

**SECURITIES AND EXCHANGE COMMISSION**  
(Release No. 34-59273; File No. SR-FINRA-2008-067)

January 22, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt Rules Governing Financial Responsibility in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 30, 2008, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially 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 a new, consolidated set of financial responsibility rules. Accordingly, FINRA proposes to adopt FINRA Rules 4110 (Capital Compliance), 4120 (Regulatory Notification and Business Curtailment), 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties), 4140 (Audit) and 4521 (Notifications, Questionnaires and Reports) in the Consolidated FINRA Rulebook and to delete NASD Rules 3130 and 3131, NASD IM-3130, Incorporated NYSE Rules 312(h), 313(d), 325, 326, 328, 416.20, 418, 420, 421 and NYSE Rule Interpretations 313(d)/01, 313(d)/02, 325(c)(1), 325(c)(1)/01 and 416/01. FINRA also proposes to revise FINRA Rule 9557 (Procedures for Regulating Activities Under Rules

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

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

4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) and FINRA Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series). Lastly, FINRA proposes to make conforming revisions to Section 4(g) of Schedule A to the FINRA By-Laws.

The text of the proposed rule change is attached hereto as Exhibit A.

## **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. In addition, FINRA discussed comments it received in response to a Regulatory Notice<sup>3</sup> it published in May of 2008 requesting comment on the proposed rule change.<sup>4</sup> 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”),<sup>5</sup> FINRA is proposing to adopt a new, consolidated set of financial

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<sup>3</sup> See FINRA Regulatory Notice 08-23 (Proposed Consolidated FINRA Rules Governing Financial Responsibility) (May 2008) (the “Notice”).

<sup>4</sup> See infra, Item II.C. for more information on the Notice and the comments received in response thereto.

<sup>5</sup> The current FINRA rulebook includes, in addition to FINRA Rules, (1) NASD Rules and (2) 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”). For more information

responsibility rules. Accordingly, FINRA proposes to adopt FINRA Rules 4110 (Capital Compliance), 4120 (Regulatory Notification and Business Curtailment), 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties), 4140 (Audit) and 4521 (Notifications, Questionnaires and Reports) in the Consolidated FINRA Rulebook and to delete NASD Rules 3130 and 3131, NASD IM-3130, Incorporated NYSE Rules 312(h), 313(d), 325, 326, 328, 416.20, 418, 420, 421 and NYSE Rule Interpretations 313(d)/01, 313(d)/02, 325(c)(1), 325(c)(1)/01 and 416/01. FINRA also proposes to revise FINRA Rule 9557 (Procedures for Regulating Activities Under Rules 4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) and FINRA Rule 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series). Lastly, FINRA proposes to make conforming revisions to Section 4(g) of Schedule A to the FINRA By-Laws.

Currently, both NASD and NYSE Rules<sup>6</sup> contain provisions governing financial responsibility. These provisions have played an important role in supporting the SEC's minimum net capital and other financial responsibility requirements by establishing criteria promoting the permanency of member's capital, requiring the review and approval of material financial transactions and establishing criteria intended to identify member firms approaching financial difficulty and to monitor their financial and operational condition. For that reason, FINRA has placed high priority on expeditiously developing the unified set of proposed rules for inclusion in the Consolidated FINRA Rulebook.

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about the rulebook consolidation process, see [FINRA Information Notice](#), March 12, 2008 (Rulebook Consolidation Process).

<sup>6</sup> For convenience, the Incorporated NYSE Rules are referred to as the “NYSE Rules.”

FINRA believes that the proposed rules would incorporate many of [these] the provisions in the existing rules but would streamline and reorganize the provisions. In addition, FINRA has tiered many provisions to apply only to those firms that clear or carry customer accounts.<sup>7</sup>

(A) Proposed FINRA Rule 4110 (Capital Compliance)

(1) Authority to Increase Capital Requirements

Proposed FINRA Rule 4110(a), based primarily on NYSE Rule 325(d), would enable FINRA to prescribe greater net capital requirements for carrying and clearing members, or require any such member to restore or increase its net capital or net worth, when deemed necessary for the protection of investors or in the public interest. The authority to act under the proposed rule would reside with FINRA's Executive Vice President charged with oversight for financial responsibility (or his or her written officer delegate) (referred to as "FINRA's EVP"). To execute such authority, FINRA would be required to issue a notice pursuant to Proposed FINRA Rule 9557 (a "Rule 9557 notice"). FINRA believes that proposed FINRA Rule 9557, much like the current rule, would afford a member adequate safeguards because, among other things, it provides opportunity for an expedited hearing pursuant to Proposed FINRA Rule 9559.<sup>8</sup>

Proposed FINRA Rule 4110(a) would be a new provision for FINRA members that are not Dual Members ("non-NYSE members") that are carrying or clearing members. However, it would not apply to introducing firms or to certain firms with

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<sup>7</sup> All requirements set forth in the proposed rules that would apply to firms that clear or carry customer accounts would also apply to firms that operate pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i). For further clarification in response to commenter concerns, see Section 2 under Item II.C. See also infra note 9.

<sup>8</sup> See also Section (F) under this Item.

limited business models (together, “non-clearing firms”).<sup>9</sup> In this regard, certain Dual Members that currently are subject to NYSE Rule 325(d) – namely those NYSE member firms that are not carrying or clearing members (“NYSE non-clearing firms”) – would not be subject to the similar requirement in the FINRA Rule. All member firms that are subject to the requirement would have an opportunity to request an expedited hearing if they receive a Rule 9557 notice, which would be a new procedural right not available under NYSE Rule 325(d).

As FINRA has explained in the Notice, the NYSE staff historically employed NYSE Rule 325(d) in limited circumstances, and FINRA anticipates that it would apply Proposed FINRA Rule 4110(a) in similar fashion. The proposed rule would enable FINRA to respond promptly to extraordinary, unanticipated or emergency circumstances. Under Proposed FINRA Rule 4110(a), FINRA’s EVP could require a carrying or clearing member to comply with increased capital requirements in circumstances such as where unanticipated systemic market events threaten the member firm’s capital, or where the member firm maintains an undue concentration in illiquid products. In such instances, FINRA’s EVP may, for example, find it appropriate, in the public interest, to raise the applicable “haircut” (that is, to increase the percentage of the market value of certain securities or commodities positions by which the member must reduce its net worth) or treat certain assets as non-allowable in computing net capital.

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<sup>9</sup> For clarification, introducing firms and firms with limited business models (for example, firms that engage exclusively in subscription-basis mutual fund transactions, direct participation programs, or mergers and acquisitions activities) are not deemed carrying or clearing members and therefore would not be subject to Proposed FINRA Rule 4110(a), or for that matter any of the other provisions of the proposed rules that would apply only to carrying or clearing members.

(2) Suspension of Business Operations

Proposed FINRA Rule 4110(b)(1) is based in part on NASD Rule 3130(e) and would provide that, unless otherwise permitted by FINRA, a member firm must suspend all business operations during any period of time in which it is not in compliance with SEA Rule 15c3-1. This requirement is consistent with current law.<sup>10</sup>

As with NASD Rule 3130(e), Proposed FINRA Rule 4110(b)(1) is self-operative (that is, a firm would automatically be required to comply with the provision without any direction from FINRA). Notwithstanding that the proposed provision is self-operative, FINRA may issue a Rule 9557 notice directing a member that is not in compliance with SEA Rule 15c3-1 to suspend all or a portion of its business. Upon receipt of a Rule 9557 notice, the firm would have the right to request an expedited hearing. Neither the fact that FINRA may issue a Rule 9557 notice nor the right to an expedited hearing would be a defense in any subsequent disciplinary proceeding with respect to a member firm's non-compliance with Proposed FINRA Rule 4110(b)(1).

(3) Withdrawal of Equity Capital

To further the goal of financial stability, Proposed FINRA Rule 4110(c)(1) would prohibit a member from withdrawing equity capital for a period of one year, unless otherwise permitted by FINRA in writing. In response to commenter<sup>11</sup> requests for clarification of this provision, the proposed rule expressly provides that, subject to the

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<sup>10</sup> The Commission notes that the net capital rule requires that "every broker or dealer shall at all times have and maintain" certain specified levels of net capital. The Commission further notes that to the extent a broker-dealer fails to maintain at least the amount of net capital specified in that rule, it must cease doing a securities business. [See 72 FR 12862, at 12872.]

<sup>11</sup> All references to "commenters" are to persons that submitted comments in response to the Notice. For further information on this issue, see infra Item II.C.

requirements of Proposed FINRA Rule 4110(c)(2), members would not be precluded from withdrawing profits earned.

FINRA anticipates that approvals for the early withdrawal of equity capital pursuant to Proposed FINRA Rule 4110(c)(1) would be granted on a limited basis.<sup>12</sup>

Proposed FINRA Rule 4110(c)(2) would apply only to carrying or clearing members and would prohibit any such member, without the prior written approval of FINRA, from withdrawing capital, paying a dividend or effecting a similar distribution that would reduce the member's equity, or making any unsecured advance or loan to a stockholder, partner, sole proprietor, employee or affiliate, where such withdrawals, payments, reductions, advances or loans in the aggregate, in any rolling 35-calendar-day period, on a net basis, would exceed 10 percent of the member's excess net capital.<sup>13</sup>

This provision is based in part on NYSE Rule 312(h) and SEA Rule 15c3-1(e). While it would be a new requirement for non-NYSE members that are carrying or clearing members, it would not apply to non-clearing firms. In this regard, NYSE non-clearing firms that currently are subject to NYSE Rule 312(h) would not be subject to the similar provision in the FINRA Rule. FINRA further notes that the 10 percent limit set forth in Proposed FINRA Rule 4110(c)(2) would provide a de minimis exception; current NYSE Rule 312(h) does not include such an exception.

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<sup>12</sup> See Section 4 under Item II.C.

<sup>13</sup> The calculation of 10 percent of excess net capital must be based on the member's excess net capital position as reported in its most recently filed Form X-17A-5. The member must assure itself that the excess net capital so reported has not materially changed since the time the form was filed.

(4) Sale-and-Leasebacks, Factoring, Financing, Loans and Similar Arrangements

To ensure the permanency of net capital in contemplated sale-and-leaseback, factoring, financing and similar arrangements, Proposed FINRA Rule 4110(d)(1)(A) would provide that no carrying or clearing member may consummate a sale-and-leaseback arrangement with respect to any of its assets, or a sale, factoring or financing arrangement with respect to any unsecured accounts receivable, where any such arrangement would increase the member's tentative net capital by 10 percent or more,<sup>14</sup> without the prior written authorization of FINRA.

Proposed FINRA Rule 4110(d)(1)(A) is based on NYSE Rule 328(a), but would apply only to carrying and clearing members. While the provision would be new for non-NYSE members that are carrying or clearing members, it would not apply to non-clearing firms. In this regard, NYSE non-clearing firms that currently are subject to NYSE Rule 328(a) would no longer be subject to the similar provision in the FINRA Rule. Moreover, unlike NYSE Rule 328(a), Proposed FINRA Rule 4110(d)(1)(A) includes a de minimis exception by permitting a member to consummate, without FINRA's prior authorization, a sale-and-leaseback arrangement with respect to any of its assets, or a sale, factoring or financing arrangement with respect to any unsecured accounts receivable where the arrangement would not increase the member firm's tentative net capital by 10 percent or more.<sup>15</sup>

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<sup>14</sup> The calculation of 10 percent of tentative net capital must be based on the member's tentative net capital position as reported in its most recently filed Form X-17A-5. The member must assure itself that the tentative net capital so reported has not materially changed since the time the form was filed.

<sup>15</sup> See supra note 14.



Proposed FINRA Rule 4110(d)(1)(B), which is also based on NYSE Rule 328(a), would provide that no carrying member may consummate any arrangement concerning the sale or factoring of customer debit balances, irrespective of amount, without the prior written authorization of FINRA. The provision would be new for non-NYSE members that are carrying members.

Proposed FINRA Rule 4110(d)(2) is based on NYSE Rule 328(b), but would apply only to carrying and clearing members. The provision would require FINRA's prior approval for any loan agreement entered into by such a member, the proceeds of which exceed 10 percent of the member's tentative net capital<sup>16</sup> and that is intended to reduce the deduction in computing net capital for fixed assets and other assets that cannot be readily converted into cash under SEA Rule 15c3-1(c)(2)(iv). Because the provision would apply only to carrying and clearing members, NYSE non-clearing firms would be relieved from current requirements under NYSE Rule 328(b). In addition, unlike NYSE Rule 328(b), the proposed rule would include a de minimis exception.

Proposed FINRA Rule 4110(d)(3) provides that any member that is subject to paragraphs (d)(1)(A), (d)(1)(B) or (d)(2) of Proposed FINRA Rule 4110 would be prohibited from consummating, without FINRA's prior written authorization, any arrangement pursuant to those paragraphs if the aggregate of all such arrangements would exceed 20 percent of the member's tentative net capital.<sup>17</sup>

Proposed FINRA Rule 4110(d)(4) implements a requirement of the SEC's net capital rule and therefore would apply to all members. It provides that any agreement relating to a determination of a "ready market" for securities based upon the securities

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<sup>16</sup> See supra note 14.

<sup>17</sup> See supra note 14.

being accepted as collateral for a loan by a bank under SEA Rule 15c3-1(c)(11)(ii) must be submitted to, and be acceptable to, FINRA before the securities may be deemed to have a “ready market.” When determining the acceptability of a loan agreement, pursuant to Proposed FINRA Rule 4110(d)(4), FINRA staff would, as a general matter, consider such factors as whether the bank would have sole recourse under the agreement and whether the term of the loan is at least one year. FINRA expects that a determination of acceptability can generally be made within approximately one week.

(5) Subordinated Loans, Notes Collateralized by Securities and Capital Borrowings

Proposed FINRA Rule 4110(e) is based in part on current NYSE Rule 420 and would address the requirements for subordinated loans and loans made to general partners of members that are partnerships.

Proposed FINRA Rule 4110(e)(1) would implement Appendix D of SEA Rule 15c3-1 and require that all subordinated loans or notes collateralized by securities must meet such standards as FINRA may require to ensure the continued financial stability and operational capability of a member, in addition to meeting those standards specified in Appendix D of SEA Rule 15c3-1.<sup>18</sup> Appendix D of SEA Rule 15c3-1 requires that all subordination agreements must be found acceptable by the Examining Authority before they can become effective.

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<sup>18</sup> See SEA Rule 15c3-1d. Note that the proposed Supplementary Material would require that, for purposes of Proposed FINRA Rule 4110(e)(1), the member must assure itself that any applicable provisions of the Securities Act of 1933 and/or state Blue Sky laws have been satisfied, and may be required to submit evidence thereof to FINRA prior to approval of the subordinated loan agreement. See Proposed FINRA Rule 4110.01 (Compliance with Applicable Law).

Proposed FINRA Rule 4110(e)(2) would require that, unless otherwise permitted by FINRA, each member whose general partner enters into any secured or unsecured borrowing, the proceeds of which will be contributed to the capital of the member, must, in order for the proceeds to qualify as capital acceptable for inclusion in computation of the member's net capital, submit to FINRA for approval a signed copy of the loan agreement. The loan agreement must have at least a 12-month duration and provide non-recourse to the assets of the member firm. Moreover, because a general partner's interest may allow the lender to reach into the assets of the broker-dealer, FINRA is requiring a provision in the loan agreement that would estop the lender from having that right.

(B) Proposed FINRA Rule 4120 (Regulatory Notification and Business Curtailment)

(1) Regulatory Notification

Proposed FINRA Rule 4120(a) is based on current NYSE Rule 325(b), but would apply only to carrying and clearing members. The proposed rule would require any such member promptly, but in any event within 24 hours, to notify FINRA when certain specified financial triggers are reached.<sup>19</sup> This would be a new notification requirement for non-NYSE members that are carrying or clearing members; it would not, however, apply to non-clearing firms. Accordingly, NYSE non-clearing firms would no longer be subject to these requirements.

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<sup>19</sup> The determination of whether the financial triggers were reached must be based on the member's financial position as reported in its most recently filed Form X-17A-5. The member must assure itself that its financial position so reported has not materially changed since the time the form was filed.

(2) Restrictions on Business Expansion

Proposed FINRA Rule 4120(b) is based on NASD Rule 3130(c) and NYSE Rule 326(a) and addresses circumstances under which a member would be prohibited from expanding its business.

Proposed FINRA Rule 4120(b)(1), which is self-operative, would apply only to carrying and clearing members, and requires any such member, unless otherwise permitted by FINRA, to refrain from expanding its business during any period in which any of the conditions described in Proposed FINRA Rule 4120(a)(1) continue to exist for the specified time period. While NASD Rule 3130(c) includes comparable provisions, the requirement would now be self-operative for non-NYSE members that are carrying or clearing members. Proposed FINRA Rule 4120(b) also provides that FINRA may issue a Rule 9557 notice directing any such member not to expand its business, in which case the member would have the right to request an expedited hearing. Neither the fact that FINRA may issue a Rule 9557 notice nor the right to an expedited hearing would be a defense in any subsequent disciplinary proceeding with respect to a member's non-compliance with Proposed FINRA Rule 4120(b)(1).

Unlike the self-operative nature of paragraph (b)(1), Proposed FINRA Rule 4120(b)(2) authorizes FINRA, for any financial or operational reason, to restrict any member's ability to expand its business by the issuance of a Rule 9557 notice. In all such cases, the member would have the right to request an expedited hearing. This same right currently applies to NASD Rule 3130(c)(2).

### (3) Reduction of Business

Proposed FINRA Rule 4120(c) is based on NASD Rule 3130(d) and NYSE Rule 326(b) and addresses circumstances under which a member would be required to reduce its business.

Proposed FINRA Rule 4120(c)(1), which is self-operative, would apply only to carrying and clearing members, requiring any such member, unless otherwise permitted by FINRA in writing, to reduce its business to a point enabling its available capital to exceed the standards set forth in Proposed FINRA Rule 4120(a)(1) when any of the enumerated conditions continue to exist for the specified time period. While NASD Rule 3130(d) includes comparable provisions, the requirement would now be self-operative for non-NYSE members that are carrying or clearing members. Proposed FINRA Rule 4120(c)(1) also provides that FINRA may issue a Rule 9557 notice directing any such member to reduce its business, in which case the member would have the right to an expedited hearing. Neither the fact that FINRA may issue a Rule 9557 notice nor the right to an expedited hearing would be a defense in any subsequent disciplinary proceeding with respect to a member's non-compliance with Proposed FINRA Rule 4120(c)(1).

Unlike the self-operative nature of paragraph (c)(1), proposed FINRA Rule 4120(c)(2) authorizes FINRA, for any financial or operational reason, to require any member firm to reduce its business by the issuance of a notice in accordance with Rule 9557. In all such cases, the member firm would have the right to request an expedited hearing. This same right currently applies to NASD Rule 3130(d)(2).

(C) Proposed FINRA Rule 4130 (Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties)

Proposed FINRA Rule 4130 would be substantially identical to NASD Rule 3131 except that the proposed rule would reflect FINRA as the designated examining authority and make other conforming revisions. The proposed rule would apply only to certain firms that are subject to the Treasury Department's liquid capital requirements.

(D) Proposed FINRA Rule 4140 (Audit)

Proposed FINRA Rule 4140 would incorporate FINRA's existing authority under NASD Rule 3130 and NASD IM-3130 and NYSE Rule 418 to request an audit or an agreed-upon procedures review under certain circumstances. The proposed rule would impose a late fee of \$100 for each day that a requested report is not timely filed, up to a maximum of 10 business days.

(E) Proposed FINRA Rule 4521 (Notifications, Questionnaires and Reports)

Drawing in part on NASD IM-3130 and Rule 3150 and NYSE Rules 325(b)(2), 416<sup>20</sup> and 421(2),<sup>21</sup> Proposed FINRA Rule 4521 would address FINRA's authority to request certain information from members to carry out its surveillance and examination

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<sup>20</sup> NYSE Rules 416(a), 416(c) and 416.10 will remain in the Transitional Rulebook to be addressed later in the rulebook consolidation process. On July 11, 2008, the SEC approved FINRA's proposal to delete NYSE Rule 416(b). See Securities Exchange Act Release No. 58149 (July 11, 2008), 73 FR 42385 (July 21, 2008) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change; File No. SR-FINRA-2008-034).

<sup>21</sup> Because FINRA proposes to delete NYSE Rule 421(2) and its related provision Rule 421.40, the proposed rule change would, in combination with rule change SR-FINRA-2008-033 (which was approved by the SEC on September 4, 2008 and took effect on December 15, 2008), delete NYSE Rule 421 in its entirety. See Securities Exchange Act Release No. 58461 (September 4, 2008), 73 FR 52710 (September 10, 2008) (Order Approving Proposed Rule Change; File No. SR-FINRA-2008-033); see also FINRA Regulatory Notice 08-57 (SEC Approves New Consolidated FINRA Rules) (October 2008).

responsibilities. As further described below, many of the provisions would apply only to carrying and clearing members.

Proposed FINRA Rule 4521(a) would provide that each carrying or clearing member must submit to FINRA such financial and operational information regarding the member or any of its correspondents as FINRA deems essential for the protection of investors and the public interest. The provisions would be new for certain non-NYSE members that are carrying or clearing members.<sup>22</sup>

Proposed FINRA Rule 4521(b) would require every member approved by the SEC pursuant to SEA Rule 15c3-1 to use the alternative method of computing net capital contained in Appendix E to that Rule to file such supplemental and alternative reports as may be prescribed by FINRA.

Proposed FINRA Rule 4521(c) would require each carrying or clearing member to notify FINRA in writing no more than 48 hours after its tentative net capital, as computed pursuant to SEA Rule 15c3-1, has declined 20 percent or more from the amount reported in its most recent FOCUS Report or, if later, the most recent such notification filed with FINRA. This would be a new requirement for non-NYSE members that are carrying or clearing members.

Proposed FINRA Rule 4521(d) would require that, unless otherwise permitted by FINRA in writing, member firms carrying margin accounts for customers must submit, on a settlement date basis: (1) the total of all debit balances in securities margin accounts;

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<sup>22</sup> FINRA notes that NASD Rule 3150 (Reporting Requirements for Clearing Firms) currently requires most carrying and clearing members to submit such data to FINRA. Rule 3150 will be addressed later in the rulebook consolidation process.

and (2) the total of all free credit balances contained in cash or margin accounts. This would be a new requirement for non-NYSE member firms that carry margin accounts.

In response to commenter suggestion, Proposed FINRA Rule 4521(e) has been revised to provide that a late fee of \$100 would be imposed for each day that any report, notification or information a member is required to file pursuant to Rule 4521 is not timely filed, up to a maximum of 10 business days.

- (F) Proposed FINRA Rules 9557 (Procedures for Regulating Activities Under Rules 4110, 4120 and 4130 Regarding a Member Experiencing Financial or Operational Difficulties) and 9559 (Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series)

FINRA Rules 9557 and 9559 address service of notice to member firms that are experiencing financial or operational difficulties and the related hearing procedures. The proposed rule change would make a number of conforming revisions to FINRA Rules 9557 and 9559 in light of several of the proposed financial responsibility rules (Proposed FINRA Rules 4110, 4120 and 4130). In response to commenter concerns, FINRA reiterates that the proposed rule change also would include new provisions to afford members with an appeals process that is both more expedited than that currently provided under FINRA Rules 9557 and 9559 and provides members with adequate safeguards.<sup>23</sup>

For example:

- Proposed FINRA Rule 9557(d) would provide that the requirements referenced in a Rule 9557 notice served upon a member are immediately effective. Under the proposed rule change, a timely request for a hearing would stay the effective date for 10 business days after the service of the notice or until a written order is issued pursuant to Proposed FINRA Rule

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<sup>23</sup> See Section 7 under Item II.C.



9559(o)(4)(A) (whichever period is less), unless it is determined that such a stay cannot be permitted with safety to investors, creditors or other member firms;

- to ensure an expedited process, Proposed FINRA Rule 9557(e) would require a member to file with the Office of Hearing Officers any written request for a hearing within two business days after service of the Rule 9557 notice;
- Proposed FINRA Rule 9559(f)(1) would provide that, after a respondent subject to a Rule 9557 notice files a written request for a hearing with the Office of Hearing Officers, the hearing must be held within five business days of such filing;
- Proposed FINRA Rule 9559(o)(4)(A) would provide that, within two business days of the date of the close of the hearing, the Office of Hearing Officers must issue the Hearing Panel's written order. The Hearing Panel order would be effective when issued. (The proposed rule change provides that, pursuant to Proposed FINRA Rules 9559(o)(4)(B) and 9559(p), the written decision explaining the reasons for the Hearing Panel's determinations must be issued within seven days of the issuance of the written order.)

Proposed FINRA Rules 9557 and 9559 set forth a number of other enhancements and clarifications of procedure. For example, Proposed FINRA Rule 9557(e)(1) provides that a member served with a Rule 9557 notice may request from FINRA staff a letter of withdrawal of the notice. The member may make this request either in lieu of or in

addition to filing with the Office of Hearing Officers the written request for a hearing. The proposed rule change would enable FINRA staff, in response to the member's request, either to withdraw the Rule 9557 notice or to reduce its requirements and/or restrictions.<sup>24</sup> The member may submit a request for a letter of withdrawal to FINRA staff at any time after the notice is served. If such request is denied by FINRA staff, the proposed rule change provides that the member shall not be precluded from making a subsequent request or requests.<sup>25</sup>

If a member requests a hearing within two business days after service of a 9557 notice, the member may seek to contest (1) the validity of the requirements and/or restrictions imposed by the notice (as the same may have been reduced by a letter of withdrawal issued by FINRA staff pursuant to Rule 9557(g)(2), where applicable) and/or (2) FINRA staff's determination not to issue a letter of withdrawal of all requirements and/or restrictions imposed by the notice, if such was requested by the member. The Hearing Panel may then either approve or withdraw the requirements and/or restrictions imposed by the notice. If the Hearing Panel approves the requirements and/or restrictions and finds the member has not complied with all of them, the Hearing Panel shall impose an immediate suspension on the respondent that shall remain in effect unless FINRA staff issues a letter of withdrawal of all requirements and/or restrictions.

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.

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<sup>24</sup> See Proposed FINRA Rule 9557(g)(2).

<sup>25</sup> See Proposed FINRA Rule 9557(e)(1).

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>26</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 because, as part of the FINRA rulebook consolidation process, the proposed rule change will streamline and reorganize existing rules that govern financial responsibility. Further, FINRA believes that the proposed rule change will provide greater regulatory clarity with respect to these issues.

### **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**

In May 2008, FINRA published the Notice<sup>27</sup> requesting comment on the proposed rule changes. A copy of the Notice is attached as Exhibit 2a.<sup>28</sup> The comment period ended on June 13, 2008. Seventeen commenters responded to the Notice. Copies

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<sup>26</sup> 15 U.S.C. 78o-3(b)(6).

<sup>27</sup> See *supra*, note 3.

<sup>28</sup> The Commission notes that while provided in Exhibit 2a to FINRA's filing with the Commission, the Notice is not attached hereto. The Notice can be accessed online at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038509.pdf>.

of the comment letters received, and a list of the commenters, are attached as Exhibit 2b.<sup>29</sup>

1. General Comments; Tiering of Requirements

Commenters expressed general support for rule consolidation,<sup>30</sup> including support specifically for FINRA's proposal to tier certain requirements to apply only to firms that carry or clear customer accounts.<sup>31</sup>

2. Members Operating Pursuant to SEA Rule 15c3-3(k)(2)(i) Exemption

As proposed in the Notice, the requirements set forth in the proposed rules that would apply to carrying and clearing members would also apply to members that operate pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i).<sup>32</sup> The Notice referred to such members as "(k)(2)(i) members," and the relevant provisions of the proposed rule text as published in the Notice designated them by the phrase "operating pursuant to the exemptive provisions of Rule 15c3-3(k)(2)(i)."

Commenters suggested that the application of the term "(k)(2)(i) member" was in need of further explanation or reconsideration,<sup>33</sup> and that it would be better either to

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<sup>29</sup> The Commission notes that while provided in Exhibit 2b to the filing, the list of the commenters and comment letters received by FINRA are not attached hereto. Those comment letters can be accessed online at <http://www.finra.org/Industry/Regulation/Notices/2008/P038501>. As stated previously, all references to "commenters" are to the commenters to the Notice, which are listed in Exhibit 2b.

<sup>30</sup> Northwestern, Wachovia, FSI, SIFMA, ING and Federated.

<sup>31</sup> ING, Thornburg and CAI.

<sup>32</sup> The Notice explained that "operating" pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i) is not meant to include firms that have elected the exemption but do not operate as such.

<sup>33</sup> SIFMA, CAI and Kinkade.

eliminate references to Rule 15c3-3(k)(2)(i) from the proposed rules or to specify that the proposed rules apply to (k)(2)(i) members that hold customer cash or securities.<sup>34</sup>

FINRA agrees that the application of the proposed rules with respect to (k)(2)(i) members as put forward in the Notice should be clarified. Accordingly, the proposed rules have been revised to eliminate the phrase “operating pursuant to the exemptive provisions of Rule 15c3-3(k)(2)(i).” Further, in response to commenter requests for clarification, FINRA notes that a firm “operates” pursuant to the exemptive provisions of Rule 15c3-3(k)(2)(i), and is therefore included as a clearing or carrying member for purposes of the proposed rules, if it either holds customer funds in a bank account established pursuant to Rule 15c3-3(k)(2)(i) or clears customer transactions through such an account. FINRA’s records currently indicate that there are approximately seventy such member firms.

### 3. Authority to Increase Capital Requirements

Four commenters expressed concern regarding the scope of FINRA’s authority under Proposed FINRA Rule 4110(a).<sup>35</sup> Three of the four suggested that the factors under which FINRA would take action pursuant to the rule should be clearly spelled out (including one suggestion that procedural protections are needed);<sup>36</sup> the fourth of these commenters suggested FINRA should not undermine haircut determinations that the SEC

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<sup>34</sup> SIFMA and ING.

<sup>35</sup> FSI, ING, Federated and Fischer.

<sup>36</sup> FSI, ING and Fischer.

makes pursuant to SEA Rule 15c3-1.<sup>37</sup> One commenter suggested that new rules are not needed.<sup>38</sup>

FINRA staff understands the noted concerns, but believes that the proposed rule does not lend itself to prescribed parameters. As explained in Section (A)(1) of Item II.A.1, because Proposed Rule 4110(a) is intended to enable FINRA to respond promptly to extraordinary, unanticipated or emergency circumstances (a goal acknowledged by at least one commenter),<sup>39</sup> FINRA does not agree that it is in the public interest to limit the rule's application by listing specific circumstances under which FINRA would exercise its authority. FINRA expects to employ its authority pursuant to the proposed rule judiciously. Further, FINRA rejects the argument that the proposed rule does not provide adequate safeguards; FINRA would be expressly required to issue a Rule 9557 notice, which among other things permits a member opportunity for an expedited hearing pursuant to Proposed FINRA Rule 9559.

#### 4. Withdrawal of Equity Capital

Three commenters said that Proposed FINRA Rule 4110(c)(1) is too restrictive or is more stringent than current or proposed SEC requirements.<sup>40</sup> One suggested that the proposed rule be revised to clarify that withdrawal of profits from an earlier period would be permitted.<sup>41</sup> Two said that the proposed rule should either be deleted or, if adopted, the factors that FINRA would take into consideration in approving requests should be

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<sup>37</sup> Federated.

<sup>38</sup> Cantella.

<sup>39</sup> Federated.

<sup>40</sup> FSI, Northwestern and CAI.

<sup>41</sup> SIFMA.

articulated;<sup>42</sup> one of these two commenters suggested that a period of time should be established within which FINRA would process any requests pursuant to the proposed rule.<sup>43</sup> One suggested that the proposed rule would restrict a parent company's support of a broker-dealer subsidiary.<sup>44</sup> One raised concerns regarding the proposed rule's potential impact on smaller or start-up firms.<sup>45</sup>

Proposed FINRA Rule 4110(c)(2) drew comments that were similar to those for Proposed FINRA Rule 4110(c)(1). Five commenters said that the proposed rule is too restrictive or is more stringent than current or proposed SEC requirements.<sup>46</sup> One suggested the proposed rule would put the financial management of firms in FINRA's hands, rather than the firms exercising their own management.<sup>47</sup> Two suggested that a period of time should be established within which FINRA would process any requests pursuant to the proposed rule.<sup>48</sup> Three suggested that the factors FINRA would consider in approving requests should be articulated.<sup>49</sup> One suggested that the proposed rule would be burdensome for smaller firms.<sup>50</sup>

In response, FINRA notes that Proposed FINRA Rule 4120 (Regulatory Notification and Business Curtailment) – in particular Proposed FINRA Rule 4120.01 –

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<sup>42</sup> FSI and Northwestern.

<sup>43</sup> FSI.

<sup>44</sup> Northwestern.

<sup>45</sup> FSI.

<sup>46</sup> SIFMA, ING, Kinkade, Baum and CAI. See also note 52 infra and accompanying text.

<sup>47</sup> Capstone.

<sup>48</sup> SIFMA and FSI.

<sup>49</sup> FSI, Baum and TBT.

<sup>50</sup> Baum.

sets forth examples of the types of factors that FINRA staff would take into consideration when considering whether to approve a request for a withdrawal of equity capital pursuant to Proposed Rules 4110(c)(1) or (c)(2). FINRA would consider the overall risks particular to the member and what the member's condition would be after the proposed withdrawal. FINRA believes that the proposed rules are not burdensome because, as a general matter, requests for a withdrawal can be handled in a routine manner – FINRA's decision typically would be issued in approximately three business days. Further, FINRA notes that Proposed FINRA Rule 4110(c)(2) provides a 10 percent de minimis threshold. Lastly, FINRA agrees that Proposed FINRA Rule 4110(c)(1) should not preclude the withdrawal of profits, and has accordingly revised the proposed rule to clarify that, subject to the requirements of Proposed FINRA Rule 4110(c)(2), the rule does not preclude a member from withdrawing profits earned.<sup>51</sup>

Several commenters appeared to express concerns regarding Proposed FINRA Rule 4110(c)(2) based on the belief that the rule would apply to introducing firms or firms with limited business models.<sup>52</sup> Because such members generally are not carrying or clearing members, they would not be subject to the proposed rule. As explained in the Notice and re-iterated in FINRA's filing with the Commission, non-clearing firms generally include, for example, firms that engage exclusively in subscription-basis mutual fund transactions, direct participation programs, or mergers and acquisitions activities.<sup>53</sup>

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<sup>51</sup> See Section (A)(3) under Item II.A.1.

<sup>52</sup> Colonnade, TBT and Capstone.

<sup>53</sup> See note 9 under Item II.A.1.



## 5. Audits

One commenter said that Proposed FINRA Rule 4140 is too broad and that the imposition of an audit pursuant to the rule would essentially operate as a sanction, for which reason there should be an appeal process in the event an audit is imposed.<sup>54</sup> FINRA disagrees. Though NASD Rule 3130 and NASD IM-3130 provide for an appeal process pursuant to current Rule 9557, NYSE Rule 418 includes no such provision. FINRA emphasizes that the purpose of Proposed FINRA Rule 4140 is to confer upon FINRA necessary authority, especially in emergency circumstances. The proposed rule would be invoked only in situations where there are “concerns regarding the accuracy or integrity of a member’s financial statements, books and records or prior audited financial statements.”<sup>55</sup> FINRA emphasizes that only FINRA’s EVP, or his or her written officer delegate, would have the authority to request an audit.

## 6. Notifications, Questionnaires and Reports

One commenter suggested expanding the late fee provided for under Proposed FINRA Rule 4521(e) to include all reports, notifications and information required under Rule 4521. (As published in the Notice, the rule would have limited the late fee to financial and operational information regarding a member or its correspondents as required under Proposed FINRA Rule 4521(a); the commenter proposed to expand that to include for instance the margin account information required under the rule.)<sup>56</sup> FINRA

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<sup>54</sup> ING.

<sup>55</sup> See Proposed FINRA Rule 4140(a).

<sup>56</sup> Thornburg.

agrees with this proposal as consistent with the goal of clarity and ease of administration, and has revised the proposed rule accordingly.<sup>57</sup>

#### 7. Service of Notice and Hearing Procedures

Two commenters expressed concern regarding the scope of the discretion that Proposed FINRA Rule 9557 would grant to FINRA staff.<sup>58</sup> Two commenters suggested that the proposed rule change does not provide sufficient time to broker-dealers;<sup>59</sup> one suggested giving members five days to decide whether to pursue an appeal rather than two.<sup>60</sup> One commenter suggested that the effectiveness of a Rule 9557 notice should be two days after being issued, rather than immediately effective.<sup>61</sup> This same commenter also said that the proposed rule change grants substantial discretion to FINRA's CEO to deny a stay of a Rule 9557 notice after a member requests a hearing and that FINRA should be required either to present the member with a factual finding in the event a stay is denied, or that the FINRA decision be made in consultation with a third party, such as the National Adjudicatory Council or the SEC.

In response, FINRA emphasizes that because Proposed FINRA Rules 9557 and 9559 are designed to enable FINRA to respond to emergency circumstances, FINRA does not believe that the effectiveness of a Rule 9557 notice should be anything other than immediate. Similarly, FINRA sees no reason to extend the time within which a member must decide whether to pursue an appeal. FINRA intentionally designed Rules

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<sup>57</sup> See Section (E) under Item II.A.1.

<sup>58</sup> SIFMA and Cantella.

<sup>59</sup> FSI and ING.

<sup>60</sup> FSI.

<sup>61</sup> SIFMA.

9557 and 9559 to provide an expedited hearing process for affected parties. Moreover, because the restrictions or requirements set forth in a Rule 9557 notice generally are stayed during the appeal process, it is imperative that the matter be resolved expeditiously in the event the Hearing Panel approves the restrictions and/or requirements. With respect to stays, FINRA further notes that the proposed rule change provides that the Rule 9557 notice is routinely stayed during the time of the hearing. The proposed rule change does not require the member to request the stay – the stay is provided for unless the CEO makes a determination otherwise, when necessary for the safety of investors, creditors or other member firms. Moreover, FINRA anticipates that the CEO would use such authority only in extraordinary circumstances. Accordingly, the only revisions that FINRA has made with respect to Proposed Rules 9557 and 9559 have been with a view to further procedural enhancements and clarifications of the rules as published in the Notice.<sup>62</sup>

#### 8. Additional Comments

In response to comments, FINRA has made a number of additional clarifying revisions to the proposed rules or has provided clarifying explanations, including:

- one commenter suggested that the language of Proposed FINRA Rule 4110(e)(2) be clarified with respect to LLCs.<sup>63</sup> In response, FINRA has reconsidered the proposed rule and determined that it is not necessary to apply it to LLCs;<sup>64</sup>

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<sup>62</sup> See Section (F) under Item II.A.1.

<sup>63</sup> SIFMA.

<sup>64</sup> See Section (A)(5) under Item II.A.1.

- one commenter proposed clarifying language for Proposed FINRA Rule 4120(c)(3)(I).<sup>65</sup> In response, FINRA has made clarifying revisions;
- one commenter suggested that FINRA clarify that though the requirements of Proposed FINRA Rule 4120(a) would only apply to carrying and clearing members, all members nonetheless remain subject to the requirements of SEA Rule 17a-11, and that the notification that would be required under the proposed rule is in addition to the notification required under SEA Rules 17a-11(b) and (c).<sup>66</sup> FINRA agrees that all members should be mindful of their obligations under Rule 17a-11 in addition to those that the proposed rule would impose;
- three commenters objected to provisions in the proposed rules (one commenter as to Proposed FINRA Rule 4110(d)(4),<sup>67</sup> the others as to Proposed FINRA Rule 4110(e)(2)<sup>68</sup>) pertaining to review by FINRA of loan documentation. In response, FINRA believes that the documentation reviews as set forth in the proposed rules are a necessary part of FINRA's function. FINRA encourages members to consult Proposed FINRA Rule 4120.01 for examples of the types of factors that FINRA staff would consider when reviewing loan documentation.

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<sup>65</sup> SIFMA.

<sup>66</sup> Thornburg. This commenter also suggested a number of clarifying edits with respect to Proposed FINRA Rules 4130(a) and 4521. FINRA has aligned Proposed FINRA Rule 4130(a) with the current requirements of NASD Rule 3131(a) (see Section (C) under Item II.A.1) and has re-organized Proposed FINRA Rule 4521 for purposes of clarity.

<sup>67</sup> Baum.

<sup>68</sup> Cantella and Kinkade.

**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

(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-2008-067 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-2008-067. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method.

The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to

File Number SR-FINRA-2008-067 and should be submitted on or before [insert date 21 days from the publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>69</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>69</sup> 17 CFR 200.30-3(a)(12).

## **Exhibit A**

**Proposed new language is underlined; deletions are in brackets.**

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**Text of Proposed New FINRA Rules 4110, 4120, 4130, 4140, 4521, 9557 and 9559  
(Proposed FINRA Rules 9557 and 9559 Are Marked to Show Changes from FINRA  
Rules 9557 and 9559, Respectively)**

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### **4000. FINANCIAL AND OPERATIONAL RULES**

#### **4100. FINANCIAL CONDITION**

##### **4110. Capital Compliance**

(a) When necessary for the protection of investors or in the public interest, FINRA may, at any time or from time to time with respect to a particular carrying or clearing member or all carrying or clearing members, pursuant to authority exercised by FINRA's Executive Vice President charged with oversight for financial responsibility, or his or her written officer delegate, prescribe greater net capital or net worth requirements than those otherwise applicable, including more stringent treatment of items in computing net capital or net worth, or require such member to restore or increase its net capital or net worth. In any such instance, FINRA shall issue a notice pursuant to Rule 9557.

(b) (1) Unless otherwise permitted by FINRA, a member shall suspend all business operations during any period in which it is not in compliance with applicable net capital requirements set forth in SEA Rule 15c3-1.

(2) FINRA may issue a notice pursuant to Rule 9557 directing a member that is not in compliance with applicable net capital requirements set forth in SEA Rule 15c3-1 to suspend all or a portion of its business.



(c) (1) Any equity capital contributed by a member may not be withdrawn for a period of one year, unless otherwise permitted by FINRA in writing. Subject to the requirements of paragraph (c)(2) of this Rule, this paragraph shall not preclude a member from withdrawing profits earned.

(2) A carrying or clearing member shall not, without the prior written approval of FINRA, withdraw capital, pay a dividend or effect a similar distribution that would reduce such member's equity, or make any unsecured advance or loan to a stockholder, partner, sole proprietor, employee or affiliate, where such withdrawals, payments, reductions, advances or loans in the aggregate, in any 35 rolling calendar day period, on a net basis, exceeds 10% of its excess net capital.

**(d) Sale-And-Leasebacks, Factoring, Financing, Loans and Similar Arrangements**

(1) (A) No carrying or clearing member shall consummate a sale-and-leaseback arrangement with respect to any of its assets, or a sale, factoring, or financing arrangement with respect to any unsecured accounts receivable, where any such arrangement would increase the member's tentative net capital by 10% or more, without the prior written authorization of FINRA.

(B) No carrying member shall consummate any arrangement concerning the sale or factoring of customer debit balances, irrespective of amount, without the prior written authorization of FINRA.

(2) Any loan agreement entered into by a carrying or clearing member, the proceeds of which exceed 10% of such member's tentative net capital and which is intended to reduce the deduction in computing net capital for fixed assets and other assets which cannot be readily converted into cash under SEA Rule 15c3-1(c)(2)(iv), must be submitted to and be acceptable to FINRA, prior to such reduction becoming effective.

(3) Members subject to paragraphs (d)(1)(A), (d)(1)(B) or (d)(2), shall not consummate any arrangement pursuant to such paragraph(s) if the aggregate of all such arrangements outstanding would exceed 20% of such member's tentative net capital, without the prior written authorization of FINRA.

(4) Any agreement relating to a determination of a "ready market" for securities based upon the securities being accepted as collateral for a loan by a bank under SEA Rule 15c3-1(c)(11)(ii), must be submitted to and be acceptable to FINRA before the securities may be deemed to have a "ready market."

(e) Subordinated Loans, Notes Collateralized by Securities and Capital

#### Borrowings

(1) All subordinated loans or notes collateralized by securities shall meet such standards as FINRA may require to ensure the continued financial stability and operational capability of the member, in addition to those specified in Appendix D of SEA Rule 15c3-1.

(2) Unless otherwise permitted by FINRA, each member partnership whose general partner enters into any secured or unsecured borrowing, the proceeds of which will be contributed to the capital of the member, shall submit

the following for approval in order for such proceeds to qualify as capital acceptable for inclusion in the computation of the net capital of the member:

A signed copy of the loan agreement which must:

(A) have at least a 12 month duration; and

(B) provide non-recourse to the assets of the member.

Additional documents may be required, the nature of which will vary, depending upon the legal status of the lender e.g. an individual, bank, estate, trust, corporation, partnership, etc.

**••• Supplementary Material: -----**

**.01 Compliance with Applicable Law.** For purposes of paragraph (e)(1), the member shall assure itself that any applicable provisions of the Securities Act of 1933 and/or State Blue Sky laws have been satisfied and may be required to submit evidence thereof to FINRA prior to approval of the subordinated loan agreement.

**4120. Regulatory Notification and Business Curtailment**

**(a) Notification**

(1) Each carrying or clearing member shall promptly, but in any event within 24 hours, notify FINRA in writing if its net capital falls below the following percentages:

(A) the member's net capital is less than 150 percent of its minimum dollar net capital requirement or such greater percentage thereof as may from time to time be designated by FINRA;

(B) the member is subject to the aggregate indebtedness requirement of SEA Rule 15c3-1, and its aggregate indebtedness is more than 1,000 percent of its net capital;

(C) the member elects to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1(a)(1)(ii), and its net capital is less than the level specified in SEA Rule 17a-11(c)(2);

(D) the member is approved to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1e, and

(i) its tentative net capital as defined in SEA Rule 15c3-1(c)(15) is less than 50 percent of the early warning notification amount required by SEA Rule 15c3-1(a)(7)(ii), or

(ii) its net capital is less than \$1.25 billion;

(E) the member is registered as a Futures Commission Merchant pursuant to the Commodity Exchange Act, and its net capital is less than 120% of the minimum risk-based capital requirements of Commodity Exchange Act Rule 1.17; or

(F) the member's deduction of capital withdrawals, which it anticipates making, whether voluntarily or as a result of a commitment, including maturities of subordinated liabilities entered into pursuant to Appendix D of SEA Rule 15c3-1, during the next six months, would result in any one of the conditions described in paragraph (a)(1)(A) through (E) of this Rule.

**(b) Restrictions on Business Expansion**

(1) Except as otherwise permitted by FINRA in writing, a member that carries customer accounts or clears transactions shall not expand its business during any period in which any of the conditions described in paragraph (a)(1) continue to exist for more than 15 consecutive business days, provided that such condition(s) has been known to FINRA or the member for at least five consecutive business days. FINRA may issue a notice pursuant to Rule 9557 directing any such member not to expand its business; however, FINRA's authority to issue such notice does not negate the member's obligation not to expand its business in accordance with this paragraph (b)(1).

(2) No member may expand its business during any period in which FINRA restricts the member from expanding its business for any financial or operational reason. In any such instance, FINRA shall issue a notice pursuant to Rule 9557.

(3) For purposes of paragraph (b) of this Rule, the term "expansion of business" may include:

(A) net increase in the number of registered representatives or other producing personnel;

(B) exceeding average capital commitments over the previous three months for market making or block positioning;

(C) initiation of market making in new securities or any new proprietary trading or other commitment in securities or commodities in which a market is not made (other than riskless trades associated with customer orders);

(D) exceeding average commitments over the previous three months for underwritings;

(E) opening of new branch offices;

(F) entering any new line of business or deliberately promoting or expanding any present lines of business;

(G) making unsecured or partially secured loans, advances, drawings, guarantees or other similar receivables; and

(H) such other activities as FINRA deems appropriate under the circumstances, in the public interest or for the protection of investors.

**(c) Reduction of Business**

(1) Except as otherwise permitted by FINRA in writing, a member that carries customer accounts or clears transactions is obligated to reduce its business to a point enabling its available capital to exceed the standards set forth in paragraph (a)(1)(A) through (F) of this Rule, when any of the following conditions continue to exist for more than 15 consecutive business days, provided that such condition(s) has been known to FINRA or the member for at least five consecutive business days:

(A) the member's net capital is less than 125 percent of its minimum dollar net capital requirement or such greater percentage thereof as may from time to time be designated by FINRA;

(B) the member is subject to the aggregate indebtedness requirement of SEA Rule 15c3-1, and its aggregate indebtedness is more than 1,200 percent of its net capital;

(C) the member elects to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1(a)(1)(ii), and its net capital is less than one percentage point below the level specified in SEA Rule 17a-11(c)(2);

(D) the member is approved to use the alternative method of computing net capital pursuant to SEA Rule 15c3-1e, and

(i) its tentative net capital as defined in SEA Rule 15c3-1(c)(15) is less than 40 percent of the early warning notification amount required by SEA Rule 15c3-1(a)(7)(ii), or

(ii) its net capital is less than \$1 billion;

(E) the member is registered as a Futures Commission Merchant pursuant to the Commodity Exchange Act, and its net capital is less than 110% of the minimum risk-based capital requirements of Commodity Exchange Act Rule 1.17; or

(F) the member's deduction of capital withdrawals, including maturities of subordinated liabilities entered into pursuant to Appendix D of SEA Rule 15c3-1, scheduled during the next six months, would result in any one of the conditions described in paragraph (c)(1)(A) through (E) of this Rule.

FINRA may issue a notice pursuant to Rule 9557 directing any such member to reduce its business to a point enabling its available capital to exceed the standards set forth in paragraph (a)(1)(A) through (F) of this Rule; however,

FINRA's authority to issue such notice does not negate the member's obligation to reduce its business in accordance with this paragraph (c)(1).

(2) A member must reduce its business as directed by FINRA for any financial or operational reason. In any such instance, FINRA shall issue a notice pursuant to Rule 9557.

(3) For purposes of paragraph (c) of this Rule, the term "business reduction" shall mean reducing or eliminating parts of a member's business in order to reduce the amount of capital required, which may include:

(A) promptly paying all or a portion of free credit balances to customers;

(B) promptly effecting delivery to customers of all or a portion of fully paid securities in the member's possession or control;

(C) introducing all or a portion of its business to another member on a fully disclosed basis;

(D) reducing the size or modifying the composition of its inventory and reducing or ceasing market making;

(E) closing of one or more existing branch offices;

(F) collecting unsecured or partially secured loans, advances, drawings, guarantees or other similar receivables;

(G) accepting no new customer accounts;

(H) restricting the payment of salaries or other sums to partners, officers, directors, shareholders, or associated persons of the member;



(I) effecting liquidating or closing customer and/or proprietary transactions;

(J) accepting only unsolicited customer orders; and

(K) such other activities as FINRA deems appropriate under the circumstances in the public interest or for the protection of investors.

**••• Supplementary Material: -----**

**.01 Exercise of Discretion by FINRA.** The following are examples of the conditions under which FINRA may exercise its discretion pursuant to paragraphs (b)(2) or (c)(2) above:

(a) The member has experienced a substantial change in the manner in which it processes its business, which, in the view of FINRA, increases the potential risk of loss to customers or other members;

(b) The member's books and records are not maintained in accordance with the provisions of SEA Rules 17a-3 or 17a-4;

(c) The member is not in compliance, or is unable to demonstrate compliance, with applicable net capital requirements;

(d) The member is not in compliance, or is unable to demonstrate compliance, with SEA Rule 15c3-3 (Customer Protection – Reserves and Custody of Securities);

(e) The member is unable to clear and settle transactions promptly; or

(f) The member's overall business operations are in such condition, given the nature of its business that, notwithstanding the absence of any of the conditions enumerated in paragraphs (a) through (e), a determination of financial or operational difficulty should be made.

.02 Correspondent Firms. The Rule contemplates that any restrictions or conditions imposed on a carrying or clearing member's business under this Rule may require that member to restrict the business activities of one or more correspondent firms for which the member clears, insofar as such business would be handled by such carrying or clearing member.

**4130. Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties**

(a) Application — For purposes of this Rule, the term "member" shall be limited to any member of FINRA registered with the SEC pursuant to Section 15C of the Exchange Act that is not designated to another self-regulatory organization by the SEC for financial responsibility pursuant to Section 17 of the Exchange Act and SEA Rule 17d-1.

(b) Each member subject to Section 402.2 of the rules of the Treasury Department shall comply with the capital requirements prescribed therein and with the provisions of this Rule.

(c) A member, when so directed by FINRA shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist for more than 15 consecutive business days:

(A) the member's liquid capital is less than 150 percent of the total haircuts or such greater percentage thereof as may from time to time be prescribed by FINRA;

(B) the member's liquid capital minus total haircuts is less than 150 percent of its minimum dollar capital requirement; or

(C) the deduction of ownership equity and maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A) or (B) of this subparagraph (1);  
or

(2) FINRA restricts the member for any other financial or operational reason.

(d) A member, when so directed by FINRA, shall forthwith reduce its business:

(1) To a point at which the member would not be subject to a prohibition against expansion of its business as set forth in paragraphs (c)(1)(A), (B), or (C) of this Rule if any of the following conditions continue to exist for more than 15 consecutive business days:

(A) the member's liquid capital is less than 125 percent of total haircuts or such greater percentage thereof as may from time to time be prescribed by FINRA;

(B) the member's liquid capital minus total haircuts is less than 125 percent of its minimum dollar capital requirement; or

(C) the deduction of ownership equity and maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A) or (B) of this subparagraph (1);  
and

(2) As required by FINRA when it restricts a member for any other financial or operational reason.

(e) A member shall suspend all business operations during any period of time when the member is not in compliance with applicable liquid capital requirements as set forth in Section 402.2 of the rules of the Treasury Department. FINRA staff may issue a notice to such member directing it to suspend all business operations; however, the member's obligation to suspend all business operations arises from its obligations under Section 402.2 of the rules of the Treasury Department and is not dependent on any notice that may be issued by FINRA staff.

(f) Any notice directing a member to limit or suspend its business operations shall be issued by FINRA staff pursuant to Rule 9557.

#### **4140. Audit**

(a) FINRA may at any time, due to concerns regarding the accuracy or integrity of a member's financial statements, books and records or prior audited financial statements, direct any member to cause an audit to be made by an independent public accountant of its accounts, or cause an examination to be made in accordance with attestation, review or consultation standards prescribed by the AICPA. Such audit or examination shall be directed pursuant to authority exercised by FINRA's Executive Vice President charged with oversight for financial responsibility, or his or her written officer delegate, and shall be made in accordance with such requirements as FINRA may prescribe.

(b) Any member failing to file an audited financial and/or operational report or examination report under this Rule in the prescribed time shall be subject to a late fee as set forth in Schedule A Section 4(g)(1) to the FINRA By-Laws.

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#### **4500. BOOKS, RECORDS AND REPORTS**

\* \* \* \* \*

#### **4520. Financial Records and Reporting Requirements**

#### **4521. Notifications, Questionnaires and Reports**

(a) Each carrying or clearing member shall submit to FINRA, or its designated agent, at such times as may be designated, or on an ongoing basis, in such form and within such time period as may be prescribed, such financial and operational information regarding the member or any of its correspondents as FINRA deems essential for the protection of investors and the public interest.

(b) Every member approved by the SEC pursuant to SEA Rule 15c3-1 to use the alternative method of computing net capital contained in Appendix E to that Rule shall file such supplemental and alternative reports as may be prescribed by FINRA.

(c) Each carrying or clearing member shall notify FINRA in writing, no more than 48 hours after its tentative net capital as computed pursuant to SEA Rule 15c3-1 has declined 20 percent or more from the amount reported in its most recent FOCUS Report or, if later, the most recent such notification filed with FINRA. For purposes of this paragraph, “tentative net capital as computed pursuant to SEA Rule 15c3-1” shall exclude withdrawals of capital previously approved by FINRA.

(d) (1) Unless otherwise permitted by FINRA in writing, members carrying margin accounts for customers are required to submit, on a settlement date basis, the information specified in paragraphs (d)(2)(A) and (d)(2)(B) of this Rule as of the last business day of the month. If a member has no information to submit, a report should be filed with a notation thereon to that effect. Reports are due as promptly as possible after the last business day of the month, but in no event later than the sixth business day of the following month. Members shall use such form as FINRA may prescribe for these reporting purposes.

(2) Each member carrying margin accounts for customers shall submit reports containing the following customer information:

(A) Total of all debit balances in securities margin accounts; and

(B) Total of all free credit balances in all cash accounts and all margin accounts.

(3) For purposes of this paragraph (d):

(A) Only free credit balances in cash and margin accounts shall be included in the member's report. Balances in short accounts and in Special Memorandum Accounts (as defined in Section 2.2 of Regulation T under the Exchange Act) shall not be considered as free credit balances.

(B) Reported debit or credit balance information shall not include the accounts of other organizations that are FINRA members, or of the associated persons of the member submitting the report where such associated person's account is excluded from the definition of customer pursuant to SEA Rule 15c3-3.

(e) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file any report, notification or information pursuant to this Rule, a late fee as set forth in Schedule A Section 4(g)(1) to the FINRA By-Laws.

(f) For purposes of this Rule, any report filed pursuant to this Rule containing material inaccuracies shall be deemed not to have been filed until a corrected copy of the report has been resubmitted.

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#### **9000. CODE OF PROCEDURE**

\* \* \* \* \*

#### **9500. OTHER PROCEEDINGS**

\* \* \* \* \*

#### **9557. Procedures for Regulating Activities Under [NASD] Rules 4110, [3130] 4120 and 4130 [3131] Regarding a Member Experiencing Financial or Operational Difficulties**

##### **(a) Notice of Requirements and/or Restrictions; FINRA Action**

FINRA staff may issue a notice directing a member to comply with the provisions of Rule 4110, 4120 or 4130 or restrict its business activities, either by limiting or ceasing to conduct those activities consistent with Rule 4110, 4120 or 4130, if FINRA staff has reason to believe that a condition specified in [NASD] Rule 4110, 4120 [3130] or 4130 [Rule 3131] exists. A notice served under this Rule shall constitute FINRA action.

**(b) No Change.**

##### **(c) Contents of Notice**

A notice issued under this Rule shall:

(1) state the specific grounds and include the factual basis for the FINRA action[.];

(2) specify the date of the notice and the requirements and/or restrictions being imposed by the notice;

(3) [The notice shall] state [when the FINRA action will take effect and] that the requirements and/or restrictions imposed by the notice are immediately effective;

(4) specify [explain what the respondent must do to avoid such action] the conditions for complying with and, where applicable, avoiding or terminating the requirements and/or restrictions imposed by the notice[.];

(5) inform the member that, pursuant to paragraph (f) of this Rule, the failure to comply with the requirements and/or restrictions imposed by an effective notice under this Rule shall be deemed, without further notice from FINRA staff, to result in automatic and immediate suspension unless FINRA staff issues a letter of withdrawal of all requirements and/or restrictions imposed by the notice pursuant to paragraph (g)(2) of this Rule;

(6) explain that the member may make a request for a letter of withdrawal of the notice pursuant to paragraph (e) of this Rule;

(7) [The notice shall] state that, in addition to making a request for a letter of withdrawal of the notice, the [respondent] member may file a written request for a hearing with the Office of Hearing Officers pursuant to Rule 9559[.];

(8) [The notice also shall] inform the [respondent] member of the applicable deadline for filing a request for a hearing and [shall] state that a request



for a hearing must set forth with specificity any and all defenses to the FINRA action[.]; and

(9) [In addition, the notice shall] explain that, pursuant to Rule[s] 8310(a) and] 9559(n), a [Hearing Officer or, if applicable,] Hearing Panel[, ] may approve[, modify] or withdraw the requirements and/or restrictions [any and all sanctions or limitations] imposed by the notice, and [may impose any other fitting sanction] that if the Hearing Panel approves the requirements and/or restrictions imposed by the notice and finds that the member has not complied with all of them, the Hearing Panel shall impose an immediate suspension on the member.

**(d) Effectiveness [Date] of the Requirements and/or Restrictions**

The requirements and/or restrictions imposed by a notice issued and served under this Rule are immediately effective, except that a timely request for a hearing shall stay the effective date for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less), unless FINRA's Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate) determines that such a stay cannot be permitted with safety to investors, creditors or other members. Such a determination by FINRA's Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate) cannot be appealed. An extension of the stay period is not permitted. Where a timely request for a hearing stays the action for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less), the notice shall not be deemed to have taken effect during that entire period. [The restrictions referenced in a notice issued and served

under this Rule shall become effective seven days after service of the notice, unless stayed by a request for a hearing pursuant to Rule 9559.]

Any requirements and/or restrictions imposed by an effective notice shall remain in effect unless FINRA staff shall remove or reduce the requirements and/or restrictions pursuant to a letter of withdrawal of the notice issued as set forth in paragraph (g)(2) of this Rule.

(e) **Request for a Letter of Withdrawal of the Notice; Request for a Hearing**

A member served with a notice under this Rule may request from FINRA staff a letter of withdrawal of the notice pursuant to paragraph (g)(2) of this Rule and/or file with the Office of Hearing Officers a written request for a hearing pursuant to Rule 9559.

(1) A request for a letter of withdrawal of the notice may be made at any time after service of a notice under this Rule. The member making the request must demonstrate to the satisfaction of FINRA staff that the requirements and/or restrictions imposed by the notice should be removed or reduced. If such a request is denied by FINRA staff, the member shall not be precluded from making a subsequent request or requests.

(2) A request for a hearing shall be made within two business days after service of a notice under this Rule [before the effective date of the notice, as indicated in paragraph (d) of this Rule]. A request for a hearing must set forth with specificity any and all defenses to the FINRA action. A request for a hearing may seek to contest:

(A) the validity of the requirements and/or restrictions imposed by the notice (as the same may have been reduced by a letter of withdrawal pursuant to paragraph (g)(2) of this Rule, where applicable); and/or

(B) FINRA staff's determination not to issue a letter of withdrawal of all requirements and/or restrictions imposed by the notice, if such was requested by the member.

**(f) [Failure to Request Hearing]**

[If a member does not timely request a hearing, the restrictions specified in the notice shall become effective seven days after service of the notice. The restrictions specified in the notice shall remain in effect until the head of the FINRA department or office that issued the notice or, if another FINRA department or office is named as the party handling the matter on behalf of the issuing department or office, the head of the FINRA department or office that is so designated reduces or removes the restrictions pursuant to paragraph (h) of this Rule.]

**[(g) Order to] Enforcement of [Sanctions] Notice**

[If FINRA staff determines that a] A member that has failed to comply with the [any] requirements and/or restrictions imposed by [a decision or] an effective notice under this Rule shall be deemed, without further notice from FINRA staff, automatically and immediately suspended [that have not been stayed, FINRA staff shall issue an order imposing the sanctions set forth in the decision or notice and specifying the effective date and time of such sanctions. The order shall inform the member that it may apply for relief from the sanctions imposed by the order by filing a written request for a hearing before the Office of Hearing Officers under Rule 9559. The procedures delineated in this

Rule shall be applicable]. Such suspension shall remain in effect unless FINRA staff shall issue a letter, pursuant to paragraph (g)(2) of this Rule, stating that the suspension is lifted.

**[(h)] (g) Additional Requirements and/or Restrictions or the Removal or Reduction [or Removal] of Requirements and/or Restrictions; Letter of Withdrawal of the Notice**

**(1) Additional Requirements and/or Restrictions**

If a member continues to experience financial or operational difficulty specified in [NASD] Rule 4110 or 4120 [3130] or 4130 [3131], notwithstanding an effective notice[, order or decision under this Rule], FINRA staff may impose additional requirements and/or restrictions by [issuing] servicing [a] an additional notice under paragraph (b) of this Rule. The additional notice shall inform the member that it may apply for relief from the additional requirements and/or restrictions by filing a written request for a letter of withdrawal of the notice and/or a written request for a hearing before the Office of Hearing Officers under Rule 9559. The procedures delineated in this Rule shall be applicable to such [a] additional notice.

**(2) [Reduction or] Removal or Reduction of Requirements and/or Restrictions and/or Lifting of Suspension; Letter of Withdrawal**

**(A) Removal or Reduction of Requirements and/or Restrictions**

If, upon the member's demonstration to the satisfaction of FINRA staff, FINRA staff determines that any requirements and/or restrictions

[previously] imposed by a notice under this Rule should be [reduced or removed or reduced, FINRA staff shall serve the member, pursuant to paragraph (b) of this Rule, a written letter of withdrawal that shall, in the sole discretion of FINRA staff, withdraw the notice in whole or in part [on the member pursuant to Rule 9134]. A notice that is withdrawn in part shall remain in force, unless FINRA staff shall remove the remaining requirements and/or restrictions.

**(B) Lifting of Suspension**

If, upon the member's demonstration to the satisfaction of FINRA staff, FINRA staff determines that a suspension imposed by a notice under this Rule should be lifted, FINRA staff shall serve the member, pursuant to paragraph (b) of this Rule, a letter that shall, in the sole discretion of FINRA staff, lift the suspension. Where all or some of the requirements and/or restrictions imposed by a notice issued under this Rule remain in force, the letter shall state that the member's failure to continue to comply with those requirements and/or restrictions that remain effective shall result in the member being immediately suspended.

(h) FINRA Staff

For purposes of this Rule, "FINRA staff" shall mean:

(1) the head of the FINRA department or office that issued the notice, or his or her written officer delegate; or

(2) if another FINRA department or office is named as the party handling the matter on behalf of the issuing department or office, the head of the FINRA department or office that is so designated, or his or her written officer delegate.

(i) Notice to Membership

FINRA shall provide notice of any suspension [final FINRA action taken] pursuant to this Rule in the next notice of Disciplinary and Other FINRA Actions.

\* \* \* \* \*

**9559. Hearing Procedures for Expedited Proceedings Under the Rule 9550 Series**

(a) No Change.

**(b) Computation of Time**

Rule 9138 shall govern the computation of time in proceedings brought under the Rule 9550 Series, except that intermediate Saturdays, Sundays and Federal holidays shall be included in the computation in proceedings brought under Rules 9556 through 9558, unless otherwise specified.

**(c) Stays**

(1) Unless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown, a timely request for a hearing shall stay the effectiveness of a notice issued under Rules 9551 through 9556[7], except that the effectiveness of a notice of a limitation or prohibition on access to services offered by FINRA or a member thereof under Rule 9555 with respect to services to which the member or person does not have access shall not be stayed by a request for a hearing.

(2) A timely request for a hearing shall stay the effectiveness of a notice issued under Rule 9557 for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less), unless FINRA's Chief Executive Officer (or such other senior officer as the Chief Executive Officer may designate) determines that a notice under Rule 9557 shall not be stayed. Where a notice under Rule 9557 is stayed by a request for a hearing, such stay shall remain in effect only for ten business days after service of the notice or until the Office of Hearing Officers issues a written order under Rule 9559(o)(4)(A) (whichever period is less) and shall not be extended.

(3) A timely request for a hearing shall not stay the effectiveness of a notice issued under Rule 9558, unless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown.

**(d) Appointment and Authority of Hearing Officer and/or Hearing Panel**

(1) For proceedings initiated under Rules 9553 and 9554, the Chief Hearing Officer shall appoint a Hearing Officer to preside over and act as the sole adjudicator for the matter.

(2) For proceedings initiated under Rules 9551, 9552, 9555, 9556, 9557 and 9558, the Chief Hearing Officer shall appoint a Hearing Panel composed of a Hearing Officer and two Panelists. The Hearing Officer shall serve as the chair of the Hearing Panel. For proceedings initiated under Rules 9551, 9552, 9555, 9556 and 9558, [T]the Chief Hearing Officer shall select as Panelists persons who meet the qualifications delineated in Rules 9231 and 9232. For proceedings initiated

under Rule 9557, the Chief Hearing Officer shall select as Panelists current or former members of the FINRA Financial Responsibility Committee.

(3) Rules 9231(e), 9233 and 9234 shall govern disqualification, recusal or withdrawal of a Hearing Officer or, if applicable, Hearing Panelist.

(4) A Hearing Officer appointed pursuant to this provision shall have authority to do all things necessary and appropriate to discharge his or her duties as set forth under Rules 9235 and 9280.

(5) Hearings under the Rule 9550 Series shall be held by telephone conference, unless the Hearing Officer orders otherwise for good cause shown.

(6) For good cause shown, or with the consent of all of the parties to a proceeding, the Hearing Officer or, if applicable, the Hearing Panel may extend or shorten any time limits prescribed by this Rule other than those relating to Rule 9557.

**(e) Consolidation or Severance of Proceedings**

Rule 9214 shall govern the consolidation or severance of proceedings, except that, where one of the notices that are the subject of consolidation under this Rule requires that a hearing be held before a Hearing Panel, the hearing of the consolidated matters shall be held before a Hearing Panel. Where two consolidated matters contain different timelines under this Rule, the Chief Hearing Officer or Hearing Officer assigned to the matter has discretion to determine which timeline is appropriate under the facts and circumstances of the case. Where one of the consolidated matters includes an action brought under a Rule [9558] that does not permit a stay of the effectiveness of the notice or where FINRA's Chief Executive Officer (or such other senior officer as the Chief Executive Officer may



designate), in the case of Rule 9557, or Hearing Officer, in the case of Rule 9558(d), determines that a request for a hearing shall not stay the effectiveness of the notice, the limitation, prohibition, condition, requirement, restriction, or suspension specified in the notice shall not be stayed pending resolution of the case [unless the Chief Hearing Officer or Hearing Officer assigned to the matter orders otherwise for good cause shown. Where one of the consolidated matters includes an action brought under Rule 9555 with respect to services to which the member or person does not have access, the effectiveness of a notice of a limitation or prohibition on access to services offered by FINRA or a member thereof shall not be stayed pending resolution of the case]. Where one of the consolidated matters includes an action brought under Rule 9557 that is stayed for up to ten business days, the requirement and/or restriction specified in the notice shall not be further stayed.

**(f) Time of Hearing**

(1) A hearing shall be held within five business days after a respondent subject to a notice issued under Rule 9557 files a written request for a hearing with the Office of Hearing Officers.

(1)2) A hearing shall be held within 14 days after a respondent subject to a notice issued under Rules 9556 [through] and 9558 files a written request for a hearing with the Office of Hearing Officers.

(2)3) A hearing shall be held within 60 days after a respondent subject to a notice issued under Rules 9551 through 9555 files a written request for a hearing with the Office of Hearing Officers.

([3]4) The timelines established by paragraphs (f)(1) [and] through (f)(2)(3) confer no substantive rights on the parties.

**(g) Notice of Hearing**

The Hearing Officer shall issue a notice stating the date, time, and place of the hearing as follows:

(1) At least two business days prior to the hearing in the case of an action brought pursuant to Rule 9557;

([1]2) At least seven days prior to the hearing in the case of an action brought pursuant to Rules 9556 [through] and 9558; and

([2]3) At least 21 days prior to the hearing in the case of an action brought pursuant to Rules 9551 through 9555.

**(h) Transmission of Documents**

(1) Not less than two business days before the hearing in an action brought under Rule 9557, not less than seven days before the hearing in an action brought under Rules 9556 [through] and 9558, and not less than 40 days before the hearing in an action brought under Rules 9551 through 9555, FINRA staff shall provide to the respondent who requested the hearing, by facsimile or overnight courier, all documents that were considered in issuing the notice unless a document meets the criteria of Rule 9251(b)(1)(A), (B) or (C). A document that meets such criteria shall not constitute part of the record, but shall be retained by FINRA until the date upon which FINRA serves a final decision or, if applicable, upon the conclusion of any review by the SEC or the federal courts.

(2) Not less than two business days before the hearing in an action brought under Rule 9557, not less than three days before the hearing in an action brought under Rules 9556 [through] and 9558, and not less than 14 days before the hearing in an action brought under Rules 9551 through 9555, the parties shall exchange proposed exhibit and witness lists. The exhibit and witness lists shall be served by facsimile or by overnight courier.

(i) through (m) No Change.

**(n) Sanctions, Costs and Remands**

(1) In any action brought under the Rule 9550 Series, other than an action brought under Rule 9557, [T]the Hearing Officer or, if applicable, the Hearing Panel may approve, modify or withdraw any and all sanctions, requirements, restrictions or limitations imposed by the notice[. The Hearing Officer or, if applicable, the Hearing Panel] and, pursuant to Rule 8310(a), [also] may also impose any other fitting sanction[, pursuant to Rule 8310(a)].

(2) In an action brought under Rule 9557, the Hearing Panel shall approve or withdraw the requirements and/or restrictions imposed by the notice. If the Hearing Panel approves the requirements and/or restrictions and finds that the respondent has not complied with all of them, the Hearing Panel shall impose an immediate suspension on the respondent that shall remain in effect unless FINRA staff issues a letter of withdrawal of all requirements and/or restrictions pursuant to Rule 9557(g)(2).

(3) The Hearing Officer or, if applicable, the Hearing Panel may impose costs pursuant to Rule 8330 regarding all actions brought under the Rule 9550 Series.

([3]4) In any action brought under the Rule 9550 Series, other than an action brought under Rule 9557, [T]the Hearing Officer or, if applicable, the Hearing Panel may remand the matter to the department or office that issued the notice for further consideration of specified matters.

**(o) Timing of Decision**

**(1) Proceedings initiated under Rules 9553 and 9554**

Within 60 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision and provide it to the National Adjudicatory Council's Review Subcommittee.

**(2) Proceedings initiated under Rules 9556 [through] and 9558**

Within 21 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision that reflects the views of the Hearing Panel, as determined by majority vote, and provide it to the National Adjudicatory Council's Review Subcommittee.

**(3) Proceedings initiated under Rules 9551, 9552 and 9555**

Within 60 days of the date of the close of the hearing, the Hearing Officer shall prepare a proposed written decision that reflects the views of the Hearing Panel, as determined by majority vote, and provide it to the National Adjudicatory Council's Review Subcommittee.

**(4) Proceedings initiated under Rule 9557**

**(A) Written Order**

Within two business days of the date of the close of the hearing, the Office of Hearing Officers shall issue a written order that reflects the Hearing Panel's summary determinations, as decided by majority vote, and shall serve the Hearing Panel's written order on the Parties. The Hearing Panel's written order under Rule 9557 is effective when issued. The Hearing Panel's written order will be followed by a written decision explaining the reasons for the Hearing Panel's summary determinations, as required by paragraphs (o)(4)(B) and (p) of this Rule.

**(B) Written Decision**

Within seven days of the issuance of the Hearing Panel's written order, the Office of Hearing Officers shall issue a written decision that complies with the requirements of paragraph (p) of this Rule and shall serve the Hearing Panel's written decision on the Parties.

(5) If not timely called for review by the National Adjudicatory Council's Review Subcommittee pursuant to paragraph (q) of this Rule, the Hearing Officer's or, if applicable, the Hearing Panel's written decision shall constitute final FINRA action. For decisions issued under Rules 9551 through 9556 and 9558, [T]the Office of Hearing Officers shall promptly serve the decision of the Hearing Officer or, if applicable, the Hearing Panel on the Parties and provide a copy to each FINRA member with which the respondent is associated.

[(5)6] The timelines established by paragraphs (o)(1) through [(4)](5) confer no substantive rights on the parties.

**(p) Contents of Decision**

The decision, which for purposes of Rule 9557 means the written decision issued under paragraph (o)(4)(B) of this Rule, shall include:

(1) a statement describing the investigative or other origin of the notice issued under the Rule 9550 Series;

(2) the specific statutory or rule provision[s that were] alleged to have been violated or providing the authority for the FINRA action;

(3) a statement setting forth the findings of fact with respect to any act or practice the respondent was alleged to have committed or omitted or any condition specified in the notice;

(4) the conclusions of the Hearing Officer or, if applicable, Hearing Panel regarding the alleged violation or condition specified in the notice [as to whether the respondent violated any provision alleged in the notice];

(5) a statement of the Hearing Officer or, if applicable, Hearing Panel in support of the disposition of the principal issues raised in the proceeding; and

(6) a statement describing any sanction, requirement, restriction or limitation imposed, the reasons therefore, and the date upon which such sanction, requirement, restriction or limitation shall become effective.

**(q) Call for Review by the National Adjudicatory Council**

(1) For proceedings initiated under the Rule 9550 Series (other than Rule 9557), [T]the National Adjudicatory Council's Review Subcommittee may call for review a proposed decision [issued] prepared by a Hearing Officer or, if applicable, Hearing Panel [under the Rule 9550 Series] within 21 days after

receipt of the decision from the Office of Hearing Officers. For proceedings initiated under Rule 9557, the National Adjudicatory Council's Review Subcommittee may call for review a written decision issued under paragraph (o)(4)(B) of this Rule by a Hearing Panel within 14 days after receipt of the written decision from the Office of Hearing Officers. Rule 9313(a) is incorporated herein by reference.

(2) No Change.

(3) For good cause shown, or with the consent of all of the parties to a proceeding, the Review Subcommittee, the National Adjudicatory Council Subcommittee or the National Adjudicatory Council may extend or shorten any time limits prescribed by this Rule other than those relating to Rule 9557.

(4) through (6) No Change.

(r) through (s) No Change.

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**Text of Proposed Changes to Section 4 of Schedule A  
to the FINRA By-Laws**

**SCHEDULE A TO THE BY-LAWS OF THE CORPORATION**

**Section 1 through Section 3 No Change.**

**Section 4 — Fees**

(a) through (f) No Change.

(g) (1) Unless a specific temporary extension of time has been granted, there shall be imposed upon each member required to file reports, as designated by this paragraph (“Designated Reports”), a fee of \$100 for each day that such report is

not timely filed. The fee will be assessed for a period not to exceed 10 business days. Requests for such extension of time must be submitted to FINRA at least three business days prior to the due date; and

(2) Any report filed pursuant to this Rule containing material inaccuracies or filed incompletely shall be deemed not to have been filed until a corrected copy of the report has been resubmitted.

(3) List of Designated Reports:

(A) SE[C]A Rule 17a-5 — Monthly and quarterly FOCUS reports and annual audit reports; [and]

(B) SE[C]A Rule 17a-10 — Schedule I[.];

(C) FINRA Rule 4140 — any audited financial and/or operational report or examination report required pursuant to Rule 4140; and

(D) FINRA Rule 4521 — any report, notification or information required pursuant to Rule 4521.

(h) No Change.

**IM-Section 4(b)(1) and (e) through Section 13** No Change.

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

**Incorporated NYSE Rules**

\* \* \* \* \*

**Rule 312. Changes Within Member Organizations**

(a) through (g) No Change.



(h) **Reserved.** [No member corporation subject to Rule 325 shall, without the prior written consent of the Exchange, redeem or repurchase any shares of its stock on less than six months notice given to the Exchange no sooner than six months after the original issuance of such shares (or any predecessor shares). Each member corporation shall promptly notify the Exchange if any redemption or repurchase of any of its stock is postponed because prohibited under the provisions of Exchange Act Rule 15c3-1 (see 15c3-1(e)).]

(i) through (j) No Change.

**Rule 313. Submission of Partnership Articles—Submission of Corporate Documents**

(a) through (c) No Change.

(d) **Reserved.** [Whenever a member organization shall offer or sell any security, as defined under the Securities Act of 1933, as amended, or the General Rules and Regulations thereunder (the 1933 Act), or under the “blue sky” law or the regulations thereunder of any state in which it is proposed that the security be offered, which security is issued by the member organization for the purpose of raising capital under Rules 325 and 326 of the Board of Directors of the Exchange, the member organization must furnish the Exchange with an opinion of counsel in form and substance satisfactory to the Exchange as to whether or not the securities being offered or sold need be registered under the 1933 Act and a survey of the type customarily prepared in respect of the underwriting of securities, but not an opinion, as to what action, if any, need be taken with respect to such offer or sale under any applicable state “blue sky” law. If, in counsel's opinion, the securities need not be registered under the 1933 Act, his opinion

shall state the exemption from the registration requirements of the 1933 Act upon which he is relying and the basis for such reliance. If the securities are required to be registered under the 1933 Act counsel's opinion shall include, in addition to such other statements as the Exchange in any particular case may require, a statement substantially to the effect that at the time the registration statement became effective, the registration statement and the prospectus (other than the financial statements contained therein) complied as to form in all material respects with the requirements of the 1933 Act (and with the Trust Indenture Act of 1939, as amended, if applicable) and nothing has come to counsel's attention that would lead counsel to believe that the registration statement at the time it became effective contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading or that the prospectus at the time the registration statement became effective or at the time of sale of the security contained an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.]

[Prior to the consummation of the sale of the security, counsel shall furnish a statement to the Exchange as to the action taken in order to comply with the state "blue sky" law of any state in which the security is offered or sold.]

[Without limiting the generality of the foregoing, counsel, among other things, is expected to give appropriate consideration to (a) any other transactions pursuant to which the member organization has raised capital in the past, or expects to do so in the future, (b) the disclosure of material information regarding the member organization to offerees

of the security, and (c) the need for representation by the purchaser of the securities as to his intention to hold the securities for investment.]

(e) through (f) No Change.

••• **Supplementary Material:** -----

**Information Regarding Partnership Articles**

.10 through .12 No Change.

[.14 **A-B-C agreements.**—[Rescinded by NYSE-2005-77].]

[.18 **Sole board member provision.**—[Removed by NYSE-2005-77].]

**Information Regarding Member Corporations**

.20 through .23 No Change.

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**Rule 416. Questionnaires and Reports**

(a) No Change.

(b) No Change.

(c) No Change.

••• **Supplementary Material:** -----

.10 No Change.

.20 **Reserved.** [Each member and member organization shall, on an ongoing basis and in such format as the Exchange may require, submit to the Exchange, or its designated agent, prescribed data of the member or member organization, and of any broker-dealer that is a party to a carrying agreement with a member or member organization pursuant to NYSE Rule 382.]

\* \* \* \* \*

**Text of NASD Rules to be Deleted in Their  
Entirety from the Transitional Rulebook**

\* \* \* \* \*

**3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION**

\* \* \* \* \*

[3130. Regulation of Activities of Members Experiencing Financial and/or Operational Difficulties]

Entire text deleted.

[IM-3130. Restrictions on a Member's Activity]

Entire text deleted.

[3131. Regulation of Activities of Section 15C Members Experiencing Financial and/or Operational Difficulties]

Entire text deleted.

\* \* \* \* \*

**Text of Incorporated NYSE Rules and NYSE Rule Interpretations to be Deleted in  
Their Entirety from the Transitional Rulebook**

**Incorporated NYSE Rules**

\* \* \* \* \*

**[Rule 325. Capital Requirements Member Organizations]**

Entire text deleted.

**[Rule 326(a). Growth Capital Requirement]**

Entire text deleted.

**[Rule 326(b). Business Reduction Capital Requirement]**

Entire text deleted.

**[Rule 326(c). Unsecured Loans and Advances]**

Entire text deleted.

**[Rule 326(d). Reduction of Elimination of Loans and Advances]**

Entire text deleted.

\* \* \* \* \*

**[Rule 328. Sale-And-Leasebacks, Factoring, Financing and Similar Arrangements]**

Entire text deleted.

\* \* \* \* \*

**[Rule 418. Audit]**

Entire text deleted.

\* \* \* \* \*

**[Rule 420. Reports of Borrowings and Subordinate Loans For Capital Purposes]**

Entire text deleted.

**[Rule 421. Periodic Reports]**

Entire text deleted.

\* \* \* \* \*

**NYSE RULE INTERPRETATION**

**[NYSE Rule 313 SUBMISSION OF PARTNERSHIP ARTICLES]**

**[SUBMISSION OF CORPORATE DOCUMENTS]**

**[(d) OPINION OF COUNSEL]**

**[/01 Loans, Demand Notes and Partners' Contributions]**

Entire text deleted.

**[/02 Independent Counsel]**

Entire text deleted.

\* \* \* \* \*

**[Rule 325 CAPITAL REQUIREMENTS]**

**[(c)(1) Long Put or Call Options]**

Entire text deleted.

[/01 SEC no-action letter to NYSE dated January 31, 1990 provides interim conditions for recognition of long unlisted options, for U.S. Government debt securities endorsed or guaranteed by a limited group of narrowly defined issuers.]

Entire text deleted.

\* \* \* \* \*

**[Rule 416 QUESTIONNAIRES AND REPORTS]**

**[/01 Gold and Silver Offerings]**

Entire text deleted.

\* \* \* \* \*