

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63181; File No. SR-FINRA-2010-052)

October 26,2010

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “SEA”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 20, 2010, 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 and II below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA is proposing to adopt certain paragraphs, as specified below, of NASD Rule 3110 (Books and Records), subject to certain amendments, as FINRA Rules in the consolidated FINRA rulebook and to adopt Incorporated NYSE Rule Interpretations 410/01 (Pre-Time Stamping) and 410/02 (Allocations of Block Orders), subject to certain amendments, as FINRA Rules in the consolidated FINRA rulebook.

The proposed rule change would delete NASD IM-3110 (Customer Account Information) and Incorporated NYSE Rule 410 (Records of Orders). In addition, the proposed rule change would delete Incorporated NYSE Rule 440 (Books and Records), with the exception of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Incorporated NYSE Rules 440.10 (Periodic Security Counts, Verifications, Comparisons, etc.) and 440.20 (Identification of Suspense Accounts and Assignment of Responsibility for General Ledger Accounts) and NYSE Rule Interpretation 440.20/01 (Suspense Accounts).

The proposed rule change would renumber NASD Rule 3110(a) (Requirements) as FINRA Rule 4511 (General Requirements), NASD Rule 3110(c) (Customer Account Information) as FINRA Rule 4512 (Customer Account Information), NASD Rules 3110(d) (Record of Written Complaints) and 3110(e) (“Complaint” Defined) as FINRA Rule 4513 (Records of Written Customer Complaints), NASD Rule 3110(f) (Requirements When Using Predispute Arbitration Agreements for Customers Accounts) as FINRA Rule 2268 (Requirements When Using Predispute Arbitration Agreements for Customer Accounts), NASD Rule 3110(g) (Negotiable Instruments Drawn From A Customer’s Account) as FINRA Rule 4514 (Authorization Records for Negotiable Instruments Drawn From a Customer’s Account), NASD Rule 3110(h) (Order Audit Trail System Record Keeping Requirements) as paragraph (a)(4) of FINRA Rule 7440 (Recording of Order Information) and NASD Rule 3110(j) (Changes in Account Name or Designation) as FINRA Rule 4515 (Approval and Documentation of Changes in Account Name or Designation) in the consolidated FINRA rulebook. The proposed rule change also would renumber NYSE Rule Interpretation 410/01 as FINRA Rule 5340 (Pre-Time Stamping) and NYSE Rule Interpretation 410/02 as FINRA Rule 4515.01 (Allocations of Orders Made by Investment Advisers).

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

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

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

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

1. Purpose

Background

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),³ FINRA is proposing to adopt NASD Rules 3110(a), 3110(c), 3110(d) and (e), 3110(f), 3110(g), 3110(h) and 3110(j) as FINRA Rules 4511, 4512, 4513, 2268, 4514, 7440(a)(4) and 4515, respectively, in the Consolidated FINRA Rulebook, with certain changes as described below.⁴ FINRA also is proposing to adopt Incorporated NYSE Rule Interpretations

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

⁴ NASD Rule 3110(b) (Marking of Customer Order Tickets) requires that members indicate on the order ticket for each transaction in a non-exchange-listed security the name of each dealer contacted and the quotations received to determine the best inter-dealer market as required by NASD Rule 2320(g) (commonly referred to as the “Three Quote Rule”), unless the member can establish and document its reliance on the

410/01 and 410/02 as FINRA Rules 5340 and 4515.01,⁵ respectively, in the Consolidated FINRA Rulebook.⁶ FINRA is proposing to delete NASD IM-3110 and NYSE Rules 410 and 440, provided, however, NYSE Rules 440.10 and 440.20 and NYSE Rule Interpretation 440.20/01 are being addressed as part of a separate proposal.⁷

Current NASD Rules and NYSE Rules require members to make and preserve certain books and records to evidence compliance with federal securities laws and FINRA and SEC rules, as well as to enable FINRA and SEC staffs to conduct effective examinations. Based in large part on the current rules, the proposed rule change would rewrite the FINRA books and records rules with three goals in view:

- to streamline the rules to make them as clear as possible;
- to group the requirements along similar subject matter lines to make finding them a more intuitive process and to provide members with a better understanding of the regulatory scheme; and

exclusions to the Three Quote Rule. FINRA is proposing to replace NASD Rule 3110(b) with a more general documentation requirement in the supplementary material to proposed FINRA Rule 5310. See Regulatory Notice 08-80 (December 2008) (Proposed FINRA Rule Addressing Best Execution). NASD Rule 3110(i) (Holding of Customer Mail) specifies the circumstances under which members may hold mail for a customer. FINRA is proposing that NASD Rule 3110(i) be rewritten as a standalone rule and relocated to the supervision section of the Consolidated FINRA Rulebook. See Regulatory Notice 08-24 (May 2008) (Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls).

⁵ For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

⁶ NYSE Rule Interpretation 410(a)(ii)(5)/01 was deleted as part of a prior rule change. See Securities Exchange Act Release No. 61473 (February 2, 2010), 75 FR 6422 (February 9, 2010) (Order Approving File No. SR-FINRA-2009-087).

⁷ See Regulatory Notice 09-03 (January 2009) (Proposed Consolidated FINRA Rules Governing Financial Responsibility and Operational Requirements).

- to eliminate those requirements contained in the current rules that have become obsolete or otherwise duplicative.

Proposed Amendments

FINRA proposes the following amendments to the books and records rules.

a. General Requirements (Proposed FINRA Rule 4511)

Currently, there are two general recordkeeping rules in effect under NASD Rules and NYSE Rules. NASD Rule 3110(a) addresses the general obligation of members under all applicable laws, rules, regulations, statements of policy, NASD Rules and SEA Rule 17a-3 to make and preserve books and records, including the obligation to preserve such books and records in formats and media and for retention periods that comply with SEA Rule 17a-4. NYSE Rule 440 also sets forth the general obligation of members to make and preserve books and records.⁸

NYSE Rule 410 is a separate NYSE recordkeeping rule for which there is no comparable NASD Rule.⁹ NYSE Rule 410, in main part, requires members to make and preserve specific records for every order received (either orally or in writing) and every order entered into the

⁸ In addition, NYSE Rules 440.10 and 440.20 and NYSE Rule Interpretation 440.20/01 set forth financial and operational recordkeeping requirements for which there are no equivalent NASD Rules.

⁹ Previously, NYSE Rule 410 applied only to orders transmitted or carried to the NYSE Trading Floor (“Floor”), but was amended in 2004 to apply to all orders sent to any marketplace, not just those carried or transmitted to the Floor. See NYSE Information Memo 04-38 (July 26, 2004) (Amendments to NYSE Rules 342, 401, 408 and 410 Relating to Supervision and Internal Controls).

NYSE's Off-Hours Trading Facility.¹⁰ NYSE Rule 410 also permits the NYSE to waive the rule's recordkeeping requirements under exceptional circumstances upon written request.

FINRA Rule 4511 streamlines, and replaces, the language of NASD Rule 3110(a) to clarify that members are obligated to make and preserve books and records as required under the FINRA rules, the Act and the applicable SEA rules.¹¹ Additionally, the proposed rule requires members to preserve for a period of at least six years those FINRA books and records for which there is no specified retention period under the FINRA Rules or applicable SEA rules. The proposed rule also clarifies that members are required to preserve the books and records required to be made pursuant to the FINRA Rules in a format and media that complies with SEA Rule 17a-4.

FINRA proposes to delete the general recordkeeping provisions of NYSE Rule 440 because its provisions are substantially similar to FINRA Rule 4511. As noted above, NYSE Rules 440.10 and 440.20 and NYSE Rule Interpretation 440.20/01 are being addressed as part of a separate proposal.

In addition, the proposed rule change would delete NYSE Rules 410(a)(1)-(3) and (b) as the provisions' requirements are largely duplicative of the SEA recordkeeping requirements that

¹⁰ The "Off-Hours Trading Facility" is the NYSE facility that permits members to effect securities transactions on the NYSE pursuant to the NYSE Rule 900 Series. See NYSE Rule 900(e)(v).

¹¹ As proposed in Regulatory Notice 08-25 (discussed in Item 5 of this filing), FINRA Rule 4511 would have required members to make and preserve books and records as required under FINRA rules, Section 17(a) of the Act and the applicable associated SEA rules; however, FINRA has modified proposed FINRA Rule 4511 to eliminate the specific reference to Section 17(a) of the Act given that certain SEA recordkeeping requirements are located outside of Section 17(a).

are incorporated by reference into FINRA Rule 4511¹² or, in some instances, are directed at orders on an exchange facility. FINRA Rule 7440 (Recording of Order Information) also mandates recordkeeping requirements that are substantially similar to those in SEA Rules 17a-3 and 17a-4 for members that must report order information via FINRA's Order Audit Trail System ("OATS") for over-the-counter ("OTC") and Nasdaq equity securities.¹³

b. Customer Account Information (Proposed FINRA Rule 4512)

NASD Rule 3110(c)(1) requires that members maintain certain information relating to customer accounts, including, among other things, the signature of the registered representative introducing the account and signature of the member, partner, officer or manager who accepts the account. FINRA proposes to simplify this provision by instead requiring members to maintain the name of the associated person, if any, responsible for the account.¹⁴ As discussed

¹² Specifically, SEA Rule 17a-3(a) sets forth detailed recordkeeping requirements for brokerage orders that include, among other required information, the order record information required by NYSE Rule 410. See SEA Rule 17a-3(a)(6)-(a)(8). Information required pursuant to SEA Rule 17a-3(a)(6) that goes beyond the recordkeeping requirements of NYSE Rule 410 includes, among other things, recording the price at which the order was executed, the account for which the order was entered, and the identity of each associated person, if any responsible for the account. Additionally, SEA Rule 17a-4(b)(1) prescribes the same record retention requirements as NYSE Rule 410.

¹³ The FINRA Rule 7400 Series (Order Audit Trail System) requires members to capture, record, and report via OATS specific data elements related to the handling or execution of orders in OTC and Nasdaq equity securities, including recording all times of these events in hours, minutes, and seconds, and to synchronize their business clocks. FINRA is proposing to extend the recording and reporting requirements in the OATS rules to include all NMS stocks. See Securities Exchange Act Release No. 62739 (August 18, 2010), 75 FR 52380 (August 25, 2010) (Notice of Filing of SR-FINRA-2010-044).

¹⁴ Members would continue to be subject to any additional requirements imposed by SEA Rule 17a-3. For example, SEA Rule 17a-3(a)(17) requires that for each account with a natural person, the account record must indicate whether it has been signed by the associated person (if any) responsible for the account. However, this requirement only applies to accounts for which the member is, or within the past 36 months has been, required to make a suitability determination under the federal securities laws or the requirements of a self-regulatory organization of which it is a member.

in more detail below, the proposed rule change would require that where a member designates multiple individuals as being responsible for an account, the member maintain each of their names and a record indicating the scope of their responsibilities with respect to the account. The proposed rule change also would clarify that members maintain the signature of the partner, officer or manager denoting that the account has been accepted in accordance with the member's policies and procedures for acceptance of accounts.

NASD Rule 3110(c)(3) requires that for discretionary accounts, in addition to the requirements set forth in NASD Rules 3110(c)(1) and (2), members must: obtain the signature of each person authorized to exercise discretion in the account; record the date such discretion is granted; and, in connection with exempted securities (other than municipals), record the age or approximate age of the customer. FINRA proposes to simplify and clarify NASD Rule 3110(c)(3) in the following ways:

- consistent with the SEA recordkeeping requirements, the rule would be amended to require members to maintain a record of the dated signature of each named, natural person authorized to exercise discretion in the account;
- the proposed rule change would delete the requirement to record the date discretion was granted¹⁵ and the requirement to record the age or approximate age of the customer in connection with exempted securities;¹⁶

¹⁵ Pursuant to NASD Rule 2510 (Discretionary Accounts), members would still be required to obtain the customer's prior written authorization. As part of the proposed changes to NASD Rule 2510, FINRA is proposing to require members to obtain the customer's dated prior written authorization. See Regulatory Notice 09-63 (November 2009) (Proposed Consolidated FINRA Rule Governing Discretionary Accounts and Transactions).

¹⁶ This would be a conforming revision. The requirement that for discretionary accounts generally members must record the age or approximate age of the customer was

- the rule would be amended to provide that its requirements do not apply to investment discretion granted by a customer as to the price at which or the time to execute an order given by the customer for the purchase or sale of a definite dollar amount or quantity of a specified security; and
- the proposed rule change would clarify that nothing in the rule shall be construed as allowing members to maintain discretionary accounts or exercise discretion in such accounts except to the extent permitted under the federal securities laws.¹⁷

In addition, as discussed in more detail below, the proposed rule change would require that members obtain a “manual” dated signature of each named, natural person authorized to exercise discretion in the account.

NASD Rule 3110(c)(4) sets forth the definition of “institutional account” for purposes of NASD Rule 3110 as well as for NASD Rules 2310 (Recommendations to Customers (Suitability)) and 2510. FINRA proposes to amend this definition of “institutional account” to delete the cross-references to NASD Rules 2310 and 2510 because these rules already include cross-references to this definition.

eliminated effective in 1991. See Notice to Members 90-52 (August 1990) (SEC Approval of Amendments to Article III, Sections 2 and 21 (c) of the Rules of Fair Practice Re: Customer Account Information).

¹⁷ In 2005, the SEC adopted Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (“Advisers Act”), a principal purpose of which was to deem broker-dealers offering “fee-based brokerage accounts” not subject to the Advisers Act. Rule 202(a)(11)-1 also included several interpretive positions regarding Advisers Act Section 202(a)(11)(C), including a provision that any account over which a broker-dealer exercises investment discretion (other than on a temporary or limited basis) is subject to the Advisers Act. In March 2007, Rule 202(a)(11)-1 was vacated. See Financial Planning Association v. SEC, 482 F.3d 481 (D.C. Cir. 2007). In September 2007, the SEC re-proposed its interpretive positions for comment, including the provision regarding the application of the Advisers Act to discretionary accounts. See Investment Advisers Act Release No. 2652 (September 24, 2007), 72 FR 55126 (September 28, 2007) (Interpretive Rule Under the Advisers Act Affecting Broker-Dealers).

FINRA also proposes to amend NASD Rule 3110(c) to provide that with respect to accounts opened pursuant to prior NASD Rules (e.g., the January 1991 cut-off specified in NASD Rule 3110(c)), members will be permitted to continue maintaining the information required by those prior NASD Rules until such time as they update the account information in the course of their routine and customary business or as required by other applicable laws or rules.

In addition, the proposed rule change would add supplementary material to:

- clarify that required customer account records are subject to a six-year retention period;
- remind members that they may be subject to additional recordkeeping requirements under the SEA (e.g., SEA Rule 17a-3(a)(17));
- remind members of their obligation to comply with the requirements of FINRA Rule 2070 (Transactions Involving FINRA Employees);¹⁸ and
- provide general explanations of the terms “maintain” and “preserve” for purposes of Rule 4512 only.

The proposed rule change would renumber NASD Rule 3110(c) as FINRA Rule 4512. The remaining provisions of NASD Rule 3110(c) would be incorporated into FINRA Rule 4512 without material change.

NASD IM-3110 includes cross-references to the requirements of certain other rules that may apply to customer accounts (such as SEA Rules 15g-1 through 15g-9 (the Penny Stock Rules)), and it includes a historical reference relating to accounts opened prior to January 1991.

¹⁸ FINRA Rule 2070 plays a vital role in helping FINRA monitor whether employees are abiding by trading restrictions imposed by the FINRA Code of Conduct.

FINRA proposes to delete NASD IM-3110 because certain provisions are redundant and others are outdated.

c. Records of Written Customer Complaints (Proposed FINRA Rule 4513)

NASD Rule 3110(d) addresses a member's obligation to preserve records of written customer complaints at each office of supervisory jurisdiction ("OSJ"). NASD Rule 3110(e) defines the term "complaint." Because the definition of "complaint" in NASD Rule 3110(e) relates directly to the requirements of NASD Rule 3110(d), FINRA proposes to merge the two provisions into one rule for simplification. The proposed rule change would renumber NASD Rules 3110(d) and (e) as FINRA Rule 4513.

The proposed rule change also would clarify that the obligation to keep customer complaint records in each OSJ applies only to complaints that relate to that office, including complaints that relate to activities supervised from that office and would provide that members may maintain the required records at the OSJ or make them promptly available at such office upon FINRA's request.

Currently, members are required to preserve customer complaint records for a period of at least three years.¹⁹ To take into account FINRA's four-year routine examination cycle for certain members, the proposed rule change would require that members preserve the customer complaint records for a period of at least four years.

d. Requirements When Using Predispute Arbitration Agreements for Customer Accounts (Proposed FINRA Rule 2268)

To ensure that customers are advised about what they are agreeing to when they sign predispute arbitration agreements, NASD Rule 3110(f) requires, among other things, that such agreements contain certain highlighted disclosures. FINRA proposes to incorporate the

¹⁹ See SEA Rules 17a-3(a)(18) and 17a-4(b)(4).

requirements of the rule with minor changes into the Consolidated FINRA Rulebook. Specifically, FINRA proposes to update the disclosure language to reflect amendments to FINRA Rule 12904 requiring arbitrators to provide an explained decision to the parties in eligible cases²⁰ if there is a joint request by all parties at least 20 days before the first scheduled hearing date.²¹

The proposed rule change would renumber NASD Rule 3110(f) as FINRA Rule 2268 and would move it to the disclosure section of the Consolidated FINRA Rulebook as a standalone rule.

e. Authorization Records for Negotiable Instruments Drawn From a Customer's Account (Proposed FINRA Rule 4514)

NASD Rule 3110(g) provides that members shall not obtain from a customer or submit for payment a check, draft or other form of negotiable paper drawn on the customer's checking, savings, share or similar account, without that person's express written authorization, which may include the customer's signature on the negotiable instrument. The rule requires members to maintain the required written authorization (other than a copy of a negotiable instrument signed by the customer) for a period of three years. FINRA proposes to amend this provision to clarify that where the required authorization is separate from the negotiable instrument, members must preserve the authorization for a period of three years following the date it expires. The proposed rule change would renumber NASD Rule 3110(g) as FINRA Rule 4514.

²⁰ Pursuant to FINRA Rule 12904(g)(6), the requirement does not apply to simplified cases decided without a hearing under FINRA Rule 12800 or to default cases conducted under FINRA Rule 12801.

²¹ See Securities Exchange Act Release No. 59358 (February 4, 2009), 74 FR 6928 (February 11, 2009) (Order Approving File No. SR-FINRA-2008-051).

f. OATS Recordkeeping Requirements (Proposed FINRA Rule 7440(a)(4))

NASD Rule 3110(h) sets forth the OATS recordkeeping requirements for members that are “Reporting Members,” as defined in the OATS rules, for orders received or executed at their trading departments. FINRA proposes to relocate this recordkeeping provision without material change into the OATS rules. The proposed rule change would renumber NASD Rule 3110(h) as paragraph (a)(4) of FINRA Rule 7440.

g. Approval and Documentation of Changes in Account Name or Designation (Proposed FINRA Rule 4515)

NASD Rule 3110(j) requires that, before a customer order is executed, the account name or designation must be placed upon the memorandum for each transaction.²² The rule also addresses the approval and documentation procedures for changes in such account name or designation.

As discussed in more detail below, FINRA proposes to amend this provision to clarify that with respect to any change in account name or designation that takes place prior to execution of the trade, the essential facts the principal relied on in approving such change must be documented in writing prior to execution. The proposed rule change would renumber NASD Rule 3110(j) as FINRA Rule 4515. NYSE Rules 410 and 410.10 also include provisions regarding approval and documentation of changes in account name or designation. FINRA proposes to delete the corresponding provisions in NYSE Rules 410 and 410.10 because these provisions are substantially similar to FINRA Rule 4515. As stated earlier, FINRA also proposes to delete the recordkeeping provisions of NYSE Rule 410.

The proposed rule change, however, would transfer NYSE Rule Interpretation 410/02 as FINRA Rule 4515.01, with certain changes as described below. NYSE Rule Interpretation

²² See also SEA Rule 17a-3(a)(6).

410/02 outlines an exception to the order entry requirements of NYSE Rule 410 by permitting a member to accept block orders and allowing investment advisers to make allocations on such orders to customers (i.e., allocations among sub-accounts), provided that the member obtains specific account designations or customer names for the order records by the end of the business day. Although the SEA recordkeeping rules do not specifically provide for this exception, SEC staff has previously indicated that the exception also applies to the SEA recordkeeping rules relating to orders.²³ There is no direct NASD equivalent.

The proposed rule change would adopt NYSE Rule Interpretation 410/02 as FINRA Rule 4515.01 with the following changes. FINRA proposes to amend the provision so that the exception applies not only to block orders, but to all orders submitted by an investment adviser on behalf of multiple customers. Additionally, members have indicated that in some cases they are unable to obtain the required information by the end of the business day on which the order is executed. Therefore, as a clerical accommodation to members, FINRA proposes to amend the provision and give members until noon of the next business day following the trading session to obtain the required information. The proposal also clarifies that the exception only applies where there is more than one customer for any particular order. Further, the current exception only applies to investment advisers that are either registered under the Investment Advisers Act or subject to state regulation pursuant to Section 203A of the Investment Advisers Act. To cover all investment advisers, FINRA proposes to expand the category of investment advisers subject to the exception to also include investment advisers that qualify for an exception from the Investment Advisers Act's registration requirements pursuant to Section 203(b) of the

²³ See NYSE Information Memo 00-19, note 2 (July 21, 2000) (Timely Designation and Allocation of Account Information – Records of Orders) (noting that pursuant to discussions with the SEC staff, NYSE Rule Interpretation 410/02 applies to the requirements of SEA Rules 17a-3(a)(6) and 17a-3(a)(7)).

Investment Advisers Act. FINRA also proposes to clarify that the exception does not apply to accounts handled by registered representatives who otherwise exercise discretionary authority over accounts pursuant to NASD Rule 2510.

Moreover, FINRA proposes to clarify that nothing in the rule or supplementary material may be construed as allowing a member knowingly to facilitate the allocation of orders from investment advisers in a manner other than in compliance with both (i) the investment adviser's intent at the time of trade execution to allocate shares on a percentage basis to the participating accounts and (ii) the investment adviser's fiduciary duty with respect to allocations for such participating accounts, including but not limited to allocations based on the performance of a transaction between the time of execution and the time of allocation.

h. Pre-Time Stamping (Proposed FINRA Rule 5340)

NYSE Rule Interpretation 410/01 notes that pre-time stamping of order tickets in connection with block positioning is contrary to NYSE Rule 410. The proposed rule change would adopt this NYSE Rule Interpretation as FINRA Rule 5340 without material change, except for replacing the reference to NYSE Rule 410 with FINRA Rule 4511. FINRA believes that retaining this requirement is appropriate as it expressly prohibits violative conduct for which there are no direct NASD rule equivalents. FINRA Rule 5340 would be new to legacy NASD-only members.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 240 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁴ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will further the purposes of the Act by streamlining the FINRA books and records rules to make them as clear as possible, grouping the requirements along similar subject matter lines to make finding them a more intuitive process and to provide members with a better understanding of the regulatory scheme, and eliminating those requirements contained in the current rules that have become obsolete or otherwise duplicative.

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 Regulatory Notice 08-25 soliciting comment on proposals relating to the FINRA books and records rules.²⁵ FINRA received eight comment

²⁴ 15 U.S.C. 78o-3(b)(6).

²⁵ Some of the proposed changes discussed in this filing were not part of the proposals set forth in Regulatory Notice 08-25, including the requirement to preserve for six years those FINRA books and records for which there is no specified retention period, revisions to the disclosure language in proposed FINRA Rule 2268 to reflect amendments to FINRA's Code of Arbitration Procedure for Customer Disputes and Code of Arbitration Procedure for Industry Disputes, the adoption of NYSE Rule Interpretation 410/01 as FINRA Rule 5340, and the adoption of NYSE Rule Interpretation 410/02 as FINRA Rule 4515.01.

letters in response to the Notice,²⁶ which are discussed below. A copy of the Notice is attached as Exhibit 2a.²⁷ A list of the comment letters received in response to the Notice is attached as Exhibit 2b.²⁸ Copies of the comment letters received in response to the Notice are attached as Exhibit 2c.²⁹

1. General Comments

Two commenters believe that the requirements in SEA Rules 17a-3 and 17a-4 are sufficiently inclusive to satisfy investor protection interests.³⁰ One of these commenters requests that FINRA refrain from considering recordkeeping requirements that are in addition to the SEA rules.³¹

²⁶ See Letter from Jerry Hamlin, dated May 18, 2008 (“Hamlin”); letter from MuniVest Financial Group, dated May 29, 2008; letter from Sanderlin Securities, LLC, dated June 11, 2008 (“Sanderlin”); letter from the Securities Industry and Financial Markets Association, dated June 11, 2008 (“SIFMA”); letter from the Financial Services Institute, Inc., dated June 13, 2008 (“FSI”); letter from ING Advisors Network, dated June 13, 2008 (“ING”); letter from the Public Investors Arbitration Bar Association, dated June 13, 2008 (“PIABA”); and letter from Wachovia Securities, LLC, dated June 13, 2008.

²⁷ 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/p038507.pdf>.

²⁸ 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/p038503>. As stated previously, all references to "commenters" are to the commenters to the Notice, which are listed in Exhibit 2b.

²⁹ Id.

³⁰ SIFMA and ING.

³¹ ING.

SEA Rules 17a-3 and 17a-4 impose minimum recordkeeping requirements.³² These rules are not intended to be the only recordkeeping requirements applicable to members. As noted above, FINRA requires members to make and preserve certain books and records to evidence compliance with FINRA Rules and to enable FINRA staff to conduct effective examinations. Accordingly, where necessary, FINRA will consider recordkeeping requirements beyond the minimum requirements of the SEA rules. For instance, as described above, to take into account FINRA's four-year routine examination cycle for certain members, FINRA proposes to increase the retention period for customer complaint records to at least four years.

2. Customer Account Information (Proposed FINRA Rule 4512)

In Regulatory Notice 08-25, FINRA specifically requested comment on whether the registered representative signature requirement in NASD Rule 3110(c)(1)(C) should be retained. As noted above, FINRA proposes to instead require members to maintain the name of the associated person, if any, responsible for the account. One commenter expressly supports eliminating the registered representative signature requirement.³³ Another commenter argues that the signatures of both the registered representative and the responsible manager are necessary to assure the authenticity of account documents and information, which may be at issue in arbitration.³⁴ For regulatory purposes, FINRA believes that it is sufficient for a member to maintain the name of the associated person (if any) responsible for the account together with the signature of the partner, officer or manager denoting that the account has been accepted in

³² See Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a-4(f), Securities Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001).

³³ SIFMA.

³⁴ PIABA.

accordance with the member's policies and procedures for acceptance of accounts. In addition, as noted above, members would continue to be subject to the associated person signature requirement of SEA Rule 17a-3(a)(17).³⁵

Two commenters suggest that the proposed rule be amended to require members to maintain the name of the registered representative responsible for the account because the individual "responsible" for an account generally has to be a registered representative.³⁶ The proposed language "the associated person, if any, responsible for the account" is intended to provide consistency with the terminology used in SEA Rule 17a-3(a)(17). Nothing contained in the proposed recordkeeping rule would obviate the requirement that where a member designates a person as being responsible for a customer's account, the person charged with such responsibility be a qualified and registered person. One commenter notes that the designation of a single individual as "responsible" for an account is not practical in cases where a group of individuals may be assigned responsibility for an account.³⁷ In response, FINRA has revised the proposed rule to clarify that where a member designates multiple individuals as being responsible for an account, the member is required to maintain each of their names and a record indicating the scope of their responsibilities with respect to the account.

Two commenters request that the requirement to maintain the signature of the partner, officer or manager denoting acceptance of the account be amended to allow members the flexibility to designate an appropriate person other than a "partner, officer or manager."³⁸

³⁵ See supra note 14.

³⁶ SIFMA and FSI.

³⁷ SIFMA.

³⁸ SIFMA and ING.

FINRA believes that the appropriate person for this purpose is a partner, officer or manager of the member. Three commenters believe that the term “signature” may be interpreted to require the “manual” signature of a partner, officer or manager.³⁹ These commenters suggest that the phrase “evidence of approval” be used instead, so as to permit the use of an “electronic” signature. The staff previously has issued guidance regarding the permissibility of “electronic” signatures under NASD Rule 3110(c)(1)(C).⁴⁰ This guidance will remain in effect.

One commenter believes that the requirement to denote that the account has been accepted in accordance with the member’s policies and procedures is unnecessary since members are required to follow their policies and procedures in all instances.⁴¹ This commenter also believes that the proposed rule may be interpreted to require a partner, officer or manager to provide a representation stating that he or she has accepted the account in accordance with the member’s policies and procedures. The proposed rule change simply clarifies that the purpose of the signature of the partner, officer or manager is to signify that the account has been accepted in accordance with the member’s policies and procedures for acceptance of accounts. The proposed rule would not require a partner, officer or manager to provide any representations.

One commenter recommends that the requirement to maintain the names of any persons authorized to transact business on behalf of a customer that is an entity be eliminated.⁴² The

³⁹ SIFMA, FSI and ING.

⁴⁰ See Letter to Selwyn Notelovitz, Charles Schwab & Co., Inc., from Eric Moss, NASD, dated June 4, 2002 (available at: <http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P002556>), and Letter to Jeffrey W. Kilduff, O’Melveny & Myers, LLP, from Nancy Libin, NASD, dated July 5, 2001 (available at: <http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P005336>).

⁴¹ SIFMA.

⁴² SIFMA.

commenter argues that the requirement (which is currently in NASD Rule 3110(c)(1)(D)) has caused significant operational burden on members and may put them at regulatory risk. The commenter also states that some institutional customers use this provision to attempt to shift the burden of enforcing compliance with the customer's internal policies and controls from the customer to the member. FINRA is not proposing any changes to this provision. Moreover, FINRA believes that when a customer is an entity, it is important that the member maintain a record that identifies the person(s) authorized to transact business on behalf of that entity.

One commenter seeks clarification regarding the impact of pending SEC rulemaking proposals relating to discretionary accounts, including whether members would need to develop additional policies and procedures with respect to such accounts.⁴³ Members have always had an obligation to establish, maintain and enforce written procedures to supervise the types of business in which they engage that are reasonably designed to achieve compliance with applicable securities laws and regulations.⁴⁴ As noted above, the proposed rule change simply clarifies that nothing in the rule shall be construed as allowing members to maintain discretionary accounts or exercise discretion in such accounts except to the extent permitted under the federal securities laws.

One commenter suggests that the requirement to maintain a record of the dated signature of each named, natural person authorized to exercise discretion in an account be amended so as to permit "electronic" signatures.⁴⁵ Given the nature of discretionary accounts and FINRA's concern for potential abuse, members are required to obtain a "manual" dated signature. FINRA

⁴³ Sanderlin.

⁴⁴ See NASD Rule 3010(b)(1).

⁴⁵ FSI.

has revised the proposed rule to reflect this requirement. However, members may choose to maintain and preserve such records on electronic storage media consistent with the requirements of SEA Rule 17a-4(f).

Two commenters believe that the requirement that members update the account information in compliance with the proposed rule whenever they update the account information in the course of their routine and customary business or as required by other applicable laws or rules is too burdensome.⁴⁶ Alternatively, they argue that the updating requirements in the proposed rule should be based on the account updating requirements under SEA Rule 17a-3. FINRA believes that to promote greater consistency and uniformity of account record information, it is necessary that members update the account information in compliance with the proposed rule whenever they update the information in the course of their routine and customary business or as required by other applicable laws or rules. In addition, FINRA does not believe that limiting the updating requirements in the proposed rule to the account updating requirements under SEA Rule 17a-3 would achieve this purpose.

One commenter argues that it may not be possible to obtain the required signatures, where retained in the proposed rule, when the account record information is updated years after the account has been opened.⁴⁷ FINRA disagrees. With respect to all existing customer accounts, members currently are required to maintain the signature of the member, partner, officer or manager who accepted the account and, for discretionary accounts, the signature of each person authorized to exercise discretion in the account.

Two commenters request that supplementary materials be used sparingly, or not at all, in

⁴⁶ ING and FSI.

⁴⁷ ING.

the proposed books and records rules and that any supplementary material be incorporated into the main part of the proposed rule wherever possible.⁴⁸ The use of supplementary materials is intended to, among other things, enhance the utility of the Consolidated FINRA Rulebook. The supplementary materials provide clarifications, explanations, interpretations and greater depth. The proposed supplementary materials are placed at the end of the proposed rule for purposes of clarity and readability, but the materials are in fact part of the rule. Further, these commenters seek clarification regarding whether the explanation in the supplementary materials regarding the terms “maintain” and “preserve” would be applied to other FINRA Rules. As stated in the supplementary materials, the explanation regarding these terms is only for purposes of the proposed rule

3. Records of Written Customer Complaints (Proposed FINRA Rule 4513)

One commenter suggests that the proposed rule be amended to further clarify that the requirement to keep and preserve complaints that relate to activities supervised from the OSJ is limited to a “customer complaint” as defined in the rule.⁴⁹ This commenter also recommends that the definition of “customer complaint” precede the other provisions in the proposed rule. Another commenter suggests that the proposed rule be amended to clarify that it applies only to “written customer complaints that relate to activities subject to regulation by FINRA” so that it excludes complaints related to outside business activities.⁵⁰ Additionally, one commenter suggests that use of the term “written customer complaints” in the proposed rule is not sufficiently clear and recommends that the definition of a “customer complaint” expressly

⁴⁸ SIFMA and ING.

⁴⁹ ING.

⁵⁰ FSI.

include only a “written grievance.”⁵¹ FINRA, however, believes that the scope of the proposed rule and the definition of “customer complaint” are both appropriate and sufficiently clear. Moreover, as discussed above, the proposed rule change would clarify that the obligation to keep customer complaint records in each OSJ applies only to complaints that relate to that office, including complaints that relate to activities supervised from that office.

With respect to the proposed four-year retention period for customer complaint records, one commenter recommends maintaining the current three-year retention period for customer complaint records.⁵² The commenter does not believe that FINRA’s four-year routine examination cycle for certain members is a sufficient or persuasive reason to increase the retention period to four years. The commenter also argues that a four-year retention period would be impractical and burdensome for members since the majority of retention periods under the securities laws are three or six years, and members have already established policies and procedures relating to these retention periods. Two commenters favor a three or six year retention period for customer complaint records.⁵³ One commenter supports the proposed four-year retention period for customer complaint records, but suggests that the retention period be increased to six years consistent with the eligibility provisions for customer disputes under FINRA Rule 12206 (Time Limits) and the six-year retention period for account record information.⁵⁴ As discussed above, the proposed four-year retention period is tailored to address

⁵¹ SIFMA.

⁵² SIFMA.

⁵³ ING and FSI.

⁵⁴ PIABA.

a specific regulatory need. FINRA does not believe that it is necessary to impose a six-year retention period to achieve this goal.

One commenter requests that the definition of “customer complaint” be consistent across all FINRA Rules, particularly when considering NASD Rule 3070 (Reporting Requirements) in the context of the Consolidated FINRA Rulebook.⁵⁵ FINRA disagrees with this comment. NASD Rule 3070 serves a different regulatory purpose than FINRA Rule 4513, which is why the definitions under these rules are different.

4. Authorization Records for Negotiable Instruments Drawn From a Customer’s Account (Proposed FINRA Rule 4514)

One commenter believes that the proposed rule should provide members the flexibility to develop reasonable policies and procedures.⁵⁶ For example, the commenter suggests that members could establish a threshold where check requests over a certain dollar amount would require written authorization, whereas requests for checks in smaller amounts would require only verbal authorization with a follow-up telephone call or email. In addition, the commenter does not believe that members should be required to preserve the written authorization for a period of three years following the date it expires as it is difficult for them to track an end date. Rather, the commenter argues that the written authorization should be preserved for a period of three years from the date of the request.

FINRA believes that the written authorization requirement in FINRA Rule 4514 (current NASD Rule 3110(g)) is an effective means of deterring the fraudulent misuse of negotiable instruments. With respect to the retention period, FINRA believes that it is imperative that the required written authorization be preserved for a period of three years following the date it

⁵⁵ SIFMA.

⁵⁶ SIFMA.

expires since a customer authorization may remain in effect beyond three years from the date of the request.

6. Approval and Documentation of Changes in Account Name or Designation
(Proposed FINRA Rule 4515)

One commenter asserts that the requirement in FINRA Rule 4515 to document in writing prior to execution of the trade the essential facts relied upon by the principal approving any changes in account names or designations could have a potentially adverse impact on investors, including institutional accounts, by affecting the timing and price of orders that were executed or booked erroneously.⁵⁷ The commenter believes that to prove compliance with the rule, members would have to implement a time-stamp or similar system at considerable expense. The commenter recommends that the proposed rule be revised to permit approval and documentation after execution of the trade for all accounts, but, at a minimum, for institutional accounts. The commenter also seeks additional clarification regarding whether “electronic” approval by a principal would comply with the proposed rule.

As FINRA (then known as NASD) stated in its response to comments to proposed NASD Rule 3110(j), account names and designations are material information that must be protected from possible fraudulent activity. Requiring a principal to authorize the change and be aware of the surrounding facts for the change is a relatively low-cost method of protecting this information. Moreover, FINRA believes that where the account name or designation is changed prior to execution of the trade, the required approval and documentation must take place prior to execution. FINRA has revised the proposed rule to further clarify this requirement.

With respect to the permissibility of “electronic” approval, FINRA believes that the standards set forth in the staff’s guidance regarding the permissibility of “electronic” signatures

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SIFMA.

under NASD Rule 3110(c)(1)(C)⁵⁸ are equally applicable to the approval and documentation requirements of FINRA Rule 4515.

7. Miscellaneous Comments

One commenter suggests that members be required to tape record outgoing telephone calls by registered persons to customers regarding their accounts and that members be required to maintain a log of the full name of the registered person who made the call.⁵⁹ A second commenter recommends that the proposed rules include a provision requiring members to provide current and former customers, upon the customer's written request, free duplicate records within a reasonable time.⁶⁰ The changes recommended by these commenters are outside the scope of the proposed changes to the books and records rules. Therefore, FINRA is not responding to their recommendations specifically herein.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

⁵⁸ See supra note 37.

⁵⁹ Hamlin.

⁶⁰ PIABA.

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2010-052 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-2010-052. 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 website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions.

You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2010-052 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶¹

Florence E. Harmon
Deputy Secretary

⁶¹ 17 CFR 200.30-3(a)(12).