

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62655; File No. SR-FINRA-2010-042)

August 5, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 4160 (Verification of Assets)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 4, 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 FINRA Rule 4160 (Verification of Assets). The proposed rule provides that a member, when notified by FINRA, may not continue to custody or retain record ownership of assets, at a non-member financial institution, which, upon FINRA staff’s request, fails promptly to provide FINRA with written verification of assets maintained by the member at such financial institution. The proposed rule change also would add a supplementary material section to the new rule.

The text of the proposed rule change is below. Proposed new language is underlined.

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**4000. FINANCIAL AND OPERATIONAL RULES**

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

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

## 4100. FINANCIAL CONDITION

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### **4160. Verification of Assets**

A member, when notified by FINRA, may not continue to custody or retain record ownership of assets, whether such assets are proprietary or customer assets, at a financial institution that is not a member of FINRA, which, upon FINRA staff's request, fails promptly to provide FINRA with written verification of assets maintained by the member at such financial institution.

### **••• Supplementary Material: -----**

**.01 Asset Transfers.** Any member required to transfer its proprietary and/or customer assets pursuant to this Rule shall effect such transfer within a reasonable period of time.

**.02 Member Obligations Under SEA Rule 15c3-3.** Nothing in this Rule shall be construed as altering in any manner a member's obligations under SEA Rule 15c3-3.

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## 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

FINRA is proposing a rule designed to ensure that FINRA can independently verify assets maintained by a member at a non-member financial institution. While FINRA currently may request such independent verification, it generally cannot compel a financial institution that is not a member to comply with the request because FINRA's rules apply only to members. This inability to obtain such information directly from a non-member financial institution may limit FINRA's ability to effectively detect fraud and protect investors.

To address these jurisdictional constraints, FINRA is proposing a rule providing that a member, when notified by FINRA, may not continue to custody or retain record ownership of assets, whether such assets are proprietary or customer assets, at a non-member financial institution, which, upon FINRA staff's request, fails promptly<sup>3</sup> to provide FINRA with written verification of assets maintained by the member at such financial institution. FINRA believes there would be significant incentive on the part of non-member financial institutions to promptly comply with staff requests for asset verification in order to continue to retain members' proprietary or customer assets. Similarly, members would seek to assure that non-member financial institutions maintaining their proprietary or customer assets comply with such requests to avoid having to transfer assets to another institution. At this time, FINRA is not proposing to require a member to enter into a written contract with a non-member financial institution maintaining its proprietary or customer assets that would obligate the institution to comply with FINRA staff's requests for verification; however, FINRA would strongly encourage a member to enter into such a contract. A non-member financial institution that has a written contractual obligation with a member but still refuses to provide FINRA with prompt written verification may be in breach of contract, and the member could seek appropriate remedies against the

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<sup>3</sup> The proposed rule does not define the term "promptly," which would be assessed based on the particular facts and circumstances.

institution. The proposed rule, however, would preclude the member from continuing to maintain assets at that financial institution and require the member to transfer the assets to another financial institution. In this regard, FINRA is mindful of the potential challenges of an asset transfer, and is proposing to adopt Supplementary Material .01 (Asset Transfers), providing that any member required to transfer its proprietary and/or customer assets pursuant to the proposed rule shall effect such transfer within a reasonable period of time.

Additionally, FINRA is proposing to adopt Supplementary Material .02 (Member Obligations Under SEA Rule 15c3-3) to clarify that nothing in the proposed rule shall be construed as altering in any manner a member's obligations under SEA Rule 15c3-3.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 30 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,<sup>4</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change is consistent with the provisions of the Act noted above in that independent verification will further strengthen FINRA's ability to effectively detect fraud and protect investors.

### B. Self-Regulatory Organization's Statement on Burden on Competition

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<sup>4</sup> 15 U.S.C. 78q-3(b)(6).

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

Written comments were neither solicited nor received.

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

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2010-042 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-2010-042. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for 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-2010-042 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.<sup>5</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>5</sup> 17 CFR 200.30-3(a)(12).