

Notices

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Arbitration Fee Changes

Amendments to the Arbitration Rules on Fees Assessed Under the Postponement and Hearing Session Fee Rules

Effective Date: May 3, 2010

Executive Summary

Effective May 3, 2010, the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes clarify the applicability of the fee waiver provision of the postponement rule and codify the hearing session fee for an unspecified damages claim heard by one arbitrator.¹

The text of the amendments to the rules 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.

April 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topic(s)

- Arbitration
- Code of Arbitration Procedure
- Postponement Rule
- Hearing Session Fee Rule

Referenced Rules & Notices

- Rule 12601(b)(3)
- Rule 12902(a)(1)
- Rule 13601(b)(3)
- Rule 13902(a)(1)

Background and Discussion

FINRA is amending the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Code of Arbitration Procedure for Industry Disputes (Industry Code) (together, the Codes) to address the fee waiver provision of the postponement rule and the hearing session fee for one arbitrator in an unspecified damages claim. First, amendments to Rules 12601(b)(3) and 13601(b)(3)—referred to as the fee waiver provision of the postponement rule—clarify that FINRA will not waive the late postponement fee, as set forth in Rule 12601(b)(2), if parties request a postponement within three business days before the scheduled hearing session. Second, amendments to Rules 12902(a)(1) and 13902(a)(1) codify the forum’s current practice of charging \$450 per hearing session for an unspecified damages claim heard by one arbitrator.

Each amendment is discussed separately below.²

Amendment to Fee Waiver Provision of Postponement Rule

The Codes require arbitration hearings to be postponed if the parties agree.³ Hearings may also be postponed by the Director of FINRA Dispute Resolution (Director), by the panel in its own discretion, or by the panel on a motion of a party.⁴ If a hearing is postponed, the arbitration panel assesses a postponement fee against one or more of the parties, which is typically equivalent to the applicable hearing session fee that would have been assessed had the hearing been held.⁵

There are instances, however, in which a postponement fee is not assessed against the parties. For example, under the Codes, parties are not charged a postponement fee if they agree to submit the matter to mediation at FINRA.⁶ If the parties agree to mediation administered through FINRA, the Director waives the postponement fee.

Under Rule 12601(b)(2), if parties request and are granted a hearing postponement within three business days of a scheduled hearing session (*i.e.*, a late postponement request), the Director assesses a fee of \$100 per arbitrator.⁷ Some parties who make late postponement requests believe they should not be charged the \$100 late postponement fee if they express intent to mediate through FINRA.

To correct this misinterpretation and ensure uniform application of the fee waiver provision of the postponement rule, FINRA is amending the Codes⁸ to state, in relevant part, that 1) FINRA will not assess a postponement fee if a hearing is postponed because the parties agree to submit the matter to mediation administered through FINRA; and 2) the parties must pay the additional fees described in the rules for late postponement requests.

Amendment to the Hearing Session Fee for One Arbitrator in Unspecified Damages Claim

In the arbitration forum, if the parties and the arbitrator(s) meet to discuss the issues giving rise to the arbitration dispute, the meeting is called a “hearing session.”⁹ The Codes authorize FINRA to assess hearing session fees against the parties for each hearing session.¹⁰ The total amount charged to the parties for each hearing session is based on the amount in dispute.¹¹ For claims that do not request or specify money damages (*i.e.*, an unspecified damages claim), however, the Codes give the Director the discretion to determine the amount of the hearing session fee, except that the fee cannot exceed \$1,200.¹²

Currently, the fee charged for each hearing session in an unspecified damages claim heard by three arbitrators is \$1,000.¹³ However, for an unspecified damages claim heard by one arbitrator, the rules list the hearing session fee as not applicable (N/A).¹⁴ FINRA is amending the Codes to change the current amount for an unspecified damages claim heard by one arbitrator from N/A to \$450.¹⁵

FINRA notes that because hearing sessions with a single arbitrator in unspecified damage claims do occur, the chart of fees should not reflect that this scenario is “not applicable.” FINRA also notes that the Codes authorize the Director to determine whether the hearing session fee for an unspecified damages claim should be more or less than the amount specified in the fee schedules of the arbitration rules. The amendment will not change FINRA’s practice of reducing or waiving fees in documented cases of financial hardship.

Effective Date Provisions

The amendments become effective on May 3, 2010, and apply to claims filed on or after that date.

Endnotes

- 1 Exchange Act Release No. 61505 (Feb. 4, 2010), 75 Federal Register 7297 (Feb. 18, 2010) (File No. SR-FINRA-2009-075).
- 2 The amendments to the rules of the Customer Code are identical to those of the Industry Code. Thus, for simplicity, the discussion will focus on the amendments to Codes because the explanation and rationale apply to the same rules of each Code.
- 3 Rule 12601(a)(1) of the Customer Code, and Rule 13601(a)(1) of the Industry Code.
- 4 Rule 12601(a)(2) of the Customer Code, and Rule 13601(a)(2) of the Industry Code.
- 5 Rule 12601(b)(1) of the Customer Code, and Rule 13601(b)(1) of the Industry Code.
- 6 Rule 12601(b)(3) of the Customer Code and Rule 13601(b)(3) of the Industry Code.
- 7 Rule 12601(b)(2) of the Customer Code, and Rule 13601(b)(2) of the Industry Code.
- 8 Rule 12601(b)(3) of the Customer Code and Rule 13601(b)(3) of the Industry Code.
- 9 A hearing session can either be an arbitration hearing or a prehearing conference. Rule 12100(n) of the Customer Code and Rule 13100(n) of the Industry Code.
- 10 Rule 12902(a)(1) of the Customer Code and Rule 13902(a)(1) of the Industry Code.
- 11 *Id.*
- 12 Rule 12902(a)(2) of the Customer Code and Rule 13902(a)(2) of the Industry Code.
- 13 Note 10.
- 14 *Id.*
- 15 *Id.*

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

12601. Postponement of Hearings

(a) No change.

(b) Postponement Fees

(1) - (2) No change.

(3) No postponement fee will be charged if a hearing is postponed:

- Because the parties agree to submit the matter to mediation [at] administered through FINRA, except that the parties shall pay the additional fees described in Rule 12601(b)(2) for late postponement requests;
- By the panel in its own discretion; or
- By the Director in extraordinary circumstances.

(c) No change.

12902. Hearing Session Fees, and Other Costs and Expenses

(a) Hearing Session Fees

(1) Hearing session fees will be charged for each hearing session. The total amount chargeable to the parties for each hearing session is based on the amount in dispute, as specified in the schedule below. In the award, the panel will determine the amount of each hearing session fee that each party must pay.

Hearing Session Fees

Amount of Claim	Hearing Session W/One Arbitrator	Hearing Session W/Three Arbitrators
Up to \$2,500	\$50	N/A
\$2,500.01 to \$5,000	\$125	N/A
\$5000.01 to \$10,000	\$250	N/A
\$10,000.01 to \$25,000	\$450	N/A
\$25,000.01 to \$50,000	\$450	\$600
\$50,000.01 to \$100,000	\$450	\$750
\$100,000.01 to \$500,000	\$450	\$1,125
Over \$500,000	\$450	\$1,200
Unspecified Damages	[N/A] <u>\$450</u>	\$1,000

(2) – (4) No change.

(b) – (e) No change.

Industry Code**13601. Postponement of Hearings**

(a) No change.

(b) Postponement Fees

(1) - (2) No change.

(3) No postponement fee will be charged if a hearing is postponed:

- Because the parties agree to submit the matter to mediation [at] administered through FINRA, except that the parties shall pay the additional fees described in Rule 13601(b)(2) for late postponement requests;
- By the panel in its own discretion; or
- By the Director in extraordinary circumstances.

(c) No change.

13902. Hearing Session Fees, and Other Costs and Expenses**(a) Hearing Session Fees**

(1) Hearing session fees will be charged for each hearing session. The total amount chargeable to the parties for each hearing session is based on the amount in dispute, as specified in the schedule below. In the award, the panel will determine the amount of each hearing session fee that each party must pay.

Hearing Session Fees

Amount of Claim	Hearing Session W/One Arbitrator	Hearing Session W/Three Arbitrators
Up to \$2,500	\$50	N/A
\$2,500.01 to \$5,000	\$125	N/A
\$5000.01 to \$10,000	\$250	N/A
\$10,000.01 to \$25,000	\$450	N/A
\$25,000.01 to \$50,000	\$450	\$600
\$50,000.01 to \$100,000	\$450	\$750
\$100,000.01 to \$500,000	\$450	\$1,125
Over \$500,000	\$450	\$1,200
Unspecified Damages	[N/A] <u>\$450</u>	\$1,000

(2) – (3) No change.

(b) – (e) No change.

Hearing Locations

Amendments to the Arbitration Rules on Hearing Locations

Effective Date: May 3, 2010

Executive Summary

Effective May 3, 2010, amendments to the Codes of Arbitration Procedure for Customer and Industry Disputes expand the criteria for selecting a hearing location for an arbitration proceeding.¹

The text of the amendments to the rules 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.

Background and Discussion

Hearing Location Criteria Under the Customer Code

Currently, Rule 12213(a) of the Code of Arbitration Procedure for Customer Disputes (Customer Code) states that generally, the Director of FINRA Dispute Resolution (Director) will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute. For example, if a customer in an arbitration proceeding lives in Hoboken, New Jersey, the Director will select the New York City hearing location, because this hearing location is closer to the customer's residence² than the FINRA hearing location in Newark, New Jersey.

April 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topic(s)

- Arbitration
- Code of Arbitration Procedure
- Hearing Location

Referenced Rules & Notices

- Rule 12213(a)
- Rule 13213(a)

FINRA amended Rule 12213(a) to expand the criteria for selecting a hearing location. Specifically, the rule now states that the Director will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute, unless the hearing location closest to the customer's residence is in a different state. In that case, the customer may request a hearing location in the state where the customer resided at the time of the events giving rise to the dispute. Applying the amended rule to the example above, if the customer requests the Newark, New Jersey, hearing location, the Director generally will grant the request, even though the closest hearing location to the customer's residence is the New York City location.

Under the rule, the Director will continue to select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute. However, the Director will grant a customer's request for a different hearing location in the customer's state of residence, if the customer makes the request before the arbitrator or arbitrators are selected. After the arbitration panel is appointed, the customer must submit to the panel any request to change the hearing location.

Hearing Location Criteria Under the Industry Code

Rule 13213(a) of the Code of Arbitration Procedure for Industry Disputes (Industry Code) currently states, in relevant part, that in cases involving an associated person, the Director will generally select the hearing location closest to where the associated person was employed at the time of the dispute.

To maintain uniformity between the Codes, FINRA amended Rule 13213(a) to permit an associated person to select a hearing location in the state where the person was employed at the time of the events giving rise to the dispute,³ if the closest hearing location to the place of employment is in a different state. Specifically, the rule now states that the Director will select the hearing location closest to where the associated person was employed at the time of the events giving rise to the dispute, unless the hearing location closest to the associated person's employment is in a different state. In that case, the associated person may request a hearing location in the state where the person was employed at the time of the events giving rise to the dispute.

Under the rule, the Director will continue to select the hearing location closest to where the associated person was employed at the time of the events giving rise to the dispute. However, the Director will grant an associated person's request for a different hearing location in the associated person's state of employment, if the associated person makes the request before the arbitrator or arbitrators are selected. After the arbitration panel is appointed, the associated person must submit to the panel any request to change the hearing location.

Effective Date Provisions

The amendments will become effective on May 3, 2010, and will apply to claims filed on or after that date.

Endnotes

- 1 Exchange Act Release No. 61497 (Feb. 4, 2010), 75 Federal Register 6769 (Feb. 10, 2010) (File No. SR-FINRA-2009-073).
- 2 Hoboken, New Jersey, is less than a mile by ferry across the Hudson River from FINRA's New York City hearing location.
- 3 The amendment to Rule 13213(a) broadens the criteria for selecting the appropriate hearing location under the Industry Code by referring to "the time of the events giving rise to the dispute." This amendment clarifies current practice and makes the rule language under the Industry Code consistent with the same rule under the Customer Code.

ATTACHMENT A

New language is underlined.

Code of Arbitration Procedure for Customer Disputes

and

Code of Arbitration Procedure for Industry Disputes

Customer Code

12213. Hearing Locations

(a) U.S. Hearing Location

(1) The Director will decide which of FINRA's hearing locations will be the hearing location for the arbitration. Generally, the Director will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute, unless the hearing location closest to the customer's residence is in a different state, in which case the customer may request a hearing location in the customer's state of residence at the time of the events giving rise to the dispute.

(2) - (4) No change.

(b) No change.

Industry Code

13213. Hearing Locations

(a) U.S. Hearing Location

(1) The Director will decide which of FINRA's hearing locations will be the hearing location for the arbitration. In cases involving an associated person, the Director will generally select the hearing location closest to where the associated person was employed at the time of the events giving rise to the dispute, unless the hearing location closest to the associated person's employment is in a different state, in which case the associated person may request a hearing location in his or her state of employment at the time of the events giving rise to the dispute.

In cases involving members only or more than one associated person, the Director will consider a variety of factors, including:

- The parties' signed agreement to arbitrate, if any;
- Which party initiated the transaction or business in issue; and
- The location of essential witnesses and documents.

(2) - (4) No change.

(b) No change.

Master Accounts and Sub-Accounts

FINRA Issues Guidance on Master and Sub-Account Arrangements

Executive Summary

FINRA reminds firms that maintain master/sub-account arrangements that, depending on the facts and circumstances of such arrangements, a firm may be required to recognize the sub-accounts as separate customer accounts for the purposes of applying FINRA rules, the federal securities laws and other applicable federal laws.¹

Questions concerning this *Notice* should be directed to:

- ▶ Kris Dailey, Vice President, Risk Oversight & Operational Regulation, at (646) 315-8434;
- ▶ Glen Garofalo, Director, Credit Regulation, at (646) 315-8464; or
- ▶ Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Background & Discussion

The application of many FINRA rules, federal securities laws and other applicable federal laws depends on the nature of the account and the identity of its beneficial owners. At times, an account may take the form of a master/sub-account arrangement where the beneficial ownership interests in the various sub-accounts may or may not be identified to the firm. FINRA recognizes there are bona fide reasons to establish master/sub-account arrangements whereby the same beneficial owner maintains multiple sub-accounts (for example, to employ different trading strategies or to trade in different asset classes). However, certain master/sub-account arrangements raise questions regarding whether the master account and all sub-accounts have the same beneficial owner and, therefore, whether they can legitimately be viewed as one customer account for purposes of FINRA rules, the federal securities laws and other applicable federal laws.

April 2010

Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Senior Management

Key Topics

- ▶ Master/Sub-Accounts

In some instances, an investment adviser or introducing firm may establish a master account that maintains multiple sub-accounts that differentiate and identify the beneficial ownership of each sub-account. In such instances, the firm knows the identity of each beneficial owner of the sub-accounts and must recognize such sub-accounts as separate customer accounts for purposes of applying FINRA rules, the federal securities laws and other applicable federal laws.

However, there are other legitimate business arrangements where the identities of the beneficial owners are not disclosed to the firm. For example, FINRA recognizes that an “investment adviser” as defined by the Investment Advisers Act of 1940 and acting in such bona fide capacity (referred to as a “bona fide IA”), may employ sub-accounts for each account it advises without identifying the beneficial owner of each account for which it advises. Similarly, in omnibus clearing arrangements, a broker-dealer that is registered with the Securities and Exchange Commission (SEC) pursuant to the Securities Exchange Act of 1934 (referred to as a “registered IBD”) may procure clearing services for the customer accounts it services on a basis in which the identities of the sub-account owners are not disclosed to the clearing broker-dealer. In these limited cases involving a bona fide IA or a registered IBD, FINRA generally will permit a firm to rely upon the information provided to it by the bona fide IA or the registered IBD as to whether to treat a master/sub-account as having a single beneficial owner.

Apart from the general principles outlined above, if a firm has actual notice that the sub-accounts of a master account have different beneficial ownership (but does not know the identities of the beneficial owners) or the firm is privy to facts and/or circumstances that would reasonably raise the issue as to whether the sub-accounts, in fact, may have separate beneficial owners (and therefore is on “inquiry notice”), then the firm must inquire further and satisfy itself as to the beneficial ownership of each such sub-account. A firm would be on inquiry notice if, for example:

1. the sub-accounts are separately documented and/or receive separate reports from the firm;
2. the firm addresses the sub-accounts separately in terms of transaction, tax or other reporting;
3. the services provided to the sub-accounts engender separate surveillance and supervision of the sub-account for compliance with rules or for risk management purposes consistent with the review of separately owned accounts;
4. the firm has financial arrangements or transactions with the sub-accounts, or separate account terms, that reasonably raise questions concerning whether such accounts represent separate beneficial owners;
5. the sub-accounts incur charges for commissions, clearance and similar expenses, separately, based upon the activity only of that subject sub-account;

6. the firm has evidence of financial transactions or transfers of assets or cash balances that would reasonably evidence separate beneficial ownership of the sub-accounts;
7. the firm is aware of or has access to a master account or like agreement that evidences that the sub-accounts have different beneficial owners;
8. the firm has evidence that a party maintaining a master/sub-account arrangement has interposed sub-accounts that have or are intended to have the effect of hiding the beneficial ownership interest; or
9. the number of sub-accounts maintained is so numerous as to reasonably raise questions concerning whether such accounts represent separate beneficial owners.
10. Items 3, 4, 5, 6, 8 and 9 above would not apply in the case of a registered IBD or a bona fide IA arrangement described in this *Notice*.

This list is not exhaustive and is only included to reflect some types of “red flags” that would put a firm on inquiry notice that the sub-accounts may have separate beneficial owners.

When a firm becomes aware of the identities of the beneficial owners of the sub-accounts pursuant to its duties arising from actual notice or inquiry notice outlined above, the firm will be required to recognize the sub-accounts as separate customer accounts for purposes of applying FINRA rules, the federal securities laws and other applicable federal laws.

Endnotes

- 1 For purposes of this *Notice*, reference to the term “laws” shall include any rules and regulations that apply in furtherance of those provisions.

Consolidated Reports

FINRA Reminds Firms of Responsibilities When Providing Customers With Consolidated Financial Account Reports

Executive Summary

The practice of providing customers with consolidated financial account reporting has become increasingly common in the financial services industry. In many cases, these reports offer a single document that combines information regarding most or all of the customer's financial holdings, regardless of where those assets are held. Firms are reminded that these reports represent communications with the public by the firm; the dissemination of these reports must comply with all applicable FINRA rules as well as the federal securities laws.

As investor demand for this service has grown and as increasingly sophisticated software and data service providers have become available, firms have developed differing practices for generating these communications. If not rigorously supervised, this activity can raise a number of regulatory concerns, including the potential for communicating inaccurate, confusing or misleading information to customers, lapses in supervisory controls, and the use of these reports for fraudulent or unethical purposes.

This *Notice* reminds firms of their responsibilities to ensure that they comply with all applicable rules when engaging in this activity, and highlights a number of sound practices. Firms are strongly encouraged to review the overall adequacy and effectiveness of their current policies and procedures relating to their consolidated reporting. Any firm that cannot properly supervise the dissemination of consolidated reports by its registered representatives must prohibit the dissemination of those reports and take the necessary steps to ensure that its registered representatives comply with this prohibition.

April 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Legal
- Operations
- Registered Representatives
- Senior Management
- Systems
- Training

Key Topics

- Account Statements
- Communications with the Public
- Correspondence
- Internal Controls
- Supervision
- Supervisory Controls Systems

Referenced Rules & Notices

- NASD Rule 2210
- NASD Rule 2340
- NASD Rule 3010
- NASD Rule 3012
- NYSE Rule 342
- NYSE Rule 409
- Regulatory Notice 08-27
- NTM 05-48

General questions about this *Notice* should be directed to:

- ▶ Steve Kasprzak, Associate Director & Principal Counsel, Sales Practice Policy, Member Regulation, at (646) 315-8603; or
- ▶ Bill Hayden, Director, Emerging Regulatory Issues, at (202) 728-8860.

For questions about communications with the public, contact Amy Sochard, Director, Programs & Investigations, Advertising Regulation, at (240) 386-4508.

Discussion and Background

Many firms, as a service to their customers, provide documents that consolidate information regarding a customer's various financial holdings.¹ For the purpose of this *Notice* we will refer to this practice and document as "consolidated reporting" and "consolidated reports," respectively. These consolidated reports offer a broad view of customers' investments, may include assets held away from the firm, and may provide not only account balances and valuations, but performance data as well. In many cases these consolidated reports are prepared at the request of the customer, who may also direct which of his or her accounts to include and provide access to data for non-held accounts. These communications may supplement, but do not replace, the customer account statement required pursuant to NASD Rule 2340 and NYSE Rule 409,² which is prepared and disseminated to the customer through a separate process. Consolidated reports may not be represented as a substitute for, and must be distinguished from, account statements that are required by rule.

Firms create consolidated reports through fully integrated, in-house data gathering and reporting systems, fully outsourced solutions from third-party vendors,³ "off-the-shelf" software applications or a combination of these methods. Firms also disseminate these consolidated reports through a variety of means, such as direct mailing to customers, providing access to secure servers via the Internet and hand delivery during face-to-face meetings. The consolidated reports themselves may contain a variety of information and may be produced as a highly customized document created by an individual representative, or as a standardized report created by a firm system. To the extent individual representatives create consolidated reports, firms are required to supervise this activity, and both the firm and the individual representatives are responsible for compliance with all applicable rules.

Consolidated reports are communications with the public. Therefore, they must be clear, accurate and not misleading.⁴ For assets held at the firm, this includes providing information, including valuations, that is consistent with the customer's official account statement.⁵ For assets held away, this includes, among other things, taking reasonable steps to accurately reproduce information obtained regarding outside accounts and not to include information that is false or misleading.

Consolidated reports, particularly those published on firm letterhead, can create a

misconception that the firm produced or verified all of the data, including the valuation of assets held away. Therefore, these reports should be constructed and provided in such a manner that neither customers nor third parties with whom the customer interacts (*e.g.*, banks, mortgage companies, other broker-dealers) are likely to be confused or misled as to the nature of the information presented, or mistake these documents for official account statements regarding the reported assets. The reports should clearly delineate between information regarding assets held on behalf of the customer, which are included on the firm's books and records, and other external accounts or assets.

If a firm is unable to test or otherwise validate data for non-held assets, including valuation information, the firm should clearly and prominently disclose that the information provided for those assets is unverified. In addition, to the extent a consolidated report contains information regarding financial products that are outside a registered representative's area of proficiency, representatives must discuss and present these financial products in a manner that does not mislead customers as to the scope of the representative's financial expertise.⁶

Consolidated reports are also subject to the regulatory requirements regarding supervision and internal controls, records retention, privacy and safeguarding of customer information.⁷ Effective firm controls would include procedures to vet and approve consolidated report templates for compliance with regulatory requirements before they are put into production. These reviews can help ensure that any new consolidated report-generating process complies with regulatory requirements and firm policies, and that it is integrated into the firm's supervisory control program. Similar controls should be put in place for any programming that permits customization, as well as any subsequent changes to the approved templates or programming.

The risks associated with a firm's failure to maintain adequate safeguards over the use and dissemination of customer account information are well established. Beyond the obvious concern regarding the use of account information for fraudulent activity, even well-intentioned but incautious consolidated reporting could result in customers being misled or confused. Given the reliance that customers may place on consolidated reports and the potential consequences if these communications contain mistakes or are misused by firm personnel, firms must review their consolidated reporting programs with particular care. The more complex a firm's program for consolidated reporting, the more difficult it may be to conform that reporting to applicable rule requirements. Factors that contribute to program complexity include:

- the production within a firm of a large number of varying types of consolidated reports, especially consolidated reports that are highly customizable;
- reporting on a wide variety of asset classes, especially assets held outside the firm; and
- a decentralized consolidated reporting structure employing multiple reporting systems.⁸

If a firm provides this service to customers, it must ensure that the size and complexity of the consolidated reporting program does not exceed the firm's ability to supervise the activity and to subject it to a rigorous system of internal controls. Any firm that cannot properly supervise the dissemination of consolidated reports by its registered representatives must prohibit the dissemination of those reports and take necessary steps to ensure that its registered representatives comply with this prohibition.

Sound Practices

FINRA encourages firms to consider the practices described below when reviewing their consolidated reporting programs. This *Notice* is not intended to be a comprehensive roadmap for compliance and supervision; rather, it outlines measures that may assist firms in complying with their various supervisory obligations. Firms should consider these practices in assessing their own procedures and in implementing improvements that will best protect their customers. Firms must adopt procedures and controls that are most effective given the firm's size, structure and operations.

1. Ongoing audits and reviews

Due to the potential risks related to consolidated reporting, some firms have incorporated a review of the consolidated reporting process as a standard element in their testing and oversight programs. These firms test for regulatory compliance, data accuracy and adherence to supervisory procedures in audits, branch office reviews and as an ongoing part of their program of internal inspections required by NASD Rule 3010. Some firms require branch offices that produce consolidated reports to obtain an annual third-party audit of the process.

2. Centralize reporting systems

Maintaining multiple consolidated reporting systems can create a patchwork of processes and applications that may be difficult to adequately supervise. Some firms have chosen to centralize their consolidated reporting programs by requiring use of a single firm-wide system. Other firms that allow multiple report-producing systems, subject them to a centralized review and approval process. Participants in this review and approval process may include personnel from information technology, compliance and legal departments.

3. Customer addresses

Some of the stronger programs require that all consolidated reports be mailed centrally using the customer's address of record,⁹ and have processes in place that reconcile address information used for account statements and consolidated reports. In the limited circumstances where different addresses are used to deliver customer account statements and consolidated reports, firms should maintain documentation explaining the discrepancy and indicating that the customer was provided notice or acknowledged the differing addresses.¹⁰

4. Assets held away

Some firms verify, when possible, information pertaining to assets held away. Some of these firms have opted not to include assets in the consolidated report when the firm cannot verify their existence or cannot validate the valuations.

5. Supporting documentation

Some firms maintain supporting documentation for reported assets with the customer file, or otherwise have it available to be reviewed alongside the consolidated report. This documentation may include information regarding source of data and methods used to determine accuracy and asset valuation. The information may be useful in discussing the consolidated reports with customers, in validating the accuracy of consolidated report-generating systems and for internal control/audit testing purposes.

6. Source documents

It is sound practice to encourage customers to review and maintain the original source documents that are integrated into the consolidated report, such as the statements for individual accounts held away from the broker-dealer. Customers may be tempted to disregard these source documents because of the convenience of the consolidated report. However, source documents may contain notices, disclosures and other information important to the customer, and may also serve as a reference should questions arise regarding the accuracy of the information in the consolidated report.

7. Report design

The design and formatting of consolidated reports is important for ensuring information is clearly communicated. In addition to the requirements outlined above, firms are encouraged to include, when applicable, the following disclosures:¹¹

- that the consolidated report is provided for informational purposes and as a courtesy to the customer, and may include assets that the firm does not hold on behalf of the customer and which are not included on the firm's books and records;
- the names of the entities providing the source data or holding the assets, their relationship with each other (*e.g.*, parent, subsidiary or affiliated organization) and their respective functions (introducing/carrying brokerage firms, fund distributor, banking/insurance product providers, etc.);
- a statement clearly distinguishing between assets held or categories of assets held by each entity included in the consolidated report;
- the customer's account number and contact information for customer service at each entity included in the consolidated report;
- identify that assets held away may not be covered by SIPC¹²; and
- if the consolidated report provides aggregate values for several different assets, an explanation of how the aggregated values of the different types of assets were arithmetically derived from separate asset totals.

8. Disclosures and attestations

To help ensure that a customer is apprised of the nature of the consolidated reporting process, and to ensure delivery of any disclosures or other pertinent information, firms may consider obtaining the customer's signed acknowledgement that he or she has been provided with the relevant disclosures and understands the nature and limitations of the consolidated reporting process. These disclosures may, for example, be included with applicable communications regarding privacy protections. Firms should consider a means to refresh this notice on a periodic basis.

Endnotes

- 1 This reporting is most commonly issued by firms that maintain an affiliated investment adviser or by registered representatives who also provide investment advisory services to their customers.
- 2 The FINRA rulebook currently consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and the 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). For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.
- 3 Vendors include Web-based application service providers (ASPs) that aggregate financial data and create reports to firm specifications that may be mailed to customers or, if the firm desires, can be accessed on a read-only basis from the ASP's Web server. To the extent that firms rely on third-party vendors, firms are responsible for complying with applicable requirements regarding outsourcing, as discussed in *Notice to Members 05-48*. The *Notice* clarifies firm responsibilities when outsourcing "covered activities," which the *Notice* identifies as activities or functions that, if performed directly by firms, would be required to be the subject of a supervisory system and written supervisory procedures pursuant to NASD Rule 3010.
- 4 Depending on the form, content and method of dissemination, these consolidated reports may be considered sales literature or correspondence. As such, they may be subject to various requirements outlined in NASD Rules 2210 and 2211 and associated guidance, such as the requirement for clear and prominent display of the firm's name on communications and disclosures related to use of performance information.
- 5 Inaccuracies may include discrepancies associated with having consolidated reports and customer account statements produced through separate systems or by different entities. For example, firms have reported finding numerous instances in which the same in-house transaction was reflected differently in each document, thereby requiring a correction before publication or dissemination.
- 6 NASD Rule 2210(d)(1)(A). See also *Regulatory Notice 08-27* (May 2008) (Misleading Communications About Expertise).
- 7 The better information security programs routinely test controls over access to systems and data related to the reporting process as part of the firm's internal controls regime. Access controls must be rigorously supervised to avoid unauthorized use or manipulation of customer account data.
- 8 These multi-system situations often arise when a firm affiliates with or acquires a new group of representatives or branch offices that bring with them legacy systems. In some instances, a reporting system may be unique to a single branch office, even to the extent that a single branch may maintain a separate contractual relationship with a third-party vendor to provide these services.

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Endnotes continued

- 9 Firms are required to have procedures to review, monitor and validate customer changes of address. These policies and procedures must include “a means or method of customer confirmation, notification, or follow-up that can be documented.” NASD Rule 3012(a)(2)(B) and NYSE Rule 401.
- 10 This is consistent with NYSE Rule 409(b) and FINRA’s proposed rule change to adopt NASD Rule 2340 (Customer Account Statements) as FINRA Rule 2231. Proposed Supplementary Material .01 (Transmission of Customer Account Statements to Other Persons or Entities) would expressly require a firm to obtain written instructions from the customer in order to send/deliver customer statements, confirmations or other communications to other persons or entities. *See Securities Exchange Act Release No. 59921 (May 14, 2009), 74 FR 23912 (May 21, 2009).*
- 11 These elements are drawn from existing guidance relating to multi-account reporting practices for customer account statements in NYSE Rule Interpretations 409(a)/04 (Assets Externally Held and Included on Statements Solely as a Service to Customers) and (a)/06 (Use of Summary Statements) and are consistent with FINRA’s proposed rule change to adopt NASD Rule 2340 (Customer Account Statements) as FINRA Rule 2231. The multi-account reporting guidance in proposed FINRA Rule 2231, Proposed Supplementary Material .04 (Assets Externally Held and Included on Statements Solely as a Service to Customers) and Proposed Supplementary Material .06 (Use of Summary Statements) are substantially unchanged from existing NYSE Rule Interpretations 409(a)/4 and 409(a)/6. *See Securities Exchange Act Release No. 59921 (May 14, 2009), 74 FR 23912 (May 21, 2009).*
- 12 Firms should consider including a disclosure clarifying that their firm’s SIPC coverage would only apply to those assets held at the firm, and to the extent some of the other reported entities may be SIPC members, customers should contact their financial representative or the other entity or refer to the other entity’s statement regarding SIPC membership.

Continuing Education

Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory Update

The Securities Industry/Regulatory Council on Continuing Education (Council) has released its Spring 2010 Firm Element Advisory (FEA). The Council produces the FEA to identify regulatory and sales practice topics that firms should consider in their Firm Element training plans. Topics updated or added since the prior FEA are indicated in the document as such.

The updated FEA is available at www.cecouncil.com/publications/council_publications/FEA_Semi_Annual_Update.pdf.

The FEA topics are not exhaustive and are intended as a guide to firms when they determine what to include in their training plans. Firms should consider the specific nature of their business, clients, products and services when creating their training plans.

In addition to the FEA, the Council offers the Firm Element Content Builder (formerly the Firm Element Organizer), a Web-based tool that can assist firms in developing their Firm Element training plans. It enables users to search an extensive database of regulatory resources related to specific investment products or services and is available at www.cecouncil.com/firm_element/organizer.

Questions concerning this *Notice* should be directed to:

- cecounciladmin@finra.org; or
- Roni Meikle, Director, Continuing Education, FINRA, at (646) 315-8688.

April 2010

Notice Type

- Guidance

Suggested Routing

- Compliance
- Continuing Education
- Legal
- Registration
- Senior Management

Key Topics

- Continuing Education
- Firm Element

SEC Approves New Consolidated FINRA Rules

SEC Approval and Effective Dates for New Consolidated FINRA Rules and the Repeal of Certain NASD and Incorporated NYSE Rules

Effective Date: June 14, 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 February and March 2010, the SEC approved six rule filings relating to the Consolidated FINRA Rulebook. The effective date for all of the proposed rule changes is June 14, 2010.

Questions regarding this *Notice* should be directed to:

- Afshin Atabaki, Assistant General Counsel, Office of General Counsel (OGC), at (202) 728-8902 (regarding FINRA Rule 3240);
- Kosha Dalal, Associate Vice President, OGC, at (202) 728-6903 (regarding the repeal of Incorporated NYSE Rule 405(4));
- Erika L. Lazar, Counsel, OGC, at (202) 728-8013 (regarding FINRA Rule 3160 and the repeal of NASD Rules 2760 and 2780, Incorporated NYSE Rules 2B and 411, and the Interpretation to Incorporated NYSE Rule 411(a)(ii)(5));
- Stan Macel, Assistant General Counsel, OGC, at (202) 728-8056 (regarding the repeal of NASD Rule 2450, NASD IM-2830-2 and Incorporated NYSE Rule 413); or
- Racquel Russell, Assistant General Counsel, OGC, at (202) 728-8363 (regarding FINRA Rule 2261).

April 2010

Notice Type

- Consolidated Rulebook
- Rule Approval

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topics

- Borrowing From or Lending to Customers
- Disclosure of Financial Condition
- Networking Arrangements

Referenced Rules & Notices

- FINRA Rule 2261
- FINRA Rule 3160
- FINRA Rule 3240
- Information Notice 03/12/08
- Information Notice 10/06/08
- Regulatory Notice 08-57

Discussion

In February and March 2010, the SEC approved the following three FINRA rules for adoption as part of the Consolidated FINRA Rulebook:

- ▶ Rule 2261 (Disclosure of Financial Condition);³
- ▶ Rule 3160 (Networking Arrangements Between Members and Financial Institutions);⁴ and
- ▶ Rule 3240 (Borrowing From or Lending to Customers).⁵

The attachment to this *Notice* sets forth additional information regarding these new consolidated rules and includes a hyperlink to the related rule filings. 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 and/or Incorporated NYSE Rules as they exist in the Transitional Rulebook. Also, the text of each new FINRA Rule is available in the online *FINRA Manual* at www.finra.org/finramanual.⁶

The attachment to this *Notice* further summarizes three additional rule filings relating to the Consolidated FINRA Rulebook approved by the SEC in February and March 2010. The rule filings address FINRA's repeal of: (1) NASD Rules 2760 and 2780, Incorporated NYSE Rules 2B and 411, and the Interpretation to Incorporated NYSE Rule 411(a)(ii)(5);⁷ (2) NASD Rule 2450, NASD IM-2830-2 and Incorporated NYSE Rule 413;⁸ and (3) Incorporated NYSE Rule 405(4).⁹

Rule Conversion Charts

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

- 1 *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).*
- 2 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The 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.
- 3 *See Exchange Act Release No. 61540 (February 18, 2010), 75 FR 8778 (February 25, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-081).*
- 4 *See Exchange Act Release No. 61706 (March 15, 2010), 75 FR 13632 (March 22, 2010) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1; File No. SR-FINRA-2009-047).*
- 5 *See Exchange Act Release No. 61537 (February 18, 2010), 75 FR 8772 (February 25, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-095).*
- 6 FINRA updates the rule text on its online *Manual* within two business days of SEC approval of changes to the rule text.
- 7 *See Exchange Act Release No. 61473 (February 2, 2010), 75 FR 6422 (February 9, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-087).*
- 8 *See Exchange Act Release No. 61542 (February 18, 2010), 75 FR 8768 (February 25, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-093).*
- 9 *See Exchange Act Release No. 61808 (March 31, 2010), 75 FR 17456 (April 6, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-005).*

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ATTACHMENT A

List of Approved Rules (and Related Rule Filings)

In February and March 2010, the SEC approved new FINRA Rules 2261, 3160 and 3240 and the repeal of NASD Rules 2450, 2760 and 2780, NASD IM-2830-2, Incorporated NYSE Rules 2B, 405(4), 413 and 411, and the Interpretation to Incorporated NYSE Rule 411(a)(ii)(5). The effective date for the new FINRA rules and the repeal of the NASD and Incorporated NYSE rules is June 14, 2010. The hyperlinks to the rule filings are included.

FINRA Rule Filing SR-FINRA-2009-081

www.finra.org/Industry/Regulation/RuleFilings/2009/P120399

FINRA Rule 2261

The rule change combines NASD Rule 2270 (Disclosure of Financial Condition to Customers) and NASD Rule 2910 (Disclosure of Financial Condition to Other Members), with certain modifications, into new FINRA Rule 2261 (Disclosure of Financial Condition). FINRA Rule 2261 sets forth members' obligations regarding making available to customers and other members information contained in a member's most recent balance sheet. Specifically, FINRA Rule 2261 provides that a member must make available to inspection by any bona fide regular customer, upon request, the information relative to such member's financial condition as disclosed in its most recent balance sheet prepared either in accordance with such member's usual practice or as required by any state or federal securities laws, or any rule or regulation thereunder.

FINRA Rule 2261 also permits a member to deliver the balance sheet to the requesting customer in paper or electronic form in lieu of making such balance sheet available to inspection, provided that, with respect to electronic delivery, the customer has consented to receive the balance sheet in electronic form. Rule 2261 defines the term "customer" as any person who, in the regular course of such member's business, has cash or securities in the possession of such member.

Additionally, FINRA Rule 2261 requires that any member who is party to an open transaction (or who has on deposit cash or securities of another member) deliver upon written request by the other member, in paper or electronic form, a statement of its financial condition as disclosed in its most recent balance sheet prepared either in accordance with such member's usual practice or as required by any state or federal securities laws, or any rule or regulation thereunder. Consent of the other member is not required to permit electronic delivery of the balance sheet.

Rule/Series No.	Rule Title
Rule 2000 Series	DUTIES AND CONFLICTS
Rule 2200 Series	COMMUNICATIONS AND DISCLOSURES
Rule 2260 Series	Disclosures
Rule 2261	Disclosure of Financial Condition

FINRA Rule Filing SR-FINRA-2009-047

www.finra.org/Industry/Regulation/RuleFilings/2009/P119402

FINRA Rule 3160

The rule change adopts NASD Rule 2350 into the Consolidated FINRA Rulebook as FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions), subject to certain changes to streamline the rule and to reflect applicable provisions of the Gramm-Leach-Bliley Act (GLB) and Regulation R. The rule change conforms the scope of FINRA Rule 3160 to the networking exception in GLB. With the exception of those requirements addressing the physical setting, FINRA Rule 3160 applies to a member that is a party to a networking arrangement with a financial institution under which the member offers broker-dealer services, regardless of whether the member is conducting broker-dealer services on or off the premises of a financial institution. Additionally, the rule change aligns the setting provision in FINRA Rule 3160 with GLB and its associated rules in Regulation R. It also clarifies that a member's networking agreement must include all broker-dealer obligations, as applicable, in Regulation R Rule 701 and that, independent of its contractual obligations, the member must comply with all such broker-dealer obligations.

FINRA Rule 3160 requires that a member that is a party to a networking arrangement with a financial institution provide certain written disclosures, at or prior to the opening of a customer account, including that securities products are: (1) not FDIC insured; (2) not deposits or other obligations of the financial institution and are not guaranteed by the financial institution; and (3) subject to investment risk, including possible loss of the principal invested (the "disclosures"). FINRA Rule 3160 also requires that such a member make the disclosures orally at or prior to the time that a customer account is opened if the account is opened on the premises of a financial institution. In addition, FINRA Rule 3160 expands the disclosure requirements with respect to a member's advertisements and sales literature so a member must include the disclosures on any advertisements and sales literature that: (1) announce the location of a financial institution where broker-dealer services are provided by the member; (2) are distributed by the member on the premises of a financial institution; (3) promote the name or services of the financial institution; or (4) are distributed by the member at any other location where the financial institution is present or represented.

Rule/Series No.	Rule Title
Rule 3000 Series	SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS
Rule 3100 Series	SUPERVISORY RESPONSIBILITIES
Rule 3160	Networking Arrangements Between Members and Financial Institutions

FINRA Rule Filing SR-FINRA-2009-095

www.finra.org/Industry/Regulation/RuleFilings/2009/P120660

FINRA Rule 3240

The rule change adopts NASD Rule 2370 (Borrowing From or Lending to Customers), with several changes, into the Consolidated FINRA Rulebook as FINRA Rule 3240 (Borrowing From or Lending to Customers). FINRA Rule 3240 prohibits registered persons from borrowing money from or lending money to their customers unless the firm has written procedures allowing such lending arrangements and: (1) the customer is a member of the registered person's immediate family; (2) the customer is in the business of lending money; (3) the customer and the registered person are both registered persons of the same firm; (4) the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or (5) the lending arrangement is based on a business relationship outside of the broker-customer relationship. Additionally, with the exception of lending arrangements between immediate family members and lending arrangements between registered persons and customers in the business of lending money, firms are required to pre-approve in writing the other lending arrangements described above.

The rule change amends the provision regarding permissible lending arrangements between registered persons and customers in the business of lending money to indicate more explicitly that such customers must be acting in the course of such business. Further, the rule change requires expressly that registered persons notify their member firms of the lending arrangements that require pre-approval and clarifies that any modifications to such lending arrangements (including any extension of the duration of such arrangements) are also subject to notification and pre-approval. The rule change also requires that firms preserve the written pre-approval required by the rule for at least three years after the date that the lending arrangement has terminated or for at least three years after the registered person's association with the firm has terminated.

Rule/Series No.	Rule Title
Rule 3000 Series	SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS
Rule 3200 Series	RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS
Rule 3240	Borrowing From or Lending to Customers

FINRA Rule Filing SR-FINRA-2009-087

www.finra.org/Industry/Regulation/RuleFilings/2009/P120494

The rule change repeals NASD Rule 2760 (Offerings “At the Market”) and NASD Rule 2780 (Solicitation of Purchases on an Exchange to Facilitate a Distribution of Securities) to reduce confusion and regulatory overlap. NASD Rule 2760 is similar to Exchange Act Rule 15c1-8, which FINRA believes appropriately protects investors without duplication by NASD Rule 2760. NASD Rule 2780 duplicates Exchange Act Rule 10b–2, which was rescinded by the SEC in 1993 because it was duplicative of other provisions of the federal securities laws, including SEC Regulation M. Therefore, FINRA believes NASD Rule 2780 should be deleted. The rule change also repeals Incorporated NYSE Rule 2B (No Affiliation between Exchange and any Member Organization), Incorporated NYSE Rule 411 (Erroneous Reports), and the Interpretation to Incorporated NYSE Rule 411(a)(ii)(5)¹ because such rules and interpretation relate to activity that concerns solely the NYSE marketplace and, in the case of Rule 411(b)(2), is duplicative of existing SEC recordkeeping requirements.

FINRA Rule Filing SR-FINRA-2009-093

www.finra.org/Industry/Regulation/RuleFilings/2009/P120633

The rule change repeals NASD Rule 2450 (Installment or Partial Sales), NASD IM-2830-2 (Maintaining the Public Offering Price) and Incorporated NYSE Rule 413 (Uniform Forms) to eliminate duplicative and unnecessary rules and remove outdated provisions from FINRA’s rulebook.

The requirements of NASD Rule 2450 are no longer necessary in light of the explicit provisions in Regulation T requiring the deposit of sufficient funds within the specified payment period. In addition, the hypothecation prohibition in NASD Rule 2450 is no longer relevant because it is predicated on a partial or installment payment under the rule. NASD IM-2830-2 is no longer relevant since today virtually all broker-dealers doing business with the public are FINRA members. In addition, NASD IM-2830-2 duplicates the requirement in Investment Company Act Section 22(d) to sell mutual fund shares to investors at the current public offering price. Incorporated NYSE Rule 413 is duplicative of several provisions in the FINRA By-Laws by which FINRA may prescribe processes for members’ activities, including the use of uniform forms.

FINRA Rule Filing SR-FINRA-2010-005

www.finra.org/Industry/Regulation/RuleFilings/2010/P120754

The rule change repeals Incorporated NYSE Rule 405(4) (Common Sales Accounts) because it contains terms that are not clearly defined and may raise potential investor protection concerns. Incorporated NYSE Rule 405(4) permits a member to effect sales of securities for customers without expressly requiring prior customer consent and without the need to send periodic account statements to the customer. FINRA notes that in the event a member may seek permission not to send customer account statements under certain limited circumstances, proposed FINRA Rule 2231 which relates to customer account statements, would authorize FINRA to exempt members from the provisions of such rule, including the requirement to deliver periodic account statements, pursuant to the Rule 9600 Series.

- 1 Although this Interpretation relates to NYSE Rule 411(a)(ii)(5), it appears in the Transitional Rulebook and in NYSE's Rulebook under the Interpretation to NYSE Rule 410.

Regulation D Offerings

Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings

Executive Summary

FINRA reminds broker-dealers of their obligation to conduct a reasonable investigation of the issuer and the securities they recommend in offerings made under the Securities and Exchange Commission's Regulation D under the Securities Act of 1933—also known as private placements.

Regulation D provides exemptions from the registration requirements of Section 5 under the Act. Regulation D transactions, however, are not exempt from the antifraud provisions of the federal securities laws. A broker-dealer has a duty—enforceable under federal securities laws and FINRA rules—to conduct a reasonable investigation of securities that it recommends, including those sold in a Regulation D offering.

Moreover, any broker-dealer that recommends securities offered under Regulation D must meet its suitability requirements under NASD Rule 2310 (Suitability), and must comply with the advertising and supervisory rules of FINRA and the SEC.

Questions regarding this *Notice* should be directed to:

- ▶ Joseph E. Price, Senior Vice President Corporate Financing/Advertising, at (240) 386-4623;
- ▶ Paul Mathews, Director, Corporate Financing Department, at (240) 386-4639; or
- ▶ Gary Goldsholle, Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8104.

April 2010

Notice Type

- ▶ Guidance

Suggested Routing

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

Key Topics

- ▶ Communications With the Public
- ▶ Private Placements
- ▶ Suitability
- ▶ Supervision

Referenced Rules & Notices

- ▶ Regulation D
- ▶ Securities Act Section 17
- ▶ SEA Section 10(b)
- ▶ Rule 10b-5
- ▶ FINRA Rule 2010
- ▶ FINRA Rule 2020
- ▶ NASD Rule 2210
- ▶ NASD Rule 2310
- ▶ NASD Rule 3010
- ▶ NTM 03-71
- ▶ NTM 05-18
- ▶ NTM 05-48
- ▶ Regulatory Notice 09-05

Background and Discussion

Part I of this *Notice* describes Regulation D. Part II describes broker-dealers' regulatory responsibilities to engage in a reasonable investigation of a Regulation D offering, enforceable under the antifraud provisions of the federal securities laws and FINRA rules. Part II also describes specific issues that pertain to a broker-dealer's (BD's) responsibilities and how the scope of a BD's responsibility to conduct a reasonable investigation will necessarily depend upon its affiliation with the issuer, its role in the transaction, and other facts and circumstances of the offering, including whether the offerees are retail investors or more sophisticated institutional investors.¹

Part III describes practices that some broker-dealers have adopted to help them discharge their reasonable investigation obligations. These practices are especially relevant to Regulation D offerings of securities of companies that are non-reporting under the Securities Exchange Act of 1934. BDs, however, may find that many of the practices are appropriate for other types of offerings.

I. Regulation D

The private placement market is an essential source of capital for American business, particularly small firms. According to one estimate, in 2008 companies intended to issue approximately \$609 billion of securities in Regulation D offerings.² While the private placement market is an important source of capital for many U.S. companies, especially smaller issuers, FINRA has found significant problems in several recent examinations and investigations. These problems include fraud and sales practice abuses in Regulation D offerings. Recently, for example, broker-dealers were sanctioned for providing private placement memoranda and sales materials to investors that contained inaccurate statements or omitted information necessary to make informed investment decisions.³

Rule 504 under Regulation D provides an exemption from the registration provisions under Section 3(b) of the Securities Act for limited offerings for which the aggregate offering price of securities within a 12-month period does not exceed \$1,000,000. Rule 505 provides an exemption under Section 3(b) of the Act for limited offerings for which the aggregate offering price of securities within a 12-month period does not exceed \$5,000,000. Rule 505 permits an offering to an unlimited number of "accredited investors" and up to 35 non-accredited investors. Rule 501 defines "accredited investor" as any person who meets, or who the issuer reasonably believes meets, certain requirements, including natural persons with a net worth in excess of \$1,000,000, or annual income in excess of \$200,000 (or \$300,000 jointly with a spouse).

Rule 506 provides a legal safe harbor for an exemption from registration under Section 4(2) of the Act for the sale of securities to an unlimited number of accredited investors and up to 35 non-accredited investors. Rule 506 (unlike Rule 505) does not limit the permissible size of the offering, but requires that non-accredited investors possess a degree of financial sophistication. Specifically, Rule 506 requires that each non-accredited investor, “either alone or with his purchaser representative(s),” have “such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment,” or the issuer must reasonably believe immediately prior to making any sale that the purchaser comes within this description.

Rule 505 and Rule 506 do not require that an issuer provide any specific written information concerning the offering to accredited investors, although issuers must provide specified information to a non-accredited investor who purchases in an offering. In practice, issuers often provide a private placement memorandum that describes the offering to all prospective purchasers, including accredited investors.⁴

II. BD Regulatory Requirements in Regulation D Offerings

A. Antifraud Provisions and FINRA Rules

The Securities and Exchange Commission (SEC) and federal courts have long held that a BD that recommends a security is under a duty to conduct a reasonable investigation concerning that security and the issuer’s representations about it.⁵ This duty emanates from the BD’s “special relationship” to the customer, and from the fact that in recommending the security, the BD represents to the customer “that a reasonable investigation has been made and that [its] recommendation rests on the conclusions based on such investigation.”⁶ Failure to comply with this duty can constitute a violation of the antifraud provisions of the federal securities laws and, particularly, Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.⁷ It also can constitute a violation of FINRA Rule 2010, requiring adherence to just and equitable principles of trade, and FINRA Rule 2020, prohibiting manipulative and fraudulent devices.⁸

Courts have found that the amount and nature of the investigation required depends, among other factors, upon the nature of the recommendation, the role of the broker in the transaction, its knowledge of and relationship to the issuer, and the size and stability of the issuer.⁹ For example, the SEC and courts recognize that a more thorough investigation is required for “securities issued by smaller companies of recent origin,”¹⁰ which could include many Regulation D issuers. While there are no “iron clad rules as to what a broker must do to meet his responsibility,”¹¹ the presence of any “red flags” also would alert the broker to the need for further inquiry.¹² Each BD must make a determination of the scope of its investigation based upon the facts and circumstances.

A BD that lacks essential information about an issuer or its securities when it makes a recommendation, including recommendations of securities in Regulation D offerings, must disclose this fact as well as the risks that arise from its lack of information.¹³ The degree to which a broker-dealer that relies on information supplied by the issuer may be found to have conducted a reasonable investigation as a basis for its recommendation will depend on the facts and circumstances. With respect to reporting companies under the Securities Exchange Act, in the absence of red flags, a BD that is not an underwriter typically may rely upon the current registration statement and periodic reports of the public company.

In general, however, a BD “may not rely blindly upon the issuer for information concerning a company,”¹⁴ nor may it rely on the information provided by the issuer and its counsel in lieu of conducting its own reasonable investigation.¹⁵ While BDs are not expected to have the same knowledge as an issuer or its management, firms are required to exercise a “high degree of care” in investigating and independently verifying an issuer’s representations and claims.¹⁶ Indeed, when an issuer seeks to finance a new speculative venture, BDs “must be particularly careful in verifying the issuer’s obviously self-serving statements.”¹⁷

The fact that a BD’s customers may be sophisticated and knowledgeable does not obviate the duty to investigate.¹⁸ Moreover, in Regulation D offerings the SEC advises issuers to provide the same information to accredited investors as they are required to provide to non-accredited investors, in view of the antifraud provisions.¹⁹

B. FINRA Suitability Obligations

NASD Rule 2310 states that a BD must have reasonable grounds to believe that a recommendation to purchase, sell or exchange a security is suitable for the customer.²⁰ This analysis has two principal components. First, the “reasonable basis” suitability analysis requires the BD to have a reasonable basis to believe, based on a reasonable investigation, that the recommendation is suitable for at least some investors. Second, the “customer specific suitability” analysis requires that the BD determine whether the security is suitable for the customer to whom it would be recommended.²¹

In the context of a Regulation D offering, Rule 2310 requires broker-dealers to conduct a suitability analysis when recommending securities to both accredited and non-accredited investors that will take into account the investors’ knowledge and experience. The fact that an investor meets the net worth or income test for being an accredited investor is only one factor to be considered in the course of a complete suitability analysis. The BD must make reasonable efforts to gather and analyze information about the customer’s other holdings, financial situation and needs, tax status, investment objectives and such other information that would enable the firm to make its suitability determination. A BD also must be satisfied that the customer “fully understands the risks involved and is...able...to take those risks.”²²

In order to ensure that it has fulfilled its suitability responsibilities, a BD in a Regulation D offering should, at a minimum, conduct a reasonable investigation concerning:

- the issuer and its management;
- the business prospects of the issuer;
- the assets held by or to be acquired by the issuer;
- the claims being made; and
- the intended use of proceeds of the offering.²³

A BD must conduct a reasonable investigation in connection with each offering, notwithstanding that a subsequent offering may be for the same issuer.²⁴

C. Specific Issues Related to a BD's Responsibilities

The scope of a BD's investigation will necessarily depend upon a number of factors, including the BD's affiliation with the issuer, its role in the transaction, and other facts and circumstances of the offering, including whether the offerees are retail customers or more sophisticated institutional investors.

1. BD That Is Affiliated With the Issuer

A BD that is an affiliate of an issuer in a Regulation D offering must ensure that its affiliation does not compromise its independence as it performs its investigation.²⁵ The BD must resolve any conflict of interest that could impair its ability to conduct a thorough and independent investigation. Indeed, its affiliation with the issuer typically would raise expectations by its customers, particularly some retail customers, that the BD has special expertise concerning the issuer.²⁶

2. BD That Prepares the Private Placement Memorandum

A BD that prepares the private placement memorandum or other offering document has a duty to investigate securities offered under Regulation D and representations made by the issuer in the private placement memorandum or other offering document.²⁷ In a recent enforcement action, FINRA found that a BD that prepared a private placement memorandum containing material misstatements and omissions about such matters as the amount and timing of distributions and the targeted return of principal to investors violated FINRA Rule 2010, which requires BDs to comply with just and equitable principles of trade.²⁸

A BD that assists in the preparation of a private placement memorandum or other offering document should expect that it will be considered a communication with the public by that BD for purposes of NASD Rule 2210, FINRA's advertising rule. If a private placement memorandum or other offering document presents information that is not fair and balanced or that is misleading, then the BD that assisted in its preparation may be deemed to have violated NASD Rule 2210. Moreover, sales literature concerning a private placement that a BD distributes will generally be deemed to constitute a communication by that BD with the public, whether or not the BD assisted in its preparation.

3. The Presence of Red Flags

In the course of a reasonable investigation, a BD must note any information that it encounters that could be considered a “red flag” that would alert a prudent person to conduct further inquiry. Red flags might arise from information that is publicly available or information that is discovered during the course of the investigation. A BD’s reasonable investigation responsibilities would obligate it to follow up on any red flags that it encounters during its inquiry as well as to investigate any substantial adverse information about the issuer.²⁹

When presented with red flags, the BD must do more than simply rely upon representations by issuer’s management, the disclosure in an offering document or even a due diligence report of issuer’s counsel. In *Kunz and Cline*, the SEC found that the broker could not justifiably rely on financial statements in private placement memoranda that had been audited and certified by an accountant when numerous “red flags” indicated that the financial statements were inaccurate.³⁰ The broker had a duty, which it failed to discharge, to conduct a further, independent investigation of the financial condition of the issuer under the circumstances. The SEC also found that the broker acted contrary to just and equitable principles of trade when the private placement memorandum failed to disclose both the broker’s consulting relationship with the issuer and the litigation history of the issuer’s president and CEO.

An issuer’s refusal to provide a broker-dealer with information that is necessary for the broker-dealer to meet its duty to investigate could itself constitute a red flag. If an issuer is not forthcoming with information requested by a broker-dealer (or provides information that is non-responsive or out-of-date), the broker-dealer must determine whether sufficient information is otherwise obtainable. While issuers are not required to provide accredited investors with a private placement memorandum in order to qualify for the exemptions in Rule 505 or Rule 506, these memoranda typically are used in Regulation D offerings and firms may need to consider whether the absence of a private placement memorandum itself might constitute a red flag.

4. Reliance on Counsel and Syndicate Managers

A BD may retain counsel or other experts to assist the firm in undertaking and fulfilling its reasonable investigation obligation. A BD must carefully review the qualifications and competency of counsel or experts retained to perform an investigation on its behalf³¹ and must ensure that all gaps or omissions in the investigation by such counsel or experts are separately addressed by the BD. Moreover, the use of counsel or experts does not necessarily complete the BD’s investigation responsibilities, insofar as a review of the counsel’s or expert’s report may identify issues or concerns that require further investigation by the BD.

It may be appropriate in a Regulation D offering in which a BD is merely a member of a syndicate or selling group to rely upon a reasonable investigation by the syndicate manager, provided the BD has reason to believe that the syndicate manager has the expertise and absence of conflicts to engage in a thorough and independent inquiry, and that it has in fact performed such an inquiry with respect to the particular Regulation D offering. Any BD who intends to rely upon the efforts of a syndicate manager should meet with the manager, obtain a description of the manager's reasonable investigation efforts, and ask questions of the manager concerning the independence and thoroughness of the manager's exercise of its responsibilities. A BD that relies upon the efforts of the syndicate manager retains its own responsibilities, to the extent that they are not addressed by the syndicate manager's efforts. For example, if there is reason to believe that the syndicate manager has not addressed a particular issue, then each BD participating in the offering will be responsible to the extent that it implicates the BD's own suitability analysis.

D. Supervision

A firm that engages in Regulation D offerings must have supervisory procedures under NASD Rule 3010 that are reasonably designed to ensure that the firm's personnel, including its registered representatives:

- engage in an inquiry that is sufficiently rigorous to comply with their legal and regulatory requirements;
- perform the analysis required by NASD Rule 2310;
- qualify their customers as eligible to purchase securities offered pursuant to Regulation D; and
- do not violate the antifraud provisions of the federal securities laws or FINRA rules in connection with their preparation or distribution of offering documents or sales literature.

These procedures must be reasonably designed to ensure that each Regulation D offering is properly supervised before it is marketed to other firms or sold directly to customers.³²

E. Documentation of Reasonable Investigation

To demonstrate that it has performed a reasonable investigation, a BD should retain records documenting both the process and results of its investigation. Such records may include descriptions of the meetings that were conducted in the course of the investigation, including meetings with the issuer or other parties, the tasks performed, the documents and other information reviewed, the results of such reviews, the date such events occurred, and the individuals who attended the meetings or conducted the reviews.

III. Reasonable Investigation Practices

A BD's reasonable investigation must be tailored to each Regulation D offering in a manner that best ensures that it meets its regulatory responsibilities. Accordingly, a single checklist of possible practices for a BD engaged in a Regulation D offering will not suffice for every offering, and mechanical reliance upon a single checklist may result in an inadequate investigation. Nevertheless, we are providing a list of practices that some firms have adopted to help them adequately discharge their responsibilities. Many of the practices described below are designed to satisfy BDs' regulatory requirements. These practices are especially relevant to Regulation D offerings of securities of companies that are non-reporting under the Securities Exchange Act.

Industry participants that we surveyed described the following as practices that help ensure they meet their reasonable investigation obligations.

A. Issuer and Management

Reasonable investigations of the issuer and its management concerning the issuer's history and management's background and qualifications to conduct the business might include:

- Examining the issuer's governing documents, including any charter, bylaws and partnership agreement, noting particularly the amount of its authorized stock and any restriction on its activities. If the issuer is a corporation, a BD might determine whether it has perpetual existence.
- Examining historical financial statements of the issuer and its affiliates, with particular focus, if available, on financial statements that have been audited by an independent certified public accountant and auditor letters to management.
- Looking for any trends indicated by the financial statements.
- Inquiring about the business of affiliates of the issuer and the extent to which any cash needs or other expectations for the affiliate might affect the business prospects of the issuer.
- Inquiring about internal audit controls of the issuer.
- Contacting customers and suppliers regarding their dealing with the issuer.
- Reviewing the issuer's contracts, leases, mortgages, financing arrangements, contractual arrangements between the issuer and its management, employment agreements and stock option plans.

- Inquiring about past securities offerings by the issuer and the degree of their success while keeping in mind that simply because a certain product or sponsor historically met obligations to investors, there are no guarantees that it will continue to do so, particularly if the issuer has been dependent on continuously raising new capital. This inquiry could be especially important for any blind pool or blank-check offering.
- Inquiring about pending litigation of the issuer or its affiliates.
- Inquiring about previous or potential regulatory or disciplinary problems of the issuer. A BD might make a credit check of the issuer.
- Making reasonable inquiries concerning the issuer's management. A BD might inquire about such issues as the expertise of management for the issuer's business and the extent to which management has changed or is expected to change. For example, a BD might inquire about any regulatory or disciplinary history on the part of management and any loans or other transactions between the issuer or its affiliates and members of management that might be inappropriate or might otherwise affect the issuer's business.
- Inquiring about the forms and amount of management compensation, who determines the compensation and the extent to which the forms of compensation could present serious conflicts of interest. A BD might make similar inquiries concerning the qualifications and integrity of any board of directors or similar body of the issuer.
- Inquiring about the length of time that the issuer has been in business and whether the focus of its business is expected to change.

B. Issuer's Business Prospects

Reasonable investigations of the issuer's business prospects, and the relationship of those prospects to the proposed price of the securities being offered, might include:

- Inquiring about the viability of any patent or other intellectual property rights held by the issuer.
- Inquiring about the industry in which the issuer conducts its business, the prospects for that industry, any existing or potential regulatory restrictions on that business and the competitive position of the issuer.
- Requesting any business plan, business model or other description of the business intentions of the issuer and its management and their expectations for the business, and analyzing management's assumptions upon which any business forecast is based. A BD might test models with information from representative assets to validate projected returns, break-even points and similar information provided to investors.

- Requesting financial models used to generate projections or targeted returns.
- Maintaining in the BD's files a summary of the analysis that was performed on financial models provided by the issuer that detail the results of any stress tests performed on the issuer's assumptions and projections.

C. Issuer's Assets

Reasonable investigations of the quality of the assets and facilities of the issuer might include:

- Visiting and inspecting a sample of the issuer's assets and facilities to determine whether the value of assets reflected in the financial statements is reasonable and that management's assertions concerning the condition of the issuer's physical plants and the adequacy of its equipment are accurate.
- Carefully examining any geological, land use, engineering or other reports by third-party experts that may raise red flags.
- Obtaining, with respect to energy development and exploration programs, expert opinions from engineers, geologists and others are necessary as a basis for determining the suitability of the investment prior to recommending the security to investors.

Endnotes

- 1 As a general matter, any reference in this *Notice* to the obligations of a BD firm is also intended to cover the concomitant responsibilities of any registered representative who recommends a Regulation D offering to his/her customers and any registered principal who is charged by his/her firm with supervising this registered representative.
- 2 Office of the Inspector General, Securities and Exchange Commission, *Regulation D Exemption Process 2* (March 31, 2009).
- 3 See, e.g., Provident Asset Management, LLC, FINRA Case No. 2009017497201 (2010); *Pacific Cornerstone Capital, Inc.* FINRA AWC No. 2007010591701 (2009).
- 4 A note to Rule 502(b)(1) states that when an issuer provides required information to any non-accredited investor, it should consider providing the information to accredited investors, too, "in view of the anti-fraud provisions of the federal securities laws."
- 5 See *Hanly v. SEC*, 415 F.2d 589, 595-96 (2d Cir. 1969); *SEC v. Great Lake Equities Co.*, 1990 U.S. Dist. LEXIS 19819 at *16-17 (E.D. Mich. 1990); *SEC v. North American Research and Development Corp.*, 424 F.2d 63,84 (2d Cir. 1970). See also *SEC v. Current Financial Services, Inc.*, 100 F. Supp. 2d 1, 14-15 (D.D.C. 2000); *District Business Conduct Committee for District No. 4 v. Everest Securities, Inc.*, 1994 NASD *Discip. Lexis 188* (Sept. 2, 1994), *aff'd*, 52 S.E.C.

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Endnotes continued

- 958, 962-63 (Aug. 26, 1996), *aff'd*, 116 F. 3d 1235 (8th Cir. 1997); Securities Act Release No. 4445, 27 Fed. Reg. 1415 (Feb. 2, 1962).
- 6 *Hanly, supra* note 5 at 597.
- 7 *See generally Hanly, supra* note 5.
- 8 *See Everest Securities, Inc.*, *supra* note 5.
- 9 *See Hanly, supra* note 5. *See also University Hill Foundation v. Goldman, Sachs & Co.*, 422 F. Supp. 879, 898 (S.D.N.Y. 1976).
- 10 *Hanly, supra* note 5 at 597.
- 11 *University Hill Foundation, supra* note 9 at 898.
- 12 *See, e.g., SEC v. Milan Capital Group, Inc.*, 2000 U.S. Dist. LEXIS 16204 (S.D.N.Y. 2000), where the court held that the duty to independently investigate is greater “where promotional materials are in some ways questionable, for example by promising unusually high returns.”
- 13 *See Hanly, supra* note 5 at 597 (“Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information”). *See also* Securities Act Release No. 4445, *supra* note 5; *Regulatory Notice 09-05* (Guidance to Member Firms Participating in Unregistered Resales of Restricted Securities) (January 2009).
- 14 *Hanly, supra* note 5 at 597. The duty of inquiry under the antifraud provisions is distinguished from the “reasonable investigation” that, under Section 11(b) of the Securities Act, permits an underwriter to escape liability for misrepresentations in a registration statement. Courts have compared the Section 11 reasonable investigation and the BD’s general duty to investigate and concluded that “somewhat more is required of an underwriter than a broker to discharge its obligation to the investing public.” *University Hill Foundation, supra* note 9 at 898-99. This is because “an underwriter’s relationship to the issuer is more substantial” than a BD that is only recommending a security, and the underwriter “plays a more central role in the marketing process.” *Id.*
- 15 *See Everest Securities, Inc. v. US*, *supra* note 5 at 1239 (“reliance on others does not excuse [the respondents] own lack of investigation”).
- 16 *Everest Securities, Inc., supra* note 5 at 963.
- 17 *Everest Securities, Inc., supra* note 5 at 963.
- 18 *Hanly* at 596, *supra* note 5.
- 19 Note to Rule 502(b)(1).
- 20 FINRA has previously discussed the responsibilities of a BD to conduct a reasonable investigation of securities it is recommending. *See, e.g., Notice to Members 03-71* (concerning non-conventional investments)(November 2003); *Notice to Members 05-18* (concerning private placements of tenants-in-common interests) (March 2005).
- 21 *F.J. Kaufman & Co.*, 50 S.E.C. 164, 168-69 (Dec. 13, 1989). *See also In the Matter of Michael Frederick Siegel*, Securities Exchange Act Release No. 58737 (October 6, 2008), 2008 SEC Lexis 2459, at *28.
- 22 *See James B. Chase*, 56 S.E.C. 149, 159 (2003).
- 23 BDs should analyze whether the investor’s money is likely to be applied according to the stated use of proceeds, and whether the stated use of proceeds is reasonable in light of the issuer’s business purpose and prospects. *See In Re Brian Prendergast*, 2001 SEC LEXIS 1533 (August 1, 2001); *Legend Merchant Group, Inc.*, NASD No. C10030058, summarized in NASD Disciplinary Actions (July 2004); *Shelman Securities, Inc.*, NASD No. C06030013, summarized in NASD Disciplinary Actions (February 2004).

Endnotes continued

- 24 See, e.g., *Shelman Securities*, *supra* note 23 (private placement memoranda contained material misrepresentations and omissions about use of proceeds in a previous offering).
- 25 See *In the Matter of C. Gilman Johnston*, 42 S.E.C. 217 (Aug. 14, 1964) (broker-dealer's control person prepared memorandum describing broker-dealer's own "highly speculative" securities without any reasonable basis for believing that the securities were suitable for some purchasers). See generally *Pacific Cornerstone Capital*, *supra* note 3 at 10 (person providing information for and reviewing and approving private placement memorandum and sales literature was BD's control person and issuer's founder). Regulation D generally prohibits a broker or other person that is affiliated with the issuer from serving as a purchaser representative to an investor. See Rule 501(h)(1)(definition of "purchaser representative").
- 26 Cf. FINRA Rule 5122 (requiring members to comply with certain requirements when engaging in private placement of securities issued by the member or a control entity).
- 27 *SEC v. Kunz and Cline Investment Management, Inc.* Admin. Proc. File No. 3-9960, *aff'd* 2003 U.S. App. LEXIS 6011 (10th Cir. 2003) (unpublished opinion).
- 28 *Pacific Cornerstone Capital, Inc.*, *supra* note 3.
- 29 *Everest Securities, Inc. v. SEC*, *supra* note 5 at 1239 (finding "the investigation that was performed was itself insufficient," and even a cursory investigation would have uncovered facts showing offering memorandum was materially misleading).
- 30 *Kunz and Cline*, *supra* note 27.
- 31 See *Notice to Members 05-48* (Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers) (July 2005) (discussing a member's accountability and supervisory responsibility for outsourced functions).
- 32 *Pacific Cornerstone Capital, Inc.*, *supra* note 3 at 9.

Trade Reporting and Compliance Engine (TRACE)

SEC Approves Reporting Asset-Backed Securities Transactions to TRACE and Related Fees

Effective Date: February 14, 2011

Executive Summary

Effective February 14, 2011, firms must begin reporting asset- and mortgage-backed securities transactions to TRACE. FINRA will not disseminate the data; it will collect and study the transaction data and may propose to disseminate it in the future.

In addition, reporting fees for asset- and mortgage-backed securities transactions, and other related amendments to TRACE and FINRA rules will go into effect on this day.¹

The amended rule text is available at www.finra.org/notices/10-23.

Questions regarding this *Notice* should be directed to:

- Patrick Geraghty, Director, Market Regulation, at (240) 386-4973;
- Elliot R. Levine, Associate Vice President and Counsel, Transparency Services, at (202) 728-8405; or
- Sharon Zackula, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8985.

April 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Fixed Income
- Legal
- Operations
- Research
- Systems
- Trading

Key Topics

- Asset-Backed Securities
- Fees
- Mortgage-Backed Securities
- Reporting
- TRACE-Eligible Security

Referenced Rules

- FINRA Rule 6710
- FINRA Rule 6720
- FINRA Rule 6730
- FINRA Rule 6750
- FINRA Rule 6760
- FINRA Rule 7730
- Securities Act Rule 144A
- SEA Section 19

Background & Discussion

The TRACE Rules (the FINRA Rule 6700 Series) provide for the reporting of transactions in TRACE-Eligible Securities to TRACE and the dissemination of transaction information, with limited exceptions.² TRACE reporting and data fees are set forth in FINRA Rule 7730.

In 2009, FINRA proposed two major expansions of TRACE.³ The first major expansion, which became effective March 1, 2010, added debt securities issued or guaranteed by U.S. federal agencies and government-sponsored enterprises (GSEs) (collectively, Agency Debt Securities) as TRACE-Eligible Securities.⁴ In addition, primary market transactions became reportable to TRACE, fee provisions were amended regarding both Agency Debt Securities and primary market transactions, and FINRA was granted certain emergency authority.⁵

On February 22, 2010, the SEC approved the second major proposed expansion of TRACE to include Asset-Backed Securities as TRACE-Eligible Securities, to require the reporting of Asset-Backed Securities transactions and to establish reporting fees. The significant changes to the TRACE Rules and FINRA Rule 7730 related to Asset-Backed Securities include:

- ▶ amendments to the definition of TRACE-Eligible Security in Rule 6710(a) to include Asset-Backed Securities, which is broadly defined in Rule 6710(m) and includes, but is not limited to, asset-backed securities, mortgage-backed securities, collateralized mortgage obligations, synthetic asset-backed securities, collateralized debt obligations, collateralized bond obligations, collateralized debt obligations of Asset-Backed Securities, collateralized debt obligations of collateralized debt obligations, including any residual tranches of such instruments, and similarly structured securities;
- ▶ amendments to the definition of Reportable TRACE Transaction to include specific requirements regarding Asset-Backed Securities in Rule 6710(c);
- ▶ the adoption of several new defined terms used in connection with Asset-Backed Securities—Sponsor, Issuing Entity, TBA, Agency Pass-Through Mortgage-Backed Security, Factor, Specified Pool Transaction, Stipulation Transaction, Dollar Roll and Remaining Principal Balance, in, respectively, Rule 6710(s), Rule 6710(t), Rule 6710(u), Rule 6710(v), Rule 6710(w), Rule 6710(x), Rule 6710(y), Rule 6710(z) and Rule 6710(aa)—and the term TRACE System Hours in Rule 6710(bb);
- ▶ amendments to the defined terms List or Fixed Offering Price Transaction and Takedown Transaction in, respectively, Rule 6710(q) and Rule 6710(r), to exclude Asset-Backed Securities;

- ▶ amendments to Rule 6730(a)(6), Rule 6730(c) and Rule 6730(d) to require the reporting of Asset-Backed Securities transactions to TRACE, including:
 - permitting the use of mortgage pool numbers and similar numeric identifiers when reporting if a CUSIP number is not available;⁶
 - reporting the original face value as the size (volume) of a transaction for transactions involving amortizing Asset-Backed Securities where par value is not used to indicate size (volume);
 - reporting the Factor used in the transaction if the Factor is not the most current Factor that is publicly available at the Time of Execution for the Asset-Backed Security;
 - reporting the total dollar amount of the commission;
 - reporting the actual date of settlement of the transaction and an indicator that the settlement is regular way or not regular way for the type of Asset-Backed Security traded; and
 - reporting the appropriate indicator if a transaction is a Specified Pool Transaction, a Stipulation Transaction, a Dollar Roll, or both a Dollar Roll and a Stipulation Transaction.
- ▶ amendments to Rule 6730(a)(6), for a six-month pilot, to extend the reporting period for Asset-Backed Securities transactions to no later than T+1 during TRACE System Hours, and, after the expiration of the six-month pilot, to require the reporting of Asset-Backed Securities transactions no later than the date of trade during TRACE System Hours, with certain exceptions for trades executed late in the trading day and outside of TRACE System Hours;⁷
- ▶ amendments to Rule 6750(b) to provide that FINRA will not disseminate information on Asset-Backed Securities transactions;
- ▶ amendments to Rule 6760 regarding the obligations of firms, including those that are a Sponsor or an Issuing Entity of an Asset-Backed Security, to provide notice to FINRA Operations regarding TRACE-Eligible Securities; and
- ▶ amendments to Rule 7730 to require firms reporting transactions in Asset-Backed Securities to pay reporting fees, and to calculate the fee based on the lesser of original face value or Remaining Principal Value (or the equivalent) at the Time of Execution for transactions in Asset-Backed Securities where par value is not used to determine the size (volume) of the transaction.

The text of all amendments to the Rule 6700 Series and Rule 7730 is set forth at www.finra.org/notices/10-23.

As noted on the previous page, FINRA will not disseminate transactions in Asset-Backed Securities when the Asset-Backed Securities amendments become effective. Instead, FINRA intends to collect and study the transaction data. After a review is undertaken, FINRA may propose to disseminate Asset-Backed Securities transaction data. Any proposal to do so will be filed with the SEC under Section 19(b) of the Securities Exchange Act as a proposed rule change, providing firms and the public an opportunity to comment.

FINRA is aware that the Asset-Backed Securities amendments will require firms to make significant operational and technological changes to incorporate the requirements in firms' business operations, technologies, and compliance and supervisory systems. Accordingly, FINRA has designated the effective date as February 14, 2011.

In addition, FINRA has extended the period to report a transaction in an Asset-Backed Security from the date of trade during TRACE System Hours to T+1 during TRACE System Hours under a six-month pilot program. Extending the reporting period during the six-month pilot program also will provide firms the time needed to make the changes required to timely and accurately report Asset-Backed Securities transactions. The pilot program will end on Sunday August 14, 2011, at 11:59:59 p.m., Eastern Time.

Endnotes

- 1 See Exchange Act Release No. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (Order Approving File No. SR-FINRA-2009-065) (Asset-Backed Securities filing).
- 2 FINRA disseminates information on publicly traded TRACE-Eligible Securities immediately upon receipt of the transaction report by TRACE. Under Rule 6750(b), a transaction is not disseminated if it is: (1) effected under Securities Act Rule 144A; (2) part of a transfer of multiple proprietary positions to effect an acquisition, merger or a similar combination involving multiple broker-dealers that qualifies under Rule 6750(b)(2); or (3) a primary market transaction that is a List or Fixed Offering Price Transaction or a Takedown Transaction. As discussed below, primary market transactions, including List or Fixed Offering Price Transactions and Takedown Transactions, became subject to TRACE reporting on March 1, 2010.
- 3 See Exchange Act Release No. 60727 (September 28, 2009), 74 FR 50991 (October 2, 2009) (Order Approving File No. SR-FINRA-2009-010) (the Agency Debt Securities filing) and Asset-Backed Securities filing, *supra* note 1.
- 4 See Agency Debt Securities filing, *supra* note 3. The amended definition of TRACE-Eligible Security that became effective on March 1, 2010, continued to exclude Asset-Backed Securities.
- 5 See Agency Debt Securities filing, *supra* note 3. The rule change modified the definition of “Reportable TRACE Transaction” in Rule 6710(c), which previously was limited to secondary market transactions. Certain primary market transactions—those defined as List or Fixed Price Offering Transactions in Rule 6710(q) and Takedown Transactions in Rule 6710(r)—are not required to be reported until close of business on T+1. Also, such transactions are not disseminated. See *supra* note 2.

The amendments to Rule 7730 established TRACE reporting and data fees for transactions in Agency Debt Securities at the same rates applicable to corporate bonds. Also, under amended Rule 7730, a member is not required to pay a reporting fee when reporting a List or Fixed Offering Price Transaction or a Takedown Transaction.

New Rule 6770 provides FINRA emergency authority to suspend the reporting and/or dissemination of certain transactions in TRACE-Eligible Securities or the reporting of certain data elements as market conditions warrant and in consultation with the SEC.
- 6 A firm’s use of a numeric identifier other than a CUSIP is not limited to Asset-Backed Securities.
- 7 See Rule 6730(a)(6)(A)(ii) and Rule 6730(a)(6)(B).
- 8 See Exchange Act Release No. 61948 (April 20, 2010), 75 FR 22670 (April 29, 2010) (Notice of Filing and Request for Comment of Immediately Effective Proposed Rule Change SR-FINRA-2010-019).

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Trade Reporting

SEC Approves Amendments to Require Reporting of OTC Trades in Equity Securities Within 30 Seconds of Execution

Effective Date: November 1, 2010

Executive Summary

Effective Monday, November 1, 2010, firms are required to report over-the-counter transactions in equity securities¹ to FINRA within 30 seconds of execution. The new reporting time frame also applies to trade cancellations that currently are subject to 90-second reporting, as well as stop stock and prior reference price trades.

Also effective as part of the November 1, 2010, changes, firms are required to report secondary market transactions in non-exchange-listed direct participation program securities within 30 seconds of execution. Therefore, such transactions will be subject to regulatory transaction fees under Section 3 of Schedule A to the FINRA By-Laws.

Firms that rely on manual trade reporting processes may qualify for an additional six months for implementation, as described in this *Notice*.

The text of the amendments is available at www.finra.org/rulefilings/2009-061.

Questions regarding this *Notice* may be directed to:

- The Legal Section, Market Regulation, at (240) 386-5126; or
- The Office of General Counsel at (202) 728-8071.

April 2010

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Executive Representatives
- Legal
- Operations
- Senior Management
- Systems
- Trading
- Training

Key Topics

- Alternative Display Facility
- Direct Participation Program Securities
- NMS Stocks
- OTC Equity Securities
- OTC Reporting Facility
- Trade Reporting Facilities

Referenced Rules & Notices

- FINRA Rule 2010
- FINRA Rule 6282
- FINRA Rule 6380A
- FINRA Rule 6380B
- FINRA Rule 6622
- FINRA Rule 7130
- FINRA Rule 7230A
- FINRA Rule 7230B
- FINRA Rule 7330
- Schedule A to the FINRA By-Laws

Background and Discussion

30-Second Trade Reporting Requirement

The SEC recently approved amendments to require firms to report over-the-counter (OTC) transactions in equity securities that are executed during the hours that the FINRA trade reporting facilities are open within 30 seconds of execution.² Trades not reported within 30 seconds of execution, unless expressly subject to a different reporting requirement or excluded from the trade reporting rules altogether, are late.

Thus, the amendments reduce the reporting time frame from 90 to 30 seconds, and all references to 90 seconds in FINRA trade reporting rules are replaced with 30 seconds.³ The amendments also apply to trade cancellations that currently are subject to 90-second reporting. Specifically, trades executed during normal market hours and canceled during normal market hours on trade date must be reported within 30 seconds of cancellation. Additionally, the amendments apply to stop stock and prior reference price trades. If the trade is executed within 30 seconds of the time the parties agree to the stop stock price, the stop stock modifier should not be used. Similarly, if the trade is executed within 30 seconds of the prior reference point in time, firms should not use the prior reference price modifier.

FINRA reminds firms that they must report trades as soon as practicable and cannot withhold trade reports; *e.g.*, by programming their systems to delay reporting until the last permissible second. Additionally, FINRA reiterates the importance of timely reporting. A pattern and practice of late reporting may be considered inconsistent with high standards of commercial honor and just and equitable principles of trade in violation of FINRA Rule 2010.

Reporting Trades in Non-Exchange-Listed DPP Securities

Pursuant to the amendments, firms are required to report secondary market transactions in non-exchange-listed direct participation program (DPP) securities to FINRA within 30 seconds of execution.⁴ For purposes of the 30-second reporting requirement, the “date of execution” and the “time of execution” are defined under the amendments (as well as current rules) as the date and time, respectively, when the parties to a transaction in a DPP have agreed to all of the essential terms of the transaction, including the price and number of units to be traded.⁵

As a result of the amendments, transactions in non-exchange-listed DPPs are now subject to regulatory transaction fees under Section 3 of Schedule A to the FINRA By-Laws (Section 3).⁶

Implementation Schedule

The amendments above become effective pursuant to the following implementation schedule:

Phase I implementation date (for all firms other than qualifying Manual Reporting Firms): Monday, November 1, 2010

Phase II implementation date (for qualifying Manual Reporting Firms only): Monday, May 2, 2011

A “Manual Reporting Firm” is a firm that uses a manual process such as WeblinkACT (also commonly referred to as the NASDAQ or ACT workstation) for all, or substantially all, of its trade reporting of OTC trades. Firms with automated processes that—on occasion—manually report trades do not fall within the scope of this definition and must comply with the Phase I implementation date for all of their trade reporting.⁷

Firms must submit advance written notice to FINRA that they are a “Manual Reporting Firm” and thereby qualify for Phase II implementation, and they must include a description of their current manual process. Such notice should be submitted at least 30 business days prior to the Phase I implementation date—by September 20, 2010—to FINRA’s Market Regulation Department:

FINRA
Market Regulation Department
Attn: Director of Trade Reporting
9509 Key West Avenue
Rockville, MD 20850

Firms with manual trade reporting systems that do not provide advance notice must comply with the amendments beginning on November 1, 2010.

Prior to May 2, 2011, qualifying Manual Reporting Firms are required to report as promptly as practicable—and in no event more than 90 seconds—following trade execution.⁸ However, as of November 1, 2010, all trades reported more than 30 seconds after execution will be modified as late for reporting and dissemination purposes. In this way, market participants will have certainty that any trade disseminated as timely reported was executed within the prior 30 seconds.

Effective May 2, 2011, all firms must comply with the 30-second trade reporting requirement.

Endnotes

- 1 Specifically, these are (1) transactions in NMS stocks effected otherwise than on an exchange, which are reported through the Alternative Display Facility (ADF) or a Trade Reporting Facility (TRF); and (2) transactions in OTC equity securities (*e.g.*, OTC Bulletin Board, Pink Sheets and non-exchange-listed direct participation program securities), which are reported through the OTC Reporting Facility (ORF).

FINRA notes that “OTC equity security” does not include restricted securities under Securities Act Rule 144(a)(3). Hence, transactions in these securities are not subject to 90-second reporting, nor are they impacted by the amendments discussed herein. *See* SR-FINRA-2010-003.
- 2 *See* Securities Exchange Act Release No. 61819 (March 31, 2010), 75 FR 17806 (April 7, 2010) (Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of File No. SR-FINRA-2009-061).
- 3 *See* FINRA Rules 6282(a); 6380A(a) and (g); 6380B(a) and (f); 6622(a) and (f); 7130(b); 7230A(b); 7230B(b); and 7330(b).
- 4 *See* FINRA Rule 6622. These transactions are no longer subject to a separate rule series (the FINRA Rule 6640 Series has been deleted in its entirety) and must be reported as any other OTC equity security pursuant to the FINRA Rule 6620 and 7300 Series.
- 5 *See* FINRA Rule 6622.01.
- 6 Pursuant to Section 31 of the Exchange Act, FINRA and the national securities exchanges are required to pay transaction fees and assessments to the SEC that are designed to recover the costs related to the government’s supervision and regulation of the securities markets and securities professionals. FINRA obtains its Section 31 fees and assessments from its membership in accordance with Section 3.
- 7 In other words, firms with automated trade reporting processes cannot qualify for Phase I implementation for some trades and Phase II implementation for other trades.
- 8 These firms also will continue to be subject to all other reporting time frames under FINRA rules (*e.g.*, the obligation to report trades executed between midnight and 8 a.m. by 8:15 a.m. Eastern Time on trade date).

Additionally, FINRA notes that qualifying Manual Reporting Firms will be required to report transactions in non-exchange-listed DPPs within 90 seconds of execution, and such transactions will be subject to Section 3 fees.

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Information Notice

Continuing Education Planning

Executive Summary

On April 14, 2010, the Securities Industry/Regulatory Council on Continuing Education (the Council) released the semi-annual Firm Element Advisory (FEA) (see *Regulatory Notice 10-20*). The Council suggests that firms consult the FEA when developing their Firm Element training needs analysis.

FINRA offers the following online training resources that address many of the topics that the Council has outlined in the FEA.

E-Learning Courses: Online training featuring assessment tests, scenarios, real-time completion tracking and certificates of completion (see www.finra.org/elearning).

Podcasts: Short audio recordings on specific targeted topics, which can be heard online or downloaded to a portable media player (see www.finra.org/podcasts).

Send questions regarding this *Notice* to education@finra.org.

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
FINRA Consolidated Rulebook	Rulebook Consolidation Podcast Series
Alternative Investments	Reverse Exchangeable Securities (Reverse Convertibles) Principal Protected Notes <ul style="list-style-type: none">• Structured Products (E-Learning)• Reverse Convertibles (Podcast)
	Exchange-Traded Funds <ul style="list-style-type: none">• Non-Traditional Exchange-Traded Funds (Podcast)

April 15, 2010

Suggested Routing

- Compliance
- Continuing Education
- Legal
- Training

Key Topics

- Continuing Education
- Firm Element

Referenced Rules & Notices

- Notice 10-20

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Anti-Money Laundering	<p>For Staff Working With Retail Customers:</p> <ul style="list-style-type: none"> • AML—Retail: Exploring New Risks (E-Learning) • AML—Retail: Recognizing and Escalating Suspicious Activity (E-Learning) • AML—Retail: The Responsibility to Know Your Customer (E-Learning) • AML—Retail: Recognizing Red Flags (E-Learning) • AML—Retail: Customer Identification Procedures (E-Learning) <hr/> <p>For Staff Working With Institutional Customers:</p> <ul style="list-style-type: none"> • AML—Institutional: Exploring New Risks (E-Learning) • AML—Institutional: Identification and Reporting Issues (E-Learning) • AML—Institutional: Identifying and Managing Higher-Risk Clients (E-Learning) • AML—Institutional: Recognizing Red Flags (E-Learning) • AML—Institutional: Customer Identification Procedures (E-Learning) <hr/> <p>For Operations Staff:</p> <ul style="list-style-type: none"> • AML—Operations: Recognizing Red Flags (E-Learning) • AML—Operations: Customer Identification Procedures (E-Learning) <hr/> <p>For Compliance Staff:</p> <ul style="list-style-type: none"> • AML Law Enforcement Requests (Podcast)
Business Continuity	<ul style="list-style-type: none"> • Business Continuity Planning: Recent Survey Findings (Podcast) • Pandemic Preparedness – Parts I & II (Podcast)
Communications With the Public	<ul style="list-style-type: none"> • Communications With the Public: An Introduction to Compliance Issues (E-Learning) • Principal Approval of Sales Material (Podcast) • Seniors: Communications (Podcast) <hr/> <p>Blogs and Social Networking</p> <ul style="list-style-type: none"> • Use of Social Media for Business Purposes (E-Learning) • Electronic Communications: Social Networking Web Sites (Podcast) • Electronic Communications: Blogs, Bulletin Boards and Chat Rooms (Podcast) • Electronic Communications: Web Sites (Podcast)

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Corporate Finance and Institutional Business	<p>Conflicts of Interest</p> <ul style="list-style-type: none"> • Conflicts of Interest (E-Learning) <hr/> <p>Member Private Offerings</p> <ul style="list-style-type: none"> • Private Placements (E-Learning) <hr/> <p>Resales of Unregistered Restricted Securities</p> <ul style="list-style-type: none"> • Unregistered Resales of Restricted Securities (Podcast)
Customer Accounts	<p>Customer Account Transfers</p> <ul style="list-style-type: none"> • Report of the Customer Account Transfer Taskforce (Podcast) <hr/> <p>Trading Ahead of Customer Limit Orders</p> <ul style="list-style-type: none"> • Life of an Equity Trade (E-Learning) <hr/> <p>Customer Information Security</p> <ul style="list-style-type: none"> • Customer Information Protection for Registered Representatives (E-Learning) • Customer Information Protection for Supervisors (E-Learning)
Finance and Operations	<p>Recordkeeping Requirements</p> <ul style="list-style-type: none"> • Record Retention Relief (Podcast) • Books and Records (E-Learning)
Registration and Disclosure	<p>Revised Forms U4 and U5</p> <ul style="list-style-type: none"> • What to Expect: The U4 and U5 Filing Process (Podcast)
Insurance and Annuities	<p>Deferred Variable Annuities</p> <ul style="list-style-type: none"> • Variable Annuities: Sales Practice Issues for 1035 Exchanges (E-Learning) • Variable Annuities: Suitability and Disclosure for New Purchases (E-Learning) • Variable Annuities: Requirements for Representatives (E-Learning) • Variable Annuities: Requirements for Supervisors (E-Learning) • Deferred Variable Annuities (Podcast) <hr/> <p>Variable Life Settlements</p> <ul style="list-style-type: none"> • Variable Life Settlements and Transactions in Related Investment Products - Your Firm's Obligations - Part I & II (Podcast)

FIRM ELEMENT ADVISORY TOPIC	FINRA OFFERINGS
Municipal Securities	<ul style="list-style-type: none"> • MSRB Supervision Rules (E-Learning) • Debt Mark-Ups (E-Learning)
Research	<p>Trading Ahead of Research Reports</p> <ul style="list-style-type: none"> • Trading Ahead of Research Reports (Podcast)
Sales Practices and Supervision	<ul style="list-style-type: none"> • Retail Branch Office Supervision: Compliance With Regulations (E-Learning) • Retail Branch Office Supervision: Understanding Supervisory Responsibilities (E-Learning) • Supervision: Obligations for Firms With Institutional Clients (E-Learning) • Supervision of Recommendations After a Registered Representative Changes Firms (Podcast) • Understanding Supervisory Controls (Podcast) • Supervisory Considerations for Working With Seniors (E-Learning) • Retail Supervision: Sales to Senior Investors (E-Learning) • Unauthorized Proprietary Trading (Podcast) • 529 College Savings Plan Sales Practices (E-Learning)
Trading Practices and Supervision	<ul style="list-style-type: none"> • Insider Trading (E-Learning) • Penny Stock Sales (E-Learning) • Mutual Fund Sales Practice (E-Learning)
Transaction Reporting and Data Dissemination	<ul style="list-style-type: none"> • Life of an Equity Trade (E-Learning)

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Information Notice

Testing and Continuing Education

Change to the Process for Scheduling Exam and Continuing Education Sessions

FINRA is making changes to the process for scheduling exams and continuing education (CE) sessions through FINRA's testing vendors— Pearson VUE and Prometric. To further safeguard the personal identifying information of our firms' exam and CE candidates, FINRA is phasing out the use of Social Security numbers (SSNs) to schedule exam and CE appointments.

Beginning May 3, 2010, registered persons may use either their CRD numbers or SSNs to schedule an exam or CE appointment.

Effective September 15, 2010, individuals will be required to use their CRD numbers to schedule an exam or CE appointment with our testing vendors and SSNs will no longer be accepted.

Questions about this *Notice* may be directed to the Gateway Call Center at (301) 869-6699.

April 20, 2010

Suggested Routing

- Compliance
- Continuing Education
- Registered Representatives
- Registration
- Training

Key Topics

- Qualifying Examinations
- Continuing Education
- Regulatory Element Program

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