Regulatory Notice 11-26

Financial Responsibility

SEC Approves Consolidated Financial Responsibility and Related Operational Rules

Effective Date: August 1, 2011

Executive Summary

The SEC approved FINRA's proposed rule change[1] to adopt a set of financial responsibility and related operational rules for the consolidated rulebook (the Consolidated FINRA Rulebook).[2] FINRA Rules 4150, 4311, 4522 and 4523 are new consolidated rules governing financial responsibility as well as certain operational and contractual requirements of members. The new rules are based in part on, and replace, provisions in the NYSE and NASD Rules.[3]

The text of the new rules is set forth in Attachment A. The questionnaire that FINRA is specifying for use by carrying firms pursuant to new FINRA Rules 4311(b)(3) and 4311.02 is in Attachment B.[4]

Questions regarding this *Notice* should be directed to:

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- Susan DeMando Scott, Associate Vice President, Financial Operations Department, at (202) 728-8411; or
- Adam H. Arkel, Assistant General Counsel, Office of General Counsel, at (202) 728-6961.

Background

New FINRA Rules 4150, 4311, 4522 and 4523, in combination with the consolidated financial responsibility rules that the SEC approved in November 2009,[5] enhance FINRA's authority to execute effectively its financial and operational surveillance and examination programs. Consistent with the approach that FINRA discussed in SR-FINRA-2008-067 and *Regulatory Notice 09-71*, many of the requirements set forth in the new rules are substantially the same as requirements found in current rules and, where appropriate, are tiered to apply only to carrying or clearing firms, or to

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Notice Type
- Consolidated Rulebook
- New Rules

Suggested Routing
- Compliance
- Legal
- Senior Management

Key Topics
- Capital Compliance
- Financial Responsibility
- Operational Rules

Referenced Rules & Notices
- FINRA Rule 4150
- FINRA Rule 4311
- FINRA Rule 4522
- FINRA Rule 4523
- NTM 94-07
- NYSE Information Memo 82-18
- NYSE Rule 322
- NYSE Rule 382
- NYSE Rule 416A
- NYSE Rule 440
- NYSE Rule Interpretations 382/01 through 382/05
- NYSE Rule Interpretation 409(a)/01
- NYSE Rule Interpretation 440.20/01
- NASD Rule 3230
- SEA Rule 15c3-1
- SEA Rule 15c3-3
- SEA Rule 17a-3
- SEA Rule 17a-4
- SEA Rule 17a-13
- Regulatory Notice 08-76
- Regulatory Notice 09-03
- Regulatory Notice 09-71
- Information Notice 03/12/08

firms that engage in certain specified activities.[6] Certain provisions of the rules are new for FINRA members that are not Dual Members (non-NYSE members). Certain other provisions are new for both Dual Members and non-NYSE members alike.

Discussion

A. FINRA Rule 4150 (Guarantees by, or Flow Through Benefits for, Members)

FINRA Rule 4150(a), based in large part on NYSE Rule 322,[7] requires that prior written notice be given to FINRA whenever a member guarantees, endorses or assumes, directly or indirectly, the obligations[8] or liabilities of another person (including an entity).[9] Paragraph (b) of the rule requires that prior written approval must be obtained from FINRA whenever any member receives flow through capital benefits in accordance with Appendix C of SEA Rule 15c3-1. Details of the rule's notice and prior approval requirements are included in Supplementary Material to the new rule (FINRA Rule 4150.01).

FINRA Rule 4150.02 provides that a member may at any time (*i.e.*, not just within the context of the prior written notice that the member provides or the prior written approval that the member seeks to obtain pursuant to the rule) be required to provide FINRA with information with respect to the arrangement, relationship and dealings with a person referred to in the rule.

FINRA Rule 4150.03 prohibits any member from entering into an arrangement described in the rule unless the member has the authority to make available promptly the books and records of the other person for inspection by FINRA in the United States. The rule provides that the books and records of the other person must be kept separately from those of the member.

With respect to persons referred to in the rule that are registered broker-dealers, FINRA Rule 4150.04 requires that the member furnish to FINRA copies of the person's FOCUS Reports simultaneous with their being filed with the person's designated examining authority (DEA). FINRA expects that members shall furnish the person's FOCUS Reports to FINRA on an ongoing basis (the member need not furnish the person's FOCUS Reports to FINRA if FINRA is the person's DEA). For persons that are not registered broker-dealers, the rule requires, in lieu of FOCUS Reports, submission of financial and operational statements, in such format and at such time periods as FINRA may require, sufficient to gauge the capital and operational effects of the arrangement or relationship on the member.

FINRA Rule 4150.05 provides that guarantees executed routinely in the normal course of business, such as trade guarantees, signature guarantees, endorsement of securities and the writing of options, are not subject to the requirements of the rule provided that, in regard to the guarantee of the writing of options, the transaction is appropriately recorded on the member's books and records in accordance with SEA Rule 17a-3(a)(10) and is reflected in its net capital computation pursuant to SEA Rule 15c3-1.

FINRA Rule 4150.06 provides that, within 30 days of the implementation date of the rule (*i.e.*, by August 31, 2011), each member must advise FINRA, in writing, of any guarantees, endorsements, assumptions of obligations/liabilities, or flow through capital benefits, in effect as of August 1, 2011 not having otherwise been reported, in writing, to the member's Regulatory Coordinator at FINRA.

B. FINRA Rule 4311 (Carrying Agreements)

New FINRA Rule 4311 is based on NASD Rule 3230 and NYSE Rule 382 (including NYSE Rule Interpretations 382/01 through 382/05 and 409(a)/01). The new rule governs the requirements applicable to members when entering into agreements for the carrying of any customer accounts in which securities transactions can be effected. Historically, the purpose of the NASD and NYSE rules upon which new FINRA Rule 4311 is based has been to ensure that certain functions and responsibilities are clearly allocated to either the introducing or carrying firm, consistent with the requirements of the SRO's and SEC's financial responsibility and other rules and regulations, as applicable.[10] The new rule continues to serve that same purpose and, accordingly, contains many requirements that are substantially unchanged from NASD Rule 3230 and NYSE Rule 382. New FINRA Rule 4311 also codifies certain provisions that are new for non-NYSE members, or are new for both Dual Members and non-NYSE members alike. Following is a summary of the major provisions of the new rule.

FINRA Rule 4311(a)(1) prohibits a member, unless otherwise permitted by FINRA, from entering into an agreement for the carrying, on an omnibus or fully disclosed basis, of any customer account in which securities transactions can be effected (for purposes of Rule 4311, "customer account" or "account"), unless the agreement is with a carrying firm that is a FINRA member.[11] This is a new requirement for all members; however, the vast majority of carrying firms in the United States are FINRA members. New FINRA Rule 4311(a)(1) also includes a provision requiring that when an introducing firm acts as an intermediary for another introducing firm or firms (so-called "piggyback" or "intermediary clearing arrangements") for the purpose of obtaining clearing services from the carrying firm, the introducing firm must notify the carrying firm of the existence of the arrangement(s) with the other introducing firm(s) and disclose the identity of the firm(s). Based in large part on NYSE Rule Interpretation 382/05, the new rule further requires that each carrying agreement identify and bind every direct and indirect recipient of clearing services as a party to the agreement.

FINRA Rule 4311(b)(1), consistent with the requirements of NASD Rule 3230(e) and NYSE Rule 382(a), requires that the carrying firm submit to FINRA for prior approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before the agreement may become effective. The rule also provides that the carrying firm must also submit to FINRA for prior approval any material changes to an approved carrying agreement before the changes may become effective.[12] The rule codifies the practice under

NASD Rule 3230 of permitting use of pre-approved standardized forms of agreement, with the exception of agreements with parties that are not U.S.-registered broker-dealers. The rule requires a carrying firm to submit separately to FINRA for approval each carrying agreement with a non-U.S.-registered broker-dealer.[13] This is a new requirement for non-NYSE members.

FINRA Rule 4311(b)(3) codifies the current practice under NYSE Rule 382 of requiring that as early as possible, but not later than 10 business days, prior to the carrying of any accounts of a new introducing firm (including the accounts of any piggyback or intermediary introducing firm(s)), the carrying firm must submit to FINRA a notice identifying each such introducing firm by name and CRD number and include such additional information as FINRA may require.[14] This is a new requirement for non-NYSE carrying members, and permits FINRA to obtain additional information that enables it to evaluate the impact of the new carrying arrangement on the financial and operational condition of the member.

FINRA Rule 4311(b)(4) expressly requires each carrying firm to conduct appropriate due diligence with respect to any new introducing firm relationship. Such due diligence is expected to be conducted prior to the commencement of the relationship. The rule provides that such due diligence must assess the financial, operational, credit and reputational risk that such arrangement will have upon the carrying firm.[15] The rule provides that FINRA, in its review of any arrangement, may in its discretion require specific items to be addressed by the carrying firm as part of the firm's due diligence requirement under the rule. The rule further provides that the carrying firm must maintain a record, in accord with the time frames prescribed by SEA Rule 17a-4(b), of the due diligence conducted for each new introducing firm.

FINRA Rule 4311(c)(1), based in part on NASD Rule 3230(a) and NYSE Rule 382(b), requires that each carrying agreement in which accounts are to be carried on a fully disclosed basis specify the responsibilities of each party to the agreement, including at a minimum the allocation of responsibilities set forth in paragraphs (c)(1)(A) through (c)(1)(I) and (c)(2) of the rule. Under federal securities regulations, the carrying firm is responsible for the safeguarding of the funds and securities held in the accounts that it carries. Consistent therewith, FINRA Rule 4311(c)(2) requires that each carrying agreement in which accounts are to be carried on a fully disclosed basis must expressly allocate to the carrying firm the responsibility for the safeguarding of funds and securities for the purposes of SEA Rule 15c3-3. Further, because FINRA believes that it is important to ensure the accuracy and integrity of customer account statements, FINRA Rule 4311(c)(2) requires that each carrying agreement in which accounts are to be carried on a fully disclosed basis must expressly allocate to the carrying firm the responsibility for preparing and transmitting statements of account to customers. The rule provides that the carrying firm may authorize the introducing firm to prepare and/or transmit such statements on the carrying firm's behalf with the prior written approval of FINRA.[16] FINRA will review the circumstances of each such request and anticipates that such exceptions will be infrequent and may require additional time for review and approval of the carrying agreement than would otherwise be required.

Based in part on NASD Rule 3230(g), NYSE Rule 382(c) and NYSE Rule Interpretation 382/03, FINRA Rule 4311(d) requires that each customer whose account is introduced on a fully disclosed basis must be notified in writing upon the opening of the account of the existence of the carrying agreement and the responsibilities allocated to each respective party. The carrying firm is responsible for the content of the notification to the customer. Further, the rule provides that the customer must be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities thereunder. Supplementary Material to the rule (FINRA Rule 4311.05) provides that, for purposes of FINRA Rule 4311(d), notification to customers of a change to any of the parties to the carrying agreement is not required in instances where, consistent with applicable FINRA rules and the federal securities laws, such customers' accounts are being transferred pursuant to:

a. ACATS using an authorized Transfer Instruction Form (TIF); or

b. a process outside of ACATS where notification to customers is provided by means of an alternative mechanism such as affirmative or negative response letters.

Consistent with NYSE Rule Interpretation 382/03, FINRA Rule 4311(e) requires that each carrying agreement expressly state that to the extent a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility. This is a new requirement for non-NYSE members.

Based in large part on NASD Rule 3230(d) and NYSE Rule 382(f), FINRA Rule 4311(f) provides that a carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers on the carrying firm's behalf, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule 15c3-3 and further that the introducing firm represents to the carrying firm in writing that the introducing firm maintains, and will enforce, supervisory policies and procedures with respect to such negotiable instruments that are satisfactory to the carrying firm.

The provisions of FINRA Rule 4311(g)(1) and (h) generally address the obligations of the parties to provide the referenced information, such as any written customer complaints and exception reports, to each other and/or to FINRA and are based upon existing NASD and NYSE rule provisions. (Note that the July 1 deadline set forth in paragraph (h)(2) of the new rule differs from the current requirement (no later than July 31) specified by the corresponding NASD and NYSE rule provisions.) FINRA Rule 4311(g)(2) provides that, upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of FINRA Rule 4311(g)(1) in instances where the introducing firm is an affiliated entity of the carrying firm. This provision is based upon NASD Rule 3230(b)(3) but is not contained in NYSE Rule 382.

FINRA Rule 4311(i) is based largely on NASD Rule 3230(h) and does not have a corresponding provision to NYSE Rule 382. The new rule provides that all carrying agreements must require each introducing firm to maintain its proprietary and customer accounts, and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each introducing firm. Consistent with NASD Rule 3230(h), the requirements of FINRA Rule 4311(i) apply only to intermediary clearing arrangements that are established on or after February 20, 2006 (the date this requirement as set forth in NASD Rule 3230(h) became effective).

C. FINRA Rule 4522 (Periodic Security Counts, Verifications and Comparisons)

FINRA Rule 4522(a), based in large part on NYSE Rule 440.10, requires each member that is subject to the requirements of SEA Rule 17a-13 to make the counts, examinations, verifications, comparisons and entries set forth in SEA Rule 17a-13. FINRA Rule 4522(b), again based in large part on NYSE Rule 440.10, requires each carrying or clearing member subject to SEA Rule 17a-13 to make more frequent counts, examinations, verifications, comparisons and entries where prudent business practice would so require. Each such carrying or clearing member is required to receive position statements no less than once per month with respect to securities held by clearing corporations, other organizations or custodians and, at least once per month, reconcile all such securities and money balances by comparison of the clearing corporations' or custodians' position statements to the member's books and records. The carrying or clearing member must promptly report any differences to the contra organization, and both the contra organization and the member firm must promptly resolve the differences. Where there is a higher volume of activity, the rule provides that good business practice may require a more frequent exchange of statements and performance of reconciliations. The rule further requires that no later than seven business days after each security count, the carrying or clearing member must enter any unresolved differences into a "Difference" account for that security count.

NASD rules do not have a provision that corresponds to NYSE Rule 440.10. Accordingly, the requirements of FINRA Rule 4522(b) are new to non-NYSE carrying or clearing members that are subject to the requirements of SEA Rule 17a-13.[17]

D. FINRA Rule 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts)

FINRA Rule 4523, based in large part on NYSE Rule 440.20, is intended to help assure the accuracy of each member's books and records and includes supervisory measures for their implementation. Paragraph (a) of the new rule requires that each member must designate an associated person to be responsible for each general ledger bookkeeping account and account of like function used by the member, and that the associated person must control

and oversee entries into each such account and determine that the account is current and accurate as necessary to comply with all applicable FINRA rules and federal securities laws governing books and records and financial responsibility requirements. The rule requires that a supervisor must, as frequently as is necessary considering the function of the account but, in any event, at least monthly, review each account to determine that it is accurate and that any items that are aged or uncertain as to resolution are promptly identified for research and possible transfer to a suspense account(s).

FINRA Rule 4523(b) requires that each carrying or clearing member must maintain a record of the name of each individual assigned primary and supervisory responsibility for each account as required by paragraph (a) of the rule. All records made pursuant to Rule 4523(b) must be preserved for a period of not less than six years (the period set forth in SEA Rule 17a-4(a)).

FINRA Rule 4523(c) provides that each member must record, in an account that must be clearly identified as a suspense account, money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. The rule requires that a record be maintained of all information known with respect to each item so recorded. Again, all records made pursuant to FINRA Rule 4523(c) must be preserved for a period of not less than six years (the period set forth in SEA Rule 17a-4(a)).

Supplementary Material to the new rule (FINRA Rule 4523.01) provides that, for the purposes of paragraphs (a) and (b) of the rule, members with only one associated person may assign primary and supervisory responsibility for each account to that associated person, subject to applicable registration requirements. Further, the Supplementary Material provides that members of limited size and resources that have more than one associated person may seek FINRA's prior written approval to assign primary and supervisory responsibility for each account to the same associated person. Further, for purposes of clarification, FINRA Rule 4523.02 provides that, for purposes of FINRA Rule 4523, all requirements that apply to a member that clears or carries customer accounts shall also apply to any member that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established thereunder.

NASD rules do not have a provision that corresponds to NYSE Rule 440.20. Accordingly, the requirements of new FINRA Rule 4523 are new to non-NYSE members.

Endnotes

1 *See* Securities Exchange Act Release No. 63999 (March 1, 2011), 76 FR 12380 (March 7, 2011) (Order Granting Approval to Proposed Rule Change; File No. SR-FINRA-2010-061).

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 FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, *see* Information Notice 03/12/08 (Rulebook Consolidation Process). For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

3 Effective August 1, 2011, NYSE Rules 322, 382, 440.10 and 440.20 and NYSE Rule Interpretations 382/01 through 382/05, 409(a)/01 and 440.20/01 and NASD Rule 3230 will be deleted from the Transitional Rulebook.

4 *See* note 14 below.

5 The consolidated financial responsibility rules went into effect on February 8, 2010. *See* Securities Exchange Act Release No. 60933 (November 4, 2009), 74 FR 58334 (November 12, 2009) (Order Granting Approval to Proposed Rule Change; File No. SR-FINRA-2008-067). *See also* Regulatory Notice 09-71 (December 2009) (SEC Approves Consolidated FINRA Rules Governing Financial Responsibility); Regulatory Notice 09-03 (January 2009) (Financial Responsibility and Related Operational Rules).

6 For purposes of the new rules—like the consolidated financial responsibility rules that went into effect pursuant to SR-FINRA-2008-067—FINRA has specified in the rule text where appropriate that all requirements that apply to a member that clears or carries customer accounts also apply to any member that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established thereunder. For further background, *see* 74 FR 58334. *See also* new FINRA Rule 4523.02 and further discussion in this *Notice*.

7 NASD rules do not have a provision that corresponds to NYSE Rule 322. Accordingly, the requirements of new FINRA Rule 4150 are new to non-NYSE members.

8 The term "obligations" includes financial obligations, as well as other obligations that may have a financial impact on a member, such as performance obligations.

9 For purposes of the new rules, all references to "persons" include entities.

10 *See, e.g.*, Notice to Members 94-07 (February 1994) (SEC Approves New NASD Rule Relating to the Obligations and Responsibilities of Introducing and Clearing Firms) and *NYSE Information Memo 82-18* (March 1982) (Carrying Agreements – Amendments to Rules 382 and 405).

11 Because carrying firms generally are FINRA members, FINRA expects requests to enter into carrying agreements with firms that are not FINRA members to be infrequent.

12 New FINRA Rule 4311.01 includes guidance as to what constitutes a material change for purposes of paragraph (b)(1) of the rule. Specifically, material changes include, but are not limited to, changes to: the allocation of responsibilities required by the rule; termination clauses applicable to the introducing firm; any terms or provisions affecting the liability of the parties; and the parties to the agreement, including, for example, the addition of a new party to the agreement, such as a "piggyback" arrangement, a new carrying firm or a new introducing firm, but not including a termination of the agreement. (However, as explained in *Regulatory Notice 08-76* (December 2008) (Reporting Clearing Arrangements), under NYSE Rule 416A carrying firms that are Dual Members are required to update their Firm Clearing Arrangement Form information on an ongoing basis no later than 30 days after the information has changed. FINRA expects to extend this requirement to all carrying firms later as part of the rulebook consolidation process.)

13 New FINRA Rule 4311(a)(2) expressly permits a carrying firm to enter into a carrying agreement for the carrying of the customer accounts of a person other than a U.S. registered broker or dealer, subject to the conditions set forth in the rule.

14 FINRA Rule 4311.02 provides that, for purposes of the notice requirement of paragraph (b)(3) of the rule, the carrying firm must submit a questionnaire in such form as to be specified by FINRA, which may be updated from time to time as FINRA deems necessary. (The questionnaire that FINRA is specifying for use by carrying firms pursuant to FINRA Rules 4311(b)(3) and 4311.02 is in Attachment B.)

15 New FINRA Rule 4311.03 provides that the due diligence may include, without limitation, inquiry by the carrying firm into the introducing firm's business model and product mix, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history.

16 Supplementary Material (FINRA Rule 4311.04) reminds members that, for purposes of paragraphs (c)(1)(F) and (c)(2) of the new rule, receipt and delivery of customers' funds and securities and the safeguarding of such funds and securities must comply with the requirements of the SEC's financial responsibility rules, in particular SEA Rule 15c3-3, and applicable SEC guidance.

17 Note that the rule by its terms does not apply to members that are exempt from SEA Rule 17a-13.

ATTACHMENT A

Below is the text of new FINRA Rules 4150, 4311, 4522 and 4523.

* * * * *

4150. Guarantees by, or Flow Through Benefits for, Members

(a) Prior written notice shall be given to FINRA whenever any member guarantees, endorses or assumes, directly or indirectly, the obligations or liabilities of another person.

(b) Prior written approval must be obtained from FINRA whenever any member receives flow through capital benefits in accordance with Appendix C of SEA Rule 15c3-1.

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

.01 Financial and Operational Impact. The written notice required by paragraph (a) of this Rule shall be given to FINRA at least 10 business days prior to entering into such arrangement or relationship with another person. Both the written notice required by paragraph (a) of this Rule and the request for approval under paragraph (b) of this Rule shall include the address and general nature of business conducted by such person, a description of the relationship or arrangement between the parties, details regarding the capitalization of such person (including the percentage of ownership or profits by the member), as well as the actual and potential effect of the arrangement or relationship on the member's capital (including net capital) and operations and such other information as FINRA may require. A request for approval under paragraph (b) of this Rule shall further include an opinion of counsel where such is required in conformity with Appendix C of SEA Rule 15c3-1.

.02 Member Dealings. A member may at any time be required to provide FINRA with information with respect to the arrangement, relationship and dealings with a person referred to in this Rule.

.03 Books and Records. No member shall enter into an arrangement described in this Rule unless it has the authority to make available promptly the books and records of such other person for inspection by FINRA in the United States. The books and records of such person shall be kept separately from those of the member.

.04 FOCUS Reporting Requirements. For persons referred to in this Rule that are registered broker-dealers, the member shall furnish to FINRA copies of such person's FOCUS Reports simultaneous with their being filed with the person's designated examining authority. For persons referred to in this Rule that are not registered broker-dealers, FINRA requires, in lieu of FOCUS, submission of financial and operational statements, in such format and at such time periods as may be required by FINRA, sufficient to gauge the capital and operational effects of the arrangement or relationship.

.05 Routine Guarantees. Guarantees executed routinely in the normal course of business such as trade guarantees, signature guarantees, endorsement of securities and the writing of options, are not subject to the requirements of this Rule provided that, in regard to the guarantee of the writing of options, the transaction is appropriately recorded on the member's books and records in accordance with SEA Rule 17a-3(a)(10) and is reflected in its net capital computation pursuant to SEA Rule 15c3-1.

.06 Guarantees Already in Effect. Within 30 days of August 1, 2011, each member shall advise FINRA, in writing, of any guarantees, endorsements, assumptions of obligations/ liabilities, or flow through capital benefits, in effect as of August 1, 2011 not having otherwise been reported, in writing, to the appropriate Regulatory Coordinator.

* * * * *

4311. Carrying Agreements

(a) (1) Unless otherwise permitted by FINRA, a member shall not enter into an agreement for the carrying, on an omnibus or fully disclosed basis, of any customer account in which securities transactions can be effected ("customer account" or "account"), unless such agreement is with a carrying firm that is a FINRA member. An introducing firm that acts as an intermediary for another introducing firm(s) for the purpose of obtaining clearing services from the carrying firm must notify such carrying firm of the existence of such arrangement(s) and the identity of the other introducing firm(s). Each such carrying agreement(s) shall identify and bind every direct and indirect recipient of clearing services as a party thereto.

(2) A carrying firm may enter into a carrying agreement(s) for the carrying of the customer accounts of a person other than a U.S. registered broker or dealer, subject to the conditions set forth in this Rule.

(b) (1) The carrying firm shall submit to FINRA for prior approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before such agreement may become effective. The carrying firm also shall submit to FINRA for prior approval any material changes to an approved carrying agreement before such changes may become effective.

(2) A carrying firm may use a standardized form of agreement that has been approved by FINRA pursuant to paragraph (b)(1) of this Rule, to enter into new carrying arrangements with other U.S. registered brokers or dealers, without the re-submission and re-approval of such agreement. However, a carrying firm must submit to FINRA for approval each carrying agreement that includes a party that is not a U. S. registered broker or dealer.

(3) As early as possible, but not later than 10 business days, prior to the carrying of any accounts of a new introducing firm (including the accounts of any introducing firm(s) for which a new or existing introducing firm is acting as an intermediary in obtaining clearing services from the carrying firm) the carrying firm shall submit to FINRA a notice identifying each such introducing firm by name and CRD number and shall include such additional information as FINRA may require.

(4) Each carrying firm shall conduct appropriate due diligence with respect to any new introducing firm relationship to assess the financial, operational, credit and reputational risk that such arrangement will have upon the carrying firm. FINRA, in its review of any arrangement, may in its discretion require specific items to be addressed by the carrying firm as part of such firm's due diligence requirement under this Rule. The carrying firm shall maintain a record, in accordance with the timeframes prescribed by SEA Rule 17a-4(b), of the due diligence conducted for each new introducing firm.

(c) (1) Each carrying agreement in which accounts are to be carried on a fully disclosed basis shall specify the responsibilities of each party to the agreement, including at a minimum the allocation of the responsibilities set forth in paragraphs (c)(1)(A) through (I) and (c)(2) of this Rule. The allocation of such responsibilities shall be subject to approval by FINRA pursuant to paragraph (b)(1) of this Rule.

(A) Opening and approving accounts.

(B) Acceptance of orders.

(C) Transmission of orders for execution.

(D) Execution of orders.

(E) Extension of credit.

(F) Receipt and delivery of funds and securities.

(G) Preparation and transmission of confirmations.

(H) Maintenance of books and records.

(I) Monitoring of accounts.

(2) Each carrying agreement in which accounts are to be carried on a fully disclosed basis shall expressly allocate to the carrying firm the responsibility for the safeguarding of funds and securities for the purposes of SEA Rule 15c3-3 and for preparing and transmitting statements of account to customers. However, the carrying firm may authorize the introducing firm to prepare and/or transmit statements of account to customers on the carrying firm's behalf with the prior written approval of FINRA.

(d) Each customer whose account is introduced on a fully disclosed basis shall be notified in writing upon the opening of the account of the existence of the carrying agreement and the responsibilities allocated to each respective party. The carrying firm shall be responsible for the content of such notification to the customer. The customer shall be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities thereunder.

(e) Each carrying agreement shall expressly state that to the extent that a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility.

(f) A carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers on the carrying firm's behalf, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule 15c3-3 and further that the introducing firm represents to the carrying firm in writing that such introducing firm maintains, and will enforce, supervisory policies and procedures with respect to the issuance of such negotiable instruments that are satisfactory to the carrying firm.

(g) (1) Each carrying agreement shall expressly authorize and direct the carrying firm to:

(A) furnish promptly to the introducing firm and the introducing firm's designated examining authority (or, if none, to its appropriate regulatory agency or authority) any written customer complaint received regarding the conduct of the introducing firm or firms and its associated persons; and

(B) notify the complaining customer, in writing, that it has received the complaint and that such complaint has been furnished to the introducing firm and its designated examining authority (or, if none, to its appropriate regulatory agency or authority).

(2) Upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of paragraph (g)(1) in instances where the introducing firm is an affiliated entity of the carrying firm.

(h) (1) At the commencement of the agreement and annually thereafter, the carrying firm must furnish to each of its introducing firms a list of all reports (e.g., exception reports) available to assist the introducing firm with the responsibilities allocated to it pursuant to the carrying agreement. The introducing firm must promptly request of the carrying firm, in writing, those offered reports that it requires.

(2) No later than July 1 of each year, the carrying firm shall notify the introducing firm's chief executive and chief compliance officer(s) in writing of the list of reports offered to, requested by and supplied to the introducing firm as of the date of the notice. A copy of this written notice must at the same time be provided to the introducing firm's designated examining authority (or if none, to its appropriate regulatory agency or authority).

(3) The carrying firm shall maintain as part of its books and records those reports requested by and supplied to the introducing firm. The carrying firm may satisfy the requirements of this paragraph by furnishing, upon request of the introducing firm's designated examining authority (or if none, to its appropriate regulatory agency or authority):

(A) a re-created copy of the report originally produced; or

(B) the format of the report and the applicable data elements contained in the original report.

(4) Upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of this paragraph (h) in instances where the introducing firm is an affiliated entity of the carrying firm.

(i) All carrying agreements shall require each introducing firm to maintain its proprietary and customer accounts, and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each introducing firm. The requirements of this paragraph (i) shall apply to intermediary clearing arrangements that are established on or after February 20, 2006.

• • • Supplementary Material ----------

.01 Material Changes. For purposes of paragraph (b)(1) of this Rule, material changes include, but are not limited to, changes to: (a) the allocation of responsibilities required by this Rule; (b) termination clauses applicable to the introducing firm; (c) any terms or provisions affecting the liability of the parties; and (d) the parties to the agreement (including, for example, the addition of a new party to the agreement, such as a "piggyback" arrangement, a new carrying firm or a new introducing firm, but not including a termination of the agreement).

.02 Notice of New Introducing Firm Arrangement. For purposes of the notice requirements of paragraph (b)(3) of this Rule, the carrying firm shall submit a questionnaire in such form as to be specified by FINRA in a Regulatory Notice, which questionnaire may be updated from time to time as FINRA deems necessary.

.03 Due Diligence. For purposes of paragraph (b)(4) of this Rule, the carrying firm's due diligence may include, without limitation, inquiry by the carrying firm into the introducing firm's business model and product mix, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history.

.04 Allocation of Responsibilities. For purposes of paragraphs (c)(1)(F) and (c)(2) of this Rule, members are reminded that receipt and delivery of customers' funds and securities and the safeguarding of such funds and securities must comply with the requirements of the SEC's financial responsibility rules, in particular SEA Rule 15c3-3, and applicable SEC guidance.

.05 Notice to Customers. For purposes of paragraph (d) of this Rule, notification to customers of a change to any of the parties to the carrying agreement is not required in instances where, consistent with applicable FINRA rules and the federal securities laws, such customers' accounts are being transferred pursuant to: (a) ACATS using an authorized Transfer Instruction Form (TIF); or (b) a process outside of ACATS where notification to customers is provided by means of an alternative mechanism such as affirmative or negative response letters.

* * * * *

4522. Periodic Security Counts, Verifications and Comparisons

(a) Each member that is subject to the requirements of SEA Rule 17a-13 shall make the counts, examinations, verifications, comparisons and entries set forth in SEA Rule 17a-13.

(b) Each carrying or clearing member subject to the requirements of SEA Rule 17a-13 shall make more frequent counts, examinations, verifications, comparisons and entries where prudent business practice would so require. In addition, each such carrying or clearing member shall:

(1) Receive position statements as frequently as good business practice requires, but no less than once per month with respect to securities held by clearing corporations, other organizations or custodians. Each such member shall at least once per month reconcile all such securities and money balances by comparison of

the clearing corporations' or custodians' position statements to the member's books and records and promptly report differences to the contra organization and such differences shall be promptly resolved by both. Where there is a higher volume of activity, good business practice may require a more frequent exchange of statements and their reconciliation; and

(2) At a maximum of seven business days after each security count, enter all unresolved differences into a "Difference" account, for that security count. The Difference account shall identify the unverified securities and reflect the number of shares or principal amount long or the number of shares or principal amount short of each security difference and the date of the security count that disclosed such difference. Thereafter, any adjustment of a difference position shall be made by entry into such account.

4523. Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts

(a) Each member shall designate an associated person who shall be responsible for each general ledger bookkeeping account and account of like function used by the member and such associated person shall control and oversee entries into each such account and shall determine that the account is current and accurate as necessary to comply with all applicable FINRA rules and federal securities laws governing books and records and financial responsibility requirements. A supervisor shall, as frequently as is necessary considering the function of the account but, in any event, at least monthly, review each account to determine that it is current and accurate and that any items that become aged or uncertain as to resolution are promptly identified for research and possible transfer to a suspense account(s).

(b) Each carrying or clearing member shall maintain a record of the names of the associated persons assigned primary and supervisory responsibility for each account as required by paragraph (a) of this Rule. All records made pursuant to this paragraph (b) shall be preserved for a period of not less than six years.

(c) Each member must record, in an account that shall be clearly identified as a suspense account, money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. A record must be maintained of all information known with respect to each item so recorded. Such suspense accounts include, but are not limited to, DK fails, unidentified fails, unallocable securities receipts versus

payment, returned deliveries, and any other receivable or payable (money or securities) "suspended" because of doubtful ownership, collectibility or deliverability. To the extent that suspense items can be distinguished by type, separate accounts may be used provided that the word "suspense" is made a prominent part of the account title. All records made pursuant to this paragraph shall be preserved for a period of not less than six years.

• • • Supplementary Material ----------

.01 Supervisory Responsibility. For the purposes of paragraphs (a) and (b) of this Rule, each member with only one associated person may assign primary and supervisory responsibility for each account to that associated person, subject to applicable registration requirements. Members of limited size and resources that have more than one associated person may seek FINRA's prior written approval to assign primary and supervisory responsibility for each account to the same associated person.

.02 Members Operating Pursuant to the Exemptive Provisions of SEA Rule 15c3-3(k)(2)(i). For purposes of this Rule, all requirements that apply to a member that clears or carries customer accounts shall also apply to any member that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established thereunder.

* * * * *

Attachment B: Carrying Firm Questionnaire

Questionnaire to be submitted by the carrying firm prior to the carrying of any accounts of a new introducing firm(s) (including omnibus firms whose accounts are to be carried by the carrying firm) ("correspondents") pursuant to FINRA Rules 4311(b)(3) and 4311.02. The completed questionnaire shall be sent to the carrying firm's Regulatory Coordinator at FINRA no later than 10 business days prior to the carrying of any accounts of a new correspondent.

If using a pre-approved form of carrying agreement pursuant to FINRA Rule 4311(b)(2), please specify form and date of FINRA's approval of such form:

_____

Section I: Correspondent Profile

1. **Name of correspondent:** _____

2. **Is the correspondent acting as an intermediary introducing firm for any other introducing firm(s) that is a party(ies) to the carrying agreement?**

   ☐ **Yes** If yes, please list the names of the other introducing firms and provide separate correspondent profile questionnaires for each:

   _____

   _____

   ☐ **No**

3. **Is the correspondent a FINRA member?**

   ☐ **Yes** (if yes, please skip to Question 4)

   ☐ **No** If no, please provide the following information:

   Is the proposed correspondent a US-registered broker-dealer?

   ☐ **Yes** If yes, please provide its SEC Registration No.: _____

   ☐ **No** If no, please list the foreign jurisdiction(s) in which the correspondent operates: _____

   _____

4. **Method of Conversion of Accounts:**

   ACATS? ☐ **Yes**
   ☐ **No**

   Bulk Transfer?

   ☐ **Yes** If yes, expected conversion date: _____
   ☐ **No**

   Name of Delivering Broker: _____

   Other? Please specify: _____

5. **Amount of clearing deposit collected from correspondent $** _____

6. **Is this an arrangement for the carrying of an omnibus account(s)?**

   ☐ **Yes** (If yes, please skip to Question 8)

   ☐ **No**

7. **Approximate number of retail accounts:** _____ **Institutional accounts:** _____

8. **Expected correspondent customer:**

   Debit balances: $_____

   Credit balances: $_____

9. **Customer Business Mix:** (Please indicate approximate number of monthly tickets):

Listed equities	_____	Asset Backed Securities	_____
Unlisted equities	_____	Commodities	_____
Municipals	_____	Options	_____
Governments	_____	Other (please specify type(s) of product(s))	_____
Corporate Bonds	_____		

10. **Does the correspondent engage in proprietary trading activities to be cleared and/or carried by the firm?** If yes, please specify trading strategies (*e.g.*, market making, speculative trading, customer facilitation, risk arbitrage, statistical arbitrage, etc.) and indicate products traded below:

    Trading strategies engaged in: _____

    _____

    _____

Listed equities	_____	Asset Backed Securities	_____
Unlisted equities	_____	Commodities	_____
Municipals	_____	Options	_____
Governments	_____	Other (please specify type(s) of product(s))	_____
Corporate Bonds	_____		

11. Will the correspondent be provided the following special margin privileges and/or have special margin requirements been established for the correspondent's customer and/or proprietary accounts?

If yes, please specify by completing a. – d. below:

a. Portfolio Margining:	Proprietary Accounts: ☐ **Yes** ☐ **No**	
	Customer Accounts: ☐ **Yes** ☐ **No**	
b. Day Trading:	Proprietary Accounts: ☐ **Yes** ☐ **No**	
	Customer Accounts: ☐ **Yes** ☐ **No**	
c. Special house requirements:	Proprietary Accounts: ☐ **Yes** ☐ **No**	
	Customer Accounts: ☐ **Yes** ☐ **No**	

d. Other (specify): _____.

12. Has a Proprietary Accounts of Introducing Brokers (PAIB) agreement been executed with the correspondent?

☐ **Yes**

☐ **No** If no, please explain. _____

_____

_____

Section II: Correspondent Risk Management

Please respond to the following questions as they apply to the proposed correspondent relationship.

Please note that FINRA Rule 4311(b)(4) requires that each carrying firm shall conduct appropriate due diligence with respect to any new introducing firm relationship to assess the financial, operational, credit and reputational risk that such arrangement will have upon the carrying firm. The questions below are representative of the type of reviews FINRA expects firms to conduct as part of their correspondent due diligence performed in accordance with this rule. However, the firm is expected to assess the extent of the review required for each correspondent and perform additional reviews as it deems necessary. Please note that a record of the due diligence conducted for each new introducing firm must be maintained by the carrying firm in accordance with the timeframes prescribed by Exchange Act Rule 17a-4(b).

1. Has a review been conducted of the correspondent's business mix and customer account activities? ☐ Yes ☐ No ☐ NA

_____

2.	Is your operational staff familiar with the clearance and settlement requirements and the associated risks of the products in which the correspondent and its customers will transact?	☐ Yes	☐ No	☐ NA
3.	Has a review of the correspondent's proprietary (including error account) and customer positions been conducted to assess any potential financial or credit risks that may result from:	☐ Yes	☐ No	☐ NA
	a. Low-priced securities?	☐ Yes	☐ No	☐ NA
	b. Concentrated securities?	☐ Yes	☐ No	☐ NA
	c. Control or restricted securities?	☐ Yes	☐ No	☐ NA
	d. Unique trading strategies?	☐ Yes	☐ No	☐ NA
	e. Other? (please specify) _____	☐ Yes	☐ No	☐ NA
4.	Has a review been conducted of the correspondent's FOCUS or similar reports (if non-broker-dealer) for the past year?	☐ Yes	☐ No	☐ NA
5.	Has a review of the correspondent's last audited financial report been performed?	☐ Yes	☐ No	☐ NA
6.	Has a review of complaint and disciplinary history for the correspondent and its principal officers and Form U4 information for persons named on Form BD, as applicable, been conducted?	☐ Yes	☐ No	☐ NA
7.	Have the accounts of the correspondent been reviewed for Master and Sub-Account structures in light of the guidance of FINRA *Regulatory Notice 10-18* (April 2010) (Master and Sub-Accounts)?	☐ Yes	☐ No	☐ NA
8.	If direct market access or sponsored access is being provided to the correspondent or its customers, has the firm reviewed, and is the firm satisfied with, the correspondent's procedures for such activities?	☐ Yes	☐ No	☐ NA

With respect to the questions above (in this Section II), any "no" response must be accompanied by a written explanation included with this questionnaire, indicating why management believes that the omission of this review is appropriate (or why a "no" answer is otherwise appropriate) and does not represent an undue risk to the carrying firm.

Signature of Chief Executive, Financial or Operational Officer/Partner Date

Print Name Title