

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60475; File No. SR-FINRA-2009-047)

August 11, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 21, 2009, 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, II, and III below, which Items have been substantially 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 NASD Rule 2350 (Broker/Dealer Conduct on the Premises of Financial Institutions) as FINRA Rule 3160 in the consolidated FINRA rulebook, subject to certain amendments.

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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),³ FINRA is proposing to adopt NASD Rule 2350 (Broker/Dealer Conduct on the Premises of Financial Institutions), subject to certain amendments, as FINRA Rule 3160 (Networking Arrangements Between Members and Financial Institutions). The details of the proposed rule change are described below.

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).

NASD Rule 2350

NASD Rule 2350 governs the activities of broker-dealers on the premises of financial institutions.⁴ Also known as the “bank broker-dealer rule,” Rule 2350 generally requires broker-dealers that conduct business on the premises of a financial institution where retail deposits are taken to: (1) enter into a written agreement with the financial institution specifying each party’s responsibilities and the terms of compensation (networking agreement); (2) segregate the securities activities conducted on the premises of the financial institution from the retail deposit-taking area; (3) allow access for inspection and examination by the SEC and FINRA; (4) ensure that communications with customers clearly identify that the broker-dealer services are provided by the member; (5) disclose to customers that the securities products offered by the broker-dealer are not insured like other banking products; and (6) make reasonable efforts at account opening to obtain a customer’s written acknowledgement of the receipt of such disclosure. Rule 2350 applies only when broker-dealer services are conducted either in person, over the telephone, or through any other electronic medium, on the premises of a financial institution where retail deposits are taken, by a broker-dealer that has a physical presence on those premises.⁵

NASD Rule 2350 was adopted to reduce potential customer confusion in dealing with broker-dealers that conduct business on the premises of financial institutions, and to

⁴ The term “financial institution” includes federal and state-chartered banks, savings and loan associations, savings banks, credit unions, and the service corporations of such institutions required by law.

⁵ See Notice to Members 97-89 (December 1997).

clarify the relationship between a broker-dealer and a financial institution entering into a networking agreement.⁶

The Gramm-Leach Bliley Act and Regulation R

In 2007, the SEC and the Board of Governors of the Federal Reserve jointly adopted rules, known as Regulation R,⁷ that implement the bank broker provisions of the Gramm-Leach Bliley Act of 1999 (“GLB”). These provisions replaced what had been a blanket exception for banks from the definition of “broker”⁸ under the Exchange Act with eleven exceptions from the definition of “broker” that are codified in Exchange Act Section 3(a)(4)(B).

Exchange Act Section 3(a)(4)(B)(i) provides an exception from the definition of “broker” for banks that enter into third-party brokerage (or networking) arrangements with a broker-dealer (the networking exception). Under this exception, a bank is not considered to be a broker if it enters into a contractual or other written arrangement with a registered broker-dealer under which the broker-dealer offers brokerage services on or off bank premises, subject to certain conditions (this differs from NASD Rule 2350, which only applies to broker-dealers offering brokerage services on a financial institution’s premises).⁹ Although this exception generally provides that a bank may not pay its unregistered employees incentive compensation for referring a customer to a

⁶ See Securities Exchange Act Release No. 39294 (November 4, 1997), 62 FR 60542, 60547 (November 10, 1997) (Approval Order).

⁷ See 17 CFR 247.700-781.

⁸ See 15 U.S.C. 78c(a)(4).

⁹ The exceptions in Section 3(a)(4)(B) of the Exchange Act apply to “banks” as defined in Exchange Act Section 3(a)(6). NASD Rule 2350 addresses “financial institutions.” See supra note 4.

broker-dealer, it does permit a bank employee to receive a “nominal one-time cash fee of a fixed dollar amount” that is not contingent on whether the referral results in a transaction with the broker-dealer.¹⁰ Further, Rule 701 of Regulation R provides an exemption for referrals of certain institutional and high net worth clients that may result in the payment of a higher referral fee (i.e., incentive compensation of more than a nominal amount) to bank employees and may be contingent on the occurrence of a securities transaction, subject to certain additional requirements.¹¹

Proposed FINRA Rule 3160

FINRA proposes to adopt NASD Rule 2350 into the Consolidated FINRA Rulebook as FINRA Rule 3160, subject to certain amendments to streamline the rule and to reflect applicable provisions of GLB and Regulation R.

First, the proposed rule change would amend the scope of the rule to conform to the networking exception in GLB. NASD Rule 2350 applies only to broker-dealer conduct on the premises of a financial institution where retail deposits are taken. However, the networking exception in GLB applies to networking arrangements in which a broker or dealer offers brokerage services on or off the premises of a bank.¹² Accordingly, with the exception of those requirements addressing the physical setting, proposed FINRA Rule 3160 would apply to a member that is a party to a networking arrangement with a financial institution under which the member offers broker-dealer

¹⁰ See 17 CFR 247.700 for definitions of the terms “nominal one-time cash fee of a fixed dollar amount,” “referral,” “contingent on whether the referral results in a transaction” and “incentive compensation.”

¹¹ See 17 CFR 247.701.

¹² See 15 U.S.C. 78c(a)(4)(B)(i).

services, regardless of whether the member is conducting broker-dealer services on or off the premises of a financial institution.¹³

Second, the proposed rule change would make certain minor changes to the provisions addressing setting, as set forth in NASD Rule 2350(c)(1) (Setting). The setting provision establishes the requirements regarding a member's presence on the premises of a financial institution. To better align the rule text with the language in the networking exception in GLB and its associated rules in Regulation R, proposed FINRA Rule 3160 would provide that a member conducting broker-dealer services on the premises of a financial institution: (1) be clearly identified as the person performing broker-dealer services and distinguish its broker-dealer services from the services of the financial institution; (2) conduct its broker-dealer services in an area that displays clearly the member's name; and (3) to the extent practicable, maintain its broker-dealer services in a location physically separate from the routine retail deposit-taking activities of the financial institution.

Third, the proposed rule change would amend the provisions addressing networking agreements, in NASD Rule 2350(c)(2) (Networking and Brokerage Affiliate Agreements), to reference certain requirements in GLB and Regulation R regarding written agreements between banks and broker-dealers. As noted above, Rule 701 of Regulation R allows a bank employee to receive a contingent referral fee not subject to the "nominal amount" restriction, so long as the client referred to the broker-dealer by the

¹³ The title of the rule would be changed from "Broker/Dealer Conduct on the Premises of Financial Institutions" to "Networking Arrangements Between Members and Financial Institutions."

bank employee is an “institutional” or “high net worth” customer, as defined in Rule 701, and the other conditions of the rule are satisfied.

Rule 701 requires that the written agreement between a bank relying on the exception from the definition of “broker” under Exchange Act Section (3)(a)(4)(B)(i) and the exemption under Rule 701 for institutional and high net worth customers and its networking broker-dealer to include terms that obligate the broker-dealer to take certain actions.¹⁴ In particular, the written agreement between the bank and broker-dealer must require that the broker-dealer:

- (1) determine that a bank employee is not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act, have a reasonable basis to believe that the customer is a “high net worth customer” or an “institutional customer” and conduct a suitability or sophistication analysis for customers and securities transactions by customers;¹⁵
- (2) promptly inform the bank if the broker-dealer determines that the customer referred to the broker-dealer is not a “high net worth customer” or an “institutional customer,” as applicable or the bank employee receiving the

¹⁴ See 17 CFR 247.701(a)(3). See also Securities Exchange Act Release No. 56501, 72 FR 56514, 56523 (October 3, 2007) (Definitions of Terms and Exemptions Relating to the “Broker” Exceptions for Banks). (“Banks and broker-dealers are expected to comply with the terms of their written networking arrangements. If a bank or broker-dealer does not comply with the terms of the agreement, however, the bank would not become a “broker” under Section 3(a)(4) of the Exchange Act or lose its ability to operate under the proposed exemption.”)

¹⁵ See 17 CFR 247.701(a)(3)(ii)-(iii).

referral fee is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act;¹⁶ and

- (3) inform the customer if the customer or the securities transaction(s) to be conducted by the customer does not meet the applicable standard set forth in the suitability or sophistication determination in Rule 701;¹⁷

In addition, the broker-dealer may be contractually obligated to provide certain disclosures to a referred customer.¹⁸

Proposed FINRA Rule 3160 would clarify that networking agreements must include all broker-dealer obligations, as applicable, in Rule 701 and that independent of their contractual obligations, members must comply with all such broker-dealer obligations. In this regard, the release adopting Regulation R specifically contemplated that FINRA would adopt a rule to require that broker-dealers comply with the requirements of Rule 701.¹⁹

Next, the proposed rule change would modify the provisions addressing customer disclosure and acknowledgements, in NASD Rule 2350(c)(3) (Customer Disclosure and

¹⁶ See 17 CFR 247.701(a)(3)(v).

¹⁷ See 17 CFR 247.701(a)(3)(iv). See Securities Exchange Act Release No. 56501, 72 FR 56514, 56526 (October 3, 2007) (re: Suitability or Sophistication Analysis by Broker-Dealer). The “sophistication” analysis is based on the elements of NASD IM-2310-3 (Suitability Obligations to Institutional Customers). FINRA is seeking comment on a proposal regarding a consolidated FINRA rule addressing suitability obligations. See Regulatory Notice 09-25 (May 2009).

¹⁸ See 17 CFR 247.701(b).

¹⁹ See Securities Exchange Act Release No. 56501, 72 FR 56514, 56528 n.135 (October 3, 2007) (“As stated in the proposal, the Commission anticipates that it may be necessary for either FINRA or the Commission to propose a rule that would require broker-dealers to comply with the written agreements entered into pursuant to Rule 701.”).

Written Acknowledgement), which require members to make certain disclosures to customers, at or prior to account opening, regarding securities products, and to make reasonable efforts to obtain a customer's written acknowledgement of the receipt of such disclosures at account opening. Such disclosures include that the securities products are: (1) not insured by the Federal Deposit Insurance Corporation; (2) not deposits or other obligations of the financial institution and not guaranteed by the financial institution; and (3) subject to investment risk, including possible loss of the principal invested. The proposal would not incorporate the written acknowledgement requirement into proposed FINRA Rule 3160, in light of the application of the rule to networking arrangements regardless of whether the member is conducting broker-dealer services on or off the premises of a financial institution and the obligation that members provide the requisite disclosures orally and in writing. In this context, FINRA believes that oral and written disclosure to customers regarding securities products is sufficient and that requiring a written acknowledgement of receipt from customers is unnecessary.

Lastly, the proposed rule change would amend the provisions addressing communications with the public, in NASD Rule 2350(c)(4) (Communications with the Public), consistent with the extension of proposed FINRA Rule 3160 to networking arrangements where the member conducts broker-dealer services on or off the premises of a financial institution. NASD Rule 2350(c)(4) requires a member to make the same disclosures regarding securities products discussed above on advertisements and sales literature that announce the location of a financial institution where broker-dealer services are provided by the member or that are distributed by the member on the premises of a financial institution. To further reduce potential customer confusion,

proposed FINRA Rule 3160 would extend this requirement to include all of the member's advertisements and sales literature that promote the name or services of the financial institution or that are distributed by the member at any other location where the financial institution is present or represented.

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.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²⁰ 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 clarify and streamline the FINRA requirements for broker-dealer networking arrangements and will serve to better align the FINRA requirements with GLB and Regulation R.

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

Written comments were neither solicited nor received.

²⁰ 15 U.S.C. 78q-3(b)(6).

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

Within 35 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 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. Please include File Number SR-FINRA-2009-047 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-2009-047. 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 inspection and copying 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-2009-047 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.²¹

Florence E. Harmon
Deputy Secretary

²¹ 17 CFR 200.30-3(a)(12).