

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2009 - 047

Amendment No.

Proposed Rule Change by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal
☒	☐	☐

Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☒	☐	☐

Rule

☐ 19b-4(f)(1)	☐ 19b-4(f)(4)
☐ 19b-4(f)(2)	☐ 19b-4(f)(5)
☐ 19b-4(f)(3)	☐ 19b-4(f)(6)

Pilot	Extension of Time Period for Commission Action	Date Expires
☐	☐	

Exhibit 2 Sent As Paper Document



Exhibit 3 Sent As Paper Document

**Description**

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed Rule Change to Adopt FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions) in the Consolidated FINRA Rulebook

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	Erika	Last Name	Lazar
Title	Senior Attorney		
E-mail	Erika.lazar@finra.org		
Telephone	(646) 315-8512	Fax	(646) 315-8783

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 07/21/2009

By Patrice Gliniecki
(Name)

Senior Vice President and Deputy General Counsel

(Title)

NOTE: Clicking the button at right will digitally sign and lock
this form. A digital signature is as legally binding as a physical
signature, and once signed, this form cannot be changed.

Patrice Gliniecki,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

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Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

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Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt NASD Rule 2350 (Broker/Dealer Conduct on the Premises of Financial Institutions) as FINRA Rule 3160 in the consolidated FINRA rulebook, subject to certain amendments.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Upon Commission approval and implementation by FINRA of the proposed rule change, the corresponding NASD rule will be eliminated from the current FINRA rulebook.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on April 16, 2009, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval.

3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

¹ 15 U.S.C. 78s(b)(1).

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),² FINRA is proposing to adopt NASD Rule 2350 (Broker/Dealer Conduct on the Premises of Financial Institutions), subject to certain amendments, as FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions). The details of the proposed rule change are described below.

NASD Rule 2350

NASD Rule 2350 governs the activities of broker-dealers on the premises of financial institutions.³ Also known as the “bank broker-dealer rule,” Rule 2350 generally requires broker-dealers that conduct business on the premises of a financial institution where retail deposits are taken to: (1) enter into a written agreement with the financial institution specifying each party’s responsibilities and the terms of compensation (networking agreement); (2) segregate the securities activities conducted on the premises of the financial institution from the retail deposit-taking area; (3) allow access for inspection and examination by the SEC and FINRA; (4) ensure that communications with customers clearly identify that the broker-dealer services are provided by the member; (5) disclose to customers that the securities products offered by the broker-dealer are not

² The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

³ The term “financial institution” includes federal and state-chartered banks, savings and loan associations, savings banks, credit unions, and the service corporations of such institutions required by law.

insured like other banking products; and (6) make reasonable efforts at account opening to obtain a customer's written acknowledgement of the receipt of such disclosure. Rule 2350 applies only where broker-dealer services are conducted either in person, over the telephone, or through any other electronic medium, on the premises of a financial institution where retail deposits are taken, by a broker-dealer that has a physical presence on those premises.⁴

NASD Rule 2350 was adopted to reduce potential customer confusion in dealing with broker-dealers that conduct business on the premises of financial institutions, and to clarify the relationship between a broker-dealer and a financial institution entering into a networking agreement.⁵

Gramm-Leach Bliley and Regulation R

In 2007, the SEC and the Federal Reserve Board jointly adopted rules, known as Regulation R,⁶ that implement the bank broker provisions of the Gramm-Leach Bliley Act of 1999 (GLB), which replaced the blanket exception for banks from the definition of "broker"⁷ under the Exchange Act. These rules permit banks to perform certain specified securities activities without having to register as a broker with the SEC or to "push-out" such activities to a registered broker, creating eleven exceptions to broker registration that are codified in Exchange Act Section 3(a)(4).

⁴ See Notice to Members 97-89 (December 1997).

⁵ See Securities Exchange Act Release No. 39294 (November 4, 1997), 62 FR 60542, 60547 (November 10, 1997) (Order Approving File No. SR-NASD-95-63).

⁶ See 17 CFR 247.700-781.

⁷ See 15 U.S.C. 78c(a)(4).

Exchange Act Section 3(a)(4)(B)(i) provides an exception from the definition of “broker” for banks that enter into third-party brokerage (or networking) arrangements with a broker-dealer (the networking exception). Under this networking exception, a bank is not considered to be a broker if it enters into a contractual or other written arrangement with a registered broker-dealer under which the broker-dealer offers brokerage services on or off bank premises, subject to certain conditions (this differs from NASD Rule 2350, which only applies to broker-dealers offering brokerage services on a financial institutions’ premises).⁸ Although this exception generally provides that a bank may not pay its unregistered employees incentive compensation for referring a customer to a broker-dealer, it does permit a bank employee to receive a “nominal one-time cash fee of a fixed dollar amount” that is not contingent on whether the referral results in a transaction with the broker-dealer.⁹ Further, Rule 701 of Regulation R provides that referrals of certain institutional and high net worth clients may result in the payment of a higher referral fee (i.e., incentive compensation of more than a nominal amount) to bank employees, and may be contingent on the occurrence of a securities transaction, subject to certain additional requirements.¹⁰

⁸ The exception applies to “banks” as defined in Exchange Act Section 3(a)(6). NASD Rule 2350 addresses “financial institutions,” see supra note 3.

⁹ See 17 CFR 247.700 for detailed definitions of the terms “nominal one-time cash fee of a fixed dollar amount,” “referral,” “contingent on whether the referral results in a transaction” and “incentive compensation.”

¹⁰ See 17 CFR 247.701.

Proposed FINRA Rule 3160

FINRA proposes to adopt NASD Rule 2350 into the Consolidated FINRA Rulebook as FINRA Rule 3160, subject to certain amendments to streamline the rule and to reflect applicable provisions of GLB and Regulation R.

First, the proposed rule change would amend the scope of the rule to conform to the networking exception in GLB. NASD Rule 2350 applies only to broker-dealer conduct on the premises of a financial institution where retail deposits are taken. However, the networking exception in GLB applies to networking arrangements in which a broker or dealer offers brokerage services on or off the premises of a bank.¹¹ Accordingly, with the exception of those requirements addressing the physical setting, proposed FINRA Rule 3160 would apply 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.¹²

Second, the proposed rule change would make certain minor changes to the provisions addressing setting, as set forth in NASD Rule 2350(c)(1) (Setting). The setting provision establishes the requirements regarding a member's presence on the premises of a financial institution. To better align the rule text with the language in the networking exception in GLB and its associated rules in Regulation R, proposed FINRA Rule 3160 would provide that a member conducting broker-dealer services on the

¹¹ See 15 U.S.C. 78c(a)(4)(B)(i).

¹² The title of the rule would be changed from "Broker/Dealer Conduct on the Premises of Financial Institutions" to "Networking Arrangements Between Members and Financial Institutions."

premises of a financial institution: (1) be clearly identified as the person performing broker-dealer services and distinguish its broker-dealer services from the services of the financial institution; (2) conduct its broker-dealer services in an area that displays clearly the member's name; and (3) to the extent practicable, maintain its broker-dealer services in a location physically separate from the routine retail deposit-taking activities of the financial institution.

Third, the proposed rule change would amend those provisions addressing networking agreements, as set forth in NASD Rule 2350(c)(2) (Networking and Brokerage Affiliate Agreements), to reflect certain requirements in GLB and Regulation R regarding written agreements between banks and broker-dealers. As noted above, Rule 701 of Regulation R allows a bank employee to receive a contingent referral fee not subject to the "nominal amount" restriction, so long as the client referred to the broker-dealer by the bank employee is an "institutional" or "high net worth" customer, as defined in Rule 701, and several other detailed conditions are satisfied.

Rule 701 requires that the written agreement between a bank operating under an exception to the definition of "broker" under Exchange Act Section 3(a)(4)(B)(i) and Rule 701 for institutional and high net worth customers and its networking broker-dealer include terms that obligate the broker-dealer to take certain actions.¹³ The written agreement between the bank and broker-dealer must require that the broker-dealer:

¹³ See 17 CFR 247.701(a)(3). See also Securities Exchange Act Release No. 56501, 72 FR 56514, 56523 (October 3, 2007) (Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks). ("Banks and broker-dealers are expected to comply with the terms of their written networking arrangements. If a bank or broker-dealer does not comply with the terms of the agreement, however, the bank would not become a "broker" under Section 3(a)(4) of the Exchange Act or lose its ability to operate under the proposed exemption.")

- (1) determine that a bank employee is not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act, have a reasonable basis to believe that the customer is a “high net worth customer” or an “institutional customer” and conduct a suitability or sophistication analysis for customers and securities transactions by customers;¹⁴
- (2) promptly inform the bank if the broker-dealer determines that the customer referred to the broker-dealer is not a “high net worth customer” or an “institutional customer,” as applicable or the bank employee receiving the referral fee is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act;¹⁵
- (3) inform the customer if the customer or the securities transaction(s) to be conducted by the customer does not meet the applicable standard set forth in the suitability or sophistication determination in Rule 701;¹⁶ and
- (4) the broker-dealer may also be contractually obligated to provide certain disclosures to a referred customer.¹⁷

Proposed FINRA Rule 3160 would clarify that networking agreements must include all broker-dealer obligations, as applicable, in Rule 701 and that independent of

¹⁴ See 17 CFR 247.701(a)(3)(ii)-(iii).

¹⁵ See 17 CFR 247.701(a)(3)(v).

¹⁶ See 17 CFR 247.701(a)(3)(iv). See Securities Exchange Act Release No. 56501, 72 FR 56514, 56526 (October 3, 2007) (re: Suitability or Sophistication Analysis by Broker-Dealer). The “sophistication” analysis is based on the elements of NASD IM-2310-3 (Suitability Obligations to Institutional Customers). FINRA is seeking comment on a proposal regarding the consolidated FINRA rule addressing suitability obligations. See Regulatory Notice 09-25 (May 2009).

¹⁷ See 17 CFR 247.701(b).

their contractual obligations, members must comply with all such broker-dealer obligations. In this regard, the SEC's Release announcing Regulation R specifically contemplates that FINRA adopt a rule to require that broker-dealers comply with the requirements set forth in Rule 701.¹⁸

Next, the proposed rule change would modify the provisions addressing customer disclosure and acknowledgements, as set forth in NASD Rule 2350(c)(3) (Customer Disclosure and Written Acknowledgement), which require members to make certain disclosures to customers, at or prior to account opening, regarding securities products, and that members make reasonable efforts to obtain a customer's acknowledgement of the receipt of such disclosures at account opening. Such disclosures include that the 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 proposal would not incorporate the written acknowledgement requirement into proposed FINRA Rule 3160, in light of the application of the rule to networking arrangements regardless of whether the member is conducting broker-dealer services on or off the premises of a financial institution and the obligation that members provide the requisite disclosures orally and in writing. In this context, FINRA believes that oral and written disclosure to customers regarding securities products is sufficient and that requiring a written acknowledgement of receipt from customers is unnecessary.

¹⁸ See Securities Exchange Act Release No. 56501, 72 FR 56514, 56528 n.135 (October 3, 2007) ("As stated in the proposal, the Commission anticipates that it may be necessary for either FINRA or the Commission to propose a rule that would require broker-dealers to comply with the written agreements entered into pursuant to Rule 701.").

Lastly, the proposed rule change would amend the provisions addressing communications with the public, as set forth in NASD Rule 2350(c)(4) (Communications with the Public), consistent with the extension of proposed FINRA Rule 3160 to networking arrangements where the member conducts broker-dealer services on or off the premises of a financial institution. NASD Rule 2350(c)(4) requires a member to make the same disclosures regarding securities products discussed above on advertisements and sales literature that announce the location of a financial institution where broker-dealer services are provided by the member or that are distributed by the member on the premises of a financial institution. To further reduce potential customer confusion, proposed FINRA Rule 3160 would extend this requirement also to include all of the members' advertisements and sales literature that promote the name or services of the financial institution or that are distributed by the member at any other location where the financial institution is present or represented.

As noted above, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will clarify and streamline the

¹⁹ 15 U.S.C. 78o-3(b)(6).

requirements for broker-dealer networking arrangements and will serve to better align the FINRA requirements with GLB and Regulation R.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.²⁰

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 5. Text of the proposed rule change.

²⁰ 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2009-047)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt NASD Rule 2350 (Broker/Dealer Conduct on the Premises of Financial Institutions) as FINRA Rule 3160 in the consolidated FINRA rulebook, subject to certain amendments.

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),³ FINRA is proposing to adopt NASD Rule 2350 (Broker/Dealer Conduct on the Premises of Financial Institutions), subject to certain amendments, as FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions). The details of the proposed rule change are described below.

NASD Rule 2350

³ The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

NASD Rule 2350 governs the activities of broker-dealers on the premises of financial institutions.⁴ Also known as the “bank broker-dealer rule,” Rule 2350 generally requires broker-dealers that conduct business on the premises of a financial institution where retail deposits are taken to: (1) enter into a written agreement with the financial institution specifying each party’s responsibilities and the terms of compensation (networking agreement); (2) segregate the securities activities conducted on the premises of the financial institution from the retail deposit-taking area; (3) allow access for inspection and examination by the SEC and FINRA; (4) ensure that communications with customers clearly identify that the broker-dealer services are provided by the member; (5) disclose to customers that the securities products offered by the broker-dealer are not insured like other banking products; and (6) make reasonable efforts at account opening to obtain a customer’s written acknowledgement of the receipt of such disclosure. Rule 2350 applies only where broker-dealer services are conducted either in person, over the telephone, or through any other electronic medium, on the premises of a financial institution where retail deposits are taken, by a broker-dealer that has a physical presence on those premises.⁵

NASD Rule 2350 was adopted to reduce potential customer confusion in dealing with broker-dealers that conduct business on the premises of financial institutions, and to

⁴ The term “financial institution” includes federal and state-chartered banks, savings and loan associations, savings banks, credit unions, and the service corporations of such institutions required by law.

⁵ See Notice to Members 97-89 (December 1997).

clarify the relationship between a broker-dealer and a financial institution entering into a networking agreement.⁶

Gramm-Leach Bliley and Regulation R

In 2007, the SEC and the Federal Reserve Board jointly adopted rules, known as Regulation R,⁷ that implement the bank broker provisions of the Gramm-Leach Bliley Act of 1999 (GLB), which replaced the blanket exception for banks from the definition of “broker”⁸ under the Exchange Act. These rules permit banks to perform certain specified securities activities without having to register as a broker with the SEC or to “push-out” such activities to a registered broker, creating eleven exceptions to broker registration that are codified in Exchange Act Section 3(a)(4).

Exchange Act Section 3(a)(4)(B)(i) provides an exception from the definition of “broker” for banks that enter into third-party brokerage (or networking) arrangements with a broker-dealer (the networking exception). Under this networking exception, a bank is not considered to be a broker if it enters into a contractual or other written arrangement with a registered broker-dealer under which the broker-dealer offers brokerage services on or off bank premises, subject to certain conditions (this differs from NASD Rule 2350, which only applies to broker-dealers offering brokerage services on a financial institutions’ premises).⁹ Although this exception generally provides that a

⁶ See Securities Exchange Act Release No. 39294 (November 4, 1997), 62 FR 60542, 60547 (November 10, 1997) (Order Approving File No. SR-NASD-95-63).

⁷ See 17 CFR 247.700-781.

⁸ See 15 U.S.C. 78c(a)(4).

⁹ The exception applies to “banks” as defined in Exchange Act Section 3(a)(6). NASD Rule 2350 addresses “financial institutions,” see supra note 4.

bank may not pay its unregistered employees incentive compensation for referring a customer to a broker-dealer, it does permit a bank employee to receive a “nominal one-time cash fee of a fixed dollar amount” that is not contingent on whether the referral results in a transaction with the broker-dealer.¹⁰ Further, Rule 701 of Regulation R provides that referrals of certain institutional and high net worth clients may result in the payment of a higher referral fee (i.e., incentive compensation of more than a nominal amount) to bank employees, and may be contingent on the occurrence of a securities transaction, subject to certain additional requirements.¹¹

Proposed FINRA Rule 3160

FINRA proposes to adopt NASD Rule 2350 into the Consolidated FINRA Rulebook as FINRA Rule 3160, subject to certain amendments to streamline the rule and to reflect applicable provisions of GLB and Regulation R.

First, the proposed rule change would amend the scope of the rule to conform to the networking exception in GLB. NASD Rule 2350 applies only to broker-dealer conduct on the premises of a financial institution where retail deposits are taken. However, the networking exception in GLB applies to networking arrangements in which a broker or dealer offers brokerage services on or off the premises of a bank.¹² Accordingly, with the exception of those requirements addressing the physical setting, proposed FINRA Rule 3160 would apply to a member that is a party to a networking

¹⁰ See 17 CFR 247.700 for detailed definitions of the terms “nominal one-time cash fee of a fixed dollar amount,” “referral,” “contingent on whether the referral results in a transaction” and “incentive compensation.”

¹¹ See 17 CFR 247.701.

¹² See 15 U.S.C. 78c(a)(4)(B)(i).

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.¹³

Second, the proposed rule change would make certain minor changes to the provisions addressing setting, as set forth in NASD Rule 2350(c)(1) (Setting). The setting provision establishes the requirements regarding a member's presence on the premises of a financial institution. To better align the rule text with the language in the networking exception in GLB and its associated rules in Regulation R, proposed FINRA Rule 3160 would provide that a member conducting broker-dealer services on the premises of a financial institution: (1) be clearly identified as the person performing broker-dealer services and distinguish its broker-dealer services from the services of the financial institution; (2) conduct its broker-dealer services in an area that displays clearly the member's name; and (3) to the extent practicable, maintain its broker-dealer services in a location physically separate from the routine retail deposit-taking activities of the financial institution.

Third, the proposed rule change would amend those provisions addressing networking agreements, as set forth in NASD Rule 2350(c)(2) (Networking and Brokerage Affiliate Agreements), to reflect certain requirements in GLB and Regulation R regarding written agreements between banks and broker-dealers. As noted above, Rule 701 of Regulation R allows a bank employee to receive a contingent referral fee not subject to the "nominal amount" restriction, so long as the client referred to the broker-

¹³ The title of the rule would be changed from "Broker/Dealer Conduct on the Premises of Financial Institutions" to "Networking Arrangements Between Members and Financial Institutions."

dealer by the bank employee is an “institutional” or “high net worth” customer, as defined in Rule 701, and several other detailed conditions are satisfied.

Rule 701 requires that the written agreement between a bank operating under an exception to the definition of “broker” under Exchange Act Section (3)(a)(4)(B)(i) and Rule 701 for institutional and high net worth customers and its networking broker-dealer include terms that obligate the broker-dealer to take certain actions.¹⁴ The written agreement between the bank and broker-dealer must require that the broker-dealer:

- (1) determine that a bank employee is not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act, have a reasonable basis to believe that the customer is a “high net worth customer” or an “institutional customer” and conduct a suitability or sophistication analysis for customers and securities transactions by customers;¹⁵
- (2) promptly inform the bank if the broker-dealer determines that the customer referred to the broker-dealer is not a “high net worth customer” or an “institutional customer,” as applicable or the bank employee receiving the referral fee is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act;¹⁶

¹⁴ See 17 CFR 247.701(a)(3). See also Securities Exchange Act Release No. 56501, 72 FR 56514, 56523 (October 3, 2007) (Definitions of Terms and Exemptions Relating to the “Broker” Exceptions for Banks). (“Banks and broker-dealers are expected to comply with the terms of their written networking arrangements. If a bank or broker-dealer does not comply with the terms of the agreement, however, the bank would not become a “broker” under Section 3(a)(4) of the Exchange Act or lose its ability to operate under the proposed exemption.”)

¹⁵ See 17 CFR 247.701(a)(3)(ii)-(iii).

¹⁶ See 17 CFR 247.701(a)(3)(v).

- (3) inform the customer if the customer or the securities transaction(s) to be conducted by the customer does not meet the applicable standard set forth in the suitability or sophistication determination in Rule 701;¹⁷ and
- (4) the broker-dealer may also be contractually obligated to provide certain disclosures to a referred customer.¹⁸

Proposed FINRA Rule 3160 would clarify that networking agreements must include all broker-dealer obligations, as applicable, in Rule 701 and that independent of their contractual obligations, members must comply with all such broker-dealer obligations. In this regard, the SEC's Release announcing Regulation R specifically contemplates that FINRA adopt a rule to require that broker-dealers comply with the requirements set forth in Rule 701.¹⁹

Next, the proposed rule change would modify the provisions addressing customer disclosure and acknowledgements, as set forth in NASD Rule 2350(c)(3) (Customer Disclosure and Written Acknowledgement), which require members to make certain disclosures to customers, at or prior to account opening, regarding securities products, and that members make reasonable efforts to obtain a customer's acknowledgement of

¹⁷ See 17 CFR 247.701(a)(3)(iv). See Securities Exchange Act Release No. 56501, 72 FR 56514, 56526 (October 3, 2007) (re: Suitability or Sophistication Analysis by Broker-Dealer). The "sophistication" analysis is based on the elements of NASD IM-2310-3 (Suitability Obligations to Institutional Customers). FINRA is seeking comment on a proposal regarding the consolidated FINRA rule addressing suitability obligations. See Regulatory Notice 09-25 (May 2009).

¹⁸ See 17 CFR 247.701(b).

¹⁹ See Securities Exchange Act Release No. 56501, 72 FR 56514, 56528 n.135 (October 3, 2007) ("As stated in the proposal, the Commission anticipates that it may be necessary for either FINRA or the Commission to propose a rule that would require broker-dealers to comply with the written agreements entered into pursuant to Rule 701.").

the receipt of such disclosures at account opening. Such disclosures include that the 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 proposal would not incorporate the written acknowledgement requirement into proposed FINRA Rule 3160, in light of the application of the rule to networking arrangements regardless of whether the member is conducting broker-dealer services on or off the premises of a financial institution and the obligation that members provide the requisite disclosures orally and in writing. In this context, FINRA believes that oral and written disclosure to customers regarding securities products is sufficient and that requiring a written acknowledgement of receipt from customers is unnecessary.

Lastly, the proposed rule change would amend the provisions addressing communications with the public, as set forth in NASD Rule 2350(c)(4) (Communications with the Public), consistent with the extension of proposed FINRA Rule 3160 to networking arrangements where the member conducts broker-dealer services on or off the premises of a financial institution. NASD Rule 2350(c)(4) requires a member to make the same disclosures regarding securities products discussed above on advertisements and sales literature that announce the location of a financial institution where broker-dealer services are provided by the member or that are distributed by the member on the premises of a financial institution. To further reduce potential customer confusion, proposed FINRA Rule 3160 would extend this requirement also to include all of the members' advertisements and sales literature that promote the name or services of

the financial institution or that are distributed by the member at any other location where the financial institution is present or represented.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁰ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will clarify and streamline the requirements for broker-dealer networking arrangements and will serve to better align the FINRA requirements with GLB and Regulation R.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date

²⁰ 15 U.S.C. 78o-3(b)(6).

if it finds such longer period to be appropriate and publishes its reasons for so finding or

(ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2009-047 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Florence E. Harmon, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-047. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-047 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²¹

Florence E. Harmon

Deputy Secretary

²¹ 17 CFR 200.30-3(a)(12).

EXHIBIT 5

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

* * * * *

**Text of Proposed New FINRA Rule
(Marked to Show Changes from NASD Rule 2350; NASD Rule 2350 to be
Deleted in its Entirety from the Transitional Rulebook)**

* * * * *

**3000. SUPERVISION AND RESPONSIBILITIES RELATING TO ASSOCIATED
PERSONS**

3100. SUPERVISORY RESPONSIBILITIES

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**[2350]3160. [Broker/Dealer Conduct on the Premises of] Networking Arrangements
Between Members and Financial Institutions**

[(a) Applicability]

[This section shall apply exclusively to those broker/dealer services conducted by members on the premises of a financial institution where retail deposits are taken. This section does not alter or abrogate members' obligations to comply with other applicable NASD rules, regulations, and requirements, nor those of other regulatory authorities that may govern members operating on the premises of financial institutions.]

[(b) Definitions]

[(1) For purposes of this section, the term "financial institution" shall mean federal and state-chartered banks, savings and loan associations, savings banks, credit unions, and the service corporations of such institutions required by law.]

[(2) “Networking arrangement” and “brokerage affiliate arrangement” shall mean a contractual or other arrangement between a member and a financial institution pursuant to which the member conducts broker/dealer services for customers of the financial institution and the general public on the premises of such financial institution where retail deposits are taken.]

[(3) “Affiliate” shall mean a company that controls, is controlled by, or is under common control with, a member as defined in Rule 2720.]

[(4) “Broker/Dealer services” shall mean the investment banking or securities business as defined in paragraph (p) of Article I of the By-Laws.]

[(c)a] Standards for Member Conduct

[No] Except as otherwise provided in this Rule, a member that is a party to a networking arrangement under which the member [shall] conduct~~s~~ broker[/]-dealer services on or off the premises of a financial institution [where retail deposits are taken unless the member complies initially and continuously with] is subject to the following requirements:

(1) Setting

[Wherever practical, the member’s broker/dealer services shall be conducted in a physical location distinct from the area in which the financial institution’s retail deposits are taken. In all situations, members shall identify the member’s broker/dealer services in a manner that is clearly distinguished from the financial institution’s retail deposit-taking activities. The member’s name shall be clearly displayed in the area in which the member conducts its broker/dealer services.]

A member that conducts broker-dealer services on the premises of a financial institution shall:

(A) be clearly identified as the person providing broker-dealer services and shall distinguish its broker-dealer services from the services of the financial institution;

(B) conduct its broker-dealer services in an area that displays clearly the member's name; and

(C) to the extent practicable, maintain its broker-dealer services in a location physically separate from the routine retail deposit-taking activities of the financial institution.

(2) Networking [and Brokerage Affiliate] Agreements

(A) Networking [and brokerage affiliate] arrangements between a member and a financial institution [must] shall be governed by a written agreement that sets forth the responsibilities of the parties and the compensation arrangements and include all broker-dealer obligations, as applicable, set forth in Rule 701 of Regulation R. Independent of their contractual obligations, members shall comply with all broker-dealer obligations, as applicable, under Rule 701 of Regulation R.

(B) The member [must] shall ensure that the written agreement stipulates that supervisory personnel of the member and representatives of the [Securities and Exchange Commission] SEC and [the Association] FINRA will be permitted access to the financial institution's premises where the member conducts broker[/]-dealer services, as applicable, in

order to inspect the books and records and other relevant information maintained by the member with respect to its broker[/]-dealer services.

(3) Customer Disclosure [and Written Acknowledgment]

At or prior to the time that a customer account is opened by a member that is a party to a networking arrangement [on the premises of a financial institution where retail deposits are taken], the member shall disclose, orally and in writing, to each customer that the broker-dealer services are being provided by the member and not by the financial institution, and that the securities products purchased or sold in a transaction are:

(A) [disclose, orally and in writing, that the securities products purchased or sold in a transaction with the member:]

[(i) are] not insured by the Federal Deposit Insurance Corporation (“FDIC”);

~~(B)~~[(ii) are] not deposits or other obligations of the financial institution and are not guaranteed by the financial institution; and

~~(C)~~[(iii) are] subject to investment risks, including possible loss of the principal invested[; and].

[(B) make reasonable efforts to obtain from each customer during the account opening process a written acknowledgment of receipt of the disclosures required by paragraph (c)(3)(A).]

(4) Communications with the Public

(A) All member confirmations and account statements [must] shall indicate clearly that the broker[/]-dealer services are being provided by the member.

(B) Advertisements and sales literature, including material published, or designed for use, in radio or television broadcasts, Automated Teller Machine (“ATM”) screens, billboards, signs, posters and brochures, that announce the location of a financial institution where broker[/]-dealer services are provided by the member or promote the name or services of the financial institution or that are distributed by the member on the premises of a financial institution or at such other location where the financial institution is present or represented shall [must disclose that securities products: are not insured by the FDIC; are not deposits or other obligations of the financial institution and are not guaranteed by the financial institution; and are subject to investment risks, including possible loss of the principal invested] include the disclosures required by paragraph (a)(3) of this Rule. The [shorter, logo format described in paragraph (c)(4)(C)] following legend may be used to provide these disclosures in advertisements and sales literature[.]

[(C) The following shorter, logo format disclosures may be used by members in advertisements and sales literature, including material published, or designed for use, in radio or television broadcasts, Automated Teller Machine (“ATM”) screens, billboards, signs, posters,

and brochures, to comply with the requirements of paragraph (c)(4)(B)], provided that such disclosures are displayed in a conspicuous manner:

- Not FDIC Insured
- No Bank Guarantee
- May Lose Value

([D]C) As long as the omission of the disclosures required by paragraph ([c]a)(4)(B) of this Rule would not cause the advertisement or sales literature to be misleading in light of the context in which the material is presented, such disclosures are not required with respect to messages contained in:

(i) [•]radio broadcasts of 30 seconds or less;

(ii) [•]electronic signs, including billboard-type signs that are electronic, time[,] and temperature signs and ticker tape signs, but excluding messages contained in such media as television, on[-]line [computer] services[,] or ATMs; and

(iii) [•]signs, such as banners and posters, when used only as location indicators.

(5) Notifications of Terminations

[The] A member [must] shall promptly notify the financial institution if any associated person of the member who is employed by the financial institution is terminated for cause by the member.

(b) Definitions

For purposes of this Rule, the following terms shall have the meanings specified below:

(1) “Financial institution” shall mean federal and state-chartered banks, savings and loan associations, savings banks, credit unions, and the service corporations of such institutions required by law.

(2) “Networking arrangement” shall mean a contractual or other written agreement between a member and a financial institution under which the member offers broker-dealer services on or off the premises of the financial institution.

(3) “Broker-dealer services” shall mean investment banking or securities business as defined in Article I of the FINRA By-Laws.

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