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*Required fields are shown with yellow backgrounds and asterisks.*

Page 1 of * 136

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

File No.* SR - 2014 - * 037
Amendment No. (req. for Amendments *)

Filing 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) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

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

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐ Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document

Exhibit 3 Sent As Paper Document

**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Adopt FINRA Rules 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation) and 2040 (Payments to Unregistered Persons) in the Consolidated FINRA Rulebook, and Amend FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar)

**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 action.

First Name * Kosha Last Name * Dalal

Title * Associate Vice President and Associate General Counsel

E-mail * kosha.dalal@finra.org

Telephone * (202) 728-6903 Fax (202) 728-8264

**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.

Date 09/10/2014

By Patrice M. Gliniecki

(Name *)

(Title *)

Senior Vice President and Deputy General Counsel

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,

*Required fields are shown with yellow backgrounds and asterisks.*

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

**Form 19b-4 Information ***

Add Remove View

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 Remove View

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 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies ***

Add Remove View

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, security-based swap submission, or advance notice 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**

Add Remove View

Exhibit Sent As Paper Document

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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 3 - Form, Report, or Questionnaire**

Add Remove View

Exhibit Sent As Paper Document

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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 4 - Marked Copies**

Add Remove View

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 Remove View

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**

Add Remove View

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 the Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" "Exchange Act" or "SEA"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt FINRA Rule 2040 (Payments to Unregistered Persons) regarding the payment of transaction-based compensation by members to unregistered persons, and Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act). The proposed rule change would streamline provisions of NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members), NASD IM-2420-2 (Continuing Commissions Policy), Incorporated NYSE Rule 353 (Rebates and Compensation), Incorporated NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) and Incorporated NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations), which would be deleted from the current FINRA rulebook. The proposed rule change also would adopt the requirements of NASD Rule 1060(b) (Persons Exempt from Registration) and Incorporated NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders), as FINRA Rule 2040(c) (Nonregistered Foreign Finders) in the consolidated FINRA rulebook without material change. In addition, the proposed rule change would amend FINRA Rule 8311 (Effect of a Suspension,

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[1] 15 U.S.C. 78s(b)(1).

Revocation, Cancellation, or Bar), add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification), and adopt the requirements of NASD IM-2420-1(a) (Non-members of the Association), as FINRA Rule 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation).

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, NASD Rule 1060(b), NASD Rule 2410, NASD Rule 2420, NASD IM-2420-1, NASD IM-2420-2, Incorporated NYSE Rule 353, and Incorporated NYSE Rule Interpretations 345(a)(i)/01 through /03 will be eliminated from the current FINRA rulebook.

(c) Not applicable.

**2. Procedures of the Self-Regulatory Organization**

At its meeting on July 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 effective date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The effective date will be no later than 240 days following Commission approval.

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

(a) Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),[2] FINRA is proposing to adopt FINRA Rule 2040 (Payments to Unregistered Persons) regarding the payment of transaction-based compensation by members to unregistered persons, and Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act). The proposed rule change would streamline provisions of NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members), NASD IM-2420-2 (Continuing Commissions Policy), NYSE Rule 353 (Rebates and Compensation), NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) and NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations), which would be deleted from the current FINRA rulebook. The proposed rule change also would adopt the requirements of NASD Rule 1060(b) (Persons Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders), as FINRA Rule 2040(c)

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[2] The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules"). 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, March 12, 2008 (Rulebook Consolidation Process). For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

(Nonregistered Foreign Finders) in the Consolidated FINRA Rulebook without material change. In addition, the proposed rule change would amend FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar), add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification), and adopt the requirements of NASD IM-2420-1(a) (Non-members of the Association), as FINRA Rule 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation).

A. Background

NASD Rule 1060(b) (Persons Exempt from Registration), NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members), and NASD IM-2420-2 (Continuing Commissions Policy) (collectively, the "NASD Non-Member Rules") govern payments by members to unregistered persons. The NASD Non-Member Rules (other than NASD Rule 1060(b)) were developed in an era when a registered broker-dealer could engage in an over-the-counter securities business and elect not to be a member of a registered securities association.[3] An original purpose of the NASD Non-Member Rules was to encourage non-members to become members by generally prohibiting members from providing commissions or

[3] See Maloney Act of 1938, Pub. L. No. 75-719, 52 Stat. 1070, which added Section 15A of the Exchange Act to provide for the establishment of national securities associations with authority, subject to SEC review, to supervise the over-the-counter securities market and promulgate rules governing voluntary membership of broker-dealers.

discounts/concessions to non-members.[4] Since the adoption of the NASD Non-Member Rules, the laws governing broker-dealers have changed, and today virtually all broker-dealers doing business with the public are FINRA members.[5]

As a result, FINRA generally has interpreted the provisions of the NASD Non-Member Rules, through interpretive letters and other guidance, to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer. Section 15(a)(1) of the Exchange Act generally requires any broker-dealer effecting transactions in securities to be registered with the SEC. FINRA has refrained from providing interpretive guidance on whether a person is acting as an unregistered broker-dealer, as the authority to interpret Section 15(a) of the

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[4] Section 15A(e)(1) of the Exchange Act states that "[t]he rules of a registered securities association may provide that no member thereof shall deal with any nonmember professional (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public." Section 15A(e)(2) of the Exchange Act defines "nonmember professional" as "(A) with respect to transactions in securities other than municipal securities, any registered broker or dealer who is not a member of a registered securities association, except such a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, and commercial bills, and (B) with respect to transactions in municipal securities, any municipal securities dealer (other than a bank or division or department of a bank) who is not a member of any registered securities association and any municipal securities broker who is not a member of any such association." The legislative reports from Congress on this provision state that exclusion from membership would in effect be a form of economic sanction on such non-members. See S. Rep. No. 1455 and H. R. Rep. No 2307, 75th Cong., 3rd Sess. (1938).

[5] Section 15(b)(8) of the Exchange Act provides that "[i]t shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to Section 15A of this title or effects transactions in securities solely on a national securities exchange of which it is a member."

Exchange Act rests with the SEC. Registration as a broker-dealer provides a framework of rules to regulate the conduct of persons who receive transaction-based compensation, the receipt of which can create potential incentives for abusive sales practices. SEC guidance states that receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer.

B. Proposed FINRA Rule 2040

FINRA is proposing to adopt new FINRA Rule 2040 (Payments to Unregistered Persons), which eliminates the current NASD Non-Member Rules and related NYSE Non-Member Rules (discussed further below) and replaces them with a more straightforward rule. The proposed rule expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation. As further discussed in Item 5 below, the proposed rule change was published for comment in Regulatory Notice 09-69.[6] FINRA received seven comment letters. A significant number of the commenters expressed concern regarding the potential regulatory burden of obtaining SEC no-action letters to determine whether particular activities would require registration of persons as broker-dealers under Section 15(a) of the Exchange Act, and the proposed deletion of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to payments to foreign finders. In an effort to respond to these concerns, FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed

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6 See Regulatory Notice 09-69 (December 2009).

FINRA Rule 2040 to provide guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. FINRA is also proposing to retain NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to foreign finders as proposed FINRA Rule 2040(c). The proposed rule sets forth the following requirements:

- Payments to Unregistered Persons

FINRA is proposing to adopt new FINRA Rule 2040(a), which prohibits members or associated persons from, directly or indirectly, paying any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments and the activities related thereto, is required to be so registered under applicable federal securities laws and SEA rules and regulations; or

(2) any appropriately registered associated person, unless such payment complies with all applicable federal securities laws, FINRA rules and SEA rules and regulations.

The proposed change would make the rule consistent with FINRA staff interpretations under NASD Rule 2420 and SEC rules and regulations under Section 15(a) of the Exchange Act.[7] Under the proposal, persons would look to SEC rules and

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[7] See FINRA Interpretative Letters issued under NASD Rule 2420: Letter to Richard Schultz, Triad Securities Corp., dated December 28, 2007; Letter to Jonathan K. Lagemann, Esq., Law Offices of Jonathan Kord Lagemann, dated June 27, 2001; Letter to Jay Adams Knight, Esq., Musick, Peeler & Garrett LLP, dated March 8, 2001; and Letter to Michael R. Miller, Esq., Kunkel Miller &

regulations to determine whether the activities in question require registration as a broker-dealer under Section 15(a) of the Exchange Act. Persons may also rely on related published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations. The proposal would align the rule with SEC staff guidance that states that receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer. The proposed change also prohibits payments to appropriately registered associated persons unless such payments comply with applicable federal securities laws, FINRA rules and SEA rules and regulations.

FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 to provide guidance to members. In applying the proposed rule, FINRA will expect members to determine that their proposed activities would not require the recipient of the payments to register as a broker-dealer and to reasonably support such determination. Members that are uncertain as to whether an unregistered person may be required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto can derive support for their determination by, among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action letter from the Commission staff; or (3) obtaining a legal opinion from independent, reputable U.S.

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Hament, dated May 31, 2000 (available at http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/ConductRules/).

licensed counsel knowledgeable in the area. The member's determination must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

- Retiring Representatives

FINRA is also proposing to adopt new FINRA Rule 2040(b), which codifies existing FINRA staff guidance on the payment by members of continuing commissions to retiring registered representatives.[8] The proposal permits members to pay continuing commissions to retiring registered representatives of the member, after they cease to be associated with the member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided that: (1) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts or servicing the accounts generating the continuing commission payments; and (2) the arrangement complies with applicable federal securities laws and SEA rules and regulations.

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[8] See FINRA Interpretative Letters issued under NASD IM-2420-2: Letter to Name Not Public, dated November 27, 2012; Letter to Ted A. Troutman, Esquire, Muir & Troutman, dated February 4, 2002; Letter to Joe Tully, Commonwealth Financial Network, dated August 9, 2001; and Letter to Peter D. Koffer, Esq, Twenty-First Securities Corporation, dated January 21, 2000 (available at http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/ConductRules/index.htm).

The proposal defines the term "retiring registered representative" to mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry.[9] In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreement with the deceased representative.

FINRA believes this proposal is consistent with SEC guidance on the payment of compensation to retiring representatives.[10]

- Nonregistered Foreign Finders

As further discussed in Item 5 below, in light of comments raised in response to Regulatory Notice 09-69, FINRA is proposing to transfer NASD Rule 1060(b) (Persons Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders) with minor technical changes into the

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9 See SEC No-Action Letter to the Securities Industry and Financial Markets Association, 2008 SEC No-Act. LEXIS 695, November 20, 2008. The letter provides that "[t]he retiring representative must sever association with the Firm and with any municipal securities dealer, government securities dealer, investment adviser or investment company affiliates (except as may be required to maintain any licenses or registrations required by any state) and, is not permitted to be associated with any other broker, dealer, municipal securities dealer, government securities dealer, investment adviser or investment company, during the term of his or her agreement. The retiring representative also may not be associated with any bank, insurance company or insurance agency (affiliated with the Firm or otherwise) during the term of his or her agreement if the retiring representative's activities relate to effecting transactions in securities." See also SEC No-Action Letter to Amy Lee, Chief Compliance Officer, Co-CEO, Packerland Brokerage Services, 2013 SEC No-Act. LEXIS 237, March 18, 2013.

10 See supra note 9.

Consolidated FINRA Rulebook as FINRA Rule 2040(c).[11] As approved by the SEC in 1993 and 1995, respectively, NYSE Rule Interpretation 345(a)(i)/03 and NASD Rule 1060(b) are largely identical provisions and provide that members and persons associated with a member may pay transaction-related compensation to non-registered foreign finders, based upon the business of customers such persons direct to members, subject to identified conditions. FINRA is proposing non-substantive, technical changes to the proposed rule text to make it easier to read. Specifically, proposed FINRA Rule 2040(c) would provide that a member may pay to a nonregistered foreign finder (the "finder") transaction-related compensation based upon the business of customers the finder directs to the member if the following conditions are met ("foreign finders exemption"):

(1) the member has assured itself that the finder who will receive the compensation is not required to register in the United States as a broker-dealer nor is subject to a disqualification as defined in Article III, Section 4 of FINRA's By-Laws, and has further assured itself that the compensation arrangement does not violate applicable foreign law;

(2) the finder is a foreign national (not a U.S. citizen) or foreign entity domiciled abroad;

(3) the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in either foreign or U.S. securities;

(4) customers receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act of 1940 ("Investment Advisers Act"), that discloses what compensation is being paid to finders;

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11 See supra note 6.

(5) customers provide written acknowledgment to the member of the existence of the compensation arrangement and such acknowledgment is retained and made available for inspection by FINRA;

(6) records reflecting payments to finders are maintained on the member's books, and actual agreements between the member and the finder are available for inspection by FINRA; and

(7) the confirmation of each transaction indicates that a referral or finders fee is being paid pursuant to an agreement.

The rules provide that if all the conditions set forth in the rule are satisfied, members can pay transaction-related compensation to non-registered foreign finders based on the business of non-U.S. customers that finders refer to members. Specifically, the rules permit compensation to "be made on an ongoing basis and tied to such variables as the level of business generated or assets under control, notwithstanding the fact that the foreign finders' sole involvement would be the initial referral to a member."[12] The SEC Foreign Finders Approval Order states that "[t]he provision was intended to give members the opportunity to enhance their competitive position in foreign countries where new accounts are frequently opened on a referral basis with ongoing compensation for such referral."[13]

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12 See Securities Exchange Act Release No. 32431 (June 8, 1993), 58 FR 33128 (June 15, 1993) (Order Approving File No. SR-NYSE-92-33 Relating to an Interpretation to NYSE Rule 345 (Employees - Registration, Approval, Records)) ("SEC Approval Order of NYSE Rule 345 Interpretation"). See also Securities Exchange Act Release No. 35361 (February 13, 1995), 60 FR 9417 (February 17, 1995) (Order Approving File No. SR-NASD-94-51) ("SEC Foreign Finders Approval Order").

13 See supra note 12.

Proposed FINRA Rule 2040(c) would have the same scope as the current rule and continue to allow on-going transaction-based payments to non-registered foreign finders under the limited circumstances set forth in the current rule. As in the current rule, "[w]hile the foreign finders' sole involvement would be the initial referral to a member or member organization [of non-U.S. customers to the firm], compensation could be made on an ongoing basis and tied to such variables as the level of business generated or assets under control. All accounts referred by such foreign finders would be carried on the books of the member."[14] Similar to NASD Rule 1060(b), any activities beyond the initial referral of non-U.S. customers and payment of transaction-based compensation for any such activities would not be within the permissible scope of the foreign finders exception as set forth in proposed FINRA Rule 2040(c). Based solely on its activities in compliance with proposed FINRA Rule 2040(c), the foreign finder would not be considered an associated person of the member. However, unless otherwise permitted by the federal securities laws or FINRA rules, a person who receives commissions or other transaction-based compensation in connection with securities transactions generally has to be a registered broker-dealer or an appropriately registered associated person of a broker-dealer who is supervised by a broker-dealer. Members that engage foreign finders

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[14] See Securities Exchange Act Release No. 34941 (November 4, 1994), 59 FR 56102 (November 10, 1994) (Notice of Filing of File No. SR-NASD-94-51). See also SEC Approval Order of NYSE Rule 345 Interpretation.

would be required to have reasonable procedures that appropriately address the limited scope of activities permissible under such arrangements.[15]

C. Amendments to FINRA Rule 8311

➢ FINRA Rule 8311

FINRA is proposing amendments to FINRA Rule 8311 to eliminate duplicative provisions in NASD IM-2420-2 and to clarify the scope of the rule on payments by members to persons subject to suspension, revocation, cancellation, bar (each a "sanction") or other disqualification. The proposed rule provides that if a person is subject to a sanction or other disqualification, a member may not allow such person to be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. The proposed rule further provides that a member may not pay or credit to any person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any salary, commission, profit, or any other remuneration that the person might accrue, not just earn, during the period of the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or to a disqualified person that has been

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15 See SEC Foreign Finders Approval Order. FINRA notes that the scope of permissible activities and associated regulatory requirements differ between foreign finders and foreign associates, who are registered persons of the member. See also NASD Rule 1100 (Foreign Associates).

approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

Specifically, the proposal clarifies that:

(1) other disqualifications, not just suspensions, revocations, cancellations or bars, are subject to the rule (and the rule is not limited to orders issued by FINRA or the SEC);

(2) a member may not allow a person subject to a sanction or disqualification to "be" associated with such member in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity, not simply "remain" associated;

(3) a member may not pay any remuneration to a person subject to a sanction or disqualification, not just payments that result directly or indirectly from any securities transaction; and

(4) the rule applies to any salary, commission, profit or remuneration that the associated person might "accrue," not just "earn" during the period of a sanction or disqualification, not just suspension.

FINRA is also proposing to add a new paragraph to the rule that would expressly permit a member to pay to any person subject to a sanction or disqualification any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment. FINRA believes that these exceptions strike the correct balance by permitting certain key payments.

- Proposed Supplementary Material .01

In addition, FINRA is proposing to add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) that relates to commissions accrued by a person prior to the effective date of a sanction or disqualification. The proposed supplementary material would permit a member to pay a person that is subject to a sanction or disqualification remuneration that the member can evidence accrued to the person prior to the effective date of the sanction or disqualification. However, a member may not pay any remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification, and any such payment or credit must comply with applicable federal securities laws. FINRA believes that adopting this new provision is necessary to address questions by the industry on a member's ability to pay commissions and other remuneration that was accrued by the person prior to a sanction or disqualification going into effect. FINRA also believes the supplementary material, together with the proposed amendments discussed above, clarify that a member may not pay trail commissions to a person that may accrue during the period of the sanction or disqualification; rather, the member can only make such payments where the member can evidence that they accrued to the person prior to the effective date of the sanction or disqualification.

D. Adoption of New General Standard – FINRA Rule 0190

In addition, FINRA is proposing to adopt a new general standard, proposed FINRA Rule 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation), that is based largely on provisions of NASD IM-2420-1(a) and would provide that a member will be treated as a non-member of FINRA from the effective date

of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member will be automatically reinstated to membership in FINRA at the termination of the suspension period. FINRA believes this is consistent with the current provisions of NASD IM-2420-1(a) and should be retained in the FINRA rulebook.

E. NASD and NYSE Rules To Be Deleted

FINRA proposes to eliminate the following NASD and NYSE Rules and related interpretations because FINRA believes that proposed FINRA Rule 2040 simplifies and clarifies the meaning of such rules consistent with Section 15(a) of the Exchange Act. Specifically, NASD Rule 2410, NASD Rule 2420, NASD IM-2420-1, NASD IM-2420-2, NYSE Rule 353, NYSE Rule Interpretation 345(a)(i)/01 and NYSE Rule Interpretation 345(a)(i)/02 will be consolidated into proposed FINRA Rule 2040, providing members with one concise rule that outlines the applicable requirements for payments to non-members.

- NASD Rule 2410

NASD Rule 2410 (Net Prices to Persons Not in Investment Banking and Securities Business) prohibits payments or concessions by members to "any person not actually engaged in the investment banking or securities business."

- NASD Rule 2420

NASD Rule 2420 (Dealing with Non-Members) generally prohibits members from dealing with, or making payments to, non-member broker-dealers, except at the same prices, fees or concessions offered to the general public. NASD Rule 2420(b) specifically prohibits members from joining any non-member broker-dealer syndicate or

group in connection with the sale of securities. NASD Rule 2420(c) provides that members may pay concessions and fees to a non-member broker or dealer in a foreign country who is not eligible for membership, provided the member obtains an agreement from such foreign broker or dealer in making sales of securities within the United States that such foreign broker or dealer will act in accordance with the general requirements of the rule to prohibit the payment of concessions or discounts to non-members that are not allowed to the general public. NASD Rule 2420(d) provides restrictions on payments by or to persons that have been suspended or expelled.

- NASD IM-2420-1

NASD IM-2420-1 (Transactions between Members and Non-Members) provides certain exemptions from the general prohibition on arrangements with non-members set forth in NASD Rule 2420. For example, the rule provides exemptions for arrangements with certain non-members relating to transactions in "exempted securities," or transactions on a national securities exchange. The rule further clarifies that a firm that is suspended or expelled from FINRA membership, or whose registration is revoked by the SEC, is to be considered a non-member for purposes of the rule.

- NASD IM-2420-2

NASD IM-2420-2 (Continuing Commissions Policy) allows members to pay continuing commissions to former registered representatives after they cease to be employed by a member, if, among other things, a bona fide contract between the member and the registered representative calling for the payments was entered into in good faith while the person was a registered representative of the employing member. The rule states that such contracts cannot permit the solicitation of new business or the opening of

new accounts by persons who are not registered, and must conform with all applicable laws and regulations. The rule also provides that NASD Rule 2830(c) (Investment Company Securities, Conditions for Discounts to Dealers) should not be interpreted to require a sales agreement for a dealer to receive commissions on direct payments by clients or automatic dividend reinvestments. The rule further contains a prohibition on the payment of any kind by a member to any person who is not eligible for FINRA membership or eligible to be associated with a member because of any disqualification, such as revocation, expulsion or suspension that is still in effect. The rule recognizes the validity of contracts entered into in good faith to allow retired representatives to receive continuing compensation on their accounts or to designate a widow or other beneficiary; however, the rule states that members are not required to enter into such contracts and FINRA will not specify the terms of such contracts.

- NYSE Rule 353

NYSE Rule 353 (Rebates and Compensation) prohibits a member, principal executive, registered representative or officer from, directly or indirectly, rebating to any person any part of the compensation he receives from the solicitation of orders for the purchase or sale of securities or other similar instruments for the accounts of customers of the member, or pay such compensation, or any part thereof, as a bonus, commission, fee or other consideration for business sought or procured for him or for any other member. NYSE Rule 353(b) further provides that a member, principal executive, registered representative or officer cannot be compensated for business done by or through his employer after the termination of his employment except as may be permitted by the NYSE.

- NYSE Rule Interpretations 345(a)(i)/01 and /02

NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) prohibits a member from paying to non-registered persons compensation based upon the business of customers they direct to the member if such compensation is, among other things, formulated as a direct percentage of commissions generated and is other than on an isolated basis.

NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations) provides that a member that is also registered with the SEC as an investment adviser may enter into arrangements that comply with Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act.

As noted above, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The effective date will be no later than 240 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 Exchange Act,[16] 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 current NASD and NYSE rules relating to payments to unregistered persons for adoption as FINRA Rules in the new Consolidated FINRA Rulebook. Specifically,

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16 15 U.S.C. 78o–3(b)(6).

proposed FINRA Rule 2040(a) expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation; proposed FINRA Rule 2040(b) codifies existing FINRA guidance on the payment by members of continuing commissions to retiring registered representatives consistent with SEC guidance in this area; and proposed FINRA Rule 2040(c) adopts the foreign finders provisions of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 with technical changes. Proposed amendments to FINRA Rule 8311 eliminate duplicate provisions in NASD IM-2420-2 and clarify the scope of the rule on payments by members to persons subject to sanctions.

**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. FINRA believes the proposed rule change is consistent with Section 15(a) of the Exchange Act and its related guidance, and will promote the goal of clarity concerning the rules applicable to payments of transaction-based compensation to unregistered persons. Specifically, the proposed rule change will clarify and streamline current NASD and NYSE rules relating to payments to unregistered persons for adoption as FINRA Rules in the new Consolidated FINRA Rulebook. Proposed FINRA Rule 2040(a) expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation; proposed FINRA Rule 2040(b) codifies existing FINRA guidance on the payment by members of continuing commissions to

retiring registered representatives consistent with SEC guidance in this area; and proposed FINRA Rule 2040(c) adopts the foreign finders provisions of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 with technical changes.

As the proposed rule change aligns FINRA's requirements with the requirements of Section 15(a) of the Exchange Act, FINRA believes that the proposed rule change is appropriately tailored to minimize the burden and cost of complying with the proposed rule change. Moreover, FINRA believes that any burden from the proposal will be minimal because, while the proposal streamlines the current rule to make it more concise, the obligation of firms to analyze payment arrangements for compliance with Section 15(a) of the Exchange Act is not new. In addition, proposed Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 aims to assist compliance efforts by firms by providing guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. Proposed Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) to FINRA Rule 8311 also provides guidance to firms regarding permissible payments.

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

The proposed rule change was published for comment in Regulatory Notice 09-69 (December 2009) ("Notice"). Seven comment letters were received in response to the

Notice.[17] A copy of the Notice is attached as Exhibit 2a. A list of the comment letters received in response to the Notice is attached as Exhibit 2b. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c. Below is a summary of the comments and FINRA's responses.

Most commenters appreciated the intent of the proposed rule change to more directly align the rules on payments made by FINRA members to unregistered persons with SEC positions regarding broker-dealer registration requirements. However, the commenters had concerns with a number of the proposed changes. Specifically, the comments focused on the following issues: (a) the proposed deletion of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to payments to foreign finders; (b) the proposed adoption of FINRA Rule 2040(b) to replace NASD IM-2420-2 (Continuing Commissions Policy); (c) the proposed deletion of NASD Rule 2420(c) relating to transactions with foreign non-members; (d) the proposed deletion of NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations); (e) the potential regulatory burden of obtaining SEC no-action letters to determine whether

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17 See comment letters from Everarado Vidaurri, Chief Executive Officer, Intercam Securities, Inc., received January 21, 2010 ("Intercam"); Jorge Ramos, President, Monex Securities, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 29, 2010 ("Monex"); Daniel E. LeGaye, The LeGaye Law Firm P.C., received February 1, 2010 ("LeGaye Law"); Peter J. Chepucavage, Executive Director, CFAW, General Counsel, Plexus Consulting LLC, on behalf of the International Association of Small Broker-Dealers and Advisers, received February 1, 2010 ("Plexus"); Cliff Kirsch and Eric Arnold, Sutherland Asbill & Brennan LLP for The Committee of Annuity Insurers, to Marcia E. Asquith, Corporate Secretary, FINRA, dated February 1, 2010 ("CAI"); Ethan W. Johnson, Partner, Morgan, Lewis & Bockius LLP, to Marcia E. Asquith, Corporate Secretary, FINRA, dated February 1, 2010 ("Morgan Lewis"); and Rex A. Staples, General Counsel, North American Securities Administrators Association, Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated February 16, 2010 ("NASAA").

particular activities would require registration as a broker-dealer; (f) the concern that the proposal does not recognize state law statutory exemptions for the payment of compensation in limited circumstances; and (g) the proposed amendments to FINRA Rule 8311 regarding payments to sanctioned persons.

As further discussed below, in light of the comments, FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 to provide guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. FINRA is also proposing to retain NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to foreign finders as proposed FINRA Rule 2040(c).

(a) Foreign Finders (Proposed Deletion of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03)

In the Notice, FINRA proposed deleting NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 ("Existing Foreign Finders Rules"), which permit members to pay transaction-based compensation to non-registered foreign finders under specified conditions. The Notice indicated that these largely identical rules would be deleted and the activity would be subject to the general requirement in proposed FINRA Rule 2040(a) that would require firms to look to SEC rules and regulations to determine whether the activity in question requires registration as a broker-dealer under Section 15(a) of the Exchange Act. Six commenters raised concerns regarding the proposed deletion of these

rules and argued strongly that FINRA retain the Existing Foreign Finders Rules.[18] Specifically, the commenters stated that the proposed elimination of these rules would harm U.S. business by reducing competitiveness and that SEC guidance in this area is not clear and, therefore, the conditions set forth in the Existing Foreign Finders Rules provide necessary clarity to the industry.[19]

- Harm Business/Reduce Competitiveness

Several commenters expressed concern regarding the potential harm to current business models if NASD Rule 1060(b) is eliminated.[20] One commenter stated that foreign "finders provide an important and necessary service in that they have introduced foreign customers to U.S. markets, which is consistent with the transition of the financial markets to be international in nature."[21] Another commenter stated that the proposed elimination of the standard established by the NASD and NYSE rules "may reduce the competitiveness of FINRA members outside the United States."[22] The commenter further stated that the rules present low risk to the securities markets and investors because, according to the commenter, "the sole involvement of the referring foreign person is to make a referral to the member firm or to obtain execution, clearing or settlement services from such member and they do not permit broader contact with U.S.

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18 See Intercam, Monex, LeGaye Law, Plexus, Morgan Lewis and NASAA.

19 See supra note 18.

20 See Intercam, Monex, LeGaye Law and Morgan Lewis.

21 See Monex.

22 See Morgan Lewis.

persons."[23] Another commenter noted that the main activity in Miami and South Florida is to provide International Private Banking Services in the U.S. to non-U.S. citizens, primarily domiciled in Latin America, and elimination of the rules would "have a very negative impact in our industry, our labor market and to the US economy as a whole."[24] This commenter believed the proposal to eliminate the Existing Foreign Finders Rules would destroy completely the business model in which firms have been operating under for many years under NASD Rule 1060(b). Two commenters noted that foreign finders provide a valuable service to firms because they have an integral knowledge of their customers that are referred to firms, including suitability and investment needs.[25]

- SEC Guidance Relating to Foreign Finder Relationships is Not Clear

Four commenters noted that the SEC's position on payments to foreign finders is not clear, and as such, will result in additional confusion for regulatory compliance professionals and members.[26] One commenter stated "that SEC rules and staff interpretations in this area are sparse and fact specific and do not give adequate guidance on the question when a non U.S. person is required to register with the SEC as a broker-dealer as a result of a relationship with a U.S. member firm."[27] Two commenters noted that SEA Rule 15a-6 does not contemplate a foreign broker-dealer introducing its non-

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23 See Morgan Lewis. As noted above, if a foreign finder's activities go beyond an initial referral of non-U.S. customers to the member, the foreign finders provisions in proposed FINRA Rule 2040(c) would not be applicable.

24 See Monex.

25 See Monex and LeGaye Law.

26 See Intercam, Monex, LeGaye Law and Morgan Lewis.

27 See Morgan Lewis.

U.S. customers to a member to make recommendations and effect transactions on behalf of the customers, while simultaneously paying the foreign broker-dealer compensation for such referral.[28]

Several commenters urged FINRA to work with the SEC to develop comprehensive guidance on this matter.[29] One commenter noted that the existing framework provides adequate protection to referred clients in the forms of additional disclosure mandated by the existing rules.[30] Other commenters noted that foreign finders are subject to regulation in their respective countries.[31] One commenter recommended that FINRA "ask that the [C]ommission clarify its position including the numerous no-action letters issued over the last 30 years … it would help the investment community understand the current status of the issue and may inform the [C]ommission as to how widespread a problem exists."[32]

- Existing Foreign Finders Rules Provide Necessary Clarity

Several commenters expressed concern that the proposed elimination of the Existing Foreign Finders Rules would eliminate rules that the industry has relied on for decades to pay transaction-based compensation to foreign finders.[33] One commenter stated that the Existing Foreign Finders Rules have "generally allowed FINRA members,

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28 See Monex and LeGaye Law.

29 See Monex, LeGaye Law and Morgan Lewis.

30 See Morgan Lewis.

31 See Monex and LeGaye Law.

32 See Plexus.

33 See Intercam, Monex, Morgan Lewis and LeGaye Law.

under the enumerated conditions, to pay transaction-based compensation to a non-U.S. finder that solicits non-U.S. business for the member."[34] The same commenter further stated that "there were a number of critical components that had to be met with respect to the rule, two of the fundamental conditions with respect to the payment of compensation to a foreign finder was: (1) that the foreign finder limit its activities so that the finder was not required to register in the U.S. as a broker-dealer; and (2) that the compensation arrangement not violate applicable foreign law." As a result, the commenter contended that "FINRA member firms should be able to rely on clear guidance with respect to these activities, and the current rules gave that guidance to members."[35] Another commenter stated that "the existing rules with respect to foreign referrals and dealing with non-member firms are helpful and provide adequate protection to foreign customers that are referred to FINRA members."[36]

- FINRA Response to Comments on Existing Foreign Finders Rules

In response to the commenters' concerns, FINRA is proposing to adopt the Existing Foreign Finders Rules, with minor technical changes, as new FINRA Rule 2040(c) in the Consolidated FINRA Rulebook. As in the current rule, a member could pay transaction-related compensation to non-registered foreign finders where the finders' sole involvement is the initial referral to the member of non-U.S. customers to the member, and the member complies with all the conditions set forth in the rule.

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34 See Monex.

35 See supra note 34.

36 See Morgan Lewis.

(b) Continuing Commission Payments to Retiring Registered Representatives (Proposed FINRA Rule 2040(b)(2))

Proposed Rule 2040(b)(2) would permit FINRA members to pay continuing commissions to retiring registered representatives of the member after they cease to be associated with the member provided that (1) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and (2) the arrangement complies with applicable federal securities laws, SEA rules and regulations. In the Notice, the proposed rule included text that provided that the arrangement also must comply with "published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations." Based on concerns raised by commenters described hereinafter, FINRA has deleted this language from the proposed rule text in this rule filing.[37] However, FINRA believes that members should review applicable SEC staff guidance in the form of releases, no-action letters and interpretations because they contain helpful interpretative information regarding the SEC staff's views on the application of SEA rules and regulations.

One commenter stated it is unclear whether the proposal is intended to add any substantive restrictions or requirements, or if it merely forbids members from making

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[37] See CAI.

payments that are already otherwise prohibited.[38] The commenter noted that FINRA members are already subject to SEC rules and regulations, so FINRA rules containing blanket references to SEC rules and published guidance is problematic, especially when SEC guidance is extremely fact specific. The commenter further states "such positions do not allow for the notice and comment period that accompanies formal rulemaking and, would in effect give such positions the force and effect of a rule."[39] The same commenter further requested clarification from FINRA that a retiring registered representative who receives compensation payable under a group variable annuity contract may receive compensation on individuals who become certificate holders under such contract after the registered representative has retired.

Another commenter raised concerns regarding the open-ended nature of this provision.[40] The commenter expressed concern regarding the extent of hidden fee arrangements between shadow parties who trade consumers' accounts and questioned, "[h]as there been consideration as to potential trigger points wherein these types of post 'retirement' payment pose potential and/or actual conflicts of interest, the dangers to the underlying account holder whose assets are being used to generate fees that are split by multiple parties, and is full disclosure to consumers being provided?"[41]

FINRA believes that the SEC guidance in this area combined with current FINRA guidance are accurately summarized in the proposal and, as such, declines to make any

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38 See supra note 37.

39 See supra note 37.

40 See NASAA.

41 See supra note 40.

substantive changes to the proposal. Guidance regarding the permissibility of payments to retiring registered representatives primarily focuses on compliance with Section 15(a) of the Exchange Act. In November 2008, the staff of the Division of Trading and Markets of the Commission issued a no-action letter in which it stated that it would "not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 against a retiring representative of a registered broker-dealer ("Firm") if the retiring representative, the Firm, and the receiving representative, comply with the terms and conditions described in [the] letter, without the retiring representative maintaining his or her status as a registered associated person of the Firm upon retirement."[42] The no-action letter was based on the use of procedures described in the letter with respect to the circumstances by which a retiring representative may be compensated after the termination of employment for business done by or through his or her employer before the termination of employment. The staff of the Division of Trading and Markets has issued several other prior no-action letters regarding payments to retiring registered representatives.[43]

Consistent with such SEC no-action letters, FINRA has issued guidance in the form of interpretative letters under NASD IM-2420-2 that specifically notes that members need to be aware of SEC no-action letters that address the conditions under which a former, retired registered representative, who is no longer employed by a broker-

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42 See supra note 9.

43 See SEC No-Action Letters: Gruntal & Co., L.L.C., 1998 SEC No-Act. LEXIS 1146, October 14, 1998, Prudential Securities Incorporated, 1994 SEC No-Act. LEXIS 750, October 11, 1994 and Shearson Lehman Brothers Inc., 1993 SEC No-Act. LEXIS 548, March 25, 1993.

dealer, may continue to receive commissions without being required to register as a broker-dealer under Section 15 of the Exchange Act.[44] Such FINRA interpretative letters have expressly stated that "[t]he determination of whether a person should be registered as a broker/dealer rests with the Securities and Exchange Commission (the "SEC"). In this regard, [the firm] may wish to direct [its] inquiry to the SEC's Division of [Trading and Markets] for guidance. To the extent that [the member] receives no-action relief from the SEC to make such payments, [the member's] payment of continuing commissions to [the retiring registered representative] would not violate NASD Rule 2420 so long as the requirements of NASD IM-2420 are satisfied."[45]

(c) Transactions with Foreign Non-Members (Proposed Deletion of NASD Rule 2420(c))

NASD Rule 2420(c) generally provides that payments can be made to any non-member broker-dealer in a foreign country who is not eligible for membership in a registered securities association provided that, in any transaction with any such non-member broker-dealer where a selling concession, discount, or other allowance is allowed, the member making the payment secures from the foreign broker-dealer an agreement that, in making any sales to purchasers within the U.S. of securities acquired as a result of such transactions, the foreign broker-dealer will comply with paragraphs (a) and (b) of NASD Rule 2420 to the same extent the member must in connection with the transaction.

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44 See supra note 8.

45 See supra note 8.

One commenter stated that "while the rule does not expressly address the relationship between U.S. clearing firms and their non-U.S. correspondents, it is frequently cited as confirmation that the FINRA rules permit members to enter into a variety of clearing and sub-clearing agreements and other brokerage arrangements with foreign non-members and to share fees or pay other forms of compensation without requiring the foreign firms or their personnel to register with the SEC.[46] The same commenter recommended that NASD Rule 2420(c) be retained in its current form, but suggested one clarification whereby the "eligible for membership in a national securities association" is changed to "not being required to be a registered broker-dealer in the United States and member of a national securities association," because the commenter believed it is difficult to determine when a foreign firm would not be eligible for membership and further eligibility is not a relevant determinant of whether a foreign firm should register. In the alternative, assuming the Existing Foreign Finders Rules and NASD Rule 2420(c) are not retained in their current forms, the same commenter recommended the following changes to the proposed rule text: (i) eliminate "or offer to pay" from the introductory clause in paragraph (a) since determining whether and when an offer to pay has been made would add a level of subjectivity that would undercut the effort to bring clarity to this area; (ii) eliminate "appropriately" from the beginning of paragraph (a)(2) as a requirement in the paragraph will need to be satisfied even if the person is "inappropriately" registered (if, according to the commenter, that is even possible); and (iii) narrow the scope of the pre-conditions in paragraph (a)(2) to just those of verifying that the person is registered and not subject to any statutory disqualifications,

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46 See Morgan Lewis.

as the burden of checking all the laws, rules and regulations cited in the proposed rule will be a strong disincentive against members ever making such payments.[47]

FINRA declines to retain NASD Rule 2420(c) because, as discussed in detail above, proposed FINRA Rule 2040(a) expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for persons to receive transaction-related compensation. In this regard, FINRA notes the commenter's suggestion that, if FINRA were to retain NASD Rule 2420(c), FINRA should replace the phrase "eligible for membership in a national securities association" with "not being required to be a registered broker-dealer in the United States and member of a national securities association." FINRA believes that proposed FINRA Rule 2040(a) is consistent with such recommendation. FINRA further does not agree with the commenter's implication that NASD Rule 2420(c) can validly be used as confirmation that FINRA rules permit members to enter into a variety of brokerage arrangements with foreign non-members and to share fees or pay other forms of compensation without requiring the foreign firms or their personnel to register with the SEC. FINRA is considering guidance on circumstances where such arrangements may comply with FINRA rules.

FINRA also declines to eliminate the word "appropriately" and to narrow the scope of the pre-conditions in proposed FINRA Rule 2040(c) to require that the member only determine that a person receiving transaction-related compensation is registered and not subject to any statutory disqualification because FINRA believes that members need to determine that the person receiving the transaction-related compensation is registered

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47 See supra note 46.

in the appropriate category necessary to receive the type of compensation being paid, and that the payments are permissible under applicable laws, consistent with SEC guidance in this area. In response to the commenter, however, FINRA is proposing to eliminate the phrase "or offer to pay" from proposed FINRA Rule 2040(a) as it agrees that the language may add uncertainty and subjectivity to the proposed rule and is not needed to achieve the regulatory purpose of the proposed rule.

(d) Compensation Paid for Advisory Solicitations (Proposed Deletion of NYSE Rule Interpretation 345(a)(i)/02)

One commenter stated "there has been substantial confusion related to the regulation of broker-dealers and investment advisers that were dually registered with the SEC ("Dual Registrants") in recent history."[48] The commenter stated that members face uncertainty where definitions or guidelines differ between the Investment Advisers Act and the Exchange Act, and by proposing to eliminate NYSE Rule Interpretation 345(a)(i)/02, FINRA is creating further confusion for Dual Registrants. NYSE Rule Interpretation 345(a)(i)/02[49] generally provides that a broker-dealer that is registered with the SEC as an investment adviser under the Investment Advisers Act may enter into arrangements that comply with Rule 206(4)-3 (Cash Payments for Client Solicitations) of

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48 See LeGaye Law.

49 NYSE Rule Interpretation 345/(a)(i)/02 (Compensation Paid for Advisory Solicitations) reads as follows: "A member organization, registered with the SEC as an investment adviser, may enter into any arrangement that fully complies with Rule 206(4)-3 ("Cash Payments for Client Solicitations") of the Investment Advisers Act of 1940. Such arrangements will not be deemed contrary to the registration requirements of Rule 345 (see also Rule 10 "Definition of Registered Representative"). Member organizations are advised to check on the applicability of any state registration requirements for member organizations and associated persons."

the Investment Advisers Act, and that such arrangements will not be deemed contrary to the registration requirements of NYSE Rule 345.[50] The commenter stated, for example, that while Rule 206(4)-3 of the Investment Advisers Act allows for the cash payment to a solicitor under certain circumstances, the proposal would require the payment to comply with all applicable federal securities laws, including FINRA rules.[51]

FINRA does not believe that it is necessary to retain the content of NYSE Rule Interpretation 345(a)(i)/02. It is FINRA's view that proposed FINRA Rule 2040 does not narrow the scope of Rule 206(4)-3 under the Investment Advisers Act, which applies to cash payments by investment advisers for client solicitations for advisory business. Where Rule 206(4)-3 payments to an investment adviser by a dually registered broker-dealer do not require the solicitor to register under Section 15(a) of the Exchange Act, proposed FINRA Rule 2040 would continue to permit them. The question of whether activities permissible under Rule 206(4)-3 under the Investment Advisers Act would require the solicitor to be registered as a broker-dealer under Section 15(a) of the Exchange Act is determined by the SEC.[52]

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50 See Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act, which generally makes it unlawful for any investment adviser that is required to be registered under the Investment Advisers Act to pay a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities unless certain specified conditions are met.

51 See supra note 48.

52 See Mayer Brown LLP, 2008 SEC No-Act. LEXIS 515, July 15, 2008 and Response of the Office of Chief Counsel, Division of Investment Management, 2008 SEC No-Act. LEXIS 524, July 28, 2008, which state that "[Firm has] not asked, and this letter does not address, whether a person's receipt of cash compensation from an investment adviser of an investment pool for soliciting or referring investors or prospective investors to invest in the pool would result in

(e) Burden of Obtaining SEC No-Action Relief

Two commenters raised concerns regarding the requirement in proposed FINRA Rule 2040 to look to SEC no-action letters to determine compliance with Section 15(a) of the Exchange Act.[53] Specifically, one commenter stated "FINRA is placing additional regulatory uncertainty on FINRA member firms and further hampering their efforts to obtain meaningful compliance."[54] Several commenters were concerned that it will be expensive and cumbersome to seek no-action relief and such no-action relief would be subject to continuous revision.[55] In addition, one commenter raised concerns that since there is no "reasonable belief" standard for reliance on specific SEC no-action relief, members will need to hire attorneys to support their positions that the SEC rules, regulations and other guidance are applicable to their arrangement.[56] Moreover, the commenter stated that the SEC has declined to consider the matter in prior no-action letters, noting that the SEC does not as "a matter of practice," provide no-action relief in this context and questioned how a firm can meaningfully comply with the proposed rule.[57]

FINRA believes that interpretation of Section 15(a) of the Exchange Act is a critical component in determining whether payments to unregistered persons are

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the person being considered a "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934."

53 See Monex and LeGaye Law.

54 See Monex.

55 See Monex, LeGaye Law, Morgan Lewis and NASAA.

56 See supra note 54.

57 See supra note 54.

permissible under the federal securities laws. FINRA acknowledges that while Section 15(a) of the Exchange Act does not specifically address the numerous and varying arrangements that may exist with respect to payments to unregistered persons, SEC guidance is controlling in this area.

As described in Item 3 above, FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 to provide guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. Members can derive support for their determination by, among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action letter from the Commission staff; or (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area. The member's determination must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

(f) Proposal Does Not Recognize State Law Exemptions

One commenter expressed concern that the proposal does not address those FINRA members that engage in primarily an intra-state business, and the state of their domicile recognizes statutory exemptions for the payment of compensation in limited

circumstances for certain finders.[58] FINRA acknowledges that state rules and regulations may permit different types of payment arrangements, and where such payments are permissible under the federal securities laws and SEC rules, regulations or guidance, such payments would be in compliance with proposed FINRA Rule 2040.

(g) Payments to Sanctioned Persons (FINRA Rule 8311)

The proposed rule change prohibits FINRA members from allowing persons subject to suspension, revocation, cancellation of registration, bar from association with a member or other disqualification to be associated with the member in any capacity inconsistent with the sanction. The proposal also would prohibit payment to a person during the period of sanction or anytime thereafter if the payment might accrue during the time of sanction.

One commenter believed the proposal is unclear as to whether registered representatives subject to sanctions would be permitted to continue to receive compensation earned as a result of automatic payments to a variable annuity contract made during the period of sanction.[59] The commenter recommended that registered representatives be permitted to receive these automatic payments, where such payments were arranged for during a time period that preceded the sanctions.

FINRA believes that proposed Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) to FINRA Rule 8311 addresses this question. Proposed Supplementary Material .01 provides that a member can pay or credit a person subject to a sanction salary, commission, profit or other

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58 See LeGaye Law.

59 See CAI.

remuneration that the member can evidence accrued to the person prior to the effective date of the sanction, unless such remuneration relates to results from the activity giving rise to the sanction. Accordingly, a member would need to demonstrate that the remuneration accrued prior to the effective date of the sanction in order to pay or credit the remuneration to the sanctioned individual.

The commenter also requested that FINRA clarify that the sanctions identified under the proposal do not in any way impact the current FINRA rules and guidance regarding registered representatives who are deemed to be "inactive" due to failure to complete the regulatory element of continuing education requirements in a timely manner under NASD Rule 1120 (now FINRA Rule 1250).[60] FINRA notes that the proposal is not intended to alter existing guidance under FINRA Rule 1250 with respect to registered representatives who are deemed to be "inactive" due to failure to complete the regulatory element of continuing education requirements in a timely manner.

**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 Exchange Act.[61]

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

Not applicable.

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60 The SEC approved the adoption of NASD Rule 1120 (Continuing Education Requirements) as new FINRA Rule 1250 (Continuing Education Requirements), subject to certain amendments, effective on October 17, 2011. See Securities Exchange Act Release No. 64687 (June 16, 2011); 76 FR 36586 (June 22, 2011) (Order Approving File No. SR-FINRA-2011-013).

61 15 U.S.C. 78s(b)(2).

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

Not applicable.

**9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act**

Not applicable.

**10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act**

Not applicable.

**11. Exhibits**

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

Exhibit 2a. Regulatory Notice 09-69 (December 2009).

Exhibit 2b. A list of the comment letters received in response to Regulatory Notice 09-69 (December 2009).

Exhibit 2c. Copies of the comment letters received in response to Regulatory Notice 09-69 (December 2009).

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2014-037)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rules 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation) and 2040 (Payments to Unregistered Persons) in the Consolidated FINRA Rulebook, and Amend FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar)

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") 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 FINRA Rule 2040 (Payments to Unregistered Persons) regarding the payment of transaction-based compensation by members to unregistered persons, and Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act). The proposed rule change would streamline provisions of NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members),

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

NASD IM-2420-2 (Continuing Commissions Policy), Incorporated NYSE Rule 353 (Rebates and Compensation), Incorporated NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) and Incorporated NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations), which would be deleted from the current FINRA rulebook. The proposed rule change also would adopt the requirements of NASD Rule 1060(b) (Persons Exempt from Registration) and Incorporated NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders), as FINRA Rule 2040(c) (Nonregistered Foreign Finders) in the consolidated FINRA rulebook without material change. In addition, the proposed rule change would amend FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar), add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification), and adopt the requirements of NASD IM-2420-1(a) (Non-members of the Association), as FINRA Rule 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation).

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

## 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 FINRA Rule 2040 (Payments to Unregistered Persons) regarding the payment of transaction-based compensation by members to unregistered persons, and Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act). The proposed rule change would streamline provisions of NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members), NASD IM-2420-2 (Continuing Commissions Policy), NYSE Rule 353 (Rebates and Compensation), NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) and NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations), which would be deleted from the current FINRA rulebook. The proposed rule change also would adopt the requirements of NASD Rule 1060(b) (Persons

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3 The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE ("Incorporated NYSE Rules"). 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, March 12, 2008 (Rulebook Consolidation Process). For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders), as FINRA Rule 2040(c) (Nonregistered Foreign Finders) in the Consolidated FINRA Rulebook without material change. In addition, the proposed rule change would amend FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar), add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification), and adopt the requirements of NASD IM-2420-1(a) (Non-members of the Association), as FINRA Rule 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation).

A. Background

NASD Rule 1060(b) (Persons Exempt from Registration), NASD Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business), NASD Rule 2420 (Dealing with Non-Members), NASD IM-2420-1 (Transactions Between Members and Non-Members), and NASD IM-2420-2 (Continuing Commissions Policy) (collectively, the "NASD Non-Member Rules") govern payments by members to unregistered persons. The NASD Non-Member Rules (other than NASD Rule 1060(b)) were developed in an era when a registered broker-dealer could engage in an over-the-counter securities business and elect not to be a member of a registered securities association.[4] An original purpose of the NASD Non-Member Rules was to encourage non-members to become members by generally prohibiting members from providing commissions or

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[4] See Maloney Act of 1938, Pub. L. No. 75-719, 52 Stat. 1070, which added Section 15A of the Exchange Act to provide for the establishment of national securities associations with authority, subject to SEC review, to supervise the over-the-counter securities market and promulgate rules governing voluntary membership of broker-dealers.

discounts/concessions to non-members.[5] Since the adoption of the NASD Non-Member Rules, the laws governing broker-dealers have changed, and today virtually all broker-dealers doing business with the public are FINRA members.[6]

As a result, FINRA generally has interpreted the provisions of the NASD Non-Member Rules, through interpretive letters and other guidance, to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer. Section 15(a)(1) of the Exchange Act generally requires any broker-dealer effecting transactions in securities to be registered with the SEC. FINRA has refrained from providing interpretive guidance on whether a person is acting as an unregistered broker-dealer, as the authority to interpret Section 15(a) of the

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5 Section 15A(e)(1) of the Exchange Act states that "[t]he rules of a registered securities association may provide that no member thereof shall deal with any nonmember professional (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public." Section 15A(e)(2) of the Exchange Act defines "nonmember professional" as "(A) with respect to transactions in securities other than municipal securities, any registered broker or dealer who is not a member of a registered securities association, except such a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, and commercial bills, and (B) with respect to transactions in municipal securities, any municipal securities dealer (other than a bank or division or department of a bank) who is not a member of any registered securities association and any municipal securities broker who is not a member of any such association." The legislative reports from Congress on this provision state that exclusion from membership would in effect be a form of economic sanction on such non-members. See S. Rep. No. 1455 and H. R. Rep. No 2307, 75th Cong., 3rd Sess. (1938).

6 Section 15(b)(8) of the Exchange Act provides that "[i]t shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to Section 15A of this title or effects transactions in securities solely on a national securities exchange of which it is a member."

Exchange Act rests with the SEC. Registration as a broker-dealer provides a framework of rules to regulate the conduct of persons who receive transaction-based compensation, the receipt of which can create potential incentives for abusive sales practices. SEC guidance states that receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer.

B. Proposed FINRA Rule 2040

FINRA is proposing to adopt new FINRA Rule 2040 (Payments to Unregistered Persons), which eliminates the current NASD Non-Member Rules and related NYSE Non-Member Rules (discussed further below) and replaces them with a more straightforward rule. The proposed rule expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation. As further discussed in Item II.C. below, the proposed rule change was published for comment in Regulatory Notice 09-69.[7] FINRA received seven comment letters. A significant number of the commenters expressed concern regarding the potential regulatory burden of obtaining SEC no-action letters to determine whether particular activities would require registration of persons as broker-dealers under Section 15(a) of the Exchange Act, and the proposed deletion of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to payments to foreign finders. In an effort to respond to these concerns, FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to

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[7] See Regulatory Notice 09-69 (December 2009).

proposed FINRA Rule 2040 to provide guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. FINRA is also proposing to retain NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to foreign finders as proposed FINRA Rule 2040(c). The proposed rule sets forth the following requirements:

- Payments to Unregistered Persons

FINRA is proposing to adopt new FINRA Rule 2040(a), which prohibits members or associated persons from, directly or indirectly, paying any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments and the activities related thereto, is required to be so registered under applicable federal securities laws and SEA rules and regulations; or

(2) any appropriately registered associated person, unless such payment complies with all applicable federal securities laws, FINRA rules and SEA rules and regulations.

The proposed change would make the rule consistent with FINRA staff interpretations under NASD Rule 2420 and SEC rules and regulations under Section 15(a) of the Exchange Act.[8] Under the proposal, persons would look to SEC rules and

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[8] See FINRA Interpretative Letters issued under NASD Rule 2420: Letter to Richard Schultz, Triad Securities Corp., dated December 28, 2007; Letter to Jonathan K. Lagemann, Esq., Law Offices of Jonathan Kord Lagemann, dated

regulations to determine whether the activities in question require registration as a broker-dealer under Section 15(a) of the Exchange Act. Persons may also rely on related published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations. The proposal would align the rule with SEC staff guidance that states that receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer. The proposed change also prohibits payments to appropriately registered associated persons unless such payments comply with applicable federal securities laws, FINRA rules and SEA rules and regulations.

FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 to provide guidance to members. In applying the proposed rule, FINRA will expect members to determine that their proposed activities would not require the recipient of the payments to register as a broker-dealer and to reasonably support such determination. Members that are uncertain as to whether an unregistered person may be required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto can derive support for their determination by, among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action letter from the

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June 27, 2001; Letter to Jay Adams Knight, Esq., Musick, Peeler & Garrett LLP, dated March 8, 2001; and Letter to Michael R. Miller, Esq., Kunkel Miller & Hament, dated May 31, 2000 (available at http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/ConductRules/index.htm).

Commission staff; or (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area. The member's determination must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

➢ Retiring Representatives

FINRA is also proposing to adopt new FINRA Rule 2040(b), which codifies existing FINRA staff guidance on the payment by members of continuing commissions to retiring registered representatives.[9] The proposal permits members to pay continuing commissions to retiring registered representatives of the member, after they cease to be associated with the member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided that: (1) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts or servicing the accounts generating the continuing commission payments; and (2) the

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9 See FINRA Interpretative Letters issued under NASD IM-2420-2: Letter to Name Not Public, dated November 27, 2012; Letter to Ted A. Troutman, Esquire, Muir & Troutman, dated February 4, 2002; Letter to Joe Tully, Commonwealth Financial Network, dated August 9, 2001; and Letter to Peter D. Koffer, Esq, Twenty-First Securities Corporation, dated January 21, 2000 (available at http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/ConductRules/index.htm).

arrangement complies with applicable federal securities laws and SEA rules and regulations.

The proposal defines the term "retiring registered representative" to mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry.[10] In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreement with the deceased representative.

FINRA believes this proposal is consistent with SEC guidance on the payment of compensation to retiring representatives.[11]

- Nonregistered Foreign Finders

As further discussed in Item II.C. below, in light of comments raised in response to Regulatory Notice 09-69, FINRA is proposing to transfer NASD Rule 1060(b)

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10 See SEC No-Action Letter to the Securities Industry and Financial Markets Association, 2008 SEC No-Act. LEXIS 695, November 20, 2008. The letter provides that "[t]he retiring representative must sever association with the Firm and with any municipal securities dealer, government securities dealer, investment adviser or investment company affiliates (except as may be required to maintain any licenses or registrations required by any state) and, is not permitted to be associated with any other broker, dealer, municipal securities dealer, government securities dealer, investment adviser or investment company, during the term of his or her agreement. The retiring representative also may not be associated with any bank, insurance company or insurance agency (affiliated with the Firm or otherwise) during the term of his or her agreement if the retiring representative's activities relate to effecting transactions in securities." See also SEC No-Action Letter to Amy Lee, Chief Compliance Officer, Co-CEO, Packerland Brokerage Services, 2013 SEC No-Act. LEXIS 237, March 18, 2013.

11 See supra note 10.

(Persons Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders) with minor technical changes into the Consolidated FINRA Rulebook as FINRA Rule 2040(c).[12] As approved by the SEC in 1993 and 1995, respectively, NYSE Rule Interpretation 345(a)(i)/03 and NASD Rule 1060(b) are largely identical provisions and provide that members and persons associated with a member may pay transaction-related compensation to non-registered foreign finders, based upon the business of customers such persons direct to members, subject to identified conditions. FINRA is proposing non-substantive, technical changes to the proposed rule text to make it easier to read. Specifically, proposed FINRA Rule 2040(c) would provide that a member may pay to a nonregistered foreign finder (the "finder") transaction-related compensation based upon the business of customers the finder directs to the member if the following conditions are met ("foreign finders exemption"):

(1) the member has assured itself that the finder who will receive the compensation is not required to register in the United States as a broker-dealer nor is subject to a disqualification as defined in Article III, Section 4 of FINRA's By-Laws, and has further assured itself that the compensation arrangement does not violate applicable foreign law;

(2) the finder is a foreign national (not a U.S. citizen) or foreign entity domiciled abroad;

(3) the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in either foreign or U.S. securities;

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12 See supra note 7.

(4) customers receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act of 1940 ("Investment Advisers Act"), that discloses what compensation is being paid to finders;

(5) customers provide written acknowledgment to the member of the existence of the compensation arrangement and such acknowledgment is retained and made available for inspection by FINRA;

(6) records reflecting payments to finders are maintained on the member's books, and actual agreements between the member and the finder are available for inspection by FINRA; and

(7) the confirmation of each transaction indicates that a referral or finders fee is being paid pursuant to an agreement.

The rules provide that if all the conditions set forth in the rule are satisfied, members can pay transaction-related compensation to non-registered foreign finders based on the business of non-U.S. customers that finders refer to members. Specifically, the rules permit compensation to "be made on an ongoing basis and tied to such variables as the level of business generated or assets under control, notwithstanding the fact that the foreign finders' sole involvement would be the initial referral to a member."[13] The SEC Foreign Finders Approval Order states that "[t]he provision was intended to give members the opportunity to enhance their competitive position in foreign countries where

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13 See Securities Exchange Act Release No. 32431 (June 8, 1993), 58 FR 33128 (June 15, 1993) (Order Approving File No. SR-NYSE-92-33 Relating to an Interpretation to NYSE Rule 345 (Employees - Registration, Approval, Records)) ("SEC Approval Order of NYSE Rule 345 Interpretation"). See also Securities Exchange Act Release No. 35361 (February 13, 1995), 60 FR 9417 (February 17, 1995) (Order Approving File No. SR-NASD-94-51) ("SEC Foreign Finders Approval Order").

new accounts are frequently opened on a referral basis with ongoing compensation for such referral."[14]

Proposed FINRA Rule 2040(c) would have the same scope as the current rule and continue to allow on-going transaction-based payments to non-registered foreign finders under the limited circumstances set forth in the current rule. As in the current rule, "[w]hile the foreign finders' sole involvement would be the initial referral to a member or member organization [of non-U.S. customers to the firm], compensation could be made on an ongoing basis and tied to such variables as the level of business generated or assets under control. All accounts referred by such foreign finders would be carried on the books of the member."[15] Similar to NASD Rule 1060(b), any activities beyond the initial referral of non-U.S. customers and payment of transaction-based compensation for any such activities would not be within the permissible scope of the foreign finders exception as set forth in proposed FINRA Rule 2040(c). Based solely on its activities in compliance with proposed FINRA Rule 2040(c), the foreign finder would not be considered an associated person of the member. However, unless otherwise permitted by the federal securities laws or FINRA rules, a person who receives commissions or other transaction-based compensation in connection with securities transactions generally has to be a registered broker-dealer or an appropriately registered associated person of a broker-dealer who is supervised by a broker-dealer. Members that engage foreign finders would be required to have reasonable procedures that

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14 See supra note 13.

15 See Securities Exchange Act Release No. 34941 (November 4, 1994), 59 FR 56102 (November 10, 1994) (Notice of Filing of File No. SR-NASD-94-51). See also SEC Approval Order of NYSE Rule 345 Interpretation.

appropriately address the limited scope of activities permissible under such arrangements.[16]

C. Amendments to FINRA Rule 8311

➢ FINRA Rule 8311

FINRA is proposing amendments to FINRA Rule 8311 to eliminate duplicative provisions in NASD IM-2420-2 and to clarify the scope of the rule on payments by members to persons subject to suspension, revocation, cancellation, bar (each a "sanction") or other disqualification. The proposed rule provides that if a person is subject to a sanction or other disqualification, a member may not allow such person to be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. The proposed rule further provides that a member may not pay or credit to any person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any salary, commission, profit, or any other remuneration that the person might accrue, not just earn, during the period of the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or to a disqualified person that has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

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16 See SEC Foreign Finders Approval Order. FINRA notes that the scope of permissible activities and associated regulatory requirements differ between foreign finders and foreign associates, who are registered persons of the member. See also NASD Rule 1100 (Foreign Associates).

Specifically, the proposal clarifies that:

(1) other disqualifications, not just suspensions, revocations, cancellations or bars, are subject to the rule (and the rule is not limited to orders issued by FINRA or the SEC);

(2) a member may not allow a person subject to a sanction or disqualification to "be" associated with such member in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity, not simply "remain" associated;

(3) a member may not pay any remuneration to a person subject to a sanction or disqualification, not just payments that result directly or indirectly from any securities transaction; and

(4) the rule applies to any salary, commission, profit or remuneration that the associated person might "accrue," not just "earn" during the period of a sanction or disqualification, not just suspension.

FINRA is also proposing to add a new paragraph to the rule that would expressly permit a member to pay to any person subject to a sanction or disqualification any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment. FINRA believes that these exceptions strike the correct balance by permitting certain key payments.

- Proposed Supplementary Material .01

In addition, FINRA is proposing to add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) that relates to commissions accrued by a person prior to the effective date of a sanction or

disqualification. The proposed supplementary material would permit a member to pay a person that is subject to a sanction or disqualification remuneration that the member can evidence accrued to the person prior to the effective date of the sanction or disqualification. However, a member may not pay any remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification, and any such payment or credit must comply with applicable federal securities laws. FINRA believes that adopting this new provision is necessary to address questions by the industry on a member's ability to pay commissions and other remuneration that was accrued by the person prior to a sanction or disqualification going into effect. FINRA also believes the supplementary material, together with the proposed amendments discussed above, clarify that a member may not pay trail commissions to a person that may accrue during the period of the sanction or disqualification; rather, the member can only make such payments where the member can evidence that they accrued to the person prior to the effective date of the sanction or disqualification.

D. Adoption of New General Standard – FINRA Rule 0190

In addition, FINRA is proposing to adopt a new general standard, proposed FINRA Rule 0190 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation), that is based largely on provisions of NASD IM-2420-1(a) and would provide that a member will be treated as a non-member of FINRA from the effective date of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member will be automatically reinstated to membership in FINRA at the termination of the suspension

period. FINRA believes this is consistent with the current provisions of NASD IM-2420-1(a) and should be retained in the FINRA rulebook.

E. NASD and NYSE Rules To Be Deleted

FINRA proposes to eliminate the following NASD and NYSE Rules and related interpretations because FINRA believes that proposed FINRA Rule 2040 simplifies and clarifies the meaning of such rules consistent with Section 15(a) of the Exchange Act. Specifically, NASD Rule 2410, NASD Rule 2420, NASD IM-2420-1, NASD IM-2420-2, NYSE Rule 353, NYSE Rule Interpretation 345(a)(i)/01 and NYSE Rule Interpretation 345(a)(i)/02 will be consolidated into proposed FINRA Rule 2040, providing members with one concise rule that outlines the applicable requirements for payments to non-members.

- NASD Rule 2410

NASD Rule 2410 (Net Prices to Persons Not in Investment Banking and Securities Business) prohibits payments or concessions by members to "any person not actually engaged in the investment banking or securities business."

- NASD Rule 2420

NASD Rule 2420 (Dealing with Non-Members) generally prohibits members from dealing with, or making payments to, non-member broker-dealers, except at the same prices, fees or concessions offered to the general public. NASD Rule 2420(b) specifically prohibits members from joining any non-member broker-dealer syndicate or group in connection with the sale of securities. NASD Rule 2420(c) provides that members may pay concessions and fees to a non-member broker or dealer in a foreign country who is not eligible for membership, provided the member obtains an agreement

from such foreign broker or dealer in making sales of securities within the United States that such foreign broker or dealer will act in accordance with the general requirements of the rule to prohibit the payment of concessions or discounts to non-members that are not allowed to the general public. NASD Rule 2420(d) provides restrictions on payments by or to persons that have been suspended or expelled.

- NASD IM-2420-1

NASD IM-2420-1 (Transactions between Members and Non-Members) provides certain exemptions from the general prohibition on arrangements with non-members set forth in NASD Rule 2420. For example, the rule provides exemptions for arrangements with certain non-members relating to transactions in "exempted securities," or transactions on a national securities exchange. The rule further clarifies that a firm that is suspended or expelled from FINRA membership, or whose registration is revoked by the SEC, is to be considered a non-member for purposes of the rule.

- NASD IM-2420-2

NASD IM-2420-2 (Continuing Commissions Policy) allows members to pay continuing commissions to former registered representatives after they cease to be employed by a member, if, among other things, a bona fide contract between the member and the registered representative calling for the payments was entered into in good faith while the person was a registered representative of the employing member. The rule states that such contracts cannot permit the solicitation of new business or the opening of new accounts by persons who are not registered, and must conform with all applicable laws and regulations. The rule also provides that NASD Rule 2830(c) (Investment Company Securities, Conditions for Discounts to Dealers) should not be interpreted to

require a sales agreement for a dealer to receive commissions on direct payments by clients or automatic dividend reinvestments. The rule further contains a prohibition on the payment of any kind by a member to any person who is not eligible for FINRA membership or eligible to be associated with a member because of any disqualification, such as revocation, expulsion or suspension that is still in effect. The rule recognizes the validity of contracts entered into in good faith to allow retired representatives to receive continuing compensation on their accounts or to designate a widow or other beneficiary; however, the rule states that members are not required to enter into such contracts and FINRA will not specify the terms of such contracts.

- NYSE Rule 353

NYSE Rule 353 (Rebates and Compensation) prohibits a member, principal executive, registered representative or officer from, directly or indirectly, rebating to any person any part of the compensation he receives from the solicitation of orders for the purchase or sale of securities or other similar instruments for the accounts of customers of the member, or pay such compensation, or any part thereof, as a bonus, commission, fee or other consideration for business sought or procured for him or for any other member. NYSE Rule 353(b) further provides that a member, principal executive, registered representative or officer cannot be compensated for business done by or through his employer after the termination of his employment except as may be permitted by the NYSE.

- NYSE Rule Interpretations 345(a)(i)/01 and /02

NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) prohibits a member from paying to non-registered persons compensation based

upon the business of customers they direct to the member if such compensation is, among other things, formulated as a direct percentage of commissions generated and is other than on an isolated basis.

NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations) provides that a member that is also registered with the SEC as an investment adviser may enter into arrangements that comply with Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The effective date will be no later than 240 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 Exchange Act,[17] 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 current NASD and NYSE rules relating to payments to unregistered persons for adoption as FINRA Rules in the new Consolidated FINRA Rulebook. Specifically, proposed FINRA Rule 2040(a) expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation; proposed FINRA Rule 2040(b) codifies existing FINRA guidance on the payment by members of continuing

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[17] 15 U.S.C. 78o–3(b)(6).

commissions to retiring registered representatives consistent with SEC guidance in this area; and proposed FINRA Rule 2040(c) adopts the foreign finders provisions of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 with technical changes. Proposed amendments to FINRA Rule 8311 eliminate duplicate provisions in NASD IM-2420-2 and clarify the scope of the rule on payments by members to persons subject to sanctions.

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. FINRA believes the proposed rule change is consistent with Section 15(a) of the Exchange Act and its related guidance, and will promote the goal of clarity concerning the rules applicable to payments of transaction-based compensation to unregistered persons. Specifically, the proposed rule change will clarify and streamline current NASD and NYSE rules relating to payments to unregistered persons for adoption as FINRA Rules in the new Consolidated FINRA Rulebook. Proposed FINRA Rule 2040(a) expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation; proposed FINRA Rule 2040(b) codifies existing FINRA guidance on the payment by members of continuing commissions to retiring registered representatives consistent with SEC guidance in this area; and proposed FINRA Rule 2040(c) adopts the foreign finders provisions of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 with technical changes.

As the proposed rule change aligns FINRA's requirements with the requirements of Section 15(a) of the Exchange Act, FINRA believes that the proposed rule change is appropriately tailored to minimize the burden and cost of complying with the proposed rule change. Moreover, FINRA believes that any burden from the proposal will be minimal because, while the proposal streamlines the current rule to make it more concise, the obligation of firms to analyze payment arrangements for compliance with Section 15(a) of the Exchange Act is not new. In addition, proposed Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 aims to assist compliance efforts by firms by providing guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. Proposed Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) to FINRA Rule 8311 also provides guidance to firms regarding permissible payments.

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

The proposed rule change was published for comment in Regulatory Notice 09-69 (December 2009) ("Notice"). Seven comment letters were received in response to the Notice.[18] A copy of the Notice is attached as Exhibit 2a. A list of the comment letters

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[18] See comment letters from Everarado Vidaurri, Chief Executive Officer, Intercam Securities, Inc., received January 21, 2010 ("Intercam"); Jorge Ramos, President, Monex Securities, to Marcia E. Asquith, Corporate Secretary, FINRA, dated January 29, 2010 ("Monex"); Daniel E. LeGaye, The LeGaye Law Firm P.C., received February 1, 2010 ("LeGaye Law"); Peter J. Chepucavage, Executive Director, CFAW, General Counsel, Plexus Consulting LLC, on behalf of the

received in response to the Notice is attached as Exhibit 2b. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c. Below is a summary of the comments and FINRA's responses.

Most commenters appreciated the intent of the proposed rule change to more directly align the rules on payments made by FINRA members to unregistered persons with SEC positions regarding broker-dealer registration requirements. However, the commenters had concerns with a number of the proposed changes. Specifically, the comments focused on the following issues: (a) the proposed deletion of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to payments to foreign finders; (b) the proposed adoption of FINRA Rule 2040(b) to replace NASD IM-2420-2 (Continuing Commissions Policy); (c) the proposed deletion of NASD Rule 2420(c) relating to transactions with foreign non-members; (d) the proposed deletion of NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations); (e) the potential regulatory burden of obtaining SEC no-action letters to determine whether particular activities would require registration as a broker-dealer; (f) the concern that the proposal does not recognize state law statutory exemptions for the payment of compensation in limited circumstances; and (g) the proposed amendments to FINRA Rule 8311 regarding payments to sanctioned persons.

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International Association of Small Broker-Dealers and Advisers, received February 1, 2010 ("Plexus"); Cliff Kirsch and Eric Arnold, Sutherland Asbill & Brennan LLP for The Committee of Annuity Insurers, to Marcia E. Asquith, Corporate Secretary, FINRA, dated February 1, 2010 ("CAI"); Ethan W. Johnson, Partner, Morgan, Lewis & Bockius LLP, to Marcia E. Asquith, Corporate Secretary, FINRA, dated February 1, 2010 ("Morgan Lewis"); and Rex A. Staples, General Counsel, North American Securities Administrators Association, Inc., to Marcia E. Asquith, Corporate Secretary, FINRA, dated February 16, 2010 ("NASAA").

As further discussed below, in light of the comments, FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 to provide guidance to members regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. FINRA is also proposing to retain NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 relating to foreign finders as proposed FINRA Rule 2040(c).

(a) Foreign Finders (Proposed Deletion of NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03)

In the Notice, FINRA proposed deleting NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 ("Existing Foreign Finders Rules"), which permit members to pay transaction-based compensation to non-registered foreign finders under specified conditions. The Notice indicated that these largely identical rules would be deleted and the activity would be subject to the general requirement in proposed FINRA Rule 2040(a) that would require firms to look to SEC rules and regulations to determine whether the activity in question requires registration as a broker-dealer under Section 15(a) of the Exchange Act. Six commenters raised concerns regarding the proposed deletion of these rules and argued strongly that FINRA retain the Existing Foreign Finders Rules.[19] Specifically, the commenters stated that the proposed elimination of these rules would harm U.S. business by reducing competitiveness and that SEC guidance in this area is not

[19] See Intercam, Monex, LeGaye Law, Plexus, Morgan Lewis and NASAA.

clear and, therefore, the conditions set forth in the Existing Foreign Finders Rules provide necessary clarity to the industry.[20]

- Harm Business/Reduce Competitiveness

Several commenters expressed concern regarding the potential harm to current business models if NASD Rule 1060(b) is eliminated.[21] One commenter stated that foreign "finders provide an important and necessary service in that they have introduced foreign customers to U.S. markets, which is consistent with the transition of the financial markets to be international in nature."[22] Another commenter stated that the proposed elimination of the standard established by the NASD and NYSE rules "may reduce the competitiveness of FINRA members outside the United States."[23] The commenter further stated that the rules present low risk to the securities markets and investors because, according to the commenter, "the sole involvement of the referring foreign person is to make a referral to the member firm or to obtain execution, clearing or settlement services from such member and they do not permit broader contact with U.S. persons."[24] Another commenter noted that the main activity in Miami and South Florida is to provide International Private Banking Services in the U.S. to non-U.S. citizens, primarily domiciled in Latin America, and elimination of the rules would "have a very

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20 See supra note 19.

21 See Intercam, Monex, LeGaye Law and Morgan Lewis.

22 See Monex.

23 See Morgan Lewis.

24 See Morgan Lewis. As noted above, if a foreign finder's activities go beyond an initial referral of non-U.S. customers to the member, the foreign finders provisions in proposed FINRA Rule 2040(c) would not be applicable.

negative impact in our industry, our labor market and to the US economy as a whole."[25] This commenter believed the proposal to eliminate the Existing Foreign Finders Rules would destroy completely the business model in which firms have been operating under for many years under NASD Rule 1060(b). Two commenters noted that foreign finders provide a valuable service to firms because they have an integral knowledge of their customers that are referred to firms, including suitability and investment needs.[26]

- SEC Guidance Relating to Foreign Finder Relationships is Not Clear

Four commenters noted that the SEC's position on payments to foreign finders is not clear, and as such, will result in additional confusion for regulatory compliance professionals and members.[27] One commenter stated "that SEC rules and staff interpretations in this area are sparse and fact specific and do not give adequate guidance on the question when a non U.S. person is required to register with the SEC as a broker-dealer as a result of a relationship with a U.S. member firm."[28] Two commenters noted that SEA Rule 15a-6 does not contemplate a foreign broker-dealer introducing its non-U.S. customers to a member to make recommendations and effect transactions on behalf of the customers, while simultaneously paying the foreign broker-dealer compensation for such referral.[29]

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25 See Monex.

26 See Monex and LeGaye Law.

27 See Intercam, Monex, LeGaye Law and Morgan Lewis.

28 See Morgan Lewis.

29 See Monex and LeGaye Law.

Several commenters urged FINRA to work with the SEC to develop comprehensive guidance on this matter.[30] One commenter noted that the existing framework provides adequate protection to referred clients in the forms of additional disclosure mandated by the existing rules.[31] Other commenters noted that foreign finders are subject to regulation in their respective countries.[32] One commenter recommended that FINRA "ask that the [C]ommission clarify its position including the numerous no-action letters issued over the last 30 years … it would help the investment community understand the current status of the issue and may inform the [C]ommission as to how widespread a problem exists."[33]

- Existing Foreign Finders Rules Provide Necessary Clarity

Several commenters expressed concern that the proposed elimination of the Existing Foreign Finders Rules would eliminate rules that the industry has relied on for decades to pay transaction-based compensation to foreign finders.[34] One commenter stated that the Existing Foreign Finders Rules have "generally allowed FINRA members, under the enumerated conditions, to pay transaction-based compensation to a non-U.S. finder that solicits non-U.S. business for the member."[35] The same commenter further stated that "there were a number of critical components that had to be met with respect to

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30 See Monex, LeGaye Law and Morgan Lewis.

31 See Morgan Lewis.

32 See Monex and LeGaye Law.

33 See Plexus.

34 See Intercam, Monex, Morgan Lewis and LeGaye Law.

35 See Monex.

the rule, two of the fundamental conditions with respect to the payment of compensation to a foreign finder was: (1) that the foreign finder limit its activities so that the finder was not required to register in the U.S. as a broker-dealer; and (2) that the compensation arrangement not violate applicable foreign law." As a result, the commenter contended that "FINRA member firms should be able to rely on clear guidance with respect to these activities, and the current rules gave that guidance to members."[36] Another commenter stated that "the existing rules with respect to foreign referrals and dealing with non-member firms are helpful and provide adequate protection to foreign customers that are referred to FINRA members."[37]

- FINRA Response to Comments on Existing Foreign Finders Rules

In response to the commenters' concerns, FINRA is proposing to adopt the Existing Foreign Finders Rules, with minor technical changes, as new FINRA Rule 2040(c) in the Consolidated FINRA Rulebook. As in the current rule, a member could pay transaction-related compensation to non-registered foreign finders where the finders' sole involvement is the initial referral to the member of non-U.S. customers to the member, and the member complies with all the conditions set forth in the rule.

(b) Continuing Commission Payments to Retiring Registered Representatives (Proposed FINRA Rule 2040(b)(2))

Proposed Rule 2040(b)(2) would permit FINRA members to pay continuing commissions to retiring registered representatives of the member after they cease to be associated with the member provided that (1) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in

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36 See supra note 35.

37 See Morgan Lewis.

good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and (2) the arrangement complies with applicable federal securities laws, SEA rules and regulations. In the Notice, the proposed rule included text that provided that the arrangement also must comply with "published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations." Based on concerns raised by commenters described hereinafter, FINRA has deleted this language from the proposed rule text in this rule filing.[38] However, FINRA believes that members should review applicable SEC staff guidance in the form of releases, no-action letters and interpretations because they contain helpful interpretative information regarding the SEC staff's views on the application of SEA rules and regulations.

One commenter stated it is unclear whether the proposal is intended to add any substantive restrictions or requirements, or if it merely forbids members from making payments that are already otherwise prohibited.[39] The commenter noted that FINRA members are already subject to SEC rules and regulations, so FINRA rules containing blanket references to SEC rules and published guidance is problematic, especially when SEC guidance is extremely fact specific. The commenter further states "such positions do not allow for the notice and comment period that accompanies formal rulemaking and,

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38 See CAI.

39 See supra note 38.

would in effect give such positions the force and effect of a rule."[40] The same commenter further requested clarification from FINRA that a retiring registered representative who receives compensation payable under a group variable annuity contract may receive compensation on individuals who become certificate holders under such contract after the registered representative has retired.

Another commenter raised concerns regarding the open-ended nature of this provision.[41] The commenter expressed concern regarding the extent of hidden fee arrangements between shadow parties who trade consumers' accounts and questioned, "[h]as there been consideration as to potential trigger points wherein these types of post 'retirement' payment pose potential and/or actual conflicts of interest, the dangers to the underlying account holder whose assets are being used to generate fees that are split by multiple parties, and is full disclosure to consumers being provided?"[42]

FINRA believes that the SEC guidance in this area combined with current FINRA guidance are accurately summarized in the proposal and, as such, declines to make any substantive changes to the proposal. Guidance regarding the permissibility of payments to retiring registered representatives primarily focuses on compliance with Section 15(a) of the Exchange Act. In November 2008, the staff of the Division of Trading and Markets of the Commission issued a no-action letter in which it stated that it would "not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 against a retiring representative of a registered broker-dealer

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40 See supra note 38.

41 See NASAA.

42 See supra note 41.

("Firm") if the retiring representative, the Firm, and the receiving representative, comply with the terms and conditions described in [the] letter, without the retiring representative maintaining his or her status as a registered associated person of the Firm upon retirement."[43] The no-action letter was based on the use of procedures described in the letter with respect to the circumstances by which a retiring representative may be compensated after the termination of employment for business done by or through his or her employer before the termination of employment. The staff of the Division of Trading and Markets has issued several other prior no-action letters regarding payments to retiring registered representatives.[44]

Consistent with such SEC no-action letters, FINRA has issued guidance in the form of interpretative letters under NASD IM-2420-2 that specifically notes that members need to be aware of SEC no-action letters that address the conditions under which a former, retired registered representative, who is no longer employed by a broker-dealer, may continue to receive commissions without being required to register as a broker-dealer under Section 15 of the Exchange Act.[45] Such FINRA interpretative letters have expressly stated that "[t]he determination of whether a person should be registered as a broker/dealer rests with the Securities and Exchange Commission (the "SEC"). In this regard, [the firm] may wish to direct [its] inquiry to the SEC's Division of [Trading

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43 See supra note 10.

44 See SEC No-Action Letters: Gruntal & Co., L.L.C., 1998 SEC No-Act. LEXIS 1146, October 14, 1998, Prudential Securities Incorporated, 1994 SEC No-Act. LEXIS 750, October 11, 1994 and Shearson Lehman Brothers Inc., 1993 SEC No-Act. LEXIS 548, March 25, 1993.

45 See supra note 9.

and Markets] for guidance. To the extent that [the member] receives no-action relief from the SEC to make such payments, [the member's] payment of continuing commissions to [the retiring registered representative] would not violate NASD Rule 2420 so long as the requirements of NASD IM-2420 are satisfied."[46]

(c) Transactions with Foreign Non-Members (Proposed Deletion of NASD Rule 2420(c))

NASD Rule 2420(c) generally provides that payments can be made to any non-member broker-dealer in a foreign country who is not eligible for membership in a registered securities association provided that, in any transaction with any such non-member broker-dealer where a selling concession, discount, or other allowance is allowed, the member making the payment secures from the foreign broker-dealer an agreement that, in making any sales to purchasers within the U.S. of securities acquired as a result of such transactions, the foreign broker-dealer will comply with paragraphs (a) and (b) of NASD Rule 2420 to the same extent the member must in connection with the transaction.

One commenter stated that "while the rule does not expressly address the relationship between U.S. clearing firms and their non-U.S. correspondents, it is frequently cited as confirmation that the FINRA rules permit members to enter into a variety of clearing and sub-clearing agreements and other brokerage arrangements with foreign non-members and to share fees or pay other forms of compensation without requiring the foreign firms or their personnel to register with the SEC.[47] The same commenter recommended that NASD Rule 2420(c) be retained in its current form, but

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46 See supra note 9.

47 See Morgan Lewis.

suggested one clarification whereby the "eligible for membership in a national securities association" is changed to "not being required to be a registered broker-dealer in the United States and member of a national securities association," because the commenter believed it is difficult to determine when a foreign firm would not be eligible for membership and further eligibility is not a relevant determinant of whether a foreign firm should register. In the alternative, assuming the Existing Foreign Finders Rules and NASD Rule 2420(c) are not retained in their current forms, the same commenter recommended the following changes to the proposed rule text: (i) eliminate "or offer to pay" from the introductory clause in paragraph (a) since determining whether and when an offer to pay has been made would add a level of subjectivity that would undercut the effort to bring clarity to this area; (ii) eliminate "appropriately" from the beginning of paragraph (a)(2) as a requirement in the paragraph will need to be satisfied even if the person is "inappropriately" registered (if, according to the commenter, that is even possible); and (iii) narrow the scope of the pre-conditions in paragraph (a)(2) to just those of verifying that the person is registered and not subject to any statutory disqualifications, as the burden of checking all the laws, rules and regulations cited in the proposed rule will be a strong disincentive against members ever making such payments.[48]

FINRA declines to retain NASD Rule 2420(c) because, as discussed in detail above, proposed FINRA Rule 2040(a) expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for persons to receive transaction-related compensation. In this regard, FINRA notes the commenter's suggestion that, if FINRA were to retain NASD Rule

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[48] See supra note 47.

2420(c), FINRA should replace the phrase "eligible for membership in a national securities association" with "not being required to be a registered broker-dealer in the United States and member of a national securities association." FINRA believes that proposed FINRA Rule 2040(a) is consistent with such recommendation. FINRA further does not agree with the commenter's implication that NASD Rule 2420(c) can validly be used as confirmation that FINRA rules permit members to enter into a variety of brokerage arrangements with foreign non-members and to share fees or pay other forms of compensation without requiring the foreign firms or their personnel to register with the SEC. FINRA is considering guidance on circumstances where such arrangements may comply with FINRA rules.

FINRA also declines to eliminate the word "appropriately" and to narrow the scope of the pre-conditions in proposed FINRA Rule 2040(c) to require that the member only determine that a person receiving transaction-related compensation is registered and not subject to any statutory disqualification because FINRA believes that members need to determine that the person receiving the transaction-related compensation is registered in the appropriate category necessary to receive the type of compensation being paid, and that the payments are permissible under applicable laws, consistent with SEC guidance in this area. In response to the commenter, however, FINRA is proposing to eliminate the phrase "or offer to pay" from proposed FINRA Rule 2040(a) as it agrees that the language may add uncertainty and subjectivity to the proposed rule and is not needed to achieve the regulatory purpose of the proposed rule.

(d) Compensation Paid for Advisory Solicitations (Proposed Deletion of NYSE Rule Interpretation 345(a)(i)/02)

One commenter stated "there has been substantial confusion related to the regulation of broker-dealers and investment advisers that were dually registered with the SEC ("Dual Registrants") in recent history."[49] The commenter stated that members face uncertainty where definitions or guidelines differ between the Investment Advisers Act and the Exchange Act, and by proposing to eliminate NYSE Rule Interpretation 345(a)(i)/02, FINRA is creating further confusion for Dual Registrants. NYSE Rule Interpretation 345(a)(i)/02[50] generally provides that a broker-dealer that is registered with the SEC as an investment adviser under the Investment Advisers Act may enter into arrangements that comply with Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act, and that such arrangements will not be deemed contrary to the registration requirements of NYSE Rule 345.[51] The commenter stated, for example, that while Rule 206(4)-3 of the Investment Advisers Act allows for the cash payment to a

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49 See LeGaye Law.

50 NYSE Rule Interpretation 345/(a)(i)/02 (Compensation Paid for Advisory Solicitations) reads as follows: "A member organization, registered with the SEC as an investment adviser, may enter into any arrangement that fully complies with Rule 206(4)-3 ("Cash Payments for Client Solicitations") of the Investment Advisers Act of 1940. Such arrangements will not be deemed contrary to the registration requirements of Rule 345 (see also Rule 10 "Definition of Registered Representative"). Member organizations are advised to check on the applicability of any state registration requirements for member organizations and associated persons."

51 See Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act, which generally makes it unlawful for any investment adviser that is required to be registered under the Investment Advisers Act to pay a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities unless certain specified conditions are met.

solicitor under certain circumstances, the proposal would require the payment to comply with all applicable federal securities laws, including FINRA rules.[52]

FINRA does not believe that it is necessary to retain the content of NYSE Rule Interpretation 345(a)(i)/02. It is FINRA's view that proposed FINRA Rule 2040 does not narrow the scope of Rule 206(4)-3 under the Investment Advisers Act, which applies to cash payments by investment advisers for client solicitations for advisory business. Where Rule 206(4)-3 payments to an investment adviser by a dually registered broker-dealer do not require the solicitor to register under Section 15(a) of the Exchange Act, proposed FINRA Rule 2040 would continue to permit them. The question of whether activities permissible under Rule 206(4)-3 under the Investment Advisers Act would require the solicitor to be registered as a broker-dealer under Section 15(a) of the Exchange Act is determined by the SEC.[53]

(e) Burden of Obtaining SEC No-Action Relief

Two commenters raised concerns regarding the requirement in proposed FINRA Rule 2040 to look to SEC no-action letters to determine compliance with Section 15(a) of the Exchange Act.[54] Specifically, one commenter stated "FINRA is placing additional regulatory uncertainty on FINRA member firms and further hampering their efforts to

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52 See supra note 49.

53 See Mayer Brown LLP, 2008 SEC No-Act. LEXIS 515, July 15, 2008 and Response of the Office of Chief Counsel, Division of Investment Management, 2008 SEC No-Act. LEXIS 524, July 28, 2008, which state that "[Firm has] not asked, and this letter does not address, whether a person's receipt of cash compensation from an investment adviser of an investment pool for soliciting or referring investors or prospective investors to invest in the pool would result in the person being considered a "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934."

54 See Monex and LeGaye Law.

obtain meaningful compliance."[55] Several commenters were concerned that it will be expensive and cumbersome to seek no-action relief and such no-action relief would be subject to continuous revision.[56] In addition, one commenter raised concerns that since there is no "reasonable belief" standard for reliance on specific SEC no-action relief, members will need to hire attorneys to support their positions that the SEC rules, regulations and other guidance are applicable to their arrangement.[57] Moreover, the commenter stated that the SEC has declined to consider the matter in prior no-action letters, noting that the SEC does not as "a matter of practice," provide no-action relief in this context and questioned how a firm can meaningfully comply with the proposed rule.[58]

FINRA believes that interpretation of Section 15(a) of the Exchange Act is a critical component in determining whether payments to unregistered persons are permissible under the federal securities laws. FINRA acknowledges that while Section 15(a) of the Exchange Act does not specifically address the numerous and varying arrangements that may exist with respect to payments to unregistered persons, SEC guidance is controlling in this area.

As described in Item 3 above, FINRA is proposing to adopt Supplementary Material .01 (Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act) to proposed FINRA Rule 2040 to provide guidance to members

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55 See Monex.

56 See Monex, LeGaye Law, Morgan Lewis and NASAA.

57 See supra note 55.

58 See supra note 55.

regarding the manner in which they can reasonably support a determination that an unregistered person is not required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member and the activities related thereto. Members can derive support for their determination by, among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action letter from the Commission staff; or (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area. The member's determination must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

(f) Proposal Does Not Recognize State Law Exemptions

One commenter expressed concern that the proposal does not address those FINRA members that engage in primarily an intra-state business, and the state of their domicile recognizes statutory exemptions for the payment of compensation in limited circumstances for certain finders.[59] FINRA acknowledges that state rules and regulations may permit different types of payment arrangements, and where such payments are permissible under the federal securities laws and SEC rules, regulations or guidance, such payments would be in compliance with proposed FINRA Rule 2040.

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[59] See LeGaye Law.

(g) Payments to Sanctioned Persons (FINRA Rule 8311)

The proposed rule change prohibits FINRA members from allowing persons subject to suspension, revocation, cancellation of registration, bar from association with a member or other disqualification to be associated with the member in any capacity inconsistent with the sanction. The proposal also would prohibit payment to a person during the period of sanction or anytime thereafter if the payment might accrue during the time of sanction.

One commenter believed the proposal is unclear as to whether registered representatives subject to sanctions would be permitted to continue to receive compensation earned as a result of automatic payments to a variable annuity contract made during the period of sanction.[60] The commenter recommended that registered representatives be permitted to receive these automatic payments, where such payments were arranged for during a time period that preceded the sanctions.

FINRA believes that proposed Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) to FINRA Rule 8311 addresses this question. Proposed Supplementary Material .01 provides that a member can pay or credit a person subject to a sanction salary, commission, profit or other remuneration that the member can evidence accrued to the person prior to the effective date of the sanction, unless such remuneration relates to results from the activity giving rise to the sanction. Accordingly, a member would need to demonstrate that the remuneration accrued prior to the effective date of the sanction in order to pay or credit the remuneration to the sanctioned individual.

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60 See CAI.

The commenter also requested that FINRA clarify that the sanctions identified under the proposal do not in any way impact the current FINRA rules and guidance regarding registered representatives who are deemed to be "inactive" due to failure to complete the regulatory element of continuing education requirements in a timely manner under NASD Rule 1120 (now FINRA Rule 1250).[61] FINRA notes that the proposal is not intended to alter existing guidance under FINRA Rule 1250 with respect to registered representatives who are deemed to be "inactive" due to failure to complete the regulatory element of continuing education requirements in a timely manner.

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

Within 45 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 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 or disapprove 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:

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61 The SEC approved the adoption of NASD Rule 1120 (Continuing Education Requirements) as new FINRA Rule 1250 (Continuing Education Requirements), subject to certain amendments, effective on October 17, 2011. See Securities Exchange Act Release No. 64687 (June 16, 2011); 76 FR 36586 (June 22, 2011) (Order Approving File No. SR-FINRA-2011-013).

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-2014-037 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2014-037. 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 website (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 website viewing and printing 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-2014-037 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.[62]

Secretary

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62 17 CFR 200.30-3(a)(12).

# Regulatory Notice 09-69

# Payments to Unregistered Persons

## FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Payments to Unregistered Persons

**Comment Period Expires: February 1, 2010**

## Executive Summary

As part of the process to develop a new consolidated rulebook (the Consolidated FINRA Rulebook),[1] FINRA is requesting comment on a proposed FINRA rule regarding payments to unregistered persons. Proposed FINRA Rule 2040 (Payments to Unregistered Persons) would be a new consolidated rule that streamlines the provisions of current:

- NASD Rule 1060(b) (Persons Exempt from Registration); Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business); Rule 2420 (Dealing with Non-Members); IM-2420-1 (Transactions Between Members and Non-Members); and IM-2420-2 (Continuing Commissions Policy);
- NYSE Rule 353 (Rebates and Compensation); NYSE Rule Interpretations 345(a)(i)/01 (Compensation to Non-Registered Persons); /02 (Compensation Paid for Advisory Solicitations); and /03 (Compensation to Non-Registered Foreign Persons Acting as Finders); and
- FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation, or Bar).

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

Questions concerning this *Notice* should be directed to Kosha K. Dalal, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-6903.

**December 2009**

### Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

### Suggested Routing

- Compliance
- Executive Representatives
- Legal
- Registered Representatives
- Registration
- Senior Management

### Key Topics

- Broker-Dealer Registration
- Compensation
- Disqualification
- Retiring Registered Representative
- Sanctions

### Referenced Rules & Notices

- FINRA Rule 8311
- Information Notice 03/12/08
- NASD Rule 1060(b)
- NASD Rule 2410
- NASD Rule 2420
- NASD IM-2420-1
- NASD IM-2420-2
- NYSE Rule 353
- Regulatory Notice 09-34

FINRA
Financial Industry Regulatory Authority

## Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by February 1, 2010.

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

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

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

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

## Important Notes

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

## Background

NASD Rules 1060(b) (Persons Exempt from Registration); 2410 (Net Prices to Persons Not in Investment Banking or Securities Business); 2420 (Dealing with Non-Members); IM-2420-1 (Transactions Between Members and Non-Members); and IM-2420-2 (Continuing Commissions Policy (collectively, the NASD Non-Member Rules)) govern payments by members to unregistered persons. These NASD Non-Member Rules were developed in an era when a registered broker-dealer could engage in an over-the-counter securities business and elect whether to be a member of a registered securities association.[4] An original purpose of the NASD Non-Member Rules was to encourage

non-members to become members by generally prohibiting members from providing commissions or discounts/concessions to non-members.[5] Since the adoption of these NASD Non-Member Rules, the laws governing broker-dealers have changed, and today virtually all broker-dealers doing business with the public are FINRA members.[6]

As a result, FINRA has generally interpreted the provisions of the NASD Non-Member Rules, through interpretive letters and other guidance, to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer.[7] FINRA has refrained from opining whether a person is acting as an unregistered broker-dealer, as the authority to interpret Section 15(a) of the Exchange Act rests with the SEC. Section 15(a)(1) of the Exchange Act generally requires any broker-dealer effecting transactions in securities to be registered with the SEC. Registration as a broker-dealer provides a framework of rules to regulate the conduct of persons who receive transaction-based compensation, the receipt of which can create potential incentives for abusive sales practices. SEC guidance states that receipt of securities transaction-based compensation is an indication that a person is engaged in the securities business and that such person generally should be registered as a broker-dealer.[8]

## Proposal

### Proposed FINRA Rule 2040

FINRA is proposing to establish new FINRA Rule 2040 (Payments to Unregistered Persons), which eliminates the current NASD Non-Member Rules and related NYSE Non-Member Rules (discussed further below) and replaces them with a more straightforward rule. The proposed rule expressly aligns with Section 15(a) of the Exchange Act and its related guidance to determine whether registration as a broker-dealer is required for certain persons to receive transaction-related compensation. The proposed rule sets forth the following requirements:

- Payments to Unregistered Persons

FINRA is proposing to establish new FINRA Rule 2040(a), which prohibits members or associated persons from, directly or indirectly, paying or offering to pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments, is required to be so registered under applicable federal securities laws and SEC rules, regulations and published guidance by the SEC or its staff in the form of releases, no-action letters or interpretations; or

(2) any appropriately registered associated person, unless such payment complies with all applicable federal securities laws, FINRA rules and SEC rules, regulations and published guidance by the SEC or its staff in the form of releases, no-action letters or interpretations.

The proposed change makes the rule consistent with FINRA staff interpretations under NASD Rule 2420 and SEC rules and regulations under Section 15(a) of the Exchange Act. The proposal also aligns the rule with SEC staff guidance that states that receipt of certain securities transaction-based compensation requires registration as a broker-dealer. Therefore, under the proposal, persons would look to SEC rules and regulations to determine whether the activities in question require registration as a broker-dealer under Section 15(a) of the Exchange Act. In cases where a member represents that the proposed activities would not require the recipient of the payments to register as a broker-dealer, and can support such position through SEC rules, regulations or other guidance, such as a no-action letter, the proposed rule does not prohibit the member from making the payments to such person.

The proposed change also clarifies that payments to associated persons are not prohibited by this rule where such payments are otherwise permissible.

➤ Retiring Representatives

FINRA is also proposing to establish new FINRA Rule 2040(b), which codifies existing FINRA staff guidance on the payment by members of continuing commissions to retiring registered representatives. The proposal permits members to pay continuing commissions to retiring registered representatives of the member, after they cease to be employed by the member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided (1) a bona fide contract between the member and the retiring registered representative calling for the payments was entered into in good faith while the person was a registered representative of the employing member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts or servicing the accounts generating the continuing commission payments; and (2) the arrangement complies with applicable SEC rules, regulations and published guidance by the SEC or its staff.

The proposal defines the term "retiring registered representative" to mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. In the case of the death of the retiring registered representative, the retiring representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreements with the deceased representative.

FINRA believes this proposal is consistent with SEC guidance on the payment of compensation to retiring representatives.[9]

## Amendments to FINRA Rule 8311

FINRA is proposing amendments to FINRA Rule 8311 to eliminate duplicative provisions in NASD IM-2420-2 and to clarify the scope of the rule on payments by members to persons subject to suspension, revocation, cancellation, bar (each a "sanction") or other disqualification. The proposed rule provides that if a person is subject to a sanction or other disqualification, a member may not allow such person to be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. The proposed rule further provides that a member may not pay or credit to a person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any remuneration that the person might have accrued during the period of the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or to a disqualified person that has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

Specifically, the proposal clarifies that:

(1) other disqualifications, not just suspensions, revocations, cancellation or bars are subject to the rule (and the rule is not limited to orders issued by FINRA or the SEC);

(2) a member may not allow a person subject to a sanction or disqualification to "be" associated with such member in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity, not simply "remain" associated;

(3) a member may not pay any remuneration to a person subject to a sanction or disqualification, not just payments that result directly or indirectly from any securities transaction; and

(4) the rule applies to any salary, commission, profit or remuneration that the associated person might have "accrued," not just "earned" during the period of a sanction or disqualification, not just suspension.

FINRA is also proposing to add a new paragraph to the rule that would expressly permit a member to pay to any person subject to a sanction or disqualification any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment. FINRA believes that these exceptions strike the correct balance by permitting certain key payments.

In addition, FINRA is proposing to add new Supplementary Material .01 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) that relates to commissions accrued by a person prior to the effective date of a sanction or disqualification. The proposed supplementary material would permit a member to pay a person that is subject to a sanction or disqualification remuneration that the member can evidence accrued to the person prior to the effective date of the sanction or disqualification. However, a member may not pay any remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification. FINRA believes that adopting this new provision is necessary to address questions by the industry on a member's ability to pay commissions and other remuneration that was accrued by the person prior to sanction or disqualification going into effect. FINRA also believes the supplementary material, together with the proposed amendments discussed above, clarify that a member may not pay trail commissions to a person that may have accrued during the period of the sanction or disqualification; rather, the member can only make such payments where the member can evidence that they accrued to the person prior to the effective date of the sanction or disqualification.

### Adoption of New General Standard

In addition, FINRA is proposing to adopt a new general standard that is based largely on provisions of NASD IM-2420-1 and would provide that a member will be treated as a non-member of FINRA from the effective date of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member will be automatically reinstated to membership in FINRA at the termination of the suspension period. FINRA believes this is consistent with the current provisions of IM-2420-1 and should be retained in the FINRA rulebook.

## NASD and NYSE Rules To Be Deleted

FINRA proposes to eliminate the following NASD and Incorporated NYSE Rules and related interpretations:

- NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03

NASD Rule 1060(b) (Persons Exempt from Registration) and NYSE Rule Interpretation 345(a)(i)/03 (Compensation to Non-Registered Foreign Persons Acting as Finders) are identical provisions and provide that member firms and persons associated with a member may pay transaction-related compensation to non-registered foreign finders, based upon the business of customers such persons direct to member firms, subject to certain conditions (foreign finder exemption).

- NASD Rule 2410

NASD Rule 2410 (Net Prices to Persons Not in Investment Banking and Securities Business) prohibits payments or concessions by members to "any person not actually engaged in the investment banking or securities business."

- NASD Rule 2420

NASD Rule 2420 (Dealing with Non-Members) generally prohibits members from dealing with, or making payments to, non-member broker-dealers, except at the same prices, fees or concessions offered to the general public. NASD Rule 2420(b) specifically prohibits members from joining any non-member broker-dealer syndicate or group in connection with the sale of securities. NASD Rule 2420(c) provides that members may pay concessions and fees to a non-member broker or dealer in a foreign country who is not eligible for membership, provided the member obtains an agreement from such foreign broker or dealer in making sales of securities within the United States that such foreign broker or dealer will act in accordance with the general requirements of the rule to prohibit the payment of concessions or discounts to non-members that are not allowed to the general public. NASD Rule 2420(d) provides restrictions on payments by or to persons that have been suspended or expelled.

- NASD Rule IM-2420-1

NASD IM-2420-1 (Transactions between Members and Non-Members) provides certain exemptions from the general prohibition on arrangements with non-members set forth in NASD Rule 2420. For example, the rule provides exemptions for arrangements with certain non-members relating to transactions in "exempted securities," or transactions on a national securities exchange. The rule further clarifies that a firm that is suspended or expelled from FINRA membership, or whose registration is revoked by the SEC, is to be considered a non-member for purposes of the rule.

- NASD Rule IM-2420-2

NASD IM-2420-2 (Continuing Commissions Policy) allows members to pay continuing commissions to former registered representatives after they cease to be employed by a member, if, among other things, a bona fide contract between the member and the registered representative calling for the payments was entered into in good faith while the person was a registered representative of the employing member. The rule states that such contracts cannot permit the solicitation of new business or the opening of new accounts by persons who are not registered, and must conform with all applicable laws and regulations. The rule also provides that NASD Rule 2830(c) (Investment Company Securities, Conditions for Discounts to Dealers), should not be interpreted to require a sales agreement for a dealer to receive commissions on direct payments by

clients or automatic dividend reinvestments.[10] The rule further contains a prohibition on the payment of any kind by a member to any person who is not eligible for FINRA membership or eligible to be associated with a member because of any disqualification, such as revocation, expulsion or suspension that is still in effect. The rule recognizes the validity of contracts entered into in good faith to allow retired representatives to receive continuing compensation on their accounts or to designate a widow or other beneficiary; however, the rule states that members are not required to enter such contracts and FINRA will not specify the terms of such contracts.

- NYSE Rule 353

NYSE Rule 353 (Rebates and Compensation) prohibits a member, principal executive, registered representative or officer from, directly or indirectly, rebating to any person any part of the compensation he receives from the solicitation of orders for the purchase or sale of securities or other similar instruments for the accounts of customers of the member, or pay such compensation, or any part thereof, as a bonus, commission, fee or other consideration for business sought or procured for him or for any other member. NYSE Rule 353(b) further provides that a member, principal executive, registered representative or officer cannot be compensated for business done by or through his employer after the termination of his employment except as may be permitted by the NYSE.

- NYSE Rule Interpretation 345(a)(i)/01 and /02

NYSE Rule Interpretation 345(a)(i)/01 (Compensation to Non-Registered Persons) prohibits a member from paying to non-registered persons compensation based upon the business of customers they direct to the member if such compensation is, among other things, formulated as a direct percentage of commissions generated and is other than on an isolated basis.

NYSE Rule Interpretation 345(a)(i)/02 (Compensation Paid for Advisory Solicitations) provides that a member that is also registered with the SEC as an investment adviser may enter into arrangements that comply with Rule 206(4)-3 (Cash Payments for Client Solicitations) of the Investment Advisers Act of 1940.

## 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 member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, *see Information Notice 3/12/08* (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) (NASD Announces Online Availability of Comments) for more information.

3 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. *See* Exchange Act Section 19 and rules thereunder.

4 *See* Maloney Act of 1938, Pub. L. No. 75-719, 52 Stat. 1070, which added Section 15A to the Exchange Act to provide for the establishment of national securities associations with authority, subject to SEC review, to supervise the over-the-counter securities market and promulgate rules governing voluntary membership of broker-dealers.

5 Section 15A(e)(1) of the Exchange Act states that "[t]he rules of a registered securities association may provide that no member thereof shall deal with any nonmember professional (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public." Section 15A(e)(2) of the Exchange Act defines "nonmember professional" as "(A) with respect to transactions in securities other than municipal securities, any registered broker or dealer who is not a member of a registered securities association, except such a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, and commercial bills, and (B) with respect to transactions in municipal securities, any municipal securities dealer (other than a bank or division or department of a bank) who is not a member of any registered securities association and any municipal securities broker who is not a member of any such association." The legislative reports from Congress on this provision state that exclusion from membership would in effect be a form of economic sanction on such non-members. *See* S. Rep. No. 1455 and H. R. Rep. No 2307, 75th Cong., 3rd Sess. (1938).

6 Section 15(b)(8) of the Exchange Act provides that "[i]t shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to Section 15A of this title or effects transactions in securities solely on a national securities exchange of which it is a member."

## Endnotes continued

7 *See* FINRA Interpretative Letters under NASD Rule 2420 and IM-2420-2 at *www.finra.org/interpretiveletters/conduct* to: Richard Schultz, Triad Securities Corp. (12/28/07); Jonathan K. Lagemann, Esq., Law Offices of Jonathan Kord Lagemann (6/27/01); Jay Adams Knight, Esq., Musick, Peeler & Garrett LLP (3/8/01); Kathleen A. Wieland, William Blair & Company (9/27/00); Michael R. Miller, Esq., Kunkel Miller & Hament (5/31/00); Gordon C. Ogden, III, Profinancial, Inc. (1/18/00); Trish Stone-Damen, Investors Retirement & Management Company, Inc. (1/29/99); Leslie D. Smith, Berthel Fisher & Company (12/9/98); Victoria Bach-Fink, Wall Street Financial Group (12/7/98); Brian C. Underwood, A.G. Edwards & Sons, Inc. (9/16/98); Daniel Schloendorn, Willkie Farr & Gallagher (6/18/98); David M. Katz, Sidley & Austin (9/25/97); Peter D. Koffler, Twenty-First Securities Corporation (8/20/97); Interpretive Letter to Name Not Public (4/11/97), Ted. A. Troutman, Esquire, Muir & Troutman (2/4/02); Joe Tully, Commonwealth Financial Network (8/9/01); Name Not Public (5/25/01); Peter D. Koffler, Esq., Twenty-First Securities Corporation (1/21/00); Leslie D. Smith, Berthel Fisher & Company (12/9/98), Name Not Public (12/23/96); Name Not Public (11/20/96).

8 *See, e.g.*, Birchtree Financial Services, Inc. SEC No-Action Letter (pub.avail. Sept 22, 1988); 1st Global, Inc., SEC No-Action Letter (pub.avail. May 7, 2001).

9 *See* Securities Industry and Financial Markets Association, SEC No-Action Letter (pub.avail. Nov. 20, 2008).

10 NASD Rule 2830(c) prohibits investment company underwriters from selling the fund's securities to a retail broker-dealer at a price other than the public offering price unless, among other things, the sale is in conformance with NASD Rule 2420. FINRA has proposed to adopt new FINRA Rule 2341, based largely on NASD Rule 2830, which would eliminate the reference to NASD Rule 2420. *See Regulatory Notice 09-34.*

## Attachment 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**

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### 0100. General Standards

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**0180. Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation**

(a) A member shall be treated as a non-member of FINRA from the effective date of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member shall be automatically reinstated to membership in FINRA at the termination of the suspension period.

(b) A member shall be treated as a non-member of FINRA from the date of acceptance by FINRA of any resignation of such member.

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### 2000. Duties and Conflicts

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**2040. Payments to Unregistered Persons**

**(a) General**

No member or associated person shall, directly or indirectly, pay or offer to pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments, is required to be so registered under applicable federal securities laws and SEA rules, regulations and published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations; or

(2) any appropriately registered associated person unless such payment complies with all applicable federal securities laws, FINRA rules and SEA rules, regulations and published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations.

**(b) Retiring Representatives**

(1) A member may pay continuing commissions to a retiring registered representative of the member, after he or she ceases to be associated with such member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement; provided:

(i) a bona fide contract between the member and the retiring registered representative calling for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and

(ii) the arrangement complies with applicable SEA rules, regulations and published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations.

(2) The term "retiring registered representative," as used in this Rule shall mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreement with the deceased representative.

* * * * *

**Text of Proposed Amendments to FINRA Rule 8311**

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## 8000. Investigations and Sanctions

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## 8300. Sanctions

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## 8311. Effect of a Suspension, Revocation, Cancellation, [or] Bar or Other Disqualification

(a) [If FINRA or the SEC issues an order that imposes]If a person is subject to a suspension, revocation, [or] cancellation of [the] registration, bar from association with a member (each a "sanction") or other disqualification [of a person associated with a member or bars a person from further association with any member], a member shall not allow such person to [remain] be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. [If FINRA or the SEC suspends a person associated with a member, the]A member also shall not pay or credit to any person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any salary, [or any] commission, profit, or any other remuneration [that results directly or indirectly from any securities transaction,] that the person [associated with a member] might have [earned] accrued during the period of [suspension] the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or to a disqualified person that has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

(b) Notwithstanding paragraph (a) of this Rule, a member may pay to a person that is subject to a sanction or disqualification described in paragraph (a) of this Rule, any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment.

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

**.01 Remuneration Accrued Prior to Effective Date of Sanction or Disqualification.** Notwithstanding this Rule, a member may pay or credit to a person that is subject of a sanction or disqualification salary, commission, profit or any other remuneration that the member can evidence accrued to the person prior to the effective date of such sanction or disqualification; provided, however, the member may not pay any salary, commission, profit or any other remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification.

• • • • •

**EXHIBIT 2b**

## REGULATORY NOTICE 09-69

Proposal to Adopt Consolidated FINRA Rule 2040 Regarding Payments to Unregistered Persons

| | Date Letter Received | Sender | Company Name |
|---|---|---|---|
| 1. | 02/01/2010 | Peter J. Chepucavage | Plexus Consulting LLC, on behalf of the International Association of Small Broker-Dealers and Advisers |
| 2. | 02/01/2010 | Ethan W. Johnson | Morgan, Lewis & Bockius LLP |
| 3. | 02/01/2010 | Cliff Kirsch and Eric Arnold | Sutherland Asbill & Brennan LLP on behalf of The Committee of Annuity Insurers |
| 4. | 02/01/2010 | Daniel E. LeGaye | The LeGaye Law Firm P.C. |
| 5. | 01/29/2010 | Jorge Ramos | Monex Securities |
| 6. | 02/16/2010 | Rex A. Staples | North American Securities Administrators Association, Inc. |
| 7. | 01/21/2010 | Everardo Vidaurri | Intercam Securities, Inc. |

The International Association of Small Broker-Dealers and Advisers www.iasbda.com submits the following comment on one general aspect of this proposal.For the last 30 years the SEC and FINRA have been dealing with the general question of finders. See ABA report on this subject included below.Each year at the SEC'S Small Business forum it is one of the chief recommendations to help small business.This year's draft recommendation is as follows;

1. Promote the Commission's twin missions of enhancing small business capital formation and protecting investors. These objectives can be met by bringing more unregulated or ineffectively-regulated activity into an appropriate regulatory environment that emphasizes disclosure and education in the area of private placement broker involvement. Action may be accelerated by the appointment of an advisory committee or designation of a working group involving the staff of the Office of Chief Counsel of the Division of Trading and Markets and the Division' of Corporation Finance's Small Business Office.

2. The Commission should adopt rules as recommended by the American Bar Association in its Report and Recommendations of the Task Force on Private Placement Broker-Dealers, dated June 20, 2005. Background: This recommendation appeared in the 2006 Final Report of the Advisory Committee on Smaller Public Companies, and was recommended by the SEC Government-Business Forum Final Reports issued in 2006, 2007 and 2008.The report is included below

3. Allow "private placement brokers" to raise capital through private placements of issuers' securities offered solely to "accredited investors" in amounts per issuer of up to 10% of the investor's net worth (excluding his or her primary residence), with full written disclosure of the broker's compensation and any relationship that would require disclosure under Item 404 of Regulation S-K, in aggregate amounts of up to $20 million per issuer. Background: This recommendation is specifically highlighted from those found in the ABA Report and Recommendations of the Task Force on Private Placement Broker-Dealers, dated June 20, 2005.

Despite this long history of debate,this rule filing regarding unregisterd finders is going forward without any substantive recognition of the complexity of this issue and can only be confusing to large numbers of business intermediaries currently acting as finders both for members and issuers.We recommend that in forwarding the rule to the commission Finra ask that the commission clarify its position including the numerous no-action letters issued over the last 30 years.If the commission did so in seeking comments on FINRA'S rule, it would help the investment community understand the current status of the issue and may inform the commission as to how widespread a problem exists.The current economic emphasis on small business job creation demands that this issue be taken seriously at this time.We believe the ABA report is a good starting point but there may be other creative ways to clarify this issue including allowing the states to deal with it in regards to small offerings.FINRA would do a great service by engaing this issue at this time

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120480.pdf

**ABA Report and Recommendations**

**of theTask Force on**

**Private Placement**

**Broker-dealers**
http://www.praxiis.com/files/SjoquistJune22005ABATaskForceReport.doc

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February 1, 2010

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 2006-1506

Re: **Comment on Proposed Consolidated FINRA Rule 2040 Governing Payments to Unregistered Persons (Regulatory Notice 09-69)**

Dear Ms. Asquith:

We are pleased to have the opportunity to submit our comments to the proposed Consolidated FINRA Rule 2040 which is intended to streamline, *inter alia,* existing NASD Rules 1060(b) and 2420 and NYSE Rule Interpretation 345(a)(i)/03 (referred to herein as the "NYSE Foreign Finder Interpretation") and related interpretations (the "Proposal"). We are writing on behalf of a number of our U.S. broker-dealer and clearing firm clients, including Pershing LLC, that will be impacted by the Proposal if it is adopted. We are submitting this letter pursuant to the request for comments published in Regulatory Notice 09-69.

We support FINRA's effort to develop clear and concise rules regarding payments to unregistered persons. However, we do not believe that the Proposal, which seeks to eliminate those aspects of NASD Rules 2420(c) and 1060(b) and the NYSE Foreign Finder Interpretation that address payments to persons and businesses residing outside of the United States, and, instead, require member firms to rely solely on guidance from the Securities and Exchange Commission (the "SEC") or its staff, promotes clarity. We are apprehensive, particularly, that the proposed elimination of the guidelines established by existing NASD and NYSE rules and interpretations may reduce the competitiveness of FINRA members outside of the United States.

Our view is based on our concern that current SEC rules and staff interpretations, as well as case law, in this area are sparse and fact-specific and do not give adequate guidance on the

question of when a non-U.S. person is required to register with the SEC as a broker-dealer as a result of its relationship with a member firm resident in the United States. This is true particularly in the context where the only point of contact of the non-U.S. person to the U.S. securities markets is the referral of other non-U.S. persons to the FINRA member or obtaining execution, clearing, settlement or custody services for non-U.S. customers.[i] If the Proposal is adopted as proposed many of our clients that provide execution, clearing, settlement, custody and other brokerage services to hundreds of non-U.S. financial firms, or have referral arrangements with foreign persons, may be forced to restructure their business models substantially or worse still, eliminate these activities entirely.[ii]

In addition to our concern that existing SEC staff guidance regarding broker-dealer status in the context of foreign referrals too often relies on a case-by-case analysis and is not helpful, we believe the existing framework under NASD Rules 1060 and the NYSE Foreign Finder Interpretation provides adequate protections to referred clients in the form of additional disclosures mandated by the existing rules. These protections would be eliminated under the Proposal since the sole question would then be whether the referring foreign person is required to register as a broker-dealer in the United States by virtue of the receipt of referral payments. Similarly, the withdrawal of Rule 2420 would eliminate the protections afforded to the U.S. markets that are contained in Rule 2420(c), such as the requirement that the member firm and foreign firm enter into an agreement restricting sales into the U.S.

We would, instead, urge FINRA either to retain Rules 1060(b) and 2420(c) and the NYSE Foreign Finder Interpretation in their current form (subject to one recommended change discussed below) or to work closely with the SEC to develop comprehensive guidance that will assure FINRA members that they may perform clearing, settlement, custody and execution services for foreign financial institutions and make referral payments to, or share compensation with, such financial institutions and other persons even though the institutions and other persons are not registered as brokers or dealers with the SEC.

***Analysis***

***NASD Rule 1060(b) and NYSE Interpretation 345(a)(i)/03.*** Existing NASD Rule 1060(b) and the NYSE Foreign Finder Interpretation (a published interpretation of NYSE Rule 345) provide that FINRA and NYSE member firms may pay transaction-related compensation to non-registered foreign persons based upon the business of customers they direct to the member firm if certain conditions are met.

Both NASD Rule 1060(b) and the NYSE Foreign Finder Interpretation are virtually identical. The only difference is the requirement in the NASD rule that the foreign finder not be subject to a statutory disqualification (as defined in the FINRA by-laws). This would include such things as certain criminal convictions, as well as bars, expulsions, current suspensions and injunctions.

***NASD Rule 2420.*** This rule generally prohibits payment of fees and commissions to non-member brokers or dealers. Paragraph (c) of the rule states that paragraphs (a) and (b) of the rule do not apply to payments to foreign brokers or dealers not eligible for membership as long as the member making the payments secures from such foreign broker or dealer an agreement that in making any sales to purchasers within the United States of securities acquired as a result of such transactions, the foreign broker or dealer will conform to the provisions of paragraphs (a) and (b) of the rule to the same extent as if it were a member. While this rule does not expressly address the relationship between U.S. clearing firms and their non-U.S. correspondents, it is frequently cited as confirmation that the FINRA rules permit member firms to enter into a variety of clearing and sub-clearing agreements and other brokerage arrangements with foreign non-member firms and to share fees or pay other forms of compensation without requiring the foreign firms or their personnel to register with the SEC.[iii]

***Recommendation***

The existing rules were developed in order to allow member firms to compete more effectively overseas where the payment of referral fees and the sharing of compensation between financial institutions is a common form of business development or practice. This goal should be preserved. The rules present low risk to the securities markets and investors because generally the sole involvement of the referring foreign person is to make a referral to the member firm or to obtain execution, clearing or settlement services from such member and they do not permit broader contact with U.S persons. Moreover, after a successful referral the foreign referring person typically does not remain involved in the relationship between the member firm and the foreign persons referred to the firm.[iv] Further, as noted above, significant additional protections are afforded under the foreign referral rule by requiring the referring party to disclose important details to the referred customers such as the fact that transaction-related compensation is being paid to the foreign referring person. As a result, we believe that FINRA should not withdraw the rules and should continue to provide guidance for foreign referral payments or other financial compensation arrangements as long as the conditions of the rules are satisfied.

We would also note that under most introducing arrangements each foreign financial institution specifically agrees to introduce only accounts that are held by non-U.S. persons domiciled outside the U.S. and represents to the member firm that: (i) it is a foreign entity domiciled outside the jurisdiction of the U.S.; (ii) it is not registered, nor is it required to register, with the SEC as a broker or dealer; (iii) it is not subject to a disqualification, as this term is defined in Article III, Section 4 of the By-Laws of the NASD; (iv) to the best of its knowledge, the compensation arrangement does not violate the law of any applicable foreign jurisdiction; and (v) every introduced account shall be either a non-U.S. national or non-U.S. organized entity domiciled outside the U.S.

Consequently, we do not believe that the arrangements whereby the member firm pays referral fees to, or shares fees and commissions with, non-member foreign persons, including foreign financial institutions, in consideration of their introduction of customers or transactions of their foreign customers pose any material risk that unlicensed firms will be providing brokerage services to U.S. persons. Moreover, in light of the absence of any promotional efforts by the foreign referring firm on behalf of the business conducted by the member firm as a result of the referral, we believe that the foreign referring firm does not have the type of "salesman's stake" that normally is addressed in connection with U.S. broker-dealer registration.

With respect to existing Rule 2420(c), we recommend that it be retained in its current form. We do recommend, however, one small change in the text of the rule. The current rule states that the provisions of paragraphs (a) and (b) of Rule 2420 do not apply to "any nonmember broker or dealer in a foreign country who is not eligible for membership in a national securities association" (emphasis added). We recommend that the exemption in paragraph (c) be based on the person not being required to be a registered broker-dealer in the United States and member of a national securities association rather than using the existing "eligible" standard. In advising our clients over the years we have found it difficult to determine when a foreign firm would not be eligible for such membership. Also, we would submit that eligibility is not a relevant determinant of whether a foreign firm should register before it may enter into clearing or other arrangements with member firms. Further, this change would make the standard applied in Rule 2420(c) consistent with the standard found in Rule 1060(b).

Lastly, we have the following comments on the proposed rule, assuming for this purpose that the existing rules will not be retained in their current forms: (i) eliminate "or offer to pay" from the introductory clause in section (a) of the proposed rule since determining whether and when an offer to pay has been made would add a level of subjectivity that would undercut the effort to bring clarity to this area; (ii) eliminate "appropriately" from the beginning of subsection (a)(2) as the requirement in the subsection will need to be satisfied even it the person is "inappropriately" registered, if that is even possible; and (iii) narrow the scope of the pre-conditions in section (a)(2) to just those of verifying that the person is registered and not subject to any statutory disqualifications – the burden of checking all the laws, rules and regulation cited in the proposed rule will be a strong disincentive against a member firm ever making such payments.

***Conclusion***

As discussed above, the existing rules with respect to foreign referrals and dealing with non-member firms are helpful and provide adequate protection to foreign customers that are referred to FINRA members and ensure that foreign non-member firms conform to FINRA standards when dealing with U.S. customers and markets. In addition, existing guidance from the SEC with respect to registration of foreign financial institutions is insufficient to

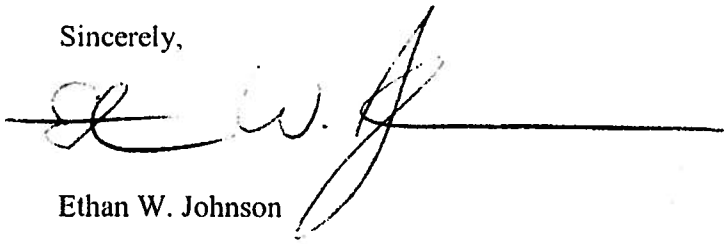
Morgan Lewis
COUNSELORS AT LAW

serve as the sole basis for determining whether compensation may be paid to foreign persons by FINRA members. Accordingly, we respectfully urge FINRA to retain the provisions of existing Rules 1060(b) and 2420 and the NYSE Foreign Finder Interpretation (subject to our recommended change) or work with the SEC to develop more comprehensive guidance in this area.

However, if FINRA determines to proceed with its proposal in its present form, we strongly urge FINRA to establish an extensive phase-in period and to grandfather existing arrangements between members and foreign financial institutions and permit them to continue operating as though the existing rules were still in force.

We and our clients appreciate the opportunity to comment on the Proposal. If you any have questions about this matter and our comments, please feel free to call me at 305-415-3394.

Sincerely,



Ethan W. Johnson

cc: Mark D. Fitterman

i The primary sources of SEC guidance are: (i) Part III B of the Adopting Release for Rule 15a-6 (34-27017); (ii) Part III of 1970 SEC Release 33-5068 dealing with the applicability of U.S. securities laws to offer and sale of mutual funds outside of the U.S.; (iii) Vickers Da Costa/Citicorp, SEC No-Action Letter (pub. avail. August 13, 1986); (iv) National Westminster Bank plc, SEC No-Action Letter (pub. avail. July 7, 1988); (v) Security Pacific Corporation, SEC No-Action Letter (pub. avail. April 1, 1988); and (vi) Dinosaur Securities LLC, SEC No-Action Letter (pub. avail. June 23, 2006). *See e.g.*, the Dinosaur Securities letter in which the SEC Staff indicated that it would not provide no-action relief on the question of whether a foreign person receiving compensation for referring customers must register as a broker-dealer with the SEC. We would note that the SEC has approved the NASD rules and NYSE interpretations discussed herein, which evidences that these existing rules reflect the SEC's current views.

ii We note that proposed FINRA Rule 4311(a)(2) expressly permits U.S. clearing firms to enter into clearing agreements with persons other than U.S.-registered brokers or dealers. The adoption of Rule 4311 as contemplated will be very helpful in closing some of the gaps identified above in this letter. At a minimum the interaction between and among proposed Rules 4311 and 2040 and existing Rules 1060(b) and 2420 should be studied carefully to maximize integration and clarity.

iii *See also* NYSE Rule 382(a) which expressly addresses agreements between NYSE member firms and foreign non-member organizations.

iv The referring party often will have a continuing relationship with the referred party and may even act as an advisor to the referred party but would not have any official capacity in the relationship between the parties.

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NEW YORK
TALLAHASSEE
WASHINGTON DC

February 1, 2010

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

**Re: Regulatory Notice 09-69: FINRA Requests Comments on Proposed Consolidated FINRA Rule Governing Payments to Unregistered Persons**

Dear Ms. Asquith:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in response to Regulatory Notice 09-69, "FINRA Requests Comments on Proposed Consolidated FINRA Rule Governing Payments to Unregistered Persons" (the "Notice"). The Notice proposes new FINRA Rule 2040 (Payments to Unregistered Persons) ("Proposed Rule 2040") and new FINRA Rule 0180 (Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation) ("Proposed Rule 0180"). The Notice also proposes revisions to current FINRA Rule 8311 (Effect of a Suspension, Revocation, Cancellation or Bar) ("Rule 8311") and proposes Supplementary Material to accompany current FINRA Rule 8311 (Remuneration Accrued Prior to Effective Date of Sanction or Disqualification) ("Proposed Supplementary Material") (the new rules and revised rules and supplementary material are collectively referred to herein as the "Proposal").

The Committee commends FINRA for undertaking, as part of the FINRA Rulebook Consolidation, to consolidate FINRA's current rules and past guidance and interpretations regarding payments to unregistered persons into new FINRA rules. The Committee appreciates the opportunity to provide comments on the Proposal.

The Committee believes many aspects of the Proposal provide additional clarity to the registration issues that arise under FINRA rules. However, as described in more detail below, the Committee also has comments on certain aspects of Proposed Rule 2040 and on Rule 8311.

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[1] The Committee of Annuity Insurers is a coalition of 30 life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over two-thirds of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.
8849681.3

**CONTINUING COMMISSION PAYMENTS TO RETIRING REGISTERED REPRESENTATIVES**

**Proposal.** Proposed Rule 2040 would prohibit members from paying or offering to pay, directly or indirectly, "any compensation, fees, concessions, discounts, commissions or other allowances" (collectively, "Payments") to any person that is not registered with the Securities and Exchange Commission ("SEC") as a broker-dealer under Section 15(a) of the Securities Exchange Act of 1934, but that would be required to be registered by reason of receiving the Payment. The Notice clarifies that in determining whether a Payment would trigger a registration requirement, the member should consider the SEC's rules and regulations. Under Proposed Rule 2040(b)(2), FINRA members are permitted to pay continuing commissions to retiring registered representatives of the member, after they cease to be employed by the member, provided that:

> (1) the member and the retiring registered representative entered into a bona fide contract in good faith calling for such payments while the person was a registered representative of the employing member; and
>
> (2) the arrangement complies with applicable SEC rules, regulations and published guidance by the SEC or its staff.

**Comments.** The Committee notes that it is unclear whether the requirement set forth in Proposed Rule 2040(b)(2) compelling compliance with SEC rules, regulations and staff guidance is intended to add any substantive restrictions or requirements, as it appears to merely forbid members from making payments that are already otherwise prohibited. The Committee does not believe as a general matter that FINRA rules should include blanket references to compliance with SEC rules and published guidance from SEC staff. Member firms are already subject to SEC rules and regulations. Moreover, the Committee believes that incorporating the positions of SEC staff as FINRA rules is extremely problematic. SEC staff positions, particularly when articulated through no-action letters, are extremely fact specific. In addition, such positions do not allow for the notice and comment period that accompanies formal rulemaking, and would in effect give such positions the force and effect of a rule. Therefore, the Committee believes that the second prong of the test for the payment of compensation to a retiring registered representative should be deleted.

The Committee also requests guidance and clarification on an issue that is of special importance to Committee members. Under Proposed Rule 2040, commissions are permitted to be paid that are "derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement." The Committee requests clarification from FINRA that a retiring registered representative who receives compensation payable under a group variable annuity contract may receive compensation based on individuals who become certificate holders

under such contract after the registered representative has retired. Under a group variable annuity contract, the contract itself is typically sold to an entity such as an employee benefit plan. Employees eligible for such plan can then purchase interests under the group variable annuity contract and become certificate holders under the group policy. Permitting retired registered representatives to receive compensation based on individuals who become certificate holders under a group variable annuity contract is the most logical interpretation of the express terms of Proposed Rule 2040(b). Since Proposed Rule 2040(b) provides that additional purchases in individual customer accounts are permitted to benefit the retiring registered representative, additional individuals becoming certificate holders under a group variable annuity contract after the retiring registered representative has left the member firm should also be permitted to benefit the registered representative. From a policy perspective, the account relationship that the retiring registered representative developed in a group variable annuity contract sale was with the employer and its plan, and therefore such representative should be permitted to continue to benefit from that relationship during retirement.

**PAYMENTS TO SANCTIONED PERSONS**

**Proposal.** Under the proposed amendments to FINRA Rule 8311, FINRA members may not allow a person subject to suspension, revocation, cancellation of registration, bar from association with a member or other disqualification (collectively, "Sanctions") to be associated with the member in any capacity inconsistent with the Sanction. The amended rule would also prohibit any payments to a person during the period of the Sanction or anytime thereafter if the payments might have accrued during the period of the Sanction. A proposed Supplementary Material to the amended rule would allow payments to Sanctioned persons that the "member can evidence accrued ... prior to the effective date" of the Sanction and that does not relate to the activity that gave rise to the Sanction.

**Comments.** The Committee notes that while the amendments would clarify the scope of sanctions subject to the rule and codify certain exceptions, some questions remain unanswered. In the proposed amendments, it is unclear whether registered representatives subject to Sanctions would be permitted to continue to receive compensation earned as a result of automatic monthly payments to a variable annuity contract made during the period of the Sanction. The Committee requests that registered representatives subject to Sanctions be permitted to continue to receive compensation earned as a result of automatic monthly payments to a variable annuity contract during the term of the disqualification, where such payments were arranged for during a time period that preceded the Sanctions.[2]

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[2] The Committee notes that other securities products (e.g., mutual funds, variable life insurance) may have similar issues with such automatic payments.

The Committee also requests clarification that the "Sanctions" identified under FINRA Rule 8311 do not in any way impact the current FINRA rules and guidance with respect to registered representatives who are deemed to be "inactive" due to a failure to complete the regulatory element of the continuing education requirements in a timely manner under NASD Rule 1120. The Committee reads the current, proposed language of FINRA Rule 8311, which is triggered by a finding that a person is "subject to a suspension, revocation, cancellation of registration, bar from association with a member (each a 'sanction') or other disqualification," as failing to cover the situation expressly addressed under NASD Rule 1120(a)(2). The Committee would appreciate clarification (which may not need to be provided through a change to the language of FINRA Rule 8311) that FINRA Rule 8311 does not impact the current treatment of registered representatives that are deemed to be inactive under NASD Rule 1120.

**CONCLUSION**

The Committee appreciates the opportunity to comment on the Proposal. Please do not hesitate to contact Cliff Kirsch (212.389.5052) or Eric Arnold (202.383.0741) if you have any questions on the issues addressed in this letter.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Cliff Kirsch EAA

BY: Eric G. Arnold

FOR THE COMMITTEE OF ANNUITY INSURERS

## Appendix A

## THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
Conseco, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
*(an Ameriprise Financial company)*
Sun Life Financial
Symetra Financial
USAA Life Insurance Company

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January 29, 2009

Via E-Mail: To pubcom@finra.org

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

RE: FINRA Regulatory Notice 09-69, Payments to Unregistered Persons

Dear Ms. Asquith:

On December 2, 2009, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 09-69 (Regulatory Notice) seeking comments on its proposal to amend its rules governing payments to unregistered persons through a proposed FINRA Rule 2040 (Proposed Rule); which is available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120480.pdf. As stated by FINRA in the Regulatory Notice, the Proposed Rule is meant to streamline the provisions of current: (i) NASD Rule 1060(b) (Persons Exempt from Registration); (ii) Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business); (iii) Rule 2420 (Dealing with Non-Members); (iv) IM-2420-1 (Transactions Between Members and Non-Members) and IM-2420-2 (Continuing Commissions Policy); NYSE Rule 353 (Rebates and Compensation); and (v) NYSE Rule Interpretations 345(a)(i)/01 (Compensation to Non-Registered Persons); /02 (Compensation Paid for Advisory Solicitations); and /03 (Compensation to Non-Registered Foreign Persons Acting as Finders).

While the intent of the Proposed Rule may generally more directly align the rules on the payments made by a FINRA member firm to a non-member firm with that of the SEC and SEC staff interpretations of broker-dealer registration requirements, our clients have expressed a number of concerns that are discussed below.

***Cash Solicitation for Investment Advisory Activities***

There has been substantial confusion related to the regulation of broker-dealers and investment advisers that were dually registered with the SEC ("Dual Registrants") in recent history, both as to who would ultimately have regulatory oversight, and how the Investment Advisers Act of 1940 (the "Act") would be interpreted by FINRA, whose primary rules are subject to The Securities Act of 1934 ("34 Act"). As a result of that confusion, member firms have faced uncertainty as to FINRA's interpretation of certain rules and definitions set forth in the Act where the definitions and or guidelines differ between the Act and the 34 Act. For example, the definition of custody on the advisory side has resulted in dual registrants being required to become a $250,000 net capital firm due to being deemed to have custody as an advisor, which can occur by invoicing in advance, and or to the advisor forwarding a security held for an advisory client to their clearing firm. It appears that by eliminating NYSE Rule Interpretations 345(a)(i) 02 (Compensation Paid for Advisory Solicitations), FINRA may be

creating even further confusion in this area for dual registrants. Thus, while SEC Rule 206(4)-3 allows for the cash payment to a solicitor under certain circumstances, the Proposed Rule would also require that such payment complies with all applicable federal securities laws, including specifically FINRA rules. Without the Interpretation, it will increase the difficulty for a FINRA member firm, who is an investment adviser, to assure itself that the activities of a solicitor that it works with do not amount to "effecting" transactions in securities which will potentially result in FINRA determining that it is paying a person who should be registered as a broker-dealer.

While the potential for confusion may be an unintended consequence of the Proposed Rule, the effect has the unfortunate potential to create another mine field for a member firm to have to navigate as it attempts to comply with the Act, the 34 Act and FINRA Rules. As a result, we would recommend that FINRA clarify the Proposed Rule to address the handling of conflicts that arise between interpretations of the Act, the 34 Act and FINRA rules.

***Foreign Finders***

Under the Proposed Rule, NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 would be eliminated. These rules have generally allowed a FINRA member firm, under the enumerated conditions, to pay transaction-based compensation to a non-U.S. finder that solicits non-U.S. business for the member. While there were a number of critical components that had to be met with respect to the current rule, two of the fundamental conditions with respect to the payment of compensation to a foreign finder was: (1) that the foreign finder limit its activities so that the finder was not required to register in the U.S. as a broker-dealer; and (2) that the compensation arrangement not violate applicable foreign law. The implication being that the foreign finder was subject to the jurisdiction of a foreign securities authority.

These finders have provided an important and necessary service in that they have introduced foreign customers to U.S. markets, which is consistent with the transition of the financial markets to be international in nature. Foreign finders have an integral knowledge of their customers that are referred to FINRA member firms, including suitability and investment needs, and they are subject to the regulatory structure of their respective countries. Member firms are still required to confirm suitability, supervise the sales activity to the foreign customer, including the recommendation of U.S. securities to such customers, and effect the transaction. FINRA member firms should be able to rely on clear guidance with respect to these activities, and the current rule gave that guidance to membership. If the finder is properly licensed in the jurisdiction where they reside, they comply with the conditions set forth in the current rule, they comply with local laws, and FINRA member firms could pay them for the referral. While relying on the SEC guidance is helpful with respect to the sale of securities with in the U.S., the SEC's position on the payment of foreign finders is not clear, and as such, will result in additional confusion for regulatory compliance professionals and member firms.

Additionally, to the extent a broker-dealer was or is a Dual Registrant as discussed above, it is unclear as to whether a firm could pay investment advisory solicitor fees to a foreign finder without conflicting with the Proposed Rule.

Therefore, we would recommend that the current NASD Rule 1060(b) be retained and or the Proposed Rule be amended to address the utilization of foreign finders. Section 15(a) does not take into consideration transactions between a U.S. broker-dealer and one that is licensed by a foreign securities authority where it is domiciled. This is basically a dealer to dealer transaction where the foreign

broker-dealer refers a customer to the U.S. broker-dealer based upon the relationship the foreign broker-dealer has with the customer. The foreign broker-dealer has a reasonable expectation to be compensated for the administration and supervision of the foreign finders who actually have the relationships.

***Foreign Dealer Relationships***

We believe that with the increased focus on the internationalization of the securities markets and the ability of foreign broker-dealers to bring their non-U.S. customers into the U.S. market through FINRA member firms is critical; and the ability of broker-dealers to pay such offshore broker-dealers is an integral part of that process. To that end, Section 15(a) fails to take into consideration transactions between a U.S. broker-dealer and one that is licensed by a foreign securities authority where it is domiciled and engaged in a securities business.

With that said, the proposed rule needs to clarify these relationships. While the Proposed Rule relies on Rule 15a-6 of the Act to exempt a foreign broker-dealer from sections 15(a)(1) or 15B(a)(1), that occurs only if the foreign broker-dealer effects transactions in securities with or for persons that have not been solicited by the foreign broker-dealer or conducts business with U.S. institutional investors or major U.S. institutional investors (including providing research under certain circumstances). The exception does not contemplate a foreign broker-dealer introducing its non-U.S. customers to a FINRA member firm to make recommendations and affect transactions on behalf of those customers, while simultaneously paying the foreign broker-dealer compensation for such referrals and introductions.

We would recommend that the Proposed Rule be amended to integrate the concept of registration or membership in or with a Foreign Financial Regulatory Authority, which would include any non-U.S. securities authority; other government body or foreign equivalent of a U.S. self-regulatory organization that is empowered by a non U.S. government to administer or enforce the laws relating to the regulation of investment-related activities, or membership organization, a function of which is to regulate the participation of its members in investment-related activities. That would provide clarity to those FINRA member firms who would engage in representing non-U.S. customers that are introduced by a foreign broker-dealer.

***State Law***

The Proposed Rule clearly anticipates that the proper venue for determining who should or shouldn't be registered as a broker-dealer is the SEC. While this will more directly align the rule with SEC and SEC staff interpretations of broker-dealer registration requirements, it does not address those FINRA member firms who engage in primarily an intra-state business, and the state of their domicile recognizes statutory exemptions for the payment of compensation in limited circumstances for certain finders. Without the ability to reasonably rely on the state statutes where a firm is domiciled and engaged in business with individuals who are also domiciled in the respective state, those FINRA member firms will be faced with increased compliance costs in that they will have to substantiate their reliance on federal law, rather than state law. We would recommend that FINRA review the Proposed Rule to provide for the ability to reasonably rely on state statutes where a member firm clearly operates a local, intra-state business.

***Regulatory Burden***

Requiring FINRA member firms to look to SEC no-action letters to determine whether the activities in question require registration as a broker-dealer, it is inconsistent with the concept of "Transparency in

Financial Markets", and require FINRA member firms to step back in time with respect to the rules governing its activities. By not providing clear guidance, FINRA is placing additional regulatory uncertainty on FINRA member firms and further hampering their efforts to obtain meaningful compliance.

While the Proposed Rule would not require a member to obtain a specific, no-action letter from the SEC, the proposal does focus on the receipt of payment as the potential trigger of the registration requirement. This could create challenging interpretive issues for FINRA member firms in determining whether a payment may be made to an unregistered person. Specifically, while SEC guidance generally views receipt of transaction-based compensation as a powerful indicator that a person is "engaged in the business of effecting transactions in securities" and therefore, are required to register as a broker-dealer, the SEC and courts give this factor and others varying weight in different situations. These interpretive issues become even more problematic when viewed in light of the fact that the Proposed Rule does not contain a "reasonable belief" standard. Thus, short of a no-action letter, absolute comfort will be difficult to attain, and that comfort will be expensive. Thus requiring broker-dealers to additionally document their decisions by having to hire attorneys to support such positions through SEC rules, regulations or other guidance, such as no-action letters, is placing a substantial cost on FINRA member firms, both in terms of time as well as money.

Finally, neither the Regulatory Notice nor the Proposed Rule specify how the FINRA member firm should determine that broker-dealer registration is not required, We all are aware that the ultimate determination of whether a particular payment subjects a person to registration as a broker-dealer is dependent on the facts and circumstances of each particular transaction. As a result, SEC guidance on this issue may not always be conclusive, and in fact, in Dinosaur Securities, LLC, SEC No-Action Letter (June 23, 2006), available at http://www.sec.gov/divisions/marketreg/ mr-oaction/dinosaur062306.htm, the SEC staff declined to consider whether intended payment recipients would be exempt from registration for the purposes of satisfying NASD rules and noting that *the SEC does not "as a matter of practice" provide no-action relief in this context, despite the NASD advising members that they obtain such relief.*

Based upon the costs and uncertainty related to obtaining SEC no-action guidance, we would recommend that FINRA review the issues and either amend the Proposed Rule to address and clarify the regulatory concerns, or provide interpretive relief with respect to these matters.

***Conclusion***

In summary, we believe that goals set forth in the Regulatory Notice regarding the Proposed Rule are important and critical to the financial industry, but we also believe that FINRA member firms need clear direction on these issues so that resources can remain focused on market protection, rather than "papering the file". Thank you for your consideration of our comments. Should you have any questions, please contact the undersigned at 281-367-2454.

Respectfully submitted,

Daniel E. LeGaye
The LeGaye Law Firm, P.C.

monex

**Securities**

Member FINRA | SIPC | NFA

January 29, 2009

Via E-Mail: To pubcom@finra.org

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

RE: FINRA Regulatory Notice 09-69, Payments to Unregistered Persons

Dear Ms. Asquith:

On December 2, 2009, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 09-69 (Regulatory Notice) seeking comments on its proposal to amend its rules governing payments to unregistered persons through a proposed FINRA Rule 2040 (Proposed Rule). As stated by FINRA in the Regulatory Notice, the Proposed Rule is meant to streamline the provisions of current: (i) NASD Rule 1060(b) (Persons Exempt from Registration); (ii) Rule 2410 (Net Prices to Persons Not in Investment Banking or Securities Business); (iii) Rule 2420 (Dealing with Non-Members); (iv) IM-2420-1 (Transactions Between Members and Non-Members) and IM-2420-2 (Continuing Commissions Policy); NYSE Rule 353 (Rebates and Compensation); and (v) NYSE Rule Interpretations 345(a)(i)/01 (Compensation to Non-Registered Persons); /02 (Compensation Paid for Advisory Solicitations); and /03 (Compensation to Non-Registered Foreign Persons Acting as Finders).

While the intent of the Proposed Rule may generally more directly align the rules on the payments made by a FINRA member firm to a non-member firm with that of the SEC and SEC staff interpretations of broker-dealer registration requirements, we have a number of concerns that are discussed below.

***Foreign Finders***

Under the Proposed Rule, NASD Rule 1060(b) and NYSE Rule Interpretation 345(a)(i)/03 would be eliminated. These rules have generally allowed a FINRA member firm, under the enumerated conditions, to pay transaction-based compensation to a non-U.S. finder that solicits non-U.S. business for the member.

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While there were a number of critical components that had to be met with respect to the current rule, two of the fundamental conditions with respect to the payment of compensation to a foreign finder was: (1) that the foreign finder limit its activities so that the finder was not required to register in the U.S. as a broker-dealer; and (2) that the compensation arrangement not violate applicable foreign law. The implication being that the foreign finder was subject to the jurisdiction of a foreign securities authority.

These finders have provided an important and necessary service in that they have introduced foreign customers to U.S. markets, which is consistent with the transition of the financial markets to be international in nature. Foreign finders have an integral knowledge of their customers that are referred to FINRA member firms, including suitability and investment needs, and they are subject to the regulatory structure of their respective countries. Member firms are still required to confirm suitability, supervise the sales activity to the foreign customer, including the recommendation of U.S. securities to such customers, and effect the transaction. FINRA member firms should be able to rely on clear guidance with respect to these activities, and the current rule gave that guidance to membership. If the finder is properly licensed in the jurisdiction where they reside, they comply with the conditions set forth in the current rule, they comply with local laws, and FINRA member firms could pay them for the referral. While relying on the SEC guidance is helpful with respect to the sale of securities with in the U.S., the SEC's position on the payment of foreign finders is not clear, and as such, will result in additional confusion for regulatory compliance professionals and member firms.

Additionally, to the extent a broker-dealer was or is a Dual Registrant as discussed above, it is unclear as to whether a firm could pay investment advisory solicitor fees to a foreign finder without conflicting with the Proposed Rule.

Therefore, we would recommend that the current NASD Rule 1060(b) be retained and or the Proposed Rule be amended to address the utilization of foreign finders. Section 15(a) does not take into consideration transactions between a U.S. broker-dealer and one that is licensed by a foreign securities authority where it is domiciled. This is basically a dealer to dealer transaction where the foreign broker-dealer refers a customer to the U.S. broker-dealer based upon the relationship the foreign broker-dealer has with the customer. The foreign broker-dealer has a reasonable expectation to be compensated for the administration and supervision of the foreign finders who actually have the relationships.

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***Foreign Dealer Relationships***

We believe that with the increased focus on the internationalization of the securities markets and the ability of foreign broker-dealers to bring their non-U.S. customers into the U.S. market through FINRA member firms is critical; and the ability of broker-dealers to pay such offshore broker-dealers is an integral part of that process. To that end, Section 15(a) fails to take into consideration transactions between a U.S. broker-dealer and one that is licensed by a foreign securities authority where it is domiciled and engaged in a securities business.

With that said, the proposed rule needs to clarify these relationships. While the Proposed Rule relies on Rule 15a-6 of the Act to exempt a foreign broker-dealer from sections 15(a)(1) or 15B(a)(1), that occurs only if the foreign broker-dealer effects transactions in securities with or for persons that have not been solicited by the foreign broker-dealer or conducts business with U.S. institutional investors or major U.S. institutional investors (including providing research under certain circumstances). The exception does not contemplate a foreign broker-dealer introducing its non-U.S. customers to a FINRA member firm to make recommendations and affect transactions on behalf of those customers, while simultaneously paying the foreign broker-dealer compensation for such referrals and introductions.

We would recommend that the Proposed Rule be amended to integrate the concept of registration or membership in or with a Foreign Financial Regulatory Authority, which would include any non-U.S. securities authority; other government body or foreign equivalent of a U.S. self-regulatory organization that is empowered by a non U.S. government to administer or enforce the laws relating to the regulation of investment-related activities, or membership organization, a function of which is to regulate the participation of its members in investment-related activities. That would provide clarity to those FINRA member firms who would engage in representing non-U.S. customers that are introduced by a foreign broker-dealer.

***Regulatory Burden***

Requiring FINRA member firms to look to SEC no-action letters to determine whether the activities in question require registration as a broker-dealer, it is inconsistent with the concept of "Transparency in Financial Markets", and require FINRA member firms to step back in time with respect to the rules governing its activities. By not providing clear guidance, FINRA is placing additional regulatory uncertainty on FINRA member firms and further hampering their efforts to obtain meaningful compliance.

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While the Proposed Rule would not require a member to obtain a specific, no-action letter from the SEC, the proposal does focus on the receipt of payment as the potential trigger of the registration requirement. This could create challenging interpretive issues for FINRA member firms in determining whether a payment may be made to an unregistered person. Specifically, while SEC guidance generally views receipt of transaction-based compensation as a powerful indicator that a person is "engaged in the business of effecting transactions in securities" and therefore, are required to register as a broker-dealer, the SEC and courts give this factor and others varying weight in different situations. These interpretive issues become even more problematic when viewed in light of the fact that the Proposed Rule does not contain a "reasonable belief" standard. Thus, short of a no-action letter, absolute comfort will be difficult to attain, and that comfort will be expensive. Thus requiring broker-dealers to additionally document their decisions by having to hire attorneys to support such positions through SEC rules, regulations or other guidance, such as no-action letters, is placing a substantial cost on FINRA member firms, both in terms of time as well as money.

Finally, neither the Regulatory Notice nor the Proposed Rule specify how the FINRA member firm should determine that broker-dealer registration is not required. We all are aware that the ultimate determination of whether a particular payment subjects a person to registration as a broker-dealer is dependent on the facts and circumstances of each particular transaction. As a result, SEC guidance on this issue may not always be conclusive, and in fact, in Dinosaur Securities, LLC, SEC No-Action Letter (June 23, 2006), available at http://www.sec.gov/divisions/marketreg/ mr-oaction/dinosaur062306.htm, the SEC staff declined to consider whether intended payment recipients would be exempt from registration for the purposes of satisfying NASD rules and noting that *the SEC does not "as a matter of practice" provide no-action relief in this context, despite the NASD advising members that they obtain such relief.*

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Based upon the costs and uncertainty related to obtaining SEC no-action guidance, we would recommend that FINRA review the issues and either amend the Proposed Rule to address and clarify the regulatory concerns, or provide interpretive relief with respect to these matters.

***Conclusion***

In summary, we believe that the issues of foreign finders and foreign broker/dealers need to be addressed in the revisions to the rules..

Respectfully submitted,

Jorge Ramos
President

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NASAA

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***Via Electronic Submission to pubcom@finra.org***

February 16, 2010

Marcia E. Asquith
Office of the Corporate Secretary
FINRA 1735 K Street, NW
Washington, DC 2006-1506

**Re: Comments on the Proposed Amendments Governing Payments to Unregistered Persons: Regulatory Notice 09-69**

Dear Ms. Asquith:

The North American Securities Administrators Association, Inc. ("NASAA")[1] appreciates the opportunity to comment on the above referenced Regulatory Notice. Our comments are the following.

## I. Process of Rulemaking

NASAA recognizes the complex nature of the issues of regulating finders, a subcategory of unregistered persons. However, the prospect of utilizing ongoing and potentially unlimited SEC No Action Letters to regulate an area of securities regulation such as finders and other unregistered persons is troublesome to NASAA. In particular, it can be very expensive for the public to find their way through a sea of No Action Letters without a more detailed codified rule coming from the SEC and/or FINRA on this topic.

Moreover, NASAA expresses concern about an approach specifically creating a rule that would be subject to continual revision through No Action Letters. NASAA believes that the proposition of having FINRA rely upon and rule make through ongoing No Action letters as it pertains to the complex issue of finders strains the principles of legislative rulemaking authority.

1 NASAA is the association of all state, provincial, and territorial securities regulators in North America. Its membership consists of the securities regulators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico. Their core mission is protecting investors from fraud and abuse in the offer and sale of securities. Organized in 1919, NASAA is the oldest international organization devoted to investor protection.

No Action letters provide advice to a particular party under specified facts and circumstances. If Regulatory Notice 09-69 passes through the system as it stands, FINRA effectively will make and re-make this rule *ad infinitum* through current and future No Action letters. There would never be a referendum for handling the complex issue of finders. Rather, the result would be a rule that would violate the Notice and Comment standards inherent in rulemaking procedures for FINRA.

## II. Transaction based compensation

The States and NASAA are quite concerned about transaction based compensation and the potential for abusive practices by finders and other unregistered persons who engage in securities business activities. States will continue to review this arena and any compensation received by unregistered person and enforce the state law applicable within their jurisdictions.

## III. Retired persons and contracts

FINRA provides the opportunity for retired persons to receive ongoing fees for current active accounts that they used to manage. NASAA questions the open ended nature of FINRA's provision for the allowance of these contractual relationships. The extent of hidden fee arrangements between shadow parties who trade consumers' accounts is particularly troublesome to NASSA. NASAA poses the question: Has there been consideration as to potential trigger points wherein these types of post "retirement" payment pose potential and/or actual conflicts of interest, the dangers to the underlying account holder whose assets are being used to generate fees that are split by multiple parties, and is full disclosure to consumers being provided?

Please do not hesitate to contact the undersigned regarding this matter.

Sincerely,

/S/

Rex A. Staples
General Counsel
NASAA

To whom it may concern

As you may know, the main activity in Miami and South Florida is to provide International Private Banking Services in the US to Non-US CITIZZENS, primarily domiciled in Latin America. There are many BDs, IA and Banks providing these services. I would say that this business is probably one of the most important sources of direct employment and revenues in the city of Miami, without considering the indirect jobs and business that rely on this activity, such as travel, insurance services, real estate etc.

I have not exact figures, but I have a good basis to estimate that just in Miami's financial district, there are more than 150 billion in financial assets from Latin American investors through US financial institutions.

Many of these clients come to the US through agreements where Banks, BD's, IA and consultants domiciled in Latin America refer clients/investors to BDs, IA and Banks in Miami. In many cases, US and non US firms operating from Miami have established and maintain affiliated entities in the region. Obviously they expect to be compensated.

I fully understand and support the rationality behind this proposal of restricting payment to Unregistered persons among US participants. Everybody shall have the same rules and requirements in the same market place.
But in this case it is a complete different situation. We are talking of NON US persons referring business into US Firms. We cannot implement the same set of rules in other jurisdictions, it would be impossible to make non-us individuals and entities to become registered persons.

I strongly believe that if this restriction is applied to non US participants (foreign finders) it would have a very negative impact in our Industry, our labor market and to the US economy as a whole, since we will be putting barriers to financial flows from abroad that wants to invest in this country, specially now that the US depends on foreign investment to fund its deficits. In many cases, it would destroy completely their business model in which they have been operating for many years under NASD RULE 1060. Maybe the consequences would be even worse if this industry transfer this activity to other financial jurisdiction.

My suggestion would be to make an exemption allowing Foreign Finders to get compensation for referrals only. I believe that the NASD rule 1060 rule addresses all the issues correctly.

I hope that my comments would be considered when making the final decision, since I'm sure that are shared by everybody in Brickell Avenue.

Please feel free to contact me at 305-377-8008 to discuss this important issue.

**Sincerely yours**

**Everardo Vidaurri**

**CEO**

Intercam Securities, Inc.
1221 Brickell Ave, #1070
Miami, FL 33131
Main 305-377-8008
Fax 305-377-0028

**EXHIBIT 5**

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

**Text of Proposed New FINRA Rule**
**(NASD Rules 2420, IM-2420-1 and IM-2420-2 to be Deleted in their Entirety from the Transitional Rulebook)**

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**0100. GENERAL STANDARDS**

* * * * *

**0190. Effective Date of Revocation, Cancellation, Expulsion, Suspension or Resignation**

(a) A member shall be considered as a non-member of FINRA from the effective date of any order or notice from FINRA or the SEC issuing a revocation, cancellation, expulsion or suspension of its membership. In the case of suspension, a member shall be automatically reinstated to membership in FINRA at the termination of the suspension period.

(b) A member shall be considered as a non-member of FINRA from the date of acceptance by FINRA of any resignation of such member.

* * * * *

**2000. DUTIES AND CONFLICTS**

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**2040. Payments to Unregistered Persons**

**(a) General**

No member or associated person shall, directly or indirectly, pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the Exchange Act but, by reason of receipt of any such payments and the activities related thereto, is required to be so registered under applicable federal securities laws and SEA rules and regulations; or

(2) any appropriately registered associated person unless such payment complies with all applicable federal securities laws, FINRA rules and SEA rules and regulations.

**(b) Retiring Representatives**

(1) A member may pay continuing commissions to a retiring registered representative of the member, after he or she ceases to be associated with such member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement, provided that:

(A) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among other things, prohibits the retiring registered

representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and

(B) the arrangement complies with applicable federal securities laws, SEA rules and regulations.

(2) The term "retiring registered representative," as used in this Rule shall mean an individual who retires from a member (including as a result of a total disability) and leaves the securities industry. In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the respective member's agreement with the deceased representative.

**(c) Nonregistered Foreign Finders**

A member may pay to a nonregistered foreign person (the "finder") transaction-related compensation based upon the business of customers the finder directs to the member if the following conditions are met:

(1) the member has assured itself that the finder who will receive the compensation is not required to register in the United States as a broker-dealer nor is subject to a disqualification as defined in Article III, Section 4 of FINRA's By-Laws, and has further assured itself that the compensation arrangement does not violate applicable foreign law;

(2) the finder is a foreign national (not a U.S. citizen) or foreign entity domiciled abroad;

(3) the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in either foreign or U.S. securities;

(4) customers receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act, that discloses what compensation is being paid to finders;

(5) customers provide written acknowledgment to the member of the existence of the compensation arrangement and such acknowledgment is retained and made available for inspection by FINRA;

(6) records reflecting payments to finders are maintained on the member's books, and actual agreements between the member and the finder are available for inspection by FINRA; and

(7) the confirmation of each transaction indicates that a referral or finders fee is being paid pursuant to an agreement.

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

**.01 Reasonable Support for Determination of Compliance with Section 15(a) of the Exchange Act**. For purposes of Rule 2040, FINRA expects members to determine that their proposed activities would not require the recipient of the payments to register as a broker-dealer and to reasonably support such determination. Members that are uncertain as to whether an unregistered person may be required to be registered under Section 15(a) of the Exchange Act by reason of receiving payments from the member can derive support for their determination by, among other things, (1) reasonably relying on previously published releases, no-action letters or interpretations from the Commission or Commission staff that apply to their facts and circumstances; (2) seeking a no-action

letter from the Commission staff; or (3) obtaining a legal opinion from independent, reputable U.S. licensed counsel knowledgeable in the area. The member's determination must be reasonable under the circumstances and should be reviewed periodically if payments to the unregistered person are ongoing in nature. In addition, a member must maintain books and records that reflect the member's determination.

* * * * *

**Amendment to FINRA Rule**

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**8000. INVESTIGATIONS AND SANCTIONS**

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**8300. Sanctions**

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**8311. Effect of a Suspension, Revocation, Cancellation, [or] Bar or Other Disqualification**

(a) [If FINRA or the SEC issues an order that imposes]If a person is subject to a suspension, revocation, [or ]cancellation of [the ]registration, bar from association with a member (each a "sanction") or other disqualification[ of a person associated with a member or bars a person from further association with any member], a member shall not allow such person to [remain] be associated with it in any capacity that is inconsistent with the sanction imposed or disqualified status, including a clerical or ministerial capacity. [If FINRA or the SEC suspends a person associated with a member, the]A member also shall not pay or credit to any person subject to a sanction or disqualification, during the period of the sanction or disqualification or any period thereafter, any salary,

[or any] commission, profit, or any other remuneration [that results directly or indirectly from any securities transaction,] that the person [associated with a member] might [have earned]accrue during the period of [suspension]the sanction or disqualification. However, a member may make payments or credits to a person subject to a sanction that are consistent with the scope of activities permitted under the sanction where the sanction solely limits an associated person from conducting specified activities (such as a suspension from acting in a principal capacity) or a disqualified person has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to associate with a member.

(b) Notwithstanding paragraph (a) of this Rule, a member may pay to a person that is subject to a sanction or disqualification described in paragraph (a) of this Rule, any remuneration pursuant to an insurance or medical plan, indemnity agreement relating to legal fees, or as required by an arbitration award or court judgment.

**• • • Supplementary Material:**

**.01 Remuneration Accrued Prior to Effective Date of Sanction or Disqualification.** Notwithstanding this Rule, a member may pay or credit to a person that is subject of a sanction or disqualification salary, commission, profit or any other remuneration that the member can evidence accrued to the person prior to the effective date of such sanction or disqualification; provided, however, the member may not pay any salary, commission, profit or any other remuneration that accrued to the person that relates to or results from the activity giving rise to the sanction or disqualification, and any such payment or credit must comply with applicable federal securities laws.

* * * * *

**Text of NASD Rule and NYSE Rule Interpretation to Remain in the Transitional Rulebook**

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**NASD Rules**

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**1060. Persons Exempt from Registration**

(a) No Change.

[(b) Member firms, and persons associated with a member, may pay to nonregistered foreign persons transaction-related compensation based upon the business of customers they direct to member firms if the following conditions are met:]

[(1) the member firm has assured itself that the nonregistered foreign person who will receive the compensation (the "finder") is not required to register in the U.S. as a broker/dealer nor is subject to a disqualification as defined in Article III, Section 4 of the Association's By-Laws, and has further assured itself that the compensation arrangement does not violate applicable foreign law;]

[(2) the finders are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad;]

[(3) the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in either foreign or U.S. securities;]

[(4) customers receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act of 1940, that discloses what compensation is being paid to finders;]

[(5) customers provide written acknowledgment to the member firm of the existence of the compensation arrangement and that such acknowledgment is retained and made available for inspection by the Association;]

[(6) records reflecting payments to finders are maintained on the member firm's books and actual agreements between the member firm and persons compensated are available for inspection by the Association; and]

[(7) the confirmation of each transaction indicates that a referral or finders fee is being paid pursuant to an agreement.]

* * * * *

**NYSE Rule Interpretation**

* * * * *

**Rule 345 Employees — Registration, Approval, Records**

(a) No Change.

/01 through /03 No Change.

**[(a) (i) COMPENSATION]**

**[/01 Compensation to Non-Registered Persons]**

[Rule 345(a) precludes member organizations from paying to non-registered persons compensation based upon the business of customers they direct to member organizations if:]

[a) the compensation is formulated as a direct percentage of the commissions or income generated, or]

[b) payment is on other than an isolated basis, or]

[c) the customers have the use of the facilities of such person for the transmission of orders or messages directly to the member organization, or]

[d) such person has formal discretionary authority to place orders or instructions with the member organizations, or]

[e) such person regularly engages in activity which may be reasonably expected to result in the procurement of new customer or orders.]

The interpretation does not preclude normal clearing and introductory arrangements between member organizations or between member organizations and non-member broker/dealers.

Please refer to /03 below for interpretation with respect to transaction-related compensation arrangements with non-registered foreign persons acting as finders.

**[/02 Compensation Paid for Advisory Solicitations]**

[A member organization, registered with the SEC as an investment adviser, may enter into any arrangement that fully complies with Rule 206(4)-3 ("Cash Payments for Client Solicitations") of the Investment Advisers Act of 1940. Such arrangements will not be deemed contrary to the registration requirements of Rule 345 (see also Rule 10 "Definition of Registered Representative"). Member organizations are advised to check on the applicability of any state registration requirements for member organizations and associated persons.]

**[/03 Compensation to Non-registered Foreign Persons Acting as Finders]**

[Member organizations may pay to non-registered foreign persons transaction-related compensation based upon the business of customers they direct to member organizations if the following conditions are met:]

[a) the member organization has assured itself that the non-registered foreign person who will receive the compensation (the "finder") is not required to register in the U.S. as a broker-dealer and has further assured itself that the compensation arrangement does not violate applicable foreign law;]

[b) the finders are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad;]

[c) the customers are foreign nationals (not U.S. citizens) or foreign entities domiciled abroad transacting business in either foreign or U.S. securities;]

[d) customers receive a descriptive document, similar to that required by Rule 206(4)-3(b) of the Investment Advisers Act of 1940, that discloses what compensation is being paid to finders;]

[e) customers provide written acknowledgement to the member organization of the existence of the compensation arrangement and that such acknowledgement is retained and made available for inspection by the Exchange;]

[(f) records reflecting payments to finders are maintained on the member organization's books and actual agreements between the member organization and persons compensated are available for inspection by the Exchange; and]

[(g) the confirmation of each transaction indicates that a referral or finders fee is being paid pursuant to an agreement.]

(b) No Change.

.11 through .18 No Change.

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**Text of NASD Rules, NASD Interpretative Materials, and NYSE Rules to be Deleted in their Entirety from the Transitional Rulebook**

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**NASD Rules**

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**[2410. Net Prices to Persons Not in Investment Banking or Securities Business]**

Entire text deleted.

**[2420. Dealing with Non-Members]**

Entire text deleted.

**[IM-2420-1. Transactions Between Members and Non-Members]**

Entire text deleted.

**[IM-2420-2. Continuing Commissions Policy]**

Entire text deleted.

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**NYSE Rule**

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**[NYSE Rule 353. Rebates and Compensation]**

Entire text deleted.

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