Regulatory Notice 15-22

Discretionary Accounts and Transactions

FINRA Requests Comment on a Revised Proposal to Adopt a Consolidated FINRA Rule Regarding Discretionary Accounts and Transactions

Comment Period Expires: August 17, 2015

Executive Summary

FINRA is requesting comment on a revised proposal to adopt the NASD and Incorporated NYSE rules regarding discretionary accounts and transactions as FINRA Rule 3260 (Discretionary Accounts and Transactions by Persons Other Than the Customer) in the consolidated FINRA rulebook.[1] In addition, the revised proposal addresses the treatment of customers' free credit balances, sweep programs, bulk transfers of customers' accounts and change of broker-dealer of record. The revised proposal also reflects the comments received on the initial proposal.

The proposed rule text is attached as Appendix A.

Questions regarding this *Notice* should be directed to Afshin Atabaki, Associate General Counsel, Office of General Counsel, at (202) 728-8071.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by August 17, 2015.

Comments must be submitted through one of the following methods:

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

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

FINRA
Financial Industry Regulatory Authority

June 2015

Notice Type
- Consolidated Rulebook
- Request for Comment

Suggested Routing
- Compliance
- Legal
- Operations
- Risk
- Senior Management

Key Topics
- Account Approval and Review
- Bulk Transfer of Customer Accounts
- Change of Broker-Dealer of Record
- Customer Authorization
- Discretionary Accounts and Transactions
- Free Credit Balances
- Negative Response Letters
- Sweep Programs
- Unauthorized and Excessive Trading

Referenced Rules & Notices
- FINRA Rules 2090, 3160 and 4512
- NASD Rules 1011, 1017 and 2510
- NTMs 83-70 and 02-57
- NYSE Info Memo 05-11
- NYSE Rule 408 and Rule Interpretation 408
- Proposed FINRA Rule 3260
- SEA Rules 15c3-3, 17a-3 and 17a-4
- SEC Regulation S-P

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

Important Notes: All comments received in response to this Notice will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.[2]

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).[3]

Background and Discussion

NASD Rule 2510 (Discretionary Accounts), Incorporated NYSE Rule 408 (Discretionary Power in Customers' Accounts)[4] and NYSE Rule Interpretation 408 (Discretionary Power in Customers' Accounts) currently set forth the obligations of a firm and its associated persons regarding the exercise of any discretionary power over a customer's account, including the obligation of the firm to detect and prevent unauthorized and excessive trading in such an account. NYSE Rule 408 also addresses the obligations of a firm when accepting an order for a customer's account from someone other than the customer. In *Regulatory Notice 09-63* (Discretionary Accounts and Transactions) (November 2009), FINRA proposed to revise and consolidate these NASD and NYSE rules as FINRA Rule 3260 in the consolidated FINRA rulebook. FINRA received eight comment letters in response to the *Notice*. Several commenters requested that FINRA clarify the proposal, including its scope. In addition, since the publication of the initial proposal, the SEC amended Rule 15c3-3 (Customer Protection–Reserves and Custody of Securities) under the Exchange Act in ways that impact FINRA rules relating to sweep programs and the use of negative response letters for a bulk transfer of customers' accounts.[5] In response to comments on the initial proposal and the SEC rule amendments, FINRA is seeking comment on a revised proposal to create a consolidated FINRA rule regarding discretionary accounts and transactions.

Proposal

A. Discretionary Transactions by Member Firms and Their Associated Persons (Proposed FINRA Rule 3260(a))

NASD Rules 2510(a) (Excessive Transactions), (b) (Authorization and Acceptance of Account) and (c) (Approval and Review of Transactions) address the obligations of firms and their associated persons that have discretionary power over a customer's account and prohibit unauthorized and excessive trading in such accounts.

NASD Rule 2510(a) prohibits a firm from effecting for a customer's account over which the firm, or an agent or employee of the firm, has any discretionary power any transactions that are excessive in size or frequency in view of the financial resources and character of the account. NASD Rule 2510(b) prohibits firms and their registered representatives from exercising any discretionary power in a customer's account unless the customer has given prior written authorization to a stated individual or individuals, and the account has been accepted by the firm as evidenced in writing by the firm or a designated partner, officer or manager of the firm. NASD Rule 2510(c) requires that the firm or designated partner, officer or manager approve promptly in writing each discretionary order entered and review all discretionary accounts at frequent intervals to detect and prevent transactions that are excessive in size or frequency in view of the financial resources and character of the account. NYSE Rules 408(a), (b) and (c) include corresponding requirements.

The initial proposal grouped together and reorganized under proposed FINRA Rule 3260(a) the requirements currently under NASD Rules 2510(a), (b) and (c). The initial proposal required that firms and their associated persons obtain the customer's "dated" prior written authorization to identify the date that discretionary authority was granted.[6] Further, the initial proposal required that a customer's written authorization be provided to a named natural person or persons, instead of a stated individual or individuals as currently required. The initial proposal also required that the account be accepted in writing by a designated partner, officer or manager of a firm denoting that the account has been accepted in accordance with the firm's policies and procedures for acceptance of discretionary accounts. In addition, the initial proposal clarified that the requirements apply to all associated persons of a firm, not just agents, employees and registered representatives. Moreover, consistent with NYSE Rule 408(b), the initial proposal clarified that the designated partner, officer or manager responsible for denoting acceptance of discretionary accounts, approving discretionary orders and reviewing such accounts has to be someone other than the associated person vested with discretionary power.

The revised proposal maintains the requirements of the initial proposal subject to a few clarifications and changes. The revised proposal clarifies that the customer must sign the written authorization.[7] Further, the revised proposal clarifies that a customer's written authorization be provided to a named associated person or associated persons, rather than a named natural person or persons as required under the initial proposal, and that the account documentation be "signed" by a partner, officer or manager[8] designated by the firm.[9] The revised proposal also requires that the associated person and the firm exercise discretionary power in such account only in the manner, and under the terms and conditions, specified in the customer's prior written authorization.[10]

For purposes of proposed FINRA Rule 3260(a), firms may approve discretionary trades post trade and in bulk, provided that the designated partner, officer or manager approves the trades promptly.

The signature and approval requirements of proposed FINRA Rule 3260(a) may be satisfied through the use of "electronic" means. FINRA will consider a valid electronic signature to be any electronic mark that clearly identifies the signatory and is otherwise in compliance with the Electronic Signatures in Global and National Commerce Act (E-Sign Act), the guidance issued by the SEC relating to the E-Sign Act,[11] and the guidance provided by FINRA through its interpretive letters,[12] which address electronic approval processes generally.

The requirements of proposed FINRA Rule 3260(a) apply to an associated person of a firm who is engaged in investment adviser discretionary activities in a customer's account at the firm[13] or who is granted non-broker-dealer and non-investment adviser discretionary authority by a customer of the firm, such as a family member who has given a power of attorney to the associated person. FINRA believes that such discretionary activities involve the placing of brokerage orders by an associated person of a firm for a customer's account at the firm, and such activities should be subject to a higher standard of review and approval.[14] FINRA also understands that some firms already conduct the review and approval required under the proposed rule based on existing practices and requirements. However, the revised proposal would exclude fee-based only accounts, including accounts that are charged only a flat fee or a fee based on assets under management, from the requirements of proposed FINRA Rule 3260(a). FINRA does not believe that the concerns relating to excessive trading apply to fee-based only accounts, and thus approval of individual trades and excessive trading restrictions are unnecessary. FINRA notes that fee-based accounts would only be excluded from the scope of proposed FINRA Rule 3260(a). Fee-based accounts would remain subject to other applicable FINRA rules, including, as discussed below, proposed FINRA Rule 3260(b) (Transactions by Agents of Customers).

Proposed FINRA Rule 3260(a) incorporates some of the requirements that are currently in NASD and NYSE rules, and it harmonizes the requirements with substantially similar requirements currently in other rules. Thus, the proposed rule should create minimal additional obligations upon firms. Further, the benefits of the proposed requirements include the protection of customers from the misuse of discretionary power by firms and associated persons. As discussed in greater detail below, proposed FINRA Rules 3260(c)(1)(A) through (F) also provide several exceptions to the requirements of proposed FINRA Rule 3260(a) based on existing NASD, NYSE and SEC requirements.

B. Transactions by Agents of Customers (Proposed FINRA Rule 3260(b))

NYSE Rule 408(a) states, in part, that no firm or employee may accept an order for a customer's account from a person other than the customer without first obtaining: (1) the customer's written authorization; (2) the signature of the person(s) authorized to exercise discretion in the account; and (3) the date such discretionary authority was granted.

The initial proposal transferred into proposed FINRA Rule 3260(b) the requirements of NYSE Rule 408(a) regarding accepting orders for a customer's account from someone other than the customer, with the exception of the requirement that the firm obtain the authorized person's signature. The initial proposal required that, before accepting an order for a customer's account from any person other than the customer, firms and associated persons obtain the customer's dated prior written authorization granting discretionary power to such person.

The revised proposal maintains the requirements of the initial proposal subject to the following changes. The revised proposal clarifies that the customer must sign the written authorization,[15] and it requires that an order placed by a person other than the customer be within the scope of that person's authority as specified in the customer's authorization.[16] A customer may provide an electronic signature for purposes of this requirement.

Further, the revised proposal applies to any person who is authorized to place orders in the customer's account, not just a person who has discretionary power over a customer's account. The revised proposal also applies to the fee-based accounts exempted from proposed FINRA Rule 3260(a). Therefore, under the revised proposal, the requirements of proposed FINRA Rule 3260(b) would apply to: (1) an investment adviser, other than an associated person, engaged in investment adviser discretionary activities in a customer's account at the firm; (2) any person, other than an associated person, granted non-investment adviser discretionary authority by a customer of the firm, such as a family member; (3) any person, including an associated person, engaged in non-discretionary trading in a customer's account;[17] or (4) transactions by firms or associated persons in fee-based accounts exempted from proposed FINRA Rule 3260(a).

In addition, the revised proposal requires that where a customer gives written authorization to a natural person, firms and associated persons obtain the prior dated manual signature of the named natural person,[18] and where a customer gives written authorization to an entity, firms and associated persons obtain the prior dated manual signature of a natural person authorized to act on behalf of the entity. For purposes of compliance with this requirement, firms must obtain a wet signature or a copy of a wet signature, such as a scanned or faxed copy of a wet signature.

The requirements of proposed FINRA Rule 3260(b) do not extend to a customer that is itself a legal entity and that has authorized its personnel to trade on behalf of the entity. Rather, the obligation of firms with respect to such customers is set forth in FINRA Rule 4512(a)(1)(E), which requires firms to maintain a record with the names of such authorized persons. Also, proposed FINRA Rule 3260(b) is not intended to apply to online brokerage activities where a customer has provided account access to another person and the firm or associated person does not know or have reason to know that a particular order is being placed by someone other than the customer. Rather, such activities are subject to other requirements governing the protection of customer information and records, and the prevention of identity theft.[19]

Moreover, proposed FINRA Rule 3260(b) only applies to those circumstances where the order is from a person other than the customer (*i.e.*, the accountholder), and it does not require a firm or an associated person to look through an intermediary (*e.g.*, an investment adviser) to the underlying beneficial owners where the intermediary, and not the underlying beneficial owners, is identified as the firm's customer. For instance, where an investment adviser opens a master account, and associated subaccounts, at a firm for trade execution purposes only and transactions are settled on a delivery-versus-payment (DVP) basis to its clients' individual accounts at the client's custodian financial institution, the investment adviser (rather than the investment adviser's clients) ordinarily would be considered the firm's customer.

Where current NASD and NYSE rules differ, proposed FINRA Rule 3260(b) incorporates the more stringent requirements of NYSE Rule 408(a) relating to accepting orders from someone other than the customer, which provides a heightened standard of investor protection as described above. Thus, the proposed rule may impose some additional obligations on firms not subject to NYSE rules, but the additional obligations may be limited as FINRA understands that most firms currently do not accept an order from someone other than the customer without some form of authorization from the customer, such as a trading authorization.

C. Temporary Time or Price Discretion (Proposed FINRA Rule 3260(c)(1)(A))

NASD Rule 2510(d)(1) provides an exception to the requirements of NASD Rules 2510(a), (b) and (c) for the exercise of discretion by a firm or an associated person as to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite amount of a specified security. Currently, the authority to exercise such discretion will be in effect only until the end of the business day on which the customer granted such discretion, unless the customer provides a specific written contrary indication signed and dated. The rule also provides an exception for the exercise of time or price discretion for an institutional account based on a valid good-'til-canceled instruction issued on a "not-held" basis, without any time limits. NASD Rule 2510(d)(1) requires that any exercise of time or price discretion be reflected on the order ticket. NYSE Rule 408(d) includes corresponding exceptions.[20]

The initial proposal transferred the existing exceptions in NASD Rule 2510(d)(1) into proposed FINRA Rule 3260(c)(1)(A). Specifically, the initial proposal provided an exception to the requirements of proposed FINRA Rule 3260(a) for a customer's limited authorization for time or price discretion for the purchase or sale of a definite dollar amount or quantity of a specified security.[21] In response to inquiries from firms regarding the duration and scope of such authorization, the initial proposal clarified that a firm may exercise: (1) time or price discretion given by a customer *during* a normal trading session, provided that such discretion is only valid during that session; or (2) time or price discretion given by a customer *after the close* of a normal trading session, provided that such discretion is only valid during the next normal trading session. For institutional accounts, the initial proposal also provided an exception to the requirements of proposed FINRA Rule 3260(a) for a firm that exercises time or price discretion for such accounts pursuant to valid good-'til-canceled instructions issued on a "not-held" basis, without time limits.[22] The revised proposal retains the exceptions set forth in the initial proposal without any changes.

For purposes of proposed FINRA Rule 3260(c)(1)(A)(i), a normal trading session is between 9:30 a.m. and 4:00 p.m., Eastern Standard Time, Monday through Friday, with the exception of market holidays. Further, firms and associated persons may continue to exercise time or price discretion that lasts longer than a normal trading session so long as such exercise of discretion is consistent with the requirements of proposed FINRA Rule 3260(a). In addition, FINRA does not believe that the exception in proposed FINRA Rule 3260(c)(1)(A)(ii) for not-held good-'til-canceled orders for institutional accounts, which is of unlimited duration, should be extended to retail accounts. FINRA believes that retail customer orders that are to last beyond a normal trading session as specified in proposed FINRA Rule 3260(c)(1)(A)(i) require the protections set forth in proposed FINRA Rule 3260(a).

FINRA understands that the terms of these exceptions, including the clarification regarding the duration of the limited authorization for time or price discretion, are consistent with current industry practices, and, thus, should not create any new significant burdens for firms.

D. Mergers and Acquisitions of Money Market Mutual Funds (Proposed FINRA Rule 3260(c)(1)(B))

NASD Rule 2510(d)(2) provides an exception to the requirements of NASD Rules 2510(a), (b) and (c) for bulk exchanges at net asset value of money market mutual funds using negative response letters in situations involving mergers or acquisitions of the mutual funds, changes of clearing firms and exchanges of money market mutual funds used in sweep accounts. Such negative response letters must include a tabular comparison of the nature and amount of the fees charged by each money market mutual fund, a comparative description of the investment objectives of each money market mutual fund and a prospectus of the money market mutual fund to be purchased. Further, the bulk exchange can be no sooner than 30 days after the date on which the negative response letter was mailed to the customer.

The initial proposal would have transferred into proposed FINRA Rule 3260(c)(1)(B) the current exceptions in NASD Rule 2510(d)(2). However, as noted earlier, following the publication of the initial proposal, the SEC amended SEA Rule 15c3-3 relating to the treatment of free credit balances outside and in sweep programs and published guidance regarding the application of the amendments to bulk transfers under FINRA rules, including bulk transfers resulting from a change in clearing firms. As a result, bulk exchanges of money market mutual funds using negative response letters in situations involving changes of clearing firms or changes in sweep accounts are now subject to different conditions and addressed separately under the proposed rule.[23]

The revised proposal continues to provide an exception to the requirements of proposed FINRA Rule 3260(a) for firms using negative response letters to effect a bulk exchange at net asset value of money market mutual funds in situations involving a merger or acquisition of the mutual funds. The revised proposal clarifies that the bulk exchange can be no sooner than 30 calendar days after the date on which the negative response letter was sent to the customer. The revised proposal also requires that where such bulk exchange involves money market mutual funds in a sweep program, the negative response letter used to effect the bulk exchange must describe the new terms and conditions of the new product, and the options available to the customer if the customer does not accept the new terms and conditions or the new product consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(3)(ii).[24]

FINRA does not believe that the proposed rule would create any additional burden on firms because firms are currently subject to these requirements.

E. Bulk Transfer of Customer Accounts and Change of Broker-Dealer of Record (Proposed FINRA Rule 3260(c)(1)(C))

Notice to Members (NTM) 02-57 (Bulk Transfer of Customer Accounts) (September 2002) identified specific situations in which the use of negative response letters by firms could be appropriate for the bulk transfer of customers' accounts. FINRA also has provided interpretive guidance on other situations where it could be appropriate for firms to use negative response letters to effect a bulk transfer[25] or change the broker-dealer of record.[26] Further, FINRA has encountered additional situations, which do not fall under *NTM 02-57* or the existing interpretive guidance, where the use of negative response letters could be appropriate to effect a bulk transfer.[27] A bulk transfer of customers' accounts may involve a transfer of free credit balances in the securities accounts of customers at one firm to another firm, including the transfer of free credit balances that result from the liquidation of products in a sweep program. Accordingly, bulk transfers of customers' accounts must also comply with SEC requirements relating to the treatment of free credit balances.

Because the bulk transfer of customers' accounts using negative response letters involves a discretionary transaction to facilitate the transfer, FINRA is proposing to address bulk transfers under proposed FINRA Rule 3260. As such, the revised proposal codifies for the first time under proposed FINRA Rule 3260(c)(1)(C) FINRA's guidance regarding the use of negative response letters to effect a bulk transfer of customers' accounts. The proposed rule also expands FINRA's existing guidance relating to bulk transfers and incorporates published SEC guidance regarding the applicability of SEA Rule 15c3-3 to bulk transfers.[28]

Specifically, proposed FINRA Rule 3260(c)(1)(C) provides an exception to the requirements of proposed FINRA Rule 3260(a) for the use of negative response letters to effect bulk transfers of customers' accounts in the following seven situations:

- an introducing firm that has entered into a clearing arrangement with a different clearing firm is seeking to transfer its customer accounts to the new clearing firm (based on *NTM 02-57*);
- an introducing firm or a clearing firm that is experiencing financial or operational difficulties is seeking to transfer all of its customer accounts, including in the case of a clearing firm all of the accounts carried by such clearing firm, to another introducing firm(s) or clearing firm(s) (based on *NTM 02-57*);[29]
- an introducing firm or a clearing firm that is going out of business, other than for financial or operational difficulties, is seeking to transfer all of its customer accounts to another introducing firm(s) or clearing firm(s);
- an introducing firm or a clearing firm that is divesting itself of a specific business line or area, such as its retail brokerage business or some of its branch offices, is seeking to transfer the affected customer accounts to another introducing firm or clearing firm;
- a clearing firm, for an introducing firm that has gone out of business, is seeking to transfer all of the introducing firm's customer accounts to another introducing firm at the same clearing firm (based on *NTM 02-57*);
- a firm that is acquired by or merged with another firm is seeking to transfer all of its customer accounts to the new firm (based on *NTM 02-57*); and
- upon the conclusion or termination of a networking arrangement between a firm and a financial institution pursuant to FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions), the firm is seeking to transfer all customer accounts established under the arrangement to a new firm with which the financial institution has formed a networking arrangement pursuant to FINRA Rule 3160 (based on *NTM 02-57*).

FINRA believes that the use of negative response letters to facilitate the bulk transfer of customer accounts in the specified situations is appropriate, given the potential risks to investors and costs to firms that could result if firms were required to solicit individual transfer instructions from each customer as required under proposed FINRA Rule 3260(a). The bulk transfer of accounts through the use of negative response letters in these situations also helps minimize interruptions to customers' access to their accounts and the trading markets.

The situations specified above address bulk transfer of customer accounts and do not apply to directly held mutual fund and variable insurance product accounts. However, FINRA is also codifying under proposed FINRA Rule 3260(c)(1)(C) its existing guidance regarding the use of negative response letters to change the broker-dealer of record on such directly held accounts.

FINRA notes that while it may be appropriate for firms to use negative response letters to transfer customer accounts or change the broker-dealer of record in the situations identified above, registered individuals may not under any circumstance use negative response letters to transfer customer accounts or change the broker-dealer of record.

The revised proposal requires that the firm send the negative response letters to the customers, absent exigent circumstances, at least 30 calendar days before the firm effects the transfer. The negative response letter must contain: (1) a brief description of the circumstances necessitating the transfer; (2) a statement that the customer has the right to object to the transfer and the date by which the customer must respond if objecting to the transfer (such date can be no sooner than 30 calendar days after the date on which the negative response letter was sent to the customer); (3) information on how the customer can effectuate a transfer to another firm; (4) disclosure of any costs to the customer if the customer initiates a transfer of the account after the account is moved pursuant to the negative response letter; and (5) a statement regarding the firm's compliance with SEC Regulation S-P in connection with the transfer. The requirements above are consistent with the current conditions in *NTM 02-57*. FINRA is proposing similar timing and disclosure requirements for negative response letters to change the broker-dealer of record.

The revised proposal imposes additional conditions on the bulk transfer of customer accounts using negative response letters.[30] For instance, notwithstanding the situation resulting in a bulk transfer of accounts, the firms involved in the transfer, if required to do so based on the requirements set forth in NASD Rule 1017 (Application for Approval of Change in Ownership, Control, or Business Operations),[31] must file an application with FINRA with respect to the proposed transfer, and such application must be approved prior to sending the negative response letters to the customers. Further, no personal confidential customer information (*e.g.*, Social Security numbers) may be provided to the receiving firm unless the sharing of such information is in compliance with SEC Regulation S-P. In addition, a firm that effects the transfer of a customer's account via a negative response letter may not charge a fee to that customer, and a firm may not charge a fee to a customer who in response to a negative response letter decides to move his or her account to another firm during the opt-out period provided in the letter.

The revised proposal codifies and expands FINRA's guidance regarding the use of negative response letters to effect a bulk transfer of customers' accounts or change the broker-dealer of record in specific situations that could result in potential risks to investors and costs to firms if those firms were required to solicit individual instructions from each customer. However, the proposed rule also imposes conditions with respect to a bulk transfer of customers' accounts or change in broker-dealer of record to protect the interests of customers. FINRA believes that the proposed rule will reduce the burden on firms while providing customers with time and information to decide whether to object to the transfer of their accounts or change in broker-dealer of record.

F. Treatment of Free Credit Balances

All transactions involving free credit balances[32] are subject to SEC requirements. Paragraph (j) (Treatment of Free Credit Balances) of SEA Rule 15c3-3 sets forth specific requirements regarding the treatment of free credit balances carried for the account of a customer. As such, as described in greater detail below, the revised proposal incorporates the SEC requirements as exceptions to the requirements of proposed FINRA Rule 3260(a).

1. Treatment of Free Credit Balances Outside of a Sweep Program (Proposed FINRA Rule 3260(c)(1)(D))

The revised proposal incorporates under proposed FINRA Rule 3260(c)(1)(D) the requirements of SEA Rule 15c3-3(j)(2)(i) with respect to transactions outside of a sweep program involving customers' free credit balances as an exception to the requirements of proposed FINRA Rule 3260(a). Consistent with SEA Rule 15c3-3(j)(2)(i), proposed FINRA Rule 3260(c)(1)(D) provides that a firm may invest, or transfer to another account or institution, free credit balances in a customer's account outside of a sweep program only upon a specific order, authorization or draft from the customer, and only in the manner, and under the terms and conditions, specified in the order, authorization or draft. Further, consistent with the SEC's published guidance,[33] proposed FINRA Rule 3260(c)(1)(D) states that a firm is not subject to the requirements above if the firm effects a bulk exchange of money market mutual funds using negative response letters consistent with proposed FINRA Rule 3260(c)(1)(B) or effects a bulk transfer of customers' accounts using negative response letters consistent with proposed FINRA Rule 3260(c)(1)(C).

FINRA does not believe that the proposed rule would create any additional burden on firms because firms are currently subject to these requirements.

2. Treatment of Free Credit Balances in a Sweep Program (Proposed FINRA Rule 3260(c)(1)(E))

The revised proposal incorporates under proposed FINRA Rule 3260(c)(1)(E) the requirements of SEA Rule 15c3-3(j)(2)(ii) relating to the treatment of free credit balances in a sweep program as an exception to the requirements of proposed FINRA Rule 3260(a). The revised proposal also incorporates NASD and NYSE requirements relating to sweep programs.

The revised proposal permits a firm to transfer free credit balances held in a customer's securities account to a product in the firm's sweep program or transfer a customer's interest in one product in a sweep program to another product in a sweep program, subject to the following conditions:

- the firm sends the customer a negative response letter consistent with the requirements of SEA Rule 15c3-3(j)(2)(ii)(B)(3);
- if the firm is transferring a customer's interest in one money market mutual fund in the member firm's sweep program to another money market mutual fund in the sweep program, the negative response letter must also include a tabular comparison of the nature and amount of the fees charged by each money market mutual fund, a comparative description of the investment objectives of each money market mutual fund and a prospectus of the money market mutual fund to be purchased;[34]
- the firm provides notice to the customer, as part of the customer's quarterly account statement, that the balance in the bank deposit account or shares of the money market mutual fund in which the customer has a beneficial interest can be liquidated on the customer's order and the proceeds returned to the securities account or remitted to the customer consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(2);
- the firm includes additional disclosures in an attachment to the negative response letter addressing any conflicts of interest relating to the sweep program, current interest rates applicable to the sweep program, the manner by which future interest rates will be determined, the nature and extent of SIPC or FDIC insurance available; and the entity that the customer should contact should the customer wish to gain access to his or her funds;[35]
- the firm posts on its website applicable bank and money market mutual fund updated interest rates and information regarding any conflicts of interest relating to its sweep program;[36] and
- the firm complies with specified recordkeeping and customer account statement requirements.[37]

The conditions above apply to existing customer accounts and accounts opened on or after the effective date of the revised proposal.

Consistent with SEA Rule 15c3-3(j)(2)(ii)(A), for accounts opened on or after the effective date of the revised proposal, proposed FINRA Rule 3260(c)(1)(E) also requires that the firm obtain the customer's prior written affirmative consent[38] to having free credit balances in the customer's securities account included in the firm's sweep program after the customer has been notified of the general terms and conditions of the products available through the sweep program and notified that the firm may change the products available under the sweep program.[39]

In addition, consistent with the SEC's published guidance,[40] the revised proposal provides that a firm is not subject to the requirements above if the firm effects a bulk exchange of money market mutual funds using negative response letters consistent with proposed FINRA Rule 3260(c)(1)(B), provided that the negative response letter used to effect the bulk exchange also complies with the disclosure requirements of SEA Rule 15c3-3(j)(2)(ii)(B)(3)(ii).

FINRA does not believe that incorporating the requirements of SEA Rule 15c3-3 and NASD Rule 2510(d)(2) relating to sweep programs would create any additional burden on firms because firms are currently subject to these requirements. The disclosure and notice requirements in NYSE *Information Memorandum 05-11* provide the benefits of a heightened standard of investor protection and will be new requirements for firms that are not NYSE member firms.

G. Money Market Mutual Fund Redemption Programs and Transactions to Satisfy Indebtedness (Proposed FINRA Rule 3260(c)(1)(F))

NYSE Rule Interpretation 408/01 (Automatic Money Market Fund Redemptions) addresses the obligation of firms that offer their customers automatic money market fund redemption programs whereby debit balances created by the purchase of securities in a customer's account are automatically satisfied by the redemption of shares of a money market fund in the account.[41] Such programs are subject to specific conditions, including the requirement to notify customers in writing regarding the programs. In addition, FINRA believes that firms and their customers should be provided the flexibility to enter into written agreements that allow transactions by firms to satisfy an indebtedness to them (such as to meet a margin call).

Therefore, the initial proposal included an exception to the requirements of proposed FINRA Rule 3260(a) for automatic money market mutual fund redemptions based on the requirements of NYSE Rule Interpretation 408/01, and an exception to address situations where a firm effects a transaction to satisfy an indebtedness to the firm.

Specifically, the initial proposal provided an exception to the requirements of proposed FINRA Rule 3260(a) for a firm that: (1) redeems money market mutual funds for the payment of securities purchases; or (2) effects transactions to satisfy an indebtedness to the firm (such as to meet a margin call), provided that such redemptions or transactions are permitted by a prior signed, written agreement between the firm and customer that prominently discloses the terms and conditions of such arrangements. The initial proposal also noted that any provisions in such agreement allowing the use of negative response letters remain subject to applicable FINRA rules and federal securities laws governing the use of such letters. The revised proposal maintains these exceptions under proposed FINRA Rule 3260(c)(1)(F), but it removes the reference to the use of negative response letters because it is superfluous.

FINRA believes that firms and their customers should be provided the flexibility to enter into such written agreements and that the proposed rule is anticipated to reduce the burden on firms.

H. Additional Supplementary Material

As originally proposed, FINRA Rule 3260.01 (Compliance With Federal Securities Laws Governing Discretionary Accounts and Transactions) stated that the requirements of proposed FINRA Rules 3260(a) and (c) applied only to the extent firms could maintain broker-dealer discretionary accounts or otherwise exercise broker-dealer discretion in an account as permitted under the federal securities laws. FINRA included this language to address the ability of broker-dealers to maintain discretionary accounts or otherwise exercise broker-dealer discretion in light of a pending SEC rulemaking proposal.[42] The revised proposal continues to require firms to comply with applicable federal securities laws in this regard, but it modifies the language to state that firms may maintain discretionary accounts or otherwise exercise discretion in an account only as permitted under the federal securities laws.

The revised proposal also would add the following supplementary material:

- Proposed FINRA Rule 3260.05 (Definition of Free Credit Balances and Sweep Program), which provides that the terms “free credit balances” and “Sweep Program” as used in proposed FINRA Rule 3260 have the meaning assigned to such terms in SEA Rule 15c3-3.

The revised proposal includes recordkeeping requirements similar to the initial proposal. Specifically, proposed FINRA Rule 3260.06 (Record Retention) requires firms to preserve customers’ prior written authorizations, signature records, records denoting acceptance of accounts and written agreements between firms and customers for at least six years after the date that such records are updated, and to preserve the last update to such records, or the original records if there are no updates, for at least six years after the date the account is closed. Further, proposed FINRA Rule 3260.06 requires that firms preserve records relating to the approval of discretionary orders under proposed FINRA Rule 3260(a) for the period of time and accessibility specified in SEA Rule 17a-4(b), which is for at least three years. In addition, for purposes of compliance with proposed FINRA Rule 3260(c)(1)(E)(vi), the revised proposal requires firms to maintain records of individual customer balances on their books and records and preserve such records for at least six years after the date the account is closed.

The proposed six-year retention period is consistent with the record retention period for similar customer account records under FINRA Rule 4512.01 (Customer Account Information Retention Periods) and under the Exchange Act.[43] The proposed three-year retention period is consistent with the record retention period for order tickets under the Exchange Act.[44] Therefore, FINRA does not believe that the proposed retention periods would create any undue burden on firms.

In general, firms would be required to update accounts established prior to the effective date of proposed FINRA Rule 3260 whenever they update the account information in the course of their routine and customary business. With respect to accounts subject to the requirements of SEA Rule 15c3-3, firms would be required to comply with the timing requirements under that rule.

The revised proposal also makes various technical, non-substantive changes, including updating cross references to FINRA rules.

I. Eliminated Rules

Similar to the initial proposal, the revised proposal deletes NYSE Rule 408 and NYSE Rule Interpretation 408 as they are substantially similar to proposed FINRA Rule 3260, otherwise incorporated as described above, rendered obsolete by the approach reflected in proposed FINRA Rule 3260, or addressed by other rules.

Economic Impact Assessment

Need for the Rule

As discussed above, the FINRA rulebook contains several provisions regarding discretionary accounts and transactions, including NASD Rule 2510 and NYSE Rule 408 (and its Interpretation). While the NASD rule generally applies to all FINRA member firms, the NYSE rule applies only to those members of FINRA that are also members of NYSE. FINRA believes that it can provide greater clarity and regulatory efficiency to firms by consolidating the NASD and NYSE rules into one rule set that applies to all FINRA member firms.

Regulatory Objective

FINRA recognizes that discretionary power over customer accounts can create value for customers by providing flexibility and convenience, but may also create opportunities for firms to compromise the interest of customers by engaging in activities such as unauthorized and excessive trading. The proposal seeks to harmonize current NASD and NYSE rules regarding discretionary accounts and transactions to eliminate duplicative rules, streamline regulation, and establish appropriate requirements for exercising discretionary power over customer accounts. It aims to bring clarity and consistency to FINRA rules without imposing any significant additional burden on member firms or undermining investor protection.

Economic Baseline

The current industry practices under existing NASD, NYSE and SEC requirements serve as an economic baseline for the proposed rule. FINRA member firms may face different requirements for the same activities depending on the rules to which they are subject. The proposed rule in the consolidated FINRA rulebook will bring to all customers the same benefits from the flexibility and investor protection provided by the rule.

The economic impact of the proposed requirements depends on how they compare to existing rules and current industry practices. Specifically, the proposed requirements that are substantially similar to existing rules or otherwise consistent with current industry practices are not expected to create any additional burden on firms. The proposed requirements that are more stringent than existing rules may impose some additional obligations on firms, but will also enhance investor protection. The proposed requirements that provide more flexibility to firms than existing rules may reduce the burden on firms. Some customers may benefit from the additional flexibility in firms' exercise of discretionary power, but such flexibility should not compromise the interest of customers.

Economic Impacts

Some of the proposed requirements are substantially similar to existing rules, while others are either more stringent or more flexible than existing rules. The economic impacts of these three types of proposed requirements are as follows.

Proposed FINRA Rule 3260(a), proposed FINRA Rule 3260(c)(1)(A), proposed FINRA Rule 3260(c)(1)(B) and proposed FINRA Rule 3260(c)(1)(D) are substantially similar to existing rules and consistent with current industry practices, and, thus, should not create any new significant burdens on firms nor alter the protections to customers.

Proposed FINRA Rule 3260(b) incorporates the requirements of NYSE Rule 408(a) regarding accepting orders for a customer's account from someone other than the customer. It incorporates the more stringent requirements of the NYSE rule where current NASD and NYSE rules differ. Under the proposed rule, firms must obtain the customer's signed and dated written authorization as well as the authorized person's manual dated signature and any orders from the authorized person must be consistent with such person's authority as specified in the customer's authorization. Thus, the proposed rule may impose additional obligations on member firms not subject to NYSE rules, but the additional obligations may be limited as FINRA understands that most firms currently do not accept an order from someone other than the customer without some form of authorization from the customer, such as a trading authorization. In addition, as noted, FINRA Rule 2090 requires firms to use reasonable diligence to understand the authority of each person acting on behalf of the customer. Similarly, proposed FINRA Rule 3260(c)(1)(E) codifies the disclosure and notice requirements in NYSE *Information Memorandum 05-11*, which will impose new requirements on firms that are not NYSE members. FINRA seeks specific comments on the potential costs to these member firms associated with the new requirements. The new requirements are expected to provide the benefits of a heightened standard of investor protection.

Proposed FINRA Rule 3260(c)(1)(C) codifies and expands FINRA's guidance regarding the use of negative response letters to effect a bulk transfer of customers' accounts or change the broker-dealer of record in specific situations. However, the proposed rule also imposes conditions with respect to a bulk transfer of customers' accounts or change in broker-dealer of record to protect the interests of customers. FINRA believes that the proposed rule will reduce the burden on firms while providing customers with time and information to decide whether to object to the transfer of their accounts or change in broker-dealer of record. Similarly, proposed FINRA Rule 3260(c)(1)(F) provides exceptions to proposed FINRA Rule 3260(a) to offer firms and their customers the flexibility to enter into written agreements that allow specified redemptions and transactions by firms. It is anticipated to reduce the burden on firms while protecting customers by requiring prior written agreements that prominently disclose the terms and conditions of such arrangements.

Request for Comments

FINRA seeks comments on the revised proposal. In addition to generally requesting comments, FINRA specifically requests comments on the questions below. FINRA requests data and quantified comments where possible.

1. As described above, many of the requirements of proposed FINRA Rule 3260 are based on existing NASD, NYSE and SEC requirements. Therefore, FINRA does not believe that the proposed rule would impose a significant burden on firms. However, FINRA is seeking specific comments on any potential costs associated with the proposed rule, including the factors or firm characteristics that contribute to any potential costs and the magnitude of any potential costs associated with developing, implementing and maintaining the systems and procedures to comply with the proposed rule.
2. What are the anticipated costs and benefits of the proposed rule to customers?
3. A customer may give discretion to a firm to purchase or sell a security or type of security limited by specific parameters established by the customer, and the firm may charge the customer per transaction in such arrangements. What is the impact of proposed FINRA Rule 3260(a) on such discretionary transactions? Do firms that exercise such discretion believe that they can satisfy the purposes of the proposed rule, such as identifying excessive trading, through the use of automated supervisory systems, or a mix of automated and manual supervisory systems?
4. What is the impact of proposed FINRA Rules 3260(a) and (b), including the requirement to obtain the signature of the authorized agent under proposed FINRA Rule 3260(b), on centrally managed accounts.

5. FINRA is proposing to exclude fee-based only accounts from the requirements of proposed FINRA Rule 3260(a) because such accounts generally do not raise concerns relating to excessive trading. Is the proposed exclusion appropriate?
6. Should the exception under proposed FINRA Rule 3260(c)(1)(A)(ii) for not-held good-'til-canceled orders for institutional accounts, which is of unlimited duration, be extended to retail accounts?
7. Proposed FINRA Rule 3260(c)(1)(C) addresses the use of negative response letters to transfer customer accounts or change the broker-dealer of record in potential situations where a firm is going out of business and is not able to service its customers' accounts (which may result in what is commonly referred to as "orphaned accounts" or "abandoned accounts"). In addition to the situations identified in proposed FINRA Rule 3260(c)(1)(C), a clearing firm that has non-transferrable assets in accounts of customers of an introducing firm for which the clearing firm no longer clears may also seek to transfer or assign such "orphaned accounts" to another introducing firm at the same clearing firm. Clearing firms have requested that they also be permitted to use negative response letters to transfer or assign such accounts. What level of due diligence do such clearing firms conduct on the prospective introducing firm and how do they address issues relating to the privacy of consumer financial information in connection with transferring or assigning the accounts? What other situations, including situations involving directly held mutual fund and variable insurance product accounts, cause accounts to be "orphaned" or "abandoned"?
8. Proposed FINRA Rules 3260(a) and (b) apply to defined benefit plans and defined contribution plans, including in situations where an individual plan participant gives an associated person of a firm or a third-party investment adviser discretion over his or her account. Are there any unique issues relating to such plans that may impact the application of the proposed rules?
9. Proposed FINRA Rule 3260(c)(1)(E) codifies the disclosure and notice requirements in NYSE *Information Memorandum 05-11*, which will impose new requirements on firms that are not NYSE members. What are the potential costs to such member firms associated with the proposed requirements?

Endnotes

1. The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, *see Information Notice 03-12-08* (Rulebook Consolidation Process).

2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.

3. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the Federal Register. Certain limited types of proposed rule changes take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.

4. For convenience, Incorporated NYSE Rules are referred to as NYSE Rules.

5. *See* Securities Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (August 21, 2013) (File No. S7-08-07) (hereinafter, Financial Responsibility Rules for Broker-Dealers); Frequently Asked Questions Concerning the Amendments to Certain Broker-Dealer Financial Responsibility Rules, Bulk Transfer Questions, Division of Trading and Markets (March 6, 2014).

6. *See also* NYSE Rule 408(a) and SEA Rule 17a-3(a)(17)(ii).

7. This signature requirement is generally consistent with SEA Rule 17a-3(a)(17)(ii), which requires that, for each discretionary account with a natural person, firms maintain a record containing the dated signature of the customer granting authorization.

8. The term "manager" as used in the proposed rule includes a principal with managerial responsibilities, but such principal does not necessarily have to be a senior executive of the firm.

9. *See also* FINRA Rule 4512(a)(1)(C) (which requires that for each account firms maintain the name(s) of the associated person(s), if any, responsible for the account) and FINRA Rule 4512(a)(1)(D) (which requires that for each account firms maintain the signature of the partner, officer or manager denoting that the account has been accepted in accordance with the firm's policies and procedures for acceptance of accounts).

10. This requirement is generally consistent with FINRA Rule 2090 (Know Your Customer), which requires firms to use reasonable diligence to understand the authority of each person acting on behalf of the customer.

11. *See* Securities Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001) (Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media Under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f)).

12. *See, e.g.*, letter to Jeffrey W. Kilduff, O'Melveny & Myers, LLP, from Nancy Libin, NASD, dated July 5, 2001.

13. *See, e.g.*, Regulatory and Compliance Alert (June 1998) (stating that when a registered investment adviser is a registered representative who establishes a customer account at the employing broker-dealer, NASD Rule 2510 applies).

14. *See also* SEA Rule 17a-3(a)(6)(i) (which requires that an order entered pursuant to the exercise of discretionary authority by an associated person of a firm be designated as such).

15. *See supra* note 7.

16. *See supra* note 10.

17. Where a customer grants a person non-discretionary trading authority over the customer's account, the person is authorized to place an order in the customer's account, but the person must obtain the customer's approval prior to placing the order.

18. *See also* FINRA Rule 4512(a)(3) (which requires that, for discretionary accounts, firms maintain a record of the dated, manual signature of each named, natural person authorized to exercise discretion in the account) and SEA Rule 17a-3(a)(17)(ii) (which requires that, for discretionary accounts with a natural person, firms maintain a record containing the dated signature of each natural person to whom discretionary authority was granted).

19. *See, e.g.*, Regulation S-P (Privacy of Consumer Financial Information and Safeguarding Personal Information) under the Exchange Act. 17 CFR Part 248.

20. However, the FINRA and NYSE rules define the term "institutional account" differently. FINRA Rule 4512(c) defines the term "institutional account" to mean the account of: (1) a bank; (2) a savings and loan association; (3) an insurance company; (4) a registered investment company; (5) an SEC-registered investment adviser or a state-registered investment adviser; or (6) a person with total assets of at least $50 million. NYSE Rule 408.11 defines the term "institutional account" to mean the account of: (1) a bank; (2) a savings association; (3) an insurance company; (4) a registered investment company; (5) a state or a political subdivision; (6) a pension or profit sharing plan, subject to ERISA, with more than $25 million in total assets under management, or of a federal agency or political subdivision; (7) any person that has a net worth of at least $45 million and financial assets of at least $40 million; or (8) an SEC-registered investment adviser. Proposed FINRA Rule 3260(c)(1)(A) incorporates the definition in FINRA Rule 4512(c).

21. *See* proposed FINRA Rule 3260(c)(1)(A)(i).

22. *See* proposed FINRA Rule 3260(c)(1)(A)(ii).

23. *See* proposed FINRA Rules 3260(c)(1)(C), (D) and (E).

24. This requirement is based on the SEC's published guidance regarding the application of its rules relating to the treatment of free credit balances to a bulk exchange at net asset value of money market mutual funds in situations involving a merger or acquisition of the mutual funds under FINRA rules. *See supra* note 5.

25. *See, e.g.*, letter to Michael R. Trocchio, Bingham McCutchen LLP, from Patricia Albrecht, NASD, dated November 10, 2004 (where a firm was divesting itself of its retail brokerage business and seeking to effect a bulk transfer of its retail customer accounts to another firm using negative response letters).

26. The broker-dealer of record refers to the broker-dealer identified on a customer's account application for accounts held directly at a mutual fund or variable insurance product issuer. Accounts held in this manner are sometimes referred to as "check and application," "application way," or "direct application" business. The broker-dealer of record generally receives fees or commissions resulting from the customer's transactions in the account. *See* memorandum from NASD Office of General Counsel, Regulatory Policy and Oversight, dated November 8, 2004 (permitting a member firm named as broker-dealer of record on directly held mutual fund and variable insurance product accounts to use negative response letters to change the broker-dealer of record on the accounts to another firm in the following situations: (1) the firm is going out of business; (2) a registered representative is leaving the firm and the firm will not be providing the services the registered representative was performing for the directly held account; or (3) a networking arrangement between the firm and a financial institution has concluded or terminated); letter to Barry Harris, Chief Counsel, Banc of America Investment Services, Inc., from Patricia Albrecht, Assistant General Counsel, NASD, dated October 20, 2004 (stating that a member firm named as broker-dealer of record on directly held mutual fund and variable insurance product accounts that is acquired by or merged with another member firm that will be the legal successor-in-interest may use negative response letters to change the broker-dealer of record on the accounts to the member firm that will become the successor-in-interest).

27. For instance, where a clearing firm is seeking to transfer all of its customer accounts to another clearing firm.

28. *See* proposed FINRA Rules 3260(c)(1)(D) (Treatment of Free Credit Balances Outside of a Sweep Program) and 3260.04 (Compliance with Rule 3260(c)(1)(E)(iii) In Connection With a Bulk Transfer of Customers' Accounts) (which provide exceptions from the requirements of SEA Rule 15c3-3 for bulk transfers of customers' accounts consistent with published SEC guidance).

29. *NTM 02-57*, however, did not expressly address transfers by a clearing firm that is experiencing financial or operational difficulties.

30. *See* proposed FINRA Rule 3260.02 (Additional Conditions for Bulk Transfers Under Rule 3260(c)(1)(C)).

31. Pursuant to NASD Rule 1017(a) (Events Requiring Application), a firm is required to file a Continuing Membership Application with FINRA if it plans to: (1) merge with another member firm (unless both are NYSE member firms or the surviving entity will continue to be an NYSE member firm); (2) directly or indirectly acquire another member firm (unless the acquiring member firm is an NYSE member firm); (3) directly or indirectly acquire or transfer 25% or more in the aggregate of its assets or any asset, business or line of operation that generates revenues comprising 25% or more in the aggregate of its earnings measured on a rolling 36-month basis (unless both the seller and acquirer are NYSE member firms); (4) change its equity ownership or partnership capital so that one person or entity directly or indirectly owns

or controls 25 percent or more of the equity or partnership capital; or (5) undergo a "material change in business operations" as defined in NASD Rule 1011(k) (Material Change in Business Operations).

32. According to the SEC, "[f]ree credit balances are funds payable by a broker-dealer to its customers on demand", and "[t]hey may result from cash deposited by the customer to purchase securities, proceeds from the sale of securities or other assets held in the customer's account, or earnings from dividends and interest on securities and other assets held in the customer's account." *See* Financial Responsibility Rules for Broker-Dealers, page 49; 17 CFR 240.15c3-3(a)(8).

33. *See supra* note 5.

34. This requirement is based on the current disclosures and notices required under NASD Rule 2510(d)(2).

35. This requirement is based on the guidance in NYSE *Information Memorandum 05-11* (February 15, 2005) relating to sweep programs, which FINRA is proposing to codify. Proposed FINRA Rule 3260.03 (Format of Disclosures Required Under Rule 3260(c)(1)(E)(iv)) provides that the required disclosures must be summarized in a one- or two-page document written in plain English and refer customers to places where additional and more detailed disclosure is available.

36. *See supra* note 35.

37. *See supra* note 35.

38. The SEC has provided no-action relief to broker-dealers from the prior written affirmative consent requirement of SEA Rule 15c3-3(j)(2)(ii)(A), subject to specified conditions, including, among other requirements, a requirement that the broker-dealer obtain the customer's affirmative consent after giving the customer notice of the general terms and conditions of the products available through the sweep program and that the broker-dealer may change the products available under the sweep program. See Letter from Randall W. Roy, Assistant Director, Division of Trading and Markets, U.S. Securities and Exchange Commission, to Thomas F. Price, Operations, Technology & BCP, Securities Industry and Financial Markets Association (February 26, 2014); Letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, U.S. Securities and Exchange Commission, to Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (February 5, 2015). The no-action relief extends until September 30, 2015.

39. A member firm receiving customers' accounts following a bulk transfer of accounts using negative response letters consistent with proposed FINRA Rule 3260(c)(1)(C) would not be subject to this requirement, provided that: (1) the customers' free credit balances were previously invested in a substantially similar product in the sweep program of the member firm delivering the accounts; (2) the negative response letters contain the general terms and conditions of the products available through the sweep program and notify customers that the member firm receiving the accounts may change the products available under the sweep program; (3) the negative response letters contain specified disclosures; and (4) if customers' free credit balances are invested in a different money market mutual fund at the member firm receiving the accounts than the one available through the sweep program of the member firm delivering the accounts, the negative response letters also contain a tabular comparison of the nature and amount of the fees charged by each money market mutual fund, a comparative description of the investment objectives of each money market mutual fund and a prospectus of the money market mutual fund to be purchased. *See* proposed FINRA Rule 3260.04. This exception is consistent with the SEC's published guidance. *See supra* note 5.

40. *See supra*a note 5.

41. *See also NTM 83-70* (Automatic Money Market Fund Redemptions) (December 1983).

42. In 2005, the SEC adopted Rule 202(a)(11)-1 under the Advisers Act, a principal purpose of which was to deem broker-dealers offering "fee-based brokerage accounts" not subject to the Advisers Act. Rule 202(a)(11)-1 also included several interpretive positions regarding Advisers Act Section 202(a)(11)(C), including a provision that any account over which a broker-dealer exercises investment discretion (other than on a temporary or limited basis) is subject to the Advisers Act. In March 2007, Rule 202(a)(11)-1 was vacated. *See Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007). In September 2007, the SEC re-proposed its interpretive positions for comment, including the provision regarding the application of the Advisers Act to discretionary accounts. *See* Investment Advisers Act Release No. 2652 (September 24, 2007), 72 FR 55126 (September 28, 2007) (Interpretive Rule Under the Advisers Act Affecting Broker-Dealers).

43. However, FINRA notes that currently member firms are required to preserve records relating to powers of attorney and other evidence of the granting of discretionary authority with respect to accounts of non-natural persons for only three years. *Compare* SEA Rule 17a-4(b)(6) *with* SEA Rule 17a-3(a)(17)(ii) *and* SEA Rule 17a-4(e)(5) (which requires a six-year retention period with respect to similar records for a discretionary account with a natural person).

44. *See* SEA Rules 17a-3(a)(6) and 17a-4(b).

Appendix A

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 3260

(Marked to Show Changes from NASD Rule 2510; NASD Rule 2510 and NYSE Rule 408 (and Its Interpretation) to Be Deleted in Their Entirety from the Transitional Rulebook)

* * * * *

[2500. SPECIAL ACCOUNTS]

[2510]3260. Discretionary Accounts and Transactions by Persons Other Than the Customer

(a) [Excessive] Discretionary Transactions by Members and Their Associated Persons

No member or associated person of the member shall exercise any discretionary power in a customer's account unless such customer has given a signed, dated prior written authorization to exercise discretionary power to a named associated person or associated persons and the account documentation has been signed by a partner, officer or manager designated by the member, other than the associated person vested with discretionary power, denoting that the account has been accepted in accordance with the member's policies and procedures for acceptance of such discretionary accounts. The associated person and the member shall exercise discretionary power in such account only in the manner, and under the terms and conditions, specified in the customer's prior written authorization. [No member] The associated person and the member shall not effect with or for [any] such [customer's] account [in respect to which such member or his agent or employee is vested with any discretionary power] any transactions of purchase or sale [which] that are excessive in size or frequency in view of the financial resources and character of such account. A partner, officer or manager designated by the member, other than the associated person vested with discretionary power, shall approve promptly in writing each discretionary order entered in such discretionary account and shall review such discretionary account at frequent intervals to detect and prevent transactions that are excessive in size or frequency in view of the financial resources and character of the account. The requirements of this paragraph (a) shall not apply to accounts that are only fee-based.

(b) [Authorization and Acceptance of Account] Transactions by Agents of Customers

No member or [registered representative] associated person of the member shall [exercise any discretionary power in a customer's account] accept an order for a customer's account from a person other than the customer unless [such] the customer has given a signed, dated prior written authorization to such person and the order is consistent with such person's authority as specified in the customer's prior written authorization. Where a customer provides written authorization to a natural person, a member or associated person must obtain the prior manual dated signature of the named natural person, and where a customer provides written authorization to an entity, a member or associated person must obtain the prior manual dated signature of a natural person authorized to act on behalf of the entity [a stated individual or individuals and the account has been accepted by the member, as evidenced in writing by the member or the partner, officer or manager, duly designated by the member, in accordance with Rule 3010].

[(c) Approval and Review of Transactions]

[The member or the person duly designated shall approve promptly in writing each discretionary order entered and shall review all discretionary accounts at frequent intervals in order to detect and prevent transactions which are excessive in size or frequency in view of the financial resources and character of the account.]

([d]c) [Exceptions] Specific Discretionary Activities; Extent Permissible

[This Rule shall not apply to:](1) Notwithstanding the requirements of paragraph (a) of this Rule, a member may engage in the activities set forth in subparagraphs (A) through (F) below.

[(1)]**(A) Temporary Time or Price Discretion**

(i) A member or an associated person may exercise discretion as to [the price at which or] the time or price [when] of execution of an order [given by a customer] for the purchase or sale of a definite dollar amount or quantity of a specified security [shall be executed] given by a customer:

a. during a normal trading session, provided that such time or price discretion shall be in effect only until the end of that normal trading session [, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written contrary indication signed and dated by the customer.]; or

b. after a normal trading session, provided that such time or price discretion shall be in effect only during the next normal trading session; and

(ii) A member or an associated person may exercise discretion as [This limitation shall not apply] to the time [and] or price [discretion exercised in] for an institutional account, as defined in FINRA Rule 4512(c) [3110(c)(4)], pursuant to valid [G]good-[T]til[l]-[C]cance[l]led instructions issued on a "not-held" basis.

Any exercise of time [and] or price discretion must be reflected on the order ticket[;].

[(2)]**(B) Mergers and Acquisitions of Money Market Mutual Funds**

A member may effect bulk exchanges at net asset value of money market mutual funds [("funds") utilizing] using negative response letters, provided[:]

[(A)][T]the bulk exchange is limited to situations involving mergers and acquisitions of money market mutual funds[,changes of clearing members and exchanges of funds used in sweep accounts;].

[(B)] Such [The] negative response letter must:

(i) contain[s] a tabular comparison of the nature and amount of the fees charged by each fund;

(ii)[(C)] [The negative response letter] contain[s] a comparative description of the investment objectives of each fund and a prospectus of the fund to be purchased; and

(iii)[(D)] [The negative response feature will] not be activated until at least 30 calendar days after the date on which the letter was [mailed] sent.

Where such bulk exchange involves money market mutual funds in a Sweep Program, the negative response letter used to effect the bulk exchange, in addition to satisfying the requirements above, also describes the new terms and conditions of the new product, and the options available to the customer if the customer does not accept the new terms and conditions or the new product consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(3)(ii).

(C) Bulk Transfer of Customer Accounts and Change of Broker-Dealer of Record

(i) A member may effect a bulk transfer of customers' accounts using negative response letters, provided that the bulk transfer is limited to the following circumstances:

a. an introducing firm that has entered into a clearing arrangement with a different clearing firm is seeking to transfer its customer accounts to the new clearing firm;

b. an introducing firm or a clearing firm that is experiencing financial or operational difficulties is seeking to transfer all of its customer accounts, including in the case of a clearing firm all of the accounts carried by such clearing firm, to another introducing firm(s) or clearing firm(s);

c. an introducing firm or a clearing firm that is going out of business, other than for financial or operational difficulties, is seeking to transfer all of its customer accounts to another introducing firm(s) or clearing firm(s);

d. an introducing firm or a clearing firm that is divesting itself of a specific business line or area, such as its retail brokerage business or some of its branch offices, is seeking to transfer the affected customer accounts to another introducing firm or clearing firm;

e. a clearing firm, for an introducing firm that has gone out of business, is seeking to transfer all of the introducing firm's customer accounts to another introducing firm at the same clearing firm;

f. a member that is acquired by or merged with another member is seeking to transfer all of its customer accounts to the new firm; and

g. upon the conclusion or termination of a networking arrangement between a member and a financial institution pursuant to FINRA Rule 3160, the member is seeking to transfer all customer accounts established under the arrangement to a new firm with which the financial institution has formed a networking arrangement pursuant to FINRA Rule 3160.

(ii) A member named as broker-dealer of record on directly held mutual fund and variable insurance product accounts may use negative response letters to change the broker-dealer of record on the accounts to another member, provided that the change in broker-dealer of record is limited to the following circumstances:

a. a member that is going out of business is seeking to change the broker-dealer of record on the directly held accounts to another member willing to service the accounts;

b. where a registered representative of a member who is servicing the directly held accounts is leaving the firm and the firm will not be providing the services the registered representative was performing for the accounts, the firm is seeking to change the broker-dealer of record on the directly held accounts to another member willing to service the accounts;

c. upon the conclusion or termination of a networking arrangement between a member and a financial institution pursuant to FINRA Rule 3160, the member is seeking to change the broker-dealer of record on directly held customer accounts established under the arrangement to a new firm with which the financial institution has formed a networking arrangement pursuant to FINRA Rule 3160; and

d. a member that is acquired by or merged with another member is seeking to change the broker-dealer of record on the directly held accounts to the member that will become the successor-in-interest.

(iii) For purposes of subparagraphs (i) and (ii) above, the member shall send the negative response letters to the customers, absent exigent circumstances, at least 30 calendar days before the member effects the transfer or change in broker-dealer of record, and the negative response letters shall contain:

a. a brief description of the circumstances necessitating the transfer or change in broker-dealer of record;

b. a statement that the customer has the right to object to the transfer or change in broker-dealer of record and the date by which the customer must respond if objecting to the transfer or change in broker-dealer of record (such date can be no sooner than 30 calendar days after the date on which the negative response letter was sent to the customer);

c. information on how the customer can effectuate a transfer or change in broker-dealer of record to another firm;

d. disclosure of any costs to the customer if the customer initiates a transfer of the account or change in broker-dealer of record after the account is moved or the broker-dealer of record has been changed pursuant to the negative response letter; and

e. a statement regarding the firm's compliance with SEC Regulation S-P (Privacy of Consumer Financial Information) in connection with the transfer or change in broker-dealer of record.

(D) Treatment of Free Credit Balances Outside of a Sweep Program

A member may invest, or transfer to another account or institution, free credit balances in a customer's account outside of a Sweep Program only upon a specific order, authorization or draft from the customer, and only in the manner, and under the terms and conditions, specified in the order, authorization or draft consistent with SEA Rule 15c3-3(j)(2)(i),provided, however, that a member may effect a (i) bulk exchange of money market mutual funds using negative response letters consistent with subparagraph (B) above, and (ii) bulk transfer of customers' accounts using negative response letters consistent with subparagraph (C) above.

(E) Treatment of Free Credit Balances in a Sweep Program

A member may transfer free credit balances held in a customer's securities account to a product in the member's Sweep Program or transfer a customer's interest in one product in a Sweep Program to another product in a Sweep Program, provided that:

(i) the member sends the customer a negative response letter consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(3)(i) at least 30 calendar days before:

a. making changes to the terms and conditions of the Sweep Program;

b. making changes to the terms and conditions of a product currently available through the Sweep Program;

c. changing, adding or deleting products available through the Sweep Program; or

d. changing the customer's investment through the Sweep Program from one product to another.

The negative response letter must describe the new terms and conditions of the Sweep Program or product or the new product, and the options available to the customer if the customer does not accept the new terms and conditions or product consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(3)(ii).

If the member is transferring a customer's interest in one money market mutual fund in the member's Sweep Program to another money market mutual fund in the Sweep Program, the negative response letter provided to the customer must also include a tabular comparison of the nature and amount of the fees charged by each money market mutual fund, a comparative description of the investment objectives of each money market mutual fund and a prospectus of the money market mutual fund to be purchased;

(ii) the member provides notice to the customer, as part of the customer's quarterly account statement, that the balance in the bank deposit account or shares of the money market mutual fund in which the customer has a beneficial interest can be liquidated on the customer's order and the proceeds returned to the securities account or remitted to the customer consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(2);

(iii) for accounts opened on or after [insert effective date of the proposed rule change], the member must also obtain the customer's prior written affirmative consent to having free credit balances in the customer's securities account included in the member's Sweep Program after the customer has been notified of the general terms and conditions of the products available through the Sweep Program and notified that the member may change the products available under the Sweep Program consistent with SEA Rule 15c3-3(j)(2)(ii)(A);

(iv) the member includes the following disclosures in an attachment to the negative response letter:

a. any conflicts of interest relating to the Sweep Program, including whether the member receives compensation or other benefits for customer balances maintained at a money market mutual fund or bank;

b. current interest rates applicable to the Sweep Program;

c. the manner by which future interest rates will be determined;

d. the nature and extent of SIPC or FDIC insurance available; and

e. the entity that the customer should contact should the customer wish to gain access to his or her funds;

(v) the member posts on its website applicable bank and money market mutual fund interest rates and information regarding any conflicts of interest relating to its Sweep Program with prominent notice of the availability of such information, and regularly updates applicable interest rates posted on its website;

(vi) where the member maintains customer bank sweep balances on an omnibus basis with an affiliated bank, the member maintains detailed individual customer balances on its books and records on behalf of the bank and the member's customers; and

(vii) where customer free credit balances swept to a bank are not under the control of the member, the member may reflect such balances on customer account statements, subject to the following conditions:

a. the member must indicate that the balance statement is informational, and is provided as a courtesy and includes assets held at different entities;

b. the member must identify each other entity, their relationship (if any) to each other and their respective functions; and

c. relative to services provided for assets included on the summary, the member must: clearly distinguish between assets held at each entity; identify the customer's account numbers at each entity; and provide a customer service telephone number at each entity (if the account number and customer service numbers are not included on the underlying statements).

Notwithstanding the requirements of this subparagraph (E), a member may effect a bulk exchange of money market mutual funds using negative response letters consistent with subparagraph (B) above, provided that the negative response letter used to effect the bulk exchange also describes the new terms and conditions of the new product, and the options available to the customer if the customer does not accept the new terms and conditions or the new product consistent with SEA Rule 15c3-3(j)(2)(ii)(B)(3)(ii).

(F) Money Market Mutual Fund Redemption Programs and Transactions to Satisfy Indebtedness

A member may:

(i) redeem money market mutual funds for payment of securities purchases; or

(ii) effect transactions to satisfy an indebtedness to the member (e.g., margin requirements),provided that such redemptions or transactions are permitted by a prior signed, written agreement between the member and customer that prominently discloses the terms and conditions of any such arrangement.

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

.01 Compliance With Federal Securities Laws Governing Discretionary Accounts and Transactions. Members may maintain discretionary accounts or otherwise exercise discretion in an account only as permitted under the federal securities laws.

.02 Additional Conditions for Bulk Transfers Under Rule 3260(c)(1)(C). A bulk transfer pursuant to Rules 3260(c)(1)(C)(i)a. through g. is subject to the following additional conditions:

(a) For purposes of a transfer pursuant to Rules 3260(c)(1)(C)(i)a. through g., (1) the firms involved in the transfer, if required to do so, must file an application under NASD Rule 1017 with FINRA with respect to the proposed transfer, and such application must be approved prior to sending the negative response letters to the customers; and (2) no personal confidential customer information (e.g., social security numbers) may be provided to the receiving introducing or clearing firm, as applicable, unless the sharing of such information is in compliance with SEC Regulation S-P (Privacy of Consumer Financial Information);

(b) For purposes of a transfer or assignment pursuant to Rules 3260(c)(1)(C)(i)b., d. and e., the firm making the transfer or assignment must provide a letter to FINRA, along with any related legal agreement entered into with the receiving firm detailing the financial and other terms of the transfer or assignment of the accounts to the receiving firm at least 30 calendar days prior to the negative response letter being sent to the customers;

(c) For purposes of a transfer pursuant to Rule 3260(c)(1)(C)(i)c., (1) the negative response letters may not be sent to the customers until there is a written executed agreement between the parties; and (2) the introducing firm or clearing firm that is going out of business must make a written representation to FINRA, to the attention of the firm's regulatory coordinator, that it will submit a Form BDW within 30 calendar days of the initial bulk transfer of the accounts; and

(d) For purposes of a transfer pursuant to Rule 3260(c)(1)(C)(i)d., (1) the accounts will be transferred to only one introducing firm or clearing firm; (2) the accounts subject to transfer are currently held at a clearing firm that is a FINRA member, whether or not the transfer of the accounts will result in a change in clearing firm; (3) the transfer does not occur until there is a fully-executed agreement between the divesting member and the receiving member; and (4) the transfer of the accounts can only be to entities that are permitted, due to the nature of their registration with the appropriate regulatory authorities, to service the accounts transferred. For instance, if a firm is selling one or more branch offices, it must sell them to an introducing firm or a clearing firm that is registered as a broker-dealer with the SEC and is a member of FINRA.

In addition, a member that effects the transfer of a customer's account via a negative response letter shall not charge a fee to that customer, and a member shall not charge a fee to a customer who in response to a negative response letter decides to move his or her account to another member during the opt-out period provided in the letter.

.03 Format of Disclosures Required Under Rule 3260(c)(1)(E)(iv). The disclosures required under paragraph (c)(1)(E)(iv) of this Rule must be summarized in a one- or two-page document written in plain English and refer customers to places where additional and more detailed disclosure is available.

.04 Compliance with Rule 3260(c)(1)(E)(iii) In Connection With a Bulk Transfer of Customers' Accounts. Notwithstanding the requirements of paragraph (c)(1)(E)(iii) of this Rule, following the bulk transfer of customers' accounts to a member using negative response letters consistent with paragraph (c)(1)(C) of this Rule, the member receiving the accounts may invest customers' free credit balances in products available through its Sweep Program in reliance on the negative response letters that were used to effect the bulk transfer of customers' accounts, provided that:

(a) the customers' free credit balances were previously invested in a substantially similar product in the Sweep Program of the member delivering the accounts;

(b) the negative response letters contained the general terms and conditions of the products available through the Sweep Program and notified customers that the member receiving the accounts may change the products available under the Sweep Program;

(c) the negative response letters contained the disclosures set forth in paragraph (c)(1)(E)(iv) of this Rule; and

(d) if customers' free credit balances were previously invested in a money market mutual fund in the Sweep Program of the member delivering the accounts different than the one available through the Sweep Program of the member receiving the accounts, the negative response letters also contained a tabular comparison of the nature and amount of the fees charged by each money market mutual fund, a comparative description of the investment objectives of each money market mutual fund and a prospectus of the money market mutual fund to be purchased.

.05 Definition of Free Credit Balances and Sweep Program. The terms "free credit balances" and "Sweep Program" as used in this Rule shall have the meaning assigned to such terms in SEA Rule 15c3-3.

.06 Record Retention. For purposes of this Rule, members shall preserve customers' prior written authorizations, signature records, records denoting acceptance of accounts and written agreements between members and customers that subsequently are updated for at least six years after the date that they are updated. Members shall preserve the last update to such records, or the original records if there are no updates, for at least six years after the date the account is closed. For purposes of paragraph (a) of this Rule, members shall preserve records relating to the approval of discretionary orders for the period of time and accessibility specified in SEA Rule 17a-4(b). For purposes of paragraph (c)(1)(E)(vi) of this Rule, members shall maintain records of individual customer balances on their books and records and preserve such records for at least six years after the date the account is closed.

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