

Regulatory Notice

08-25

Books and Records

Proposed Consolidated FINRA Rules Governing Books and Records Requirements

Comment Period Expires: June 13, 2008

Executive Summary

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

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

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

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

May 2008

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Legal
- Compliance
- Operations
- Senior Management
- Systems

Key Topic(s)

- Books and Records

Referenced Rules & Notices

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

Action Requested

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

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

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

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

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

Important Notes:

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

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

Discussion

FINRA is soliciting comments on the following proposals.

A. General Requirements (Proposed FINRA Rule 4511)⁵

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

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

B. Records Relating to the Three Quote Rule

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

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

C. Customer Account Information (Proposed FINRA Rule 4512)

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

1. Signature Requirement

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

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

2. *Discretionary Accounts*

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

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

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

3. *Additional Clarifying Revisions*

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

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

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

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

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

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

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

E. Disclosures Relating to Customer Predispute Arbitration Agreements

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

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

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

G. Order Audit Trail System Recordkeeping Requirements

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

H. Hold Mail Rule

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

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

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

Endnotes

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

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Endnotes

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

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

ATTACHMENT A

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

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

[3110] 4510. Books and Records Requirements

[(a)] 4511. General Requirements

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

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

[(c)] 4512. Customer Account Information

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

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

(A) through (B) No Change.

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

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

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

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

(2) No Change.

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

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

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

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

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

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

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

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

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

• • • Supplementary Material: -----

.01 Customer Account Information Retention Periods

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

.02 Additional Customer Account Records Under the Exchange Act

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

.03 Compliance With NASD Rule 3090

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

.04 “Maintain” and “Preserve”

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

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

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

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

[(e) “Complaint” Defined]

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

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

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

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

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

[(i) Holding of Customer Mail]⁵

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

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

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

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

* * * * *