rule 3110(c) is largely based on NASD Rule 3010(c). However, FINRA is proposing to revise NASD Rule 3010(c)(3)'s provisions prohibiting certain persons from conducting office inspections to make the provisions less prescriptive. To that end, the proposed rule would eliminate the heightened office inspection requirements member firms must implement if the branch office manager and the person conducting the office inspection report to the same person. These provisions would be replaced with provisions requiring a member firm to:

- prevent the effectiveness of the inspection from being lessened in any manner due to any conflicts of interest that may be present; and
- have a location inspected by someone who is not an associated person of that location or supervised by someone at that location.

If a member firm could not comply with this last condition due to its size or business model, it would have to document why it could not comply and how the inspection otherwise prohibits conflicts of interest from lessening the effectiveness of the inspection.

FINRA is also proposing to relocate certain provisions in NASD Rule 3012 requiring procedures to review and monitor certain specific activities, such as transmittals of funds and securities, and customer changes of address and investment objectives, into Proposed FINRA Rule 3110(c).

4. *Proposed FINRA Rule 3110(d): Branch Office and OSJ Definitions and Standards for Review of Offices*

FINRA is proposing to retain the definitions of “branch office” and “office of supervisory jurisdiction” in NASD Rule 3010(g) and NASD IM-3010-1 (Standards of Reasonable Review) relating to standards for reasonable review of offices, which have already been harmonized with the analogous NYSE rules. Additionally, FINRA is proposing to incorporate into Proposed FINRA Rule 3110 the requirement in NASD IM-1000-4 (Branch Offices and Offices of Supervisory Jurisdiction) that all branch offices and OSJs must be registered as either a branch office or OSJ.

5. *Proposed FINRA Rule 3110 Supplementary Material*

In addition to the proposals to the text of the supervision rule described above, FINRA is proposing Supplementary Material to Proposed FINRA Rule 3110 that would codify existing FINRA staff guidance or move rule text from NASD Rule 3010 into Supplementary Material regarding:

- registration of main offices as either branch offices or OSJs if the locations meet the definitions;
- designation of additional OSJs;
- supervision of one-person OSJs;
- supervision of multiple OSJs by a single principal;
- a general presumption of a three-year limit for periodic inspection schedules at non-branch locations; and
- delivery methods for the annual compliance meeting required for registered personnel.

In addition, FINRA is proposing to add Supplementary Material to Proposed FINRA Rule 3110 that would clarify and/or assist firms in complying with the provisions of Proposed FINRA Rule 3110 described above, specifically provisions relating to:

- risk-based review of a member firm’s investment banking and securities business;
- reliance by a member firm on a bank or supervised bank affiliate to supervise dual employees;
- risk-based review of correspondence (including hard copy and electronic) and internal communications;
- methods to evidence review of correspondence and internal communications;
- delegation of certain functions relating to the review of correspondence and internal communications;

- retention requirements for correspondence and internal communications;
- permissible exceptions to prohibiting supervisory personnel from supervising their own activities; and
- permissible exceptions to prohibiting certain persons from conducting office inspections.

FINRA is also proposing to adopt as Supplementary Material a provision based on the NYSE requirements that a firm's insider trading procedures specifically include the review of trades that are effected for the firm's account or for the accounts of the firm's employees and family members for potential insider trading. The Insider Trading & Securities Fraud Enforcement Act of 1988 (ITSFEA) requires every broker-dealer to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by the broker-dealer or any associated person of the broker-dealer.⁸

NYSE Rule 342.21 (Trade Review and Investigation) sets forth specific supervisory procedures for compliance with ITSFEA by requiring firms to review trades in NYSE-listed securities and related financial instruments that are effected for the firm's account or for the accounts of the firm's employees and family members. NYSE Rule 342.21 also requires firms to promptly conduct an internal investigation into any trade the firm identifies that may have violated insider trading laws or rules.

FINRA is proposing to incorporate the provisions of NYSE Rule 342.21 into the Proposed FINRA Rule 3110 Supplementary Material and extend the requirement beyond NYSE-listed securities and related financial instruments. The proposed Supplementary Material would require internal investigations into suspicious trades and would require firms that engage in "investment banking services," as that term will be defined in the consolidated research analyst rules, to provide reports to FINRA regarding such investigations.

C. Proposed FINRA Rule 3120 (Supervisory Control System)

FINRA is proposing to replace NASD Rule 3012 (Supervisory Control System) with Proposed FINRA Rule 3120. Proposed FINRA Rule 3120 retains the NASD Rule 3012 testing and verification requirements, including the requirement to prepare and submit to the firm's senior management a report at least annually summarizing the test results and any necessary amendments. FINRA is also proposing to apply certain content requirements in NYSE Rule 342.30 (Annual Report and Certification) to firms that reported \$150 million or more in gross revenue on their FOCUS reports in the prior calendar year.

Under the proposed rule, firms subject to the supplemental information requirement would have to include in the following year's reports a tabulation of the previous year's customer complaints and a discussion of the previous year's compliance efforts in a number of specified areas, such as trading and market activities, investment banking activities and sales practices. FINRA believes the \$150 million threshold serves as an appropriate benchmark to identify those firms for which this additional information is most beneficial given the nature and complexity of the firms' activities, and by using FOCUS report data, firms can easily and readily determine whether they are subject to the enhanced information requirement. This supplemental information was a valuable tool for the NYSE regulatory program and will also be valuable information for FINRA's regulatory program going forward.

As noted above, FINRA is also proposing to relocate several of NASD Rule 3012's provisions (as proposed to be amended) into Proposed FINRA Rule 3110.

D. Proposed FINRA Rule 3150 (Holding of Customer Mail)

NASD Rule 3110(i) (Holding of Customer Mail) imposes particular time limits for member firms holding mail for a customer. FINRA is proposing that the rule be re-written as a standalone rule to allow member firms generally to hold customer mail in accordance with the customer's instructions.

E. Proposed FINRA Rule 3170 (Tape Recording of Registered Persons by Certain Firms)

FINRA is proposing to relocate the provisions in NASD Rule 3010(b)(2) (often referred to as the "Taping Rule") to a standalone supervision rule, subject to minor changes to make it more clear.

F. Proposed FINRA Rule 1260 (Responsibility of Member to Investigate Applicants for Registration)

FINRA is proposing to relocate the requirements concerning a member firm's responsibilities during a person's registration as a representative or principal in NASD Rule 3010(e) (Qualifications Investigated) to a standalone registration rule.⁹

G. Proposal to Eliminate Other NASD and NYSE Rules

As noted above, FINRA is proposing to eliminate certain NASD rules after either incorporating their requirements within Proposed FINRA Rule 3110 or its Supplementary Material, or creating a standalone rule. Those eliminated rules include NASD IM-1000-4, NASD Rule 3040 and NASD Rule 3110(i).

FINRA is also proposing to eliminate several of NYSE Rule 342's provisions, supplementary material and interpretations as they are, in main part, either duplicative of the proposed FINRA supervision requirements described in this *Notice* or do not align with the recommended changes.

The NYSE rule provisions concerning supervision that FINRA is proposing to eliminate include:

- Rule 342.10 (Definition of Branch Office);
- Rule 342.12 (Foreign Branch Offices);
- Rule 342.13 (Acceptability of Supervisors);
- Rule 342.14 (Experience of Senior Management);
- Rule 342.15 (Small Offices) and Interpretations 342.15/01-05;
- Rule 342.16 (Supervision of Registered Representatives);
- Rule 342.19 (Supervision of Producing Managers);
- Rule 351(e) (Reporting Requirements);
- Rule 354 (Reports to Control Persons); and
- Rule 401(b) (Business Conduct).

FINRA is also proposing to delete those parts of NYSE Rule 407(b) (Transactions—Employees of Members, Member Organizations and the Exchange) and NYSE Rule 407.11 that are analogous to the requirements of NASD Rule 3040 regarding the supervision of outside securities activities.

Finally, FINRA is proposing to delete the requirements of NYSE Rule 343 (Offices—Branch Office Space-Sharing Arrangements and Main Office of Business Hours) and related Supplementary Material. Certain provisions relating to disclosure of space-sharing arrangements are duplicative of information currently reported on Form BR. Certain other provisions contain outdated requirements relating to hours of operation, display of membership certificates and permissible space-sharing arrangements.

Endnotes

- 1 The current FINRA rulebook consists of two sets of rules: (1) NASD rules and (2) rules incorporated from NYSE (Incorporated NYSE Rules) (together referred to hereinafter as the Transitional Rulebook). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). Dual Members also must comply with NASD rules. For more information about the rulebook consolidation process, see *FINRA Information Notice, March 12, 2008* (Rulebook Consolidation Process).
- 2 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 4 The proposed rules may be renumbered as part of the final Consolidated FINRA Rulebook.
- 5 Proposed FINRA Rule 3110(b), which mirrors in large part NASD Rule 3010(b), requires a member firm to have written supervisory procedures for all business activities in which it engages.
- 6 The proposed rule defines a “dual employee” as “a natural person who has prior written approval from the member to perform as both an associated person of a member and a bank employee.”
- 7 The proposed rule defines a “supervised bank affiliate” as a “bank affiliate that is subject to consolidated supervision by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation or the Director of the Office of Thrift Supervision.”
- 8 See Exchange Act Section 15(f).
- 9 FINRA is also proposing to delete NASD Rule 3010(f) (Applicant’s Responsibility) requiring an applicant for registration to provide, upon a member’s request, a copy of his or her Form U5. The provision is no longer necessary as a member has electronic access to an applicant’s Form U5 through FINRA’s Registration and Disclosure Department.

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Attachment A

Below is the text of the proposed rule change. New language is underlined; deletions are in brackets.

* * * * *

PROPOSED FINRA SUPERVISION RULES

3110[3010]. Supervision¹

(a) Supervisory System

Each member shall establish and maintain a system to supervise the activities of each [registered representative, registered principal, and other] associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable [NASD]FINRA and Municipal Securities Rulemaking Board (MSRB) [R]rules. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) The establishment and maintenance of written procedures as required by paragraphs (b) and (c) of this Rule.

(2) The designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages [for which registration as a broker/dealer is required].

(3) The registration and designation as a branch office and/or an office of supervisory jurisdiction (OSJ) of each location, including the main office, that meets the definitions contained in paragraph[(g)](d) of this Rule. [Each member shall also designate such other OSJs as it determines to be necessary in order to supervise its registered representatives, registered principals, and other associated persons in accordance with the standards set forth in this Rule, taking into consideration the following factors:]

[(A) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;]

[(B) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;]

¹ The draft text is marked to show changes between NASD Rule 3010 and Proposed FINRA Rule 3110.

[(C) whether the location is geographically distant from another OSJ of the firm;]

[(D) whether the member's registered persons are geographically dispersed; and]

[(E) whether the securities activities at such location are diverse and/or complex.]

(4) The designation of one or more appropriately registered principals in each OSJ[, including the main office,] and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the member.

(5) No change.

(6) The use of [R]reasonable efforts to determine that all supervisory personnel are qualified, either by virtue of experience or training, to carry out their assigned responsibilities.

(7) No change.

(b) Written Procedures

(1) General Requirements

Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and [to supervise]the activities of its[registered representatives, registered principals, and other] associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with [the] applicable FINRA and MSRB [R]rules [of NASD].

[(2) Tape recording of conversations]²

(2) Review of Member's Investment Banking and Securities Business

The supervisory procedures required by this paragraph (b) shall include procedures for the review by a registered principal, evidenced in writing, of all transactions relating to the investment banking or securities business of the member.

2 NASD Rule 3010(b)(2) (Tape Recording of Conversations) would be reconstituted as a separate standalone supervision rule, without substantive change. *See Notice*, Section E.

(3) Supervision of Outside Securities Activities

(A) Unless a member provides prior written approval, no associated person may conduct any investment banking or securities business outside the scope of the member's business. If the member gives such written approval, such activity is within the scope of the member's business and shall be supervised in accordance with this Rule, subject to the exceptions set forth in subparagraph (B).

(B) Dual Employees

(i) The supervision required by subparagraph (A) shall not be required with respect to the bank-related securities activities of dual employees when such activities are included within any of the statutory or regulatory exemptions from registration as a broker or dealer, provided that the member receives written notice of, and approves, such activities.

(ii) A member shall not approve the activities of dual employees pursuant to subparagraph (i) unless the member has written assurance that the bank or a supervised bank affiliate will:

a. have a comprehensive view of the dual employee's securities activities;

b. employ policies and procedures reasonably designed to achieve compliance with the anti-fraud provisions of the federal securities laws; and

c. give prompt notice to the member of any dual employee's violation of such policies and procedures.

(iii) A member may rely upon the written representation of any enumerated entity in subparagraph (ii) that it is employing the policies and procedures required in subparagraph b. provided the member supplies access and information, in compliance with SEC Regulation S-P, as is necessary for the execution of such policies and procedures. Upon receiving notice of a dual employee's violation of the policies and procedures required in subparagraph b., the member shall assure itself that the policies and procedures of the enumerated entity in subparagraph (ii) are reasonably designed to achieve compliance with the anti-fraud

provisions of the federal securities laws or have been amended to achieve such compliance. In the event a member cannot reach such assurance, the member must revoke its approval of the dual employee's bank-related securities activities.

(iv) For purposes of this subparagraph (B), the term "dual employee" means a natural person who has prior written approval from the member to perform as both an associated person of a member and a bank employee.

(v) For purposes of this subparagraph (B), the term "supervised bank affiliate" means a bank affiliate that is subject to consolidated supervision by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Director of the Office of Thrift Supervision.

(4) Review of Correspondence and Internal Communications

The supervisory procedures required by this paragraph (b) shall include procedures for the review of incoming and outgoing written (including electronic) correspondence with the public and internal communications relating to the member's investment banking or securities business. The supervisory procedures must be appropriate for the member's business, size, structure, and customers. The supervisory procedures must ensure that the member properly identifies and handles in accordance with firm procedures, customer complaints, customer instructions, funds and securities, and communications that are of a subject matter that require review under FINRA and MSRB rules and federal securities laws. Reviews of correspondence with the public and internal communications must be conducted by a registered principal and must be evidenced in writing, either electronically or on paper.

(5) Review of Customer Complaints

The supervisory procedures required by this paragraph (b) shall include procedures to capture, acknowledge, and respond to all written (including electronic) customer complaints.

(6) Documentation and Supervision of Supervisory Personnel

[(3)]The[member's written] supervisory procedures required by this paragraph (b) shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include:

(A) the titles, registration status, and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and FINRA and MSRB [the R]rules[of this Association].

(B) [The member shall maintain on an internal]a record, preserved by the member for a period of not less than three years, the first two years in an easily accessible place, of the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective.[Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.]

(C) procedures prohibiting associated persons who perform a supervisory function from:

- (i) supervising their own activities; and
- (ii) reporting to, or having their compensation or continued employment determined by, a person or persons they are supervising.

a. If a member determines, with respect to any of its supervisory personnel, that compliance with subparagraph (i) or (ii) above is not possible because of the member's size or a supervisory personnel's position within the firm, the member must:

1. document the factors the member used to reach such determination; and
2. have policies and procedures evidencing a supervisory arrangement with respect to such supervisory personnel that otherwise complies with the general supervision requirements of paragraph (a) of this Rule.

(D) procedures preventing the supervision required by this Rule from being lessened in any manner (such as the nature, scope and response to detected non-compliant conduct), due to any conflicts of interest that may be present with respect to the associated person being supervised, including the position of such person, the revenue such person generates for the firm, or any compensation that the associated person conducting the supervision may derive from the associated person being supervised.

(7) Maintenance of Written Supervisory Procedures

[(4)]A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws or[and] regulations, including [the]FINRA and MSRB [R]rules[of this Association], and as changes occur in its supervisory system[, and e]. Each member [shall be]is responsible for communicating amendments throughout its organization.

(c) Internal Inspections

(1) Each member shall conduct a review, at least annually, of the businesses in which it engages.[, which]. The review shall be reasonably designed to assist the member in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable [NASD]FINRA and MSRB rules. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses. Each member shall also retain a written record of the dates upon which each review and inspection is conducted.

(A) Each member shall inspect at least annually every [office of supervisory jurisdiction]OSJ and any branch office that supervises one or more non-branch locations.

(B) Each member shall inspect at least every three years every branch office that does not supervise one or more non-branch locations. In establishing how often to inspect each non-supervisory branch office, the [firm]member shall consider whether the nature and complexity of the securities activities for which the location is responsible, the volume of

business done at the location, and the number of associated persons assigned to the location require the non-supervisory branch office to be inspected more frequently than every three years. If a member establishes a more frequent inspection cycle, the member must ensure that at least every three years, the inspection requirements enumerated in paragraph (c)(2) have been met. The member's written supervisory and inspection procedures shall set forth [T]the non-supervisory branch office examination cycle, an explanation of the factors the member used in determining the frequency of the examinations in the cycle, and the manner in which a member will comply with paragraph (c)(2) if using more frequent inspections than every three years[shall be set forth in the member's written supervisory and inspection procedures].

(C) Each member shall inspect on a regular periodic schedule every non-branch location. In establishing such schedule, the [firm]member shall consider the nature and complexity of the securities activities for which the location is responsible and the nature and extent of contact with customers. The member's written supervisory and inspection procedures shall set forth[T]the schedule and an explanation regarding how the member determined the frequency of the examination.

[Each member shall retain a written record of the dates upon which each review and inspection is conducted.]

(2) An [office]inspection and review by a member pursuant to paragraph (c)(1) must be reduced to a written report and kept on file by the member for a minimum of three years, unless the inspection is being conducted pursuant to paragraph (c)(1)(C) and the regular periodic schedule is longer than a three-year cycle, in which case the report must be kept on file at least until the next inspection report has been written.

(A) The written inspection report must [also]include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:

[A](i) [S]safeguarding of customer funds and securities;

[B](ii) [M]maintaining books and records;

[C](iii) [S]supervision of supervisory personnel[customer accounts serviced by branch office managers];

[D](iv) [Transmittal of funds between customers and registered representatives and between customers and third parties] transmittals of funds (e.g., wires or checks, etc.) or securities from customers to third party accounts (i.e., a transmittal that would result in a change of beneficial ownership); from customer accounts to outside entities (e.g., banks, investment companies, etc.); from customer accounts to locations other than a customer's primary residence (e.g., post office box, "in care of" accounts, alternate address, etc.); and between customers and registered representatives, including the hand-delivery of checks; and

[E](v) changes of customer account information, including address and investment objectives changes and [V]validation of [customer address]such changes[; and].

[(F) Validation of changes in customer account information.]

(B) The policies and procedures required by paragraph (c)(2)(A)(iv) must include a means or method of customer confirmation, notification, or follow-up that can be documented. Members may use reasonable risk-based criteria to determine the authenticity of the transmittal instructions.

(C) The policies and procedures required by paragraph (c)(2)(A)(v) must include, for each change processed, a means or method of customer confirmation, notification, or follow-up that can be documented and that complies with SEA Rules 17a-3(a)(17)(i)(B)(2) and 17a-3(a)(17)(i)(B)(3).

(D) If a member does not engage in all of the activities enumerated in paragraphs (c)(2)(A)(i) through (c)(2)(A)(v)[above], the member's written supervisory procedures must identify those activities in which [it]the member does not engage [in the written inspection report] and document [in the report]that supervisory policies and procedures for such activities must be in place before the member can engage in them.

(3) [An office inspection by a]Each member must have procedures that are reasonably designed to[pursuant to paragraph (c)(1)]:

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

(B) prevent the inspection from being lessened in any manner due to any conflicts of interest, including but not limited to, economic, commercial, or financial interests in the associated persons and businesses being inspected that may be present.

(i) If a member determines that compliance with paragraph (c)(3)(A) is not possible either because of a member's size or its business model, the member must document in the inspection report the factors the member used to make its determination and how the inspection otherwise comports with paragraph (c)(3)(B).[may not be conducted by the branch office manager or any person within that office who has supervisory responsibilities or by any individual who is directly or indirectly supervised by such person(s). However, if a member is so limited in size and resources that it cannot comply with this limitation (e.g., a member with only one office or a member has a business model where small or single-person offices report directly to an office of supervisory jurisdiction manager who is also considered the offices' branch office manager), the member may have a principal who has the requisite knowledge to conduct an office inspection perform the inspections. The member, however, must document in the office inspection reports the factors it has relied upon in determining that it is so limited in size and resources that it has no other alternative than to comply in this manner.]

[A member must have in place procedures that are reasonably designed to provide heightened office inspections if the person conducting the inspection reports to the branch office manager's supervisor or works in an office supervised by the branch manager's supervisor and the branch office manager generates 20% or more of the revenue of the business units supervised by the branch office manager's supervisor. For the purposes of this subsection only, the term "heightened inspection" shall mean those inspection procedures that are designed to avoid conflicts of interest that serve to undermine complete and effective inspection because of the economic, commercial, or financial interests that the branch manager's supervisor holds in the associated persons and businesses being inspected. In addition, for the purpose of this section only, when calculating the 20% threshold, all of the revenue generated by or credited to the branch office or branch office manager shall be attributed as revenue generated by the business units supervised by the branch office manager's supervisor irrespective of a member's internal allocation of such revenue. A member must calculate the 20% threshold on a rolling, twelve-month basis.]

[(d) Review of Transactions and Correspondence]³

[(e) Qualifications Investigated]⁴

[(f) Applicant's Responsibility]⁵

[(g)](d) Definitions

(1) "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place:

- (A) order execution and/or market making;
- (B) structuring of public offerings or private placements;
- (C) maintaining custody of customers' funds and/or securities;
- (D) final acceptance (approval) of new accounts on behalf of the member;
- (E) review and endorsement of customer orders, pursuant to paragraph [(d)](b)(2) above;
- (F) final approval of advertising or sales literature for use by persons associated with the member, pursuant to NASD Rule 2210(b)(1), except for an office that solely conducts final approval of research reports; or
- (G) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

(2)(A) A "branch office" is any location where one or more associated persons of a member regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or is held out as such, excluding:

- (i) Any location that is established solely for customer service and/or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;

3 The supervision requirements for review of transactions and correspondence would be rewritten and relocated in Proposed FINRA Rule 3110 and its Supplementary Material. *See Notice*, Section B.2.b. and B.2.d. The text of such proposed Supplementary Material is set forth in this Attachment A.

4 NASD Rule 3010(e) would be reconstituted as Proposed FINRA Rule 1260. *See Notice*, Section F. The text of Proposed FINRA Rule 1260 is set forth in this Attachment A.

5 NASD Rule 3010(f) would be deleted as obsolete. *See Notice*, endnote 9.

- (ii) Any location that is the associated person's primary residence; provided that
- a. Only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;
 - b. The location is not held out to the public as an office and the associated person does not meet with customers at the location;
 - c. Neither customer funds nor securities are handled at that location;
 - d. The associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, advertisements and other communications to the public by such associated person;
 - e. The associated person's correspondence and communications with the public are subject to the firm's supervision in accordance with this Rule[3010];
 - f. Electronic communications (e.g., e-mail) are made through the member's electronic system;
 - g. All orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office;
 - h. Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member; and
 - i. A list of the residence locations is maintained by the member;
- (iii) Any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year, provided the member complies with the provisions of subparagraph [(A)](2)(A)(ii)a. through h. above;

(iv) Any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as an office; *

(v) Any location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 securities transactions in any one calendar year; provided that any advertisement or sales literature identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised;

(vi) The Floor of a registered national securities exchange where a member conducts a direct access business with public customers; or

(vii) A temporary location established in response to the implementation of a business continuity plan.

(B) Notwithstanding the exclusions in subparagraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member is considered to be a branch office.

(C) The term “business day” as used in paragraph [Rule 3010(g)](d)(2)(A) of this Rule shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

* Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of [the NYSE,] other self-regulatory organizations, and securities and banking regulators may be displayed and shall not be deemed “holding out” for purposes of this section.

••• Supplementary Material:

.01 Registration of Main Office. – A member’s main office location is required to be registered and designated as a branch office and/or OSJ if it meets the definitions of a “branch office” and/or “office of supervisory jurisdiction” as set forth in Rule 3110(d). In general, the nature of activities conducted at a main office will satisfy the requirements of such terms.

.02 Designation of Additional OSJs. – In addition to the locations that meet the definition of OSJ in Rule 3110(d), each member shall also register and designate other offices as OSJs as is necessary to supervise its associated persons in accordance with the standards set forth in Rule 3110. In making a determination as to whether to designate a location as an OSJ, the member should consider the following factors:

(a) whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;

(b) whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;

(c) whether the location is geographically distant from another OSJ of the firm;

(d) whether the member's registered persons are geographically dispersed; and

(e) whether the securities activities at such location are diverse and/or complex.

.03 One-Person OSJs. – A location with only one registered person that either meets the definition of OSJ in Rule 3110(d) or that the member has selected as an additional OSJ pursuant to .02 above, must be registered and designated as an OSJ. The registered person must be an appropriately registered principal and designated, pursuant to Rule 3110(a)(4), to carry out supervisory responsibilities assigned to that office ("on-site principal"). If the on-site principal is authorized to engage in business activities other than the supervision of associated persons or other offices as enumerated in Rule 3110(d)(1)(D) through (G), the principal cannot supervise his or her own activities. Such one-person OSJ location must be under the close supervision and control of another appropriately registered principal ("senior principal"). The senior principal will be responsible for supervising the activities of the on-site principal at such office. The senior principal must conduct on-site supervision of such OSJ location on a regular periodic schedule to be determined by the member. In establishing such schedule, the member shall consider, among other factors, the nature and complexity of the securities activities for which the location is responsible, the nature and extent of contact with customers, and the disciplinary history of the on-site principal.

.04 Supervision of Multiple OSJs by a Single Principal. – Rule 3110(a)(4) requires a member to designate one or more appropriately registered principals in each OSJ with the authority to carry out the supervisory responsibilities assigned to that office. The designated principal for each OSJ must have a physical presence, on a regular and routine basis, at each OSJ for which the principal has supervisory responsibilities. Consequently, there is a general presumption that a principal will not be designated and assigned to supervise more than one OSJ. If a member determines it is necessary to designate and assign one appropriately registered principal to supervise two or more OSJs, the member must take into consideration, among others, the following factors:

- (a) whether the principal is qualified by virtue of experience and training to supervise the activities and associated persons in each location;
- (b) whether the principal has the capacity and time to supervise the activities and associated persons in each location;
- (c) whether the principal is a producing registered representative;
- (d) whether the OSJ locations are in sufficiently close proximity to ensure that the principal is physically present at each location on a regular and routine basis; and
- (e) the nature of activities at each location, including size and number of associated persons, scope of business activities, nature and complexity of products and services offered, volume of business done, the disciplinary history of persons assigned to such locations, and any other indicators of irregularities or misconduct.

The member must establish, maintain and enforce written supervisory procedures regarding the supervision of all OSJs. In all cases where a member designates and assigns one principal to supervise more than one OSJ, the member must document in the member's written supervisory and inspection procedures the factors used to determine why the member considers such supervisory structure to be reasonable.

There is a further general presumption that a determination by a member to designate and assign one principal to supervise more than two OSJs is unreasonable. If a member determines to designate and assign one principal to supervise more than two OSJs, the member's determination will be subject to greater scrutiny, and the member will have a greater burden to evidence the reasonableness of such structure.

.05 Annual Compliance Meeting. – A member is not required to conduct in-person meetings with each registered person or group of registered persons to comply with the annual compliance meeting (or interview) required by Rule 3110(a)(7). A member that chooses to conduct compliance meetings using other methods (i.e., on-demand webcast, video conference, interactive classroom setting, telephone, or other electronic means) must ensure, at a minimum, that each registered person attends the entire meeting (e.g., an on-demand annual compliance webcast would require each registered person to use a unique user ID and password to gain access and use a technology platform to track the time spent on the webcast, provide click-as-you go confirmation, and have an attestation of completion at the end of a webcast) and is able to ask questions to the presenter and receive answers from the presenter in a timely fashion (e.g., an on-demand annual compliance webcast that allows registered persons to ask questions via an email to a centralized address or telephone hotline with questions and the webcast presenter's timely responses posted on the member's intranet site).

.06 Risk-based Review of Member's Investment Banking and Securities Business. – A member may use a risk-based review system to comply with Rule 3110(b)(2), which requires the review by a registered principal, as evidenced in writing, of all transactions relating to the investment banking or securities business of the member.

.07 Reliance on Bank or Affiliated Entity to Supervise Dual Employees. – Rule 3110(b)(3)(B)(iii) requires a member to consider the sufficiency of the policies and procedures of the bank or the supervised bank affiliate on which the member is relying to supervise the conduct of dual employees (the supervisory system) in the event of a notice of a dual employee's violation of the referenced policies and procedures. However, it is understood that not every violation must result in the conclusion that the supervisory system being employed is insufficient or improperly designed. Members' conclusions in this regard must be reasonable and reached in good faith. Members should understand that repeated violations, violations that by their nature raise systemic problems, and/or violations of a long duration in time call into question the reasonableness of any determination that the supervisory system that was employed remains viable without the need for any amendments, reconfigurations, or altered control and oversight functions.

A member that cannot reach the reasonable determination that the supervisory system remains viable should revoke its approval of all dual employees being supervised under that supervisory system until such time as the member can assure itself that problems with the supervisory system have been corrected.

.08 Transaction review and investigation. – (a) To help ensure its compliance with the provisions of the Exchange Act, the rules thereunder, and FINRA rules prohibiting insider trading and manipulative and deceptive devices, each member shall:

(1) include in its supervisory procedures a process for the review of securities transactions that are effected for the account(s) of the member and/or the member's associated persons and their family members to identify trades that may violate the provisions of the Exchange Act, the rules thereunder, or FINRA rules prohibiting insider trading and manipulative and deceptive devices; and

(2) conduct promptly an internal investigation into any such trade to determine whether a violation of those laws or rules has occurred.

(b) A member engaging in investment banking services must file with FINRA, written reports, signed by a senior officer of the member, at such times and, without limitation, including such content, as follows:

(1) within ten business days of the initiation of the internal investigation of any trade pursuant to paragraph (a)(2), a written report that discloses the identity of the member, the date the internal investigation commenced, and the identity of the security, trades, accounts, employees, or employee's family members, under review, and that includes a copy of the member's policies and procedures required by paragraph (a)(1).

(2) a quarterly written report addressing the progress of each open internal investigation filed with FINRA pursuant to paragraph (b)(1) by the 15th day of the month following the quarter.

(3) within five business days of completion of the internal investigation pursuant to paragraph (a)(2), a written report detailing the completion of the investigation, including the results of the investigation, any internal disciplinary action taken, and any referral of the matter to FINRA, another self-regulatory organization, the SEC, or any other federal, state, or international regulatory authority.

(c) For purposes of paragraph (b), "investment banking services" include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

.09 Risk-based Review of Correspondence and Internal Communications. – By employing risk-based principles, a member may decide the extent to which additional policies and procedures for the review of incoming and outgoing written (including electronic) correspondence with the public and internal communications that fall outside of the subject matters listed in Rule 3110(b)(4) are appropriate for its business and structure. If a member's procedures do not require that all correspondence be reviewed before use or distribution, the procedures must provide for:

- (a) the education and training of associated persons regarding the firm's procedures governing correspondence;
- (b) the documentation of such education and training; and
- (c) surveillance and follow-up to ensure that such procedures are implemented and followed.

.10 Evidence of Review of Correspondence and Internal Communications. – The evidence of review required in Rule 3110(b)(4) must be chronicled either electronically or on paper and must clearly identify the reviewer, the communication that was reviewed, the date of review, and the actions taken by the member as a result of any significant regulatory issues identified during the review. Merely opening a communication is not sufficient review.

.11 Delegation of Correspondence and Internal Communication Review Functions. – In the course of the supervision and review of correspondence with the public and internal communications required by Rule 3110(b)(4), a supervisor/principal may delegate certain functions to persons who need not be registered. However, the supervisor/principal remains ultimately responsible for the performance of all necessary supervisory reviews, irrespective of whether he or she delegates functions related to the review. Accordingly, supervisors must take reasonable and appropriate action to ensure delegated functions are properly executed and should evidence performance of their procedures sufficiently to demonstrate overall supervisory control.

.12 Retention of Correspondence and Internal Communication. – Each member shall retain the internal communications and correspondence of associated persons relating to the member's investment banking or securities business for the period of time and accessibility specified in SEA Rule 17a-4(b). The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records, and the retained records shall be readily available to FINRA, upon request.

.13 Supervision of Supervisory Personnel. – A member’s determination that it is not possible to comply with paragraphs (b)(6)(C)(i) or (b)(6)(C)(ii) of Rule 3110 prohibiting supervisory personnel from supervising their own activities and from reporting to, or otherwise having compensation or continued employment determined by, a person or persons they are supervising generally will arise only in instances where:

(a) the member is a sole proprietor in a single-person firm;

(b) a registered person is the member’s most senior executive officer (or similar position); or

(c) a registered person is one of several of the member’s most senior executive officers (or similar positions).

.14 Standards for Reasonable Review. – In fulfilling its obligations under Rule 3110(c), each member must conduct a review, at least annually, of the businesses in which it engages. The review must be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations and with FINRA and MSRB rules. Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, the firm’s size, organizational structure, scope of business activities, number and location of the firm’s offices, the nature and complexity of the products and services offered by the firm, the volume of business done, the number of associated persons assigned to a location, the disciplinary history of registered representatives or associated persons, and any indicators of irregularities or misconduct (i.e., “red flags”), etc. The procedures established and reviews conducted must provide that the quality of supervision at remote locations is sufficient to ensure compliance with applicable securities laws and regulations and with FINRA and MSRB rules. A member must be especially diligent in establishing procedures and conducting reasonable reviews with respect to a non-branch location where a registered representative engages in securities activities. Based on the factors outlined above, members may need to impose reasonably designed supervisory procedures for certain locations and/or may need to provide for more frequent reviews of certain locations.

.15 General Presumption of Three-Year Limit for Periodic Inspection Schedules. – Rule 3110(c)(1)(C) requires a member to inspect on a regular periodic basis every non-branch location. In establishing a non-branch location inspection schedule, there is a general presumption that a non-branch location will be inspected at least every three years, even in the absence of any indicators of irregularities or misconduct (i.e., “red flags”). If a member establishes a longer periodic inspection schedule, the member must document in its written supervisory and inspection procedures the factors used in determining that a longer periodic inspection cycle is appropriate.

.16 Exception to Persons Prohibited from Conducting Inspections. – A member’s determination that it is not possible to comply with Rule 3110(c)(3)(A) with respect to who is not allowed to conduct a location’s inspection will generally arise only in instances where:

(a) the member has only one office; or

(b) the member has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices’ branch office manager.

* * * * *

3120[3012]. Supervisory Control System⁶

(a) [General Requirements]

[(1)] Each member shall designate and specifically identify to [NASD]FINRA one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that:

[(A)](1) test and verify that the member’s supervisory procedures are reasonably designed with respect to the activities of the member and its [registered representatives and] associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable [NASD]FINRA and Municipal Securities Rulemaking Board (MSRB) rules; and

[(B)](2) create additional or amend supervisory procedures where the need is identified by such testing and verification. The designated principal or principals must submit to the member’s senior management no less than annually, a report^[1] detailing each member’s system of supervisory controls, the summary of the test results and significant identified exceptions, and any additional or amended supervisory procedures created in response to the test results.

(b) Each report provided to senior management pursuant to paragraph (a) in the calendar year following a calendar year in which a member reported \$150 million or more in gross revenue must include:

(1) a tabulation of the reports pertaining to customer complaints and internal investigations made to FINRA during the preceding year; and

6 The draft text is marked to show changes between NASD Rule 3012 and Proposed FINRA Rule 3120.

(2) discussion of the preceding year's compliance efforts, including procedures and educational programs, in each of the following areas:

(A) trading and market activities;

(B) investment banking activities;

(C) antifraud and sales practices;

(D) finance and operations;

(E) supervision;

(F) anti-money laundering; and

(G) risk management.

(c) For purposes of paragraph (b), "gross revenue" is defined as total revenue as reported on FOCUS Form Part II or IIA (line item 4030) less Commodities Revenue (line item 3990), if applicable.

[(2) through (3)]

[(b) Dual Member]

* * * * *

3150. Holding of Customer Mail⁷

A member may hold mail for a customer who will not be receiving mail at his or her usual address, provided that the member receives written instructions from the customer that include the time period during which the member is requested to hold the customer's mail. If the time period included in the instructions is for an extended time, the member must verify at reasonable intervals that the customer's instructions still apply. During the time that a member is holding mail for a customer, the member must be able to communicate with the customer in a timely manner to provide important account information, as necessary. A member holding a customer's mail pursuant to this Rule must take actions reasonably designed to ensure that the customer's mail is not tampered with, held without the customer's consent, or used by an associated person of the member in any manner that would violate FINRA rules, Municipal Securities Rulemaking Board rules, or the federal securities laws.

* * * * *

⁷ NASD Rule 3110(i) (Holding of Customer Mail) would be rewritten as Proposed FINRA Rule 3150. See Notice, Section D.

PROPOSED FINRA REGISTRATION RULE

1260. Responsibility of Member to Investigate Applicants for Registration

(a) Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making a certification in the application of such person for registration with FINRA. Where an applicant for registration has previously been registered with FINRA, the member shall review a copy of the Uniform Termination Notice of Securities Industry Registration (Form U5) filed with FINRA by such person's most recent previous FINRA member employer, together with any amendments thereto that may have been filed pursuant to Article V, Section 3 of the FINRA By-Laws. The member shall review the Form U5 as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to FINRA that it has made reasonable efforts to comply with the requirement. Further inquiry shall be made as warranted based on the background or other information developed, and the member shall then take such action as may be deemed appropriate.

(b) Where an applicant for registration has been previously registered with a registered futures association ("RFA") member that is or has been registered as a broker-dealer pursuant to Section 15(b)(11) of the Exchange Act ("notice-registered broker-dealer") with the SEC to trade security futures, the member shall review a copy of the Notice of Termination of Associated Person (Form 8-T) filed with the RFA by such person's most recent previous RFA member employer, together with any amendments thereto. The member shall review the Form 8-T as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to FINRA that it has made reasonable efforts to comply with the requirement. Further inquiry shall be made as warranted based on the background or other information developed, and the member shall then take such action as may be deemed appropriate.

* * * * *

Books and Records

Proposed Consolidated FINRA Rules Governing Books and Records Requirements

Comment Period Expires: June 13, 2008

Executive Summary

As part of the process of developing a new, consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on proposals relating to the FINRA books and records rules (the proposed rules). Current NASD and Incorporated NYSE Rules² require member firms to make and preserve certain books and records to evidence compliance with federal securities laws and FINRA and SEC rules, as well as to enable FINRA and SEC staffs to conduct effective examinations. Based in large part on the current rules, the proposed rules would rewrite the FINRA books and records provisions with three goals in view:

- ▶ to streamline the books and records rules to make them as clear as possible;
- ▶ to group books and records requirements along similar subject matter lines to make finding them a more intuitive process and to provide firms with a better understanding of the regulatory scheme; and
- ▶ to eliminate those books and records requirements contained in the current NASD and NYSE Rules that have become obsolete or otherwise duplicative.

The text of the proposed rules is set forth in Attachment A.

Questions regarding this *Notice* should be directed to Afshin Atabaki, Assistant General Counsel, Office of General Counsel (OGC), at (202) 728-8902; or Adam H. Arkel, Assistant General Counsel, OGC, at (202) 728-6961.

May 2008

Notice Type

- ▶ Request for Comment
- ▶ Consolidated FINRA Rulebook

Suggested Routing

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

Key Topic(s)

- ▶ Books and Records

Referenced Rules & Notices

- ▶ NASD Rule 2320
- ▶ NASD Rule 3110
- ▶ NASD IM-3110
- ▶ NYSE Rule 440
- ▶ NYSE Interpretation Handbook Rule 440.20/01
- ▶ SEA Rule 17a-3
- ▶ SEA Rule 17a-4

Action Requested

FINRA encourages all interested parties to comment on the proposals. Comments must be received by June 13, 2008. Comments received after the close of the comment period will not be considered, although interested parties will have further opportunity to comment when the proposals resulting from this *Notice* process are filed with the SEC for approval.

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

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

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

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

Important Notes:

The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.³

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.⁴

Discussion

FINRA is soliciting comments on the following proposals.

A. General Requirements (Proposed FINRA Rule 4511)⁵

Currently, there are two general recordkeeping rules in effect under NASD and NYSE Rules. NASD Rule 3110(a) (Requirements) addresses the general obligation of member firms under all applicable laws, rules, regulations, statements of policy, NASD Rules and Securities Exchange Act (SEA) Rule 17a-3 to make and preserve books and records, including the obligation to preserve such books and records in formats and media that comply with SEA Rule 17a-4. NYSE Rule 440 (Books and Records) also sets forth the general obligation of firms to make and preserve books and records.

Proposed FINRA Rule 4511 would streamline, and replace, the language of NASD Rule 3110(a) to clarify that member firms are obligated to make and preserve books and records as required under the FINRA rules, SEA Section 17(a) and applicable associated SEA rules. NYSE Rule 440 would be deleted⁶ because its provisions are substantially duplicative of Proposed FINRA Rule 4511.

B. Records Relating to the Three Quote Rule

NASD Rule 3110(b) (Marking of Customer Order Tickets) requires that firms indicate on the order ticket for each transaction in a non-exchange-listed security the name of each dealer contacted and the quotations received to determine the best inter-dealer market as required by NASD Rule 2320(g) (commonly referred to as the Three Quote Rule), unless the firm can establish and document its reliance on the exclusions to the Three Quote Rule.

FINRA proposes that NASD Rule 3110(b) be moved to and incorporated within the Three Quote Rule as part of a later phase of the rulebook consolidation process. Until such time, NASD Rule 3110(b) would remain unchanged as part of the Transitional Rulebook.

C. Customer Account Information (Proposed FINRA Rule 4512)

Except as described below, NASD Rule 3110(c) (Customer Account Information) would be incorporated into Proposed FINRA Rule 4512 without substantive change.

1. Signature Requirement

NASD Rule 3110(c)(1) requires that firms maintain certain information relating to customer accounts, including, among other things, the signature of the registered representative introducing the account. Proposed FINRA Rule 4512(a)(1)(C) would simplify this provision by instead requiring firms to maintain the name of the associated person, if any, responsible for the account.⁷

FINRA is soliciting comments specifically on whether the current signature requirement has any identifiable value and should be retained.

2. *Discretionary Accounts*

NASD Rule 3110(c)(3) requires that for discretionary accounts, in addition to the requirements set forth in Rules 3110(c)(1) and (2), firms must: obtain the signature of each person authorized to exercise discretion in the account; record the date such discretion is granted; and, in connection with exempted securities (other than municipals), record the age or approximate age of the customer.

Proposed FINRA Rule 4512(a)(3) would simplify and clarify NASD Rule 3110(c)(3) in several ways. Specifically, the proposed rule would:

- ▶ consistent with the SEA recordkeeping requirements, provide that, in addition to the information required under Proposed FINRA Rule 4512(a)(1) (current NASD Rule 3110(c)(1)) and, to the extent applicable, Rule 4512(a)(2) (current NASD Rule 3110(c)(2)), member firms maintain a record of the dated signature of each *named, natural person* authorized to exercise discretion in the account;
- ▶ delete the requirement to record the age or approximate age of the customer in connection with exempted securities;⁸
- ▶ provide that its requirements do not apply to investment discretion granted by a customer as to the price at which or the time to execute an order given by the customer for the purchase or sale of a definite dollar amount or quantity of a specified security; and
- ▶ clarify that firms must maintain discretionary accounts and exercise discretion in such accounts to the extent permitted under the federal securities laws; this proposed change is designed to make the rule self-limiting, as there are currently SEC rulemaking proposals pending that may limit the legal ability of broker-dealers to maintain discretionary accounts.⁹

3. *Additional Clarifying Revisions*

Proposed FINRA Rule 4512 and the proposed Supplementary Material thereto would make a number of other clarifying revisions to NASD Rule 3110(c):

- ▶ NASD Rule 3110(c)(4) sets forth the definition of “institutional account” for purposes of Rule 3110 as well as for NASD Rules 2310 (Recommendations to Customers (Suitability)) and 2510 (Discretionary Accounts). Proposed FINRA Rule 4512(c) would amend this definition of “institutional account” to delete the cross-references to NASD Rules 2310 and 2510 because these rules already include cross-references to this definition.

- Proposed FINRA Rule 4512.01 would clarify that required customer account records are subject to a six-year retention period, which is consistent with the retention period under the SEA for similar records.
- Proposed FINRA Rule 4512.02 would remind firms that they may be subject to additional recordkeeping requirements under the SEA (*e.g.*, SEA Rule 17a-3(a)(17)).
- Proposed FINRA Rule 4512(b) would provide that with respect to accounts opened pursuant to prior NASD Rules (*e.g.*, the January 1991 cut-off specified in NASD Rule 3110(c)), firms will be permitted to continue maintaining the information required by those prior NASD Rules until such time as they update the account information in the course of their routine and customary business or as required by other applicable laws or rules.
- Proposed FINRA Rule 4512.03 would include a provision reminding firms of their obligation to comply with the requirements of NASD Rule 3090 (Transactions Involving Association and American Stock Exchange Employees).¹⁰
- Proposed FINRA Rule 4512.04 would provide general explanations of the terms “maintain” and “preserve” for purposes of Proposed FINRA Rule 4512.
- NASD IM-3110 (Customer Account Information) includes cross-references to the requirements of certain other rules that may apply to customer accounts (such as SEA Rules 15g-1 through 15g-9 (the Penny Stock Rules)), and it includes a historical reference relating to accounts opened prior to January 1991. NASD IM-3110 would be deleted because certain provisions are redundant and others are outdated.

D. Records of Written Customer Complaints (Proposed FINRA Rule 4513)

NASD Rule 3110(d) (Record of Written Complaints) addresses a member firm’s obligation to preserve records of written customer complaints at each office of supervisory jurisdiction (OSJ). NASD Rule 3110(e) defines the term “complaint.”

Because the definition of “complaint” in NASD Rule 3110(e) relates directly to the requirements of NASD Rule 3110(d), the FINRA proposal would merge the two provisions into Proposed FINRA Rule 4513 for simplification. In addition:

- Proposed FINRA Rule 4513(a) would clarify that the obligation to keep customer complaint records in each OSJ applies only to complaints that relate to that office, including complaints that relate to activities supervised from that office.
- The proposed rule would provide that firms may maintain the required records at the OSJ or make them promptly available at such office upon FINRA’s request.
- Currently, member firms are required to preserve customer complaint records for a period of at least three years.¹¹ To take into account FINRA’s four-year routine examination cycle for certain member firms, Proposed FINRA Rule 4513(a) would require that firms preserve the customer complaint records for a period of at least four years.

E. Disclosures Relating to Customer Predispute Arbitration Agreements

To ensure that customers are advised about what they are agreeing to when they sign predispute arbitration agreements, NASD Rule 3110(f) (Requirements When Using Predispute Arbitration Agreements for Customers Accounts) requires, among other things, that such agreements contain certain highlighted disclosures. FINRA is proposing to incorporate the requirements of NASD Rule 3110(f) with non-substantive changes into the new Consolidated FINRA Rulebook. NASD Rule 3110(f) would be renumbered and located in the disclosure section of the Consolidated FINRA Rulebook as a standalone rule.

F. Authorization Records for Negotiable Instruments Drawn From a Customer's Account (Proposed FINRA Rule 4514)

NASD Rule 3110(g) (Negotiable Instruments Drawn From a Customer's Account) provides that member firms shall not obtain from a customer or submit for payment a check, draft or other form of negotiable paper drawn on the customer's checking, savings, share or similar account, without that person's express written authorization, which may include the customer's signature on the negotiable instrument. The Rule requires firms to maintain the required written authorization for a period of three years. Proposed FINRA Rule 4514 would clarify that the required authorization must be preserved for a period of three years *following the date it expires*.

G. Order Audit Trail System Recordkeeping Requirements

NASD Rule 3110(h) (Order Audit Trail System Record Keeping Requirements) sets forth the Order Audit Trail System (OATS) recordkeeping requirements for member firms that are "Reporting Members," as defined in the OATS rules. FINRA is proposing to relocate this recordkeeping provision with non-substantive changes into the OATS rules, which would become part of the new Consolidated FINRA Rulebook.

H. Hold Mail Rule

NASD Rule 3110(i) (Holding of Customer Mail) specifies the circumstances under which firms may hold mail for a customer. FINRA is proposing that the Rule be rewritten as a standalone rule and relocated to the supervision section of the new Consolidated FINRA Rulebook. This proposal will be addressed in greater detail in a separate *Notice* regarding proposed changes to the FINRA supervision rules.

I. Approval and Documentation of Changes in Account Name or Designation (Proposed FINRA Rule 4515)

NASD Rule 3110(j) (Changes in Account Name or Designation) requires that, before a customer order is executed, the account name or designation must be placed upon the memorandum for each transaction.¹² The Rule also addresses the approval and documentation procedures for changes in such account name or designation. Proposed FINRA Rule 4515 would clarify that the essential facts relied upon by the principal approving any changes in account names or designations must be documented in writing *prior to execution*.

Endnotes

- 1 The current FINRA rulebook consists of two sets of rules: (1) NASD Rules and (2) rules incorporated from NYSE (Incorporated NYSE Rules) (together referred to hereinafter as the Transitional Rulebook). The Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). Dual Members also must comply with NASD Rules. For more information about the rulebook consolidation process, see *FINRA Information Notice March 12, 2008* (Rulebook Consolidation Process).
- 2 For convenience, the Incorporated NYSE Rules are hereinafter referred to as the “NYSE Rules.”
- 3 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 4 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 5 The proposed rules may be renumbered as part of the final Consolidated FINRA Rulebook.
- 6 Note that NYSE Rules 440.10 and 440.20 and NYSE Interpretation Handbook Rule 440.20/01 set forth financial and operational recordkeeping requirements for which there are no equivalent NASD Rules. NYSE Rules 440.10 and 440.20 and NYSE Interpretation Handbook Rule 440.20/01 would remain in the Transitional Rulebook to be addressed as part of a later phase of the rulebook consolidation process.

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Endnotes

- 7 Firms should be aware that SEA Rule 17a-3 continues to impose additional requirements. For example, SEA Rule 17a-3(a)(17) requires that for each account with a natural person, the account record must indicate whether it has been signed by the associated person responsible for the account. However, this requirement only applies to accounts for which the firm is, or within the past 36 months has been, required to make a suitability determination under the federal securities laws or the requirements of a self-regulatory organization of which it is a member.
- 8 This would be a conforming revision. The requirement that for discretionary accounts generally members must record the age or approximate age of the customer was eliminated effective in 1991. *See NASD Notice to Members 90-52* (August 1990) (SEC Approval of Amendments to Article III, Sections 2 and 21(c) of the Rules of Fair Practice Re: Customer Account Information).
- 9 In 2005, the SEC adopted Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (Advisers Act), the principal purpose of which was to deem broker-dealers offering “fee-based brokerage accounts” not subject to the Advisers Act. The Rule also included several interpretive positions regarding Advisers Act Section 202(a)(11)(C), including a provision that any account over which a broker-dealer exercises investment discretion (other than on a temporary or limited basis) is subject to the Advisers Act. In March 2007, Rule 202(a)(11)-1 was vacated. *See Financial Planning Association v. SEC, 482 F.3d 481* (D.C. Cir. 2007).

In response to requests from the industry to clarify the status of the interpretive positions regarding Section 202(a)(11)(C), in September 2007 the SEC re-proposed its interpretive positions for comment, including the provision regarding the application of the Advisers Act to discretionary accounts. *See Investment Advisers Act Release No. 2652* (September 24, 2007), 72 FR 55126 (September 28, 2007) (Interpretive Rule Under the Advisers Act Affecting Broker-Dealers).
- 10 NASD Rule 3090 plays a vital role in helping FINRA monitor whether employees are abiding by trading restrictions imposed by the FINRA Code of Conduct.
- 11 *See* SEA Rules 17a-3(a)(18) and 17a-4(b)(4).
- 12 *See also* SEA Rule 17a-3(a)(6).

ATTACHMENT A

Below is the text of the proposed rule change. New language is underlined; deletions are in brackets.¹

[3100] 4500. BOOKS, [AND] RECORDS[,] AND [FINANCIAL CONDITION] REPORTS

[3110] 4510. Books and Records Requirements

[(a)] 4511. General Requirements

[Each] [m]Members shall make and preserve books[, accounts,] and records[, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with] as required under the FINRA [R]rules [of this Association] and [as prescribed by SEC Rule 17a-3] Section 17(a) of the Exchange Act and the applicable associated Exchange Act rules. [The record keeping format, medium, and retention period shall comply with Rule 17a-4 under the Securities Exchange Act of 1934.] All books and records required to be made pursuant to the FINRA rules shall be preserved in a format and media that complies with SEA Rule 17a-4.

[(b)] Marking of Customer Order Tickets]²

[(c)] 4512. Customer Account Information

(a) Each member shall maintain the following information [accounts opened after January 1, 1991 as follows]:

(1) for each account[, each member shall maintain the following information]:

(A) through (B) No Change.

(C) [signature] name of the [registered representative introducing] associated person, if any, responsible for the account and signature of the [member or] partner, officer[, or manager [who accepts the account] denoting that the account has been accepted in accordance with the member's policies and procedures for acceptance of accounts; and

1 Attachment A sets forth the text of current NASD Rule 3110 marked to show changes between NASD Rule 3110 and Proposed FINRA Rules 4511 through 4515.

2 NASD Rule 3110(b) would remain unchanged as part of the Transitional Rulebook and addressed as part of a later phase of the rulebook consolidation process. See Section B of this Notice.

(D) if the customer is a corporation, partnership[,] or other legal entity, the names of any persons authorized to transact business on behalf of the entity;

(2) No Change.

(3) for discretionary accounts, in addition to compliance with subparagraph[s] (1) and, to the extent applicable, subparagraph (2) above, and NASD Rule 2510(b) [of these Rules], the member shall maintain a record of the dated [:]

[(A) obtain the] signature of each named, natural person authorized to exercise discretion in the account[;]. This recordkeeping requirement shall not apply to investment discretion granted by a customer as to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite dollar amount or quantity of a specified security. Members shall maintain discretionary accounts and exercise discretion in such accounts to the extent permitted under the federal securities laws.

[(B) record the date such discretion is granted; and]

[(C) in connection with exempted securities other than municipals, record the age or approximate age of the customer.]

(b) A member need not meet the requirements of this Rule with respect to any account that was opened pursuant to a prior FINRA rule until such time as the member updates the information for the account either in the course of the member's routine and customary business or as otherwise required by applicable laws or rules.

[(4)] (c) For purposes of this Rule, [Rule 2310, and Rule 2510] the term "institutional account" shall mean the account of:

[(A)] (1) a bank, savings and loan association, insurance company[,] or registered investment company;

[(B)] (2) an investment adviser registered either with the [Securities and Exchange Commission] SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or

[(C)] (3) any other [entity] person (whether a natural person, corporation, partnership, trust[,] or otherwise) with total assets of at least \$50 million.

• • • Supplementary Material: -----

.01 Customer Account Information Retention Periods

For the purposes of this Rule, members shall preserve a record of any customer account information that subsequently is updated for at least six years after the date that such information is updated. Members shall preserve a record of the last update to any customer account information, or the original account information if there are no updates to the account information, for at least six years after the date the account is closed.

.02 Additional Customer Account Records Under the Exchange Act

Members should be aware that they may be required to make and preserve additional customer account records as required under Section 17(a) of the Exchange Act and the applicable associated Exchange Act rules.

.03 Compliance With NASD Rule 3090

With respect to paragraph (a)(2)(B) of this Rule, members should be aware that they have an obligation to comply with the requirements of NASD Rule 3090(a) if they have actual notice that a customer having a financial interest in, or controlling trading in, an account is an employee of FINRA.

.04 “Maintain” and “Preserve”

For the purposes of this Rule, as a general matter, the term “maintain” is used to reflect customer account information that is current or in use. The term “preserve” is used to reflect customer account information that is no longer current or in use.

[(d)] 4513. Records of Written Customer Complaints

(a) Each member shall keep and preserve in each office of supervisory jurisdiction[, as defined in Rule 3010,] either a separate file of all written customer complaints [of customers] that relate to that office (including complaints that relate to activities supervised from that office) and action taken by the member, if any, or a separate record of such complaints and a clear reference to the files in that office containing the correspondence connected with such complaints [as maintained in such office]. Rather than keep and preserve the customer complaint records required under this Rule at the office of supervisory jurisdiction, the member may choose to make them promptly available at that office, upon request of FINRA. Customer complaint records shall be preserved for a period of at least four years.

(b) For the purposes of this Rule, “customer complaint” means any grievance by a customer or any person authorized to act on behalf of the customer involving the activities of the member or a person associated with the member in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer.

[(e) “Complaint” Defined]

[A “complaint” shall be deemed to mean any written statement of a customer or any person acting on behalf of a customer alleging a grievance involving the activities of those persons under the control of the member in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer.]

[(f) Requirements When Using Predispute Arbitration Agreements for Customers Accounts]³

[(g) 4514. Authorization Records for Negotiable Instruments Drawn From [A] a Customer’s Account

No member or person associated with a member shall obtain from a customer or submit for payment a check, draft[,], or other form of negotiable paper drawn on a customer’s checking, savings, share[,], or similar account, without that person’s express written authorization, which may include the customer’s signature on the negotiable instrument. Each member shall [maintain] preserve this authorization for a period of three years following the date the authorization expires. This provision shall not, however, require [maintenance of] members to preserve copies of negotiable instruments signed by customers.

[(h) Order Audit Trail System Record keeping Requirements]⁴

[(i) Holding of Customer Mail]⁵

- 3 NASD Rule 3110(f) would be relocated with non-substantive changes to the disclosure section of the Consolidated FINRA Rulebook as a standalone rule. *See* Section E of this *Notice*.
- 4 NASD Rule 3110(h) would be relocated with non-substantive changes into the OATS rules, which would become part of the Consolidated FINRA Rulebook. *See* Section G of this *Notice*.
- 5 NASD Rule 3110(i) would be rewritten as a standalone rule and relocated to the supervision section of the Consolidated FINRA Rulebook. Proposed changes to NASD Rule 3110(i) will be addressed in greater detail in a separate *Notice* regarding proposed changes to the FINRA supervision rules. *See* Section H of this *Notice*.

[(j)] 4515. Approval and Documentation of Changes in Account Name or Designation

Before any customer order is executed, there must be placed upon the [memorandum] order form or other similar record of the member for each transaction, the name or designation of the account (or accounts) for which such order is to be executed. No change in such account name(s) (including related accounts) or designation(s) (including error accounts) shall be made unless the change has been authorized by a qualified and registered principal designated by the member [or a person(s) designated under the provisions of NASD rules]. Such person must, prior to giving his or her approval of the account designation change, be personally informed of the essential facts relative thereto and indicate his or her approval of such change in writing on the order or other similar record of the member. The essential facts relied upon by the person approving the change must be documented in writing prior to execution and preserved for [a] the period of time and accessibility specified in SEA Rule 17a-4(b) [not less than three years, the first two years in an easily accessible place, as the term “easily accessible place” is used in SEC Rule 17a-4].

[For purposes of this paragraph (j), a person(s) designated under the provisions of NASD rules to approve account name or designation changes must pass a qualifying principal examination appropriate to the business of the firm.]

* * * * *

Investor Education

Proposed Consolidated FINRA Rule Addressing Investor Education and Protection

Comment Period Expires: June 13, 2008

Executive Summary

As part of the process of developing a new consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is proposing to adopt a new FINRA rule based on NASD Rule 2280 (Investor Education and Protection). The rule would require member firms, with certain exceptions, to provide customers with FINRA's Web site address and information regarding FINRA's BrokerCheck program at least once every calendar year.

The text of the proposed rule is set forth in Attachment A.

Questions regarding this *Notice* should be directed to Rachael Grad, Counsel, Office of General Counsel, at (202) 728-8290.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by June 13, 2008. Comments received after the close of the comment period will not be considered, although interested parties will have further opportunity to comment when the proposal resulting from this *Notice* process is filed with the SEC for approval.

May 2008

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topic(s)

- BrokerCheck
- FINRA Web Site Address
- Investor Education

Referenced Rules & Notices

- NASD Rule 2280
- NTM 98-03

Member firms and other interested parties can submit their comments by:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

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

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

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.³

Discussion

NASD Rule 2280 requires that each member firm (other than a firm that does not carry customer accounts and does not hold customer funds or securities) provide its customers with the following information in writing not less than once every calendar year: (1) the “Public Disclosure Program” hotline number; (2) the NASD Regulation Web site address; and (3) a statement regarding the availability of an investor brochure that includes information describing the “Public Disclosure Program.” There is no comparable incorporated NYSE Rule.⁴

Proposed Revisions

Except as described below, NASD Rule 2280 would be adopted as new Proposed FINRA Rule 2267 (the proposed rule) without change.⁵

1. *Applicability of Rule*

NASD Rule 2280 currently applies to all member firms that carry customer accounts and hold customer funds or securities. The proposed rule would apply to all member firms, with two general exceptions. Any member firm that does not have customers or is an introducing firm that is party to a carrying agreement where the carrying firm member complies with the rule would not be subject to the rule.

Unlike NASD Rule 2280, the proposed rule would apply to member firms that conduct a limited business with customers, such as mutual fund distributors and member firms that deal solely with direct participation programs. These member firms would be required to comply with the rule and provide the disclosures to their customers at least once every calendar year (of course, these firms also would be excepted from the proposed rule to the extent such firms are parties to a carrying agreement and the carrying member complies on their behalf). FINRA believes that customers who transact business with these member firms should be provided with the disclosures under the proposed rule.

2. *Technical Revisions*

In December 2003, FINRA announced that its “Public Disclosure Program” would thereafter be known as “BrokerCheck.” Accordingly, the proposed rule would include references to “BrokerCheck” rather than the “Public Disclosure Program.” The proposed rule also would include references to the FINRA Web site address rather than the NASD Regulation Web site address.

3. *Electronic Delivery*

The proposed rule would clarify that the information required under the rule may be provided electronically to customers.⁶

Endnotes

1. For more information about the rulebook consolidation process, see *FINRA Information Notice, March 12, 2008* (Rulebook Consolidation Process).
2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
3. Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and the rules thereunder.
4. The current FINRA rulebook consists of two sets of rules: (1) NASD rules and (2) rules incorporated from NYSE (Incorporated NYSE Rules). The Incorporated NYSE Rules apply only to those member firms of FINRA that are also members of the NYSE (Dual Members). Dual Members also must comply with NASD rules.
5. The proposed rule may be renumbered as part of the final Consolidated FINRA Rulebook.
6. See *NASD Notice to Members 98-3* (Electronic Delivery of Information Between Members and Their Customers) (setting forth the policy applicable to electronic delivery of information between member firms and their customers as permitted or required by NASD rules).

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ATTACHMENT A

Below is the text of the proposed rule change. New language is underlined; deletions are in brackets.¹

[2280.] 2267. Investor Education and Protection

[(a)] Each member, except a member that does not have customers or is an introducing firm that is party to a carrying agreement where the carrying firm member complies with this Rule, shall[, with a frequency of not less than] once every calendar year[,] provide in writing (which may be electronic) to each customer the following items of information:

[(1)a] [NASD Regulation Public Disclosure Program]FINRA BrokerCheck Hotline Number;

[(2)b] [NASD Regulation]FINRA Web [S]site [A]address; and

[(3)c] A statement as to the availability to the customer of an investor brochure that includes information describing [the Public Disclosure Program]FINRA BrokerCheck.

[(b)] Notwithstanding the requirement in paragraph (a) above, any member that does not carry customer accounts and does not hold customer funds or securities is exempt from the provisions of this Rule.]

1. Attachment A sets forth the text of current NASD Rule 2280 marked to show changes between NASD Rule 2280 and Proposed FINRA Rule 2267.

Misleading Communications About Expertise

The Obligation of Firms When Supervising their Registered Representatives' Use of Marketing Materials to Establish Expertise

Executive Summary

FINRA reminds firms of their obligation to supervise representatives' communications with the public used to establish their expertise. FINRA is concerned that some representatives are misrepresenting their investment acumen by using ghostwritten communications that mislead investors.

Questions concerning this *Notice* should be directed to Thomas A. Pappas, Vice President, Advertising Regulation, at (240)386-4553; or Amy C. Sochard, Director, Programs & Investigations, Advertising Regulation, at (240)386-4508.

Background & Discussion

Some vendors prepare and sell publications for use by registered representatives and other types of financial intermediaries. Certain publications enable the purchaser to affix his name or otherwise imply that the purchaser is the author. The following describes some of these communications:

- ▶ Hard-cover books or pamphlets on investment topics that can be purchased with the representative's name printed on the cover, thereby implying the representative wrote the book or pamphlet.
- ▶ Newspaper, magazine or Web articles where the public might reasonably assume the representative is the author, when this is not the case.

May 2008

Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Advertising
- ▶ Compliance
- ▶ Legal
- ▶ Municipal
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Training

Key Topics

- ▶ Communications with the Public
- ▶ Ghostwritten Communications
- ▶ Representatives' Use of Designations and Titles
- ▶ Supervision
- ▶ Third-Party Marketing Material

Referenced Rules & Notices

- ▶ NASD Rule 2110
- ▶ NASD Rule 2120
- ▶ NASD Rule 2210
- ▶ NYSE Rule 472
- ▶ Regulatory Notice 07-43

- ▶ Interview-style broadcasts, webcasts or other public appearances where it appears that an independent third party is interviewing a representative when the interview questions and answers are in fact pre-determined; or, in the case of printed interviews, where the questions and answers were created by or for the representative.
- ▶ Handouts in the form of magazines that appear to contain articles written by or about the representative when, in fact, they are produced by a vendor at the request of the representative. In some cases, the representative further misrepresents his or her credibility by including his or her photograph next to a photograph of a well-known financial or political figure.

FINRA reminds broker-dealers that they must supervise the use of these types of communications by their registered representatives. NASD Rule 2210 prohibits false, misleading or exaggerated communications with the public and the omission of material facts or qualifications that would cause a communication to be misleading. All communications must comply with principles of fair dealing and good faith. Some of these communications appear to raise serious questions of compliance with these standards.

As noted in *Regulatory Notice 07-43*, some third-party vendors market ghostwritten books on senior investing to registered representatives as tools to establish credibility. As stated in the Notice, implying that one is the author of a book on senior investing, and therefore an expert, could violate a number of rules, including NASD Rules 2110, 2120 and 2210 and Incorporated NYSE Rule 472.¹ These concerns would apply to any ghostwritten publication.

Registered representatives may not suggest (or encourage others to suggest) that they authored investment-related books, articles or similar publications if they did not write them. Such a publication created by a third-party vendor must disclose that it was prepared either by the third party or for the representative's use. FINRA also reminds firms that they must prominently disclose their names in all advertisements and sales literature as required by Rule 2210.

If a firm or representative has paid for the publication, production or distribution of any communication that appears to be a magazine, article or interview, then the communication must be clearly identified as an advertisement. FINRA regards this information as material to ensuring that such communications are not misleading.

Regulatory Notice 07-43 also states that firms that allow the use of any title or designation that conveys an expertise in senior investments or retirement planning where such expertise does not exist may violate NASD Rules 2110 and 2210, Incorporated NYSE Rule 472 and, possibly, the antifraud provisions of the federal securities laws. This concern applies to the misuse of any title or designation in a manner that exaggerates the representative's expertise or implies expertise where none exists. In addition, some states prohibit or restrict the use of certain senior designations.

Firms must supervise their registered representatives in a manner reasonably designed to ensure that they do not engage in the deceptive practices identified above.

Endnotes

- 1 The FINRA rulebook currently consists of both NASD rules and certain NYSE rules that FINRA has incorporated (Incorporated NYSE Rules), including NYSE Rule 472 (Communications With the Public). The Incorporated NYSE Rules apply solely to members of FINRA that are also members of NYSE on or after July 30, 2007, referred to as "Dual Members." Dual Members also must comply with NASD rules. Until the adoption of a Consolidated FINRA Rulebook, FINRA's *Regulatory Notices* will address both NASD and the Incorporated NYSE Rules.

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Options Supervision Requirements

SEC Approves Amendments to Eliminate the Requirement for the Senior Registered and Compliance Registered Options Principals (SROP and CROP)

Effective Date: June 23, 2008

Executive Summary

Effective June 23, 2008, the requirement for separate designations of Senior Registered Options Principal and Compliance Registered Options Principal is eliminated and member firms are required to integrate the responsibility for supervision and compliance of their public customer options business into their overall supervisory and compliance programs.¹ The amendments to NASD Rules 1022, 2220 and 2860 are set forth in Attachment A of this *Notice*.

Questions regarding this *Notice* may be directed to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; or Kathryn M. Moore, Assistant General Counsel, OGC, at (202) 974-2974.

May 2008

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Institutional
- Legal
- Operations
- Options
- Registration
- Senior Management

Key Topic(s)

- Compliance Registered Options Principal
- Discretionary Accounts
- Options
- Principal Registration
- Registered Options and Security Futures Principal
- Senior Registered Options Principal
- Supervision

Referenced Rules & Notices

- NASD Rule 1022
- NASD Rule 2220
- NASD Rule 2860
- NASD Rule 3010

Background and Discussion

FINRA amended its rules to allow a member firm to integrate the responsibility for supervision and compliance of its public customer options business into its overall supervisory and compliance program. As part of these changes, FINRA eliminated the requirement that a firm must designate a specific officer or general partner to serve as the Senior Registered Options Principal (SROP), and a specific individual (who may also be the SROP) to serve as the Compliance Registered Options Principal (CROP). The amendments provide member firms with the flexibility to allow several individuals to fulfill these supervisory functions, in accordance with the firm's overall supervisory structure. FINRA reminds firms of their obligation to designate appropriately registered principal(s) to supervise their public customer options activities pursuant to NASD Rule 3010(a)(2).²

NASD Rule 1022 (Categories of Principal Registration) has been amended to delete the reference to the SROP and CROP and clarify that if a person is engaged in the supervision of a member firm's options and security futures business, including a person designated pursuant to NASD Rule 3010(a)(2), then such person must be registered as a Registered Options and Security Futures Principal (ROSFP).

FINRA also made a few technical changes to the rules.³ All references to "Registered Options Principal" have been changed to "Registered Options and Security Futures Principal," to reflect the change in title when rules governing security futures were adopted.⁴ FINRA notes that this change to the principal title neither requires currently registered options principals to complete the security futures firm element continuing education requirement, nor does it permit a ROSFP to supervise security futures activities unless he or she has satisfied the firm-element continuing education program.⁵

NASD Rule 2220(b) (Options Communications with the Public) has been amended to delete the reference to the CROP and instead requires that all advertisements, sales literature (except completed worksheets) and educational material issued by a member firm pertaining to options be approved in advance by a ROSFP designated by the member firm's written supervisory procedures.

In addition, NASD Rule 2860 (Options) has been amended in several respects. First, paragraph (b)(16)(E)(iii) was amended to delete the reference to the SROP and CROP and requires that a specific ROSFP(s) be designated to be responsible for approving customer accounts that do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved. This change allows members the flexibility to assign this responsibility, which formerly rested solely with the SROP and/or CROP, to a specific ROSFP(s).

Second, the rule change amends paragraph (b)(18) and the treatment of options discretionary accounts. Under the rule change, each firm must designate specific ROSFPs to review discretionary accounts.⁶ In addition, a ROSFP other than the ROSFP who accepted the account must review the acceptance of each discretionary account to determine that the ROSFP accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the strategies or transactions proposed, and must maintain a record of the basis for such determination.

The rule change also eliminates the requirement in paragraph (b)(18) that a ROSFP approve and initial each discretionary options order on the day of entry provided that a firm uses computerized surveillance tools. Discretionary orders for firms using computerized surveillance tools instead may be reviewed in accordance with the member firm's written supervisory procedures. Firms that do not use computerized surveillance tools must continue to approve and initial each discretionary order on the day entered, as is required today.

Paragraph (b)(18) also has been revised to limit the duration of the time and price discretionary authority to the day such authority is granted, absent specific written authorization by the customer to the contrary. These amendments mirror the limitations to discretionary authority provided in NASD Rule 2510(d).

Finally, paragraph (b)(20) has been revised to delete the reference to the SROP and CROP and clarify that each member firm that conducts a public customer options business must ensure that its written supervisory system policies and procedures pursuant to NASD Rules 3010, 3012 and 3013 adequately address the firm's public customer options business. Although the rule change eliminated entirely the positions and titles of the SROP and CROP, a firm is still required pursuant to NASD Rule 3010(a)(2) to designate "an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required," which would include designating one or more ROSFPs to supervise a member firm's public customer options activities.

The amendments become effective on June 23, 2008.

Endnotes

- 1 See Securities Exchange Act Release No. 57775 (May 5, 2008), 73 FR 26453 (May 9, 2008) (Approval Order of SR-FINRA-2007-035).
- 2 NASD Rule 3010(a)(2) requires that member firms designate “an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required.”
- 3 All references to “the Association” have been changed to “NASD” for ease of reference while the rules continue to be part of the legacy NASD rulebook, until such time as the legacy NASD and incorporated NYSE rules are consolidated into the FINRA rulebook when all references to “NASD” will be changed to “FINRA.”
- 4 See Securities Exchange Act Release No. 46663 (October 15, 2002), 67 FR 64944 (October 22, 2002) (Approval Order for File No. SR-NASD-2002-040).
- 5 See *Notice to Members 02-73* (November 2002).
- 6 Previously, the SROP was required to review the acceptance of each discretionary account and the CROP was required to perform frequent supervisory review of such accounts.

ATTACHMENT A

New language is underlined, deletions are in brackets.

1022. Categories of Principal Registration

(a) through (e) No Change.

(f) Limited Principal – Registered Options and Security Futures

(1) Every member of [the Association]NASD that is engaged in, or that intends to engage in transactions in security futures or [put or call] options with the public shall have at least one Registered Options and Security Futures Principal who shall have satisfied the requirements of this subparagraph. [As to options transactions, each member shall also designate a Senior Registered Options Principal and a Compliance Registered Options Principal in accordance with the provisions of Rule 2860(b)(20) and identify such persons to the Association.] Every person engaged in the supervision of options and security futures sales practices, including a person designated pursuant to Rule 3010(a)(2) [the management of the day-to-day options or security futures activities of a member] shall [also] be registered as a Registered Options and Security Futures Principal.

(2) through (5) No Change.

(g) through (h) No Change.

2220. Options Communications with the Public

(a) No Change.

(b) Approval by [Compliance]a Registered Options and Security Futures Principal and Recordkeeping

All advertisements, sales literature (except completed worksheets), and educational material issued by a member or member organization pertaining to options shall be approved in advance by [the Compliance Registered Options Principal or designee]a Registered Options and Security Futures Principal designated by the member's written supervisory procedures. Copies thereof, together with the names of the persons who prepared the material, the names of the persons who approved the material and, in the case of sales literature, the source of any recommendations contained therein, shall be

retained by the member or member organization and be kept at an easily accessible place for examination by [the Association]NASD for a period of three years.

(c) through (d) No Change.

* * * * *

2860. Options

(a) No Change.

(b) Requirements

(1) through (15) No Change.

(16) Opening of Accounts

(A) through (D) No Change.

(E) Uncovered Short Option Contracts

Each member transacting business with the public in writing uncovered short option contracts shall develop, implement and maintain specific written procedures governing the conduct of such business which shall include, at least, the following:

(i) through (ii) No Change.

(iii) Designation of [the Senior Registered Options Principal and/or Compliance Registered Options Principal] a specific Registered Options and Security Futures Principal(s) as [the person] responsible for approving customer accounts that do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved;

(iv) through (v) No Change.

(17) No Change.

(18) Discretionary Accounts

(A) Authorization and Approval

(i) No Change.

(ii) [The Senior Registered Options Principal] Each firm shall designate specific Registered Options and Security Futures Principals to review discretionary accounts. A Registered Options and Security Futures Principal other than the Registered Options and Security Futures Principal who accepted the account shall review the acceptance of each discretionary account to determine that the Registered Options and Security Futures Principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risk of the strategies or transactions proposed, and shall maintain a record of the basis for such determination. [Each discretionary order shall be approved and initialed on the day entered by the branch office manager or other Registered Options Principal, provided that if the branch office manager is not a Registered Options Principal, such approval shall be confirmed within a reasonable time by a Registered Options Principal. Each] Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by [the Compliance Registered Options Principal] a Registered Options and Security Futures Principal who is not exercising the discretionary authority. The provisions of this subparagraph (18) shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts in a specified security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in Rule 3110(c)(4), pursuant to valid Good-Till-Cancelled instructions issued on a "not held" basis. Any exercise of time and price discretion must be reflected on the order ticket.

(iii) Any member that does not utilize computerized surveillance tools for the frequent and appropriate review of discretionary activity must establish and implement procedures to require specific Registered Options and Security Futures Principals who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.

(B) through (C) No Change.

(19) No Change.

(20) Supervision of Accounts

(A) Duty to Supervise[; Senior Registered Options Principal]

[Every member shall develop and implement a written program providing for the diligent supervision of all of its customer accounts, and all orders in such accounts, to the extent such accounts and orders relate to options contracts, by a general partner (in the case of a partnership) or officer (in the case of a corporation) of the member who is a Registered Options Principal and who has been specifically identified to the Association as the member's Senior Registered Options Principal. A Senior Registered Options Principal, in meeting his responsibilities for supervision of customer accounts and orders, may delegate to qualified employees (including other Registered Options Principals) responsibility and authority for supervision and control of each branch office handling transactions in option contracts, provided that the Senior Registered Options Principal shall have overall authority and responsibility for establishing appropriate procedures of supervision and control over such employees. Every such member shall also develop and implement specific written procedures concerning the manner of supervision of customer accounts maintaining uncovered short option positions and specifically providing for frequent supervisory review of such accounts.]Each member that conducts a public customer options business shall ensure that its written supervisory system policies and procedures pursuant to Rules 3010, 3012, and 3013 adequately address the member's public customer options business.

[(B) Compliance Registered Options Principal]

[Every member shall designate and specifically identify to the Association a Compliance Registered Options Principal (CROP), who may be the Senior Registered Options Principal, who shall have no sales functions and who shall be responsible to review and to propose appropriate action to secure the member's compliance with securities laws and regulations and Association Rules in respect of its options business. The CROP shall regularly furnish reports directly to the Compliance officer (if the CROP is not himself the Compliance officer) and to other senior management of the member. The

requirement that the CROP have no sales functions shall not apply to a member that has received less than \$1,000,000 in gross commissions on options business for either of the preceding two fiscal years or that currently has ten or fewer registered representatives.]

[(C)](B) Branch Offices

No branch office of a member shall transact an options business unless the principal supervisor of such branch office accepting options transactions has been qualified as either a Registered Options and Security Futures Principal or a Limited Principal—General Securities Sales Supervisor; provided that this requirement shall not apply to branch offices in which no more than three registered representatives are located, so long as the options activities of such branch offices are appropriately supervised by either a Registered Options and Security Futures Principal or a Limited Principal—General Securities Sales Supervisor.

[(D)](C) Headquarters Review of Accounts

Each member shall maintain at the principal supervisory office having jurisdiction over the office servicing customer accounts, or have readily accessible and promptly retrievable, information to permit review of each customer's options account on a timely basis to determine:

- (i) the compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved;
- (ii) the size and frequency of options transactions;
- (iii) commission activity in the account;
- (iv) profit or loss in the account;
- (v) undue concentration in any options class or classes, and
- (vi) compliance with the provisions of Regulation T of the Federal Reserve Board.

(21) through (24) No Change.

(c) No Change.

* * * * *

Information Notice

April 2008 Supplement to the Options Disclosure Document

On April 30, 2008, the SEC approved a supplement to the Options Disclosure Document (www.optionsclearing.com/publications/risks/riskstoc_apr08_sup.pdf) (ODD). The ODD contains general disclosures on the characteristics and risks of trading standardized options. The recently approved supplement provides additional disclosures regarding certain binary options, also known as fixed-return options, and delayed start options. The supplement also amends the front cover page of the ODD to update the list of U.S. exchanges that trade options issued by The Options Clearing Corporation. As with other supplements to the ODD, this should be read in conjunction with the current ODD entitled *Characteristics and Risks of Standardized Options* (www.optionsclearing.com/publications/risks/riskstoc.pdf).

NASD Rule 2860(b)(11) requires that member firms deliver the current ODD, as amended to include this supplement, to each customer at or prior to the time the customer is approved to trade options. In addition, the rule provides that a member firm must distribute a copy of each amendment to the ODD to each customer to whom the member firm previously delivered the ODD. Firms may distribute the amendment in various ways, including, but not limited to, one of the following:

1. A firm may choose to conduct a mass mailing of the supplement to all of its customers approved to trade options who have already received the ODD; or
2. A firm may distribute the supplement to a customer, who has already received the ODD, not later than the time a confirmation of a transaction in the category of options to which the amendment pertains is delivered to such customer.

May 15, 2008

Suggested Routing

- Compliance
- Institutional
- Legal
- Options
- Senior Management
- Trading

Key Topics

- Binary Options
- Delayed Start Options
- Fixed-Return Options
- Options
- Options Disclosure Document

Referenced Rules & Notices

- NASD Rule 2860
- NTM 98-3

Firms are reminded that they may electronically transmit documents that they are required to furnish to customers under NASD rules, including the ODD and amendments thereto, provided the member adheres to the standards contained in the May 1996 and October 1995 Securities Exchange Commission Releases¹ and as discussed in *Notice to Members 98-3* (January 1998)(www.finra.org/ntm/98-3).

Questions regarding this *Notice* may be directed to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; or Kathryn M. Moore, Assistant General Counsel, OGC, at (202) 974-2974.

Endnotes

- 1 See Securities Act Release No. 7288 (May 9, 1996) 61 FR 24644 (May 15, 1996) and Securities Act Release No. 7233 (October 6, 1995) 60 FR 53458 (October 13, 1995).

Disciplinary and Other FINRA Actions

Firm Expelled, Individual Sanctioned

Costa Financial Securities, Inc., (CRD #45039, Boca Raton, Florida) and Andrew Grigsby Costa (CRD #1600926, Registered Principal, Fort Lauderdale, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm was expelled from FINRA membership and Costa was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, the firm and Costa consented to the described sanctions and to the entry of findings that they failed to respond to FINRA requests for documents and information. **(FINRA Case #2007011553501)**

Firm Suspended, Individual Sanctioned

CMG Institutional Trading, LLC (CRD #47264, Chicago, Illinois) and Shawn Derrick Baldwin (CRD #4281564, Registered Principal, Chicago, Illinois) were fined \$25,000 jointly and severally. The firm was suspended in all capacities for two years and Baldwin was suspended from association with any FINRA member in any capacity for two years. The National Adjudicatory Council (NAC) imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that the firm and Baldwin failed to respond completely to FINRA requests for information.

This decision has been appealed to the Securities and Exchange Commission (SEC), and the sanctions are not in effect pending consideration of the appeal. **(FINRA Case #E8A2005025201)**

Firms Fined, Individuals Sanctioned

Leonard & Company (CRD #36527, Troy, Michigan) and James Sylvester Currier (CRD #2070654, Registered Principal, Bloomfield Hills, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$100,000. Currier was suspended from association with any FINRA member in any principal capacity for 10 business days. Without admitting or denying the findings, the firm and Currier consented to the described sanctions and to the entry of findings that the firm engaged in a private placement self-offering of unregistered preferred shares the firm issued, pursuant to private placement memoranda (PPM), to public customers; but the offerings failed to qualify for the intra-state exemption from registration because on many occasions, the firm sold shares to investors who lived out of state. The findings stated that the offerings failed to qualify for a Regulation D exemption because shares were sold to non-accredited investors without providing them with financial information, which is required under SEC Rule 502. The findings also stated that the firm, acting through Currier, failed to disclose in the

Reported for May 2008

FINRA® has taken disciplinary actions against the following firms and individuals for violations of NASD Rules; federal securities laws, rules and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB).

PPMs that remuneration in the form of finder's fees was being paid to the firm's registered representatives in connection with the sale of preferred shares. The findings also included that the firm, acting through Currier, failed to disclose in the PPMs that proceeds would be used to retire debt related to operating expenses, and omitted and negligently misrepresented to the customers that the firm's cash flow was sufficient to meet its operating expenses.

FINRA found that the firm, acting through Currier, negligently misrepresented a material aspect of the firm's financial condition in that the PPMs failed to disclose the parent company's financial condition. FINRA also found that the firm did not qualify for a claimed exemption under NASD Rule 2710 and failed to submit any documentation about the public offering of the preferred shares to FINRA prior to their sales. In addition, FINRA determined that the firm made no written disclosure in the PPMs of conflicts of interest and other information. Furthermore, FINRA found that the firm failed to obtain and retain subscription agreements with regard to the sale of the preferred shares. Moreover, the findings stated that the firm, acting through Currier, failed to maintain a reasonable supervisory system and failed to develop reasonable written supervisory procedures relating to the creation and development of PPM and the training of representatives who solicited potential investors and sold them shares of the private offering.

The suspension in a principal capacity was in effect from April 21, 2008, through May 2, 2008. (FINRA Case #E8A2005012902)

Newbridge Securities Corporation (CRD #104065, Fort Lauderdale, Florida), Kenneth Brown (CRD #1325762, Registered Principal, Coral Springs, Florida) and Eric Manuel Vallejo (CRD #1754908, Registered Principal, Hollywood, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm was fined \$177,500, \$10,000 of which was jointly and severally with Brown and \$10,000 was jointly and severally with Vallejo. The firm was ordered to pay \$61,416.35, plus interest, in restitution to public customers, and consented to a one-year pre-use filing requirement with FINRA for all customer advertisements and sales literature relating to seminars the firm and/or its representatives offer. Brown and Vallejo were each suspended from association with any FINRA member in any principal capacity for 15 days.

Without admitting or denying the findings, the firm, Brown and Vallejo consented to the described sanctions and to the entry of findings that the firm charged excessive markups/markdowns totaling \$66,019.48 on customer stock transactions, and the firm, acting through Vallejo, failed to reasonably supervise the markups/markdowns charged in stock transactions to ensure that they were not excessive and failed to follow its written supervisory procedures regarding markups/markdowns. The findings stated that the firm failed to develop and implement a written anti-money laundering (AML) program reasonably designed to achieve and monitor its compliance with the requirements of the Bank Secrecy Act and the regulations promulgated thereunder. The findings also stated that the firm failed to timely report customer complaints within the time frame NASD Rule 3070 specified. The findings also included that the firm, acting through Brown, approved the use of variable annuity seminar materials that contained misleading statements, material omissions and inadequate risk disclosures, and Brown failed to file the materials with FINRA.

FINRA found that the firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable rules and regulations in the following areas: markups/markdowns, AML requirements, customer sellouts and instant message correspondence. FINRA also found that the firm, acting through Brown, failed to establish and maintain a supervisory system reasonably designed to ensure that the firm's practice of paying trading credits to registered representatives as extra compensation in connection with the sales of certain stocks did not result in sales practice problems. In addition, FINRA determined that the firm failed to enforce its written supervisory procedures with regard to internal disciplinary actions against registered representatives with patterns of Regulation T violations, restricted/watch list procedures, prospective registered representative screening procedures, procedures related to special supervision of registered representatives and enforcement of margin account restrictions placed on representatives. Moreover, the findings stated that the firm failed to file an application for approval of a material change in business activity, failed to implement an adequate supervisory system to ensure compliance with NASD Rule 1017 and failed to register one of its offices as a branch office.

Brown's and Vallejo's suspensions in any principal capacity were in effect from April 7, 2008, through April 21, 2008. (FINRA Case #E072003019507)

VSR Financial Services, Inc. (CRD #14503, Overland Park, Kansas), Robert Francis Monckton Jr. (CRD #2820308, Registered Principal, Overland Park, Kansas) and Michael Hardwicke Lewis Sr. (CRD #1688042, Registered Representative, Baton Rouge, Louisiana) submitted Letters of Acceptance, Waiver and Consent in which the firm was censured and fined \$20,000, jointly and severally with Monckton. Monckton was suspended from association with any FINRA member in any principal capacity for 10 business days. Lewis was fined \$5,000, suspended from association with any FINRA member in any capacity for 30 business days and required to provide satisfactory proof to FINRA that a promissory note payable to VSR Financial Services has been paid in full upon his submission of a Uniform Application for Securities Industry Registration or Transfer (Form U4) for employment or association with a member firm. Lewis' fine must be paid either immediately upon his reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier.

Without admitting or denying the findings, the firm, Monckton and Lewis consented to the described sanctions and to the entry of findings that Lewis recommended the purchase of Class B shares of mutual funds in particular mutual fund families to public customers when the customers had already invested more than \$1 million in that family and could have purchased Class A shares with no front-end load, avoided higher annual 12b-1 fees and contingent deferred sales charges if the Class B shares had been sold within eight years. The findings stated that Lewis did not have reasonable grounds to believe his recommendations were suitable for the customers. The findings also stated that Lewis recommended and executed purchases of Class A shares of mutual funds for a public customer, and failed to obtain the correct breakpoints on the purchases for the customer and therefore did not have reasonable grounds for believing his recommendations were suitable. The findings also included that the firm and Monckton failed to supervise Lewis in a manner reasonably calculated to prevent his misconduct regarding unsuitable recommendations and breakpoints.

Monckton's suspension in any principal capacity was in effect from April 7, 2008, through April 18, 2008. Lewis' suspension in any capacity was in effect from March 17, 2008, through April 28, 2008. (FINRA Cases #20060039822-01/20060039822-02)

Firms Fined

A.G. Edwards & Sons, Inc. (CRD #4, St. Louis, Missouri) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it sold corporate bonds to customers and failed to sell the bonds at a price that was fair, taking into consideration all relevant circumstances including market conditions with respect to each bond at the time of the transaction, the expense involved and that the firm was entitled to a profit. The findings stated that the firm purchased municipal securities for its own account from customers and/or sold municipal securities for its own account to customers at an aggregate price (including any markdown or markup) that was not fair and reasonable, taking into consideration all relevant factors including the best judgment of the broker, dealer or municipal securities dealer as to the fair market value of the securities at the time of transactions and of any securities exchanged or traded in connection with the transactions, the expense involved in effecting the transactions, the fact that the broker, dealer or municipal securities dealer is entitled to a profit, and the total dollar amount of the transactions. (FINRA Case #20050004740-01).

Bishop, Rosen & Co., Inc. (CRD #1248, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it charged unreasonable and excessive commissions on numerous options transactions. The findings stated that the excessive commissions charged ranged to as much as 128 percent and resulted in \$22,739.72 in excessive charges to public customers. (FINRA Case #E102005004901)

Butler, Wick & Co., Inc. (CRD #120, Youngstown, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$29,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it acted as an underwriter and failed to file advance refunding documents and Municipal Securities Rulemaking Board (MSRB) Forms G-36 Advanced Refunding Document (ARD)) with the MSRB. The findings stated that the firm failed to file timely the final official statement and MSRB Form G-36 Official Statement (OS) for one issue and filed other Forms G-36(OS) inaccurately with the MSRB. The findings also stated that the firm failed to list new issues for which it acted as an underwriter on the appropriate Form G-37/G-38 with the MSRB, and failed to file a quarterly report in a timely manner. The findings also included that the firm failed to enforce its written supervisory procedures related to the submission of Forms G-36 and Forms G-37/G-38 to the MSRB. (FINRA Case #2007007328301)

Electronic Brokerage Systems, LLC (CRD #104031, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$22,500 and required to revise its written supervisory procedures regarding SEC Rules 203(a) (long sales), 203(b)(1) (locate requirements) and 203(b)(3) (threshold securities), NASD Rule 5100 and NASDAQ Rule 3350. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it accepted short sale orders in equity securities from another person, or effected a short sale in an equity security for its own account without borrowing the security or entering into a bona fide arrangement to borrow the security; or having reasonable grounds to believe that the security could be borrowed so that it could be delivered on the date delivery is due; and without documenting compliance with SEC Rule 203(b)(1) of Regulation SHO. The findings stated that the firm failed to report to the Trade Reporting Facility (TRF) the correct symbol indicating whether transactions were buy, sell, sell short, sell short exempt or cross for transactions in reportable securities. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning SEC Rules 203(a) (long sales), 203(b)(1) (locate requirements) and 203(b)(3) (threshold securities), NASD Rule 5100 and NASDAQ Rule 3350. The findings also included that the firm failed to provide documentary evidence that it performed the supervisory reviews set forth in its written supervisory procedures concerning the requirements of SEC Rule 200(g) (order marking) and NASD Rule 6130(d)(6). (FINRA Case #20060059948-01)

Empire Financial Group, Inc. (CRD #28759, Longwood, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$70,000, ordered to pay \$3,042.10, plus interest, in restitution to customers and ordered to revise its written supervisory procedures concerning SEC Rule 604 and trade reporting. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to immediately display customer limit orders in NASDAQ securities in its public quotation, when each order was at a price that would have improved the firm's bid or offer in each security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each security, and the size of the order represented more than a de minimis change in relation to the size associated with the firm's bid or offer in each security. The findings stated that the firm failed, within 90 seconds after execution, to transmit to the OTC Reporting Facility last sale reports of transactions in OTC equity securities and failed to designate some sale reports as late. The findings also stated that in transactions for or with a customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customers was as favorable as possible under prevailing market conditions. The findings also included that the firm executed short sale orders and failed to properly mark the orders as short; failed to provide written notification disclosing to its customers its correct capacity in transactions and, when it acted as principal for its own account, failed to provide written notification disclosing to its customers that it was a market maker in each security.

FINRA found that the firm failed, within 90 seconds after execution, to transmit to NASDAQ last sale reports of transactions in eligible securities; failed to report to the appropriate TRF the correct symbol indicating whether the firm executed transactions in reportable securities in a principal, riskless principal or agency capacity; incorrectly designated as “.PRP” to NASDAQ last sale reports of transactions in eligible securities; when it acted as principal for its own account, disclosed its compensation as a commission instead of a commission equivalent. FINRA also found that the firm’s supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning SEC Rule 604 and trade reporting. **(FINRA Case #20050001158-01)**

Global Crown Capital, LLC (CRD #16761, San Francisco, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$20,000, \$2,500 of which was jointly and severally with an individual. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it conducted a securities business, utilizing the means and instrumentalities of interstate commerce, while failing to maintain the minimum net capital required by SEC Rule 15c3-1. The findings stated that the firm failed to adopt and implement written supervisory procedures reasonably designed to achieve compliance with NASD Rule 2711 as it pertains to personal trading by research analysts, accurately identifying research publications as reports subject to that rule, disclosures in research reports and the qualifications of persons who supervised research analysts and the preparation of research reports. The findings also stated that the firm maintained a materially inaccurate Uniform Application for Broker-Dealer Registration (Form BD) in that it represented that a family trust established by a principal of the firm was a firm owner when the trust had no ownership interest. **(FINRA Case #20060037540-01)**

HSBC Securities (USA) Inc. (CRD #19585, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report to the Trade Reporting and Compliance Engine (TRACE) transactions in TRACE-eligible securities executed on a business day during TRACE system hours within 15 minutes of execution time. The findings stated that the firm failed to report the correct time of trade execution for TRACE-eligible securities and failed to show the correct time of execution on order memoranda in TRACE-eligible securities. **(FINRA Case #20060059732-01)**

Kershner Trading Group, LLC (CRD #16908, Austin, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it allowed registered representatives to conduct a securities business while their registrations were deemed inactive due to their failure to timely complete the Regulatory Element of the Continuing Education requirement. **(FINRA Case #2007007163501)**

Lavaflow, Inc. fka Ontrade, Inc. (CRD #120444, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$10,000 and required to revise its written supervisory procedures regarding the Order Audit Trail System (OATS). Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it reported Route or Combined Order/Route Reports to OATS that the OATS system was unable to link to the related order routed to SuperMontage due to inaccurate, incomplete or improperly formatted data. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning OATS. **(FINRA Case #20060046156-01)**

Leonard & Company (CRD #36527, Troy, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$25,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that in connection with the sale of unregistered promissory notes, it was unable to establish that the sale of the notes qualified for any exemption from registration. The findings stated that the firm failed to submit any documentation about the public offering of the unregistered promissory notes to FINRA prior to their sale, and made no written disclosures to the purchasers of the conflict of interest in the offering of unregistered promissory notes prior to their purchase. **(FINRA Case #E8A2005012903)**

Leonard & Company (CRD #36527, Troy, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$65,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to disclose on order memoranda the execution time in inter-dealer municipal debt securities transactions, and the receipt time and execution time in other customer transactions for municipal debt securities. The findings stated that the firm failed to include an execution time on customer order memoranda regarding corporate debt securities. The findings also stated that the firm failed to maintain all of the required information for customer accounts and failed to retain email communication registered representatives sent and/or received. The findings also included that the firm failed to comply with the terms of its membership agreement in that it opened branch offices while failing to obtain prior approval from FINRA because of its material change in business operations. FINRA found that the firm failed to establish and maintain a system to supervise each registered representative's activities reasonably designed to achieve compliance with applicable securities laws and NASD rules, in that the firm failed to have a supervisory system designed to ensure that its offices were registered as branch offices. FINRA also found that the firm failed to report a reportable event within 10 business days after it knew, or should have known, of the existence of disciplinary action it was taking against an individual. In addition, FINRA found that the firm failed to timely file amended Forms U4 and Uniform Termination Notices for Securities Industry Registration (Forms U5). **(FINRA Case #E8A2005012904)**

Piper Jaffray & Co. (CRD #665, Minneapolis, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$25,000 and ordered to disgorge profits of \$260,157.89 in prohibited municipal underwritings. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it engaged in municipal securities business within two years of political contributions made by a municipal finance professional of the firm to an official of the securities issuer, and received \$260,157.89 in management fees and designation fees in connection with the prohibited underwritings. The findings stated that the firm failed to have a supervisory system to adequately monitor the political contributions of its municipal finance professionals to ensure compliance with MSRB rules. **(FINRA Case #E0420050081-01)**

SG Americas Securities, LLC (CRD #128351, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$175,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it distributed research reports and research notes/updates to its U.S. institutional customers that its non-member foreign affiliates prepared and failed to determine whether disclosures were required. The findings stated that a qualified individual did not review any of the reports prior to their distribution to U.S. customers. The findings also stated that by displaying the firm logo, the research reports inaccurately represented that the firm's U.S. member affiliate had produced them. The findings also included that the firm failed to detect and correct the inaccurate representation as to the source of the research reports in a timely manner, and failed to establish, maintain and enforce a supervisory system reasonably designed to achieve compliance with applicable NASD disclosure and communication rules. **(FINRA Case #20070095217)**

Southwest Securities, Inc. (CRD #6220, Dallas, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$67,500 and required to revise its supervisory procedures regarding timely reporting of municipal securities transactions. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to preserve brokerage order memoranda for a period of not less than three years, the first two in an accessible place; and failed to show the execution date, the execution time, the time of entry and/or the terms and conditions of each order on some of the order memoranda. The findings stated that in transactions for or with a customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant prices to its customers were as favorable as possible under prevailing market conditions. The findings also stated that the firm failed to report the correct trade execution time for transactions in TRACE-eligible securities to TRACE, and failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of execution time. The findings also included that the firm failed to report information regarding purchase and sale transactions in municipal securities to the Real-time Transaction Reporting System (RTRS) in the manner prescribed by Rule G-14 RTRS Procedures and the RTRS Users Manual, because it failed to report information about transactions within 15 minutes of trade time to an RTRS Portal. FINRA found that the

firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and MSRB rules concerning timely reporting of municipal securities transactions. **(FINRA Case #20050000962-01)**

Individuals Barred or Suspended

Larry Chaluru Ajedewe (CRD #4166261, Registered Principal, Yonkers, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 30 days. The fine must be paid either immediately upon Ajedewe's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Ajedewe consented to the described sanctions and to the entry of findings that he borrowed \$1,500 from a public customer without notifying or receiving approval from his member firm regarding the loan and in contravention of the firm's compliance manual prohibiting registered representatives from borrowing money from customers.

The suspension in any capacity is in effect from April 21, 2008, through May 20, 2008. **(FINRA Case #2007011355801)**

Virginia Eberly Ali (CRD #5205635, Registered Representative, Ft. Myers, Florida) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Ali consented to the described sanction and to the entry of findings that she falsified customers' signatures on insurance application forms authorizing an insurance company to convert their term-life policies to whole-life policies. The findings stated that the customers had not authorized the conversions and had not authorized Ali to sign on their behalf. **(FINRA Case #2007008269901)**

Nicole Yvette Allen (CRD #3075257, Registered Representative, Dallas, Texas) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Allen failed to respond to FINRA requests for information. The findings stated that Allen engaged in a private securities transaction without providing prior written notice to her member firm. **(FINRA Case #2006005891201)**

Lori Jean Barnes (CRD #3032726, Registered Representative, Greenfield, Indiana) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. Without admitting or denying the findings, Barnes consented to the described sanctions and to the entry of findings that she implemented a covered call writing strategy and used her discretion to effectuate securities transactions in a public customer's account without the customer's prior written authorization and her member firm's written acceptance.

The suspension in any capacity was in effect from April 7, 2008, through April 18, 2008. **(FINRA Case #2005003298301)**

Marc Allen Brooks (CRD #5225762, Registered Representative, Charlotte, North Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Brooks consented to the described sanction and to the entry of findings that he made numerous unauthorized withdrawals, totaling \$13,000, from a public customer's account and misappropriated the funds. **(FINRA Case #2007009388301)**

Fredrick N. Brown (CRD #1605920, Registered Representative, Arlington, Tennessee) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Brown consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm. The findings stated that Brown knowingly or recklessly made material misrepresentations to public customers in connection with a real estate entity/fund. The findings also stated that Brown failed to respond to FINRA requests for information. **(FINRA Case #2006006508901)**

Paul Brian Bulgajewski (CRD #4171069, Registered Representative, Chicago, Illinois) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Bulgajewski engaged in a check kiting scheme by drawing checks totaling \$1,150 from a bank account which exceeded the funds available and depositing them into his personal account maintained at the bank affiliate of his member firm, which created inflated balances of uncollected funds and allowed other checks to clear when he knew, or should have known, that there were insufficient funds in his personal account at the bank to cover the checks. The findings stated that Bulgajewski failed to respond to FINRA requests for information. **(FINRA Case #2006006436101)**

Steven Paul Cariati (CRD #1519724, Registered Principal, Slingsland, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. Without admitting or denying the findings, Cariati consented to the described sanctions and to the entry of findings that he engaged in an outside business activity, for compensation, outside the scope of his employment with a member firm and without prompt written notice to his member firm.

The suspension in any capacity was in effect from April 7, 2008, through April 18, 2008. **(FINRA Case #2008012269901)**

Joanna King Cheung (CRD #3058119, Registered Representative, Foster City, California) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Cheung received premium refund checks and a title insurance refund check totaling \$610.35, and instead of forwarding the checks to the insurance customers, she deposited them into an account she maintained for the benefit of her member firm's affiliate and then applied the funds to the payment of her personal expenses. The findings stated that Cheung failed to appear for a FINRA on-the-record interview. **(FINRA Case #20070082842-01)**

Patrick Leroy Covin (CRD #4322065, Registered Representative, Canyon, Texas) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Covin consented to the described sanction and to the entry of findings that he received \$25,085.61 from public customers for insurance premium payments, but failed to deposit the funds into the required bank account, and converted \$4,550.82 in cash payments to his own use and benefit. (FINRA Case #2007008945401)

Bryan Lee Croger (CRD #2829939, Registered Representative, Noblesville, Indiana) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Croger converted \$18,398.29 from public customers' bank accounts to his own use and benefit without the customers' knowledge or consent. The findings stated that to conceal his withdrawal from one customer's bank account, Croger executed a sale in the customer's securities account without any written or oral authorization to exercise discretion so that the proceeds would automatically be transferred to the customer's checking account. The findings also stated that Croger failed to respond to FINRA requests for information. (FINRA Case #2006006397601)

Michael Englese Jr. (CRD #3221850, Registered Representative, Ozone Park, New York) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Englese executed purchases of a penny stock in public customers' accounts and failed to provide the customers with the required disclosure document, disclosure of the current bid and offer quotations, and disclosure of the compensation he and the firm were to receive for executing the transactions. The findings stated that Englese failed to respond to FINRA requests for information. (FINRA Case #2005002464701)

Victor Gregory Grieco (CRD #2632509, Registered Representative, Wellington, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. The fine must be paid either immediately upon Grieco's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Grieco consented to the described sanctions and to the entry of findings that he engaged in outside business activities without prompt written notice to his member firm. The findings stated that Grieco referred public customers to an independent insurance broker to purchase life insurance and received \$18,000 in commissions from the sale of the policies.

The suspension in any capacity was in effect from April 7, 2008, through April 18, 2008. (FINRA Case #2007008267701)

Bernard Benedict Gross (CRD #2559063, Registered Representative, Lawrence, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$10,000 and suspended from association with any FINRA member in any capacity for two years. The fine is due and payable either immediately upon Gross' reassociation with a FINRA member firm following the suspension, or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier. Without admitting or denying the findings,

Gross consented to the described sanctions and to the entry of findings that he opened and/or had control over securities accounts at brokerage firms and failed to inform his member firm that he had opened the accounts, and failed to inform the brokerage firms where he had the accounts that he was associated with a FINRA member firm. The findings stated that in connection with these accounts, Gross made intentional misrepresentations on the account opening documents as well as on subsequent forms concerning his employer's identity, his affiliation with a securities firm and his occupation, in order to avoid detection.

The suspension in any capacity is in effect from April 7, 2008, through April 6, 2010. **(FINRA Case #2006005125301)**

Juan Carlos Hernandez (CRD #2789264, Registered Representative, Guaynabo, Puerto, Rico) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Hernandez consented to the described sanction and to the entry of findings that he engaged in a pattern of charging commissions on equity trades substantially in excess of his member firm's standard commission rate that began at the start of, and continued throughout, his employment with the firm. The findings stated that Hernandez manipulated the firm's order entry system so as to enable him to charge the commissions in question. The findings stated that Hernandez had an express agreement with a public customer to charge a lower commission rate, but he fraudulently violated the agreement. The findings also stated that Hernandez failed to report complaint letters from the customer as reportable complaints to his member firm, causing his firm to violate NASD Rule 3070(c). **(FINRA Case #2007009435601)**

Brenda Lois Hobson (CRD #4115641, Associated Person, College Station, Texas) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Hobson consented to the described sanction and to the entry of findings that she made unauthorized withdrawals totaling \$5,485 from a public customer's account without the customer's knowledge, authorization or consent. The findings stated that Hobson signed wire transfer documents in the customer's name, and wired the funds into her own bank account. The findings also stated that Hobson attempted to conceal the withdrawals by transferring funds totaling \$5,548.91 from a second account the customer held to the account where the initial withdrawals were made, without the customer's knowledge, authorization or consent, thereby converting the customer's funds to her own use and benefit. **(FINRA Case #2007009464001)**

Carl Frazier Hyde Jr. (CRD #1269632, Registered Representative, Prospect, Kentucky) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Hyde consented to the described sanction and to the entry of findings that he accepted a signed blank check from a public customer to purchase a variable annuity and, instead, made the check payable to a family member for personal use. The findings stated that Hyde failed to respond to FINRA requests for an on-the-record interview. **(FINRA Case #2007009444001)**

Leonard Demont Jackson Jr. (CRD #4821901, Registered Representative, Wichita, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Jackson consented to the described sanction and to the entry of findings that he submitted a term conversion form for a public customer to an insurance company without the customer's authorization and forged the customer's signature on the form. The findings stated that Jackson submitted the form to the insurance company to collect \$2,646 in commissions. **(FINRA Case #20070088887-01)**

Cheryl Diane Jimerson (CRD #1379935, Registered Representative, Sayville, New York) was barred from association with any FINRA member in any capacity and ordered to pay \$34,229 in restitution to public customers. The sanctions were based on findings that Jimerson effected securities transactions in public customers' accounts without the customers' prior knowledge, authorization or consent. The findings stated that Jimerson engaged in a pattern of unsuitable excessive and short-term trading in a customer's individual retirement account (IRA) in light of the customer's objectives, financial situation and needs. The findings also stated that Jimerson failed to appear for FINRA on-the-record interviews. **(FINRA Case #E102004089201)**

John Walter Keller (CRD #873009, Registered Representative, Menlo Park, California) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Keller consented to the described sanction and to the entry of findings that he submitted account-related documents to his member firm on which he signed public customers' names without their authorization. The findings stated that Keller did not make a notation on the documents that he signed on the customers' behalf and did not notify his firm that he was signing the documents for the customers. The findings also stated that Keller did not have discretionary authority, letters of authorization or powers of attorney over any of the customers and signed the customers' names knowing that it was against security industry rules. The findings also included that Keller failed to respond to FINRA and NYSE requests to provide on-the-record testimony. **(FINRA Case #2007009429901)**

Gary Gerard Kelly (CRD #1604064, Registered Representative, Milton, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member firm in any capacity for six months. The fine is due and payable either immediately upon Kelly's reassociation with a FINRA member firm following the suspension, or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier. Without admitting or denying the findings, Kelly consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his member firm's annual update questionnaire and his Form U4.

The suspension in any capacity is in effect from April 7, 2008, through October 6, 2008. **(FINRA Case #2007009425001)**

Daniel Elmer Koffman (CRD #2691737, Registered Principal, Charlevoix, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. Without admitting or denying the findings, Koffman consented to the described sanctions and to the entry of findings that he effected securities transactions on a discretionary basis in a public customer's account without the customer's prior written authorization to exercise discretion and his member firm's prior written acceptance of the account as discretionary.

The suspension in any capacity was in effect from April 7, 2008, through April 18, 2008. (FINRA Case #2005002232303)

Kevin Troy Litterell (CRD #1859910, Registered Representative, Wenatchee, Washington) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Litterell failed to respond to FINRA requests for information. The findings stated that Litterell failed to timely amend his Form U4 with material information. (FINRA Case #2006007157201)

Darrin Michael Marion (CRD #3262749, Registered Representative, Indianapolis, Indiana) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Marion consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4. The findings stated that Marion failed to appear for a FINRA on-the-record interview. (FINRA Case #2007008359701)

Miguel Angel Molina (CRD #4187160, Registered Representative, Salt Lake City, Utah) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Molina consented to the described sanction and to the entry of findings that he received \$8,813 from public customers intended for payment of insurance premiums and either failed to forward the full payment amounts or did not forward any of the payments to the insurance company. The findings stated that Molina acted without the customers' knowledge or consent when he failed to apply the premium payments to the customers' insurance policies and, instead, withheld the money for his personal use and benefit. (FINRA Case #2007008922101)

John Edward Mulligan (CRD #1260708, Registered Supervisor, Sarasota, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for one month. The fine must be paid either immediately upon Mulligan's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Mulligan consented to the described sanctions and to the entry of findings that he "cut and pasted" a public customer's signature to a spousal IRA rollover form without the customer's knowledge or consent.

The suspension in any capacity was in effect from March 24, 2008, through April 23, 2008. (FINRA Case #2007008540901)

Charles Robert Murdough (CRD #2437321, Registered Representative, Buffalo, New York) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Murdough failed to respond to FINRA requests for information. The findings stated that Murdough borrowed \$25,000 from a public customer, contrary to his member firm's policy prohibiting registered representatives from borrowing money from customers unless they were family members. **(FINRA Case #2006005136901)**

Oscar Donald Overbey Jr. (CRD #2066217, Registered Representative, Evanston, Illinois) was barred from association with any FINRA member in any capacity and required to pay \$50,000, plus interest, in restitution to a public customer. The sanctions were based on findings that Overbey failed to respond to FINRA requests for information. The findings stated that Overbey borrowed \$50,000 from a public customer in violation of his member firm's policy that prohibited registered representatives from borrowing money from customers unless they were family members. **(FINRA Case #2006006292602)**

Robert John Parker (CRD #1070201, Registered Representative, Mullica Hill, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Parker consented to the described sanction and to the entry of findings that he received checks totaling \$35,100 from public customers for investment purposes, negotiated the checks and converted the proceeds for his own use and benefit. The findings stated that Parker failed to respond to FINRA requests for information. **(FINRA Case #2007008486601)**

Terrance Reid Pipenhagen (CRD #716645, Registered Principal, Orlando, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Pipenhagen consented to the described sanction and to the entry of findings that he solicited individuals to invest \$475,000 in commodities trading accounts he maintained and controlled. The findings stated that Pipenhagen lost all of the investors' funds and sent false account statements to the investors in order to conceal their losses and to prevent them from pulling out their investments before he had a chance to recover their losses. The findings also stated that Pipenhagen engaged in private securities transactions without prior written notice to his member firm. **(FINRA Case #2006006849601)**

Francie Bea Rachal (CRD #2039587, Registered Principal, Murphy, Texas) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any FINRA member in any principal capacity for 10 business days. Without admitting or denying the findings, Rachal consented to the described sanctions and to the entry of findings that she failed to reasonably supervise a registered representative who engaged in unauthorized transactions and sold securities in states in which he was not licensed.

The suspension in any principal capacity was in effect from April 21, 2008, through May 2, 2008. **(FINRA Case #2005002154902)**

Jeffrey Scott Ramson (CRD #1574903, Registered Principal, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 60 days. The fine must be paid either immediately upon Ramson's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Ramson consented to the described sanctions and to the entry of findings that, in his capacity as his member firm's Chief Executive Officer (CEO), he approved a retroactive application of a higher commission rate to transactions that had been previously confirmed in writing to a public customer, thereby increasing the commissions charged from \$12,500 to \$480,000.

The suspension in any capacity is in effect from April 7, 2008, through June 5, 2008. (FINRA Case #2005003607001)

Wayne Allen Ritenour Jr. (CRD #3206373, Registered Principal, Niceville, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Ritenour consented to the described sanction and to the entry of findings that he engaged in a private securities transaction without prior written notice to, and approval from, his member firm. The findings stated that Ritenour failed to appear for a FINRA on-the-record interview. (FINRA Case #2006006476901)

Robert James Roesch Jr. (CRD #4233031, Registered Representative, Red Bank, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for three months. The fine must be paid either immediately upon Roesch's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Roesch consented to the described sanctions and to the entry of findings that he wrote checks totaling \$2,200 payable to himself against a personal bank account that had been closed, knowing that the checks would be dishonored, but he cashed them anyway. The findings stated that Roesch subsequently deposited sufficient funds to cover the checks.

The suspension in any capacity is in effect from April 21, 2008, through July 20, 2008. (FINRA Case #2007009042401)

Philip Paul Rusnak (CRD #1030407, Registered Representative, Columbia, South Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 30 days. Without admitting or denying the findings, Rusnak consented to the described sanctions and to the entry of findings that he engaged in an outside business activity, for compensation, without prompt written notice to his member firm.

The suspension in any capacity is in effect from April 21, 2008, through May 20, 2008. (FINRA Case #2006006744601)

Dale Eugene Shields II (CRD #5101892, Associated Person, Middletown, Ohio) submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 30 business days. Without admitting or denying the allegations, Shields consented to the described sanctions and to the entry of findings that he failed to disclose a material fact on his Form U4.

The suspension in any capacity is in effect from April 21, 2008, through June 2, 2008. (FINRA Case #2006005506601)

Jeffrey Steve Stephan (CRD #862599, Associated Person, Valparaiso, Indiana) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for one year. The fine must be paid either immediately upon Stephan's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Stephan consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form U4.

The suspension in any capacity is in effect from April 21, 2008, through April 20, 2009. (FINRA Case #2007008535601)

Robert Martin Sweeney III (CRD #3198872, Registered Representative, Archbald, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for three months. The fine must be paid either immediately upon Sweeney's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Sweeney consented to the described sanctions and to the entry of findings that he signed a customer's name on a tax certification form related to a life insurance policy without the customer's authorization or consent.

The suspension in any capacity is in effect from March 17, 2008, through June 16, 2008. (FINRA Case #2007008997101)

Ike Joseph Talbot (CRD #1695719, Registered Representative, Lake Jackson, Texas) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Talbot consented to the described sanction and to the entry of findings that he borrowed \$87,500 from public customers in violation of his member firm's written supervisory procedures that prohibited borrowing from customers under any circumstances. (FINRA Case #2006006856601)

Scott Howard Weissman (CRD #2664118, Registered Representative, Miami, Florida) was barred from association with any FINRA member in any capacity and ordered to pay \$16,000, plus interest, in restitution to a public customer. The sanctions were based on findings that Weissman transferred \$30,000 from a customer's securities account to the bank account of a movie production company for which he was the president,

thereby converting the funds to his own use and benefit. The findings stated that Weissman executed a transaction in customers' joint account without the customers' knowledge or consent. The findings also stated that Weissman offered and sold securities that were not exempt from registration and for which no registration statement was in effect, in violation of Section 5 of the Securities Act of 1933. (FINRA Case #2005001067201)

Luke St. James Youngblood (CRD #5246072, Associated Person, Milford Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$4,000 and suspended from association with any FINRA member in any capacity for five months. The fine is must be paid either immediately upon Youngblood's reassociation with a FINRA member firm following his suspension, or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier. Without admitting or denying the findings, Youngblood consented to the described sanctions and to the entry of findings that he failed to disclose material facts on an application for employment submitted to a member firm.

The suspension in any capacity is in effect from April 7, 2008, through September 6, 2008. (FINRA Case #20070094721)

Decisions Issued

The Office of Hearing Officers (OHO) issued the following decisions, which have been appealed to or called for review by the NAC as of March 31, 2008. The NAC may increase, decrease, modify or reverse the findings and sanctions imposed the decisions. Initial decisions whose time for appeal has not yet expired will be reported in the next *Regulatory Notices*.

Lisa Ann Tomiko Nouchi (CRD #2367719, Registered Representative, Fairfield, California) was fined \$10,000 and suspended from association with any FINRA member in any capacity for 90 days. The sanctions were based on findings that Nouchi made entries on her member firm's electronic mutual fund order entry system that falsely represented certain public customers selling Class B mutual fund shares as disabled when, in reality, they were not disabled. The findings stated that Nouchi improperly obtained contingent deferred sales charge (CDSC) waivers for mutual fund redemption transactions effected for these customers to which they were not entitled. The findings also stated that Nouchi caused her member firm's books and records to contain false and misleading information regarding the customers' disability status and their entitlement to CDSC waivers.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (FINRA Case #E102004083705)

Marc Winters (CRD #4053113, Registered Representative, Chatsworth, California) was fined \$30,000 and suspended from association with any FINRA member in any capacity for 30 business days. The sanctions were based on findings that Winters made entries on his member firm's electronic mutual fund order entry system that falsely represented certain public customers selling Class B mutual fund shares as disabled

when, in reality, they were not disabled. The findings stated that Winters caused his member firm's books and records to contain false and misleading information regarding the customers' disability status and their entitlement to CDSC waivers.

This decision has been called for review by the NAC, and the sanctions are not in effect pending consideration of the review. (FINRA Case #E102004083704)

Complaints Filed

FINRA issued the following complaints. Issuance of a disciplinary complaint represents FINRA's initiation of a formal proceeding in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, you may wish to contact the respondent before drawing any conclusions regarding these allegations in the complaint.

Holly Ann Gunnette (CRD #3066284, Registered Representative, Riverside, California) was named as a respondent in a FINRA complaint alleging that she caused her personal residence to be reflected as the address of record for investment accounts of a public customer at her member firm, and established an account for the customer at another member firm, using her personal residence address as the account's address of record. The complaint alleges that Gunnette received checks totaling \$925,513.28 drawn on the accounts, deposited the checks into bank accounts she owned or controlled, and used the proceeds for her own benefit and not for the customer's, thereby converting the funds to her own use and benefit. The complaint also alleges that Gunnette caused her member firm's and the other firm's records to be falsified by using her personal address for the customer's address. (FINRA Case #2006004943101)

Jose Daniel Iriarte Jr. (CRD #4146368, Registered Representative, Severn, Maryland) was named as a respondent in a FINRA complaint alleging that he converted a public customer's funds intended for investment to repay a second customer, from whom he had earlier borrowed funds, without the first customer's permission or authority. The complaint alleges that Iriarte, in contravention of his member firm's written procedures prohibiting registered representatives from borrowing money from customers unless the customer is a family member, failed to receive his firm's approval to borrow money from the customer. The complaint also alleges that Iriarte failed to respond to FINRA requests for information. (FINRA Case #2007010369701)

Regina Kay Locke (CRD #2324166, Registered Representative, Houston, Texas) was named as a respondent in a FINRA complaint alleging that she wrongfully converted funds totaling \$40,000 from a public customer's account by altering and submitting IRA distribution documents to her member firm, resulting in the distribution of funds from the customer's IRA account to Locke or to a third party for Locke's personal use and benefit. The complaint alleges that Locke caused her member firm's books and records to be inaccurate by submitting, or causing the submission of, altered and falsified IRA Distribution Request Forms and Addenda to her member firm. (FINRA Case #2007009424701)

Robert Alan Uhr (CRD #4563861, Registered Representative, Boca Raton, Florida) was named as a respondent in a FINRA complaint alleging that he exercised control over a customer's IRA, made excessive and unsuitable trades in that account in a manner inconsistent with the customer's objectives, risk tolerance and financial situation, and acted with the intent to defraud or with reckless disregard for the customer's interests and for the purpose of generating commissions. The complaint alleges that in connection with the purchase or sale of securities, Uhr, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, knowingly or recklessly employed devices, schemes or artifices to defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; engaged in acts, practices or courses of business that operated, or would operate, as a fraud, deceit upon any person; or effected transactions in, or induced the purchase or sale of, any security by means of manipulative, deceptive or other fraudulent device or contrivance. The complaint also alleges that Uhr's churning and unsuitable trading activity generated \$16,574 in commissions. **(FINRA Case #2006006965701)**

Firms Suspended for Failure to Supply Financial Information

(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

Centreinvest, Inc.
New York, New York
(March 6, 2008)

Docent Financial Services Corp.
Natick, Massachusetts
(October 8, 2007 – February 29, 2008)

Harvest Capital Investments LLC
Vienna, Virginia
(March 6, 2008)

Firms Suspended Pursuant to NASD Rule 9553 for Failure to Pay Annual Assessment Fees
(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

Fifth Street Capital, LLC
Austin, Texas
(March 26, 2008 – April 2, 2008)

Harvest Capital Investments LLC
Vienna, Virginia
(March 26, 2008)

Individuals Revoked for Failing to Pay Fines and/or Costs Pursuant to NASD Rule 8320

Anthony Cipriano
West Islip, New York
(March 5, 2008)

Timothy Patrick Shively
San Antonio, Texas
(March 3, 2008)

Individuals Barred Pursuant to NASD Rule 9552(h)

(If the bar has been vacated, the date follows the bar date.)

Kendall George Sohaski
Fort Wayne, Indiana
(March 11, 2008)

Nwaka Ogwuru Ugokwe
Smyrna, Georgia
(March 24, 2008)

Individuals Suspended Pursuant to NASD Rule 9552(d)

(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

Anthony E. DeVito
Wellington, Ohio
(March 21, 2008)

Robert Rush Reynolds
Fairhope, Alabama
(March 3, 2008)

**Individuals Suspended Pursuant to NASD
Rule Series 9554 for Failure to Comply
with an Arbitration Award or Settlement
Agreement**

(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

Lynda Ann Findlay
Cordova, Tennessee
(March 10, 2008)

Michael Edward Hampton
St. Louis, Missouri
(March 10, 2008)

James Edward Hynes
Nesconset, New York
(March 24, 2008)

Abed Mansoor
Manhasset, New York
(March 10, 2008)

Peter Michael Muer
West Palm Beach, Florida
(March 19, 2008)

Craig Steven Redding
Port St. Lucie, Florida
(March 24, 2008 – March 28, 2008)

James David Rossi
Staten Island, New York
(March 24, 2008)

Stephen Jefferson Sumner
Ormond Beach, Florida
(November 28, 2007 – March 28, 2008)

FINRA Fines, Suspends 16 State Farm Representatives for Test-Taking Irregularities in the Firm's Continuing Education Program

Supervisors Directed or Allowed Registered Representatives of State Farm VP Management Corp. to Take "Firm Element" Proficiency Tests for Supervisors or Other Representatives

The Financial Industry Regulatory Authority (FINRA) announced has fined and suspended 16 current and former registered representatives of State Farm VP Management Corp. of Bloomington, IL, for misconduct involving FINRA's Continuing Education requirements for registered representatives.

The individual representatives received fines ranging from \$5,000 to \$10,000 and suspensions ranging from 30 days to six months. One representative also was barred as a principal. State Farm VP Management Corp. is engaged in the business of selling mutual funds and variable products.

Nine of the sanctioned representatives were supervisors who directed or allowed subordinates to take State Farm's "Firm Element" proficiency test for them. One was a supervisor who directed a subordinate to take the test for other registered representatives. Six of the sanctioned representatives completed the Firm Element test for their superiors.

The representatives engaged in this misconduct without any authorization from State Farm. State Farm reported the misconduct to FINRA after uncovering test-taking irregularities in one of its regions and conducting a preliminary investigation. State Farm then expanded its internal investigation nationwide and provided FINRA with its findings.

"The Continuing Education requirement leads to better trained and informed securities industry professionals and promotes investor protection," said Susan L. Merrill, FINRA Executive Vice President and Chief of Enforcement. "In this case, while the failures by the firm's brokers to complete the requirements are disappointing enough, it is especially troubling that supervisors directed subordinates to help them avoid this important requirement."

Since 1995, FINRA, in conjunction with other self-regulatory organizations and the Securities Industry/Regulatory Council on Continuing Education, has administered a two-part mandatory Continuing Education Program. The Continuing Education requirements consist of a Regulatory Element and a Firm Element. The Regulatory Element requires all registered persons to take computer-based training, devoted to industry rules and regulations, on the second anniversary of their initial securities registration and every three years thereafter. The Firm Element requires firms to administer appropriate training to their registered persons who have direct contact with customers, and to the registered persons' immediate supervisors, on an ongoing basis. The training must cover topics specifically related to their business, such as new products, sales practices, risk disclosure, and new regulatory requirements and concerns.

The 2005 Firm Element designed by State Farm was an internal, computer-based system. Covered representatives were required to complete a two-hour training session and then pass a proficiency test with a minimum score of 80%. In order to access the Firm Element training session and proficiency test, the participant was required to sign on to the system using a user ID and password. The subordinate representatives who took the test for their superiors signed on as the superiors for whom they were taking the test, using the superiors' user IDs and passwords.

One sanctioned representative, a former registered principal of the firm, Rebecca Sappington, was fined \$10,000, barred as a principal and suspended for six months in all capacities. FINRA found that Sappington directed a subordinate to obtain the user IDs and passwords of at least four State Farm registered representatives working in her area, and complete the Firm Element program for these representatives by taking their proficiency tests. When Sappington learned that her directive had not been carried out, she instructed her subordinate to delegate the task to another person, who was an unregistered and newly hired employee of State Farm. This unregistered person then obtained the user IDs and passwords for at least four representatives, logged onto the system and completed the Firm Element program for the representatives by taking their proficiency tests.

In concluding these settlements, the registered representatives neither admitted nor denied the charges, but consented to the entry of FINRA's findings. The individuals agreed to the following sanctions:

Series 26 Principals who directed a subordinate to take their proficiency tests:

- ▶ **Todd Rindfuss** received a \$10,000 fine, a six-month suspension as a principal and a 90-day suspension in all capacities. Rindfuss' suspension in a principal capacity is in effect from March 17, 2008, through September 16, 2008. His suspension in any capacity is in effect from March 17, 2008, through June 14, 2008
- ▶ **Michael Stansbury** received a \$10,000 fine, a six-month suspension as a principal and a 90-day suspension in all capacities. Stansbury's suspension in a principal capacity is in effect from March 17, 2008, through September 16, 2008. His suspension in any capacity is in effect from March 17, 2008, through June 14, 2008.

Series 26 Principal who directed subordinates to take the test for others:

- ▶ **Rebecca Sappington** received a \$10,000 fine, a bar as a principal and a six-month suspension in all capacities, which is in effect from January 7, 2008, through July 6, 2008.

Series 6 Representatives who directed or allowed a subordinate to take their proficiency tests:

- **Jeffery Coleman** received a \$5,000 fine and a 60-day suspension, which is in effect from April 7, 2008, through June 5, 2008.
- **Walter Culbreth** received a \$5,000 fine and a 60-day suspension, which is in effect from April 7, 2008, through June 5, 2008.
- **Beverly Lochard** received a \$5,000 fine and a 60-day suspension, which is in effect from April 7, 2008, through June 5, 2008.
- **William Nickum** received a \$5,000 fine and a 60-day suspension, which is in effect from April 7, 2008, through June 5, 2008.
- **Robert Olive** received a \$5,000 fine and a 60-day suspension, which is in effect from March 17, 2008, through May 15, 2008.
- **Valerie Tichy-Drummer** received a \$5,000 fine and a 60-day suspension, which is in effect from March 17, 2008, through May 15, 2008.
- **Karen Curtis** received a \$5,000 fine and a 60 day suspension, which was in effect from November 19, 2007, through January 17, 2008.

Series 6 Representatives who completed the proficiency tests for their superiors:

- **Kenneth Capell** received a \$5,000 fine and a 30-day suspension, which was in effect from March 17, 2008, through April 15, 2008.
- **Mayka Hardy** received a \$5,000 fine and a 30-day suspension, which was in effect from March 17, 2008, through April 15, 2008.
- **Teresa King** received a \$5,000 fine and a 30-day suspension, which was in effect from March 17, 2008, through April 15, 2008.
- **Lori Love** received a \$5,000 fine and a 30-day suspension, which was in effect from March 17, 2008, through April 15, 2008.
- **Heather Montagne** received a \$5,000 fine and a 30-day suspension, which was in effect from March 17, 2008, through April 15, 2008.
- **John Reich** received a \$5,000 fine and a 30-day suspension, which was in effect from March 17, 2008, through April 15, 2008.

FINRA Hearing Panel Fines, Suspends Investprivate's Chairman and CEO for Failure to Disclose Tax Liens, Customer Complaints

A Financial Industry Regulatory Authority (FINRA) Hearing Panel issued a decision that imposed a 90-day suspension, a concurrent 10-day suspension, and a \$12,500 fine against Scott Mathis, Chairman and CEO of New York's Investprivate, Inc. (now known as DPEC Capital, Inc.), for failing to disclose tax liens and two customer complaints on his Form U4s. Mathis and Investprivate were originally charged by FINRA with securities fraud, but those charges were later withdrawn.

The hearing panel decision addressed the last outstanding charges brought by NASD (FINRA's predecessor) in 2004 against Mathis. FINRA's Enforcement Department previously settled several other charges from that 2004 action against Investprivate; Mathis; Donald Geraghty, the firm's Director of Compliance; and Ronald Robbins, Executive Vice President of Investprivate's parent company, Diversified Biotech Holdings Corporation.

The 2004 complaint charged Investprivate and Mathis with securities fraud and other violations in connection with two securities self-offerings that raised approximately \$17.6 million for the firm and its parent between June 2000 and February 2003. Geraghty was charged with supervisory and other violations, while Robbins was charged with participating in the management of Investprivate without being registered with NASD in any capacity.

FINRA's Enforcement Department later withdrew the fraud charges against Investprivate and Mathis. In May 2007, it reached a partial settlement with Mathis and full settlements with the firm, Geraghty and Robbins. At that time, the disclosure violation charges against Mathis were severed from the original complaint for consideration by a hearing panel.

Investprivate was censured and fined \$205,000, of which \$67,500 was imposed jointly and severally with Mathis; another \$40,000 was imposed jointly and severally with Mathis and Geraghty; and \$15,000 was imposed jointly and severally with Geraghty. The firm was suspended for 60 days from seeking or accepting new engagements to conduct or participate in the offer or sale of unregistered securities through any private offering, private placement or private investment in public equity (PIPE) transaction. The firm was also required to retain an independent consultant to conduct a comprehensive review of the adequacy of the firm's policies, systems, procedures and training relating to the offer or sale of unregistered securities.

In addition, Mathis and Geraghty were suspended from association with any registered firm in any principal capacity for 30 days. Robbins was fined \$10,000 and suspended from associating with a registered firm in any capacity for 10 business days.

Without admitting or denying the charges, the firm and individuals consented to the entry of NASD's findings, which included: that the firm, through Mathis, negligently made untrue statements or omitted material facts from private placement memoranda distributed to investors or potential investors; that the firm, acting through Mathis, offered and sold securities without registration statements filed with the Securities and Exchange Commission; that the firm, acting through Geraghty, failed to report, or to timely report, customer complaints and settlements of customer complaints to NASD; that the firm, acting through Robbins, Mathis and Geraghty, permitted Robbins to engage in activity requiring registration as a general securities principal and a general securities representative without obtaining the required registrations; and, that the firm, acting through Geraghty failed to implement and enforce an effective supervisory system that would have enabled the firm to comply with federal securities laws and NASD rules.

The FINRA hearing panel issued its ruling on the remaining charges against Mathis—for failure to disclose tax liens and customer complaints on his Form U4—in December 2007. The Hearing Panel found that the failure to disclose tax liens was willful and material, subjecting Mathis to a statutorily disqualification from association with any FINRA member. Mathis has appealed the hearing panel decision to FINRA's National Adjudicatory Council.