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Regulatory Notice

09-69

Payments to Unregistered Persons

FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Payments to Unregistered Persons

Comment Period Expires: February 1, 2010

Executive Summary

As part of the process to develop a new consolidated rulebook (the Consolidated FINRA Rulebook), FINRA is requesting comment on a proposed FINRA rule regarding payments to unregistered persons. Proposed FINRA Rule 2040 (Payments to Unregistered Persons) would be a new consolidated rule that streamlines the provisions of current:

- NASD Rule 1060(b) (Persons Exempt from Registration); Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business); Rule 2420 (Dealing with Non-Members); IM-2420-1 (Transactions Between Members and Non-Members); and IM-2420-2 (Continuing Commissions Policy);
- NYSE Rule 353 (Rebates and Compensation); NYSE Rule Interpretations 345(a)(i)/01 (Compensation to Non-Registered Persons); /02 (Compensation Paid for Advisory Solicitations); and /03 (Compensation to Non-Registered Foreign Persons Acting as Finders); and
- ➤ FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar).

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

Questions concerning this *Notice* should be directed to Kosha K. Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-6903.

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Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Executive Representatives
- ➤ Legal
- Registered Representatives
- ➤ Registration
- Senior Management

Key Topics

- ➤ Broker-Dealer Registration
- Compensation
- Disqualification
- Retiring Registered Representative
- Sanctions

Referenced Rules & Notices

- ➤ FINRA Rule 8311
- ➤ Information Notice 03/12/08
- ➤ NASD Rule 1060(b)
- ➤ NASD Rule 2410
- NASD Rule 2420
- ➤ NASD IM-2420-1
- ➤ NASD IM-2420-2
- ➤ NYSE Rule 353
- ➤ Regulatory Notice 09-34



Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by February 1, 2010.

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

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

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

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

Important Notes

The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this Notice will be made available to the public on the FINRA 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 Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the Federal Register.3

Background

NASD Rules 1060(b) (Persons Exempt from Registration); 2410 (Net Prices to Persons Not in Investment Banking or Securities Business); 2420 (Dealing with Non-Members); IM-2420-1 (Transactions Between Members and Non-Members); and IM-2420-2 (Continuing Commissions Policy (collectively, the NASD Non-Member Rules)) govern payments by members to unregistered persons. These NASD Non-Member Rules were developed in an era when a registered broker-dealer could engage in an over-thecounter securities business and elect whether to be a member of a registered securities association.⁴ An original purpose of the NASD Non-Member Rules was to encourage

non-members to become members by generally prohibiting members from providing commissions or discounts/concessions to non-members. Since the adoption of these NASD Non-Member Rules, the laws governing broker-dealers have changed, and today virtually all broker-dealers doing business with the public are FINRA members.

As a result, FINRA has generally interpreted the provisions of the NASD Non-Member Rules, through interpretive letters and other guidance, to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer. FINRA has refrained from opining whether a person is acting as an unregistered broker-dealer, as the authority to interpret Section 15(a) of the Exchange Act rests with the SEC. Section 15(a)(1) of the Exchange Act generally requires any broker-dealer effecting transactions in securities to be registered with the SEC. Registration as a broker-dealer provides a framework of rules to regulate the conduct of persons who receive transaction-based compensation, the receipt of which can create potential incentives for abusive sales practices. SEC guidance states that receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer.8

Proposal

Proposed FINRA Rule 2040

FINRA is proposing to establish new FINRA Rule 2040 (Payments to Unregistered Persons), which eliminates the current NASD Non-Member Rules and related NYSE Non-Member Rules (discussed further below) and replaces them with a more straightforward rule. The proposed rule expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation. The proposed rule sets forth the following requirements:

Payments to Unregistered Persons

FINRA is proposing to establish new FINRA Rule 2040(a), which prohibits members or associated persons from, directly or indirectly, paying or offering to pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments, is required to be so registered under applicable federal securities laws and SEC rules, regulations and published guidance by the SEC or its staff in the form of releases, no-action letters or interpretations; or

(2) any appropriately registered associated person, unless such payment complies with all applicable federal securities laws, FINRA rules and SEC rules, regulations and published guidance by the SEC or its staff in the form of releases, no-action letters or interpretations.

The proposed change makes the rule consistent with FINRA staff interpretations under NASD Rule 2420 and SEC rules and regulations under Section 15(a) of the Exchange Act. The proposal also aligns the rule with SEC staff guidance that states that receipt of certain securities transaction-based compensation requires registration as a broker-dealer. Therefore, under the proposal, persons would look to SEC rules and regulations to determine whether the activities in question require registration as a broker-dealer under Section 15(a) of the Exchange Act. In cases where a member represents that the proposed activities would not require the recipient of the payments to register as a broker-dealer, and can support such position through SEC rules, regulations or other guidance, such as a no-action letter, the proposed rule does not prohibit the member from making the payments to such person.

The proposed change also clarifies that payments to associated persons are not prohibited by this rule where such payments are otherwise permissible.

Retiring Representatives

FINRA is also proposing to establish new FINRA Rule 2040(b), which codifies existing FINRA staff guidance on the payment by members of continuing commissions to retiring registered representatives. The proposal permits members to pay continuing commissions to retiring registered representatives of the member, after they cease to be employed by the member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided (1) a bona fide contract between the member and the retiring registered representative calling for the payments was entered into in good faith while the person was a registered representative of the employing member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts or servicing the accounts generating the continuing commission payments; and (2) the arrangement complies with applicable SEC rules, regulations and published guidance by the SEC or its staff.

The proposal defines the term "retiring registered representative" to mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. In the case of the death of the retiring registered representative, the retiring representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreements with the deceased representative.

FINRA believes this proposal is consistent with SEC guidance on the payment of compensation to retiring representatives.⁹

Amendments to FINRA Rule 8311

FINRA is proposing amendments to FINRA Rule 8311 to eliminate duplicative provisions in NASD IM-2420-2 and to clarify the scope of the rule on payments by members to persons subject to suspension, revocation, cancellation, bar (each a "sanction") or other disqualification. The proposed rule provides that if a person is subject to a sanction or other disqualification, a member may not allow such person to be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. The proposed rule further provides that a member may not pay or credit to a person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any remuneration that the person might have accrued during the period of the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or to a disqualified person that has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

Specifically, the proposal clarifies that:

- (1) other disqualifications, not just suspensions, revocations, cancellation or bars are subject to the rule (and the rule is not limited to orders issued by FINRA or the SEC);
- (2) a member may not allow a person subject to a sanction or disqualification to "be" associated with such member in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity, not simply "remain" associated;
- (3) a member may not pay any remuneration to a person subject to a sanction or disqualification, not just payments that result directly or indirectly from any securities transaction; and
- (4) the rule applies to any salary, commission, profit or remuneration that the associated person might have "accrued," not just "earned" during the period of a sanction or disqualification, not just suspension.

FINRA is also proposing to add a new paragraph to the rule that would expressly permit a member to pay to any person subject to a sanction or disqualification any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment. FINRA believes that these exceptions strike the correct balance by permitting certain key payments.

In addition, FINRA is proposing to add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) that relates to commissions accrued by a person prior to the effective date of a sanction or disqualification. The proposed supplementary material would permit a member to pay a person that is subject to a sanction or disqualification remuneration that the member can evidence accrued to the person prior to the effective date of the sanction or disqualification. However, a member may not pay any remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification. FINRA believes that adopting this new provision is necessary to address questions by the industry on a member's ability to pay commissions and other remuneration that was accrued by the person prior to sanction or disqualification going into effect. FINRA also believes the supplementary material, together with the proposed amendments discussed above, clarify that a member may not pay trail commissions to a person that may have accrued during the period of the sanction or disqualification; rather, the member can only make such payments where the member can evidence that they accrued to the person prior to the effective date of the sanction or disqualification.

Adoption of New General Standard

In addition, FINRA is proposing to adopt a new general standard that is based largely on provisions of NASD IM-2420-1 and would provide that a member will be treated as a non-member of FINRA from the effective date of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member will be automatically reinstated to membership in FINRA at the termination of the suspension period. FINRA believes this is consistent with the current provisions of IM-2420-1 and should be retained in the FINRA rulebook.

NASD and NYSE Rules To Be Deleted

FINRA proposes to eliminate the following NASD and Incorporated NYSE Rules and related interpretations:

➤ NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03

NASD Rule 1060(b) (Persons Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders) are identical provisions and provide that member firms and persons associated with a member may pay transaction-related compensation to non-registered foreign finders, based upon the business of customers such persons direct to member firms, subject to certain conditions (foreign finder exemption).

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➤ NASD Rule 2410

NASD Rule 2410 (Net Prices to Persons Not in Investment Banking and Securities Business) prohibits payments or concessions by members to "any person not actually engaged in the investment banking or securities business."

NASD Rule 2420

NASD Rule 2420 (Dealing with Non-Members) generally prohibits members from dealing with, or making payments to, non-member broker-dealers, except at the same prices, fees or concessions offered to the general public. NASD Rule 2420(b) specifically prohibits members from joining any non-member broker-dealer syndicate or group in connection with the sale of securities. NASD Rule 2420(c) provides that members may pay concessions and fees to a non-member broker or dealer in a foreign country who is not eligible for membership, provided the member obtains an agreement from such foreign broker or dealer in making sales of securities within the United States that such foreign broker or dealer will act in accordance with the general requirements of the rule to prohibit the payment of concessions or discounts to non-members that are not allowed to the general public. NASD Rule 2420(d) provides restrictions on payments by or to persons that have been suspended or expelled.

➤ NASD Rule IM-2420-1

NASD IM-2420-1 (Transactions between Members and Non-Members) provides certain exemptions from the general prohibition on arrangements with non-members set forth in NASD Rule 2420. For example, the rule provides exemptions for arrangements with certain non-members relating to transactions in "exempted securities," or transactions on a national securities exchange. The rule further clarifies that a firm that is suspended or expelled from FINRA membership, or whose registration is revoked by the SEC, is to be considered a non-member for purposes of the rule.

➤ NASD Rule IM-2420-2

NASD IM-2420-2 (Continuing Commissions Policy) allows members to pay continuing commissions to former registered representatives after they cease to be employed by a member, if, among other things, a bona fide contract between the member and the registered representative calling for the payments was entered into in good faith while the person was a registered representative of the employing member. The rule states that such contracts cannot permit the solicitation of new business or the opening of new accounts by persons who are not registered, and must conform with all applicable laws and regulations. The rule also provides that NASD Rule 2830(c) (Investment Company Securities, Conditions for Discounts to Dealers), should not be interpreted to require a sales agreement for a dealer to receive commissions on direct payments by clients or automatic dividend reinvestments. The rule further contains a prohibition

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on the payment of any kind by a member to any person who is not eligible for FINRA membership or eligible to be associated with a member because of any disqualification, such as revocation, expulsion or suspension that is still in effect. The rule recognizes the validity of contracts entered into in good faith to allow retired representatives to receive continuing compensation on their accounts or to designate a widow or other beneficiary; however, the rule states that members are not required to enter such contracts and FINRA will not specify the terms of such contracts.

➤ NYSE Rule 353

NYSE Rule 353 (Rebates and Compensation) prohibits a member, principal executive, registered representative or officer from, directly or indirectly, rebating to any person any part of the compensation he receives from the solicitation of orders for the purchase or sale of securities or other similar instruments for the accounts of customers of the member, or pay such compensation, or any part thereof, as a bonus, commission, fee or other consideration for business sought or procured for him or for any other member. NYSE Rule 353(b) further provides that a member, principal executive, registered representative or officer cannot be compensated for business done by or through his employer after the termination of his employment except as may be permitted by the NYSE.

➤ NYSE Rule Interpretation 345(a)(i)/01 and /02

NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) prohibits a member from paying to non-registered persons compensation based upon the business of customers they direct to the member if such compensation is, among other things, formulated as a direct percentage of commissions generated and is other than on an isolated basis.

NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations) provides that a member that is also registered with the SEC as an investment adviser may enter into arrangements that comply with Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act of 1940.

Endnotes

- 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 3/12/08 (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 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 the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and rules thereunder.
- 4 See Maloney Act of 1938. Pub. L. No. 75-719, 52 Stat. 1070, which added Section 15A to the Exchange Act to provide for the establishment of national securities associations with authority, subject to SEC review, to supervise the over-the-counter securities market and promulgate rules governing voluntary membership of broker-dealers.
- Section 15A(e)(1) of the Exchange Act states that "[t]he rules of a registered securities association may provide that no member thereof shall deal with any nonmember professional (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public." Section 15A(e)(2) of the Exchange Act defines "nonmember professional" as "(A) with respect to transactions in securities other than municipal securities, any registered broker or dealer who is not a member of a registered securities association, except such a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, and commercial bills, and (B) with respect to transactions in municipal securities, any municipal securities dealer (other than a bank or division or department of a bank) who is not a member of any registered securities association and any municipal securities broker who is not a member of any such association." The legislative reports from Congress on this provision state that exclusion from membership would in effect be a form of economic sanction on such non-members. See S. Rep. No. 1455 and H. R. Rep. No 2307, 75th Cong., 3rd Sess. (1938).
- 6 Section 15(b)(8) of the Exchange Act provides that "[i]t shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to Section 15A of this title or effects transactions in securities solely on a national securities exchange of which it is a member."

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Endnotes continued

- See FINRA Interpretative Letters under NASD Rule 2420 and IM-2420-2 at www.finra.org/ interpretiveletters/conduct to: Richard Schultz, Triad Securities Corp. (12/28/07); Jonathan K. Lagemann, Esq., Law Offices of Jonathan Kord Lagemann (6/27/01); Jay Adams Knight, Esq., Musick, Peeler & Garrett LLP (3/8/01); Kathleen A. Wieland, William Blair & Company (9/27/00); Michael R. Miller, Esq., Kunkel Miller & Hament (5/31/00); Gordon C. Ogden, III, Profinancial, Inc. (1/18/00); Trish Stone-Damen, Investors Retirement & Management Company, Inc. (1/29/99); Leslie D. Smith, Berthel Fisher & Company (12/9/98); Victoria Bach-Fink, Wall Street Financial Group (12/7/98); Brian C. Underwood, A.G. Edwards & Sons, Inc. (9/16/98); Daniel Schloendorn, Willkie Farr & Gallagher (6/18/98); David M. Katz, Sidley & Austin (9/25/97); Peter D. Koffler, Twenty-First Securities Corporation (8/20/97); Interpretive Letter to Name Not Public (4/11/97); Ted. A. Troutman, Esquire, Muir & Troutman (2/4/02); Joe Tully, Commonwealth Financial Network (8/9/01); Name Not Public (5/25/01); Peter D. Koffler, Esq., Twenty-First Securities Corporation (1/21/00); Leslie D. Smith, Berthel Fisher & Company (12/9/98); Name Not Public (12/23/96); Name Not Public (11/20/96).
- 8 See, e.g., Birchtree Financial Services, Inc. SEC No-Action Letter (pub.avail. Sept 22, 1988); 1st Global, Inc., SEC No-Action Letter (pub.avail. May 7, 2001).
- 9 See Securities Industry and Financial Markets Association, SEC No-Action Letter (pub.avail. Nov. 20, 2008).
- 10 NASD Rule 2830(c) prohibits investment company underwriters from selling the fund's securities to a retail broker-dealer at a price other than the public offering price unless, among other things, the sale is in conformance with NASD Rule 2420. FINRA has proposed to adopt new FINRA Rule 2341, based largely on NASD Rule 2830, which would eliminate the reference to NASD Rule 2420. See Regulatory Notice 09-34.

Attachment A

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

* * * * *

Text of Proposed New FINRA Rule

* * * *

0100. General Standards

* * * * *

0180. Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation

(a) A member shall be treated as a non-member of FINRA from the effective date of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member shall be automatically reinstated to membership in FINRA at the termination of the suspension period.

(b) A member shall be treated as a non-member of FINRA from the date of acceptance by FINRA of any resignation of such member.

2000. Duties and Conflicts

* * *

2040. Payments to Unregistered Persons

(a) General

No member or associated person shall, directly or indirectly, pay or offer to pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments, is required to be so registered under applicable federal securities laws and SEA rules, regulations and published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations; or

Regulatory Notice

(2) any appropriately registered associated person unless such payment complies with all applicable federal securities laws, FINRA rules and SEA rules, regulations and published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations.

(b) Retiring Representatives

- (1) A member may pay continuing commissions to a retiring registered representative of the member, after he or she ceases to be associated with such member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement; provided:
 - (i) a bona fide contract between the member and the retiring registered representative calling for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and
 - (ii) the arrangement complies with applicable SEA rules, regulations and published guidance issued by the SEC or its staff in the form of releases, noaction letters or interpretations.
- (2) The term "retiring registered representative," as used in this Rule shall mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreement with the deceased representative.

Text of Proposed Amendments to FINRA Rule 8311

8000. Investigations and Sanctions

8300. Sanctions

8311. Effect of a Suspension, Revocation, Cancellation, [or] Bar <u>or Other Disqualification</u>

(a) [If FINRA or the SEC issues an order that imposes] If a person is subject to a suspension, revocation, [or] cancellation of [the] registration, bar from association with a member (each a "sanction") or other disqualification [of a person associated with a member or bars a person from further association with any member], a member shall not allow such person to [remain] be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. [If FINRA or the SEC suspends a person associated with a member, the A member also shall not pay or credit to any person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any salary, [or any] commission, profit, or any other remuneration [that results directly or indirectly from any securities transaction,] that the person [associated with a member] might have [earned] accrued during the period of [suspension] the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or to a disqualified person that has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

(b) Notwithstanding paragraph (a) of this Rule, a member may pay to a person that is subject to a sanction or disqualification described in paragraph (a) of this Rule, any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment.

• • • Supplementary Material: ——————

.01 Remuneration Accrued Prior to Effective Date of Sanction or Disqualification.

Notwithstanding this Rule, a member may pay or credit to a person that is subject of a sanction or disqualification salary, commission, profit or any other remuneration that the member can evidence accrued to the person prior to the effective date of such sanction or disqualification; provided, however, the member may not pay any salary, commission, profit or any other remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification.

* * * * *

Regulatory Notice

09-70

Registration and Qualification Requirements

FINRA Requests Comment on Proposed Consolidated FINRA Rules Governing Registration and Qualification Requirements

Comment Period Expires: February 1, 2010

Executive Summary

As part of the process of developing a new consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on a proposal to streamline and amend the FINRA registration and qualification rules.

The text of the proposed rules is available as Attachment B on our Web site at www.finra.org/notices/09-70.

Questions regarding this *Notice* should be directed to:

- ➤ Afshin Atabaki, Assistant General Counsel, Office of General Counsel, at (202) 728-8902; or
- ➤ Joe McDonald, Director, Testing and Continuing Education Department, at (240) 386-5065.

December 2009

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- ➤ Compliance
- Legal
- Operations
- Registration
- > Senior Management

Key Topic(s)

- **➤** Examination
- > Principal
- Qualification
- Registration
- Representative

Referenced Rules & Notices

- ➤ Information Notice 3/12/08
- NASD IM-1000-2 and IM-1000-3
- NASD Rules 1021 and 1022
- ➤ NASD IM-1022-1 and IM-1022-2
- ➤ NASD Rules 1031 and 1032
- NASD Rules 1041, 1042 and 1043
- NASD Rules 1050, 1060(a), 1070 and 1080
- NASD Rule 1100
- ➤ NASD Rule 3010(e)
- NTMs 87-47, 89-78, 95-37, 99-49, 00-50, 01-51, 03-37, 04-81 and 07-04
- NYSE Rule 10 and Its Interpretation
- ➤ NYSE Rule Interpretations 311(b)(5)/01, /02, /03 and (g)/01
- ➤ NYSE Rule 321.15
- NYSE Rule 344 and Its Interpretation
- NYSE Rule 345 and Its Interpretation
- Regulatory Notices 07-55, 08-24, 09-41 and 09-55



Action Requested

FINRA encourages all interested parties to comment on the proposed rules. Comments must be received by February 1, 2010.

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, 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 Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be approved by the SEC, following publication for comment in the *Federal Register*.³

Background

The Exchange Act requires FINRA to prescribe standards of training, experience and competence for persons associated with FINRA members. Accordingly, FINRA has adopted registration and qualification requirements (registration rules) to ensure that persons associated with FINRA members attain and maintain specified levels of competence and knowledge. The current FINRA registration rules include both NASD Rules and certain NYSE Rules, 4 some of which pertain specifically to persons engaged in NYSE floor activities. (The similarities and differences between the current NASD Rules and NYSE Rules are described in greater detail in Attachment A.)

In general, the registration rules: (1) require that associated persons engaged in a member's investment banking or securities business be registered in an appropriate registration category and pass prescribed qualification examinations or obtain a waiver; (2) exempt certain associated persons from the registration requirement; and (3) provide for permissive registration of certain persons.

Proposal

FINRA proposes to transfer the NASD Rules into the Consolidated FINRA Rulebook with certain changes that take into account requirements under the NYSE Rules. The most significant proposed changes are described generally below. However, FINRA urges member firms to carefully review the entire proposed rule text (in Attachment B at www.finra.org/notices/09-70) to understand the full extent of the proposed changes. (All provisions discussed below will be transferred to the registration and qualification section in the Consolidated FINRA Rulebook unless stated otherwise.)

A. Registration Requirements (Proposed FINRA Rule 1210)

Among other things, proposed FINRA Rule 1210 will expressly differentiate between an "active" and "inactive" registration status and will integrate the provisions regarding required and permissive registrations into a single rule.

 Required Active Registration of Persons Engaged in the Investment Banking or Securities Business of a Member (Proposed FINRA Rule 1210(a))

FINRA proposes to consolidate and streamline the provisions in current NASD Rules 1021(a) and 1031(a) that require associated persons engaged in the investment banking or securities business of a member to register in a principal or representative category appropriate to their assigned functions. FINRA will presume that such registrations are "active" unless it is otherwise notified that they are "inactive" as described below.⁵

FINRA also proposes to consolidate in this rule the provisions in the various registration categories that prohibit persons from functioning in any registered capacity other than that for which they are registered. FINRA further proposes to delete NASD IM-1000-3 (potential disciplinary implications of failing to register a representative) as superfluous, since the failure to register a representative as required under current NASD Rule 1031(a) is in fact a violation.

2. Permissive Inactive Registration of Persons Engaged in a Bona Fide Business Purpose of a Member (Proposed FINRA Rule 1210(b))

Currently, NASD Rules 1021(a) and 1031(a) provide for permissive registration as a principal or representative of a person who performs legal, compliance, internal audit, back-office operations or similar responsibilities for a member (and permit a member to maintain the registration of such person).

FINRA proposes to expand this provision by permitting a member to register as a principal or representative any associated person (or maintain the registration of such person), provided that such person is engaged in a bona fide business purpose of the member.

Under the proposal, a person registered *solely* pursuant to this permissive registration category (*i.e.*, not otherwise required to be registered based on his or her functions) is deemed to have an "inactive" registration upon notification to FINRA of such registration status. Also, the member must notify FINRA when the inactive registration status has been terminated. Such person will be an associated person for all purposes, but will be considered a registered person only for purposes of the following provisions:⁶

- FINRA By-Laws and Schedule A to the By-Laws (fees and charges);
- ➤ Forms U4 and U5;
- ➤ The FINRA consolidated registration rules;
- ➤ Current NASD Rule 1120 (applicable continuing education requirements);
- ➤ Current NASD Rule 3010(a)(5) (which requires the assignment of each registered person to an appropriately registered supervisor);⁷
- Current NASD Rule 3010(a)(7) (which requires participation in an annual compliance meeting); and
- Current NASD Rule 3010(e) (which addresses personnel background investigations).

Among other purposes, these provisions ensure that such person maintains an appropriate level of competence and knowledge and is subject to a level of supervision commensurate with his or her status.

The proposed rule will supersede the existing permissive registration provisions. Therefore, those persons currently registered based solely on performing legal, compliance, internal audit, back-office operations or similar responsibilities who seek to maintain such permissive registrations will have to become appropriately registered in accordance with the proposed rule.

Additionally, the proposed rule permits a person who is required to be registered as a principal or representative based on his or her assigned functions to register, or maintain registrations, in non-required principal or representative categories by virtue of being engaged in a bona fide business purpose of the member. For instance, a person who is registered as a General Securities Representative and General Securities Principal, but whose functions only require him to be registered as a General Securities Representative, could maintain his registration as a General Securities Principal. However, all of such person's registrations will be deemed "active" registrations, subjecting such person to all FINRA Rules applicable to a registered person. Notwithstanding the status of such person's registrations as active, the proposed rule also requires that such person be appropriately supervised to ensure that he or she is not acting outside the scope of his or her assigned functions. For instance, if the person in the example above is assigned to function *only* as a General Securities Representative, he may not perform any of the functions of a General Securities Principal.

The proposed rule further provides that a person whose sole registration is a permissive registration as a Compliance Officer (this category is described in greater detail below) by virtue of being engaged in a bona fide business purpose of the member (*i.e.*, not required to register as a Compliance Officer or in any other category of registration) may have an active or inactive registration with respect to such registration; however, the person must be engaged in compliance activities at the member to have an active registration. If a member elects to designate such person as having an active registration, such person will be subject to the same requirements as any other person with an active registration.

In 2007, FINRA filed with the SEC a similar proposal that was never published for comment in the *Federal Register*.8 FINRA intends to withdraw that proposal in conjunction with filing these consolidated rules. The reasons to allow permissive registration for those engaged in a bona fide business purpose of the member remain largely the same.

First, a member may have a foreseeable need to move an associated person whose principal or representative registration has lapsed for more than two years back into a position that will require or permit such person to be registered. Currently, such persons are required to re-register and re-test (or obtain a waiver of the applicable qualification examinations). Second, the proposed rule allows members to develop a depth of associated persons with registrations in the event of unanticipated personnel changes and also encourages greater regulatory literacy. Finally, the proposed rule eliminates an inconsistency in the rules, which permit certain persons to obtain permissive registrations, but not others who equally are engaged in other bona fide business purposes of the member.

Members will need to distinguish between functions that require an active registration and functions that permit a bona fide business purpose inactive registration and require notification to FINRA. Members should register an associated person as "inactive" only if they reasonably believe that such person will not be performing functions that require registration.

 Permissive Inactive Registration of Persons Engaged in the Business of a Financial Services Industry Affiliate of a Member (Proposed FINRA Rule 1210(c))

NASD Rules 1021(a) and 1031(a) also permit a member to register as a principal or representative a person who is engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member (or maintain the registration of such person).

The proposed rule expands these provisions by permitting a member to register as a principal or representative any individual (or maintain the registration of such person) who is engaged in the business of a financial services industry affiliate of the member that controls, is controlled by or is under common control with the member. Such person will be designated as a Retained Associate and his or her registration deemed an "inactive" registration upon notification to FINRA of such registration status. Also, the member will be required to notify FINRA when such inactive registration status has been terminated.

The "financial services industry," for purposes of the proposed rule, is defined as any industry regulated by the SEC, Commodity Futures Trading Commission, state securities authorities, federal or state banking authorities, state insurance authorities, or substantially equivalent foreign regulatory authorities.

The proposed rule permits a person to be designated as a Retained Associate with one or more members for ten consecutive years (commencing on the date the person is initially designated as a Retained Associate), subject to the following:

- ➤ First, to mitigate the risk of customer confusion that might be caused by frequent switching between a person's Retained Associate status and active or other inactive statuses, a Retained Associate who subsequently enters an active registration or a bona fide business purpose inactive registration must remain in such registration(s) for at least a consecutive 12-month period to be eligible for any years that may be remaining on his or her Retained Associate period. This 12-month period may be split between different members. However, a person's active registration or bona fide business purpose inactive registration cannot run concurrently with the person's Retained Associate inactive registration.
- Second, FINRA will toll a Retained Associate's inactive registration period day-forday for each day that such person is in active registration, provided that the person is in active registration for at least a consecutive 12-month period and FINRA is properly notified of such person's period of active registration.
- ➤ Third, a person will forfeit any remaining Retained Associate period if such person subsequently engages in other business activities instead of those that require an active registration or permit a bona fide business purpose or Retained Associate inactive registration.
- ➤ Fourth, to facilitate such person's transition from one member to another, the proposed rule provides such person up to 30 days following the submission of a Form U5 to enter active registration or a bona fide business purpose or Retained Associate inactive registration with another member. Such person will forfeit any remaining Retained Associate period if he or she does not enter active registration or a bona fide business purpose or Retained Associate inactive registration with another member within 30 days following the submission of a Form U5.

The following scenarios illustrate the application of the proposed rule:

Scenario (After an Initial Period as a Retained Associate With the Financial Services Industry Affiliate of Member A)	Remaining Retained Associate Period
Person A enters a Retained Associate inactive registration with the financial services industry affiliate of Member B within 30 days following the submission of his Form U5.	Not forfeited; not tolled
Person A enters an active registration or a bona fide business purpose inactive registration with Member A for a consecutive 7-month period and then returns to work at the financial services industry affiliate of Member A.	Forfeited
Person A enters an active registration with Member A for a consecutive 12-month period.	Tolled (for each day of active registration)
Person A enters an active registration with Member A for a consecutive 7-month period and within 30 days following the submission of his Form U5 he enters an active registration with Member B for a consecutive 5-month period.	Tolled (for each day of active registration)
Person A enters a bona fide business purpose inactive registration with Member A for a consecutive 12-month period.	Not forfeited; not tolled
Person A enters a bona fide business purpose inactive registration with Member A for a consecutive 7-month period and within 30 days following the submission of his Form U5 he enters a bona fide business purpose inactive registration with Member B for a consecutive 5-month period.	Not forfeited; not tolled
Person A enters an active registration or a bona fide business purpose inactive registration with Member B 60 days following the submission of his Form U5 by Member A.	Forfeited
Person A engages in other business activities instead of entering an active registration or a bona fide business purpose or Retained Associate inactive registration.	Forfeited

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While a Retained Associate generally will not be considered a registered person (or an associated person), such person will be subject to the following provisions:¹⁰

- ➤ FINRA By-Laws and Schedule A to the By-Laws;
- Forms U4 and U5;
- The FINRA consolidated registration rules;
- Current NASD Rule 1120;
- Current NASD Rule 3010(a)(5);¹¹
- Current NASD Rule 3010(a)(7);
- Current NASD Rule 3010(e);
- ➤ Current NASD Rule 3050 (which addresses personal securities transactions through other members or financial institutions);
- Current NASD Rule 3070 (relating to reporting requirements);
- > FINRA Rule 5130 (the New Issue Rule); and
- > FINRA Rule 8000 and 9000 Series (relating to investigations, sanctions and disciplinary procedures).

Similar to the provisions in the bona fide business purpose category, these provisions (among other purposes) are designed to ensure that Retained Associates maintain an appropriate level of competence and knowledge and are subject to a level of supervision commensurate with their status.

A person subject to a statutory disqualification will not be eligible to be placed on, or remain in, a Retained Associate status. Among other reasons, this is because a member cannot ensure adequate supervision of all activities engaged in by such person, as ordinarily is required of a member who seeks to associate with a disqualified person.

FINRA believes that an expansion of the permissive registration categories to include Retained Associates is appropriate for reasons similar to those underlying the permissive registration of persons engaged in a bona fide business purpose of a member (e.q., foreseeable need to move such persons back into a position that will require registration, developing a depth of persons with registrations in the event of unanticipated personnel changes, encouraging greater regulatory literacy through registration). 12 FINRA further believes the time and manner limitations are appropriate to guard against abuse of the privilege.

4. Notification Requirements for Persons Serving in the Armed Forces of the United States (Proposed FINRA Rule 1210(d))

To enhance the efficiency of the notification process for registered persons serving in the Armed Forces (current NASD IM-1000-2), FINRA proposes to amend the provision to require that the member with which such person is registered promptly notify FINRA of such person's return to active employment with the member and that, in the case of a sole proprietor, the sole proprietor promptly notify FINRA of his or her return to active participation in the investment banking or securities business.

5. Two-Principal Requirement (Proposed FINRA Rule 1210(e))

FINRA proposes to amend the two-principal requirement (current NASD Rule 1021(e)(1)) to clarify that a member is required to have a minimum of two General Securities Principals who have satisfied the General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative prerequisite. Alternatively, if the member's business is limited to investment company and variable contracts products or direct participation programs, the member may opt to have two Investment Company and Variable Contracts Products Principals or Direct Participation Programs Principals, respectively.

Currently, a sole proprietor member (without any other associated persons) is not subject to the two-principal requirement since such member is operating as a one-person firm. Given that one-person firms may be organized in legal forms other than a sole proprietorship (such as a single-person limited liability company), FINRA proposes to modify the exception to clarify that any member with only one associated person is excluded from the two-principal requirement.

In addition, the proposed rule clarifies that existing members as well as new applicants may request a waiver of the two-principal requirement (current NASD Rule 1021(e)(2)). The proposed rule similarly clarifies that the provision requiring additional principals for members with certain types of operations (current NASD Rule 1021(e)(3)) applies to existing members as well as new applicants.

The proposed rule further clarifies that all members are required to have an appropriately registered Chief Compliance Officer (current NASD Rule 1022(a)(1)) and Financial and Operations Principal (or Introducing Broker-Dealer Financial and Operations Principal, as applicable) (current NASD Rules 1022(b) and (c)) and provides that all members are required to have an appropriately registered Principal Financial Officer and Principal Operations Officer (as discussed further below). Additionally, the proposed rule clarifies that a member engaged in certain investment banking activities must have a General Securities Principal who has also satisfied the Investment Banking Representative prerequisite requirement (current NASD Rules 1022(a)(1) and 1032(i)) and that a member engaged in certain research activities must have a Research Principal (current NASD Rule 1022(a)(5)).

6. Personnel Background Investigations (Proposed FINRA Rule 1210(f))

FINRA proposes to transfer into the proposed rule with non-substantive changes the provision regarding background investigations (current NASD Rule 3010(e)).

7. Impermissible Registrations (Proposed FINRA Rule 1210(g))

Consistent with the proposed changes to the registration requirements discussed above, FINRA proposes to replace the provisions prohibiting the "parking" of registrations (current NASD Rules 1021(a) and 1031(a)) with provisions prohibiting a member from registering or maintaining the registration of a person unless it is an active registration or a bona fide business purpose or Retained Associate inactive registration. The proposed rule also permits a member to maintain the inactive registration of a registered person serving in the Armed Forces of the United States, which is consistent with the current registration requirements.

B. Qualification Examination Requirements and Waiver of Requirements (Proposed FINRA Rule 1220)

Among other things, proposed FINRA Rule 1220 integrates the qualification examination requirements and waiver of requirements into a single rule.

1. Qualification Examinations (Paragraphs (a), (b) and (d) through (g) of Proposed FINRA Rule 1220)

The proposed rule consolidates for simplification the general provisions requiring a person to pass an appropriate qualification examination (including any applicable prerequisite) before such person's registration can become effective (current NASD Rules 1021(a) and 1031(a)). The proposed rule clarifies that a person is not subject to this requirement if such person obtains a waiver of the applicable examination(s) or is registering solely as a Securities Lending Representative, Securities Lending Supervisor or Proctor (which, as noted below, do not require an examination).

The proposed rule streamlines the general provisions regarding the examination process (current NASD Rules 1070(a), (b) and (c)). FINRA proposes to transfer into the proposed rule with non-substantive changes the provision regarding waiting periods for retaking failed examinations (current NASD Rule 1070(e)).

The proposed rule also consolidates for simplification the provisions requiring that a person re-test if his or her registration has lapsed for more than two years (current NASD Rules 1021(c), 1031(c) and 1041(c)). The proposed rule clarifies that a person is not subject to this requirement if he or she obtains a waiver of the applicable examination(s) or is registering solely as a Securities Lending Representative, Securities Lending Supervisor or Proctor.

Further, FINRA proposes to amend the provision permitting a member to designate any representative to function as a principal for a limited period (current NASD Rule 1021(d)) to require the designation of a representative who has been registered as a representative in active registration for at least 18 months within the five-year period immediately preceding such designation. This change is intended to ensure that such persons have an appropriate level of registered representative experience. The proposed rule clarifies that such person must fulfill all applicable prerequisite registration, fee and examination requirements prior to his or her designation as a principal. The proposed rule also extends the time period that such person may function as a principal prior to passing the applicable principal examination from 90 calendar days to 120 calendar days (since the current window in CRD for passing an examination is 120 calendar days). A person registered as an Order Processing Assistant Representative or registered solely as a Securities Lending Representative, Securities Lending Supervisor or Proctor will be prohibited from functioning as a principal under this provision because of the very limited scope of his or her registered representative activities. Finally, the proposed rule clarifies that members that lose their sole Registered Options Principal are subject to separate requirements (current NASD IM-1022-1).

2. Waivers (Proposed FINRA Rule 1220(c))

FINRA proposes to transfer into the proposed rule with non-substantive changes the provision regarding waiver of examination requirements (current NASD Rule 1070(d)).

C. Registration Categories (Proposed FINRA Rule 1230)

Among other things, proposed FINRA Rule 1230 integrates the following registration categories into a single rule: principal, representative, Order Processing Assistant Representative, Proctor and Research Analyst.

1. Definition of Principal (Proposed FINRA Rule 1230(a)(1))

The proposed rule streamlines the definition of the term "principal" (current NASD Rule 1021(b)) and clarifies that a member's chief executive officer and chief financial officer (or equivalent officers) are considered principals based solely on their status. The proposed rule also clarifies that the term "principal" includes any other associated person who is performing functions or carrying out responsibilities that are required to be performed or carried out by a principal under FINRA Rules. Further, the proposed rule codifies existing guidance regarding the term "actively engaged in the management of the member's investment banking or securities business." ¹³

2. General Securities Principal (Proposed FINRA Rule 1230(a)(2))

FINRA proposes to eliminate the grandfathering provision for persons who were registered as principals prior to the adoption of the General Securities Principal registration category (current NASD Rule 1022(a)(1)) since it is outdated. As discussed below, FINRA also proposes to move the provision regarding the registration of Chief Compliance Officers to a new stand-alone registration category for Compliance Officers and create a stand-alone registration category for Research Principals. Additionally, the proposed rule clarifies that:

- ➤ A person registered solely as a General Securities Principal is not qualified to function as a Research Principal, Principal Financial Officer or Principal Operations Officer:
- Registration as a United Kingdom Securities Representative or Canada Securities Representative is an acceptable alternative prerequisite to the General Securities Representative prerequisite;¹⁴ and
- Registration as a Corporate Securities Representative or Private Securities Offerings Representative will satisfy the prerequisite registration requirement, provided that such persons have limited supervisory responsibilities (consistent with their representative category).

3. Research Principal (Proposed FINRA Rule 1230(a)(3))

The proposed rule creates a stand-alone registration category for Research Principals (current NASD Rule 1022(a)(5)) and modifies the examination requirements for those persons. By way of background, the Analysis (Series 86) portion of the Research Analyst examination tests knowledge of fundamental analysis and valuation of equity securities and the Regulatory Administration and Best Practices (Series 87) portion of the Research Analyst examination tests knowledge of applicable rules and regulations pertaining to research. The Supervisory Analyst (Series 16) examination tests both knowledge of applicable rules and regulations and fundamental analysis and valuation. Currently, a Research Principal is required to be registered as a General Securities Principal and pass either the Series 87 or the Series 16 examination. FINRA believes that a Research Principal will be able to carry out his or her supervisory responsibilities more effectively by having an appropriate level of knowledge of fundamental analysis and valuation. Therefore, the proposed rule requires that a Research Principal pass the General Securities Principal examination¹⁵ and (1) the Series 86 and Series 87 examinations or (2) the Series 16 examination.

A person registered as a Research Principal immediately prior to the effective date of the proposed rule will be grandfathered. The proposed rule also codifies existing guidance regarding exceptions from the Research Principal requirement for principals responsible for reviewing and approving third-party research reports, principals assigned to supervise for compliance with only the disclosure provisions of NASD Rule 2711 and Supervisory Analysts who are permitted pursuant to FINRA Rules to approve research reports.¹⁶

4. Compliance Officer (Proposed FINRA Rule 1230(a)(4))

FINRA proposes to establish a new stand-alone registration category for Compliance Officers, which will also contain the Chief Compliance Officer registration requirement (current NASD Rule 1022(a)(1)). The proposed rule revises and redesignates as the Compliance Officer examination the current Compliance Official examination—an NYSE requirement¹⁷ applicable to persons responsible for day-to-day compliance activities and other persons directly supervising ten or more compliance personnel. FINRA believes that the role of the Chief Compliance Officer has critical importance and that a Compliance Officer examination tailored to the functions performed by a Chief Compliance Officer is the most appropriate examination for those individuals. The General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative examination will be the prerequisite to the Compliance Officer examination.

The proposed rule will require all persons designated as Chief Compliance Officers on Schedule A of Form BD to register as Compliance Officers and pass the Compliance Officer examination before their registrations can become effective, subject to the following provisions intended to facilitate the transition to the new examination.

- ➤ A person designated as a Chief Compliance Officer on Schedule A of Form BD, or registered as a Compliance Official, immediately prior to the effective date of the proposed rule will be qualified to register as a Compliance Officer without having to pass the Compliance Officer examination.
- A person designated as a Chief Compliance Officer on Schedule A of Form BD after the effective date of the proposed rule, but before the introduction of the Compliance Officer examination, will be required to pass the General Securities Principal examination (and the General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative prerequisite) to qualify to register as a Compliance Officer. This requirement will apply to all members. Such persons will not be required to pass the Compliance Officer examination after its introduction.

➤ A person designated as a Chief Compliance Officer on Schedule A of Form BD after the effective date of the proposed rule and the introduction of the Compliance Officer examination will be required to pass the Compliance Officer examination to qualify to register as a Compliance Officer, unless such person has earned the FINRA Institute at Wharton Certified Regulatory and Compliance Professional™ (CRCP™) designation.

FINRA believes that the General Securities Principal qualification examination in combination with the CRCP designation, which provides an in-depth understanding of the foundation, theory and practical application of securities laws and regulation, is appropriately tailored to the functions performed by a Chief Compliance Officer. Therefore, the proposed rule provides that a person who has passed the General Securities Principal qualification examination (and the General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative prerequisite) and has earned the CRCP designation will be qualified to register as a Compliance Officer without having to pass the Compliance Officer examination.

 Financial and Operations Principal, Introducing Broker-Dealer Financial and Operations Principal, Principal Financial Officer and Principal Operations Officer (Proposed FINRA Rule 1230(a)(5))

The proposed rule maintains the requirement that a member have a Financial and Operations Principal or Introducing Broker-Dealer Financial and Operations Principal, as applicable, but merges these registration categories (current NASD Rules 1022(b) and (c)) for simplification.

Additionally, the proposed rule modifies the NASD and NYSE requirements that members designate and register Chief Financial Officers (current NASD Rules 1022(b) and (c)) and Chief Financial Officers and Chief Operations Officers (current NYSE Rule Interpretations 311(b)(5)/02 and /03), respectively. FINRA does not believe it necessary for an officer to have the title of Chief Financial Officer or Chief Operations Officer for purposes of these provisions so long as the designated person performs the same functions.

More specifically, the proposed rule requires members to designate: (1) a Principal Financial Officer with primary responsibility for financial filings and the related books and records; and (2) a Principal Operations Officer with primary responsibility for the day-to-day operations of the business, including overseeing the receipt and delivery of securities and funds, safeguarding customer and firm assets, calculation and collection of margin from customers and processing dividend receivables and payables and reorganization redemptions and those books and records related to such activities.

Consistent with the current examination requirements, the proposed rule requires that a member's Principal Financial Officer and Principal Operations Officer register as Financial and Operations Principals (or Introducing Broker-Dealer Financial and Operations Principals, as applicable).

Since the financial and operational activities of members that neither self clear nor provide clearing services are limited, such members may designate the same person as the Principal Financial Officer, Principal Operations Officer and Financial and Operations Principal (or Introducing Broker-Dealer Financial and Operations Principal) (i.e., such members are not required to designate different persons to function in these capacities).

Given the level of financial and operational responsibility at clearing and self-clearing members, FINRA believes that it is necessary for such members to designate separate persons to function as Principal Financial Officer and Principal Operations Officer. Such persons may also carry out the other responsibilities of a Financial and Operations Principal (e.g., supervision of individuals engaged in financial and operational activities). The proposed rule also provides that a clearing or self-clearing member that is limited in size and resources may, pursuant to the FINRA Rule 9600 Series, request a waiver of the requirement to designate separate persons to function as Principal Financial Officer and Principal Operations Officer.

6. Registered Options Principal (Paragraph (a)(6) and Supplementary Material .02 and .03 of Proposed FINRA Rule 1230)

FINRA proposes to convert into supplementary material the provision in the Registered Options Principal category (current NASD Rule 1022(f)) regarding security futures activities, together with similar provisions in the General Securities Sales Supervisor (current NASD Rule 1022(g)) and General Securities Representative (current NASD Rule 1032(a)) categories. Consistent with FINRA Rule 2360 (Options), which allows a General Securities Sales Supervisor (in addition to a Registered Options Principal) to also approve the opening of an options account, the proposed rule provides that a General Securities Sales Supervisor may supervise options activities pursuant to FINRA Rule 2360.

As discussed below, FINRA is proposing to eliminate the Options Representative category (current NASD Rule 1032(d)). Therefore, the proposed rule eliminates from the Registered Options Principal category the Options Representative prerequisite. The proposed rule also removes the Corporate Securities Representative co-prerequisite since it is tied to the Options Representative prerequisite. Consequently, a person registering as a Registered Options Principal after the effective date of the proposed rule must satisfy one of the remaining prerequisites—the General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative prerequisite. A person registered as a Registered Options Principal immediately prior to the effective date of the proposed rule will be grandfathered from the new prerequisite requirement.

In addition, the provision regarding members that lose their sole Registered Options Principal (current NASD IM-1022-1) will be transferred with non-substantive changes into supplementary material.

7. Government Securities Principal (Proposed FINRA Rule 1230(a)(7))

The proposed rule eliminates the grandfathering provision for persons who were registered as principals prior to the 1988 adoption of the Government Securities Principal category since the provision is outdated.

Further, the proposed rule clarifies that: (1) a person registering as a Government Securities Principal is required to satisfy the General Securities Representative, United Kingdom Securities Representative, Canada Securities Representative or Government Securities Representative (current NASD Rule 1032(g)) prerequisite; and (2) a General Securities Principal who has satisfied the General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative prerequisite (or who is also registered as a Government Securities Representative) is qualified to function as a Government Securities Principal without having to register separately as such.

8. Investment Company and Variable Contracts Products Principal and Direct Participation Programs Principal (Paragraphs (a)(8) and (a)(9) of Proposed FINRA Rule 1230)

The proposed rule clarifies that a General Securities Principal who has satisfied the General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative prerequisite is qualified to function as an Investment Company and Variable Contracts Products Principal (current NASD Rule 1022(d)) or as a Direct Participation Programs Principal (current NASD Rule 1022(e)) without having to register separately in such categories.

9. General Securities Sales Supervisor (Paragraph (a)(10) and Supplementary Material .04 of Proposed FINRA Rule 1230)

Consistent with FINRA Rule 2360 (Options), FINRA proposes to add "approval of customer accounts" to the list of permissible supervisory activities of a General Securities Sales Supervisor.

Currently, for purposes of compliance with NASD Rule 2210 (Communications with the Public), a General Securities Sales Supervisor is permitted to approve most sales literature, but is not permitted to provide final approval of advertisements. However, as detailed in *Regulatory Notice 09-55*, FINRA is proposing to amend the communications rules, including NASD Rule 2210, to combine the definitions of advertisement, sales literature and independently prepared reprint into a single category—retail communications. Since FINRA is proposing to remove the distinction between

advertisements and sales literature as part of the communications rules, FINRA also proposes to amend the General Securities Sales Supervisor registration category to remove the restriction from providing final approval of advertisements. Thus, the proposed rule permits a General Securities Sales Supervisor to approve retail communications to the same extent a General Securities Sales Supervisor may currently approve sales literature.

Further, the provision explaining the General Securities Sales Supervisor category (current NASD IM-1022-2) will be transferred into supplementary material with changes consistent with the proposed changes to the General Securities Sales Supervisor registration category.

10. Supervisory Analyst (Proposed FINRA Rule 1230(a)(11))

NYSE Rules require that an individual who is responsible for approving research reports be registered and qualified as a Supervisory Analyst. Pursuant to NASD Rules (current NASD Rules 1050(f)(3)(A), 2210(b)(1)(B) and 2711(h)(13)(C) and existing guidance¹⁸), a Supervisory Analyst may approve research reports in lieu of a Research Principal. If a member elects to have a Supervisory Analyst approve research, then a Research Principal must supervise the overall conduct of the Supervisory Analyst and Research Analyst.

Consistent with NASD Rules and existing guidance, FINRA proposes to adopt a standalone permissive registration category for Supervisory Analysts. A person may register as a Supervisory Analyst, provided his or her activities are limited to approving research reports pursuant to the applicable rules and the person passes the Supervisory Analyst examination. Unlike the current NYSE requirement, the proposed rule does not require evidence of appropriate experience. Rather than passing the entire Supervisory Analyst examination, a person may obtain a waiver from the securities analysis portion (Part II) of the Supervisory Analyst qualification examination upon verification that the person has passed Level I of the Chartered Financial Analyst examination, which is consistent with the current NYSE provision. The proposed rule further clarifies that a Supervisory Analyst must be supervised by a Research Principal.

11. General Securities Representative (Proposed FINRA Rule 1230(b)(2))

The proposed rule deletes references to the Japan Module of the General Securities Representative examination. Current NASD Rule 1032(a)(2)(D) permits a person registered and in good standing as a representative with the Japanese securities regulators to become qualified as a General Securities Representative by passing the Japan Module of the General Securities Representative examination. The Japan Module, however, was never implemented.

12. Securities Lending Representative and Securities Lending Supervisor (Proposed FINRA Rule 1230(b)(6))

NASD Rules currently do not have a specific registration category for associated persons engaged in securities lending activities and in the direct supervision of such activities. Whether such persons are required to be registered depends on whether they are functioning as "representatives" or "principals" under current NASD Rules. Given the scope of such activities and for tracking and FINRA examination purposes, FINRA believes that it is appropriate to have a specific registration category for such persons similar to the NYSE registration requirements.

The proposed rule generally adopts the NYSE registration requirements for Securities Lending Representatives and Securities Lending Supervisors. The proposed rule requires an associated person who has discretion to commit a member to any contract or agreement (written or oral) involving securities lending or borrowing activities with any other person, and the direct supervisor of the associated person to register as a Securities Lending Representative and Securities Lending Supervisor, respectively. While they will not be subject to a qualification examination at this time, they will be required to register as such for tracking and FINRA examination purposes, regardless of their registrations in other categories.

Unlike the NYSE requirement, the proposed rule does not require such persons to sign an agreement (representing a form of code of ethics), pursuant to which they agree to abide by all policies and procedures established by their employers as well as all applicable federal and state securities laws and NYSE rules. FINRA has determined not to adopt this agreement in its current form at this time in light of the status of such persons as registered persons.

13. Order Processing Assistant Representative (Proposed FINRA Rule 1230(b)(7))

The proposed rule streamlines and consolidates the Order Processing Assistant Representative category (current NASD Rules 1041 and 1042) and clarifies that a person whose sole function is to accept unsolicited customer orders is not required to register as an Order Processing Assistant Representative if he or she chooses to register in another appropriate representative category. However, if the person registers in another appropriate representative category, the person will be precluded from registering as an Order Processing Assistant Representative.

The proposed rule further codifies an existing restriction that prohibits an Order Processing Assistant Representative from accepting customer orders for municipal securities and direct participation programs. ¹⁹ The proposed rule also clarifies that Order Processing Assistant Representatives will not be precluded from registering in another registration category, but upon such registration they will lose their Order Processing Assistant Representative registration.

14. Proctor (Proposed FINRA Rule 1230(b)(8))

The proposed rule amends the Proctor category to clarify that persons registered solely as Proctors (current NASD Rule 1043) based on the scope of their activities are subject to the same compensation restrictions as persons registered solely as Order Processing Assistant Representatives; *i.e.*, they may only be compensated through an hourly wage, a salary, or bonuses or other compensation based on a member's profit sharing plan or similar arrangement.

15. Investment Company and Variable Contracts Products Representative (Proposed FINRA Rule 1230(b)(9))

Consistent with the registration provisions of MSRB Rule G-3(a)(ii)(C), the proposed rule amends the Investment Company and Variable Contracts Products Representative category (current NASD Rule 1032(b)) to clarify that such persons are also permitted to engage in the solicitation, purchase or sale of municipal fund securities as defined under MSRB Rule D-12.

16. Representatives Engaged in Options Activities (Proposed FINRA Rule 1230.01)

FINRA believes that there is diminishing utility in the Options Representative category. Therefore, FINRA proposes to eliminate this category and instead require that a representative engaged in options activities register as a General Securities Representative, United Kingdom Securities Representative or Canada Securities Representative, which is consistent with the current NYSE requirements. A person registered as an Options Representative immediately prior to the effective date of the proposed rule will be grandfathered from this requirement.

17. Qualification Examination Requirements for Foreign Associates (Proposed FINRA Rule 1230.05)²⁰

Pursuant to current NASD Rule 1100, a Foreign Associate may function as a registered representative, including acting as a trader or the registered person responsible for servicing the accounts of a foreign national. However, Foreign Associates are exempt from the requirement to pass a qualification examination and are not subject to continuing education requirements.

Considering the type of interaction that Foreign Associates may have with customers, FINRA believes there is no reason such persons should not demonstrate the same level of competence and knowledge required of their counterparts in the United States. The proposed rule therefore eliminates the Foreign Associate category and requires that a person registered as a Foreign Associate immediately prior to the effective date of the proposed rule register in an appropriate registration category (and pass any applicable examination) within one year of the effective date of the proposed rule.

18. Other Provisions Transferring With Non-Substantive Changes (Paragraphs (a)(2)(B), (b)(1), (b)(3) through (b)(5) and (b)(10) through (b)(13) of Proposed FINRA Rule 1230))

FINRA proposes to transfer into the proposed rule with non-substantive changes the following registration categories and provisions:

- General Securities Principal responsible for supervising investment banking activities (current NASD Rule 1022(a)(1));21
- ➤ Definition of the term "Representative" (current NASD Rule 1031(b));
- Direct Participation Programs Representative (current NASD Rule 1032(c));
- Corporate Securities Representative (current NASD Rule 1032(e));
- Equity Trader (current NASD Rule 1032(f));
- Government Securities Representative (current NASD Rule 1032(g));
- Private Securities Offerings Representative (current NASD Rule 1032(h));
- ► Investment Banking Representative (current NASD Rule 1032(i));²² and
- Research Analyst (current NASD Rule 1050).

D. Associated Persons Exempt from Registration (Proposed FINRA Rule 1240)23

1. Active Versus Inactive

Current NASD Rule 1060(a)(2) exempts from registration those associated persons who are not actively engaged in the investment banking or securities business. This exemption relates to the current provisions prohibiting the "parking" of registrations, which, among other things, prohibit a member from maintaining a registration for any person who is no longer active in the member's investment banking or securities business. The proposed changes to the registration requirements render the exemption obsolete; therefore, FINRA proposes to delete the exemption.

2. Codification of Guidance Regarding Contact with Prospective Customers (Proposed FINRA Rule 1240.01)

FINRA proposes to codify existing guidance permitting unregistered persons to have limited contact with prospective customers (subject to certain restrictions).²⁴

3. Rescission of Guidance Regarding Unregistered Persons Who Occasionally Receive Unsolicited Customer Orders (Paragraph (a) and Supplementary Material .02 of Proposed FINRA Rule 1240)

FINRA proposes to rescind existing guidance permitting unregistered administrative personnel to occasionally receive an unsolicited customer order at a time when appropriately qualified representatives or principals are unavailable.²⁵ FINRA believes that to accept customer orders a person must be appropriately registered. The proposed rule clarifies that the function of accepting customer orders is not considered a clerical or ministerial function (current NASD Rule 1060(a)(1)) and that associated persons who accept customer orders under any circumstances are required to be appropriately registered and qualified.

4. Other Exemptions from Registration (Paragraphs (b) and (c) of Proposed FINRA Rule 1240)

Current NASD Rule 1060(a)(4)(A) exempts from registration associated persons whose functions are related solely and exclusively to effecting transactions on the floor of a national securities exchange, provided they are registered as floor members with such exchange. Since exchanges have registration categories other than the floor member category, FINRA proposes to amend this provision to clarify that the exemption applies to associated persons solely and exclusively effecting transactions on the floor of a national securities exchange, provided they are appropriately registered with such exchange.

FINRA proposes to transfer into the proposed rule with non-substantive changes the remaining exemptions from registration (current NASD Rules 1060(a)(3) and (a)(4)(B) through (D)).

E. NYSE Provisions Proposed for Deletion²⁶

FINRA proposes to delete the following NYSE provisions as they are substantially similar to the proposed consolidated registration rules, otherwise incorporated as described above, rendered obsolete by the proposed approach reflected in the registration rules, or addressed by other rules:

- ➤ NYSE Rule 10 (definition of "registered representative");²⁷
- NYSE Rule Interpretations 10/01 and 345(a)/01 (clerical and ministerial exemption from registration);
- NYSE Rule Interpretation 311(b)(5)/01 (qualification requirements for principal executives):
- NYSE Rule Interpretations 311(b)(5)/02 and /03 (relating to the designation and registration of a Chief Financial Officer and a Chief Operations Officer);
- ➤ NYSE Rule Interpretation 311(g)/01 (requirement that certain members have at least two general partners);
- NYSE Rule 321.15 (registration of certain employees of a foreign subsidiary);
- NYSE Rule 344 and its Interpretation (Research Analyst and Supervisory Analyst categories);
- NYSE Rules 345(a), 345.10, 345.15(2) through 345.15(4) and NYSE Rule Interpretation 345.15/02 (representative categories);²⁸
- NYSE Rules 345.11(a) and (b) and NYSE Rule Interpretation 345.11/01 (personnel background investigations);
- NYSE Rule 345.11(c) and NYSE Rule Interpretation 345.11/02 (Form U4 recordkeeping obligations);
- NYSE Rules 345.12, 345.13, 345.17 and 345.18 and NYSE Rule Interpretations 345.12/01 and 345.18/01 (Forms U4 and U5 filing requirements);
- NYSE Rule 345.15(1)(a) (examination requirement);
- ➤ NYSE Rule 345.15(1)(b) and NYSE Rule Interpretation 345.15/01 (examination waivers);
- ➤ NYSE Rule Interpretation 345(a)/02 (independent contractor status);
- NYSE Rule Interpretation 345(a)/03) (status of persons serving in the Armed Forces);
- ➤ NYSE Rule Interpretation 345(b) (provisions regarding officers);²⁹ and
- NYSE Rule 345.16 (requirement to provide information regarding employees).

Endnotes

- 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).
- 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 Notice to Members (NTM) 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 or SEA) 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 Exchange Act Section 19 and rules thereunder.
- 4 For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.
- 5 The proposal contains several provisions that require notification to FINRA. FINRA will advise members through a *Regulatory Notice* of the manner of the required notifications.

- 6 Some of these provisions are subject to pending proposals related to the rulebook consolidation process.
- For purposes of the proposed rule, the assigned registered supervisor will only be responsible for supervising such person's activities to ensure that such person is not engaged in any activities that will require registration and is complying with the provisions applicable to such person based on his or her status as a (permissively) registered person.
- 8 See SR-FINRA-2007-004.
- Persons who are currently registered pursuant to this permissive category, to the extent that they seek to maintain such registrations, will have to be appropriately registered in accordance with the proposed rule.

 Additionally, FINRA is proposing to delete NYSE Rule 321.15 (which requires the registration of certain employees of a foreign subsidiary). Thus, persons who are currently registered pursuant to NYSE Rule 321.15, to the extent that they seek to maintain such registrations, will also have to be appropriately registered in accordance with the proposed rule.
- 10 See supra note 6.
- 11 For purposes of the proposed rule, the assigned registered supervisor will only be responsible for supervising such person's activities to ensure that such person is: (1) in fact engaged in the business of the member's financial services industry affiliate; (2) not engaged in any activities that will require registration or make such person eligible for inactive registration by engaging in a bona fide business purpose of the member; and (3) complying with the provisions applicable to such person based on his or her status as a Retained Associate.

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Endnotes continued

- 12 In 2005, the NYSE filed a proposal, SR-NYSE-2005-59, with the SEC to permit a member to maintain the registration (as a retained associate) of a person employed by a financial services industry affiliate of the member. The NYSE proposal has not been published for comment in the Federal Register.
- 13 See NTM 99-49 (June 1999).
- 14 The proposed consolidated registration rules provide similar clarifications regarding these prerequisite categories in the context of other registration categories (with the exception of the General Securities Sales Supervisor category, which requires the General Securities Representative prerequisite).
- 15 A person may qualify to function as principal or representative based on a combination of registrations and examinations. For instance, a person who is registered as a General Securities Sales Supervisor and passes the General Securities Principal Sales Supervisor Module (Series 23) examination also satisfies the General Securities Principal examination requirement. See NTM 03-37 (July 2003).
- 16 See NTMs 04-81 (November 2004) and 07-04 (January 2007).
- 17 The NYSE Compliance Official requirement (NYSE Rule 342.13(b) and NYSE Rule Interpretation 342(a)(b)/02) is proposed to be deleted as part of the proposed changes to the supervision rules. See Regulatory Notice 08-24 (May 2008).
- 18 See NTM 04-81.
- 19 See NTM 89-78 (December 1989).

- 20 FINRA will address NASD Rule 1090 (Foreign Members), which relates to members that do not maintain an office in the United States responsible for preparing and keeping financial and other required reports, as part of a separate phase of the rulebook consolidation.
- 21 See Regulatory Notice 09-41 (July 2009).
- 22 See id.
- FINRA will address the foreign finder provision (current NASD Rule 1060(b)), the corresponding NYSE provision (NYSE Rule Interpretation 345(a)(i)/03) and NYSE Rule Interpretations 345(a)(i)/01 and /02 (relating to compensation paid to non-registered persons and compensation paid for advisory solicitations) as part of a separate phase of the rulebook consolidation. See Regulatory Notice 09-69 (December 2009).
- 24 See NTM 00-50 (August 2000).
- 25 See NTM 87-47 (July 1987).
- 26 The NYSE registration requirements for certain supervisors (NYSE Rules 342(d) and .13(a) and NYSE Rule Interpretation 342.13/01) are proposed to be deleted as part of the proposed changes to the supervision rules. See Regulatory Notice 08-24. Supervisors registered as General Securities Principals or General Securities Sales Supervisors will not lose these registrations since these categories will be maintained as part of the FINRA registration rules. Supervisors registered solely by having passed the General Module (Series 10) of the General Securities Sales Supervisor examination (or the historical equivalent to the Series 10) will lose these stand-alone registrations. However, FINRA will consider upon request the Series 10 registration, among other considerations, in determining whether to grant such persons a waiver of a principal examination.

Endnotes continued

- 27 FINRA believes that the definition of the term "representative" in current NASD Rule 1031(b) is more consistent with the functions customarily performed by a registered representative.
- 28 FINRA also is proposing to delete the NYSE registration requirements relating to commodities solicitors (NYSE Rule 345.15(5)) and floor members and floor clerks (NYSE Rule Interpretation 345.15/02) as these activities are not within the scope of the proposed registration rules.
- 29 This is a conforming change. The corresponding NYSE Rule, NYSE Rule 345(b), was deleted as part of a prior rule change. See Exchange Act Release No. 58533 (September 12, 2008), 73 FR 54652 (September 22, 2008) (Order Approving SR-FINRA-2008-036).

Attachment A

Comparison of Current Rules Regarding Registration and Qualification Requirements

The table below explains the similarities and differences between current NASD and NYSE rules regarding registration and qualification requirements. FINRA proposes to transfer the NASD rules into the Consolidated FINRA Rulebook with certain changes that take into account requirements under the NYSE rules. FINRA urges member firms to carefully review the entire proposed rule text in Attachment B at www.finra.org/notices/09-70 to understand the full extent of the proposed changes.

Similar Requirements	
Description	Applicable FINRA/NASD/NYSE Provisions
General Registration/Qualification Requirements	
FINRA By-Laws and NASD and NYSE Rules require that members file Forms U4 and U5, including any amendments, and that such filings be made through the Central Registration Depository.	Article V, Sections 2 and 3, of the FINRA By-Laws FINRA Rule 1010 NYSE Rule 345.12, .13, .17 and .18 NYSE Rule Interpretation 345.12/01 and .18/01
NASD and NYSE Rules remind members of their Form U4 recordkeeping obligations under the Exchange Act.	FINRA Rule 1010 NYSE Rule 345.11(c) NYSE Rule Interpretation 345.11/02
NASD and NYSE Rules require members to investigate the background of prospective personnel.	NASD Rule 3010(e) Regulatory Notice 07-55 NYSE Rule 345.11(a) NYSE Rule Interpretation 345.11/01
NASD and NYSE Rules require an applicant for registration to provide, upon a member's request, a copy of his or her Form U5.	NASD Rule 3010(f) ¹ NYSE Rule 345.11(b)
NASD and NYSE Rules set forth provisions regarding the status of registered persons serving in the Armed Forces of the United States.	NASD IM-1000-2(a) and (b) NYSE Rule Interpretation 345(a)/03
NASD and NYSE Rules set forth a general requirement that persons pass an appropriate qualification examination (including any applicable prerequisites) before their registration can become effective.	NASD Rules 1021(a) and 1031(a) NYSE Rule 345.15(1)(a)
NASD and NYSE Rules provide that if a person does not register with a member within two years of his or her last registration, his or her qualification will lapse and the person must then re-test as applicable to function in a registered category.	NASD Rules 1021(c), 1031(c) and 1041(c) NYSE Rule Interpretation 345A(a)/04

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Similar Requirements	
Description	Applicable FINRA/NASD/NYSE Provisions
NASD and NYSE Rules provide an exemption from registration for associated persons whose functions are solely and exclusively clerical or ministerial.	NASD Rule 1060(A)(1) NTM 87-47 NYSE Rule Interpretations 10/01 and 345(a)/01
NASD and NYSE Rules set forth provisions regarding waiver of the applicable qualification examinations.	NASD Rule 1070(d) NYSE Rules 342.13 and 345.15(1)(b) NYSE Rule Interpretations 344/01 and 345.15/01
NASD and NYSE Rules set forth waiting periods for retaking failed examinations.	NASD Rule 1070(e) Information Memorandum 04-16
NASD and NYSE Rules require that examinations be kept confidential.	NASD Rule 1080 Information Memorandum 88-37
FINRA and NYSE Rules require members to provide information regarding their employees.	FINRA Rule 8210 NYSE Rule 345.16
Requirements Applicable to Principals/Supervisors/Representatives	
NASD and NYSE Rules require that certain supervisory personnel have at least one year of direct experience or two years of related experience in the subject area that they supervise.	NASD Rule 1014(a)(10)(D) NYSE Rule 342.13(a)
NASD and NYSE Rules require that members engaged in options transactions with the public have an associated person registered and qualified as a Registered Options Principal.	NASD Rules 1021(e)(3) and 1022(f) NYSE Rule 720 ²
NASD and NYSE Rules set forth specific registration and qualification requirements for associated persons engaged in security futures activities.	NASD Rules 1022(f)(5), 1022(g)(3), 1032(a)(2)(A) and 1032(d)(4) NYSE Rule Interpretation 345A(b)(2)(i)/02 Information Memorandum 03-43
NASD and NYSE Rules require that a representative register and qualify as a General Securities Representative. Alternatively, if the representative does not engage in municipal securities activities, NASD and NYSE Rules permit the representative to register and qualify as a United Kingdom Limited Securities Representative or Canada Limited Securities Representative.	NASD Rules 1031(a) and 1032(a) NYSE Rule 345.10 and .15(2) NYSE Rule Interpretation 345.15/02 Information Memoranda 91-09 and 96-06

Similar Requirements	
Description	Applicable FINRA/NASD/NYSE Provisions
NASD and NYSE Rules provide that a representative is not required to register as a General Securities Representative if the person's activities are so limited as to qualify such person for one or more of the limited categories of representative registration, including an Investment Company and Variable Contracts Products Representative or a Direct Participation Programs Representative.	NASD Rule 1032(a)(1), (b) and (c) NYSE Rule 345.15(3) NYSE Rule Interpretation 345.15/02
NASD and NYSE Rules require that an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report be registered and qualified as a Research Analyst.	NASD Rule 1050 NYSE Rule 344, .10 and .12 NYSE Rule Interpretation 344/01 and /02
NASD and NYSE Rules require that an associated person designated as a Proctor for the purposes of in-firm delivery of the Regulatory Element be registered as a Proctor. Proctors are not subject to a qualification examination. Associated persons who are registered in other registration categories may be designated as Proctors without having to register as such.	NASD Rules 1120(a)(6)(E) and 1043 NYSE Rule Interpretation 345A(a)/03E Information Memorandum 02-49

Differing Requirements	
Description	Applicable FINRA/NASD/NYSE Provisions
General Registration/Qualification Requirements	
NASD Rules set forth provisions regarding the deferment of the lapse of registration requirements in NASD Rules 1021(c), 1031(c), and 1041(c) for formerly registered persons serving in the Armed Forces of the United States.	NASD IM-1000-2(c)
NASD Rules include a provision regarding the disciplinary implications of failing to register a representative.	NASD IM-1000-3

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NASD Rules prohibit a member from maintaining a principal or representative registration with FINRA for any person who is no longer active in the member's investment banking or securities business, who is no longer functioning as a principal or representative as defined under the rules, or where the sole purpose is to avoid the re-testing requirement applicable to persons whose registration in such categories has lapsed for more than two years. These rules also prohibit a member from making application for the registration of a person as principal or representative where the member does not intend to employ the person in its investment banking or securities business.	NASD Rules 1021(a) and 1031(a)
However, the rules permit a member to maintain, or make application for, the registration as a principal or representative of a person who performs legal, compliance, internal audit, back-office operations (e.g., cashiering, accounting, settling, and the record keeping of customers' cash or margin accounts) or similar responsibilities for the member. In addition, the rules permit a member to maintain, or make application for, the registration as a principal or representative of a person who is engaged in the investment banking or securities business of a foreign securities affiliate or subsidiary of the member.	
NYSE Rules require that certain persons apply to the NYSE for Approved Person status. ³ Natural persons applying for Approved Person status are required to submit a Form U4 and register as an Approved Person. Approved Persons are not subject to a qualification examination.	NYSE Rules 2(c) and 304(e) ⁴ Information Memorandum 00-21
NYSE Rules provide that an independent contractor is deemed an employee of a member for purposes of the NYSE Rules and require that the member comply with certain requirements when entering into an arrangement with any person asserting independent contractor status, including a requirement that the independent contractor execute a "consent to jurisdiction" form. ⁵	NYSE Rule Interpretation 345(a)/02
NASD Rules provide that the following associated persons are not required to be registered: (1) associated persons who are not actively engaged in the investment banking or securities business; (2) associated persons whose functions are related solely and exclusively to the member's need for nominal corporate officers or for capital participation; and (3) associated persons whose functions are related solely and exclusively to: effecting transactions on the floor of a national securities exchange and who are registered as floor members with such exchange, transactions in municipal securities, transactions in commodities or transactions in security futures (provided that any such person is registered with a registered futures association).	NASD Rule 1060(a)
NASD Rules provide general information relating to the examination process.	NASD Rule 1070(a), (b) and (c)

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
Requirements Applicable to Principals/Supervisors/Representatives	
NYSE Rules require that an employee of a non-U.S. registered foreign subsidiary whose duties (involving the purchase or sale of U.S. securities) correspond to those of a registered representative file a Form U4 and be approved by the NYSE as a registered representative of the parent member.	NYSE Rule 321.15 Information Memorandum 93-54
NASD Rules require that a principal register and qualify as a General Securities Principal. The term "principal" includes sole proprietors, officers, partners, managers of offices of supervisory jurisdiction and directors who are actively engaged in the management of the member's investment banking or securities business, such as supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions.	NASD Rules 1021(a), 1021(b) and 1022(a) <i>NTM 99-49</i>
An associated person registered solely as a General Securities Principal is not qualified to function as a Financial and Operations Principal; Introducing Broker-Dealer Financial and Operations Principal; Registered Options Principal; General Securities Sales Supervisor; Municipal Securities Principal; or Municipal Fund Securities Limited Principal, unless the General Securities Principal is also registered and qualified in these other categories.	
NASD Rules provide that a principal is not required to register as a General Securities Principal if the person's activities are so limited as to qualify such person for one or more of the limited categories of principal registration, including a Financial and Operations Principal, an Introducing Broker-Dealer Financial and Operations Principal, a Registered Options Principal, an Investment Company and Variable Contracts Products Principal, a Direct Participation Programs Principal, General Securities Sales Supervisor or Government Securities Principal.	NASD Rule 1022(a) through (h) NASD IM-1022-2
NYSE Rules require that persons designated by a member to be in charge of any office of the member, any regional or other group of offices, or any sales department or activity pass the General Securities Sales Supervisor examination. The General Securities Principal examination and the General Module (Series 10) of the General Securities Sales Supervisor examination are acceptable alternative examinations to the General Securities Sales Supervisor examination. However, persons that pass these alternative examinations cannot supervise options or municipal securities activities.	NYSE Rule 342(d) and .13(a) NYSE Rule Interpretation 342.13/01
NYSE Rules require that "principal executives" be appropriately qualified to perform their assigned functions.	NYSE Rule 311.17 NYSE Rule Interpretation 311(b)(5)/01

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NASD Rules require that a member's Chief Compliance Officer (CCO) designated on Schedule A of the member's Form BD be registered as a General Securities Principal. If the member's activities are limited to investment company and variable contracts products, direct participation programs or government securities, the member's CCO may instead be registered as an Investment Company and Variable Contracts Principal, Direct Participation Programs Principal or Government Securities Principal, respectively. In addition, for purposes of the CCO requirement for Dual Members, FINRA recognizes the Compliance Official examination as an acceptable alternative to the principal examination requirements for General Securities Principal, Investment Company and Variable Contracts Principal and Direct Participation Programs Principal, as applicable. The NASD Rules also include a grandfathering provision for certain CCOs.	NASD Rule 1022(a)(1) FINRA Rule 3130(a) <i>NTM 01-51</i>
NYSE Rules require that Compliance Officials, the person (or persons) designated by a member to direct day-to-day compliance activity (such as the CCO) and each other person designated by the member to directly supervise ten or more persons engaged in compliance activity, pass the Compliance Official qualification examination. If a member's commissions and other fees from its public business (retail and institutional) are under \$500,000 in the preceding calendar year and it introduces to another broker-dealer, the member's Compliance Officials are exempt from the Compliance Official qualification examination requirement. Compliance Officials that supervise ten or more persons whose compliance responsibilities are limited to the registration of individuals with regulatory bodies are also exempt from the Compliance Official qualification examination requirement. If a member is conducting a specialist business in addition to a public	NYSE Rule 342.13(b) NYSE Rule Interpretation 342(a)(b)/02
business, the member's Compliance Officials are also required to pass the Compliance Official for Specialist Firm qualification examination. However, if a member's activities are limited to the execution of orders on the NYSE floor and it does not conduct any public business, the member's Compliance Officials are subject only to the Compliance Official for Specialist Firm qualification examination requirement.	
NASD Rules require that a General Securities Principal who is responsible for supervising investment banking activities as described in NASD Rule 1032(i) also be registered as an Investment Banking Representative.	NASD Rule 1022(a)(1)

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NASD Rules require that a member's Research Principal, a principal who is responsible for supervising the overall conduct of a Research Analyst or Supervisory Analyst or who is responsible for approving research reports (other than a principal responsible for reviewing and approving third-party research reports, a principal assigned to supervise for compliance with only the disclosure provisions of NASD Rule 2711 or a Supervisory Analyst who is permitted to approve research reports), be registered as either a General Securities Principal and pass the Regulatory Administration and Best Practices (Series 87) portion of the Research Analyst examination or a General Securities Principal and pass the Supervisory Analyst examination.	NASD Rule 1022(a)(5) NTMs 04-81 and 07-04
NASD Rules permit a Supervisory Analyst to approve research reports. If a member elects to have a Supervisory Analyst approve research, then a Research Principal must supervise the overall conduct of the Supervisory Analyst and Research Analyst.	NASD Rules 1050(f)(3)(A), 2210(b)(1)(B) and 2711(h)(13)(C) NTM 04-81
NYSE Rules require that an individual who is responsible for approving research reports be registered and qualified as a Supervisory Analyst. Such person is required to present evidence of appropriate experience (which means having at least three years prior experience within the immediately preceding six years involving securities or financial analysis) and pass the Supervisory Analyst qualification examination. Rather than passing the entire Supervisory Analyst qualification examination, such person may obtain a waiver from the securities analysis portion (Part II) of the Supervisory Analyst qualification examination upon verification that the person has passed Level I of the Chartered Financial Analyst examination.	NYSE Rules 344, 344.11 and 472(a)(2) NYSE Rule Interpretation 344/03 and /04
NASD Rules require that a principal who is responsible for the financial and operational management of a member that has a minimum net capital requirement of \$250,000 under SEA Rules 15c3-1(a)(1)(ii) and 15c3-1(a)(2)(i), or a member that has a minimum net capital requirement of \$150,000 under SEA Rule 15c3-1(a)(8), be designated, registered and qualified as a Financial and Operations Principal. Such members also are required to designate a Chief Financial Officer (CFO) who is required to be registered and qualified as a Financial and Operations Principal. In addition, NASD Rules require that a principal who is responsible for the financial and operational management of a member that is subject to the net capital requirements of SEA Rule 15c3-1, other than a member that is subject to the net capital requirements of SEA Rules 15c3-1(a)(1)(ii), (a)(2)(i) or (a)(8), be designated, registered and qualified as a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal.	NASD Rules 1021(e)(3), 1022(b) and (c)

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NYSE Rules require that members designate a CFO and a Chief Operations Officers (COO) and that the CFO and the COO be registered and qualified as a Financial and Operations Principal if the member is a clearing firm or as either a Financial and Operations Principal or an Introducing Broker-Dealer Financial and Operations Principal if the member is an introducing firm.	NYSE Rule Interpretation 311(b)(5)/02 and /03
If the member is an introducing firm, the same person may be designated as both the CFO and COO.	
NASD Rules require that a principal engaged in government securities activities be registered as a Government Securities Principal. Such persons are not subject to a principal qualification examination. The rules include a grandfathering provision for certain principals.	NASD Rule 1022(h)
NASD Rules provide that a person who is currently registered with a member as a representative and whose duties are changed by the member so as to require registration as a principal may function as a principal for up to 90 calendar days before he or she is required to pass the appropriate qualification examination for principal.	NASD Rule 1021(d)
In addition, NASD Rules provide that a person who is not registered with a member as a representative and who is required to register as a principal may function as a principal for up to 90 calendar days after first satisfying all applicable prerequisite requirements before he or she is required to pass the appropriate qualification examination for principal.	
NASD Rules require that a member, except a sole proprietorship, have a minimum of two registered principals with respect to each aspect of the member's investment banking and securities business. In situations that indicate conclusively that only one registered principal should be required, FINRA may waive the two-principal requirement pursuant to the Rule 9600 Series and permit such member to have only one registered principal.	NASD Rule 1021(e)(1) and (2)
NYSE Rules require that a member carrying customer accounts have at least two general partners who are natural persons actively engaged in the member's business. ⁷	NYSE Rule Interpretation 311(g)/01
NASD Rules require that members that have one Registered Options Principal promptly notify FINRA and agree to certain conditions if such person is terminated, resigns, becomes incapacitated or is otherwise unable to perform his or her duties.	NASD IM-1022-1

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NASD Rules define the term "representative" as an associated person, including assistant officer other than a principal, who is engaged in the investment banking or securities business for the member, such as supervision, solicitation, conduct of business in securities or the training of persons associated with a member for any of these functions.	NASD Rule 1031(b)
NYSE Rules define the term "registered representative" as an employee engaged in the solicitation or handling of accounts or orders for the purchase or sale of securities, or other similar instruments for the accounts of customers of his or her employer or in the solicitation or handling of business in connection with investment advisory or investment management services furnished on a fee basis by his or her employer.	NYSE Rule 10
NASD Rules provide that a representative is not required to register as a General Securities Representative if the person's activities are so limited as to qualify such person for one or more of the limited categories of representative registration, including an Options Representative, a Corporate Securities Representative, Government Securities Representative or Private Securities Offerings Representative.	NASD Rule 1032(a)(1), (d), (e), (g) and (h)
Subject to certain exceptions, NASD Rules require that each representative who, with respect to transactions in equity, preferred or convertible debt securities effected otherwise than on a securities exchange, is engaged in proprietary trading, the execution of transactions on an agency basis or the direct supervision of such activities be registered as an Equity Trader.	NASD Rule 1032(f)
NASD Rules provide that associated persons engaged in investment banking activities are required to be registered as Investment Banking Representatives.	NASD Rule 1032(i)
NASD Rules provide that a person associated with a member is not required to register as a General Securities Representative or in one or more of the limited categories of representative registration if the person's activities are so limited as to qualify such person for registration as an Order Processing Assistant Representative. An Order Processing Assistant Representative is an associated person whose only function is to accept unsolicited customer orders (other than orders for municipal securities and direct participation programs) for submission for execution by the member. Order Processing Assistant Representatives are subject to certain restrictions regarding their activities and compensation and are subject to certain supervisory requirements. In addition, they may not be registered concurrently in any other capacity.	NASD Rules 1041 and 1042 <i>NTM 89-78</i>

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NASD Rules provide that associated persons (who are to function as representatives for the member) that meet the "Foreign Associate" criteria are exempt from the requirement to pass a qualification examination. To qualify for the Foreign Associate registration category, an associated person must meet the following criteria: (1) cannot be a citizen, national, or resident of the U.S. or any of its territories or possessions; (2) must conduct all of his or her securities activities in areas outside the jurisdiction of the U.S.; and (3) cannot engage in any securities activities with or for any citizen, national or resident of the U.S.	NASD Rule 1100 <i>NTM 95-37</i>
on behalf of the member, including acting as a trader or the registered person responsible for servicing the accounts of a foreign national.	
To designate an associated person as a Foreign Associate, a member must: (1) file a Form U4 with FINRA and certify that the person meets the criteria for a Foreign Associate; (2) attest that the person is not disqualified from registration; and (3) certify that service of process for any proceeding by FINRA for such person may be sent to an address designated by the member. If the Foreign Associate is terminated, the member must notify FINRA immediately (by filing a Form U5). Foreign Associates are not subject to continuing education requirements.	
NYSE rules require that a securities lending representative (any person who has discretion to commit his or her employer member to any contract or agreement (written or oral) involving securities lending or borrowing activities with any other person) and the direct supervisor of a securities lending representative be registered by filing a Form U4 and sign an agreement (representing a form of code of ethics) as an addendum to the Form U4. The rules also require that such persons complete the regulatory element of the continuing education requirements. However, such persons are not required to pass a qualification examination.	NYSE Rule 345(a) and .10 NYSE Rule Interpretations 345.15/02 and 345A(a)/02
NYSE Rules require that a "Registered Options Representative," a representative who transacts business with the public in option contracts, pass the General Securities Representative qualification examination.	NYSE Rules 345.10, 345.15(4) and 700(b)(49) ⁸ NYSE Rule Interpretation 345.15/02
NYSE Rules require that commodities solicitors, individuals who are engaged in the solicitation or handling of business in, or the sale of, commodities futures contracts, satisfy a solicitor's examination requirement (acceptable to the NYSE) of a national commodities exchange.	NYSE Rule 345.15(5)

Differing Requirements	
Description	Applicable FINRA/ NASD/NYSE Provisions
NYSE Rules permit floor members and floor clerks who conduct a public business limited to accepting orders directly from "professional customers" for execution on the NYSE floor to pass the Series 7A qualification examination instead of the General Securities Representative qualification examination. The Floor Member qualification examination and the Trading Assistant qualification examination are prerequisites for the Series 7A qualification examination for such floor members and floor clerks, respectively.	NYSE Rule Interpretation 345.15/02
NYSE Rules require that: (1) individuals who work as Front Line Specialist Clerks on the NYSE floor pass the Front Line Specialist Clerk qualification examination; (2) individuals who effect transactions on the NYSE floor pass the Floor Member qualification examination; (3) individuals who work as Trading Assistants on the NYSE floor pass the Trading Assistant qualification examination; and (4) other individuals who work as Floor Employees register as such (however, they are not subject to a qualification examination). Such persons also are subject to certain training requirements. NYSE Rules require that associated persons who conduct a public business (with other than "professional customers" on the NYSE floor) also pass the General Securities Representative qualification examination.	NYSE Rules 35 and 304A(a) NYSE Rule Interpretation 35° Information Memorandum 06-36

Endnotes – Attachment A

- NASD Rule 3010(f) is proposed to be deleted as part of the proposed changes to the supervision rules. See Regulatory Notice 08-24 (May 2008).
- NYSE Rule 720 was deleted as part of the changes to the FINRA options rules, which took effect on February 17, 2009. See Exchange Act Release No. 58932 (November 12, 2008), 73 FR 69696 (November 19, 2008) (Order Approving SR-FINRA-2008-032).
- An Approved Person is a person who either controls a member or is engaged in a securities or kindred business and is controlled by or under common control with a member.
- 4. NYSE Rule 304(e) was not incorporated into the FINRA rulebook.
- The status of independent contractors as associated persons of a member under FINRA and NASD Rules is well settled. See, e.g., Letter from Douglas Scarff, Director, Division of Market Regulation, SEC, to Gordon S. Macklin, President, NASD (June 18, 1992).
- 6. A person may qualify to function as principal or representative based on a combination of registrations and examinations. For instance, a person who is registered as a General Securities Sales Supervisor and passes the General Securities Principal Sales Supervisor Module (Series 23) examination also satisfies the General Securities Principal examination requirement. See NTM 03-37 (July 2003).

- NYSE Rule 311(h), which included a similar provision, was deleted as part of a prior rule change. See Exchange Act Release No. 58533 (September 12, 2008), 73 FR 54652 (September 22, 2008) (Order Approving SR-FINRA-2008-036).
- NYSE Rule 700(b)(49) was deleted as part of the changes to the FINRA options rules, which took effect on February 17, 2009. See Exchange Act Release No. 58932 (November 12, 2008), 73 FR 69696 (November 19, 2008) (Order Approving SR-FINRA-2008-032).
- NYSE Rules 35 and 304A(a) and NYSE Rule Interpretation 35 were not incorporated into the FINRA rulebook.

09-71

Financial Responsibility

SEC Approves Consolidated FINRA Rules Governing Financial Responsibility

Effective Date: February 8, 2010

Executive Summary

The SEC approved FINRA's proposed rule change¹ to adopt a new set of financial responsibility rules for the consolidated rulebook (the Consolidated FINRA Rulebook).² FINRA Rules 4110, 4120, 4130, 4140 and 4521 are new consolidated rules governing financial responsibility that are based in part on, and replace, provisions in the NASD and Incorporated NYSE Rules.³ The rule change also amends FINRA Rules 9557 and 9559 to, among other things, provide members served with a notice under the financial responsibility rules an expedited appeal process, and makes certain conforming revisions to Section 4(g) of Schedule A to the FINRA By-Laws.⁴

The text of the new rules is set forth in Attachment A on our Web site at www.finra.org/notices/09-71. The chart in Attachment B summarizes the applicability of the new rules to members.

Questions concerning this Notice should be directed to:

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

December 2009

Notice Type

- Consolidated FINRA Rulebook
- ➤ New Rules

Suggested Routing

- Compliance
- ➤ Legal
- Senior Management

Key Topics

- ➤ Capital Compliance
- ➤ Financial Responsibility

Referenced Rules & Notices

- ➤ FINRA Rule 4110
- ➤ FINRA Rule 4120
- ➤ FINRA Rule 4130
- ➤ FINRA Rule 4140
- ➤ FINRA Rule 4521
- ➤ FINRA Rule 9557
- ➤ FINRA Rule 9559
- ➤ SEA Rule 15c3-1
- ➤ SEA Rule 15c3-3
- Section 4(g) of Schedule A to FINRA By-Laws



Background

FINRA's financial responsibility rules play an important role in supporting the SEC's minimum net capital and other financial responsibility requirements. Generally, the rules establish criteria promoting the permanency of members' capital, require the review and approval of certain material financial transactions, and establish criteria intended to identify members approaching financial difficulty and to monitor their financial and operational condition.

The new rules incorporate many provisions in the existing NASD and NYSE Rules⁵ that govern financial responsibility, but streamline and reorganize those provisions. In addition, FINRA has tiered many provisions so that they apply only to those members that clear or carry customer accounts.⁶

Discussion

A. FINRA Rule 4110 (Capital Compliance)

1. Authority to Increase Capital Requirements

FINRA Rule 4110(a), based primarily on NYSE Rule 325(d), enables FINRA to prescribe greater net capital requirements for carrying and clearing members, 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 rule resides 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 is required under the rule to issue a notice pursuant to FINRA Rule 9557 (a Rule 9557 notice). (As amended by the rule change, FINRA Rule 9557 provides, among other things, opportunity for an expedited hearing pursuant to FINRA Rule 9559; see Section F of this Notice for more detail.)

Rule 4110(a) is a new provision for FINRA members that are not Dual Members (non-NYSE members) that are carrying or clearing members. However, it does not apply to introducing firms or to certain 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 acquisition activities are not subject to the provision.) In this regard, certain Dual Members that are subject to current NYSE Rule 325(d)—namely those NYSE member firms that are not carrying or clearing members (NYSE non-clearing firms)—will not be subject to the similar requirement in the FINRA Rule. Pursuant to the rule change, all members that are subject to the requirement will have an opportunity to request an expedited hearing if they receive a Rule 9557 notice, which is a new procedural right not available under current NYSE Rule 325(d).

As FINRA has explained,⁷ NYSE staff historically employed NYSE Rule 325(d) in limited circumstances, and FINRA anticipates that it will apply FINRA Rule 4110(a) in similar fashion. The new rule enables FINRA to respond promptly to extraordinary, unanticipated or emergency circumstances. Under FINRA Rule 4110(a), FINRA's EVP may require a carrying or clearing member to comply with increased capital requirements in circumstances such as where unanticipated systemic market events threaten the member's capital, or where the member 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

FINRA Rule 4110(b)(1) is based in part on current NASD Rule 3130(e) and provides that, unless otherwise permitted by FINRA, a member must suspend all business operations during any period of time in which it is not in compliance with SEA Rule 15c3-1. This requirement is consistent with current law.⁸

As with NASD Rule 3130(e), FINRA Rule 4110(b)(1) is self-operative (that is, a member is automatically 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 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 FINRA Rule 4110(b)(1).

3. Withdrawal of Equity Capital

To further the goal of financial stability, FINRA Rule 4110(c)(1) prohibits a member from withdrawing equity capital for a period of one year, unless otherwise permitted by FINRA in writing. The rule expressly provides that, subject to the requirements of FINRA Rule 4110(c)(2), members are not precluded from withdrawing profits earned.

FINRA anticipates that approvals for the early withdrawal of equity capital pursuant to Rule 4110(c)(1) would be granted on a limited basis.

FINRA Rule 4110(c)(2) applies only to carrying or clearing members and prohibits 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, or making any unsecured advance or loan to a stockholder, partner, sole proprietor, employee or affiliate, where such withdrawals, payments, reductions, advances or loans 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 current NYSE Rule 312(h) and SEA Rule 15c3-1(e). While this is a new requirement for non-NYSE members that are carrying or clearing members, it does not apply to non-clearing firms. In this regard, NYSE non-clearing firms that currently are subject to NYSE Rule 312(h) will not be subject to the new rule. FINRA further notes that the 10 percent limit set forth in Rule 4110(c)(2) provides a *de minimis* exception; current 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, FINRA Rule 4110(d)(1)(A) provides that no carrying or clearing 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, 10 without the prior written authorization of FINRA.

FINRA Rule 4110(d)(1)(A) is based on NYSE Rule 328(a), but applies only to carrying and clearing members. While the provision is new for non-NYSE members that are carrying or clearing members, it does not apply to non-clearing firms. In this regard, NYSE non-clearing firms that currently are subject to NYSE Rule 328(a) will not be subject to the new rule. Moreover, unlike NYSE Rule 328(a), 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's tentative net capital by 10 percent or more.¹¹

Proposed FINRA Rule 4110(d)(1)(B), which is also based on NYSE Rule 328(a), provides 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 is new for non-NYSE members that are carrying members.

Proposed FINRA Rule 4110(d)(2) is based on NYSE Rule 328(b), but applies only to carrying and clearing members. The provision requires 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 capital¹² 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 applies only to carrying and clearing members, NYSE non-clearing firms will be relieved from current requirements under NYSE Rule 328(b). In addition, unlike current NYSE Rule 328(b), FINRA Rule 4110(d)(2) includes a *de minimis* exception.

FINRA Rule 4110(d)(3) provides that any member that is subject to paragraphs (d)(1)(A), (d)(1)(B) or (d)(2) of Rule 4110 is 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. 13

FINRA Rule 4110(d)(4) implements a requirement of the SEC's net capital rule and therefore applies 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." When determining the acceptability of a loan agreement, pursuant to FINRA Rule 4110(d)(4), FINRA would, as a general matter, consider such factors as whether the bank would have sole recourse under the agreement and whether the term of the loan is at least one year. FINRA expects that a determination of acceptability can generally be made within approximately one week.

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

FINRA Rule 4110(e) is based in part on current NYSE Rule 420 and addresses the requirements for subordinated loans and loans made to general partners of members that are partnerships.

FINRA Rule 4110(e)(1) implements Appendix D of SEA Rule 15c3-1 and requires 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 15c3-1.¹⁴ 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.¹⁵

FINRA Rule 4110(e)(2) requires that, unless otherwise permitted by FINRA, each member whose general partner enters into any secured or unsecured borrowing, the proceeds of which will be contributed 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. Moreover, because a general partner'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 estops the lender from having that right.

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

1. Regulatory Notification

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

2. Restrictions on Business Expansion

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

FINRA Rule 4120(b)(1), which is self-operative, applies only to carrying and clearing 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 FINRA Rule 4120(a)(1) continue to exist for the specified time period. While NASD Rule 3130(c) includes comparable provisions, the requirement under the new rule is self-operative for non-NYSE members that are carrying or clearing members. 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 FINRA Rule 4120(b)(1).

Unlike the self-operative nature of paragraph (b)(1), 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 right currently applies to NASD Rule 3130(c)(2).

3. Reduction of Business

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.

FINRA Rule 4120(c)(1), which is self-operative, applies only to carrying and clearing members, requiring 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 FINRA Rule 4120(a)(1) when any of the enumerated conditions continue to

exist for the specified time period. While current NASD Rule 3130(d) includes comparable provisions, the requirement under the new rule is self-operative for non-NYSE members that are carrying or clearing members. 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 FINRA Rule 4120(c)(1).

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

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

FINRA Rule 4130 is substantially identical to NASD Rule 3131 except that the new rule reflects FINRA as the designated examining authority and makes other conforming revisions. FINRA Rule 4130 applies only to certain firms that are subject to the Treasury Department's liquid capital requirements.

D. FINRA Rule 4140 (Audit)

FINRA Rule 4140 incorporates 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 new rule imposes a late fee of \$100 for each day that a requested report is not timely filed, up to a maximum of 10 business days.

E. FINRA Rule 4521 (Notifications, Ouestionnaires and Reports)

Drawing in part on NASD IM-3130 and Rule 3150 and NYSE Rules 325(b)(2), 416¹⁷ and 421(2),¹⁸ FINRA Rule 4521 addresses 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 apply only to carrying and clearing members.

FINRA Rule 4521(a) provides that each carrying or clearing 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 are new for certain non-NYSE members that are carrying or clearing members.¹⁹

FINRA Rule 4521(b) requires 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 to file such supplemental and alternative reports as may be prescribed by FINRA.

FINRA Rule 4521(c) requires each carrying or clearing 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 is a new requirement for non-NYSE members that are carrying or clearing members.

FINRA Rule 4521(d) requires that, unless otherwise permitted by FINRA in writing, members 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 is a new requirement for non-NYSE members that carry margin accounts.²⁰

FINRA Rule 4521(e) provides that a late fee of \$100 may be imposed for each day that any report, notification or information a member is required to file pursuant to Rule 4521 is not timely filed, up to a maximum of 10 business days.

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

FINRA Rules 9557 and 9559 address service of notice to members that are experiencing financial or operational difficulties and the related hearing procedures. The rule change makes a number of conforming revisions to FINRA Rules 9557 and 9559 in light of several of the new financial responsibility rules (FINRA Rules 4110, 4120 and 4130). The rule change also amends Rules 9557 and 9559 to afford members with an expedited appeals process. For example, under the new rule amendments:

- ➤ FINRA Rule 9557(d) provides that the requirements referenced in a Rule 9557 notice served upon a member are immediately effective. 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 pursuant to FINRA Rule 9559(o)(4)(A) (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, FINRA Rule 9557(e) requires 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;

- ➤ FINRA Rule 9559(f)(1) provides 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;
- ➤ FINRA Rule 9559(o)(4)(A) provides that, within two business days of the date of the close of the hearing, the Office of Hearing Officers must issue the Hearing Panel's written order. The Hearing Panel order would be effective when issued. (The rule change provides that, pursuant to FINRA Rules 9559(o)(4)(B) and 9559(p), the written decision explaining the reasons for the Hearing Panel's determinations must be issued within seven days of the issuance of the written order.)

As amended by the rule change, FINRA Rules 9557 and 9559 set forth a number of other enhancements and clarifications of procedure. For example, FINRA Rule 9557(e)(1) provides that a member served with a Rule 9557 notice may request from FINRA staff a letter of withdrawal of the notice. The member may make this request either in lieu of or in addition to filing with the Office of Hearing Officers the written request for a hearing. The rule change enables FINRA staff, in response to the member's request and upon the member's demonstration to the satisfaction of FINRA staff that any requirements and/or restrictions imposed by a notice should be removed or reduced, either to withdraw the Rule 9557 notice or to reduce its requirements and/or restrictions.²¹ The member may submit a request for a letter of withdrawal to FINRA staff at any time after the notice is served. If such request is denied by FINRA staff, the proposed rule change provides that the member shall not be precluded from making a subsequent request or requests.²²

If a member requests a hearing within two business days after service of a 9557 notice, the member may seek to contest (1) the validity of the requirements and/or restrictions imposed by the notice (as the same may have been reduced by a letter of withdrawal issued by FINRA staff pursuant to Rule 9557(g)(2), where applicable) and/or (2) FINRA staff's determination not to issue a letter of withdrawal of all requirements and/or restrictions imposed by the notice, if such was requested by the member. The Hearing Panel may then either approve or withdraw the requirements and/or restrictions imposed by the notice. If the Hearing Panel approves the requirements and/or restrictions and finds the member has not complied with all of them, the Hearing Panel would be required to impose an immediate suspension on the respondent that would remain in effect unless FINRA staff issues a letter of withdrawal of all requirements and/or restrictions.

Endnotes

- See Exchange Act Release No. 60933 (November 4, 2009), 74 FR 58334 (November 12, 2009) (Order Granting Approval to Proposed Rule Change; File No. SR-FINRA-2008-067) (Approval Order).
- 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 3/12/08 (Rulebook Consolidation Process).
- 3 Effective February 8, 2010, NASD Rules 3130 and 3131, NASD IM-3130, Incorporated NYSE Rules 312(h), 313(d), 325, 326, 328, 416.20, 418, 420, 421 and NYSE Rule Interpretations 313(d)/01, 313(d)/02, 325(c)(1), 325(c)(1)/01 and 416/01 will be deleted from the Transitional Rulebook.
- 4 FINRA notes that, in devoting this *Notice* to announcing the effective date of a single set of rules and rule amendments, it is deviating from the protocol by which FINRA generally announces the effective dates of the new FINRA rules that are being adopted as part of the consolidated rulebook. *See Information Notice 10/06/08* (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart). FINRA believes that a single *Notice* devoted to the new financial responsibility rules is warranted in view of the regulatory subject matter and the nature of the changes.

- 5 For convenience, the Incorporated NYSE Rules are referred to as the "NYSE Rules."
- All requirements set forth in the new rules that apply to members that clear or carry customer accounts also apply to members that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clear customer transactions pursuant to such exemptive provisions or hold customer funds in a bank account established thereunder. See FINRA Rules 4110.02, 4120.03 and 4521.01. For further discussion, see Approval Order, note 8, at 74 FR 58334.
- 7 See, e.g., Regulatory Notice 08-23 (Proposed Consolidated FINRA Rules Governing Financial Responsibility) (May 2008).
- 8 See Approval Order, note 13, at 74 FR 58335.
- 9 The calculation of 10 percent of excess net capital must be based on the member's excess net capital position as reported in its most recently filed Form X-17A-5. The member must assure itself that the excess net capital so reported has not materially changed since the time the form was filed.
- The calculation of 10 percent of tentative net capital must be based on the member's tentative net capital position as reported in its most recently filed Form X-17A-5. The member must assure itself that the tentative net capital so reported has not materially changed since the time the form was filed.
- 11 See note 9 supra.
- 12 See note 9 supra.
- 13 See note 9 supra.

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Endnotes continued

- 14 See SEA Rule 15c3-1d. Note that the Supplementary Material requires that, for purposes of 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 FINRA Rule 4110.01 (Compliance with Applicable Law).
- 15 FINRA will issue a separate Regulatory Notice addressing standards for obtaining approval of subordinated loans.
- 16 The determination of whether the financial triggers were reached must be based on the member's financial position as reported in its most recently filed Form X-17A-5. The member must assure itself that its financial position so reported has not materially changed since the time the form was filed.
- 17 Note that NYSE Rules 416(a), 416(c) and 416.10 will remain in the Transitional Rulebook to be addressed later in the rulebook consolidation process. On July 11, 2008, the SEC approved FINRA's proposal to delete NYSE Rule 416(b). See Exchange Act Release No. 58149 (July 11, 2008), 73 FR 42385 (July 21, 2008) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change; File No. SR-FINRA-2008-034).

- 18 Because the rule change deletes NYSE Rule 421(2) and its related provision Rule 421.40, the rule change, in combination with rule change SR-FINRA-2008-033 (which was approved by the SEC on September 4, 2008, and took effect on December 15, 2008), deletes NYSE Rule 421 in its entirety. See Exchange Act Release No. 58461 (September 4, 2008), 73 FR 52710 (September 10, 2008) (Order Approving Proposed Rule Change; File No. SR-FINRA-2008-033); see also Regulatory Notice 08-57 (SEC Approves New Consolidated FINRA Rules) (October 2008).
- 19 Note that NASD Rule 3150 (Reporting Requirements for Clearing Firms) currently requires most carrying and clearing members to submit certain data to FINRA. Rule 3150 will be addressed later in the rulebook consolidation process.
- 20 FINRA will issue a separate Regulatory Notice containing guidance with respect to filing requirements under FINRA Rule 4521(d).
- 21 See FINRA Rule 9557(g)(2).
- 22 See FINRA Rule 9557(e)(1).

ATTACHMENT B – Financial Responsibility Rules Summary Chart

Proposed FINRA Rule #	Proposed FINRA Rule Requirement/Topic	Applies to
4110	Capital Compliance	
4110 (a)	Authority to increase capital requirements	Carrying/clearing members¹
4110(b)	Suspension of business operations	All members
4110(c)(1)	Withdrawal of equity capital	All members
4110(c)(2)	Withdrawal of equity capital	Carrying/clearing members
4110(d)(1)(A)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Carrying/clearing members
4110(d)(1)(B)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Carrying members
4110(d)(2)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Carrying/clearing members
4110(d)(3)	Sale-and-leasebacks, factoring, financing, loans and similar arrangements	Members 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 members
4110(e)(1)	Subordinated loans, notes collateralized by securities and capital borrowing	All members
4110(e)(2)	Subordinated loans, notes collateralized by securities and capital borrowing	All members that are partnerships

¹ As explained in the *Notice*, all requirements set forth in the rule change that apply to a member that clears or carries customer accounts also apply to any member that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established thereunder.

Proposed FINRA Rule #	Proposed FINRA Rule Requirement/Topic	Applies to
4120	Regulatory Notification and Business Curtailment	
4120(a)	Regulatory notification	Carrying/clearing members
4120(b)(1)	Restrictions on business expansion	Carrying/clearing members
4120(b)(2)	Restrictions on business expansion	All members
4120(c)(1)	Reduction of business	Carrying/clearing members
4120(c)(2)	Reduction of business	All members
4130	Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties	Certain members subject to the Treasury Department's liquid capital requirements
4140	Audit	All members
4521	Notifications, Questionnaires and Reports	
4521(a), (c)	Notifications, questionnaires and reports	Carrying/clearing members
4521(b)	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(d)	Notifications, questionnaires and reports	Members carrying margin accounts for customers
4521(e), (f)	Notifications, questionnaires and reports	Any member subject to 4521(a) through (d)

09-72

SEC Approves New Consolidated FINRA Rules

SEC Approval and Effective Dates for New Consolidated FINRA Rules

Effective Date (all rules except FINRA Rule 2330): February 15, 2010

Effective Date (FINRA Rule 2330): February 8, 2010

Executive Summary

Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA established a process to develop a new consolidated rulebook (Consolidated FINRA Rulebook), which FINRA has discussed in previous *Information Notices*.¹ FINRA is proposing new consolidated rules in phases for approval by the SEC as part of the Consolidated FINRA Rulebook.² In October and November, the SEC approved eight new consolidated FINRA rules.³ All of the new rules take effect on February 15, 2010 except for FINRA Rule 2330, which has an implementation date of February 8, 2010.

Questions regarding this Notice should be directed to:

- Adam Arkel, Assistant General Counsel, Office of General Counsel (OGC), at (202) 728-6961 (regarding FINRA Rule 2251);
- ➤ Lisa Horrigan, Associate General Counsel, OGC, at (202) 728-8190 (regarding FINRA Rule 5290);
- ➤ Stan Macel, Assistant General Counsel, OGC, at (202) 728-8056 (regarding FINRA Rules 2130 and 2270);
- Racquel Russell, Assistant General Counsel, OGC, at (202) 728-8363 (regarding FINRA Rules 5210 and 5220);

December 2009

Notice Type

- Consolidated Rulebook
- Rule Approval

Suggested Routing

- ➤ Compliance
- ➤ Legal
- Operations
- > Senior Management

Key Topics

- Approval Procedures for Day-Trading Accounts
- Day-Trading Risk Disclosure Statement
- Forwarding of Proxy and Other Issuer-Related Materials
- Members' Responsibilities Regarding Deferred Variable Annuities
- ➤ Offers at Stated Prices
- ➤ Order Entry and Execution Practices
- Publication of Transactions and Quotations
- Use of Information Obtained in Fiduciary Capacity

Referenced Rules & Notices

- ➤ FINRA Rule 2060
- ➤ FINRA Rule 2130
- ➤ FINRA Rule 2251
- ➤ FINRA Rule 2270
- ➤ FINRA Rule 2330
- ➤ FINRA Rule 5210
- ➤ FINRA Rule 5220
- ➤ FINRA Rule 5290
- ➤ Information Notice 03/12/08
- ➤ Information Notice 10/06/08
- Regulatory Notice 08-57



- ➤ Matthew Vitek, Counsel, OGC, at (202) 728-6961 (regarding FINRA Rule 2060); or
- ➤ Jim Wrona, Associate Vice President & Associate General Counsel, OGC, at (202) 728-8270 (regarding FINRA Rule 2330).

Background & Discussion

In October and November 2009, the SEC approved eight FINRA rules as part of the Consolidated FINRA Rulebook:

- Rule 2060 (Use of Information Obtained in Fiduciary Capacity);⁴
- Rule 2130 (Approval Procedures for Day-Trading Accounts);⁵ >
- ➤ Rule 2251 (Forwarding of Proxy and Other Issuer-Related Materials);⁶
- Rule 2270 (Day-Trading Risk Disclosure Statement);7
- Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities);8
- Rule 5210 (Publication of Transactions and Quotations);⁹
- Rule 5220 (Offers at Stated Prices);¹⁰ and
- Rule 5290 (Order Entry and Execution Practices). 11

The attachment to this Notice sets forth additional information regarding these new consolidated rules and includes a hyperlink to each related rule filing. The filings provide, among other things, FINRA's statement of the purpose of the rule changes and an exhibit showing the changes between the new rule text and the text of the NASD rule as it exists in the Transitional Rulebook. Also, the text of each new FINRA Rule is available in the online FINRA Manual at www.finra.org/finramanual.12

Rule Conversion Chart

As discussed in additional detail in *Information Notice* 10/06/08 and *Regulatory Notice* 08-57, FINRA has posted three Rule Conversion Charts on its Web site to help firms become familiar with the new rules and show how the new rules relate to the NASD and/or Incorporated NYSE Rules in the Transitional Rulebook that they will replace.

Firms should be aware that the charts are intended as a reference aid only. FINRA reminds firms that the charts do not in any way serve as a substitute for diligent review of the relevant new rule language. The Rule Conversion Charts are located at www.finra.org/ruleconversionchart.

Endnotes

- See Information Notice 10/06/08 (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart); see also Information Notice 03/12/08 (Rulebook Consolidation Process).
- 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 new FINRA Rules apply to all member firms, unless such rules have a more limited application by their terms. As the Consolidated FINRA Rulebook expands with the SEC's approval and with the new FINRA Rules taking effect, the rules in the Transitional Rulebook that address the same subject matter of regulation will be eliminated. When the Consolidated FINRA Rulebook is completed, the Transitional Rulebook will have been eliminated in its entirety.
- FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) was filed for immediate effectiveness pursuant to Section 19(b)(3)(A) of the Exchange Act. See discussion of FINRA Rule 2330 in Attachment A.

- 4 See Exchange Act Release No. 61071 (November 30, 2009); 74 FR 64109 (December 7, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-067).
- 5 See Exchange Act Release No. 61059 (November 24, 2009); 74 FR 62847 (December 1, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-059).
- 6 See Exchange Act Release No. 61052 (November 23, 2009); 74 FR 62857 (December 1, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-066).
- 7 See supra note 4.
- 8 See Exchange Act Release No. 61122 (December 7, 2009); 74 FR 65816 (December 11, 2009) (Notice of Filing and Immediate Effective of Proposed Rule Change; File No. SR-FINRA-2009-083).
- 9 See Exchange Act Release No. 60835 (October 16, 2009); 74 FR 54616 (October 22, 2009) (Order Approving Proposed Rule Change; File No. SR-FINRA- 2009-055).
- 10 See supra note 8.
- 11 See supra note 3.
- 12 FINRA updates the rule text on its online Manual within two business days of SEC approval of changes to the rule text.

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Attachment A

List of Approved Rules (and Related Rule Filings)

The SEC approved the following new FINRA rules in October and November 2009. The effective date of all of the rules is February 15, 2010, except for Rule 2330 which has an implementation date of February 8, 2010.

FINRA Rule Filing SR-FINRA-2009-055

www.finra.org/rulefilings/2009-055

FINRA Rule 5210

The rule change adopts, without material change, NASD Rule 3310 (Publication of Transactions and Quotations) and NASD IM-3310 (Manipulative and Deceptive Quotations) as FINRA Rule 5210 (Publication of Transactions and Quotations) in the Consolidated FINRA Rulebook.

FINRA Rule 5210 prohibits members from publishing or circulating, or causing to be published or circulated, any communication that purports to report any transaction as a purchase or sale of any security, unless such member believes that such transaction was a bona fide purchase or sale of such security. The rule also prohibits members from publishing or circulating, or causing to be published or circulated, any communication that purports to quote the bid price or asked price for any security, unless the member believes that such quotation represents a bona fide bid for, or offer of, such security.

Supplementary material to FINRA Rule 5210 provides that it would be inconsistent with FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices) and 5210 (Publication of Transactions and Ouotations) for a member to publish or circulate or cause to be published or circulated, by any means whatsoever (1) any report of any securities transaction or of any purchase or sale of any security unless such member knows or has reason to believe that such transaction was a bona fide transaction, purchase or sale, or (2) any quotation for any security without having reasonable cause to believe that such quotation is a bona fide quotation, is not fictitious and is not published or circulated or caused to be published or circulated for any fraudulent, deceptive or manipulative purpose.

As further addressed in Notice to Members (NTM) 04-66, FINRA reminds members of their obligations under NASD Rule 3010 (Supervision) to have in place a supervisory system and written supervisory procedures reasonably designed to ensure that such orders placed into trading systems are not entered in error or in a manner inconsistent with FINRA rules, including NASD Rule 5210 (Publication of Transactions and Quotations).

FINRA Rule 5220

The rule change adopts, without material change, NASD Rule 3320 (Offers at Stated Prices) and NASD IM-3320 (Firmness of Quotations) as FINRA Rule 5220 (Offers at Stated Prices) in the Consolidated FINRA Rulebook.

FINRA Rule 5220 provides that no member shall make an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell.

Supplementary material to FINRA Rule 5220 provides that it shall be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade if a member "backs away" from its quotation. Rule 5220 recognizes that members change inter-dealer quotations constantly in the course of trading, but under normal circumstances where the member is making a firm trading market in any security, it is expected at least to buy or sell a normal unit of trading in the quoted stock at its then-prevailing quotations, unless clearly designated as "not firm" or "firm for less than a normal unit of trading" when supplied by the member. The supplementary material further provides that, if at the time an order for the purchase or sale of the quoted security is presented, the member is in the process of effecting a transaction in such quoted security, and immediately after the completion of such transaction, communicates a revised quotation size, such member shall not be obligated to purchase or sell the quoted security in an amount greater than such revised quotation size.

Rule/Series Number	Rule Title
Rule 5000 Series	SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES
Rule 5200 Series	QUOTATION AND TRADING OBLIGATIONS AND PRACTICES
Rule 5210	Publication of Transactions and Quotations
Rule 5220	Offers at Stated Prices

FINRA Rule Filing SR-FINRA-2009-059

www.finra.org/rulefilings/2009-059

FINRA Rules 2130 and 2270

The rule change adopts, with certain modifications, NASD Rule 2360 (Approval Procedures for Day-Trading Accounts) as FINRA Rule 2130 (Approval Procedures for Day-Trading Accounts); and NASD Rule 2361 (Day-Trading Risk Disclosure Statement) as FINRA Rule 2270 (Day-Trading Risk Disclosure Statement).

FINRA Rules 2130 and 2270 focus on members' obligations to disclose to non-institutional customers the basic risks of engaging in a day-trading strategy and to assess the appropriateness of day-trading strategies for such customers. FINRA Rule 2130 creates an obligation on members that promote a day-trading strategy regarding account-opening approval procedures for non-institutional customers. FINRA Rule 2270 creates an obligation on such members to disclose to non-institutional customers the unique risks of engaging in a day-trading strategy.

The rule change made minor changes to the previous NASD rules. These changes included adding supplementary materials to clarify the concept of promoting a day-trading strategy based on previous guidance; to codify the process by which a member may submit advertising materials to FINRA's Advertising Department for review and guidance; and to alert members of additional FINRA rules specifically addressing day-trading.

Rule/Series Number	Rule Title
Rule 2000 Series	DUTIES AND CONFLICTS
Rule 2100 Series	TRANSACTIONS WITH CUSTOMERS
Rule 2130	Approval Procedures for Day-Trading Accounts
Rule 2200 Series	COMMUNICATIONS AND DISCLOSURES
Rule 2260 Series	DISCLOSURES
Rule 2270	Day-Trading Risk Disclosure Statement

FINRA Rule Filing SR-FINRA-2009-066

www.finra.org/rulefilings/2009-066

FINRA Rule 2251

The rule change adopts, without material change, NASD Rule 2260 (Forwarding of Proxy and Other Materials) and NASD IM-2260 (Approved Rates of Reimbursement) as FINRA Rule 2251 (Forwarding of Proxy and Other Issuer-Related Materials) in the Consolidated FINRA Rulebook. The rule change makes minor clarifying changes and other changes primarily to reflect the new formatting and terminology conventions of the Consolidated FINRA Rulebook.

FINRA Rule 2251 sets forth certain requirements with respect to the transmission of proxy materials and other communications to beneficial owners of securities and the limited circumstances in which members are permitted to vote proxies without instructions from those beneficial owners. The rule generally requires that a member must, in connection with an equity security, forward promptly or, in connection with a debt security, make reasonable efforts to forward promptly certain information to the beneficial owner, or the beneficial owner's designated investor adviser, if the member carries the account in which the security is held for the beneficial owner and the security is registered in a name other than the name of the beneficial owner. The rule prohibits a member from giving a proxy to vote stock that is registered in its name, unless the member is the beneficial owner of the stock. (The rule sets forth certain exceptions. For example, FINRA Rule 2251(c)(2) provides that a member may give a proxy to vote any stock pursuant to the rules of any national securities exchange of which it is a member provided that the records of the member clearly indicate the procedure it is following.)

The supplementary material to FINRA Rule 2251 regulates the reimbursement that members are entitled to receive in connection with forwarding proxy materials and other communications.

Rule/Series Number	Rule Title
Rule 2200 Series	COMMUNICATIONS AND DISCLOSURES
Rule 2250 Series	PROXY MATERIALS
Rule 2251	Forwarding of Proxy and Other Issuer-Related Materials

FINRA Rule Filing SR-FINRA-2009-067

www.finra.org/rulefilings/2009-067

FINRA Rule 2060

The rule change adopts, without material change, NASD Rule 3120 (Use of Information Obtained in Fiduciary Capacity) as FINRA Rule 2060 (Use of Information Obtained in Fiduciary Capacity); and NASD Rule 3380 (Order Entry and Execution Practices) as FINRA Rule 5290 (Order Entry and Execution Practices).

FINRA Rule 2060 provides that a member that receives information as to the ownership of securities while acting in the capacity of paying agent, transfer agent, trustee or otherwise shall under no circumstances make use of the information for soliciting purchases, sales or exchanges except at the request and on behalf of the issuer.

FINRA Rule 5290

FINRA Rule 5290 prohibits members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. This is commonly also referred to as "trade shredding," which is the unlawful practice of splitting customer orders for securities into multiple smaller orders for the primary purpose of maximizing payments or rebates to the member.

Rule/Series Number	Rule Title
Rule 2000 Series	DUTIES AND CONFLICTS
Rule 2060	Use of Information Obtained in Fiduciary Capacity
Rule 5000 Series	SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES
Rule 5200 Series	QUOTATION AND TRADING OBLIGATIONS AND PRACTICES
Rule 5290	Order Entry and Execution Practices

FINRA Rule Filing SR-FINRA-2009-083

www.finra.org/rulefilings/2009-083

The rule change—which FINRA filed with the SEC for immediate effectiveness on November 20, 2009, with an implementation date of February 8, 2010—adopts (without material change) NASD Rule 2821 (Members' Responsibilities Regarding Deferred Variable Annuities) as FINRA Rule 2330 (Members' Responsibilities Regarding Deferred Variable Annuities) in the Consolidated FINRA Rulebook. FINRA Rule 2330 establishes sales practice standards for recommended purchases and exchanges of deferred variable annuities. The rule has six main sections. First, it addresses general considerations, such as the rule's applicability. Second, the rule has requirements governing broker recommendations, including suitability and disclosure obligations. Third, the rule includes various principal review and approval obligations. Fourth, the rule requires members to establish and maintain supervisory procedures reasonably designed to achieve compliance with the standards set forth in the rule. Fifth, the rule has a training component. And sixth, the rule has a supplementary material section that addresses a variety of issues, ranging from the handling of customer funds and checks to information gathering and sharing.

Rule/Series Number	Rule Title
Rule 2000 Series	DUTIES AND CONFLICTS
Rule 2300 Series	SPECIAL PRODUCTS
Rule 2330	Members' Responsibilities Regarding Deferred Variable Annuities

Regulatory Notice

09-73

Principal-Protected Notes

FINRA Reminds Firms of Their Sales Practice Obligations Relating to Principal-Protected Notes

Executive Summary

The retail market for principal-protected notes (PPNs) has grown in recent years, in part because they are often marketed as combining the relative safety of bonds with a potential for growth not available with traditional fixed income products.¹ However, these products are not risk-free, and their terms and structures can be complex. Firms must ensure that their promotional materials or communications to the public regarding these products are fair and balanced, and do not overstate either the level of protection offered or an investment's potential returns. Firms also have a duty to ensure that their registered representatives understand the risks, terms and costs associated with these products, and that they perform an adequate suitability analysis before recommending them to a customer.

Questions concerning this *Notice* should be directed to the Office of Emerging Regulatory Issues at (202) 728-8472.

Background and Discussion

PPNs typically combine a zero-coupon bond with an option or other derivative product whose payoff is linked to an underlying asset, such as an equities index or basket of indices. The investor is guaranteed the return of some or all principal at a set maturity date—typically ranging up to ten years from issuance—and also is entitled to participate in a return that is linked to a specified change in the value of the underlying asset.

PPNs sold to retail investors often have reassuring names that include some variant of "principal protection," "capital guarantee," "absolute return," "minimum return" or similar terms. However, they are not without risk. Most importantly, the principal guarantee is subject to the creditworthiness of the guarantor. In addition, principal protection levels can vary. While some products guarantee 100 percent return of principal,

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Notice Type

➤ Guidance

Suggested Routing

- Advertising
- Compliance
- Legal
- Senior Management

Key Topics

- Communications With the Public
- Principal-Protected Notes
- Structured Products
- Suitability
- Training

Referenced Rules & Notices

- NASD Rule 2210
- NASD Rule 2310
- ➤ NTM 05-26
- ➤ NTM 05-59



others guarantee as little as 10 percent. In most cases, the principal guarantee only applies to notes that are held to maturity. Issuers may (but are not obligated to) provide a secondary market for certain notes but, depending on demand, the notes may trade at significant discounts to their purchase price and might not return all of the guaranteed amount.

Some PPNs have complicated pay-out structures that can make it hard for registered representatives and their customers to accurately assess their risk and potential for growth. For example,² a PPN that guarantees a 10 percent return of principal might be structured so that, if at any time up to and including the maturity date, the underlying index gains by more than 40 percent, the payout at maturity would be as follows:

If the underlying index's return is	then the note's return is	so the note investor gets	Examples
A gain of more than 40%	10%	110% of principal returned	Index rises to 160% of its initial level prior to the maturity date and ultimately finishes at 160% of its initial level; note returns 110% of principal. Index rises to 150% of its initial level prior to the maturity date but ultimately finishes at 80% of its initial level; note returns 110% of principal.

However, if the underlying index does not gain by more than 40 percent at any time during the life of the note, then the payout would be as follows:

If the underlying index's return is	then the note's return is	so the note investor gets	Examples
A loss of more than 10%	The underlying index return + 10%	From 10% up to (but not including) 100% of principal returned	Index loses 100% as of the maturity date; note loses 90% (<i>i.e.</i> , returns 10% of principal). Index loses 50% as of the maturity date; note loses 40% (<i>i.e.</i> , returns 60% of principal).
A loss of more than 10%	0%	100% of principal returned	Index loses 2% as of the maturity date; note returns 100% of principal. Index loses 10% as of the maturity date; note returns 100% of principal.
A loss of more than 10%	0%	100% of principal returned	
A gain of up to 40%	The underlying index return	More than 100% up to (and including) 140% of principal returned	Index rises 35% as of the maturity date; note gains 35% (<i>i.e.</i> , returns 135% of principal).

In another example, a PPN that offers 100 percent principal protection and is linked to the spread between the 30-year and two-year constant maturity swap rates (capturing any widening of the yield curve between long-term rates and short-term rates) might be structured so that in the first year, the note pays the investor a fixed coupon of 10 percent, regardless of the spread:

If the spread between the 30-year and two-year constant maturity swap rates is	then the note's return is	so the note investor gets	Example
Any	10% for that year	10% after one year, paid as a coupon	Regardless of the spread, the note investor receives a coupon of 10% at the end of the first year.

However, after the first year:

If the spread between the 30-year and two-year constant maturity swap rates is	then the note's return is	so the note investor gets	Examples
Always less than 70 basis points during the year	0% for that year	No coupon payment for that year	Spread fluctuates but is always less than 40 basis points during the year; no coupon is paid.
Greater than 70 basis points on N% of the days in the year (on at least one day but not all days during the year)	10% multiplied by <i>N%</i> for that year	More than 0% but less than 10% for that year, paid as a coupon	Spread exceeds 70 basis points on half of the days during the year; 5% coupon is paid.
Always greater than 70 basis points during the year	10% for that year	10% for that year, paid as a coupon	Spread fluctuates but always exceeds 80 basis points during the year; 10% coupon is paid.

PPNs are also linked to a wide variety of assets or benchmarks, including foreign equity indices, currencies, foreign exchange rates, commodities, spreads between interest rates and "hybrid" baskets of various asset types. For example, a note might be based on the performance of an equally weighted basket comprised of the Russell 2000, Dow Jones U.S. Real Estate Index Exchange Traded Fund, the Brazilian Real-U.S. Dollar exchange rate and the price of copper.

Communications With the Public

Under NASD Rule 2210, all communications with the public, including advertisements and public appearances regarding PPNs, must present a fair and balanced picture regarding both their risks and potential benefits. Rule 2210 also prohibits exaggerated, unwarranted or misleading statements and the omission of any material fact or qualification that would cause a communication to be misleading.

Therefore, in marketing or describing a product as offering principal protection, firms must ensure that their communications accurately and fairly explain how the securities operate. For example, firms must not overstate either the level of protection offered or the investment's potential for growth. Promotional materials must be balanced, with appropriate disclosures concerning, among other things:

- the level of principal protection offered;
- the credit-worthiness of the guarantor;
- the potential returns and pay-out structure (including any limits on upside potential);
- the investor's ability to access funds pending maturity date or the expiration of a lock-up period; and
- > any costs or fees that might affect the return of principal.

Moreover, sales materials and oral presentations that omit a description of the derivative component of a product and instead present such products as ordinary debt securities could violate Rule 2210. Firms should also be careful to balance any statements concerning the fact that a structured product has a ticker symbol or has been approved for listing on an exchange with the risks that an active and liquid trading market may not develop. Firms are further reminded that providing risk disclosure in a prospectus supplement does not cure otherwise deficient disclosure in sales material, even if such sales material is accompanied or preceded by the prospectus supplement.

Suitability

NASD Rule 2310 requires that, before recommending the purchase or sale of a security, firms must have a reasonable basis for determining that the product is suitable for at least some investors. To make this determination, firms must perform adequate due diligence, which includes carefully reviewing and understanding the risks, costs, terms and conditions of the product being offered. Rule 2310 also requires that, before executing a recommended transaction, a firm must make reasonable efforts to obtain information concerning the customer's financial status, tax status, investment objectives and "such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer."

Therefore, before recommending a PPN, firms must review its suitability, both generally and for specific customers. Among other things, firms should consider the creditworthiness of the guarantor in assessing the suitability of products offering full or partial principal protection. Firms should also fully understand the nature and terms of the principal guarantee, as well as the investment's pay-out structure, costs and fees.

If the investment is designed to be held until maturity or involves significant lock-up periods, firms should consider the likelihood that the customer will need to access their money before the maturity date arrives or the lock-up period expires. Firms should also understand and consider the call risk associated with any callable notes. There also may be tax consequences that can affect whether the notes are suitable for a specific customer. For example, unless a fund invested in zero-coupon bonds is held in a tax-deferred retirement account, investors may have to pay U.S. income tax yearly on the imputed interest from the fund's zero-coupon bond holdings as it accrues. This may be true even if no actual cash distributions are paid into the account from the zero-coupon bonds held in the fund's portfolio.

Depending on their structure and terms, some PPNs can involve high fees and hidden costs. In addition, investors may be sacrificing higher yield to obtain the principal guarantee. It is also important to note that the principal guarantee generally relates to nominal principal and does not offer inflation protection. While investors may be willing to absorb these costs in exchange for the security provided by principal-protected products, firms should nonetheless take them into account when assessing their general and customer-specific suitability.

Given the similarity between options and the derivative components of some PPNs, firms should also consider whether purchases of certain notes that guarantee only a limited return of principal should be restricted to investors whose accounts have been approved for options trading, and whether it would be appropriate to apply the suitability requirements for options trading to those products.³ Firms that do not limit purchases of structured products in which investors' principal is at risk from market movements in the reference security to accounts approved for options trading should develop other comparable procedures designed to ensure that structured products are only sold to persons for whom the risk of such products is appropriate. These firms should be prepared to demonstrate the basis for allowing investors with accounts not approved for trading options to purchase structured products.

In addition, NASD IM-2310-2(e) (Fair Dealing with Customers with Regard to Derivative Products or New Financial Products) emphasizes firms' obligations to deal fairly with customers when making recommendations or accepting orders for new financial products. The IM states that "[a]s new products are introduced from time to time, it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products."

Training

Firms must train registered persons about the characteristics, risks and rewards of each product before they allow registered persons to recommend that product to investors. Likewise, firms should train registered persons about the factors that would make such products either suitable or unsuitable for certain investors. In the case of PPNs, that training should emphasize the need to understand and consider:

- ➤ the risks associated with such products, including the credit-worthiness of the guarantor;
- ➤ the terms and conditions, including the pay-out structure;
- the underlying index, asset or benchmark;
- the investment's potential for growth;
- ➤ the fee structure; and
- any other features that might impact the product's suitability, both generally and for a specific customer.

Endnotes

- As used in this *Notice*, the terms "principalprotected note" and "PPN" refer to any structured product that combines a bond with a derivative component and that guarantees a full or partial return of principal at maturity.
- 2 The examples in this Notice are hypothetical composites based on terms and structures of real notes, and are included for illustrative purposes only.
- 3 See Notice to Members (NTM) 05-59. Also see NTM 05-26 regarding vetting new products.

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Regulatory Notice

09-74

Arbitration Rules

SEC Approves Changes to Arbitration Rules on Definition of Associated Person, Distribution of the FINRA Discovery Guide and Applicability of Hearing Session Fees

Effective Date: January 18, 2010

Executive Summary

Effective January 18, 2010, amendments to the Customer and Industry Codes of Arbitration:

- clarify the definition of "associated person" and make it conform to the same term in the FINRA By-Laws;
- streamline a case administration procedure; and
- clarify that customers could be assessed hearing session fees based on their own claims for relief in connection with an industry claim.¹

The amendments will apply to claims filed on or after the effective date. The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- Kenneth L. Andrichik, Senior Vice President, Chief Counsel and Director of Mediation and Strategy, Dispute Resolution (DR), at (212) 858-3915 or ken.andrichik@finra.org; or
- Mignon McLemore, Assistant Chief Counsel, DR, at (202) 728-8151 or mignon.mclemore@finra.org.

December 2009

Notice Type

Rule Amendment

Suggested Routing

- Compliance
- ➤ Legal
- ➤ Senior Management

Key Topic(s)

- Arbitration
- Associated Persons
- Discovery Guide
- ➤ Fees

Referenced Rules & Notices

- ➤ FINRA Rule 12100(r)
- ➤ FINRA Rule 12506(a)
- ➤ FINRA Rule 12902(a)
- ➤ FINRA Rule 13100(r)



Background and Discussion

The SEC has approved a proposal to amend FINRA Rules 12100(r), 12506(a) and 12902(a) of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Rule 13100(r) of the Code of Arbitration Procedure for Industry Disputes (Industry Code) regarding the definition of "associated person," the distribution of the FINRA Discovery Guide and the applicability of hearing session fees. Each amendment is discussed below.

Definition of "Person Associated with a Member"

FINRA has amended the definition of "person associated with a member" under the Customer and Industry Codes to make it conform to the definition of the same term in FINRA's By-Laws.

The definition of a "person associated with a member" under Rule 12100(r) of the Customer Code and Rule 13100(r) of the Industry Code is similar to the definition in FINRA's By-Laws,² with two exceptions.³ First, the current definition of associated person under the Codes could be interpreted to include corporate entities.⁴ Thus, FINRA has amended the definition to insert the word "other" before the second reference to "natural person" to clarify that the definition does not include corporate entities.

Second, the current definition of an associated person under the Codes does not pertain to individuals who have applied for registration with FINRA. Thus, FINRA has amended the definition to expand the forum's jurisdiction to natural persons who have applied for registration. FINRA's By-Laws make it clear that individuals who have signed and submitted a Form U4 are subject to FINRA's rules. 5 This conforming change to the Codes will ensure that such individuals also will be required to arbitrate a dispute that arises while they are awaiting their licenses.

Distribution of the FINRA Discovery Guide

During the arbitration process, parties can request the discovery of documents, names of witnesses and other information from each other to prepare their cases for the hearing. To help parties understand what information they should disclose, FINRA automatically provides a copy of the FINRA Discovery Guide⁶ to parties when it serves the statement of claim.7

In light of the availability of Dispute Resolution forms, guides and the claim filing system on FINRA's Web site, FINRA believes that it is no longer necessary to distribute automatically a printed Discovery Guide to parties when they file a claim. Thus, FINRA has amended Rule 12506 to state that, when FINRA serves the statement of claim, it will notify parties of the location of the Discovery Guide (which includes the Document Production Lists) on FINRA's Web site, but will not provide a printed copy except upon request.

Applicability of Hearing Session Fees

On January 24, 2007, the SEC approved the "Code Revision," which reorganized the old Code of Arbitration Procedure (old Code) into three separate procedural codes: the Customer Code, the Industry Code and the Mediation Code. The Code Revision simplified the language of the old Code, codified current dispute resolution practices and implemented several substantive changes to dispute resolution rules.

Under the old Code, arbitrators could allocate hearing session fees against any party.9 Rule 10332(c)¹⁰ of the old Code protected customers from potentially higher forum fees (now hearing session fees) triggered by amounts sought in industry claims by prohibiting the arbitrators from assessing forum fees against customers if the industry claim was dismissed. Moreover, the rule protected customers from higher forum fees by requiring that the amount of the forum fees be based on the amount awarded to an industry party and not on the amount of damages requested by the industry claim. However, Rule 10332(c) also provided that customers could be subject to potential forum fees based on their own claims for relief in connection with the industry claim.

During the drafting of the Code Revision, FINRA inadvertently omitted from the corresponding rule in the Customer Code¹¹ the provision (in old Rule 10332(c)) that permitted the forum to assess fees against the customer based on the customer's claim in an industry dispute. Thus, FINRA has amended Rule 12902(a)(4) to incorporate the omitted language, which makes it clear to customers that if they file a claim in connection with a claim filed by a firm, they may be subject to filing fees and hearing session fees based on their own claim for relief.

Effective Date Provisions

The amendments will become effective January 18, 2010, and will apply to claims filed on or after that date.

Endnotes

- Exchange Act Release No. 60878 (Oct. 26, 2009), 74 Federal Register 56679 (Nov. 2, 2009) (File No. SR-FINRA-2009-041).
- 2 See By-Laws of Corporation, Article I, Definitions (rr).
- 3 The reference to Procedural Rule 8210 in the By-Law definition would not apply to FINRA's dispute resolution forum and, therefore, has not been added to the Code definitions.
- 4 See Rule 12100(r)(2) of the Customer Code and Rule 13100(r)(2) of the Industry Code.
- Note ii. *See also Notice to Members (NTM)* 99-95 (November 1999).
- The Discovery Guide provides parties in customer cases with guidance on which documents they should exchange without arbitrator or staff intervention (called Document Production Lists) and provides guidance to arbitrators in determining which documents parties are presumptively required to produce. The Discovery Guide was approved by the SEC and was made available for use in arbitration proceedings involving customer disputes upon the publication of NTM 99-90 (November 1999).
- 7 See Rule 12506 of the Customer Code.
- See Securities Exchange Act Release No. 55158 (January 24, 2007); 72 FR 4574 (January 31, 2007) (File Nos. SR-NASD-2003-158 and SR-NASD-2004-011).

- If the parties and arbitrators meet in connection with an arbitration proceeding, the meeting is called a "hearing session." FINRA charges the parties a fee for each hearing session; the fee is based on the amount in dispute. See Rule 12902(a)(1).
- 10 Rule 10332(c) of the old Code stated, in relevant part, that "no fees shall be assessed against a customer in connection with an industry claim that is dismissed; however, in cases where there is also a customer claim, the customer may be assessed forum fees based on the customer claim."
- 11 For example, if a firm filed a claim against a customer, and the arbitrators dismissed the claim, the customer would not be assessed any forum fees. However, if, in connection with the industry claim, the customer filed a counterclaim against the firm, the customer would be subject to potential forum fees based on the customer's own claim for relief.
- 12 See Rule 12902(a)(4).

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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. Definitions

(r) Person Associated with a Member

The term "person associated with a member" means:

- (1) A natural person <u>who is</u> registered <u>or has applied for registration</u> under the Rules of FINRA; or
- (2) A sole proprietor, partner, officer, director, or branch manager of a member, or [a] <u>other</u> natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA.

12506. Document Production Lists

(a) Applicability of Document Production Lists

When the Director serves the statement of claim, the Director will [provide] notify parties of the location of the FINRA Discovery Guide and Document Production Lists on FINRA's Web site, but will provide a copy to the parties upon request. Document Production Lists 1 and 2 describe the documents that are presumed to be discoverable in all arbitrations between a customer and a member or associated person. Other Document Production Lists may also apply, depending on the specific cause(s) of action alleged.

(b) - (c) No change.

* * * *

Regulatory Notice

12902. Hearing Session Fees, and Other Costs and Expenses

- (a) Hearing Session Fees
 - (1) (3) No change.
- (4) If hearing session fees are allocated against a customer in connection with a claim filed by a member or associated person, the amount of hearing session fees the customer must pay must be based on the amount actually awarded to the member or associated person, rather than on the amount claimed by the member or associated person. No hearing session fees may be assessed against a customer in connection with a claim filed by a member that is dismissed; however, in cases where there is also a customer claim, the customer may be assessed a filing fee under Rule 12900(a), and may be subject to hearing session fees.
- **(b) (e)** No change.

Industry Code

13100. Definitions

(r) Person Associated with a Member

The term "person associated with a member" means:

- (1) A natural person who is registered or has applied for registration under the Rules of FINRA; or
- (2) A sole proprietor, partner, officer, director, or branch manager of a member, or [a] other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA.

Election Notice

District Elections

Upcoming District Committee and District Nominating Committee Elections

Executive Summary

The purpose of this *Election Notice* is to notify member firms of the upcoming nomination and election process to fill forthcoming vacancies on FINRA District Committees and District Nominating Committees.

The current District Committee and District Nominating Committee members are included in Attachment A. Information on District Election procedures is included in Attachment B. A candidate profile form is available online at www.finra.org/Notices/Election/121109 and as Attachment C of this Notice.

Note: This *Notice* was distributed electronically only to the Executive Representative of each FINRA member firm and it is posted on FINRA's Web site. Executive Representatives should circulate this Notice to their firm's branch managers.

Questions concerning this *Election Notice* may be directed to:

- The appropriate District Director;
- Marcia Asquith, Senior Vice President and Corporate Secretary, at (202) 728-8949 or via email to CorporateSecretary@finra.org.

December 11, 2009

Suggested Routing

- Branch Managers
- Executive Representatives
- > Senior Management



Background

The FINRA District Committees serve an important role in the self-regulatory process by, among other things:

- alerting FINRA to industry trends that could present regulatory concerns;
- consulting with FINRA on proposed policies and rule changes; and
- serving on disciplinary panels in accordance with FINRA rules.

Committee members must have the experience, ability and commitment to fulfill these responsibilities, including:

- understanding the issues facing the securities industry and possessing the ability to apply knowledge and expertise to these issues to develop solutions;
- educating firms in their District on the responsibilities of FINRA;
- attending regularly and participating in a collegial manner in District Committee meetings; and
- remaining objective and unbiased in the performance of District Committee matters.

Committee members must also adhere to the following prohibitions and restrictions:

- refraining from serving as an expert witness in FINRA disciplinary hearings or arbitrations;
- being sensitive to conflicts, and refraining from participating in a particular matter when a conflict exists;
- refraining from using membership on the District Committee for commercial purposes, or otherwise suggesting special access to FINRA; and
- > keeping sensitive, non-public or proprietary information confidential.

Vacancies and Terms

In this election, the District Committees for Districts 2, 3, 4, 5, 7, 8, 9 and 11 each have three positions to fill; the District Committee for District 6 has four positions to fill; the District Committee for District 1 has five positions to fill; and the District Committee for District 10 has six positions to fill.¹ The term of office for District Committee members is three years unless elected to complete an existing term. Additionally, each District Nominating Committee will have five vacancies to fill for one-year terms.

The three-year terms for District Committee members and one-year terms for District Nominating Committee members rotate on a June 1 to May 31 annual cycle. Terms of the individuals elected during this election will begin on June 1, 2010.²

Nomination Process

Individuals from firms of all sizes and segments of the industry are encouraged to submit names for consideration for membership on the eleven (11) District Committees and District Nominating Committees.

Individuals who are interested in serving on the District Committee or the District Nominating Committee within their district must complete a candidate profile form³ and submit it by email, facsimile, mail, courier service or hand delivery to the appropriate District Director. Completed candidate profile forms must be received by the District Director on or before **December 31, 2009**. Candidate profile forms received after this date will not be considered. FINRA encourages current and former committee members to assist FINRA by soliciting candidates for both committees.

Article VIII, Sections 8.2 and 8.9 of the By-Laws of FINRA Regulation establish formal eligibility requirements for members of the District Committees and District Nominating Committees respectively. They provide that such members:

- 1) be registered with a FINRA member firm eligible to vote in the district for District Committee elections; and
- work primarily from such FINRA member firm's principal office or a branch office that is located within the district where the member serves on a District Committee or District Nominating Committee.

Completed candidate profile forms that are received by **December 31, 2009**, will be provided to all appropriate District Nominating Committee members for review. FINRA anticipates that on or before **January 29, 2010**, each District Director, acting on behalf of the District Nominating Committee, will notify FINRA's Corporate Secretary of each candidate nominated by the District Nominating Committee and the committee to which the candidate is nominated.

Firm Contact Information

Firms are reminded of the importance of accurately maintaining their Executive Representative's name and email address information, and their firm's main postal address, in FINRA's records. This will ensure that mailings, such as election information, are properly directed. Failure to keep this information accurate may jeopardize the member firm's ability to participate in District elections as well as other votes.

Pursuant to NASD Rule 1160, firms must update their contact information promptly, but in any event not later than 30 days following any change in such information, as well as review and, if necessary, update the information within 17 business days after the end of each calendar year. Additionally, firms must comply with any FINRA request for such information promptly, but in any event not later than 15 days following the request, or such longer period that may be agreed to by FINRA staff.⁴

To update an Executive Representative's name and contact information, firms should access the FINRA Contact System (FCS), located on FINRA's Web site at www.finra.org/fcs. For assistance updating FCS, you may contact our Call Center at (301) 590-6500.

Endnotes

- In some cases, a District Committee may have positions to fill if a member of the District Committee has resigned since the last election, as indicated in Attachment A.
- Due to the Consolidation of NASD and the member regulation functions of the New York Stock Exchange during 2007, the District Committee and District Nominating Committee election calendar was delayed by six months.
- A candidate profile form is available online at www.finra.org/Notices/Election/121109 and as Attachment C of this Notice.
- 4 See NASD Rule 1160 and Regulatory Notice 07-42 (September 2007).

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Attachment A—District Committee and District Nominating Committee Lists

Expiring and vacant positions are highlighted.

District 1

Northern California (the counties of Monterey, San Benito, Fresno and Inyo, and the remainder of the state north or west of such counties), northern Nevada (the counties of Esmeralda and Nye, and the remainder of the state north or west of such counties) and Hawaii

Christian A. Zrull, District Director

One Montgomery Street, Suite 2100, San Francisco, CA 94104 (415) 217-1100 Christian.Zrull@finra.org fax (415) 956-1931

District Committee for District 1—Chair: James H. Williams

- ➤ Committee members to be elected to terms expiring May 31, 2013: 3
- ➤ Committee member to be elected to a term expiring May 31, 2012: 1
- ➤ Committee member to be elected to a term expiring May 31, 2011: 1

Committee Members to Serve Until May 31, 2010

Robert Angle	White Pacific Securities, Inc.	San Francisco, CA
Leonard Berry	Backstrom McCarley Berry & Co. LLC	San Francisco, CA
James H. Williams	Financial Telesis, Inc.	San Rafael, CA

Committee Members to Serve Until May 31, 2011

Step	hen H. Chipman	Foo	othill Securities, Inc.	Mountain View, CA
Phili	o J. Economopoul	os Ho	owe Barnes Hoefer & Arnett, Inc.	San Francisco, CA

VACANT*

Committee Members to Serve Until May 31, 2012

Nancy A. Mullally	Alamo Capital	Walnut Creek, CA
Robert J. Zamecki	Lighthouse Capital Corporation	Monterey, CA

VACANT*

District Nominating Committee for District 1—Chair: Kevin T. Kitchin

Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Kevin T. Kitchin	Wells Fargo Advisors, LLC	San Francisco, CA
Bruce W. Nollenberger	Nollenberger Capital Partners, Inc.	San Francisco, CA
Daniel W. Roberts	Roberts & Ryan Investments Inc.	San Francisco, CA
Francis X. Roche, II	RBC Capital Markets Corporation	San Francisco, CA
Edward M. Stephens	FSC Securities Corporation	Santa Rosa, CA

^{*} Christopher Charles of Wulff Hansen & Co. in San Francisco, CA and Douglas C. Heske of Nollenberger Capital Partners, Inc. in San Francisco, CA were appointed to replace resigning Committee members and are currently serving in these positions until elections are held.

Southern California (that part of the state south or east of the counties of Monterey, San Benito, Fresno and Inyo), southern Nevada (that part of the state south or east of the counties of Esmeralda and Nye) and the former U.S. Trust Territories

David A. Greene, District Director

300 South Grand Avenue, Suite 1600, Los Angeles, CA 90071-3126 (213) 229-2300 David.Greene@finra.org fax (213) 617-3299

District Committee for District 2—Chair: Craig R. Watanabe

Committee members to be elected to terms expiring May 31, 2013: 3

Mark S. Stewart	Mark Stewart Securities, Inc.	Lake Forest, CA
Craig R. Watanabe VACANT	Penniall & Associates, Inc.	Pasadena, CA

Committee Members to Serve Until May 31, 2011

Kerry E. Cunningham	ING Financial Partners, Inc.	El Segundo, CA
Donna B. Lawson	First Allied Securities, Inc.	San Diego, CA
Westley H. King	Centaurus Financial, Inc.	Anaheim, CA

Committee Members to Serve Until May 31, 2012

Silas Kendrick Dunn, Jr.	Pacific Select Distributors, Inc,	Newport Beach, CA
Steven L. Thornton	Valtus Capital Group, LLC	Tarzana, CA
Peter Vonk	CUSO Financial Services, L.P.	San Diego, CA

District Nominating Committee for District 2—Chair: Valorie A. Seyfert

Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

M. LaRae Bakerink	WBB Securities, LLC	San Diego, CA
Kenneth R. Hyman	Partnervest Securities Inc.	Santa Barbara, CA
Steven K. Klein	Farmers Financial Solutions, LLC	Agoura Hills, CA
Gary A. Martino	brokersXpress, LLC	Thousand Oaks, CA
Valorie A. Seyfert	CUSO Financial Services, LP	San Diego, CA

(206) 624-0790

fax (206) 623-2518

District 3

Arizona, Colorado, New Mexico, Utah and Wyoming

Joseph M. McCarthy, Senior Vice President and Regional Director	(West Region)
4600 S. Syracuse Street, Suite 1400, Denver, CO 80237	(303) 446-3100
Joseph.McCarthy@finra.org	fax (303) 620-9450
Alaska, Idaho, Montana, Oregon and Washington	
Michael E. Lewis, District Director	

Michael.Lewis@finra.org District Committee for District 3—Chair: Douglas W. Schriner

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Committee Members to Serve Until May 31, 2010

601 Union Street, Suite 1616, Seattle, WA 98101-2327

Chester J. Hebert	Colorado Financial Service Corporation	Centennial, CO
Steven S. Iversen	NEXT Financial Group, Inc.	Albuquerque, NM
Douglas W. Schriner	Harrison Douglas, Inc.	Aurora, CO

Committee Members to Serve Until May 31, 2011

James R. Cannon	United Planners Financial Service	Scottsdale, AZ
Adam M. Carmel	Larimer Capital Corporation	Denver, CO
Paige W. Pierce	RW Smith & Associates, Inc.	Sandy, UT

Committee Members to Serve Until May 31, 2012

Paul T. Amsbury	Morgan Stanley & Co., Inc.	Portland, OR
Kay A. Johnson	National Securities Corporation	Seattle, WA
Bruce J. Maranda	Canaccord Capital Corporation USA, Inc.	Vancouver, BC

District Nominating Committee for District 3—Chair: Russell R. Diachok

➤ Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Louis H. DeMers	Wells Fargo Investments, LLC	Seattle, WA
Russell R. Diachok	Geneos Wealth Management, Inc.	Centennial, CO
David J. Director	McAdams Wright Ragen, Inc.	Seattle, WA
Craig A. Jackson	Financial Network Investment Corporation	Roseburg, OR
Harry L. Striplin	Umpqua Investments Inc.	Portland, OR

Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota

120 W. 12th Street, Suite 800, Kansas City, MO 64105 (816) 421-5700 Tom.Clough@finra.org (816) 421-5029

District Committee for District 4—Chair: Richard D. Link

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Committee Members to Serve Until May 31, 2010

Robert E. Hillard	Arlington Securities, Inc.	St. Louis, MO
Richard D. Link	Edward Jones	St. Louis, MO
Daniel J. May	Financial Network Investment	Minneapolis, MN
	Corporation	

Committee Members to Serve Until May 31, 2011

Christopher A. Cokinis	ING Financial Partners, Inc.	Des Moines, IA
Cheryl L. Heilman	Ameritas Investment Corp.	Lincoln, NE
James E. Nelson	Minnesota Valley Investments	Redwood Falls, MN

Committee Members to Serve Until May 31, 2012

Dana Bjornson	George K. Baum & Company	Kansas City, MO
Jennifer Relien	Woodbury Financial Services, Inc.	Woodbury, MN
Amy Webber	Cambridge Investment Research, Inc.	Fairfield, IA

District Nominating Committee for District 4—Chair: Patricia Bartholomew

➤ Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Patricia Bartholomew	Craig-Hallum Capital Group, LLC	Minneapolis, MN
Allen J. Moore	SMITH HAYES Financial Services	Lincoln, NE
	Corporation	
Andrew Small	Scottrade, Inc.	St. Louis, MO
Minoo Spellerberg	Principal Global Investments	Des Moines, IA
Pamela Ziermann	Dougherty & Company, LLC	Minneapolis, MN

Alabama, Arkansas, Louisiana, Mississippi, Oklahoma and Tennessee

Keith E. Hinrichs, District Director

1100 Poydras Street, Energy Centre, Suite 850 (504) 522-6527 New Orleans, LA 70163-0802 fax (504) 522-4077 Keith.Hinrichs@finra.org

District Committee for District 5—Chair: Gary K. Wunderlich, Jr.

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Committee Members to Serve Until May 31, 2010

Robert Keenan, Jr.	St. Bernard Financial Services, Inc.	Russellville, AR
Michael J. Mungenast	ProEquities, Inc.	Birmingham, AL
Gary K. Wunderlich, Jr.	Wunderlich Securities, Inc.	Memphis, TN

Committee Members to Serve Until May 31, 2011

Rush F. Harding, III	Crews & Associates, Inc.	Little Rock, AR
Phillip H. Palmer	First Independent Financial Services, Inc.	Tulsa, OK
Sarah J. Sherck	Avondale Partners, LLC	Nashville, TN

Committee Members to Serve Until May 31, 2012

James F. Dixon, III	Sterne Agee & Leach, Inc.	Birmingham, AL
LeRoy H. Paris, II	InvestLinc Securities LLC	Jackson, MS
Mark Sheridan	Johnson Rice & Company L.L.C.	New Orleans, LA

District Nominating Committee for District 5—Chair: J. French Hill

➤ Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Philip J. Dorsey	Dorsey & Company, Inc.	New Orleans, LA
J. French Hill	Delta Trust Investments, Inc.	Little Rock, AR
James S. Jones	Crews & Associates, Inc.	Little Rock, AR
Michaela D. Myers	NAFA CapitalMarkets, LLC	Oklahoma City, OK
Jennifer Carty Scola	Carty & Company, Inc.	Memphis, TN

Texas

Michael G. Rufino, Senior Vice President

12801 N. Central Expressway, Suite 1050, Dallas, TX 75243

Michael.Rufino@finra.org

(972) 701-8554

fax (972) 716-7646

District Committee for District 6—Chair: Fenner R. Weller, Jr.

- ➤ Committee members to be elected to terms expiring May 31, 2013: 3
- ➤ Committee members to be elected to terms expiring May 31, 2012: 1

Committee Members to Serve Until May 31, 2010

	First Southwest Company VSR Financial Services, Inc.	Dallas, TX Dripping Springs, TX
Fenner R. Weller, Jr. Committee Members to	Weller Anderson & Co., Ltd. Serve Until May 31, 2011 Amberst Securities Group I.P.	Houston, TX

Darla K. Bartkowiak	Amherst Securities Group, LP	Houston, TX
Frederick T. Greene	Raymond James Financial Services, Inc.	The Woodlands, TX
Wilson H. Williams	WFG Investments, Inc.	Dallas, TX

Committee Members to Serve Until May 31, 2012

Adan Araujo First Command Financial Planning, Inc. Fort Worth, TX
Kelly R. Welker LPL Financial Corporation San Antonio, TX

VACANT

District Nominating Committee for District 6—Chair: Bryan T. Emerson

➤ Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Starlight Investments, LLC	Houston, TX
Weaver Tidwell Capital, LLC	Dallas, TX
Kirk Securities Corporation	Denton, TX
Lowell & Company, Inc.	Lubbock, TX
Coastal Securities, Inc.	Houston, TX
	Weaver Tidwell Capital, LLC Kirk Securities Corporation Lowell & Company, Inc.

Georgia, North Carolina and South Carolina

Daniel J. Stefek, Associate Vice President and District Director

One Securities Centre (404) 239-6100 Suite 500, 3490 Piedmont Road, NE, Atlanta, GA 30305 fax (404) 237-9290 Daniel.Stefek@finra.or

Florida, Puerto Rico, the Canal Zone and the Virgin Islands

Mitchell C. Atkins, Vice President and District Director

Crystal Corporate Center (561) 443-8000 2500 N. Military Trail, Suite 302, Boca Raton, FL 33431 fax (561) 443-7995 Mitch.Atkins@finra.org

District Committee for District 7—Chair: Raymond H. Smith

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Committee Members to Serve Until May 31, 2010

Jed E. Bandes	Mutual Trust Co. of America Securities	Clearwater, FL
Karen Z. Fischer	Hunter Scott Financial, LLC	Delray Beach, FL
John T. Rhett, III	Sun Trust Investment Services, Inc.	Atlanta, GA

Committee Members to Serve Until May 31, 2011

Richard K Bryant	Capital Investment Group, Inc.	Raleigh, NC
Matthew A. Guerrise	FMSBonds, Inc.	Boca Raton, FL
Raymond H. Smith, Jr.	Smith, Brown & Groover, Inc.	Macon, GA

Committee Members to Serve Until May 31, 2012

Ruth A. Burgess	INVEST Financial Corporation	Tamps, FL
Donald K. Runkle	Raymond James Financial Services, Inc.	St. Petersburg, FL
Caroline Wisniewski	Bridge Capital Associates, Inc.	Norcross, GA

District Nominating Committee for District 7—Chair: Charles F. O'Kelley

Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Susan J. Hechtlinger	Sun Trust Investment Services, Inc.	Atlanta, GA
Landrum H. Henderson, Jr.	Robert W. Baird & Co., Inc.	Charlotte, NC
William G. McMaster	Scott & Stringfellow, Inc.	Columbia, SC
Charles F. O'Kelley	Atlantic Coast Securities Corporation	Tampa, FL
Roark A. Young	Young Stovall and Company	Miami, FL

Illinois, Indiana, Kentucky, Michigan, Ohio and Wisconsin

Carla A. Romano, Senior Vice President and Regional Director
55 West Monroe Street, Suite 2700, Chicago, IL 60603-5052
Carla.Romano@finra.org
fax (31

Midwest Region (312) 899-4400 fax (312) 899-4399

District Committee for District 8—Chair: Joel R. Blumenschein

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Joel R. Blumenschein	Freedom Investors Corp.	Brookfield, WI
Thomas A. Bono	David A. Noyes & Company	Oak Park, IL
VACANT		

Committee Members to Serve Until May 31, 2011

Jeffry F. Freiburger	Robert W. Baird & Co.	Milwaukee, WI
Edward A. Horwitz	Horwitz & Associates, Inc.	Riverwoods, IL
James P. Miller	SII Investments, Inc.	Appleton, WI

Committee Members to Serve Until May 31, 2012

Timothy P. Brynes	Morgan Stanley Smith Barney	Barrington, IL
Anthony C. Larosa	JJB Hillard, W.L. Lyons, LLC	Indianapolis, IN
Joseph R.V. Romano	Romano Brothers & Co.	Evanston, IL

District Nominating Committee for District 8—Chair: Richard M. Arceci

Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Richard M. Arceci	ValMark Securities, Inc.	Akron, OH
Eric A. Bederman	Bernardi Securities, Inc.	Chicago, IL
Thomas M. McDonald	Thomas McDonald Partners, LLC	Cleveland, OH
James Rogers	J.J.B. Hilliard, W.L. Lyons, LLC	Louisville, KY
Barbara A. Turner	The O.N. Equity Sales Company	Cincinnati, OH

New Jersey and New York (except for the counties of Nassau and Suffolk, and the five boroughs of New York City)

Gary K. Liebowitz, Senior Vice President and Regional Director	North Region
581 Main Street, 7th Floor, Woodbridge, NJ 07095	(732) 596-2025
Gary.Liebowitz@finra.org	fax (732) 596-2001

Delaware, the District of Columbia, Maryland, Pennsylvania, Virginia and West Virginia

Robert B. Kaplan, Vice President and District Director

1835 Market Street, Suite 1900, Philadelphia, PA 19103 (215) 963-1992 *Robert.Kaplan@finra.org* fax (215) 963-7442

District Committee for District 9—Chair: Timothy L. Smith

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Committee Members to Serve Until May 31, 2010

Wayne F. Holly	Sage Rutty & Co.	Rochester, NY
Richard Seelaus	R. Seelaus & Co., Inc.	Summit, NJ
Timothy L. Smith	Comprehensive Asset Management	Parsippany, NJ

Committee Members to Serve Until May 31, 2011

Nancy L. H. Boyd	Lincoln Investment Planning, Inc.	Wyncote, PA
Sarah McCafferty	T. Rowe Price Investment Services, Inc.	Baltimore, MD
Kenneth I. Schindler	Prudential Investment Management	Newark, NJ

Services LLC

Committee Members to Serve Until May 31, 2012

Irene A. Feeley	Capital Analysts, Incorporated	Horsham, PA
Mark A. Gomez	NY Life Distributors LLC	Parsippany, NJ
Michael K. Kauffelt, II	Bill Few Associates, Inc.	Pittsburgh, PA

District Nominating Committee for District 9—Chair: John P. Meegan

➤ Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Michael T. Corrao	Knight Equity Markets, LP	Jersey City, NJ
W. Dean Karrash	BLB & B Advisors, LLC	Ambler, PA
John M. Ivan	Janney Montgomery Scott LLC	Philadelphia, PA
John P. Meegan	Hefren-Tillotson, Inc.	Pittsburgh, PA
Thomas T. Wallace	Johnston, Lemon & Co. Incorporated	Washington, DC

New York (the counties of Nassau and Suffolk, and the five boroughs of New York City)

Hans L. Reich, Senior Vice President and Regional DirectorNew York RegionOne Liberty Plaza, 49th Floor, 165 Broadway, New York, NY 10006(212) 858-4000Hans.Reich@finra.orgfax (212) 858-4078

District Committee for District 10—Chair: James D. Lamke

- Committee members to be elected to terms expiring May 31, 2013: 4
- ➤ Committee members to be elected to terms expiring May 31, 2012: 2

Committee Members to Serve Until May 31, 2010

James A. Brodie	Tocqueville Securities L.P.	New York, NY
Kathryn G. Casparian	CIBC World Markets Corp.	New York, NY
Paul S. Ehrenstein	Zenith American Securities Corp.	New York, NY
James D. Lamke	Sanford C. Bernstein & Co., LLC	New York, NY

Committee Members to Serve Until May 31, 2011

Eric L. Kriftcher	Banc of America Securities LLC	New York, NY
Robin A. Oliver	Raymond James Financial Services, Inc.	New York, NY
Thomas J. Santucci	Royal Alliance Associates, Inc.	Garden City, NY
David M. Sobel	Abel/Noser Corp.	New York, NY

Committee Members to Serve Until May 31, 2012

Craig B. Jampol	Sterne, Agee & Leach, Inc.	New York, NY
David V. Shields	Shields & Company	New York, NY

VACANT*

VACANT*

District Nominating Committee for District 10—Chair: Allen Meyer

Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Clifford H. Goldman	Marco Polo Securities Inc.	New York, NY
Raymond C. Holland, Sr.	Triad Securities, Corp.	New York, NY
Allen Meyer	Credit Suisse First Boston, LLC	New York, NY
Howard Spindel	Integrated Management Solutions	New York, NY
Tom M. Wirstshafter	American Portfolios Financial Services, Inc.	Holbrook, NY

^{*} Robert Hackel of R.F. Lafferty & Co., Inc. in New York, NY and George Mandl of Mitsubishi UFJ Securities (USA) Inc. in New York, NY were appointed to fill two vacancies and are currently serving in these positions until elections are held.

Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont

Elizabeth F. Page, District Director

99 High Street, Suite 900, Boston MA 02110 (617) 532-3401 Elizabeth.Page@finra.org fax (617) 451-3524

District Committee for District 11—Chair: Tina Blakely Maloney

➤ Committee members to be elected to terms expiring May 31, 2013: 3

Committee Members to Serve Until May 31, 2010

Michael E. Callaghan	Harvest Capital LLC	Wethersfield, CT
David J. Freniere	LPL Financial Corporation	Boston, MA
Tina Blakeley Maloney	Winslow, Evans & Crocker	Boston, MA

Committee Members to Serve Until May 31, 2011

Vincent M. Manzi	State Street Global Markets, LLC	Boston, MA
Victoria L. Olson	Prudential Annuities Distributors	Shelton, CT
Stephen L. Schardin	Charles River Brokerage, LLC	Burlington, MA

Committee Members to Serve Until May 31, 2012

Michael J. Mahoney	John Hancock Funds, LLC	Boston, MA
J. Dennis McCarron	Lincoln Financial Securities Corporation	Braintree, MA
John A. Vaccaro	MML Investors Services, Inc.	Springfield, MA

District Nominating Committee for District 11—Chair: Joseph Gritzer

➤ Committee members to be elected to terms expiring May 31, 2011: 5

Committee Members to Serve Until May 31, 2010

Martin W. Courage	J.P. Morgan Securities, Inc.	Boston, MA
John I. Fitzgerald	Leerink Swann, LLC	Boston, MA
Joseph Gritzer	USI Securities, Inc.	Glastonbury, CT
Moira C. Lowe	Sun Life Financial Distributors, Inc.	Wellesley Hills, MA
Robert J. Reilly	UBS Securities LLC	Boston, MA

ATTACHMENT B—Procedures for Electing District Committee and District Nominating Committee Members

- 1. Each FINRA District shall maintain a District Committee and District Nominating Committee in the manner specified in Article VIII of FINRA Regulation's By-Laws.
- FINRA's Corporate Secretary has sent a letter to each District Nominating Committee member and each District Director identifying the members of the District Committee and the District Nominating Committee whose terms expire on May 31, 2010. The letter described the election procedures to be followed in filling these positions.
- 3. FINRA will email a reminder to all members of their responsibility, and obligation, to keep current and accurate the information on their Executive Representative. The email will contain a reference to the FINRA Contact System, located on FINRA's Web site at www.finra.org/fcs, for changing a firm's Executive Representative name, email and postal address. This email will note that failure to keep this information accurate may jeopardize the member's ability to participate in the district elections, as well as in other member votes.
- 4. FINRA will send an *Election Notice* announcing the forthcoming elections to all member firms and the Executive Representative of all FINRA firms eligible to vote in each district. The *Election Notice* will describe the election procedures and identify the number of positions to be filled in each district and the incumbent members of each District Committee. Individuals who are interested in serving on the District Committee or the District Nominating Committee within their district must complete a candidate profile form and submit it by hand delivery, courier service, mail or facsimile to the District Director. Completed candidate profile forms must be received by the District Director on or before **December 31, 2009.** Candidate profile forms received after this date will not be considered.
- 5. Completed candidate profile forms received by the District Director on or before December 31, 2009, will be provided to all members of the appropriate District Nominating Committee for review. FINRA staff also will provide the District Nominating Committee members with information considered to be relevant to the nomination process and analytical data pertaining to the district's membership. Soon after receiving the candidate profile forms and district membership information, the District Nominating Committee will identify and solicit candidates to nominate for election to the District Committee and the District Nominating Committee.
- 6. In determining its slate of candidates for the election, the District Nominating Committee will review the background and qualifications of the proposed candidates, and endeavor to secure appropriate and fair representation on the District Committee and on the District Nominating Committee of the various sections of the district and various classes and types of FINRA members engaged in the investment banking or securities business within the district. The slate must include the same number of nominees as there are positions to be filled on the District Committee and the District Nominating Committee.

A District Nominating Committee may not nominate more than two incumbent members of the District Nominating Committee to succeed themselves. Each District Nominating Committee member shall: (1) be registered with a FINRA member eligible to vote in the district for District Committee elections, and (2) work primarily from such FINRA member's principal office or a branch office that is located within the district where the member serves on a District Nominating Committee, but shall not be a member of the District Committee. A majority of the members of the District Nominating Committee must include persons who previously have served on a District Committee, as a current or former Director of the FINRA Regulation Board, or as a current or former Governor of the FINRA Board, or its predecessors.

A District Nominating Committee shall not nominate an incumbent member of the District Committee to succeed himself or herself on the District Committee unless the incumbent member of the District Committee was appointed to fill a vacancy on the District Committee resulting from (1) death, resignation, removal, or other cause of a regularly elected member's office prior to the expiration of the full term or (2) a newly created membership on a District Committee by virtue of an increase in the authorized number of members on the District Committee. Each District Committee member shall: (1) be registered with a FINRA member eligible to vote in the district for District Committee elections, and (2) work primarily from such FINRA member's principal office or a branch office that is located within the district where the member serves on a District Committee. District Committee members may not serve more than two consecutive terms.

The District Nominating Committee may also nominate one alternate candidate for the District Committee and one alternate candidate for the District Nominating Committee. In the event of an uncontested election pursuant to Article VIII, Section 8.19 of FINRA Regulation's By-Laws, the alternate candidate would replace any member of the nominated slate of candidates who withdrew or was determined to be ineligible.

- 7. On or before **January 29, 2010**, the District Director, acting on behalf of the District Nominating Committee, will notify FINRA's Corporate Secretary of each candidate nominated by the District Nominating Committee and the committee and, if applicable, class to which the candidate is nominated.
- 8. On or before **February 12, 2009**, FINRA will send a second Election Notice to the District Committees and the Executive Representatives of FINRA member firms eligible to vote in each district, identifying the nominees for the District Committees and the District Nominating Committees.

If the District Nominating Committee nominates the same number of nominees as there are positions to be filled on the District Committee and the District Nominating Committee and no additional candidate comes forward by delivering written notice to the appropriate District Director within 14 calendar days after the date of the second *Election Notice* identifying the district nominees, the candidates nominated by the District Nominating Committee are considered duly elected.

9. If a person who is otherwise eligible to serve on the District Committee or the District

Nominating Committee was not nominated by the District Nominating Committee and wants to be considered for election as an additional candidate, he/she must notify the District Director in writing within 14 calendar days after the date of the second *Election Notice* referenced in item 8 above. The District Director must make a written record of the time and date of the receipt of such notification. Such person will be designated as an "additional candidate."

- 10. Promptly following receipt of the additional candidate's timely notice by the District Director, FINRA's Corporate Secretary will provide to the additional candidate a list of all FINRA member firms eligible to vote in the district, their mailing addresses and their Executive Representatives.
- 11. An additional candidate is considered nominated if a petition signed by the Executive

Representative of at least 10 percent of the FINRA member firms eligible to vote in the district is filed with the District Nominating Committee within 30 calendar days after the mailing date of the list to the additional candidate referenced in item 10 above.

12. If an additional candidate secures the required petition within the 30-day designated timeframe, the election is considered a contested election. The Corporate Secretary of FINRA will send a third Election Notice to the Executive Representatives of the FINRA member firms eligible to vote in the district announcing the names of all candidates and describing the contested election procedures.

Additional information pertaining to the District Committee and District Nominating Committee Election Procedures may be found in Article VIII of FINRA Regulation's By-Laws.

ATTACHMENT C—Candidate Profile Form

Please complete all sections and print your responses. An electronic version of this candidate profile form also is available at www.finra.org/notices/election/121109.

Indicate the position for which you wish to be con-	Indicate the position for which you wish to be considered:		
$\hfill \square$ District Committee $\mathbf{OR} \hfill \square$ District Nominating	Committee		
For which District:			
Current Registration			
Name:	CRD#:		
Firm Name:	Firm#:		
Title/Primary Responsibility:			
Address:			
City:	State: Zip:		
Phone: Fax:	Email:		
Prior Registrations (List the most recent first. Feel fr	ree to include extra pages if necessary.)		
Firm:			
Title/Primary Responsibility:			
Firm:			
Title/Primary Responsibility:			
General Areas of Expertise (please check all that apply)	Product Expertise (please check all that apply)		
 □ Compliance/Legal □ Corporate Finance □ Financial/Operational □ Institutional Sales □ Investment Advisory 	 □ Corporate Bonds □ Direct Participation □ Programs □ Equity Securities □ Municipal/ □ Government Securities □ Investment Company ○ Options ○ Variable Contracts ○ Securities ○ Other 		
Memberships/Positions in Trade or Business Organ	nizations		
Past NASD or FINRA Experience and Dates of Servi	ce (please check all that apply)		
☐ Committee Member (Identify committee):	Approx. Dates:		
☐ Arbitrator	Approx. Dates:		
Mediator Approx. Dates:			
Expert Witness (arbitrations; disciplinary proceedings) Approx. Dates:			
Other:	Approx. Dates:		
Educational Background			
School: Deg	gree:		
School: Deg	gree:		

Return completed candidate profile forms to the appropriate District Director on or before December 31, 2009.

Election Notice

NAC and SFAB Elections

FINRA Announces Recently Elected and Appointed National Adjudicatory Council and Small Firm Advisory Board Members

Executive Summary

The purpose of this *Election Notice* is to announce the names of the recently elected and appointed National Adjudicatory Council (NAC) and Small Firm Advisory Board (SFAB) members.

Questions concerning this *Notice* may be directed to Marcia E. Asquith, Senior Vice President and Corporate Secretary, at (202) 728-8949 or *CorporateSecretary@finra.org*.

Background and Discussion

NAC Election and Board Appointments

One elected Small Firm NAC Member and one appointed At-Large Industry NAC Member will replace the two industry members whose terms expire at the end of 2009. Additionally, three Non-Industry NAC Members were appointed to replace the Non-Industry NAC Members whose terms expire at the end of 2009.

In an election that concluded in October 2009, Stephen Kohn, President and CEO of Stephen A. Kohn & Associates, Ltd. in Lakewood, Colorado who had successfully petitioned to be added to the Small Firm NAC Member ballot received the most votes. As required by the FINRA Regulation By-Laws, Mr. Kohn was appointed by the Board as a Small Firm NAC Member to a three-year term beginning January 2010.

Earlier in the year there was also a vacancy for the Mid-Size NAC Member seat. The Nominating and Governance Committee nominated John Muschalek, Managing Director of the Clearing Services of First Southwest Company as FINRA's nominee.

December 18, 2009

Suggested Routing

- Compliance
- ➤ Legal
- Operations
- Registration
- Senior Management



The nomination was not contested and Mr. Muschalek was appointed by the Board to complete an existing term.

The Nominating and Governance Committee nominated, and the FINRA Board appointed, the following individuals to fill the at-large industry position and the three appointed Non-Industry NAC Members whose terms expire at the end of 2009:

At-Large Industry NAC Member Appointee

 Andrew S. Margolin – Principal and Associate General Counsel, Bank of America Merrill Lynch, New York, New York

Non-Industry NAC Member Appointees

- Michael Fishman Norman Strunk Professor of Financial Institutions, Kellogg School of Management of Northwestern University, Evanston, Illinois
- **Donald C. Langevoort –** Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center, Washington, DC
- **Donna Nagy** C. Ben Dutton Professor of Law, Indiana University Maurer School of Law, Bloomington, Indiana

Additional information on each of these candidates is included in Attachment A.

SFAB Election and Board Appointments

In an election for the West and North Region seats concluded in November 2009, the following individuals were elected to three-year terms beginning in January 2010:

West Region SFAB Member

• Daniel W. Roberts - President & Chief Executive Officer, Roberts & Ryan Investments Inc., San Francisco, California

North Region SFAB Member

• **Tina Blakeley Maloney** - Chairman/Financial Operations and Compliance, Winslow, Evans & Crocker, Inc., Boston, Massachusetts

In addition, the Board appointed the following individuals to fill three At-Large seats on the SFAB:

- Mark Cresap President and Founder, Cresap, Inc., Radnor, Pennsylvania
- Robert Muh Co-Founder, Sutter Securities Incorporated, San Francisco, California
- David M. Sobel Executive Vice President, General Counsel and Chief Compliance Officer, Abel/Noser Corp., New York, New York

Mr. Cresap and Mr. Muh will both serve three-year terms beginning in January 2010. Mr. Sobel was appointed to complete the remainder of a term of a resigning SFAB member and will serve from January 2010 through December 2010.

Additional information on the new SFAB members is included in Attachment B.

Attachment A: Profiles of New NAC Members

Elected Small Firm NAC Member

Stephen Kohn is the President and CEO of Stephen A. Kohn & Associates, Ltd., a Colorado based, full service, and independent FINRA member firm founded in 1996. He came into the financial services industry in 1984 as a municipal bond salesman. Ultimately, he rose to become a branch manager of the largest OTC brokerage in the country. His experience has been with a number of small and large firms. Mr. Kohn is a member of the Independent Broker-Dealer Association (IBDA). He is also a Member of the Securities Industry Professional Association (SIPA) and a FINRA Arbitrator. Mr. Kohn graduated from C.W. Post College in 1964 with a Bachelor of Arts. He has served in the U.S. Coast Guard Reserve.

At-Large Industry NAC Member Appointees

Andrew S. Margolin is Principal and Associate General Counsel for Bank of America Merrill Lynch, where he currently serves as Global Equities Regulatory Counsel and Counsel for U.S. Broker-Dealer Regulation. He joined the bank in 2003 and primarily advises the U.S. Equities businesses and regulatory programs of the bank, which are generally conducted through Merrill Lynch Pierce Fenner & Smith, Banc of America Securities, LLC, and Banc of America Specialist, Inc. and their affiliates. He has previously focused his coverage in Sales and Trading, Institutional Research Sales, and Electronic Trading Services (Program Trading, Algorithmic Trading and Direct Market Access). Mr. Margolin has been Chairman of FINRA's Market Regulation Committee, as well as a member of FINRA's Advisory Council and the NASDAO Market Regulation Committee. He also serves on several SIFMA Committees and working groups. Mr. Margolin formerly was Assistant General Counsel for the NASDAO Stock Market and began his legal career at the Securities and Exchange Commission, working in the Chief Counsel's office for the Division of Market Regulation and the Office of Compliance Inspections and Examinations. He received his J.D. from Brooklyn Law School, a B.A. from C.U.N.Y. at Oueens College and is a graduate of the Bronx High School of Science. He is a member of the New York and District of Columbia bars.

Non-Industry NAC Member Appointees

Michael Fishman is the Norman Strunk Professor of Financial Institutions at the Kellogg School of Management of Northwestern University in Evanston, Illinois. He has been a member of the Kellogg Finance Department since 1985 and he served as Chairman of the Finance Department from 2002 – 2005. He is the co-Director of the Finance Ph.D. program and he was recently appointed co-Director of the Northwestern JD-MBA program. At Northwestern, Professor Fishman has won numerous teaching awards. Professor Fishman has served as Editor of the *Review of Financial Studies*, Associate Editor for four other finance journals, and is currently a Director of the Western Finance Association. Professor Fishman's research has focused on financial market regulation and financial contracting. His research has investigated the enforcement of insider trading regulations, mandatory disclosure requirements, the role of self-regulatory organizations, long-term financial contracting and corporate investment. He has won several awards for his research. He also co-edited the book *A Primer on Securitization* (MIT Press, 1996). Professor Fishman received his Ph.D. in economics from the University of Chicago in 1986 and a B.A. in economics from the University of Illinois.

Donald C. Langevoort is the Thomas Aquinas Reynolds Professor of Law at Georgetown University Law Center, Washington, DC. He joined the Georgetown faculty in 1999 after 18 years at Vanderbilt University School of Law, where he had been the Lee S. & Charles A. Speir Professor. He has also been a visiting professor at the University of Michigan, Harvard Law School, and the University of Sydney in Australia. Professor Langevoort graduated from the Harvard Law School in 1976, and went into private practice with the law firm of Wilmer, Cutler & Pickering in Washington. In 1978, he joined the staff of the U.S. Securities & Exchange Commission as Special Counsel in the Office of the General Counsel.

Since entering academia in 1981, Professor Langevoort has written a treatise on insider trading, co-authored a casebook on securities regulation, and produced numerous law review articles on topics such as insider trading, the impact of technology on securities regulation, investor behavior and the intersection between cognitive psychology and lawyers' professional responsibilities. He has served on the Legal Advisory Committee of the NYSE, the Legal Advisory Board of NASD, the SEC's Advisory Committee on Market Information (chairing its subcommittee on alternative models for data consolidation), and the Nominating Committee of the MSRB, and has testified numerous times before Congressional committees on matters relating to securities regulation and litigation. Professor Langevoort is also a member of the American Law Institute.

Professor Donna M. Nagy joined the Indiana University Maurer School of Law— Bloomington faculty in 2006 as the C. Ben Dutton Professor of Law. She began her teaching career in 1994 at the University of Cincinnati College of Law, where she served as Interim Dean from 2004 – 05 and as Associate Dean for Faculty Development from 2002 – 04. In Spring 2001, she was a Visiting Professor of Law at the University of Illinois College of Law, and was a Visiting Scholar at the University of Canterbury School of Law in Christchurch, New Zealand in Spring 2002. Professor Nagy teaches and writes in the areas of securities litigation, securities regulation and corporations. Her scholarship includes articles in the *Iowa Law Review*, the *Cornell Law Review*, and the Notre Dame Law Review as well as two co-authored books, one on the law of insider trading and a casebook on Securities Litigation and Enforcement. She is a frequent speaker on securities regulation and litigation topics at law schools and professional conferences. She serves as a Vice President and a member of the Board of Trustees of the SEC Historical Society. She also serves on the Association of American Law School's Committee on Audit and Investment Policy and was Chair of the AALS Section on Securities Regulation in 2004 – 05.

Prior to teaching, Professor Nagy was an associate with Debevoise & Plimpton in Washington, DC (1989 – 94), specializing in securities enforcement and litigation. She earned her J.D. from New York University School of Law, where she was an Articles Editor of the Law Review and elected to Order of the Coif. She graduated with general and departmental honors from Vassar College, with a B.A. in political science.

Attachment B: Profiles of New SFAB Members

Elected Midwest Region Representative

Dan Roberts entered the brokerage industry in 1972 as a registered representative for Dean Witter & Co. After having served as assistant manager for the main office, in 1987 he founded the San Francisco-based regional firm of Roberts & Ryan, a full-service, high-net-worth retail firm. He manages this firm which continues to serve the investment needs of thousands of retail and institutional clients.

In 1965 he received from San Francisco State University his undergraduate degree in business administration (emphasis in accounting) and in 1972 his MBA (emphasis in finance) from Loyola University of Chicago.

From a compliance standpoint, he is closely and personally involved with compliance as rules impact the smaller firm. He has and will continue to give feedback to FINRA about rulemaking in general, especially as impacts the smaller firm.

Mr. Roberts maintains several memberships in the investment industry including the Bond Club of San Francisco – Board of Directors; California Disabled Veteran Business Alliance – President; FINRA committee member – District 1, 2004-2007; FINRA Small Firms Advisory Board (SFAB), elected member Western Region, 2008-Present; Better Business Bureau of San Francisco, President; Independent Broker Dealer Association; FINRA hearing panelist/NYSE arbitration panelist and FINRA District 1 nominating committee member – 2009. He is a frequent program speaker in the area of compliance at the FSX Investment Conferences in 2008 and 2009.

Mr. Roberts maintains FINRA Series 4, 7, 24, 27, 53 and 63 licenses. He is also a Life and Variable Insurance Agent.

Elected North Region Representative

Tina Blakeley Maloney is the chairman and majority owner of Winslow, Evans & Crocker, Inc. (Winslow), a dually licensed full-service broker-dealer and SEC-registered investment advisor headquartered in Boston, Massachusetts. Ms. Maloney manages the financial operations and compliance areas of the firm and is active in business and client development. Since joining Winslow in January 1994, Ms. Maloney has served the firm in the capacities of Chief Financial Officer, President and Chief Operating Officer.

Ms. Maloney's career in the securities industry began in 1979. Her experience in management, sales, compliance and administration includes work for both small and large firms, namely Winslow, Merrill Lynch, Lawrence Energy Associates, Putnam Financial Services, Dean Witter, Moseley, Hallgarten, Estabrook & Weeden and Drexel Burnham Lambert.

Ms. Maloney is a General Securities Principal, Financial Operations Principal, and a Registered Investment Advisor Representative (Series 24, 27, 7, 63, 65). She is Chairman of the FINRA District 11 Committee, member of the FINRA 2009 Advisory Council, and serves as a Hearing Panelist in various FINRA Disciplinary Hearings. She attended Suffolk and Northeastern Universities in Boston.

Appointed At-Large SFAB Members

Mark Cresap is the President and founder of Cresap Inc., a small full-service securities brokerage firm located in Radnor, PA. Mark founded Cresap Inc., in 1989. Prior to establishing Cresap Inc., Mark served as the President of 1717 Capital Management (fka PML Securities) and was responsible for over 1,800 registered representatives. Mark has also worked with CIGNA Securities and W.H. Newbolds & Sons.

In 2000 Mr. Cresap served as Chairman for NASD's District 9 Committee. Mark served as Chairman on the NASD District 9 Nominating Committee as well as serving on NASD's Membership Committee.

Mr. Cresap currently holds Series 4, 7, 24, 27, 40, 53 and 63 licenses. Mr. Cresap graduated from Williams College in Williamstown, MA, where he received his B.A.

Robert Muh co-founded Sutter Securities Incorporated in 1992 where he is the Chief Executive Officer. Sutter is a San Francisco-based full-service brokerage firm specializing in trading fixed-income securities and underwriting municipal bonds. In addition to being the firm's CEO, Bob is the firm's Chief Compliance Officer.

Prior to founding Sutter, Mr. Muh was a senior managing director in charge of the San Francisco region of Bear, Stearns & Co where he supervised the overall operations of 200 professionals and staff. Bear Stearns' activities in San Francisco included corporate finance, retail brokerage, institutional sales, fixed income sales and public finance in Northern California and the Pacific Northwest.

Mr. Muh was chairman of Newburger, Loeb & Co., Inc. a New York Stock Exchange member firm, from 1970-1972 and with McKinsey & Co., management consultants from 1966-1969. Immediately after graduate school, Mr. Muh served as a 2nd Lt. in the US Army.

Mr. Muh is a trustee of the Massachusetts Institute of Technology, The Culinary Institute of America and The Napa Valley Opera House. He was appointed by the Financial Industry Regulatory Authority to its Small Firm Advisory Board where he currently serves as Chairman.

Mr. Muh has a bachelor's degree from the Massachusetts Institute of Technology and an M.B.A. and Master of Philosophy from Columbia University. While at Columbia, Mr. Muh was an Adjunct Assistant Professor of Finance. Bob is currently an Adjunct Professor at the University of San Francisco School of Law.

David M. Sobel is currently Executive Vice President, General Counsel and Chief Compliance Officer of Abel/Noser Corp., a FINRA / NYSE member broker/dealer. He was previously a partner at The Goldstein Law Group, P.C. where he concentrated in the areas of broker-dealer compliance/regulation; securities litigation, including arbitration and mediation; and disciplinary/enforcement matters at the SEC, NYSE, AMEX and FINRA.

Mr. Sobel was a Floor Member of the New York Stock Exchange from 1982 through 1991 as a floor broker for both H.A. Brandt & Co. and First Options of Chicago, and President of his own NYSE member firm, Ampro Securities, Inc. After leaving the NYSE floor, he was a Senior Equity Trader/Market Maker for Trimark Securities.

Mr. Sobel has a Master of Science from Brooklyn College and a Law Degree (JD) from Pace Law School where he was an Editor of the International Law Review. Since 1998 he has been a member of the FINRA Board of Arbitrators (Chairperson Qualified), a current member of FINRA District 10 Committee, the Board of Directors of the NAIBD, the NYSE Hearing Board and on the Faculty of the National Society of Compliance Professionals.

Mr. Sobel has been quoted in and/or interviewed by *Compliance Reporter*, WSJ.com, Complinet, *Traders Magazine*, *Wall Street Letter*, *Op/Risk and Compliance Magazine* and *Institutional Investor News*, and is a frequent speaker at securities conferences for SIFMA, NSCP, NRS, NAIBD and FMW. Recent conference topics include: Managing Risk at Small BDs; Internal Audits; and Supervisory Responsibility, Financial Responsibility, Fraud Prevention in Portfolio Management and Forensic Compliance.

He is admitted to practice before the Supreme Courts of New York and Connecticut, the United States District Courts for the Southern and Eastern Districts of New York and the Second Circuit Court of Appeals. He is a member of the New York County Lawyers Association (Securities and Exchange Committee), the New York State Bar Association (Section on Alternate Dispute Resolution) and the American Bar Association.

Certification of Annual Audits

Firm Auditors Must Complete PCAOB Registration to Certify Financial Statements

Executive Summary

FINRA is issuing this *Notice* to remind firms that their auditor must be registered with the Public Company Accounting Oversight Board (PCAOB). *Information Notice* 1/8/09 stated that SEC registration relief expired December 31, 2008, and that firms must file financial statements certified by a PCAOB-registered auditor for their fiscal years ending after that date.

FINRA will treat financial statements certified by an auditor who is not PCAOB-registered as not having been filed under Schedule A of the FINRA By-Laws, Section 4(g)(2)&(3). Such firms are subject to suspension under the procedures set out in FINRA Rule 9552 (Failure to Provide Information or Keep Information Current).

Ouestions concerning this *Notice* should be directed to:

- Chip Jones, Senior Vice President, Member Relations, at (240) 386-4797;
 or
- Susan DeMando Scott, Associate Vice President, Financial Operations, at (202) 728-8411.

Background and Discussion

Once an accounting firm submits its registration application to the PCAOB, the PCAOB has up to 45 days to take action on that application. In light of the unusually large number of applications expected for auditors of firms with fiscal years ending December 31, firms and their auditors should not count on significantly faster action on an application. In addition, if the PCAOB requests additional information concerning the application, a new 45-day period will begin when the PCAOB receives it.

December 9, 2009

Suggested Routing

- Compliance
- ➤ Financial Reporting
- Legal
- Senior Management

Key Topics

Annual Financial Audit

Referenced Rules & Notices

- ➤ FINRA Rule 9552
- ➤ Information Notice 1/8/09
- Schedule A of the FINRA By-Laws



FINRA recommends that firms verify the PCAOB registration status of the auditor they plan to use to audit their annual financial statements. If the accounting firm is not yet registered with the PCAOB, FINRA recommends that firms encourage the auditor to apply for registration as soon as possible.

Firms can find an up-to-date list of registered accounting firms on the PCAOB's Web site at www.pcaobus.org/Registration/index.aspx. Please note that a separate list on that Web page identifies accounting firms with registration applications pending—firms on that list are not registered with the PCAOB.

For more information, see the SEC's frequently asked questions on registration of auditors of non-public broker-dealers (www.sec.gov/divisions/marketreg/faq-pcaobregbdauditors.htm), and the PCAOB's statement on the registration process for auditors of non-public broker-dealers (www.pcaobus.org/News_and_Events/News/2009/01-07.aspx).

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2010 Holiday Trade Date, Settlement Date and Margin Extensions Schedule

Executive Summary

FINRA is providing the following schedule to assist member firms and reduce the number of Federal Reserve Board Regulation T and Securities Exchange Act Regulation 15c3-3 extensions denied around holidays. "Regular way" transactions made on the business days noted below will be subject to the following schedule.

Questions regarding this Notice should be directed to

- Debra German, Senior Credit Regulation Coordinator, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8467;
- ➤ Theresa Reynolds, Credit Regulation Coordinator, ROOR, at (646) 315-8567; or
- ➤ Vincent Rotolo, Senior Credit Specialist, ROOR, at (646) 315-8576.

Background

Brokers, dealers and municipal securities dealers should use the following settlement dates for purposes of clearing and settling transactions pursuant to the securities exchanges.

As specified in Sections 220.4(d) and 220.8(b)(4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a margin account or cash account if payment is not received within five business days from the date of purchase or, pursuant to Section 220.4(c)(3) and 220.8(d)(1), apply to extend the time period specified. The date by which firms must take such action is shown below in the column titled "Regulation T Date."

Similarly, SEA Regulation 15c3-3 requires firms to take prompt steps to obtain possession or control of securities pursuant to paragraph (m) through a buy-in procedure or otherwise if securities are not received

December 14, 2009

Suggested Routing

- Compliance
- ➤ Internal Audit
- ➤ Legal
- Municipal/Government Securities
- Operations
- ➤ Trading

Key Topic(s)

- Holiday Settlement Dates
- ➤ Holiday Extension Dates

Referenced Rules and Notices

- Regulation T 220.4 and 220.8
- ➤ SEA Rule 15c3-3



within ten business days from the settlement date of the sale or, pursuant to paragraph (n), apply to extend the time period specified. The date by which firms must take such action is shown below in the column titled "SEC Extension Date."

All SEA Rule 15c-3 extension requests **must be** received on the due dates listed below. Adherence to this procedure will reduce the number of denied requests for improper dates and establish uniformity among member firms.

SEA Rule 15c3-3 Subparagraph	Date Due
(d)(2)	on the 30th calendar day after settlement date
(d)(3)	on the 45th calendar day after settlement date
(h)	on the 45th calendar day after settlement date
(m)	on the 10th business day after settlement date

These dates also apply to a security listed on a foreign exchange. Firms must file SEA Rule 15c3-3 extensions on the appropriate dates regardless of the settlement cycle established by the foreign security market on which the security is traded.

New Year's Day:

The securities exchanges will be closed on **Friday**, **January 1**, **2010**, in observance of New Year's Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
December 24	December 30	January 4	January 14
25	Markets Closed	_	_
28	31	5	15
29	January 4	6	19
30	5	7	20
31	6	8	21
January 1	Markets Closed	_	_
4	7	11	22

Martin Luther King, Jr. Day:

The securities exchanges will be closed on **Monday**, **January 18**, **2010**, in observance of Martin Luther King, Jr.'s birthday.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
January 11	January 14	January 19	January 29
12	15	20	February 1
13	19	21	2
14	20	22	3
15	21	25	4
18	Markets Closed	_	_
19	22	26	5

Presidents' Day:

The securities exchanges will be closed on **Monday**, **February 15**, **2010**, in observance of Presidents' Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
February 8	February 11	February 16	February 26
9	12	17	March 1
10	16	18	2
11	17	19	3
12	18	22	4
15	Markets Closed	_	_
16	19	23	5

Good Friday:

The securities exchanges will be closed on **Friday**, **April 2**, **2010**, in observance of Good Friday.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
March 26	March 31	April 5	April 15
29	April 1	6	16
30	5	7	19
31	6	8	20
April 1	7	9	21
2	Markets Closed	_	_
5	8	12	22

Memorial Day:

The securities exchanges will be closed on **Monday, May 31, 2010,** in observance of Memorial Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
May 24	May 27	June 1	June 11
25	28	2	14
26	June 1	3	15
27	2	4	16
28	3	7	17
31	Markets Closed	_	_
June 1	4	8	18

Independence Day:

The securities exchanges will be closed on **Monday**, **July 5**, **2010**, in observance of Independence Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
June 28	July 1	July 6	July 16
29	2	7	19
30	6	8	20
July 1	7	9	21
2	8	12	22
5	Markets Closed	_	_
6	9	13	23

Labor Day:

The securities exchanges will be closed on **Monday, September 6, 2010,** in observance of Labor Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
August 30	September 2	September 7	September 17
31	3	8	20
September 1	7	9	21
2	8	10	22
3	9	13	23
6	Markets Closed	_	_
7	10	14	24

Columbus Day:

The securities exchanges will be **open** for trading on Columbus Day, **Monday, October 11, 2010**. Therefore, it is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
October 4	October 7	October 11	October 21
5	8	12	22
6	12	13	26
7	13	14	27
8	14	15	28
11	14	18	28
12	15	19	29

Veteran's Day:

The securities exchanges will be **open** for trading on Veteran's Day, **Thursday, November 11, 2010**. Therefore, it is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
November 4	November 9	November 11	November 23
5	10	12	24
8	12	15	29
9	15	16	30
10	16	17	December 1
11	16	18	1
12	17	19	2

Thanksgiving Day:

The securities exchanges will be closed on **Thursday, November 25, 2010,** in observance of Thanksgiving Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
November 18	November 23	November 26	December 8
19	24	29	9
22	26	30	10
23	29	December 1	13
24	30	2	14
25	Markets Closed	_	_
26	December 1	3	15

Christmas Day:

The securities exchanges will be closed on **Friday**, **December 24**, **2010**, in observance of Christmas Day.

Trade Date	Settlement Date	Regulation T Date	SEC Extension Date
December 17	December 22	December 27	January 6, 2011
20	23	28	7
21	27	29	10
22	28	30	11
23	29	31	12
24	Markets Closed	_	_
27	30	January 3	13

New Rate for Fees Paid Under Section 31 of the Exchange Act

Effective Date: January 15, 2010

Executive Summary

The SEC has enacted its regular appropriation under Section 31 of the Securities Exchange Act of 1934. Effective January 15, 2010, the Section 31 fee will decrease the rate applicable to specified securities transactions on the exchanges and in the over-the-counter markets from \$25.70 per million dollars to \$12.70 per million dollars. This fee rate will remain in place until further notice.

Question concerning this Notice should be directed to:

- > Robert Wood, Senior Vice President, Finance, at (240)386-5298; or
- ➤ Kathleen O'Mara, Associate General Counsel, Office of Oversight Liaison and Counsel, at (240)386-5309.

Background and Discussion

After operating under a continuing resolution since the start of Fiscal Year (FY) 2010 on October 1, 2009, the Securities and Exchange Commission (SEC) announced in Fee Rate Advisory #4 for FY 2010 (see www.sec.gov/news/press/2009/2009-270.htm) that the appropriation bill that included funding for the SEC was signed by President Obama on December 16, 2009. Accordingly, the new Section 31 fee rate of \$12.70 per million dollars that is applicable to specified securities transactions on the exchanges and in the over-the-counter markets will take effect on January 15, 2010. Until that date, the current rate of \$25.70 per million dollars remains in effect.

December 24, 2009

Suggested Routing

- Compliance
- Legal
- Trading

Key Topic

➤ Section 31 Fee

Referenced Rules & Notices

- Section 3 of Schedule A to the By-Laws
- Section 31 of the Securities Exchange Act of 1934



The SEC is required to adjust the filing and securities transaction fee rates on an annual basis, after consultation with the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB). A copy of the SEC's April 30, 2009, order regarding the fee rates for FY 2010 is available at www.sec.gov/rules/other/2009/33-9030.pdf.

The SEC will announce the new fee rates for FY 2011 no later than April 30, 2010. The 2011 fee rates will become effective October 1, 2010, or after the SEC's FY 2011 appropriation is enacted, whichever is later. In addition, the SEC may be required to make a mid-year adjustment to the Section 31 fee rate for FY 2010, after consultation with CBO and OMB.

FINRA obtains its Section 31 fees from member firms, in accordance with Section 3 of Schedule A to the By-Laws. Section 3 specifies that the amount assessed on firms will be determined periodically in accordance with Section 31 of the Act.

December 2009 Supplement to the Options Disclosure Document

On December 10, 2009, the SEC approved a supplement to the Options Disclosure Document (www.optionsclearing.com/components/docs/December_2009_ODD_Definitive_Supplement.pdf) (ODD). The ODD contains general disclosures on the characteristics and risks of trading standardized options. The recently approved supplement adds disclosure regarding the characteristics and special risks of dividend index options. The supplement also adds disclosure stating that the options markets may use methods other than those specified in the ODD to set exercise prices. 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/components/docs/riskstoc.pdf). This supplement supersedes and replaces the September 2008 supplement to the ODD, which relates to selected index options, as described in Information Notice 11/12/08.

Rule 9b-1 under the Securities Exchange Act requires broker-dealers to deliver the ODD and supplements to customers.¹ FINRA has similar requirements in FINRA Rule 2360(b)(11)(A)(1), which requires firms to deliver the current ODD to each customer at or before the time the customer is approved to trade options. In addition, FINRA Rule 2360(b)(11)(A)(1) requires firms to distribute a copy of each ODD supplement to customers who previously received the ODD. Firms must deliver the ODD supplements no later than the time a customer receives a confirmation of a transaction in the category of options to which the amendment pertains. FINRA Rule 2360(b)(11)(A)(3) requires that FINRA advise firms when revisions to the ODD are made.

December 29, 2009

Suggested Routing

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

Key Topics

- Dividend Index Options
- Options
- Options Disclosure Document

Referenced Rules & Notices

- ➤ FINRA Rule 2360
- ➤ Information Notice 11/12/08
- ➤ NTM 98-03
- ➤ SEA Rule 9b-1



To comply with the requirements of FINRA Rule 2360(b)(11)(A)(1), firms may distribute the ODD supplement in various ways, including, but not limited to, one of the following:

- 1. conducting a mass mailing of the supplement to all of its customers approved to trade options who have already received the ODD; or
- 2. distributing the supplement to a customer who has already received the ODD not later than the time a customer receives a confirmation of a transaction in the category of options to which the amendment pertains.

FINRA reminds firms that they may electronically transmit documents that they are required to furnish to customers under FINRA rules, including the ODD and supplements thereto, provided the firm adheres to the standards contained in the May 1996 and October 1995 Securities Exchange Commission Releases² and as discussed in *Notice to Members 98-03* (January 1998)(www.finra.org/notices/98-03). As recently noted, firms may transmit the ODD and supplements to customers who have consented to electronic delivery through the use of a hyperlink.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 17 CFR 240.9b-1.
- 2 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).
- 3 See Securities Act Release No. 58738 (October 6, 2008) 73 FR 60371 (October 10, 2008).

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