

**SECURITIES AND EXCHANGE COMMISSION**  
(Release No. 34-60135; File No. SR-FINRA-2009-014)

June 18, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("SEA" or "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 24, 2009, Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items substantially 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 certain paragraphs, as specified below, of NASD Rule 2330 (Customers' Securities or Funds) as FINRA Rule 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) in the consolidated FINRA rulebook taking into account certain provisions of Incorporated NYSE Rule 352 (Guarantees, Sharing in Accounts, and Loan Arrangements)<sup>3</sup> and to delete NYSE Rule 352, with the exception of NYSE Rules 352(e)

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> For convenience, Incorporated NYSE Rule 352 is hereinafter referred to as "NYSE Rule 352."

(Limitations on Borrowing From or Lending to Customers), 352(f) (Loan Procedures) and 352(g).

The proposed rule change would renumber NASD Rule 2330(a) (Improper Use) as FINRA Rule 2150(a) (Improper Use), NASD Rule 2330(e) (Prohibition Against Guarantees) as FINRA Rule 2150(b) (Prohibition Against Guarantees) and NASD Rule 2330(f) (Sharing in Accounts; Extent Permissible) as FINRA Rule 2150(c) (Sharing in Accounts; Extent Permissible) in the consolidated FINRA rulebook. The proposed rule change also would add a “Supplementary Material” section to proposed FINRA Rule 2150 that contains certain clarifications and codifications of existing staff guidance. The text of the proposed rule change is set forth below. Proposed new language is underlined; proposed deletions are in brackets.

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**Text of Proposed New FINRA Rule  
(NASD Rules 2330(a), 2330(e) and 2330(f) and Incorporated NYSE Rules 352(a),  
352(b), 352(c) and 352(d) to be Deleted in Their Entirety from the Transitional  
Rulebook)**

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**2000. DUTIES AND CONFLICTS**

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**2100. TRANSACTIONS WITH CUSTOMERS**

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**2150. Improper Use of Customers’ Securities or Funds; Prohibition Against  
Guarantees and Sharing in Accounts**

**(a) Improper Use**

No member or person associated with a member shall make improper use of a customer's securities or funds.

**(b) Prohibition Against Guarantees**

No member or person associated with a member shall guarantee a customer against loss in connection with any securities transaction or in any securities account of such customer.

**(c) Sharing in Accounts; Extent Permissible**

(1)(A) Except as provided in paragraph (c)(2), no member or person associated with a member shall share directly or indirectly in the profits or losses in any account of a customer carried by the member or any other member; provided, however, that a member or person associated with a member may share in the profits or losses in such an account if:

(i) such person associated with a member obtains prior written authorization from the member employing the associated person;

(ii) such member or person associated with a member obtains prior written authorization from the customer; and

(iii) such member or person associated with a member shares in the profits or losses in any account of such customer only in direct proportion to the financial contributions made to such account by either the member or person associated with a member.

(B) Exempt from the direct proportionate share limitation of paragraph (c)(1)(A)(iii) are accounts of the immediate family of such member or person associated with a member. For purposes of this Rule,

the term “immediate family” shall include parents, mother-in-law or father-in-law, husband or wife, children or any relative to whose support the member or person associated with a member otherwise contributes directly or indirectly.

(2) Notwithstanding the prohibition of paragraph (c)(1), a member or person associated with a member that is acting as an investment adviser may receive compensation based on a share in profits or gains in an account if:

(A) such person associated with a member seeking such compensation obtains prior written authorization from the member employing the associated person;

(B) such member or person associated with a member seeking such compensation obtains prior written authorization from the customer;  
and

(C) all of the conditions in Rule 205-3 of the Investment Advisers Act (as the same may be amended from time to time) are satisfied.

**••• Supplementary Material: -----**

**.01 Inapplicability of Rule to Certain Guarantees.** For purposes of paragraph (b) of this Rule, a “guarantee” that is extended to all holders of a particular security by an issuer as part of that security generally would not be subject to the prohibition against guarantees.

**.02 Permissible Reimbursement by Member of Certain Losses.** Nothing in this Rule shall preclude a member, but not an associated person of the member, from determining on an after-the-fact basis, to reimburse a customer for transaction losses; provided,

however, that the member shall comply with all reporting requirements that may be applicable to such payment. For example, if the payment can reasonably be construed as a settlement, the member shall report the payment as a settlement under the applicable reporting requirement(s). In addition, nothing in this Rule shall preclude a member, but not an associated person of the member, from correcting a bona fide error. This Supplementary Material .02 does not apply to an associated person of a member because of the concern that any such payment may conceal individual misconduct.

**.03 Record Retention.** For purposes of paragraph (c) of this Rule, members shall preserve the required written authorization(s) for at least six years after the date the account is closed.

**.04 Applicability of Other Rules to Sharing Arrangements.** Members and associated persons should be aware that participation in a sharing arrangement permitted under paragraph (c) of this Rule does not affect the applicability of other FINRA rules, including paragraph (b) of this Rule and NASD Rules 3030, 3040 and 3050, to such sharing arrangement.

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**Text of NASD Rules and Incorporated NYSE Rules  
to Remain in the Transitional Rulebook**

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**NASD Rules**

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**2330. Customers' Securities or Funds**

(a) Reserved. [Improper Use]

[No member or person associated with a member shall make improper use of a customer's securities or funds.]

(b) No Change.

(c) No Change.

(d) No Change.

(e) Reserved. [**Prohibition Against Guarantees**]

[No member or person associated with a member shall guarantee a customer against loss in connection with any securities transaction or in any securities account of such customer.]

(f) Reserved. [**Sharing in Accounts; Extent Permissible**]

[(1)(A) Except as provided in paragraph (f)(2) no member or person associated with a member shall share directly or indirectly in the profits or losses in any account of a customer carried by the member or any other member; provided, however, that a member or person associated with a member may share in the profits or losses in such an account if (i) such person associated with a member obtains prior written authorization from the member employing the associated person; (ii) such member or person associated with a member obtains prior written authorization from the customer; and (iii) such member or person associated with a member shares in the profits or losses in any account of such customer only in direct proportion to the financial contributions made to such account by either the member or person associated with a member.]

[(B) Exempt from the direct proportionate share limitation of paragraph (f)(1)(A)(iii) are accounts of the immediate family of such

member or person associated with a member. For purposes of this Rule, the term “immediate family” shall include parents, mother-in-law or father-in-law, husband or wife, children or any relative to whose support the member or person associated with a member otherwise contributes directly or indirectly.]

[(2) Notwithstanding the prohibition of paragraph (f)(1), a member or person associated with a member that is acting as an investment adviser (whether or not registered as such) may receive compensation based on a share in profits or gains in an account if (i) such person associated with a member seeking such compensation obtains prior written authorization from the member employing the associated person; (ii) such member or person associated with a member seeking such compensation obtains prior written authorization from the customer; and (iii) all of the conditions in Rule 205-3 of the Investment Advisers Act of 1940 (as the same may be amended from time to time) are satisfied.]

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### **Incorporated NYSE Rules**

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### ***Rule 352. Guarantees, Sharing in Accounts, and Loan Arrangements***

#### ***[Prohibitions Against Guarantees]***

(a) Reserved. [No member organization shall guarantee or in any way represent that it will guarantee any customer against loss in any account or on any transaction; and no member, principal executive, registered representative or officer shall guarantee or in any way represent that either he or she, or his or her employer, will guarantee any customer against loss in any customer account or on any customer transaction. The

prohibitions in this paragraph extend to the payment, in whole or in part, of a debit balance.]

**[Prohibition Against Sharing in Profits and Losses]**

(b) Reserved. [Except as otherwise provided by this Rule, no member, member organization, principal executive, officer, or any other person acting in the capacity of a registered representative shall, directly or indirectly, (i) take or receive or agree to take or receive a share in the profits, or (ii) share or agree to share in any losses, in any customer's account or of any transaction effected therein.]

**[Joint Accounts and Order Errors]**

(c) Reserved. [Subject to compliance with paragraph (a), paragraph (b) of this Rule shall not preclude a member not associated with a member organization, or a member organization or, with the prior written authorization of the member organization, a member associated with such member organization, a principal executive or other person acting in the capacity of a registered representative, from participating with a customer in a joint account and sharing in the profits or losses therein in direct proportion to financial contributions made to such account. Accounts of immediate family members of such persons are exempt from the direct proportionate share limitation. (See Rule 93 for reporting and approval requirements concerning participation in joint accounts by members and member organizations.) Nor shall it preclude a member not associated with a member organization or a member organization from sharing or agreeing to share any losses in a customer account if it has been established that the loss was caused in whole or in part by an error resulting from the action or inaction of such member, member organization, or person associated therewith (See also Rule 134).]

[For purposes of this section (c), the term “immediate family” shall include parents, mother-in-law or father-in-law, husband or wife, children or any relative to whose support the principal executive or persons acting in the capacity of a registered representative otherwise contributes directly or indirectly.]

**[Certain Investment Advisory Arrangements]**

(d) Reserved. [Notwithstanding the prohibition of paragraph (b), a person acting as an investment adviser (whether or not registered as such) may receive compensation based on a share of profits or gains in an account if all the of the conditions in Rule 205-3 of the Investment Advisers act of 1940 (as may be amended from time to time) are satisfied. All advisory compensation arrangements should be reviewed by member organizations and their counsel in light of applicable State and Federal law (e.g., ERISA).]

**Limitations on Borrowing From or Lending to Customers**

(e) No Change.

**Loan Procedures**

(f) No Change.

(g) No Change.

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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

Background

As part of the process of developing a new consolidated rulebook (the “Consolidated FINRA Rulebook”),<sup>4</sup> FINRA is proposing to adopt NASD Rules 2330(a), 2330(e) and 2330(f) as FINRA Rules 2150(a), 2150(b) and 2150(c), respectively, in the Consolidated FINRA Rulebook, with certain changes as described below.<sup>5</sup> Proposed FINRA Rule 2150 also would take into account certain provisions of NYSE Rule 352. In addition, proposed FINRA Rule 2150 includes a “Supplementary Material” section that contains certain clarifications and codifications of existing staff guidance. The proposed rule change would delete NYSE Rule 352 (with the exception of paragraphs (e), (f) and (g))<sup>6</sup> from the Transitional Rulebook.

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<sup>4</sup> The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

<sup>5</sup> NASD Rules 2330(b) (General Provisions), 2330(c) (Authorization to Lend), 2330(d) (Segregation and Identification of Securities) and Interpretive Material 2330 (Segregation of Customers’ Securities) set forth certain financial and operational requirements. These provisions would remain in the Transitional Rulebook to be addressed as part of a later phase of the rulebook consolidation process.

<sup>6</sup> NYSE Rules 352(e), 352(f) and 352(g) govern borrowing from or lending to customers. These provisions generally are equivalent to the provisions of NASD

## Proposed Amendments

FINRA is proposing the following amendments.

a. Improper Use of Customers' Securities or Funds (proposed FINRA Rule 2150(a))

NASD Rule 2330(a) prohibits members and associated persons from making improper use of a customer's securities or funds. The improper use of customer securities or funds threatens the fundamental relationship between a broker and a customer and undermines the integrity of the securities industry. NASD Rule 2330(a) has proven effective through nearly 70 years of regulatory experience. There is no Incorporated NYSE Rule equivalent to NASD Rule 2330(a). FINRA is proposing to adopt NASD Rule 2330(a) as FINRA Rule 2150(a) in the Consolidated FINRA Rulebook without changes.

b. Prohibition Against Guarantees (proposed FINRA Rule 2150(b))

NASD Rule 2330(e) prohibits members and their associated persons from guaranteeing a customer against loss in connection with any securities transaction or in any securities account of the customer. The reason for the prohibition is that such guarantees create the expectation that the customer is insulated from market risk intrinsic in securities ownership and may induce the customer to engage in a securities transaction that is not otherwise appropriate for the customer.

FINRA is proposing to adopt NASD Rule 2330(e) as FINRA Rule 2150(b) in the Consolidated FINRA Rulebook without changes. FINRA is proposing to delete NYSE

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Rule 2370 (Borrowing From or Lending to Customers). NASD Rule 2370 and the corresponding NYSE provisions would remain in the Transitional Rulebook to be addressed as part of a later phase of the rulebook consolidation process.

Rule 352(a) (Prohibitions Against Guarantees) because its provisions are substantially similar to proposed FINRA Rule 2150(b).

c.      Sharing in Accounts (proposed FINRA Rule 2150(c))

NASD Rule 2330(f) prohibits members and associated persons from sharing in the profits or losses in a customer's account except under certain limited conditions. NASD Rule 2330(f)(1) permits a member or associated person to share in the profits or losses in a customer's account if: (1) the associated person obtains the prior written authorization of his or her employing member; (2) the member or associated person obtains the prior written authorization of the customer; and (3) the member or associated person shares in the profits or losses in the account only in direct proportion to the member's or associated person's financial contributions to the account. The rule exempts from the proportionality requirement accounts of the immediate family of the member or associated person. NASD Rule 2330(f)(2) permits a member or associated person that is acting as an investment adviser, whether or not registered as such under the Investment Advisers Act of 1940 ("Advisers Act"), to receive compensation based on a share in the profits or gains in a customer's account if: (1) the associated person obtains the prior written authorization of his or her employing member; (2) the member or associated person obtains the prior written authorization of the customer; and (3) all of the conditions specified in Rule 205-3 of the Advisers Act are satisfied.

Similar to NASD Rule 2330(f)(1), NYSE Rules 352(b) (Prohibition Against Sharing in Profits and Losses) and 352(c) (Joint Accounts and Order Errors) provide that sharing profits or losses in a joint account with a customer is permitted if it is in direct proportion to financial contributions made to the account, and the member provides prior written authorization. However, NYSE Rules 352(b) and (c) do not require the prior

written authorization of the customer as required under NASD Rule 2330(f)(1). In addition, NYSE Rule 352(c) expressly permits sharing in customer losses resulting from an error transaction. Similar to NASD Rule 2330(f)(2), NYSE Rule 352(d) (Certain Investment Advisory Arrangements) permits sharing arrangements that comply with Section 205 of the Advisers Act and the associated rules. However, NYSE Rule 352(d) does not require members to obtain the customer's prior written authorization as required under NASD Rule 2330(f)(2).

FINRA is proposing to adopt NASD Rule 2330(f) as FINRA Rule 2150(c) in the Consolidated FINRA Rulebook, with only minor changes. Specifically, FINRA is proposing to delete the provision in NASD Rule 2330(f)(2) regarding the registration status under the Advisers Act of members and associated persons acting as investment advisers. This provision was intended to clarify the application of the rule to broker-dealers that were deemed not to be subject to the Advisers Act under Rule 202(a)(11)-1 of the Advisers Act.<sup>7</sup> Since Rule 202(a)(11)-1 has been vacated, the provision is no longer necessary.

FINRA is proposing to delete NYSE Rules 352(b), (c) and (d) because these provisions are substantially similar to proposed FINRA Rule 2150(c) or are otherwise incorporated as part of the supplementary material to proposed FINRA Rule 2150, as noted below.

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<sup>7</sup> In 2005, the SEC adopted Advisers Act Rule 202(a)(11)-1, a principal purpose of which was to deem broker-dealers offering "fee-based brokerage accounts" as not subject to the Advisers Act. In March 2007, Rule 202(a)(11)-1 was vacated. See Financial Planning Association v. SEC, 482 F.3d 481 (D.C. Cir. 2007).

d. Proposed Supplementary Material

In addition, FINRA is proposing to add a “Supplementary Material” section to proposed FINRA Rule 2150 that would:

- codify existing staff guidance clarifying that a “guarantee” extended to all holders of a particular security by an issuer as part of that security generally would not be subject to the prohibition against guarantees<sup>8</sup> and that a permissible sharing arrangement remains subject to other applicable FINRA rules;<sup>9</sup>
- clarify that the rule does not preclude a member from determining on an after-the-fact basis, to reimburse a customer for transaction losses, provided however that the member shall comply with all reporting requirements that may be applicable to such payment;<sup>10</sup>
- consistent with NYSE Rule 352(c), clarify that the rule does not preclude a member from correcting a bona fide error; and,
- clarify that the required written authorization(s) shall be preserved for a period of at least six years after the date the account is closed, which is consistent with the retention period under the SEA for similar records.

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<sup>8</sup> See SR-NASD-2002-180; Notice to Members 03-21 (April 2003). FINRA is proposing to make this clarification even though such arrangements do not implicate the express language of the rule, in light of member inquiries regarding such securities and existing staff guidance. See Securities Exchange Act Release No. 47354 (February 12, 2003), 68 FR 8053 (February 19, 2003) (Order Approving File No. SR-NASD-2002-180).

<sup>9</sup> See id.

<sup>10</sup> Associated persons would not similarly be permitted to reimburse their customers for losses under the rule given the concern that such payments may conceal individual misconduct.

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

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>11</sup> 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 further the purposes of the Act by protecting investors against potential misconduct.

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

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

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

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

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

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<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

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

#### IV. Solicitation of Comments

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

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2009-014 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2009-014. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-014 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.<sup>12</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>12</sup> 17 CFR 200.30-3(a)(12).