

Regulatory Notice

10-21

SEC Approves New Consolidated FINRA Rules

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

Effective Date: June 14, 2010

Executive Summary

Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA established a process to develop a new consolidated rulebook (Consolidated FINRA Rulebook), which FINRA has discussed in previous *Information Notices*.¹ FINRA is proposing new consolidated rules in phases for approval by the SEC as part of the Consolidated FINRA Rulebook.²

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

Questions regarding this *Notice* should be directed to:

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

April 2010

Notice Type

- Consolidated Rulebook
- Rule Approval

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topics

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

Referenced Rules & Notices

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

Discussion

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

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

The attachment to this *Notice* sets forth additional information regarding these new consolidated rules and includes a hyperlink to the related rule filings. The filings provide, among other things, FINRA's statement of the purpose of the rule changes and an exhibit showing the changes between the new rule text and the text of the NASD and/or Incorporated NYSE Rules as they exist in the Transitional Rulebook. Also, the text of each new FINRA Rule is available in the online *FINRA Manual* at www.finra.org/finramanual.⁶

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

Rule Conversion Charts

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

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

Endnotes

- 1 *See Information Notice 10/06/08 (Rulebook Consolidation Process: Effective Dates of New Consolidated Rules; Introduction of Rule Conversion Chart); see also Information Notice 03/12/08 (Rulebook Consolidation Process).*
- 2 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The new FINRA Rules apply to all member firms, unless such rules have a more limited application by their terms. As the Consolidated FINRA Rulebook expands with the SEC's approval and with the new FINRA Rules taking effect, the rules in the Transitional Rulebook that address the same subject matter of regulation will be eliminated. When the Consolidated FINRA Rulebook is completed, the Transitional Rulebook will have been eliminated in its entirety.
- 3 *See Exchange Act Release No. 61540 (February 18, 2010), 75 FR 8778 (February 25, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-081).*
- 4 *See Exchange Act Release No. 61706 (March 15, 2010), 75 FR 13632 (March 22, 2010) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1; File No. SR-FINRA-2009-047).*
- 5 *See Exchange Act Release No. 61537 (February 18, 2010), 75 FR 8772 (February 25, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-095).*
- 6 FINRA updates the rule text on its online *Manual* within two business days of SEC approval of changes to the rule text.
- 7 *See Exchange Act Release No. 61473 (February 2, 2010), 75 FR 6422 (February 9, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-087).*
- 8 *See Exchange Act Release No. 61542 (February 18, 2010), 75 FR 8768 (February 25, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2009-093).*
- 9 *See Exchange Act Release No. 61808 (March 31, 2010), 75 FR 17456 (April 6, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-005).*

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ATTACHMENT A

List of Approved Rules (and Related Rule Filings)

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

FINRA Rule Filing SR-FINRA-2009-081

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

FINRA Rule 2261

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

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

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

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

FINRA Rule Filing SR-FINRA-2009-047

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

FINRA Rule 3160

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

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

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

FINRA Rule Filing SR-FINRA-2009-095

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

FINRA Rule 3240

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

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

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

FINRA Rule Filing SR-FINRA-2009-087

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

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

FINRA Rule Filing SR-FINRA-2009-093

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

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

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

FINRA Rule Filing SR-FINRA-2010-005

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

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

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