

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63784; File No. SR-FINRA-2010-052)

January 27, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Adopting FINRA Rules Regarding Books and Records in the Consolidated FINRA Rulebook

I. Introduction

On October 20, 2010, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change adopting FINRA rules regarding books and records in the consolidated FINRA Rulebook. The proposed rule change was published for comment in the Federal Register on November 1, 2010.³ The Commission received three comments on the proposed rule change.⁴ On January 13, 2011, FINRA responded to the comments.⁵ This order approves the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 63181 (October 26, 2010), 75 FR 67155 (November 1, 2010).

⁴ See Letter from Holly H. Smith and Susan S. Krawczyk, Sutherland Asbill & Brennan LLP, for the Committee of Annuity Insurers, to Elizabeth M. Murphy, Secretary, SEC, dated November 22, 2010 (“CAI”); Letter from William A. Jacobson, Associate Clinical Professor of Law and Director, the Cornell Securities Law Clinic, Cornell University Law School, to Elizabeth M. Murphy, Secretary, SEC, dated November 22, 2010 (“Cornell”); and Letter from Melissa MacGregor, Managing Director and Associate General Counsel, the Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, SEC, dated November 23, 2010 (“SIFMA”). (Available at <http://www.sec.gov/comments/sr-finra-2010-052/finra2010052.shtml>).

⁵ See Letter from Afshin Atabaki, FINRA, to Elizabeth M. Murphy, Secretary, SEC, dated January 13, 2011 (“Response to Comments”).

II. Description of 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 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 Pre-dispute Arbitration Agreements for Customers Accounts) as FINRA Rule 2268 (Requirements When Using Pre-dispute 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).

A. Background

1. Purpose

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),⁶ 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.⁷ FINRA also is proposing to adopt Incorporated NYSE Rule Interpretations

⁶ 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).

⁷ 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 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

410/01 and 410/02 as FINRA Rules 5340 and 4515.01,⁸ respectively, in the Consolidated FINRA Rulebook.⁹ 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.¹⁰

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

2. Proposed Amendments

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

Regulatory Notice 08-24 (May 2008) (Proposed Consolidated FINRA Rules Governing Supervision and Supervisory Controls).

⁸ For convenience, the Incorporated NYSE Rules are referred to as the NYSE Rules.

⁹ 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).

¹⁰ See Regulatory Notice 09-03 (January 2009) (Proposed Consolidated FINRA Rules Governing Financial Responsibility and Operational Requirements).

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) requires each member to make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder, with FINRA's Rules, and as prescribed by Exchange Act Rule 17a-3. NASD Rule 3110(a) further states that the record keeping format, medium, and retention period shall comply with Exchange Act Rule 17a-4. NYSE Rule 440 also sets forth the general obligation of members to make and preserve books and records.¹¹

NYSE Rule 410 is a separate NYSE recordkeeping rule for which there is no comparable NASD Rule.¹² 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 NYSE's Off-Hours Trading Facility.¹³ 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

¹¹ 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.

¹² 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).

¹³ 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).

FINRA rules, the Exchange Act and the applicable Exchange Act rules.¹⁴ 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 Exchange Act 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 Exchange Act 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.¹⁵

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 Exchange Act requirements that are incorporated by reference into FINRA Rule 4511¹⁶ or, in some instances, are directed at orders on an exchange facility. FINRA Rule 7440 (Recording of Order Information) also mandates requirements that are substantially similar to those in Exchange Act Rules 17a-3 and 17a-4 for

¹⁴ 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 Exchange Act and the applicable associated Exchange Act rules; however, FINRA has modified proposed FINRA Rule 4511 to eliminate the specific reference to Section 17(a) of the Act given that certain Exchange Act recordkeeping requirements are located outside of Section 17(a).

¹⁵ See supra note 10.

¹⁶ See generally 17 CFR 240.17a-3(a)(6)-(a)(8).

members that must report order information via FINRA’s Order Audit Trail System (“OATS”) for over-the-counter (“OTC”) and Nasdaq equity securities.¹⁷

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. As discussed 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

¹⁷ 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).

approximate age of the customer. FINRA proposes to simplify and clarify NASD Rule 3110(c)(3) in the following ways:

- consistent with the Exchange Act requirements,¹⁸ 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 granted¹⁹ and the requirement to record the age or approximate age of the customer in connection with exempted securities;²⁰
- 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.

¹⁸ See 17 CFR 240.17a-3(a)(17)(ii).

¹⁹ 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).

²⁰ 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 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).

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.

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 Exchange Act (e.g., Exchange Act Rule 17a-3(a)(17));
- remind members of their obligation to comply with the requirements of FINRA Rule 2070 (Transactions Involving FINRA Employees);²¹ and

²¹ 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.

- 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 Exchange Act Rules 15g-1 through 15g-9), and it includes a historical reference relating to accounts opened prior to January 1991. 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.²² 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 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 cases²³ if there is a joint request by all parties at least 20 days before the first scheduled hearing date.²⁴

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

²² See 17 CFR 240.17a-3(a)(18); 17 CFR 240.17a-4(b)(4).

²³ 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.

²⁴ See Securities Exchange Act Release No. 59358 (February 4, 2009), 74 FR 6928 (February 11, 2009) (Order Approving File No. SR-FINRA-2008-051).

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.

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.²⁵ 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

²⁵ See also 17 CFR 240.17a-3(a)(6).

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.

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

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 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 explicitly state 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.

III. Summary of Comment Letters and FINRA's Response

The proposed rule change was published for comment in the Federal Register on November 1, 2010, and the comment period closed on November 22, 2010. The Commission received three comment letters in response to the proposing release: the CAI Letter, the Cornell letter, and the SIFMA letter.²⁶

A. Requirements when Using Predispute Arbitration Agreements for Customer Accounts (Proposed FINRA Rule 2268)

One commenter requested that FINRA confirm that the proposed disclosure language applies to predispute arbitration agreements entered into after the effective date of FINRA Rule 2268.²⁷ In its Response to Comments, FINRA confirmed that the requirement will apply prospectively to predispute arbitration agreements entered into on or after the effective date of FINRA Rule 2268.

B. General Requirements (Proposed Rule 4511)

FINRA noted in its filing with the Commission that its proposed rule would require members to preserve for a period of at least six years those FINRA books and records for which there is no other specified retention period under the FINRA rules or applicable Exchange Act rules. One commenter noted that this requirement is too vague.²⁸ Another commenter requested that the proposed rule provide a start date for the six-year retention period.²⁹ In its Response to

²⁶ See supra, note 4.

²⁷ CAI.

²⁸ SIFMA.

²⁹ CAI.

Comments, FINRA noted that this six-year retention period is a default retention period for FINRA rules that require members to preserve certain books and records but do not specify a retention period, and where there is no retention period specified under Exchange Act rules.

C. Customer Accounts Information (Proposed FINRA Rule 4512)

One commenter requests that FINRA provide guidance regarding the use of “electronic” signatures to satisfy any FINRA signature requirements relating to a member’s book and records.³⁰ In its Response to Comments, FINRA found this comment to be outside of the scope of the proposed rule change and directed the commenter to review the various Commission and self-regulatory organization guidance available. This same commenter also requested clarification on the scope of FINRA Rule 4512(a)(3).³¹ In its Response to Comments, FINRA clarified that the provision applies to all discretionary accounts. FINRA further stated that it would address the requirements applicable to other types of accounts in which a person is authorized by a customer to act on the customer’s behalf in the context of the proposed changes to NASD Rule 2510 (Discretionary Accounts).³²

One commenter inquired about the customer age component of Rule 4512(a)(1)(B).³³ Under proposed FINRA Rule 4512(a)(1)(B) members are required to maintain certain information about their customers, including, “whether the customer is of legal age.” One commenter suggests that members should instead collect and retain a customer’s date of birth.³⁴ In its Response to Comments, FINRA disagreed and specified that its rule requires members to

³⁰ SIFMA.

³¹ SIFMA.

³² See Regulatory Notice 09-63 (November 2009) (Proposed Consolidated FINRA Rule Governing Discretionary Accounts and Transactions).

³³ SIFMA.

³⁴ SIFMA.

maintain information establishing that the customer is of legal age to engage in transactions with the member.

FINRA Rule 4512(a)(1)(C) requires members to maintain the name of the associated person, if any, responsible for the account. One commenter requested that the register representative signature requirement currently used in NASD Rule 3110(c)(1)(C) be retained in the new consolidated FINRA rulebook.³⁵ In its Response to Comments, FINRA reaffirmed that it believes 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 accordance with the member’s policies and procedures for acceptance of accounts.” Regarding this same rule section, one commenter asked for clarification that commission sharing on a customer account or sharing responsibility does not necessarily determine whether an individual is engaged in activities whereby the individual becomes “responsible” for the account.³⁶ In its Response to Comments, FINRA clarified that for purposes of this rule, responsibility is determined on the scope of the individual’s activities with respect to the account.

Finally, with respect to FINRA Rule 4512, one commenter believes that the requirement to update account information for accounts that were opened prior to FINRA Rule 4512 is burdensome.³⁷ In its Response to Comments, FINRA disagreed, noting that this new requirement promotes greater consistency and uniformity with regards to account record information.

³⁵ Cornell.

³⁶ CAI.

³⁷ CAI.

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

Two commenters requested that FINRA maintain its current three-year retention period for customer complaint records, rather than the proposed four-year retention period.³⁸ One commenter further explained that, “[e]xtending the retention period to four (4) years for customer complaint records increases compliance costs for all member firms without regard to the inspection cycles for the majority of firms, and overlooks the fact that all firms, regardless of inspection cycle, report customer complaints directly to FINRA.” In its Response to Comments, FINRA noted that its four-year retention period better accommodates its four-year routine examination cycle for certain members. One commenter also suggested that the phrase “written customer complaints” in the proposed rule was not sufficiently clear and recommended that the definition of a “customer complaint” expressly include only a “written grievance.”³⁹ In its Response to Comments, FINRA stated that it believes that the scope of the proposed rule and the definition of “customer complaint” are both appropriate and sufficiently clear.⁴⁰

E. Allocations of Orders Made by Investment Advisers (Proposed FINRA Rule 4515.01)

One commenter was concerned with the scope of Rule 4515.01 and asked whether this provision required the broker-dealers to make a legal determination regarding an adviser’s fiduciary duty. In its Response to Comments, FINRA noted that, in this case, “the ‘knowingly facilitate’ standard means the broker-dealer may not act recklessly or with knowledge in facilitating an investment adviser’s breach of its fiduciary duty to clients, and compliance with that standard turns on the facts and circumstances.”

³⁸ CAI and SIFMA.

³⁹ SIFMA.

⁴⁰ Response to Comments.

F. Other Comment

Finally, one commenter requested that FINRA specifically state that the proposed rule requirements, “apply only to records generated after the effective date of the proposal.”⁴¹ In its Response to Comments, FINRA responded to the request by specifying that the requirements, “will apply prospectively on or after the effective date of the proposed rule change.”

IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, the comments received, and FINRA’s Response to Comments and finds that the proposed rule change is consistent with the requirements of the Exchange Act, and the rules and regulations thereunder that are applicable to a national securities association.⁴² In particular, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act,⁴³ which requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest.

Proposed FINRA Rule 4511 would streamline and replace the language of current NASD Rule 3110(a), as well as, eliminate NYSE Rule 410 and subparagraphs (a)(1)-(3) and (b) of NYSE Rule 440.⁴⁴ Further, in cases where there is no specified retention period under FINRA rules or applicable Exchange Act rules, the proposed rule would require members to preserve

⁴¹ SIFMA.

⁴² In approving this proposed rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴³ 15 U.S.C. 78o-3(b)(6).

⁴⁴ See supra Part II.A.2.a.

such records for a period of six years. The Commission notes that one commenter stated that the six-year default retention period was too vague,⁴⁵ and another commenter requested clarification regarding the start date for the default six-year retention period.⁴⁶ FINRA adequately responded to these concerns in its Response to Comments. The Commission believes this proposed change would be beneficial insofar as it would consolidate in one rule the obligations of FINRA members to make and preserve certain books and records. In so doing, the proposed rule would clarify the obligations of FINRA members and promote compliance by virtue of such greater clarity.

Proposed FINRA Rule 4512 would, among other things, simplify the customer account information requirements in NASD Rule 3110(c)(1) and simplify and clarify certain requirements set forth in NASD Rule 3110(c)(3) with respect to discretionary accounts. As noted above, proposed FINRA Rule 4512 would also provide that with respect to accounts opened prior to January 1991, members will be permitted to continue maintaining the information required by the prior NASD rules in effect at that time until such time as the member updates the account information in the course of their routine and customary business or as otherwise required by law or rules.⁴⁷ The proposed rule would also eliminate certain redundant cross-references.

FINRA received a number of comments on this aspect of the proposed rule change,⁴⁸ and the Commission believes that FINRA has adequately responded to such comments in its

⁴⁵ SIFMA.

⁴⁶ CAI.

⁴⁷ See supra Part II.A.2.b.

⁴⁸ SIFMA, CAI, Cornell.

Response to Comment.⁴⁹ Further, the Commission believes that the proposed changes in FINRA Rule 4512 would update, clarify, and streamline existing rule requirements regarding customer account information. The Commission believes that such changes will be helpful to FINRA members, as well as assist FINRA in fulfilling its responsibilities as an SRO under the Act.

As noted above, proposed FINRA Rule 4513 would merge existing requirements in NASD Rules 3110(d) and 3110(e), clarify that the obligation to keep customer complaint records in each OSJ applies only to complaints that relate to that office and provide that members may maintain the required records at the OSJ or make them promptly available at such office upon FINRA's request.⁵⁰ Finally, the proposed rule change would require that members preserve customer complaints be preserved for at least four years to take into account FINRA's four-year routine examination cycle.

Two commenters recommended maintaining the current three-year retention period for customer complaint records,⁵¹ and one of these commenters suggested the use of the term "written customer complaints" in the proposed rule is not sufficiently clear.⁵² The Commission believes that FINRA adequately responded to these concerns in its Response to Comments. The Commission also believes that the changes relating to the definition of the term "complaint" in NASD Rules 3110(d) and 3110(e), and the elucidation regarding the obligation to keep customer complaint records, are helpful changes that will clarify FINRA's rulebook and promote compliance by FINRA members. Similarly, preserving customer complaint records for four

⁴⁹ Response to Comments.

⁵⁰ See supra Part II.A.2.c.

⁵¹ SIFMA and CAI.

⁵² SIFMA.

years will promote FINRA’s ability to supervise its members for compliance with the federal securities laws and FINRA’s rules.

As noted above, FINRA is also proposing to incorporate NASD Rule 3110(f), relating to predispute arbitration agreements, into the Consolidated FINRA Rulebook as FINRA Rule 2268, with some additional changes to reflect amendments to FINRA Rule 12904.⁵³ One commenter requested that FINRA confirm that the proposed disclosure language will only apply to predispute arbitration agreements entered into after the effective date of FINRA Rule 2268.⁵⁴ In its Response to Comments, FINRA provided such confirmation.⁵⁵ Consistent with other changes FINRA is proposing, the Commission believes FINRA Rule 2268 will update and clarify the FINRA rulebook and that such changes will promote greater compliance by FINRA members and assist FINRA in discharging its duties as an SRO.

FINRA also proposes to relocate the OATS recordkeeping requirement for members that are “Reporting Members” (as defined in the OATS rules) from NASD Rule 3110(h) to paragraph (a)(4) of FINRA Rule 7440.⁵⁶ The Commission believes that this aspect of the proposed rule change is reasonable given that it is logical to include an OATS recordkeeping requirement in the OATS rules.

FINRA also proposes to amend NASD Rule 3110(j) 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 upon in approaching such change must be documented in

⁵³ See supra Part II.A.2.d.

⁵⁴ CAI.

⁵⁵ Response to Comments.

⁵⁶ See supra Part II.A.2.f.

writing prior to execution.⁵⁷ This modified provision would be designated as FINRA Rule 4515. FINRA also is proposing to delete corresponding provisions in NYSE Rules 410 and 410.10, because these provisions are largely duplicative of proposed FINRA Rule 4515. FINRA would transfer NYSE Rule Interpretation 410/02 as FINRA Rule 4515.01, with certain modifications as described above in more detail.⁵⁸

The Commission believes that the changes in proposed FINRA Rule 4515 relating to clarifying the change in account name or designation prior to trade execution are consistent with the protection of investors because the proposed rule provides that any such changes will be documented in writing, an important safeguard. Further, as stated previously with respect to other changes eliminating duplicative or overlapping provisions, the elimination of NYSE Rules 410 and 410.10 should provide a clearer, more streamlined, and simplified rulebook that will promote greater compliance by FINRA members and help FINRA discharge its responsibilities as an SRO.⁵⁹ The Commission also notes that with respect to the rule change adopting NYSE Rule Interpretation 410/02 as FINRA Rule 4515.01, FINRA has explicitly stated 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 the 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.

⁵⁷ See supra Part II.A.2.g.

⁵⁸ Id.

⁵⁹ See supra Part II.A.2.g.

NYSE Rule Interpretation 410/01 notes that pre-time stamping of order tickets in connection with block positioning is contrary to NYSE Rule 410. FINRA proposes incorporating NYSE Rule Interpretation 410/01 as FINRA Rule 5340 without substantive changes. FINRA has stated, and the Commission agrees, that retaining this requirement is appropriate because it expressly prohibits violative conduct for which there are no direct NASD rule equivalents.⁶⁰

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁶¹ that the proposed rule change (SR-FINRA-2010-052) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶²

Elizabeth M. Murphy
Secretary

⁶⁰ See supra Part II.A.2.h.

⁶¹ 15 U.S.C. 78(b)(2).

⁶² 17 CFR 200.30-3(a)(12).