

## Financial Responsibility and Related Operational Rules

### FINRA Requests Comment on Proposed Consolidated FINRA Rules Governing Financial Responsibility and Operational Requirements

Comment Period Expires: February 20, 2009

#### Executive Summary

In its continued effort to develop a set of financial responsibility and related operational rules<sup>1</sup> for the consolidated rulebook (the Consolidated FINRA Rulebook),<sup>2</sup> FINRA is requesting comment on proposed new FINRA Rules 4150, 4311, 4522 and 4523 (the proposed rules). The proposed rules are based in part on Incorporated NYSE<sup>3</sup> and NASD Rules and would, in combination with the proposed rules FINRA recently filed with the SEC,<sup>4</sup> govern financial responsibility as well as certain operational and contractual requirements of member firms.<sup>5</sup>

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

Questions regarding this *Notice* should be directed to:

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

January 2009

#### Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

#### Suggested Routing

- Compliance
- Legal
- Senior Management

#### Key Topic(s)

- Capital Compliance
- Financial Responsibility
- Operational Rules

#### Referenced Rules & Notices

- NASD Rule 3230
- NYSE Rule 322
- NYSE Rule 382
- NYSE Rule Interpretation 382
- NYSE Rule 440.10
- NYSE Rule 440.20
- SEA Rule 15c3-1
- SEA Rule 15c3-3
- SEA Rule 17a-3(a)(10)
- SEA Rule 17a-4(b)
- SEA Rule 17a-13

## Action Requested

FINRA encourages all interested parties to comment on the proposed rules. Comments must be received by February 20, 2009.

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

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

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

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.<sup>6</sup>

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*.<sup>7</sup>

## Background

The proposed rules enhance FINRA's authority to execute effectively its financial and operational surveillance and examination programs. Consistent with the approach that FINRA discussed in SR-FINRA-2008-067 and *Regulatory Notice 08-23*, many of the requirements set forth in the proposed rules are substantially the same as requirements found in current rules and, where appropriate, are tiered to apply only to carrying or clearing firms, or to firms that engage in certain specified activities. Certain of the proposed rule provisions are new for FINRA member firms that are not Dual Members (referred to as "non-NYSE member firms"). Certain other provisions are new for both Dual Members and non-NYSE member firms alike. The more significant changes are discussed below.

## Discussion

### **A. Proposed FINRA Rule 4150 (Guarantees by, or Flow Through Benefits for, Members)**

Proposed FINRA Rule 4150, based in large part on NYSE Rule 322, requires that prior written notice be given to FINRA whenever a member firm guarantees, endorses or assumes, directly or indirectly, the obligations or liabilities of another person (including entity),<sup>8</sup> or receives flow-through capital benefits in accordance with Appendix C of SEA Rule 15c3-1. The timing and details of what constitutes the notice are included in proposed FINRA Rule 4150.01. Proposed FINRA Rule 4150.02 provides that a member firm may at any time (*i.e.*, not just within the context of the prior written notice the member firm provides pursuant to the proposed rule) be required to provide FINRA with information with respect to the arrangement, relationship and dealings with a person referred to in the proposed rule.

Proposed FINRA Rule 4150.03 prohibits any member firm from entering into an arrangement described in the proposed rule unless the firm has the authority to make available promptly the books and records of the other person for inspection by FINRA in the United States. The proposed rule provides that the books and records of the other person must be kept separately from those of the member firm.

With respect to persons referred to in the proposed rule that are registered broker-dealers, proposed FINRA Rule 4150.04 requires that the member firm must furnish to FINRA copies of the persons' FOCUS Reports simultaneous with their being filed with the persons' designated examining authority. With respect to persons that are not registered broker-dealers, the proposed rule requires, in lieu of FOCUS Reports, submission of financial and operational statements, in such format and at such time periods as FINRA may require, sufficient to gauge the capital and operational effects of the arrangement or relationship on the member firm.

Proposed FINRA Rule 4150.05 provides that guarantees executed routinely in the normal course of business, such as trade guarantees, signature guarantees, endorsement of securities and the writing of options, are not subject to the requirements of the proposed rule provided that, in regard to the guarantee of the writing of options, the transaction is appropriately recorded on the member firm's books and records in accordance with SEA Rule 17a-3(a)(10) and is reflected in its capital computation.

NASD Rules do not have a provision that corresponds to NYSE Rule 322. Accordingly, the requirements of proposed FINRA Rule 4150 are new to non-NYSE members.

## **B. Proposed FINRA Rule 4311 (Carrying Agreements)**

Proposed FINRA Rule 4311 is based on NASD Rule 3230 and NYSE Rule 382 (including its Interpretations). The proposed rule governs the requirements applicable to member firms when entering into agreements for the carrying of customer accounts. Historically, the purpose of the NASD and NYSE rules upon which the proposed rule is based has been to ensure that certain functions and responsibilities are clearly allocated to either the introducing or carrying firm, consistent with any requirements of the SRO's and SEC's financial responsibility and other rules and regulations, as applicable.<sup>9</sup> The proposed rule continues to serve that same purpose and, accordingly, contains many requirements that are substantially unchanged from NASD Rule 3230 and NYSE Rule 382. Proposed FINRA Rule 4311 also codifies certain provisions that are new for non-NYSE members, or are new for both Dual Members and non-NYSE members alike. Following is a summary of the more significant and/or new provisions of the proposed rule.

Proposed FINRA Rule 4311(a)(1) prohibits a member firm from entering into an agreement with a carrying firm for the carrying of its customer accounts on an omnibus or fully disclosed basis, unless the carrying firm is a FINRA member firm. This is a new requirement for all member firms; however, the vast majority of carrying firms in the United States are FINRA member firms. Proposed FINRA Rule 4311(a)(1) also includes a provision that requires that when an introducing firm acts as an intermediary for another introducing firm or firms (so-called "piggyback" or "intermediary clearing arrangements") for the purpose of obtaining clearing services from the carrying firm, the introducing firm must notify the carrying firm of the existence of the arrangement(s) with the other introducing firm(s) and disclose the identity of the firm(s). Based in large part on NYSE Rule Interpretation 382/05, the proposed rule further requires that each carrying agreement must identify and bind every direct and indirect recipient of clearing services as a party thereto.

Proposed FINRA Rule 4311(b)(1), consistent with the requirements of NASD Rule 3230(e) and NYSE Rule 382(a), requires that the carrying firm must submit to FINRA for approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before such agreement can become effective. The proposed rule also provides that the carrying firm must also submit to FINRA for approval any material changes to an approved carrying agreement before the changes become effective.<sup>10</sup>

The proposed rule codifies the practice under NASD Rule 3230 of permitting use of pre-approved standardized forms of agreement, with the exception of agreements with parties that are not U.S.-registered broker-dealers. The proposed rule requires a carrying firm to submit to FINRA for approval each carrying agreement with a non-U.S.-registered broker-dealer.<sup>11</sup> This is a new requirement for non-NYSE member firms.

Proposed FINRA Rule 4311(b)(3) codifies the current practice under NYSE Rule 382 of requiring that as early as possible, but not later than 10 business days, prior to the carrying of any accounts of a new introducing firm (including the accounts of any piggyback or intermediary introducing firm(s)), the carrying firm must submit to FINRA a notice identifying each such introducing firm by name and CRD number and include such additional information as FINRA may require.<sup>12</sup> This is a new requirement for non-NYSE carrying member firms, and permits FINRA to obtain additional information that enables it to evaluate the impact of the new carrying arrangement on the financial and operational condition of the member firm. Proposed FINRA Rule 4311(b)(4) expressly requires each carrying firm to conduct appropriate due diligence with respect to any new introducing firm relationship, including, but not limited to, inquiry into the introducing firm's business mix and customer account activity, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history. The carrying firm must maintain a record, in accordance with the timeframes prescribed by SEA Rule 17a-4(b), of the due diligence conducted for each new introducing firm.

Based in part on NASD Rule 3230(g), NYSE Rule 382(c) and NYSE Rule Interpretation 382/03, proposed FINRA Rule 4311(d) requires that each customer whose account is introduced on a fully disclosed basis must be notified in writing upon the opening of the account of the existence of the carrying agreement and the responsibilities allocated to each respective party. The proposed rule provides that the carrying firm would be responsible for the content of the notification to the customer. A new provision further provides that the customer must be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities thereunder.

Consistent with NYSE Rule Interpretation 382/03, proposed FINRA Rule 4311(e) requires that each carrying agreement must expressly state that to the extent that a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility. This is a new requirement for non-NYSE member firms.

Based in large part on NASD Rule 3230(d) and NYSE Rule 382(f), proposed FINRA Rule 4311(f) provides that a carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule 15c3-3 and further that the introducing firm represents to the carrying firm in writing that the introducing firm maintains, and will enforce, supervisory policies and procedures with respect to such check writing that are satisfactory to the carrying firm.

The provisions of proposed FINRA Rule 4311(g)(1), and (h) generally address the obligations of the parties to provide the referenced information to each other and/or to FINRA and are based upon existing rule provisions. Proposed FINRA Rule 4311(g)(2) provides that, upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of proposed FINRA Rule 4311(g)(1) in instances where the introducing firm is an affiliated entity of the carrying firm. This provision is based upon NASD Rule 3230(b)(3) but is not in NYSE Rule 382. Member firms should also note that the July 1 deadline set forth in paragraph (h)(2) of the proposed rule differs from the current requirement (no later than July 31) specified by the corresponding NASD and NYSE rule provisions.

Proposed FINRA Rule 4311(i) is based largely on NASD Rule 3230(h) and does not have a corresponding provision to NYSE Rule 382. The proposed rule provides that all carrying agreements must require each introducing firm to maintain its proprietary and customer accounts, and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each introducing firm. Consistent with NASD Rule 3230(h), the proposed rule's requirements apply only to intermediary clearing arrangements that are established on or after February 20, 2006.

### **C. Proposed FINRA Rule 4522 (Periodic Security Counts, Verifications and Comparisons)**

Proposed FINRA Rule 4522(a), based in large part on NYSE Rule 440.10, requires each member firm that is subject to the requirements of SEA Rule 17a-13 to make the counts, examinations, verifications, comparisons and entries set forth in SEA Rule 17a-13. Proposed FINRA Rule 4522(b), again based in large part on NYSE Rule 440.10, requires each carrying or clearing member firm subject to SEA Rule 17a-13 to make more frequent counts, examinations, verifications, comparisons and entries where prudent business practice would so require. Each such carrying or clearing member firm would be required to receive position statements no less than once per month with respect to securities held by clearing corporations, other organizations or custodians and, at least once per month, reconcile all such securities and money balances by comparison of the clearing corporations' or custodians' position statements to the member firm's books and records. The carrying or clearing member firm must promptly report any differences to the contra organization, and both the contra organization and the member firm must promptly resolve the differences. Where there is a higher volume of activity, the proposed rule provides that good business practice may require a more frequent exchange of statements and performance of reconciliations. The rule further requires that no later than seven business days after each security count, the carrying or clearing member firm must enter any unresolved differences in a "Difference" account for that security count.

NASD Rules do not have a provision that corresponds to NYSE Rule 440.10. Accordingly, the requirements of proposed FINRA Rule 4522(b) are new to non-NYSE carrying or clearing member firms that are subject to the requirements of SEA Rule 17a-13.

**D. Proposed FINRA Rule 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts)**

Proposed FINRA Rule 4523, based in large part on NYSE Rule 440.20, is intended to help assure the accuracy of each member firm's books and records and includes supervisory measures for their implementation. Paragraph (a) of the proposed rule requires that members designate an individual to be responsible for each general ledger account of the member firm. This individual is responsible for controlling and overseeing the entries into each such account and determining that it is current and accurate. The proposed rule requires that a supervisor must review each account at least monthly for accuracy, to determine that any items that are aged or uncertain as to resolution are promptly identified for research and possible transfer to a suspense account. Paragraph (b) of the proposed rule requires that each carrying or clearing member firm must maintain a record of the name of each individual assigned primary and supervisory responsibility for each account as required by paragraph (a) of the rule. Paragraph (c) of the proposed rule requires each member firm to record, in an account that must be clearly identified as a suspense account, money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. The proposed rule requires that member firms maintain a record of all information known with respect to each item so recorded.

NASD Rules do not have a provision that corresponds to NYSE Rule 440.20. Accordingly, the requirements of proposed FINRA Rule 4523 are new to non-NYSE members.

## Endnotes

- 1 See *SR-FINRA-2008-067 (Proposed Rule Change to Adopt Rules Governing Financial Responsibility in the Consolidated FINRA Rulebook)* (filed on December 29, 2008).
- 2 The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice 03/12/08 (Rulebook Consolidation Process)*.
- 3 For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.
- 4 See *supra* note 1.
- 5 The proposed rules would replace NYSE Rules 322 (Guarantees by, or Flow Through Benefits for Members or Member Organizations), 382 (Carrying Agreements) (including Rule 382's related Interpretations), 440.10 (Periodic Securities Counts, Verifications, Comparisons, etc.) and 440.20 (Identification of Suspense Accounts and Assignment of Responsibility for General Ledger Accounts) and NASD Rule 3230 (Clearing Agreements).
- 6 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.
- 7 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.
- 8 NASD Rule 0120(n) defines "person" to include any natural person, partnership, corporation, association, or other legal entity. Similarly, NYSE Rule 2(d) states that "person" means a natural person, corporation, limited liability company, partnership, association, joint stock company, trust, fund or any organized group of persons whether incorporated or not. All references to "persons" in this *Notice* include entities.
- 9 See e.g. *NASD Notice to Members 94-7* (SEC Approves New NASD Rule Relating to the Obligations and Responsibilities of Introducing and Clearing Firms) (February 1994) and *NYSE Information Memo 82-18* (Carrying Agreements – Amendments to Rules 382 and 405) (March 1982).

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- 10 The proposed rule includes guidance as to what constitutes a material change. Specifically, material changes would include, but not be limited to, the allocation of responsibilities required by the proposed rule, termination clauses applicable to the introducing firm, changes affecting the liability of the parties and changes to the parties to the agreement. (See Proposed FINRA Rule 4311.01.)
- 11 Note that proposed FINRA Rule 4311(a)(2) would expressly permit a carrying firm to enter into a carrying agreement with a person other than a U.S. registered broker or dealer, subject to the conditions set forth in the proposed rule.
- 12 Proposed FINRA Rule 4311.02 provides that, for purposes of the notice requirement, the carrying firm must submit a form letter to be specified by FINRA in a *Regulatory Notice*, which form letter may be updated from time to time as FINRA deems necessary.

## ATTACHMENT A

Below is the text of Proposed FINRA Rules 4150, 4311, 4522 and 4523.

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### 4000. FINANCIAL AND OPERATIONAL RULES

#### 4100. FINANCIAL CONDITION

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#### 4150. Guarantees by, or Flow Through Benefits for, Members

Prior written notice shall be given to FINRA whenever any member:

(a) guarantees, endorses or assumes, directly or indirectly, the obligations or liabilities of another person; or

(b) receives flow through capital benefits in accordance with Appendix C of SEA Rule 15c3-1.

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

**.01 Financial and Operational Impact.**— The written notice required by this Rule shall be given to FINRA at least 10 business days prior to entering into such arrangement or relationship with another person and shall include the address and general nature of business conducted by such person, a description of the relationship or arrangement between the parties, details regarding the capitalization of such person (including the percentage of ownership or profits by the member), as well as the actual and potential effect of the arrangement or relationship on the member's capital (including net capital) and operations and such other information as FINRA may require.

**.02. Dealings with members.**— A member may at any time be required to provide FINRA with information with respect to the arrangement, relationship and dealings with a person referred to in this Rule.

**.03 Books and records.**— No member shall enter into an arrangement described in this Rule unless it has the authority to make available promptly the books and records of such other person for inspection by FINRA in the United States. The books and records of such person shall be kept separately from those of the member.

**.04 FOCUS Reporting Requirements.**— For persons referred to in this Rule that are registered broker-dealers, the member shall furnish to FINRA copies of such person's FOCUS Reports simultaneous with their being filed with the person's designated examining authority. For persons referred to in this Rule that are not registered broker-dealers, FINRA requires, in lieu of FOCUS Reports, submission of financial and operational statements, in such format and at such time periods as may be required by FINRA, sufficient to gauge the capital and operational effects of the arrangement or relationship.

**.05. Routine guarantees.**— Guarantees executed routinely in the normal course of business such as trade guarantees, signature guarantees, endorsement of securities and the writing of options, are not subject to the requirements of this Rule provided that, in regard to the guarantee of the writing of options, the transaction is appropriately recorded on the member's books and records in accordance with SEA Rule 17a-3(a)(10) and is reflected in its capital computation.

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## **4300. OPERATIONS**

### **4310. Member Agreements and Contracts**

#### **4311. Carrying Agreements**

(a)(1) A member shall not enter into an agreement with a carrying firm for the carrying of its customer accounts on an omnibus or fully disclosed basis, unless such carrying firm is a FINRA member. An introducing firm that acts as an intermediary for another introducing firm(s) for the purpose of obtaining clearing services from the carrying firm must notify such carrying firm of the existence of such arrangement(s) and the identity of the other introducing firm(s). Each such carrying agreement(s) shall identify and bind every direct and indirect recipient of clearing services as a party thereto.

(2) A carrying firm may enter into a carrying agreement(s) with a person other than a U.S. registered broker or dealer, subject to the conditions set forth in this Rule.

(b)(1) The carrying firm shall submit to FINRA for approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before such agreement can become effective. The carrying firm also shall submit to FINRA for approval any material changes to an approved carrying agreement before such changes become effective.

(2) A carrying firm may use a standardized form of agreement that has been approved by FINRA pursuant to paragraph (b)(1) of this Rule, to enter into new carrying arrangements with other U.S. registered brokers or dealers, without the re-submission and re-approval of such agreement. However, a carrying firm must submit to FINRA for approval each carrying agreement that includes a party that is not a U. S. registered broker or dealer.

(3) As early as possible, but not later than 10 business days prior to the carrying of any accounts of a new introducing firm (including the accounts of any introducing firm(s) for which a new or existing introducing firm is acting as an intermediary in obtaining clearing services from the carrying firm), the carrying firm shall submit to FINRA a notice identifying each such introducing firm by name and CRD number and shall include such additional information as FINRA may require.

(4) Each carrying firm shall conduct appropriate due diligence with respect to any new introducing firm relationship, including but not limited to inquiry into the introducing firm's business mix and customer account activity; proprietary and customer positions; FOCUS and similar reports; audited financial statements; and complaint and disciplinary history. The carrying firm shall maintain a record, in accordance with the timeframes prescribed by SEA Rule 17a-4(b), of such due diligence conducted for each new introducing firm.

(c) Each carrying agreement in which accounts are to be carried on a fully disclosed basis shall specify the responsibilities of each party to the agreement, including at a minimum the allocation of the responsibilities set forth in paragraphs (c)(1) through (10) of this Rule. The allocation of responsibilities shall be subject to approval by FINRA pursuant to paragraph (b)(1) of this Rule.

- (1) Opening and approving accounts.
- (2) Acceptance of orders.
- (3) Transmission of orders for execution.
- (4) Execution of orders.

- (5) Extension of credit.
- (6) Receipt and delivery of funds and securities.
- (7) Safeguarding of funds and securities for the purposes of SEA Rule 15c3-3.
- (8) Confirmations and statements.
- (9) Maintenance of books and records.
- (10) Monitoring of accounts.

(d) Each customer whose account is introduced on a fully disclosed basis shall be notified in writing upon the opening of the account of the existence of the carrying agreement and the responsibilities allocated to each respective party. The carrying firm shall be responsible for the content of such notification to the customer. The customer shall be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities there under.

(e) Each carrying agreement shall expressly state that to the extent that a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility.

(f) A carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule 15c3-3 and further that the introducing firm represents to the carrying firm in writing that such introducing firm maintains, and will enforce, supervisory policies and procedures with respect to such check writing that are satisfactory to the carrying firm.

(g)(1) Each carrying agreement shall expressly authorize and direct the carrying firm to:

- (A) furnish promptly to the introducing firm and the introducing firm's designated examining authority (or, if none, to its appropriate regulatory agency or authority) any written customer complaint received regarding the conduct of the introducing firm or firms and its associated persons; and

(B) notify the complaining customer, in writing, that it has received the complaint and that such complaint has been furnished to the introducing firm and its designated examining authority (or, if none, to its appropriate regulatory agency or authority).

(2) Upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of paragraph (g)(1) in instances where the introducing firm is an affiliated entity of the carrying firm.

(h)(1) At the commencement of the agreement and annually thereafter, the carrying firm must furnish to each of its introducing firms a list of all reports (*e.g.* exception reports) available to assist the introducing firm with the responsibilities allocated to it pursuant to the carrying agreement. The introducing firm must promptly request of the carrying firm, in writing, those offered reports that it requires.

(2) No later than July 1 of each year, the carrying firm shall notify the introducing firm's chief executive and chief compliance officer(s) in writing of the list of reports offered to, requested by and supplied to the introducing firm as of the date of the notice. A copy of this written notice must at the same time be provided to the introducing firm's designated examining authority (or if none, to its appropriate regulatory agency or authority).

(3) The carrying firm shall maintain as part of its books and records those reports requested by and supplied to the introducing firm. The carrying firm may satisfy the requirements of this paragraph by furnishing, upon request of the introducing firm's designated examining authority (or if none, to its appropriate regulatory agency or authority):

(A) a recreated copy of the report originally produced; or

(B) the format of the report and the applicable data elements contained in the original report.

(4) Upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of this paragraph (h) in instances where the introducing firm is an affiliated entity of the carrying firm.

(i) All carrying agreements shall require each introducing firm to maintain its proprietary and customer accounts and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each such introducing firm. The requirements of this paragraph (i) shall apply to intermediary clearing arrangements that are established on or after February 20, 2006.

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

**.01 Material Changes.**— For the purpose of paragraph (b)(1), material changes include, but are not limited to, the allocation of responsibilities required by this Rule, termination clauses applicable to the introducing firm, changes affecting the liability of the parties and changes to the parties to the agreement.

**.02 Notice of New Introducing Firm Arrangement.**— For the purposes of the notice requirements of paragraph (b)(3), the carrying firm shall submit a form letter to be specified by FINRA in a Regulatory Notice, which form letter may be updated from time to time as FINRA deems necessary.

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## 4500. BOOKS, RECORDS AND REPORTS

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### 4520. Financial Records and Reporting Requirements

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#### 4522. Periodic Security Counts, Verifications and Comparisons

(a) Each member that is subject to the requirements of SEA Rule 17a-13 shall make the counts, examinations, verifications, comparisons and entries set forth in SEA Rule 17a-13.

(b) Each carrying or clearing member subject to the requirements of SEA Rule 17a-13 shall make more frequent counts, examinations, verifications, comparisons and entries where prudent business practice would so require. In addition, each such carrying or clearing member shall:

(1) Receive position statements as frequently as good business practice requires, but no less than once per month with respect to securities held by clearing corporations, other organizations or custodians. Each such member shall at least once per month reconcile all such securities and money balances by comparison of the clearing corporations' or custodians' position statements to the member's books and records and promptly report differences to the contra organization and such differences shall be promptly resolved by both. Where there is a higher volume of activity, good business practice may require a more frequent exchange of statements and their reconciliation; and

(2) At a maximum of seven business days after each security count, enter all unresolved differences into a Difference account, for that security count. The Difference account shall identify the unverified securities and reflect the number of shares or principal amount long or the number of shares or principal amount short of each security difference and the date of the security count that disclosed such difference. Thereafter, any adjustment of a difference position shall be made by entry into such account.

#### **4523. Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts**

(a) Each member shall designate an individual who shall be responsible for each general ledger bookkeeping account and account of like function used by the member and such individual shall control and oversee entries into each such account and shall determine at all times that the account is current and accurate. A supervisor shall, as frequently as is necessary considering the function of the account but, in any event, at least monthly, review each account to determine that it is current and accurate and that any items that become aged or uncertain as to resolution are promptly identified for research and possible transfer to a suspense account(s).

(b) Each carrying or clearing member shall maintain a record of the names of the individuals assigned primary and supervisory responsibility for each account as required by paragraph (a) of this Rule.

(c) Each member must record, in an account that shall be clearly identified as a suspense account, money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. A record must be maintained of all information known with respect to each item so recorded. Such suspense accounts include, but are not limited to, DK fails, unidentified fails, unallocable securities receipts versus payment, returned deliveries, and any other receivable or payable (money or securities) "suspended" because of doubtful ownership, collectibility or deliverability. To the extent that suspense items can be distinguished by type, separate accounts may be used provided that the word "suspense" is made a prominent part of the account title.

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