

Notices

Regulatory Notices

- 14-05** SEC Approves Consolidated FINRA Rules 4314 (Securities Loans and Borrowings), 4330 (Customer Protection – Permissible Use of Customers’ Securities) and 4340 (Callable Securities); **Effective Date: May 1, 2014; Deadline for Notification to FINRA of Existing Programs under Rule 4330.06: May 30, 2014; Effective Date for FINRA Rule 4330(b)(2)(B): October 28, 2014**
- 14-06** FINRA Announces Updates of the Interpretations of Financial and Operational Rules
- 14-07** SEC Approves New Requirements for Alternative Trading Systems; **Implementation Dates: May 12, 2014 (ATS**
- 14-08** SEC Approves Changes to Expand the Categories of Civil Judicial Disclosures Permanently Included in BrokerCheck and to Include in BrokerCheck Information About Member Firms and Their Associated Persons of Any Registered National Securities Exchange That Uses the CRD System for Registration Purposes; **Effective Date: June 23, 2014 Reporting Requirement); November 10, 2014 (MPID Requirement)**
- 14-09** FINRA Requests Comment on a Proposed Rule Set for Limited Corporate Financing Brokers; **Comment Period Expires: April 28, 2014**

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Notices (December 1996 to current) are also available on the Internet at www.finra.org/notices.

Consolidated Financial and Operational Rules

SEC Approves Consolidated FINRA Rules 4314 (Securities Loans and Borrowings), 4330 (Customer Protection – Permissible Use of Customers’ Securities) and 4340 (Callable Securities)

Effective Date: May 1, 2014

Deadline for Notification to FINRA of Existing Programs under Rule 4330.06: May 30, 2014

Effective Date for FINRA Rule 4330(b)(2)(B): October 28, 2014

Executive Summary

The SEC approved FINRA’s proposed rule change¹ to adopt additional financial and operational rules for the consolidated FINRA Rulebook (the Consolidated Rulebook).² FINRA Rules 4314, 4330 and 4340 are new consolidated rules governing securities loans and borrowings, permissible use of customers’ securities and callable securities. The new rules are based in part on, and replace, provisions of the NYSE and NASD rules³ and include new provisions.

The text of the new rules is available at www.finra.org/notices/14-05.

Questions regarding this *Notice* should be directed to:

- ▶ Kris Dailey, Vice President, Risk Oversight & Operational Regulation (ROOR), at (646) 315-8434 or by [email](#); or
- ▶ Kosha Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-6903 or by [email](#).

Background & Discussion

The SEC recently approved new FINRA Rules 4314, 4330 and 4340 relating to securities loans and borrowings, permissible use of customers’ securities and callable securities.

February 2014

Notice Type

- ▶ Consolidated Rulebook

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Margin
- ▶ Operations
- ▶ Risk
- ▶ Senior Management

Key Topics

- ▶ Margin Lending
- ▶ Operational Rules
- ▶ Partial Redemption of Securities
- ▶ Securities Lending and Borrowing

Referenced Rules & Notices

- ▶ FINRA Rule 2111(b)
- ▶ FINRA Rule 4314
- ▶ FINRA Rule 4330
- ▶ FINRA Rule 4340
- ▶ NASD Rule 2330
- ▶ NYSE Rule 296 and its interpretations
- ▶ NYSE Rule 402
- ▶ NYSE Rule 402.30
- ▶ SEA Rule 15c3-3
- ▶ SEA Rule 17a-3
- ▶ SEA Rule 17a-4

FINRA Rule 4314 (Securities Loans and Borrowings)

FINRA Rule 4314, based on NYSE Rule 296, sets forth the obligations of a firm that engages in lending and borrowing securities and establishes consistent disclosure and record keeping requirements relating to a firm's securities lending activities. The rule, among other things, requires a firm that acts as agent in a loan or borrow transaction to disclose its capacity. In cases where the firm lends securities to or borrows securities from a counterparty that is acting in an agency capacity, the firm must maintain books and records to reflect the details of the transaction with the agent and each principal(s) on whose behalf the agent is acting.

Specifically, Rule 4314(a) requires a firm that lends or borrows securities in the capacity of agent to disclose its capacity to the other party to the transaction, and prior to lending securities to or borrowing securities from a person that is not a FINRA member firm, to determine whether the other party is acting as principal or agent in the transaction. When the other party (which may or may not be a member firm) is acting as agent in the transaction, the member firm is required to maintain books and records that reflect: (1) the details of the transaction with the agent; and (2) each principal(s) on whose behalf the agent is acting and the details of each transaction therewith.

Supplementary Material .02 allows a firm to satisfy its disclosure obligation under Rule 4314(a) by, among other things, providing specific disclosure of its capacity as agent in the written agreement between the parties or in the individual confirmations of each loan and borrow transaction. Supplementary Material .03 clarifies the books and records requirements imposed by Rule 4314(a) and requires firms to create and maintain records for each security loan or borrow transaction in accordance with Securities Exchange Act (SEA) Rules 17a-3 and 17a-4. It further provides that when a firm enters into a security loan or borrow transaction with a party that is acting as agent on behalf of another principal(s), the firm must maintain a record of the transaction with the agent, including identifying the specific security and quantity loaned or borrowed, the contract value and the type and description of the security collateral provided to the agent, and the identity of each underlying principal and the amount and description of the collateral allocated to each such principal.

Rule 4314(b), based on NYSE Rule 296(a), continues to provide each firm that is a party to an agreement with another firm for the loan and borrowing of securities with the right to liquidate the transaction whenever the other party becomes subject to one of the liquidation conditions specified in the rule. Rule 4314(c) requires all firms that lend or borrow any security to or from any person that is not a FINRA member firm, including any customer, to have a written agreement, which may consist of the exchange of contract confirmations, that confers upon the member firm the contractual right to liquidate such transaction because of a liquidation condition of the kind specified in Rule 4314(b).

Supplementary Material .04 reminds firms of their obligations under Rule 4330(b) to provide written disclosures to customers regarding the risks and financial impact associated with the customer's loan(s) of securities, and requires that firms disclose in the written notice their right to liquidate the borrow transactions with customers under the conditions specified in Rule 4314(b). In addition, Supplementary Material .05 requires, for purposes of Rule 4314(c), that each firm that is subject to the provisions of SEA Rule 15c3-3 and that borrows fully paid or excess margin securities from a customer comply with the provisions of SEA Rule 15c3-3 relating to the requirements for a written agreement between the borrowing firm and the lending customer.

Rule 4330 (Customer Protection – Permissible Use of Customers' Securities)

FINRA Rule 4330, based on NYSE Rule 402 and NASD Rule 2330, sets forth requirements applicable to a firm's use of customers' securities.

a. FINRA Rule 4330(a) (Authorization to Lend Customers' Margin Securities)

FINRA Rule 4330(a) requires a firm to obtain a customer's written authorization prior to lending securities that are held on margin for a customer and that are eligible to be pledged or loaned. Supplementary Material .02 permits a firm to use a single customer account agreement/margin agreement/loan consent signed by the customer as written authorization under Rule 4330(a), provided such customer account agreement/margin agreement/loan consent includes clear and prominent disclosure that the firm may lend either to itself or others any securities held by the customer in its margin account.

b. FINRA Rule 4330(b) (Requirements for Borrowing of Customers' Fully Paid or Excess Margin Securities)

1. Notification to FINRA

Rule 4330(b) establishes new requirements to address the borrowing and lending of customers' fully paid or excess margin securities. Specifically, Rule 4330(b)(1) requires a firm that borrows fully paid or excess margin securities carried for the account of any customer to:

- ▶ comply with the requirements of SEA Rule 15c3-3;
- ▶ comply with the requirements of SEA Section 15(e) (Notices to Customers Regarding Securities Lending) to provide notices to customers regarding securities lending; and
- ▶ notify FINRA, in such manner and format as FINRA may require, at least 30 days prior to first engaging in such securities borrows.

Supplementary Material .06 (Notification to FINRA of Pre-existing Fully Paid or Excess Margin Securities Borrows and Disclosures to Customers) requires firms that have any existing fully paid or excess margin securities borrows with customers as of May 1, 2014 (*i.e.*, the effective date of the rule) to notify FINRA in writing, in such manner and format as FINRA may require, of such borrows. Firms must provide such notice to FINRA on or before May 30, 2014.

The notifications required under Rule 4330(b) for new programs and Supplementary Material .06 for pre-existing programs must be provided by a firm to its Regulatory Coordinator in writing, either in hard copy or electronically. The written notification must include the following:

- ▶ name and CRD number of the firm;
- ▶ name of individual contact at firm;
- ▶ type(s) and number of customers that are parties to the fully paid or excess margin securities borrow arrangement(s);
- ▶ type(s) of collateral provided to customers in connection with such securities borrow arrangements and how collateral is held (*e.g.*, in broker-dealer's custody, delivered to customer);
- ▶ for a new program, the proposed start date of the program; and
- ▶ for an existing program, the date the program commenced.

Pursuant to Supplementary Material .03 (Notification to FINRA), FINRA may request additional information to evaluate compliance with SEA Rule 15c3-3, SEA Section 15(e) and other applicable FINRA rules or federal securities laws or rules. FINRA is considering alternative methods of notification, such as through Firm Gateway, and will announce any changes to the notification procedures in a future *Regulatory Notice*.

2. Appropriateness Determination

FINRA Rule 4330(b)(2) requires a firm to make an appropriateness determination prior to first entering into a securities borrow with a customer and to provide specified written disclosures to customers with respect to the customer's securities loan transactions. Rule 4330(b)(2)(A) requires a firm to have reasonable grounds for believing that the customer's loan(s) of securities are appropriate for the customer. In making this determination, the firm must exercise reasonable diligence to ascertain the essential facts relative to the customer, including, but not limited to:

- ▶ the customer's financial situation and needs;
- ▶ tax status;
- ▶ investment objectives;

- ▶ investment time horizon;
- ▶ liquidity needs;
- ▶ risk tolerance; and
- ▶ any other information the customer may disclose to the firm or associated person in connection with entering such securities loans.

Supplementary Material .04 (Appropriateness of Customer's Loan(s) of Securities), provides that in making the appropriateness determination, when the firm has entered into a carrying agreement with an introducing firm pursuant to Rule 4311, the firm may rely on the representations of the introducing firm that has a customer relationship with the lender.

Supplementary Material .05 (Appropriateness Determination for Institutional Customers) provides that a firm may fulfill the obligation set forth in Rule 4330(b)(2)(A) for an institutional account, as defined in Rule 4512(c), by complying with the requirements of Rule 2111(b). FINRA reminds firms that they also are required to comply with FINRA Rule 2111 (Suitability) when recommending a securities lending program, individual transactions within such program, or an investment strategy that includes a securities lending program to a customer.⁴

3. Disclosure Documents and Delayed Implementation Date

FINRA Rule 4330(b)(2)(B) requires a firm, prior to first entering into securities borrowing arrangement with a customer, to provide the customer, in writing (which may be electronic), with a clear and prominent notice stating that the provisions of the Securities Investor Protection Act of 1970 (SIPA) may not protect the customer with respect to the customer's securities loan transaction and that the collateral delivered to the customer may constitute the only source of satisfaction of the member firm's obligation in the event the member firm fails to return the borrowed securities.

Rule 4330(b)(2)(B) further requires a firm to provide the customer with disclosures regarding the customer's rights with respect to the loaned securities, and the risks and financial impact associated with the customer's loan(s) of securities. These disclosures include, but are not limited to:

- ▶ the loss of voting rights;
- ▶ the customer's right to sell the loaned securities and any limitations on the customer's ability to do so, if applicable;
- ▶ the factors that determine the amount of compensation received by the member firm and its associated persons in connection with the use of the securities borrowed from the customer;

- ▶ the factors that determine the amount of compensation (*e.g.*, interest rate) to be paid to the customer and whether or not such compensation can be changed by the firm under the terms of the borrow agreement;
- ▶ the risks associated with each type of collateral provided to the customer;
- ▶ that the securities may be “hard-to-borrow” because of short-selling or may be used to satisfy delivery requirements resulting from short sales;
- ▶ the potential tax implications, including payments deemed cash-in-lieu of dividend paid on securities while on loan; and
- ▶ the firm’s right to liquidate the transaction because of a condition of the kind specified in Rule 4314(b) (Securities Loans and Borrowings-Right to Liquidate Transaction).

Firms must provide customers with the written disclosures no later than October 28, 2014.

Rule 4330(b)(3) requires a firm to create and maintain books and records showing compliance with Rule 4330(b)(2). Such records must be maintained in accordance with the requirements of SEA Rule 17a-4(a).

Rule 4340 (Callable Securities)

FINRA Rule 4340, based in part on NYSE Rule 402.30 (Securities Callable in Part), requires a firm that has in its possession or control bonds or preferred stocks that are callable in part, whether specifically set aside or otherwise, to identify such securities and establish an impartial lottery system by which it will allocate among its customers the securities to be redeemed or selected as called in the event of a partial redemption or call. The rule applies to any security that by its terms may be called or redeemed prior to maturity.

The rule allows a firm to establish and make available on its website procedures by which it will allocate among its customers, on a fair and impartial basis, the securities to be redeemed or selected as called in the event of a partial redemption or call. In addition, the rule requires the firm to provide written notice (which may be electronic) to new customers at the opening of an account, and to all customers at least once every calendar year, of the manner in which they may access the allocation procedures on the firm’s website and that, upon a customer’s request, the firm will provide hard copies of the allocation procedures to the customer.

In addition, Rule 4340(b) and (c) set forth allocation restrictions firms must follow in the event of a favorable or unfavorable redemption of callable securities. Where a redemption of callable securities is made on terms favorable to the called parties, a firm must not allocate the securities to any account in which it or its associated persons have an interest until all other customers’ positions in such securities have been satisfied.⁵ Similarly, where the redemption of callable securities is made on terms unfavorable to the called parties, the rule provides that a firm cannot exclude its positions or those of its associated persons, including the accounts of clerical and ministerial associated persons, from the pool of securities eligible to be called.

Supplementary Material .02 (Allocations of Partial Redemptions or Calls) provides that a firm's allocation procedures may include the use of an impartial lottery system, acting on a pro-rata basis, or such other means as will achieve a fair and impartial allocation of the partially redeemed or called securities. Supplementary Material .03 (Accounts of an Introducing Member and its Associated Persons) provides that where an introducing firm is a party to a carrying agreement with another firm that is conducting an allocation pursuant to the rule, any accounts in which the introducing firm or its associated persons have an interest shall be subject to the provisions regarding participation in favorable and unfavorable calls or redemptions. In addition, the introducing firm must identify such accounts to the firm conducting the allocation.

Endnotes

1. See Securities Exchange Act Release No. 70958 (November 27, 2013) (*Order Approving Proposed Rule Change*; File No. SR-FINRA-2013-035); 78 FR 72951 (December 4, 2013).
2. The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see [Information Notice March 12, 2008](#) (Rulebook Consolidation Process).
3. Effective May 1, 2014, NASD Rule 2330, NASD IM-2330, Incorporated NYSE Rule 296, including Supplementary Material .10 and .20, Incorporated NYSE Rule 402, including Supplementary Material .30, and NYSE Rule Interpretations 296(b)/01 and 402(b)/01 will be eliminated from the Transitional Rulebook.
4. FINRA previously has provided guiding principles that firms and registered representatives could consider when determining whether a particular communication could be viewed as a recommendation for purposes of the suitability rule. See, e.g., [Regulatory Notice 12-25](#) (discussing the term “recommendation” and citing various resources that explain the guiding principles that firms could use when analyzing whether a communication constitutes a recommendation); [Regulatory Notice 11-02](#) (discussing FINRA’s guiding principles); [Regulatory Notice 10-06](#), at 3-4 (providing guidance on recommendations made on blogs and social networking websites); [Notice to Members 01-23](#) (announcing the guiding principles and providing examples of communications that likely do and do not constitute recommendations); [Michael F. Siegel](#), Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459, at *21-27 (Oct. 6, 2008) (applying the guiding principles to the facts of the case to find a recommendation), *aff’d in relevant part*, 592 F.3d 147 (D.C. Cir.), *cert. denied*, 130 S.Ct. 3333 (2010).
5. Supplementary Material .01 (Definition of Associated Person; Clerical and Ministerial Functions) to FINRA Rule 4340 clarifies that the term “associated person” as used in the rule has the same meaning as provided in SEA Section 3(a)(18), which expressly excludes, for certain purposes, any persons associated with the member whose functions are solely clerical or ministerial (referred to as “clerical and ministerial associated persons”).

SEC Financial Responsibility and Reporting Rules

FINRA Announces Updates of the Interpretations of Financial and Operational Rules

Executive Summary

FINRA is making updates to the imbedded text of the Securities Exchange Act (SEA) financial responsibility and reporting rules in the Interpretations of Financial and Operational Rules to reflect the effectiveness of rule amendments the SEC recently adopted.¹ The updated text relates to SEA Rules 15c3-1, 15c3-1a, 15c3-2, 15c3-3, 17a-5 and 17a-11. FINRA is also making available related updates of the Interpretations of Financial and Operational Rules that have been communicated to FINRA staff by the staff of the SEC's Division of Trading and Markets (SEC staff). The updated interpretations relate to SEA Rule 15c3-1.

Questions concerning this *Notice* should be directed to:

- ▶ Yui Chan, Managing Director, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8426; or
- ▶ Susan DeMando Scott, Associate Vice President, ROOR, at (240) 386-4620.

Background & Discussion

In August 2013, the SEC adopted amendments to the financial responsibility and reporting rules for broker-dealers.² FINRA is updating the imbedded text of the portions of SEC rules in the Interpretations of Financial and Operational Rules to reflect the rule amendments that have taken effect.

Further, SEC staff continues to communicate and issue written and oral interpretations of the financial responsibility and reporting rules. FINRA previously published such interpretations in the Interpretations of Financial and Operational Rules on its website in [Regulatory Notice 08-56](#) and subsequently updated such interpretations in [Regulatory Notice 13-44](#). As FINRA noted in these *Notices*, the interpretations, referred to as the Interpretations of Financial and Operational Rules, are imbedded in the text of relevant rules and immediately follow the section of the rule that they interpret.

February 2014

Notice Type

- ▶ Guidance

Suggested Routing

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

Key Topics

- ▶ Books and Records
- ▶ Customer Protection
- ▶ Financial Reporting
- ▶ Net Capital
- ▶ Notification Provisions

Referenced Rules & Notices

- ▶ Regulatory Notice 08-56
- ▶ Regulatory Notice 13-44
- ▶ SEA Rule 15c3-1
- ▶ SEA Rule 15c3-1a
- ▶ SEA Rule 15c3-2
- ▶ SEA Rule 15c3-3
- ▶ SEA Rule 17a-5
- ▶ SEA Rule 17a-11

The interpretation updates resulting from the SEC's August 2013 amendments to SEA Rule 15c3-1 are set forth below. Page references are to the hardcopy version. These interpretations are being updated with specified additions, revisions and rescissions and are available in portable digital format (pdf) on FINRA's [Interpretations of Financial and Operational Rules](#) page.

The following two interpretations have been **rescinded**:

- ▶ SEA Rule 15c3-1(c)(1)/20 (Temporary Capital Infusions in a Broker-Dealer) on page 156: This interpretation, relating to the net capital treatment of temporary capital infusions in a broker-dealer, has been rescinded, as the respective requirements are incorporated in new SEA Rule 15c3-1(c)(2)(i)(G) and are reflected on page 225.
- ▶ SEA Rule 15c3-1(c)(2)(vi)(D)/01 (Money Market Funds) on page 451: This interpretation, relating to the net capital treatment of money market funds, has been rescinded, as the respective requirements are incorporated in revised SEA Rule 15c3-1(c)(2)(vi)(D)(1) and are reflected on page 451.

FINRA member firms and others that maintain the hardcopy version of the Interpretations of Financial and Operational Rules may refer to the accompanying [updated pages](#), containing the aforementioned rule text updates and interpretations, which are being distributed as replacements for existing pages. The filing instructions for the new pages are as follows:

SEA Rule	Remove Old Pages	Add New Pages
15c3-1	1	1
15c3-1	63	63
15c3-1	156	156
15c3-1	221-226	221-225
15c3-1	255-272	255-272
15c3-1	451-452	451
15c3-1	725-726	725
15c3-1	784	784-785
15c3-1	851-854	851-854
15c3-1a	1013	1013
15c3-2	1901-1902	1901
15c3-3	2464	2464-2466
17a-5	3201-3206	3201-3207
17a-5	3232	3232
17a-5	3243-3248	3243-3244
17a-11	3301-3302	3301-3302

Endnotes

1. See Securities Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (August 21, 2013) (Financial Responsibility Rules for Broker-Dealers) and Securities Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910 (August 21, 2013) (Broker-Dealer Reports). The SEC subsequently modified the effective date of specified amendments to these rules pursuant to an Exemptive Order. See Securities Exchange Act Release No. 70701 (October 17, 2013), 78 FR 62930 (October 22, 2013) (Order Providing Broker-Dealers a Temporary Exemption from the Requirements of Certain New Amendments to the Financial Responsibility Rules for Broker-Dealers under the Securities Exchange Act of 1934).
2. See note 1.

Alternative Trading Systems

SEC Approves New Requirements for Alternative Trading Systems

Implementation Dates: May 12, 2014 (ATS Reporting Requirement); November 10, 2014 (MPID Requirement)

Executive Summary

The SEC approved a rule change to require alternative trading systems (ATS) to (i) report to FINRA weekly volume information and number of securities transactions within the ATS by security and (ii) acquire and use a single, unique market participant identifier (MPID) when reporting information to FINRA.¹ The ATS reporting requirement will be implemented beginning May 12, 2014. The first ATS reports for the week of May 12 through May 16, 2014, will then be due by May 28, 2014. Each ATS must begin reporting order and trade information to FINRA using a unique MPID by November 10, 2014. This *Notice* provides more information for firms regarding each of these new requirements.

Questions concerning this *Notice* should be directed to:

- ▶ FINRA Product Management at (866) 899-2107;
- ▶ FINRA Market Operations at (866) 776-0800; or
- ▶ for legal and interpretive questions, Brant Brown, Associate General Counsel, Office of General Counsel, at (202) 728-6927.

February 2014

Notice Type

- ▶ New Rule
- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Institutional
- ▶ Internal Audit
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Risk
- ▶ Senior Management
- ▶ Systems
- ▶ Trading

Key Topics

- ▶ Alternative Trading Systems
- ▶ Market Participant Identifiers
- ▶ Trade Reporting

Referenced Rules & Notices

- ▶ Regulatory Notice 09-08
- ▶ FINRA Rule 4552
- ▶ FINRA Rule 6160
- ▶ FINRA Rule 6170
- ▶ FINRA Rule 6480
- ▶ FINRA Rule 6720
- ▶ FINRA Rule 7440
- ▶ SEA Rule 3b-16

Background & Discussion

On January 17, 2014, the SEC approved a proposed rule change to (i) adopt FINRA Rule 4552 to require each ATS² to report to FINRA weekly volume information and number of securities transactions within the ATS (ATS reporting requirement); and (ii) amend FINRA Rules 6160, 6170, 6480 and 6720 to require each ATS to acquire and use a single, unique MPID when reporting information to FINRA (MPID requirement). As part of these new requirements, FINRA will make the reported volume and trade count information for equity securities publicly available on its website as described below. The ATS reporting requirement will be implemented beginning May 12, 2014. The first ATS reports for the week of May 12 through May 16, 2014, will then be due by May 28, 2014. Each ATS must begin reporting order and trade information to FINRA using a unique MPID by November 10, 2014.

ATS Reporting Requirement

New FINRA Rule 4552 requires each ATS that has filed a Form ATS with the SEC to report to FINRA its aggregate weekly volume information and number of trades, by security, per ATS in both equity securities and debt securities subject to FINRA trade reporting requirements.³ The ATS reporting requirement thus applies to any NMS stock,⁴ OTC Equity Security,⁵ or any debt security subject to FINRA's Trade Reporting and Compliance Engine (TRACE) rules (TRACE-eligible securities).⁶ Rule 4552 requires this information to be reported to FINRA on a security-by-security basis within seven business days after the end of each calendar week. FINRA will make the reported information for equity securities publicly available on a delayed basis as described below.

To ensure consistent reporting and to avoid potential over-counting of volume, Rule 4552 and Supplementary Material .01 specify how an ATS should calculate and report the volume of securities traded and the number of trades. Under the rule, an ATS must include only those trades executed within the ATS. If two orders are crossed by the ATS, the volume calculation would include only the number of shares or par value of bonds crossed as a single trade (*e.g.*, crossing a buy order of 1,000 shares with a sell order of 1,000 shares would be calculated as a single trade of 1,000 shares of volume). An ATS should only report trades executed within the ATS (not orders routed out of the ATS) and should only report the volume of each executed trade once (not separate or double counting for the buy and sell side of a trade).

Under Supplementary Material .01, volume is considered to be “within an ATS” for purposes of Rule 4552 if the ATS (i) executes the trade; (ii) is considered the “executing party” to the trade under FINRA rules; or (iii) otherwise matches orders constituting the trade in a manner as contemplated by SEA Rule 3b-16⁷ or SEC Regulation ATS.⁸ For example, a trade would be considered to have occurred “within an ATS” for purposes of Rule 4552 if the ATS uses established, non-discretionary methods under which orders interact with each other, and the buyers and sellers entering the orders agree to the terms of the trade.⁹ The Supplementary Material notes that this standard would include, but not be limited to:

- ▶ any trade executed as a result of the ATS bringing together the purchaser and seller on or through its system;
- ▶ any trade executed by the ATS’s subscribers where the subscribers used the ATS to negotiate the trade, even if the ATS did not itself execute the trade; or
- ▶ any trade in which the ATS takes either side of a trade for clearing or settlement or in any other way inserts itself into a trade (*e.g.*, exchanging securities or funds on behalf of one or both subscribers taking part in the trade).

If an ATS routes an order to another firm or other execution venue for handling or execution where that initial order matches against interest resident at the other venue, then the trade would not be considered “within an ATS” (*i.e.*, the ATS would not be considered to have executed the trade or to be the executing party) and would not include such volume for reporting purposes.¹⁰ In addition, if an ATS utilizes another ATS to match an order for execution (*e.g.*, by using another ATS’s messaging system), the ATS matching the order would include the transaction as volume, while the ATS initially receiving the order would not.

Dissemination of ATS Volume Information

Rule 4552 also provides that FINRA will publish on its website the reported information in each equity security for each ATS.¹¹ Initially, FINRA will publish the aggregate reported information regarding NMS stocks in Tier 1 of the NMS Plan to Address Extraordinary Market Volatility¹² on a two-week delayed basis. FINRA will publish the information on all other NMS stocks and OTC Equity Securities subject to FINRA trade reporting requirements on a four-week delayed basis. For example, a typical reporting scenario (*i.e.*, no federal holidays) would require an ATS to report the information for a given week by the second Tuesday following the week. FINRA would publish the information regarding Tier 1 NMS stocks no earlier than the following Monday. Information on all other equity securities subject to FINRA trade reporting requirements would be published two weeks following the publication of information for the Tier 1 NMS stocks.

TRACE-Eligible Securities

As noted above, the ATS reporting requirement applies to equity securities and TRACE-eligible securities. With respect to TRACE-eligible securities, a member firm that is a “party to a transaction” as defined in FINRA Rule 6710(e) must report a trade involving TRACE-eligible securities to TRACE under Rule 6730(a).¹³ A “party to a transaction” is defined as “an introducing broker-dealer, if any, an executing broker-dealer, or a customer.”¹⁴ An ATS, which includes electronic communications networks, is a party to a transaction under TRACE rules and has a trade reporting obligation when a transaction in a TRACE-eligible security is executed through the ATS.¹⁵ Similarly, FINRA equity trade reporting rules require that over-the-counter transactions between member firms be reported to FINRA by the “executing party.” “Executing party”¹⁶ is defined as the member that receives an order for handling or execution or is presented an order against its quote, does not subsequently re-route the order, and executes the transaction. An ATS is the “executing party” and has the trade reporting obligation where the transaction is executed on the ATS.¹⁷ FINRA expects firms to follow the TRACE reporting rules and guidance, in addition to the new provisions in Rule 4552, for purposes of calculating and reporting volume in TRACE-eligible securities pursuant to the ATS reporting requirement.

Unique MPID Requirement

The SEC also approved amendments to FINRA Rules 6160, 6170, 6480 and 6720 (MPID amendments) to require each ATS to acquire and use a single, unique MPID when reporting information to FINRA. The MPID amendments require a firm operating an ATS to obtain for each such ATS a single, unique MPID that is designated for exclusive use for reporting each ATS’s transactions. A firm is not permitted to use multiple MPIDs for a single ATS, and firms that operate multiple ATSs or engage in other lines of business requiring the use of an MPID are required to obtain and use multiple MPIDs.¹⁸ Firms also must notify FINRA before changing the usage of the MPID in any way (*e.g.*, repurposing an MPID from reflecting ATS activity to other trading activity at the firm). Once a unique MPID is assigned to the particular ATS, the ATS must use such separate MPID to report all transactions executed within the ATS to the appropriate reporting facility (*e.g.*, a FINRA Trade Reporting Facility, the Alternative Display Facility, the OTC Reporting Facility, TRACE), and any order information required to be reported to the Order Audit Trail System (OATS) must include the MPID assigned to the particular ATS.¹⁹ The MPID amendments prohibit a firm from using a separate MPID assigned to an ATS to report any transaction that is not executed within the ATS and require firms to have policies and procedures in place to ensure that trades reported with a separate MPID obtained under the rules are restricted to trades executed within the ATS.

As noted in the filing with the SEC, FINRA will evaluate the ATS reporting requirement after the MPID amendments are implemented to determine whether reporting continues to be necessary. If the MPID amendments are operating as anticipated, FINRA will eliminate the weekly ATS reporting requirement for an ATS subject to FINRA trade reporting requirements.²⁰ For an ATS already using a separate MPID, FINRA believes weekly reporting is still necessary for comparison purposes; thus, initially, each ATS will be required to report volume information to FINRA under Rule 4552 even if it already uses a unique MPID for reporting information to FINRA.

Reporting Specifications and Information

Each ATS will report the weekly information required by Rule 4552 to FINRA via the Secure File Transfer Protocol (SFTP). To submit files via SFTP, an ATS must (i) have an FTP account set up with ATS File Transfer privileges and (ii) request an ATS identifier. If an ATS does not already have an FTP account with FINRA, it must submit a request to create an FTP account. If an ATS already has an FTP account, it must add the ATS File Transfer privilege to that account. Each ATS will be required to submit the file of its weekly volume data in a pre-defined format as defined by FINRA in the Alternative Trading System (ATS) Transparency Trade Report File Specification and User Guide, which is available on the [ATS Transparency pages](#). For information about requesting FTP accounts or adding FTP account privileges, refer to [Entitlement Information for FTP Users](#). Please note that the revised form with the new ATS File Transfer privilege will be available before implementation. If you have questions concerning FINRA Entitlement, please refer to the [FINRA Entitlement Program](#) or contact the FINRA Entitlement Group, at (240) 386-4185 or the FINRA Gateway Call Center at (301) 869-6699.

Although an ATS is not required to begin using a unique MPID for trade reporting until November 10, 2014, each ATS will need to submit a completed FINRA MPID Request Form²¹ to FINRA Market Operations prior to submitting trade data pursuant to Rule 4552. The FINRA MPID Request Form will allow an ATS to request a unique identifier so it can submit data files to FINRA with this identifier.²² The identifier will then serve as the unique MPID for an ATS once the MPID requirement goes into effect. Once an ATS has received authorization for its FTP account and has been provided with its identifier, it will be able to submit its data to FINRA via SFTP.

Endnotes

1. See Securities Exchange Act Release No. 71341 (January 17, 2014), 79 FR 4213 (January 24, 2014) (Order Approving SR-FINRA-2013-042).
2. Regulation ATS defines an “alternative trading system” as “any organization, association, person, group of persons, or system: (1) That constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Exchange Act Rule 3b-16]; and (2) That does not: (i) Set rules governing the conduct of subscribers other than the conduct of such subscribers’ trading on such organization, association, person, group of persons, or system; or (ii) Discipline subscribers other than by exclusion from trading.” 17 CFR 242.300(a). Rule 4552 and the amendments discussed in this Notice apply to any alternative trading system, as that term is defined in Regulation ATS, that has filed a Form ATS with the SEC.
3. An ATS that has received an exemption from FINRA to permit its subscribers to report trades to FINRA must still submit a weekly volume report. See FINRA Rules 6183, 6625 and 6731. An ATS is also required to submit a weekly report for weeks where the ATS has no volume. In these instances, the ATS would affirmatively indicate no volume on the report.
4. See FINRA Rule 6110.
5. See FINRA Rule 6410.
6. See FINRA Rules 6710, 6730(a).
7. See 17 CFR 240.3b-16.
8. See 17 CFR 242.300 et seq.
9. See 17 CFR 240.3b-16(a)(2).
10. If, however, an ATS matches orders but routes those orders to another execution venue for execution and dissemination, the trade would be considered to have occurred “within the ATS” and would count as volume of the ATS for reporting purposes.
11. FINRA will be submitting a proposed rule change to the SEC to establish a fee for professional users of the data to recover costs that may be incurred in providing the information; however, non-professional users can receive the data free of charge.
12. Tier 1 NMS stocks include those NMS stocks in the S&P 500 Index or the Russell 1000 Index and certain ETPs. See NMS Plan to Address Extraordinary Market Volatility. FINRA will make changes to the Tier 1 NMS stocks in accordance with the indices. Changes to the S&P 500 are made on an as needed basis and are not subject to an annual or semi-annual reconstitution. S&P typically does not add new issues until they have been seasoned for six to twelve months. Russell 1000 rebalancing typically takes place in June.
13. In transactions between member firms, each firm must report the trade, and for transactions between a member firm and a customer, the member firm must report the trade. See Rule 6730(a).
14. Under Rule 6710(e), “customer” includes a broker-dealer that is not a FINRA member.
15. See question 7.4 under the [Reporting of Corporate and Agencies Debt Frequently Asked Questions](#).
16. See Rules 6282, 6380A, 6380B and 6622.

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17. See Securities Exchange Act Release No. 58903 (November 5, 2008), 73 FR 67905 (November 17, 2008) (Order Approving File No. SR-FINRA-2008-011); and [Regulatory Notice 09-08](#) (January 2009). See also, e.g., [Trade Reporting Frequently Asked Questions](#), Sections 203, 307 and 308.
18. In 2010, FINRA adopted amendments to Rule 6160 establishing a voluntary program to allow firms operating an ATS dark pool to have their daily aggregate trading data published by the TRFs. See Securities Exchange Act Release No. 61658 (March 5, 2010), 75 FR 11972 (March 12, 2010). To date, no firm has voluntarily taken part in the program. Under Rule 6160(c), firms voluntarily participating in the program are required to obtain and use a separate MPID designated exclusively for the reporting of transactions executed within the ATS dark pool, which is defined as “an ATS that does not display quotations or subscribers’ orders to any person or entity either internally within the ATS dark pool or externally beyond the ATS dark pool (other than employees of the ATS).” See FINRA Rule 6160(c). Because the MPID amendments require the use of a single, unique MPID for all ATS, Rule 6160(c) was amended to expand the MPID requirement to all ATSs; however, FINRA is maintaining the provisions specific to the ATS dark pool program in Supplementary Material .02 to Rule 6160 with some minor changes to incorporate defined terms and to adjust cross-references.
19. OATS Reporting Members are required to include an MPID on OATS reports. See, e.g., FINRA Rule 7440(b)(3), (c)(1)(B), (c)(2)(A)(ii), (c)(2)(A)(iii). FINRA has not amended the OATS rules in connection with the MPID requirement; however, current OATS guidance provides that “[a]n order that is transferred between two valid MPIDs within the same firm is also considered routed.” See *OATS Reporting Technical Specifications*, at 4-3 (ed. December 11, 2012). Consequently, after the MPID requirement is implemented, an order routed to an ATS will require the submission of a Route Report, which must reflect the unique MPID of the ATS to which the order was routed. See FINRA Rule 7440(c).
20. An ATS that meets specified criteria can apply for an exemption from its trade reporting obligations. See FINRA Rules 6183, 6625 and 6731. Any ATS that is granted an exemption will likely need to continue to report, even after the MPID requirement is implemented, because its volume will not be captured by the use of a unique MPID in trade reports. The terms of the exemption already require exempt ATSs to provide FINRA with data relating to the volume of trades by security executed by the ATS’s member subscribers using the ATS’s system. FINRA is also considering making another field available on trade reports to identify the exempt ATS in those circumstances, but only in the limited circumstance where the ATS has been granted an exemption to its trade reporting obligations under Rule 6183, 6625 or 6731.
21. The FINRA MPID Request Form is not yet available. When available, it will be posted to the [ATS Transparency page](#).
22. An ATS that already has an existing unique MPID is still required to complete a FINRA MPID Request Form to identify the MPID that will be used by the ATS for weekly reporting purposes.

FINRA BrokerCheck

SEC Approves Changes to Expand the Categories of Civil Judicial Disclosures Permanently Included in BrokerCheck and to Include in BrokerCheck Information About Member Firms and Their Associated Persons of Any Registered National Securities Exchange That Uses the CRD System for Registration Purposes

Effective Date: June 23, 2014

Executive Summary

The SEC approved two rule changes related to FINRA Rule 8312 (FINRA BrokerCheck Disclosure). First, the SEC approved amendments to permanently make publicly available in BrokerCheck information about former associated persons of a FINRA member firm who were registered on or after August 16, 1999, and who have been the subject of an investment-related civil action brought by a state or foreign financial regulatory authority that was dismissed pursuant to a settlement agreement.¹ Second, the SEC approved amendments to include in BrokerCheck information about member firms and their associated persons of any registered national securities exchange that uses the Central Registration Depository (CRD[®]) for registration purposes.² Both rule changes will become effective on June 23, 2014.

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

Questions concerning this *Notice* should be directed to FINRA's Gateway Call Center at (301) 590-6500.

February 2014

Notice Type

- ▶ Rule Amendment

Suggested Routing

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

Key Topics

- ▶ BrokerCheck
- ▶ Central Registration Depository
- ▶ Uniform Registration Forms

Referenced Rules & Notices

- ▶ Exchange Act Section 15A(i)
- ▶ FINRA Rule 8312

Background & Discussion

FINRA Rule 8312 governs the information FINRA releases to the public via BrokerCheck. FINRA established BrokerCheck in 1988 (then known as the Public Disclosure Program) to provide the public with information on the professional background, business practices, and conduct of FINRA member firms and their associated persons. The information that FINRA releases to the public through BrokerCheck is derived from the CRD system, the securities industry online registration and licensing database. Firms, their associated persons and regulators report information to the CRD system via the uniform registration forms.³ Among other things, BrokerCheck helps investors make informed choices about the individuals and firms with which they conduct business.

Expansion of the Categories of Civil Judicial Disclosures Permanently Included in BrokerCheck

Pursuant to FINRA Rule 8312, BrokerCheck provides information regarding current and former member firms, as well as current associated persons and persons who were associated with a member firm within the preceding 10 years. In addition, BrokerCheck makes publicly available on a permanent basis information about former associated persons of a member firm who have not been associated with a member firm within the preceding 10 years, and (a) were ever the subject of a final regulatory action, or (b) were registered on or after August 16, 1999, and were (i) convicted of or pled guilty or nolo contendere to a crime; (ii) the subject of a civil injunction in connection with investment-related activity or a civil court finding of involvement in a violation of any investment-related statute or regulation (Civil Judicial Disclosures); or (iii) named as a respondent or defendant in an investment-related arbitration or civil litigation which alleged that the person was involved in a sales practice violation and which resulted in an arbitration award or civil judgment against the person.

Beginning on June 23, 2014, FINRA will expand the categories of Civil Judicial Disclosures that are permanently included in BrokerCheck. Specifically, FINRA will permanently make publicly available in BrokerCheck information about former associated persons of a member firm who were registered on or after August 16, 1999, and who have been the subject of an investment-related civil action brought by a state or foreign financial regulatory authority that was dismissed pursuant to a settlement agreement, as reported to the CRD system via a uniform registration form.⁴

FINRA will disclose through BrokerCheck information concerning such settlements, administrative information (*e.g.*, employment and registration history), and information as to passed qualification examinations regarding these formerly registered individuals. FINRA also will provide the most recently submitted comment, if any has been provided by the formerly registered individual, presuming the comment is in the form, in accordance with the procedures established by FINRA, and relates to the information provided through BrokerCheck.

Inclusion in BrokerCheck of Information About Member Firms and Their Associated Persons of Any Registered National Securities Exchange that Uses the CRD System for Registration Purposes

Since BrokerCheck's establishment in 1988, the registration information available through BrokerCheck has been limited to firms and individuals that have been registered with FINRA. BrokerCheck has not contained information regarding firms or individuals whose registrations have been exclusively with a registered national securities exchange (although such information is contained in the CRD system for exchanges that use the CRD system for registration purposes).

Congress amended Section 15A(i) of the Securities Exchange Act of 1934 to, among other things, require FINRA to provide through BrokerCheck registration information on the members and their associated persons of any registered national securities exchange that uses the CRD system for the registration of its members and their associated persons.⁵ Accordingly, beginning on June 23, 2014, FINRA will expand BrokerCheck to include information about these non-FINRA registered firms and individuals.⁶ The information that will be disclosed through BrokerCheck for these firms and their associated persons will be the same as the information disclosed about FINRA member firms and their associated persons pursuant to FINRA Rule 8312. In addition, these non-FINRA registered firms and individuals will be able to dispute inaccuracies in their BrokerCheck reports as provided for in FINRA Rule 8312(e).

Endnotes

1. See Securities Exchange Act Release No. 71196 (December 27, 2013), 79 FR 417 (January 3, 2014) (Order Approving SR-FINRA-2013-048).
2. See Securities Exchange Act Release No. 71195 (December 27, 2013), 79 FR 419 (January 3, 2014) (Order Approving SR-FINRA-2013-047). The amendments also include non-substantive technical changes to FINRA Rule 8312 to reflect a change in FINRA's style convention for referencing the CRD system.
3. The uniform registration forms are Form U4 (Uniform Application for Securities Industry Registration or Transfer), Form U5 (Uniform Termination Notice for Securities Industry Registration), Form U6 (Uniform Disciplinary Action Reporting Form), Form BD (Uniform Application for Broker-Dealer Registration), Form BDW (Uniform Request for Broker-Dealer Withdrawal), and Form BR (Uniform Branch Office Registration Form).
4. This information currently is elicited by Question 14H(1)(c) on Form U4.
5. See Military Personnel Financial Services Protection Act, Pub. L. No. 109-290, 120 Stat. 1317 (2006).
6. Firms and individuals that have been registered exclusively with a registered national securities exchange will be included in BrokerCheck only if such registration occurred on or after August 16, 1999.

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Attachment A

New language is underlined; deletions are in brackets.

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8000. INVESTIGATIONS AND SANCTIONS

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8300. SANCTIONS

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8312. FINRA BrokerCheck Disclosure

(a) In response to a written inquiry, electronic inquiry, or telephonic inquiry via a toll-free telephone listing, FINRA shall release through FINRA BrokerCheck information regarding: [a current or former member or current or former associated person through FINRA BrokerCheck.]

(1) a current or former FINRA member or a current or former member of a registered national securities exchange that uses the Central Registration Depository ("CRD") for registration purposes ("CRD Exchange") (collectively, "BrokerCheck Firms");
or

(2) a current or former associated person of a BrokerCheck Firm.

(b)(1) Except as otherwise provided in paragraph (d) below, FINRA shall release the information specified in subparagraph (2) below for inquiries regarding a current or former BrokerCheck Firm [member], a person currently associated with a BrokerCheck Firm [person], or a person who was associated with a BrokerCheck Firm [member] within the preceding ten years.

(2) The following information shall be released pursuant to this paragraph (b):

(A) through (B) No Change.

(C) summary information about certain arbitration awards against a BrokerCheck Firm [member] involving a securities or commodities dispute with a public customer;

(D) through (G) No Change.

(H) the name and succession history for current or former BrokerCheck Firms [members].

(c)(1) Except as otherwise provided in paragraph (d) below, FINRA shall release the information specified in subparagraph (2) below for inquiries regarding a person who was formerly associated with a BrokerCheck Firm [member], but who has not been associated with a BrokerCheck Firm [member] within the preceding ten years, and:

(A) was ever the subject of a final regulatory action as defined in Form U4 that has been reported to the CRD system on a Registration Form; or

(B) was registered with FINRA or a CRD Exchange on or after August 16, 1999, and any of the following applies, as reported to the CRD system on a Registration Form:

(i) No Change.

(ii) was the subject of a civil injunction in connection with investment-related activity, [or] a civil court finding of involvement in a violation of any investment-related statute or regulation, or an investment-related civil action brought by a state or foreign financial regulatory authority that was dismissed pursuant to a settlement agreement; or

(iii) No Change.

(2) No Change.

For purposes of this paragraph (c), a final regulatory action as defined in Form U4 may include any final action, including any action that is on appeal, by the SEC, the Commodity Futures Trading Commission, a federal banking agency, the National Credit Union Administration, another federal regulatory agency, a state regulatory agency, a foreign financial regulatory authority, or a self-regulatory organization (as those terms are used in Form U4).

(d) FINRA shall not release:

(1) through (5) No Change.

(6) the most recent information reported on a Registration Form, if:

(A) FINRA has determined that the information was reported in error by a BrokerCheck Firm [member], regulator or other appropriate authority;

(B) No Change.

(7) No Change.

(e) Eligible parties may dispute the accuracy of certain information disclosed through FINRA BrokerCheck pursuant to the administrative process described below:

(1) Initiation of a Dispute

(A) The following persons (each an “eligible party”) may initiate a dispute regarding the accuracy of information disclosed in that eligible party’s BrokerCheck report:

(i) any current BrokerCheck Firm [member];

(ii) any former BrokerCheck Firm [member], provided that the dispute is submitted by a natural person who served as the former BrokerCheck Firm’s [member’s] Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Legal Officer or Chief Compliance Officer, or individual with similar status or function, as identified on Schedule A of Form BD at the time the former BrokerCheck Firm [member] ceased being registered with FINRA or a CRD Exchange; or

(iii) any associated person of a BrokerCheck Firm [member] or person formerly associated with a BrokerCheck Firm [member] for whom a BrokerCheck report is available.

(B) No Change.

(2) No Change.

(3) Investigation and Resolution of Disputes

(A) If FINRA determines that the written notice and supporting documentation submitted by the eligible party is sufficient to update, modify or remove the information that is the subject of the request, FINRA will make the appropriate change. If the written notice and supporting documentation do not include sufficient information upon which FINRA can make a determination, FINRA, under most circumstances, will contact the entity that reported the disputed information (the “reporting entity”) to the CRD system [Central Registration Depository] and request that the reporting entity verify that the information, as disclosed through BrokerCheck, is accurate in content and presentation. If a reporting entity other than FINRA is involved, FINRA will defer to the reporting entity about whether the information received is accurate. If the reporting entity acknowledges that the information is not accurate, FINRA will update, modify or remove the information,

as appropriate, based on the information provided by the reporting entity. If the reporting entity confirms that the information is accurate in content and presentation or the reporting entity no longer exists or is otherwise unable to verify the accuracy of the information, FINRA will not change the information.

(B) through (C) No Change.

(f) No Change.

• • • **Supplementary Material:** -----

.01 No Change.

.02 Disputes Not Eligible for Investigation. For purposes of paragraph (e) of this Rule, examples of situations in which FINRA will determine that a dispute is not eligible for investigation include, but are not limited to:

(a) through (e) No Change.

(f) a dispute that involves information contained in the CRD system [Central Registration Depository] that is not disclosed through BrokerCheck.

.03 Availability of Information Regarding Firms and Associated Persons Registered Exclusively With a CRD Exchange. Information about firms and associated persons that have been registered exclusively with a CRD Exchange is available through BrokerCheck only if the firm or associated person has been registered with a CRD Exchange on or after August 16, 1999.

* * * * *

Limited Corporate Financing Brokers

FINRA Requests Comment on a Proposed Rule Set for Limited Corporate Financing Brokers

Comment Period Expires: April 28, 2014

Executive Summary

FINRA is soliciting public comment on a proposed rule set for firms that meet the definition of “limited corporate financing broker” (LCFB). An LCFB is a firm that engages in a limited range of activities, essentially advising companies and private equity funds on capital raising and corporate restructuring. The rule set would not apply to firms that carry or maintain customer accounts, handle customers’ funds or securities, accept customers’ trading orders, or engage in proprietary trading or market-making.

The proposed rules are available as Attachment A at www.finra.org/notices/14-09.

Questions concerning this *Notice* should be directed to Joseph P. Savage, Vice President and Counsel, Regulatory Policy, at (240) 386-4534.

Action Requested

FINRA encourages all interested parties to comment on the proposed rule set. Comments must be received by April 28, 2014.

Comments must be submitted through one of the following methods:

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

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

February 2014

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Senior Management

Key Topics

- ▶ Corporate Restructuring
- ▶ Limited Corporate Financing Brokers
- ▶ Mergers & Acquisitions
- ▶ Private Equity Funds

Referenced Rules & Notices

- ▶ FINRA Rule 1000 Series
- ▶ FINRA Rule 2000 Series
- ▶ FINRA Rule 3000 Series
- ▶ FINRA Rule 4000 Series
- ▶ FINRA Rule 5122
- ▶ FINRA Rule 8000 Series
- ▶ FINRA Rule 9000 Series
- ▶ FINRA Rule 10000 Series
- ▶ FINRA Rule 12000 Series
- ▶ FINRA Rule 13000 Series
- ▶ FINRA Rule 14000 Series
- ▶ NASD Rule 1000 Series
- ▶ NASD Rule 2000 Series
- ▶ NASD Rule 3170

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposed rule set.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, comments will be posted as they are received.¹

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).²

Background & Discussion

Some FINRA-regulated firms are solely corporate financing firms that advise companies on mergers and acquisitions, advise issuers on raising debt and equity capital in private placements with institutional investors, or provide advisory services on a consulting basis to companies that need assistance analyzing their strategic and financial alternatives. These firms often are registered as broker-dealers because they may receive transaction-based compensation as part of their services.

Nevertheless, these firms do not engage in many of the types of activities typically associated with traditional broker-dealers. For example, these firms do not maintain customer accounts, handle customer funds or securities, accept orders to purchase or sell securities either as principal or agent for the customer, exercise investment discretion on behalf of any customer, or engage in proprietary trading of securities or market-making activities.

FINRA is proposing to establish a separate rule set that would apply exclusively to firms that meet the definition of limited corporate financing broker. An LCFB would be subject to the FINRA By-Laws, as well as core FINRA rules that FINRA believes should apply to all firms. The rule set would include other FINRA rules that are tailored to address an LCFB's business activities.

General Standards (LCFB Rule 010 Series)

Proposed LCFB Rule 014 provides that an LCFB and persons associated with an LCFB will be subject to the FINRA By-Laws (including the schedules thereto), unless the context requires otherwise, and the Limited Corporate Financing Broker Rules. Proposed LCFB Rule 015 provides that the LCFB Rules do not apply to transactions in, and business activities relating to, municipal securities as that term is defined in the Exchange Act.

LCFB Rule 016 sets forth basic definitions modified as appropriate to apply to an LCFB. The proposed definitions of "limited corporate financing broker" is particularly important to the application of the rule set.

The term “limited corporate financing broker” would include any broker that solely engages in one or more of the following activities:

- ▶ advising an issuer, including a private fund, concerning its securities offerings or other capital raising activities;
- ▶ advising a company regarding its purchase or sale of a business or assets or regarding its corporate restructuring, including a going-private transaction, divestiture or merger;
- ▶ advising a company regarding its selection of an investment banker;
- ▶ assisting in the preparation of offering materials on behalf of an issuer;
- ▶ providing fairness opinions; and
- ▶ qualifying, identifying or soliciting potential institutional investors.³

A firm would be permitted to register as, or change its status to, an LCFB only if the firm solely engages in one or more of these activities.

The term limited corporate financing broker would not include any broker or dealer that:

- ▶ carries or maintains customer accounts;
- ▶ holds or handles customers’ funds or securities;
- ▶ accepts orders from customers to purchase or sell securities either as principal or as agent for the customer;
- ▶ possesses investment discretion on behalf of any customer; or
- ▶ engages in proprietary trading of securities or market-making activities.⁴

Member Application and Associated Person Registration (LCFB Rule 100 Series)

The proposed LCFB Rule 100 series sets forth the requirements for firms that wish to register as an LCFB. The proposed LCFB Rule 100 series generally incorporates by reference FINRA Rules 1010 (Electronic Filing Requirements for Uniform Forms), 1122 (Filing of Misleading Information as to Membership or Registration), and 1230(b)(6) (Operations Professional), and NASD Rules 1011 (Definitions), 1012 (General Provisions), 1013 (New Member Application and Review), 1014 (Department Decision), 1015 (Review by National Adjudicatory Council), 1016 (Discretionary Review by FINRA Board), 1017 (Application for Approval of Change in Ownership, Control, or Business Operations), 1019 (Application to Commission for Review), 1090 (Foreign Members), 1100 (Foreign Associates) and IM-1011-1 (Safe Harbor for Business Expansions). Accordingly, an LCFB applicant would follow the same procedures for membership as any other FINRA applicant, with four modifications.

- ▶ First, an applicant for membership that seeks to qualify as an LCFB would have to state in its application that it intends to operate as such.

- ▶ Second, in reviewing an application for membership as an LCFB, the FINRA Member Regulation Department would consider, in addition to the standards for admission set forth in NASD Rule 1014, whether the applicant's proposed activities are consistent with the limitations imposed on an LCFB under LCFB Rule 016(g).
- ▶ Third, proposed LCFB Rule 116(b) sets forth the procedures for an existing FINRA firm to change its status to an LCFB. If an existing firm is already approved to engage in the activities of an LCFB, and the firm does not intend to change its existing ownership, control or business operations, it would not be required to file either a New Member Application (NMA) or a Change in Membership Application (CMA). Instead, such a firm would be required to file a request to amend its membership agreement or obtain a membership agreement (if none exists currently) to provide that: (i) the firm's activities will be limited to those permitted for an LCFB under LCFB Rule 016(g), and (ii) the firm agrees to comply with the LCFB Rules.⁵
- ▶ Fourth, proposed LCFB Rule 116(c) sets forth the procedures for an existing LCFB to terminate its status as such and continue as a FINRA firm. Such a firm would be required to file a CMA with the FINRA Member Regulation Department, and to amend its membership agreement to provide that the firm agrees to comply with all FINRA Rules.⁶

The proposed LCFB Rule 100 series also would govern the registration and qualification examinations of principals and representatives that are associated with an LCFB. These rules incorporate by reference NASD Rules 1021 (Registration Requirements – Principals), 1031 (Registration Requirements – Representatives), 1060 (Persons Exempt from Registration), 1070 (Qualification Examinations and Waiver of Requirements), and 1080 (Confidentiality of Examinations), and FINRA Rule 1230(b)(6) (Operations Professional). Accordingly, LCFB firm principals and representatives would be subject to the same registration and qualification examination requirements as principals and representatives of other FINRA firms.

However, LCFB firm principals and representatives would be eligible for fewer registration categories.⁷ LCFB principals would be eligible to register as a general securities principal (Series 24), limited principal – financial and operations (Series 27), limited principal – introducing broker/dealer financial and operations (Series 28), and limited principal – general securities sales supervisor (Series 9 and 10). LCFB associated persons would be eligible to register as a general securities representative (Series 7), limited representative – corporate securities (Series 62), limited representative – private securities offerings (Series 82), limited representative – investment banking (Series 79) and operations professional (Series 99).

Proposed LCFB Rule 125 would subject an LCFB to continuing education requirements that are more streamlined than those imposed on other firms under FINRA Rule 1250. Proposed LCFB Rule 125 would not impose any Regulatory Element continuing education requirements on an LCFB, but would impose Firm Element requirements. The Firm Element requirements would apply to any person registered with an LCFB who has direct contact with customers in the conduct of the firm's corporate financing activities, and to their immediate supervisors.

The proposed rule would require an LCFB to establish and implement Firm Element programs that are appropriate for the LCFB's business, to administer the program in accordance with its annual evaluation and written plan, and to maintain records documenting the program's content and completion by covered persons. The rule would require covered persons to take all appropriate and reasonable steps to participate in continuing education programs required by their firms. The rule also would authorize FINRA to require an LCFB to provide special training to its covered persons in such areas as FINRA deems appropriate.

Duties and Conflicts (LCFB Rule 200 Series)

The proposed LCFB Rule 200 series would establish a streamlined set of conduct rules. An LCFB would be subject to FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), 2070 (Transactions Involving FINRA Employees), 2080 (Obtaining an Order of Expungement of Customer Dispute Information from the CRD System), 2263 (Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4), and 2268 (Requirements When Using Pre-dispute Arbitration Agreements for Customer Accounts), and NASD Rule 2420 (Dealing with Non-Members) and IM-2420-1 (Transactions Between Members and Non-Members).

LCFB Rules 209 and 211 would impose more streamlined know-your-customer and suitability obligations than are imposed under FINRA Rules 2090 and 2111.

Proposed LCFB Rule 221 is an abbreviated version of FINRA Rule 2210 (Communications with the Public), essentially prohibiting false and misleading statements.

Under proposed LCFB Rule 240, if an LCFB or associated person of an LCFB had engaged in activities that would require the LCFB to register as a broker or dealer under the Exchange Act, and that are inconsistent with the limitations imposed on an LCFB under LCFB Rule 016(g), FINRA could examine for and enforce all FINRA rules against the broker or associated person, including any rule that applies to a FINRA broker-dealer that is not an LCFB or to an associated person who is not associated with an LCFB.

Supervision and Responsibilities Related to Associated Persons (LCFB Rule 300 Series)

The proposed LCFB Rule 300 series would establish a limited set of supervisory rules for an LCFB. An LCFB would be subject to FINRA Rules 3220 (Influencing or Rewarding Employees of Others), 324 (Borrowing from or Lending to Customers), and 327 (Outside Business Activities of Registered Persons).

Proposed LCFB Rule 311 would subject an LCFB to some, but not all, of the requirements of FINRA Rule 3110 (Supervision) and, consistent with Rule 3110, is designed to permit an LCFB flexibility to tailor its supervisory systems to its business models. An LCFB would be subject to many of the provisions of Rule 3110 concerning the supervision of offices, personnel, customer complaints, correspondence and internal communications. However, an LCFB would not be subject to the provisions of Rule 3110 that require annual compliance meetings (paragraph (a)(7)), review and investigation of transactions (paragraphs (b)(2) and (d)), specific documentation and supervision procedures for supervisory personnel (paragraph (b)(6)), and internal inspections (paragraph (c)).

Proposed LCFB Rule 313 would require an LCFB to designate and identify one or more principals to serve as a firm's chief compliance officer.

Proposed LCFB Rule 331 would require each LCFB to implement a written anti-money laundering (AML) program. This is consistent with the SEC's requirements and Chapter X of Title 31 of the Code of Federal Regulations. Accordingly, the proposed rule is similar to FINRA Rule 3310 (Anti-Money Laundering Compliance Programs); however, the proposed rule contemplates that an LCFB would be eligible to conduct the required independent testing for compliance every two years.

Financial and Operational Rules (LCFB Rule 400 Series)

The proposed LCFB Rule 400 series would establish a streamlined set of rules concerning firms' financial and operational obligations. An LCFB would be subject to FINRA Rules 4140 (Audit), 4150 (Guarantees by, or Flow through Benefits for, Members), 4160 (Verification of Assets), 4360 (Fidelity Bonds), 4511 (Books and Records – General Requirements), 4513 (Records of Written Customer Complaints), 4530 (Reporting Requirements), and 4570 (Custodian of Books and Records), and NASD Rules 1150 (Executive Representative), 1160 (Contact Information Requirements) and 3170 (Mandatory Electronic Filing Requirements).

Proposed LCFB Rule 411 includes some, but not all, of the capital compliance requirements of FINRA Rule 4110. An LCFB would be required to suspend business operations during any period a firm is not in compliance with the applicable net capital requirements set forth in SEA Rule 15c3-1, and the rule also would authorize FINRA to direct an LCFB to suspend its operation under those circumstances. Proposed LCFB Rule 411 also sets forth requirements concerning withdrawal of capital, subordinated loans, notes collateralized by securities and capital borrowings.

Because an LCFB would not carry or maintain customer accounts, it would have more limited customer information requirements than is imposed under FINRA Rule 4512.⁸ Each LCFB would have to maintain each customer's name and residence, whether the customer is of legal age (if applicable), and the names of any persons authorized to transact business of the customer. An LCFB would still have to maintain all records required under SEA Rules 17a-3 and 17a-4.

Proposed LCFB Rule 452 establishes a limited set of requirements for the supervision and review of a firm's general ledger accounts.

Investigations and Sanctions, Code of Procedure, and Arbitration and Mediation (LCFB Rules 800, 900 and 1000)

Each LCFB would be subject to the FINRA Rule 8000 series governing investigations and sanctions of firms, other than FINRA Rules 8110 (Availability of Manual to Customers), 8211 (Automated Submission of Trading Data Requested by FINRA), and 8213 (Automated Submission of Trading Data for Non-Exchange-Listed Securities Requested by FINRA).

An LCFB would be subject to the FINRA Rule 9000 series governing disciplinary and other proceedings involving firms, other than the FINRA Rule 9700 series (Procedures on Grievances Concerning the Automated Systems). Proposed LCFB Rule 900(c) would provide that any LCFB may be subject to a fine under FINRA Rule 9216(b) with respect to an enumerated list of FINRA By-Laws, LCFB Rules and SEC Rules under the Exchange Act. Proposed LCFB Rule 900(d) would authorize FINRA staff to require an LCFB to file communications with the FINRA Advertising Regulation Department at least ten days prior to use if the staff determined that the LCFB had departed from LCFB Rule 221's standards.

An LCFB would be subject to the FINRA Rule 10000 series (Code of Arbitration Procedure), 12000 series (Code of Arbitration Procedure for Customer Disputes), 13000 (Code of Arbitration Procedure for Industry Disputes) and 14000 series (Code of Mediation Procedure).

Request for Comment

FINRA requests comment on all aspects of the proposed rules, including any impact on institutional customers and issuers, potential costs and burdens that the proposal could impose on an LCFB, and any cost savings and reduced burdens that the proposal would create for an LCFB. FINRA also requests comment on whether an LCFB should be subject to any FINRA Rules that are not included in the proposed rule set.

FINRA particularly requests comment concerning the following issues:

- ▶ Does the proposed rule set provide sufficient protections to customers of an LCFB? If not, what additional protections are warranted and why?
- ▶ Does the proposed rule set appropriately accommodate the scope of LCFB business models? If not, what other accommodations are necessary and how would customers be protected?
- ▶ Is the definition of “limited corporate financing broker” appropriate? Are there any activities in which broker-dealers with limited corporate financing functions typically engage that are not included in the definition? Are there activities that should be added to the list of activities in which an LCFB may not engage?
- ▶ Are there firms that would qualify for the proposed rule set but that would choose not to be treated as an LCFB? If so, what are the reasons for this choice?
- ▶ What is the likely economic impact to an LCFB, other broker-dealers and their competitors of adoption of the LCFB rules?
- ▶ FINRA welcomes estimates of the number of firms that would be eligible for the proposed rule set.
- ▶ Proposed LCFB Rule 123 would limit the principal and representative registration categories that would be available for persons associated with an LCFB. Are there any registration categories that should be added to the rule? Are there any registration categories that are currently included in the proposed rule but that are unnecessary for persons associated with an LCFB?
- ▶ Should principals and representatives that hold registration categories not included within LCFB Rule 123 be permitted to retain these registrations?
- ▶ Does an LCFB normally make recommendations to customers to purchase or sell securities? Should an LCFB be subject to rules requiring firms to know their customers (LCFB Rule 209) and imposing suitability obligations (LCFB Rule 211) to an LCFB?
- ▶ Does the SEC staff no-action letter issued to Faith Colish, et al., dated January 31, 2014,⁹ impact the analysis of whether a firm would become an LCFB? Is it likely that some limited corporate financing firms will not register as a broker consistent with the fact pattern set forth in the no-action letter, or will they register as an LCFB?

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. [See Notice to Members 03-73](#) (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the Federal Register. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. See proposed LCFB Rule 016(g)(1). An LCFB would not be permitted to qualify, identify or solicit potential purchasers of securities unless the purchaser meets the definition of “institutional investor.” However, an LCFB would be allowed to serve clients (such as individuals or entities seeking advice on securities offerings or sales of businesses) who do not meet the “institutional investor” definition.

The term “institutional investor” would have the same meaning as that term has under FINRA Rule 2210 (Communications with the Public). The term would include any:

- bank, savings and loan association, insurance company or registered investment company;
- governmental entity or subdivision thereof;
- employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans;

- qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans;
- other person (whether a natural person, corporation, partnership, trust, family office or otherwise) with total assets of at least \$50 million; and
- any person acting solely on behalf of any such institutional investor.

See proposed LCFB Rule 016(f).

FINRA purposely does not propose to define “institutional investor” based on a more inclusive standard, such as the definition of “accredited investor” in Regulation D under the Securities Act of 1933. See 17 C.F.R. § 230.501(a). The LCFB Rules are intended to govern the activities of firms that engage in a limited range of activities, such as advising companies and private equity funds on capital raising and corporate restructuring. As part of these activities, an LCFB would be permitted to qualify, identify and solicit potential institutional investors, as defined by the LCFB Rules.

FINRA’s regulatory programs have uncovered serious concerns with the manner in which firms market and sell private placements to accredited investors. Application of the LCFB Rules to firms that market and sell private placements to accredited investors would require FINRA to expand the applicable conduct rules and other provisions. Therefore, lowering the threshold of “institutional investor” would eviscerate the benefits of a streamlined rule set.

4. *See* proposed LCFB Rule 016(g)(2).
5. There would not be an application fee associated with this request.
6. Absent a waiver, such a firm would have to pay an application fee associated with the CMA. *See* FINRA By-Laws, Schedule A, Section 4(i).
7. *See* proposed LCFB Rule 123.
8. *See* proposed LCFB Rule 451(b).
9. *See Faith Colish, Esq., Carter Ledyard & Milburn LLP, et al.*, SEC no-action letter (Jan. 31, 2014).