

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60701; File No. SR-FINRA-2009-014)

September 21, 2009

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

I. Introduction

On March 24, 2009, the Financial Industry Regulatory Authority, Inc. ("FINRA" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change as part of the process of developing a new consolidated rulebook (the "Consolidated FINRA Rulebook").³ FINRA proposed to adopt NASD Rules 2330(a), 2330(e) and 2330(f) as FINRA Rules 2150(a), 2150(b) and 2150(c), respectively, in the Consolidated FINRA Rulebook, with certain changes as described below.⁴ Proposed FINRA Rule 2150 also would take into account certain provisions of NYSE Rule 352. In addition, proposed FINRA

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process).

⁴ Other provisions that set forth certain financial and operational requirements, including, NASD Rules 2330(b) (General Provisions), 2330(c) (Authorization to Lend), 2330(d) (Segregation and Identification of Securities) and Interpretive Material 2330 (Segregation

Rule 2150 includes a “Supplementary Material” section that contains certain clarifications and codifications of existing staff guidance. FINRA further proposed to delete NYSE Rule 352 (with the exception of paragraphs (e), (f) and (g))⁵ from the Transitional Rulebook. The proposed rule change was published for public comment in the Federal Register on June 24, 2009.⁶ The Commission received no comment letters regarding proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

FINRA proposed to adopt certain paragraphs, as specified below, of NASD Rule 2330 (Customers’ Securities or Funds) as FINRA Rule 2150 (Improper Use of Customers’ Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) in the Consolidated FINRA Rulebook taking into account certain provisions of Incorporated NYSE Rule 352 (Guarantees, Sharing in Accounts, and Loan Arrangements)⁷ and to delete NYSE Rule 352, with the exception of NYSE Rules 352(e) (Limitations on Borrowing From or Lending to Customers), 352(f) (Loan Procedures) and 352(g).

The proposed rule change would renumber NASD Rule 2330(a) (Improper Use) as FINRA Rule 2150(a) (Improper Use), NASD Rule 2330(e) (Prohibition Against Guarantees) as FINRA Rule 2150(b) (Prohibition Against Guarantees) and NASD Rule 2330(f) (Sharing in

of Customers’ Securities) would remain in the Transitional Rulebook to be addressed as part of a later phase of the consolidation process.

⁵ NYSE Rules 352(e), 352(f) and 352(g) govern borrowing from or lending to customers. These provisions generally are equivalent to the provisions of NASD Rule 2370 (Borrowing From or Lending to Customers). NASD Rule 2370 and the corresponding NYSE provisions would remain in the Transitional Rulebook to be addressed as part of a later phase of the rulebook consolidation process.

⁶ Securities Exchange Act Release No. 60135 (June 18, 2009), 74 FR 30198 (“Notice”).

⁷ For convenience, Incorporated NYSE Rule 352 is hereinafter referred to as “NYSE Rule 352.”

Accounts; Extent Permissible) as FINRA Rule 2150(c) (Sharing in Accounts; Extent Permissible) in the consolidated FINRA rulebook. The proposed rule change also would add a “Supplementary Material” section to proposed FINRA Rule 2150 that contains certain clarifications and codifications of existing staff guidance.

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

NASD Rule 2330(a) prohibits members and associated persons from making improper use of a customer’s securities or funds. The improper use of customer securities or funds threatens the fundamental relationship between a broker and a customer and undermines the integrity of the securities industry. FINRA proposed to adopt NASD Rule 2330(a) as FINRA Rule 2150(a) in the Consolidated FINRA Rulebook without changes.

B. Prohibition against Guarantees (proposed FINRA Rule 2150(b))

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

FINRA proposed to adopt NASD Rule 2330(e) as FINRA Rule 2150(b) in the Consolidated FINRA Rulebook without changes and delete NYSE Rule 352(a) (Prohibitions Against Guarantees) because its provisions are substantially similar to proposed FINRA Rule 2150(b).

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

NASD Rule 2330(f) prohibits members and associated persons from sharing in the profits or losses in a customer’s account except under certain limited conditions specified in the Rule.

FINRA proposed to adopt NASD Rule 2330(f) as FINRA Rule 2150(c) in the Consolidated FINRA Rulebook, with only minor changes.

FINRA proposed to delete NYSE Rules 352(b), (c) and (d) as they are substantially similar to proposed FINRA Rule 2150(c) or are otherwise incorporated as part of the supplementary material to proposed FINRA Rule 2150.

D. Proposed Supplementary Material

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

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

⁸ Associated persons would not similarly be permitted to reimburse their customers for losses under the rule given the concern that such payments may conceal individual misconduct.

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

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.⁹ In particular, the Commission believes the proposal is consistent with the requirements of Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that the Association's rules 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. Further, the Commission believes it is appropriate to transfer these NASD Rules into the FINRA Consolidated Rulebook, with the changes specified, and to delete the noted NYSE Rules as proposed because the proposal will protect investors against potential misconduct.

⁹ In approving this rule proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78o-3(b)(6).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-FINRA-2009-014) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²

Florence E. Harmon
Deputy Secretary

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).