

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68832; File No. SR-FINRA-2012-050)

February 5, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1, and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt a Supplementary Schedule for Derivatives and Other Off-Balance Sheet Items Pursuant to FINRA Rule 4524 (Supplemental FOCUS Information)

I. Introduction

On November 15, 2012, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt a supplementary schedule for derivatives and other off-balance sheet items pursuant to FINRA Rule 4524 (Supplemental FOCUS Information). The proposed rule change was published for comment in the Federal Register on November 27, 2012.<sup>3</sup> The Commission received one comment letter on the proposed rule change.<sup>4</sup> On February 1, 2013, FINRA filed Amendment No. 1 with the Commission to respond to the comment letter and to propose technical changes and the addition of a clarifying instruction.<sup>5</sup> The Commission is publishing this notice and order to solicit comments on Amendment No. 1

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

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

<sup>3</sup> Exchange Act Release No. 68270 (Nov. 20, 2012), 77 FR 70860 (Nov. 27, 2012).

<sup>4</sup> See E-mail from Suzanne Shatto to Commission, dated Jan. 3, 2013, available at <http://sec.gov/comments/sr-finra-2012-056/finra2012056-1.pdf>.

<sup>5</sup> See SEC File No. SR-FINRA-2012-050 Amendment No. 1, dated Feb. 1, 2013 (“Amendment No. 1”). Amendment No. 1 is described below in Section III.B. and the text of Amendment No. 1 is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, and on the Commission’s website at <http://www.sec.gov/rules/sro.shtml>.

and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

## II. Description of Proposal

FINRA Rule 4524 requires each firm, as FINRA shall designate, to file such additional financial or operational schedules or reports as FINRA may deem necessary or appropriate for the protection of investors or in the public interest as a supplement to the FOCUS reports. Pursuant to FINRA Rule 4524, FINRA proposed the adoption of a supplemental schedule to the FOCUS reports to capture important information that is not otherwise reported on certain firms' balance sheets. To that end, the proposal would require all carrying or clearing firms to file with FINRA the Derivatives and Other Off-Balance Sheet Items Schedule ("OBS") within 22 business days of the end of each calendar quarter. The proposed OBS is necessary for FINRA to more effectively examine for compliance with, and enforce, its rules on capital adequacy. The proposed OBS enables FINRA to examine on an ongoing basis the potential impact off-balance sheet activities may have on carrying and clearing firms' net capital, leverage and liquidity, and ability to fulfill their customer protection obligations.

In the aftermath of the financial crisis, FINRA began to closely monitor firms' levels of leverage and available liquidity to meet their funding needs and began to collect certain additional information from certain carrying and clearing firms with regard to their proprietary positions, financing transactions and certain off-balance sheet transactions. FINRA believes the proposed OBS will allow FINRA to obtain more comprehensive and consistent information regarding carrying and clearing firms' off-balance sheet assets, liabilities and other commitments. The proposed OBS would require firms to report their gross exposures in financing transactions (e.g., reverse repos, repos and other transactions that are otherwise netted

under generally accepted accounting principles, reverse repos and repos to maturity and collateral swap transactions), interests in and exposure to variable interest entities, non-regular way settlement transactions (including to be announced or TBA securities and delayed delivery/settlement transactions), underwriting and other financing commitments, and gross notional amounts in centrally cleared and non-centrally cleared derivative contracts involving equities, commodities, interest rates, foreign exchange derivatives and credit default swaps. However, the proposed OBS contains a de minimis off-balance sheet activity exception for each reporting period. If the aggregate of all gross amounts of off-balance sheet items is less than 10% of the firm's excess net capital on the last day of the reporting period, the firm will not be required to file the proposed OBS for the reporting period.<sup>6</sup>

FINRA stated that it would announce the first quarterly reporting period (i.e., the implementation date for purposes of the proposed off-balance sheet schedule) in a regulatory notice to be published no later than 60 days following Commission approval of the proposed rule change. The due date for the first proposed schedule would be no later than 210 days following Commission approval of the proposed rule change.

### III. Summary of Comment Letter, FINRA's Response, and Amendment No. 1

#### A. Summary of and FINRA's Response to Comment Letter

As stated above, the Commission received one comment letter in response to the proposed rule change.<sup>7</sup> The commenter asked if reporting will begin for the OBS on January 22, 2013, and if the OBS will be public. In addition, the commenter questioned if the information in

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<sup>6</sup> For purposes of the proposed OBS, the term "excess net capital" means net capital reduced by the greater of the minimum dollar net capital requirement or two percent of combined aggregate debit items as shown in the Formula for Reserve Requirements pursuant to 17 CFR 240.15c3-3.

<sup>7</sup> See supra note 4.

the OBS will be in the December 31, 2012 financials. In response, FINRA reiterated the statement in its initial filing: “FINRA will announce the first quarterly reporting period (i.e., the implementation date for purposes of the proposed off-balance sheet schedule) in a regulatory notice to be published no later than 60 days following Commission approval of the proposed rule change.” Further, the proposed OBS will be treated with the same confidentiality as the FOCUS report to which it relates.<sup>8</sup> Finally, firms are required to file annually with the SEC audited financial statements that include a publicly available Statement of Financial Condition.<sup>9</sup> The footnotes to the Statement of Financial Condition should contain off-balance sheet disclosures as required by generally accepted accounting principles.

B. Description of Amendment No. 1

Not in connection with the comment letter, FINRA filed Amendment No. 1 with the Commission proposing to amend the OBS and the instructions to the OBS. First, FINRA is proposing to clarify that the de minimis exception is based on the aggregate of all gross amounts of off-balance sheet items. Second, FINRA is making a technical change to require a firm that claims the de minimis exception to affirmatively indicate through functionality on the eFOCUS system that no filing is required for the reporting period. Third, FINRA is proposing to add instructions for item 6 (Total gross notional amount) of the OBS. Fourth, FINRA is proposing to renumber as line 25 both “for period ending” lines 24 and 3932 of the OBS.<sup>10</sup>

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<sup>8</sup> See 17 CFR 240.17a-5(a)(3).

<sup>9</sup> See 17 CFR 240.17a-5(d) and 17 CFR 240.17a-5(e)(3).

<sup>10</sup> See Amendment No. 1.

#### IV. Commission's Findings

After careful consideration of the proposed rule change, as modified by Amendment No. 1, the comment letter received, and FINRA's response to the comment letter, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>11</sup> In particular, the Commission finds that the proposal, as modified by Amendment No. 1, is consistent with Section 15A(b)(6) of the Exchange Act,<sup>12</sup> 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, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that FINRA adequately addressed the comments raised in response to FINRA's notice.

The proposed OBS will provide FINRA with the ability to obtain more specific information about the finances of a member broker-dealer. Thus, the Commission believes that the proposed rule change, as modified by Amendment No. 1, is consistent with the provisions of the Exchange Act noted above in that the proposed OBS will permit FINRA to assess more effectively on an ongoing basis the potential impact off-balance sheet activities may have on carrying and clearing firms' net capital, leverage and liquidity, and ability to fulfill their customer protection obligations.

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<sup>11</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>12</sup> See 15 U.S.C. 78o-3(b)(6).

The Commission believes that the proposed rule change, as modified by Amendment No. 1, works in conjunction with the existing Commission broker-dealer financial responsibility rules and will further FINRA's ability to oversee its members by, among other things, increasing the transparency of the various revenue streams and sources of income of broker-dealers.

The Commission does not believe that the proposed rule change, as modified by Amendment No. 1, will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. As stated above, the Commission believes the proposed OBS will allow FINRA to better understand the potential impact off-balance sheet activity may have on carrying and clearing firms' net capital, leverage and liquidity, and ability to fulfill their customer protection obligations. Ready access to the information in the proposed OBS is important for FINRA to efficiently monitor on an ongoing basis the financial condition of firms.

The Commission also believes FINRA has carefully crafted the proposed OBS to achieve its intended and necessary regulatory purpose while being cognizant of the burden on firms. The information required to complete the proposed OBS should be readily available to firms due to firms' obligations to maintain books and records and take applicable capital charges in relation to off-balance sheet activity. Further, firms that are owned by a publicly held company provide much of the information required by the proposed OBS to the SEC on the quarterly Form 10-Q or on the annual Form 10-K. Finally, for those firms that conduct limited off-balance sheet activity, the proposed OBS contains a de minimis exception for each reporting period.

V. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act<sup>13</sup> for approving the proposal, as modified by Amendment No. 1, prior to the 30th day after publication of Amendment No. 1 in the Federal Register. The changes proposed in Amendment No. 1 are technical or clarifying changes and do not raise regulatory concerns.

Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2012-050 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-2012-050. 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

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<sup>13</sup> 15 U.S.C. 78s(b)(2).

comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2012-050 and should be submitted on or before [insert date 21 days from publication in the Federal Register].



VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,<sup>14</sup> that the proposed rule change (SR-FINRA-2012-050), as modified by Amendment No. 1, be and hereby is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> See 17 CFR 200.30-3(a)(12).