

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63375; File No. SR-FINRA-2010-061)

November 24, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt Rules Governing Guarantees, Carrying Agreements, Security Counts and Supervision of General Ledger Accounts in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “SEA”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 12, 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 Rules 4150 (Guarantees by, or Flow Through Benefits for, Members), 4311 (Carrying Agreements), 4522 (Periodic Security Counts, Verifications and Comparisons) and 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts) in the consolidated FINRA rulebook and to delete NASD Rule 3230, Incorporated NYSE Rules 322, 382, 440.10 and 440.20 and Incorporated NYSE Rule Interpretations 382/01 through 382/05, 409(a)/01 and 440.20/01.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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.

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 new, consolidated rules governing guarantees, carrying agreements, security counts and supervision of general ledger accounts for purposes of the Consolidated FINRA Rulebook. FINRA proposes to adopt FINRA Rules 4150 (Guarantees by, or Flow Through Benefits for, Members), 4311 (Carrying Agreements), 4522 (Periodic

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

Security Counts, Verifications and Comparisons) and 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts) in the Consolidated FINRA Rulebook and to delete NASD Rule 3230, NYSE Rules 322, 382, 440.10 and 440.20 and NYSE Rule Interpretations 382/01 through 382/05, 409(a)/01 and 440.20/01.⁴

The proposed rules would, in combination with the new consolidated financial responsibility rules that the SEC has approved,⁵ enhance FINRA's authority to execute effectively its financial and operational surveillance and examination programs. Consistent with the approach that FINRA discussed in SR-FINRA-2008-067 and Regulatory Notice 09-71, many of the requirements set forth in the proposed rules are substantially the same as requirements found in current rules and, where appropriate, are tiered to apply only to carrying or clearing firms, or to firms that engage in certain specified activities.⁶ Certain of the proposed rule provisions are new for FINRA members that are not Dual Members ("non-NYSE members"). Certain other provisions are new for both Dual Members and non-NYSE members alike.

⁴ For convenience, the Incorporated NYSE Rules are referred to as the "NYSE Rules."

⁵ See Securities Exchange Act Release No. 60933 (November 4, 2009), 74 FR 58334 (November 12, 2009) (Order Granting Accelerated Approval to Proposed Rule Change; File No. SR-FINRA-2008-067). See also Regulatory Notice 09-71 (December 2009) (SEC Approves Consolidated FINRA Rules Governing Financial Responsibility); Regulatory Notice 09-03 (January 2009) (Financial Responsibility and Related Operational Rules).

⁶ For purposes of the new consolidated financial responsibility rules and the proposed rules, FINRA has specified in the rule text where appropriate that all requirements that apply to a member that clears or carries customer accounts also apply to any member that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established thereunder. For further discussion, see 74 FR 58334. See also proposed FINRA Rule 4523.02 in this rule filing.

(A) Proposed FINRA Rule 4150 (Guarantees by, or Flow Through Benefits for, Members)

Proposed FINRA Rule 4150(a), based in large part on NYSE Rule 322, requires that prior written notice be given to FINRA whenever a member guarantees, endorses or assumes, directly or indirectly, the obligations⁷ or liabilities of another person (including an entity).⁸ Paragraph (b) of the rule requires that prior written approval must be obtained from FINRA whenever any member receives flow-through capital benefits in accordance with Appendix C of SEA Rule 15c3-1.⁹ Details of the rule's notice and prior approval requirements are included in proposed FINRA Rule 4150.01. Proposed FINRA Rule 4150.02 provides that a member may at any time (i.e., not just within the context of the prior written notice that the member provides or the prior written approval that the member seeks to obtain pursuant to the proposed rule) be required to provide FINRA with information with respect to the arrangement, relationship and dealings with a person referred to in the proposed rule.

Proposed FINRA Rule 4150.03 prohibits any member from entering into an arrangement described in the proposed rule unless the member has the authority to make available promptly the books and records of the other person for inspection by FINRA in the United States. The proposed rule provides that the books and records of the other person must be kept separately from those of the member.

⁷ In response to comments, FINRA notes that the term "obligations" includes financial obligations, as well as other obligations that may have a financial impact on a member, such as performance obligations. See Section (A) under Item II.C.

⁸ NASD Rule 0120(n) defines "person" to include any natural person, partnership, corporation, association, or other legal entity. Similarly, NYSE Rule 2(d) states that "person" means a natural person, corporation, limited liability company, partnership, association, joint stock company, trust, fund or any organized group of persons whether incorporated or not. All references to "persons" in this filing include entities.

⁹ In the interest of clarity, FINRA has revised the proposed rule so as to better align it with the requirements of Appendix C.

With respect to persons referred to in the proposed rule that are registered broker-dealers, proposed FINRA Rule 4150.04 requires that the member must furnish to FINRA copies of the person's FOCUS Reports simultaneous with their being filed with the person's designated examining authority ("DEA"). FINRA expects that members shall furnish the person's FOCUS Reports to FINRA on an ongoing basis (the member need not furnish the person's FOCUS Reports to FINRA if FINRA is the person's DEA). With respect to persons that are not registered broker-dealers, the proposed rule requires, in lieu of FOCUS Reports, submission of financial and operational statements, in such format and at such time periods as FINRA may require, sufficient to gauge the capital and operational effects of the arrangement or relationship on the member.

Proposed FINRA Rule 4150.05 provides that guarantees executed routinely in the normal course of business, such as trade guarantees, signature guarantees, endorsement of securities and the writing of options, are not subject to the requirements of the proposed rule provided that, in regard to the guarantee of the writing of options, the transaction is appropriately recorded on the member's books and records in accordance with SEA Rule 17a-3(a)(10) and is reflected in its net capital computation pursuant to SEA Rule 15c3-1.¹⁰

In response to commenter suggestions, proposed FINRA Rule 4150.06 provides that, within 30 days of the implementation date of the rule, each member must advise FINRA, in writing, of any guarantees, endorsements, assumptions of obligations/liabilities, or flow through capital benefits, in effect as of the implementation date of the rule, not having otherwise been reported, in writing, to the appropriate Regulatory Coordinator.¹¹

¹⁰ See note 33.

¹¹ See Section (A) under Item II.C.

NASD Rules do not have a provision that corresponds to NYSE Rule 322. Accordingly, the requirements of proposed FINRA Rule 4150 would be new to non-NYSE members.

(B) Proposed FINRA Rule 4311 (Carrying Agreements)

Proposed FINRA Rule 4311 is based on NASD Rule 3230 and NYSE Rule 382 (including NYSE Rule Interpretations 382/01 through /05 and 409(a)/01). The proposed rule governs the requirements applicable to members when entering into agreements for the carrying of any customer accounts in which securities transactions can be effected. Historically, the purpose of the NASD and NYSE rules upon which the proposed rule is based has been to ensure that certain functions and responsibilities are clearly allocated to either the introducing or carrying firm, consistent with the requirements of the SRO's and SEC's financial responsibility and other rules and regulations, as applicable.¹² The proposed rule continues to serve that same purpose and, accordingly, contains many requirements that are substantially unchanged from NASD Rule 3230 and NYSE Rule 382. Proposed FINRA Rule 4311 also codifies certain provisions that are new for non-NYSE members, or are new for both Dual Members and non-NYSE members alike. Following is a summary of the more significant provisions of the proposed rule.

Proposed FINRA Rule 4311(a)(1) prohibits a member, unless otherwise permitted by FINRA, from entering into an agreement for the carrying, on an omnibus or fully disclosed basis, of any customer account in which securities transactions can be effected (for purposes of Rule 4311, "customer account" or "account"), unless the agreement is with a carrying firm that is a

¹² See, e.g., Notice to Members 94-7 (February 1994) (SEC Approves New NASD Rule Relating to the Obligations and Responsibilities of Introducing and Clearing Firms) and NYSE Information Memo 82-18 (March 1982) (Carrying Agreements – Amendments to Rules 382 and 405).

FINRA member.¹³ This is a new requirement for all members; however, the vast majority of carrying firms in the United States are FINRA members. Proposed FINRA Rule 4311(a)(1) also includes a provision that requires that when an introducing firm acts as an intermediary for another introducing firm or firms (so-called “piggyback” or “intermediary clearing arrangements”) for the purpose of obtaining clearing services from the carrying firm, the introducing firm must notify the carrying firm of the existence of the arrangement(s) with the other introducing firm(s) and disclose the identity of the firm(s). Based in large part on NYSE Rule Interpretation 382/05, the proposed rule further requires that each carrying agreement must identify and bind every direct and indirect recipient of clearing services as a party thereto.

Proposed FINRA Rule 4311(b)(1), consistent with the requirements of NASD Rule 3230(e) and NYSE Rule 382(a), requires that the carrying firm must submit to FINRA for prior approval any agreement for the carrying of accounts, whether on an omnibus or fully disclosed basis, before such agreement may become effective. The proposed rule also provides that the carrying firm must also submit to FINRA for prior approval any material changes to an approved carrying agreement before the changes may become effective.¹⁴ The proposed rule codifies the

¹³ Because carrying firms generally are FINRA members, FINRA expects requests to enter into carrying agreements with firms that are not FINRA members to be infrequent. Further, as proposed in Regulatory Notice 09-03, the proposed rule’s scope would reach any customer account. FINRA has revised proposed Rule 4311 to clarify that the rule applies, unless otherwise permitted by FINRA, to the carrying of any customer account in which securities transactions can be effected. FINRA has made other minor changes to the proposed rule in the interest of clarity.

¹⁴ In response to commenter suggestion, the proposed rule includes revised guidance as to what constitutes a material change for purposes of Rule 4311(b)(1). See Section (B)(3) under Item II.C. Specifically, as set forth in proposed FINRA Rule 4311.01, material changes include, but are not limited to, changes to: the allocation of responsibilities required by the proposed rule; termination clauses applicable to the introducing firm; any terms or provisions affecting the liability of the parties; and the parties to the agreement, including, for example, the addition of a new party to the agreement, such as a “piggyback” arrangement, a new carrying firm or a new introducing firm, but not

practice under NASD Rule 3230 of permitting use of pre-approved standardized forms of agreement, with the exception of agreements with parties that are not U.S.-registered broker-dealers. The proposed rule requires a carrying firm to submit to FINRA for approval each carrying agreement with a non-U.S.-registered broker-dealer.¹⁵ This is a new requirement for non-NYSE members.

Proposed FINRA Rule 4311(b)(3) codifies the current practice under NYSE Rule 382 of requiring that as early as possible, but not later than 10 business days, prior to the carrying of any accounts of a new introducing firm (including the accounts of any piggyback or intermediary introducing firm(s)), the carrying firm must submit to FINRA a notice identifying each such introducing firm by name and CRD number and include such additional information as FINRA may require.¹⁶ This is a new requirement for non-NYSE carrying members, and permits FINRA to obtain additional information that enables it to evaluate the impact of the new carrying arrangement on the financial and operational condition of the member.

including a termination of the agreement. (However, as explained in Regulatory Notice 08-76, under NYSE Rule 416A carrying firms that are Dual Members are required to update their Firm Clearing Arrangement Form information on an ongoing basis no later than 30 days after the information has changed. FINRA expects to extend this requirement to all carrying firms later as part of the rulebook consolidation process. See Regulatory Notice 08-76 (December 2008) (Reporting Clearing Arrangements).) Lastly, FINRA has made other minor changes to proposed FINRA Rule 4311(b)(1) in the interest of clarity.

¹⁵ Note that proposed FINRA Rule 4311(a)(2) would expressly permit a carrying firm to enter into a carrying agreement for the carrying of the customer accounts of a person other than a U.S. registered broker or dealer, subject to the conditions set forth in the proposed rule.

¹⁶ Proposed FINRA Rule 4311.02 provides that, for purposes of the notice requirement, the carrying firm must submit a questionnaire in such form as to be specified by FINRA in a Regulatory Notice, which questionnaire may be updated from time to time as FINRA deems necessary.

Proposed FINRA Rule 4311(b)(4) expressly requires each carrying firm to conduct appropriate due diligence with respect to any new introducing firm relationship. In response to commenter suggestion, the proposed rule provides that such due diligence must assess the financial, operational, credit and reputational risk that such arrangement will have upon the carrying firm.¹⁷ The rule provides that FINRA, in its review of any arrangement, may in its discretion require specific items to be addressed by the carrying firm as part of the firm's due diligence requirement under the rule. The rule further provides that the carrying firm must maintain a record, in accord with the time frames prescribed by SEA Rule 17a-4(b), of the due diligence conducted for each new introducing firm.

Proposed FINRA Rule 4311(c), based in part on NASD Rule 3230(a) and NYSE Rule 382(b), requires that each carrying agreement in which accounts are to be carried on a fully disclosed basis must specify the responsibilities of each party to the agreement. The rule sets forth the minimum responsibilities that the agreement must allocate. Because FINRA believes that it is important to ensure the accuracy and integrity of customer account statements, the proposed rule requires that each carrying agreement in which accounts are to be carried on a fully disclosed basis must expressly allocate to the carrying firm the responsibility for preparing and transmitting statements of account to customers.¹⁸

¹⁷ Supplementary Material to the proposed rule provides that, for purposes of proposed FINRA Rule 4311(b)(4), the due diligence may include, without limitation, inquiry by the carrying firm into the introducing firm's business model and product mix, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history. See proposed FINRA Rule 4311.03. See also Section (B)(2) under Item II.C.

¹⁸ However, the proposed rule provides that the carrying firm may authorize the introducing firm to prepare and/or transmit such statements on the carrying firm's behalf with the prior written approval of FINRA. See proposed FINRA Rule 4311(c)(2). In the interest of customer protection, FINRA has revised proposed FINRA Rule 4311(c)(2) (and made corresponding revisions to Rule 4311(c)(1)) to provide that the safeguarding of funds and

Based in part on NASD Rule 3230(g), NYSE Rule 382(c) and NYSE Rule Interpretation 382/03, proposed FINRA Rule 4311(d) requires that each customer whose account is introduced on a fully disclosed basis must be notified in writing upon the opening of the account of the existence of the carrying agreement and the responsibilities allocated to each respective party. The carrying firm would be responsible for the content of the notification to the customer. Further, the proposed rule provides that the customer must be notified promptly and in writing in the event of any change to any of the parties to the agreement or any material change to the allocation of responsibilities thereunder. In response to commenter suggestion,¹⁹ Supplementary Material to the proposed rule provides that, for purposes of proposed FINRA Rule 4311(d), notification to customers of a change to any of the parties to the carrying agreement is not required in instances where, consistent with applicable FINRA rules and the federal securities laws, such customers' accounts are being transferred pursuant to: (a) ACATS using an authorized Transfer Instruction Form (TIF); or (b) a process outside of ACATS where notification to customers is provided by means of an alternative mechanism such as affirmative or negative response letters.²⁰

Consistent with NYSE Rule Interpretation 382/03, proposed FINRA Rule 4311(e) requires that each carrying agreement must expressly state that to the extent that a particular responsibility is allocated to one party, the other party or parties will supply to the responsible organization all appropriate data in their possession pertinent to the proper performance and supervision of that responsibility. This is a new requirement for non-NYSE members.

securities for the purposes of SEA Rule 15c3-3 must also be expressly allocated to the carrying firm.

¹⁹ See Section (B)(3) under Item II.C.

²⁰ See proposed FINRA Rule 4311.04.

Based in large part on NASD Rule 3230(d) and NYSE Rule 382(f), proposed FINRA Rule 4311(f) provides that a carrying agreement may authorize an introducing firm to issue negotiable instruments directly to its customers on the carrying firm's behalf, using instruments for which the carrying firm is the maker or drawer, provided that the parties comply with SEA Rule 15c3-3 and further that the introducing firm represents to the carrying firm in writing that the introducing firm maintains, and will enforce, supervisory policies and procedures with respect to such negotiable instruments that are satisfactory to the carrying firm.²¹

The provisions of proposed FINRA Rule 4311(g)(1) and (h) generally address the obligations of the parties to provide the referenced information, such as any written customer complaints and exception reports, to each other and/or to FINRA and are based upon existing NASD and NYSE rule provisions. (FINRA notes that the July 1 deadline set forth in paragraph (h)(2) of the proposed rule differs from the current requirement (no later than July 31) specified by the corresponding NASD and NYSE rule provisions.) Proposed FINRA Rule 4311(g)(2) provides that, upon a showing of good cause, FINRA, at its discretion, may exclude certain carrying firms from the requirements of proposed FINRA Rule 4311(g)(1) in instances where the introducing firm is an affiliated entity of the carrying firm. This provision is based upon NASD Rule 3230(b)(3) but is not contained in NYSE Rule 382.

Proposed FINRA Rule 4311(i) is based largely on NASD Rule 3230(h) and does not have a corresponding provision to NYSE Rule 382. The proposed rule provides that all carrying agreements must require each introducing firm to maintain its proprietary and customer accounts, and the proprietary and customer accounts of any introducing firm for which it is acting as an intermediary in obtaining clearing services from the carrying firm, in such a manner

²¹ FINRA has made minor changes to the proposed rule in the interest of clarity.

as to enable the carrying firm and FINRA to specifically identify the proprietary and customer accounts belonging to each introducing firm. Consistent with NASD Rule 3230(h), the proposed rule's requirements apply only to intermediary clearing arrangements that are established on or after February 20, 2006.

(C) Proposed FINRA Rule 4522 (Periodic Security Counts, Verifications and Comparisons)

Proposed FINRA Rule 4522(a), based in large part on NYSE Rule 440.10, requires each member firm that is subject to the requirements of SEA Rule 17a-13 to make the counts, examinations, verifications, comparisons and entries set forth in SEA Rule 17a-13. Proposed FINRA Rule 4522(b), again based in large part on NYSE Rule 440.10, requires each carrying or clearing member subject to SEA Rule 17a-13 to make more frequent counts, examinations, verifications, comparisons and entries where prudent business practice would so require. Each such carrying or clearing member would be required to receive position statements no less than once per month with respect to securities held by clearing corporations, other organizations or custodians and, at least once per month, reconcile all such securities and money balances by comparison of the clearing corporations' or custodians' position statements to the member's books and records. The carrying or clearing member must promptly report any differences to the contra organization, and both the contra organization and the member firm must promptly resolve the differences. Where there is a higher volume of activity, the proposed rule provides that good business practice may require a more frequent exchange of statements and performance of reconciliations. The proposed rule further requires that no later than seven business days after each security count, the carrying or clearing member must enter any unresolved differences in a "Difference" account for that security count.

NASD Rules do not have a provision that corresponds to NYSE Rule 440.10.

Accordingly, the requirements of proposed FINRA Rule 4522(b) are new to non-NYSE carrying or clearing members that are subject to the requirements of SEA Rule 17a-13.²²

(D) Proposed FINRA Rule 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts)

Proposed FINRA Rule 4523, based in large part on NYSE Rule 440.20, is intended to help assure the accuracy of each member's books and records and includes supervisory measures for their implementation. Paragraph (a) of the proposed rule requires that each member must designate an associated person to be responsible for each general ledger bookkeeping account and account of like function used by the member, and that the associated person must control and oversee entries into each such account and determine that the account is current and accurate as necessary to comply with all applicable FINRA rules and federal securities laws governing books and records and financial responsibility requirements. The proposed rule requires that a supervisor must, as frequently as is necessary considering the function of the account but, in any event, at least monthly, review each account to determine that it is accurate and that any items that are aged or uncertain as to resolution are promptly identified for research and possible transfer to a suspense account(s).

Proposed FINRA Rule 4523(b) requires that each carrying or clearing member must maintain a record of the name of each individual assigned primary and supervisory responsibility for each account as required by paragraph (a) of the rule. In the interest of clarity, FINRA has revised the proposed rule to require that all records made pursuant to Rule 4523(b) must be preserved for a period of not less than six years (the period set forth in SEA Rule 17a-4(a)).

²² In response to commenter request for clarification, FINRA notes that the proposed rule, by its terms, does not apply to members that are exempt from SEA Rule 17a-13. See Section (C) under Item II.C.

Proposed FINRA Rule 4523(c) provides that each member must record, in an account that must be clearly identified as a suspense account, money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. The proposed rule requires that a record must be maintained of all information known with respect to each item so recorded. Again, in the interest of clarity, FINRA has revised proposed Rule 4523(c) to require that all records made pursuant to that paragraph must be preserved for a period of not less than six years (the period set forth in SEA Rule 17a-4(a)).

In response to commenter suggestion,²³ Supplementary Material to the proposed rule provides that, for the purposes of paragraphs (a) and (b) of the rule, members with only one associated person may assign primary and supervisory responsibility for each account to that associated person, subject to applicable registration requirements.²⁴ Further, the Supplementary Material provides that members of limited size and resources that have more than one associated person may seek FINRA's prior written approval to assign primary and supervisory responsibility for each account to the same associated person. Further, for purposes of clarification, proposed FINRA Rule 4523.02 provides that, for purposes of Rule 4523, all requirements that apply to a member that clears or carries customer accounts shall also apply to any member that, operating pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i), either clears customer transactions pursuant to such exemptive provisions or holds customer funds in a bank account established thereunder.²⁵

²³ See Section (D) under Item II.C.

²⁴ See proposed FINRA Rule 4523.01.

²⁵ See note 6.

NASD Rules do not have a provision that corresponds to NYSE Rule 440.20.

Accordingly, the requirements of proposed FINRA Rule 4523 are new to non-NYSE 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 120 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,²⁶ 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 further the purposes of the Act because, as part of the FINRA rulebook consolidation process, the proposed rule change will streamline and reorganize existing rules that govern guarantees, carrying agreements, security counts and supervision of general ledger accounts. Further, the proposed rule change will provide greater regulatory clarity with respect to these issues.

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

The proposed rule change was published for comment in Regulatory Notice 09-03 (January 2009) (Financial Responsibility and Related Operational Rules) (the "Notice"). Four

²⁶ 15 U.S.C. 78q-3(b)(6).

comments were received in response to the Notice.²⁷ A copy of the Notice is attached to the filing as Exhibit 2a.²⁸ A list of the comment letters received in response to the Notice is attached to the filing as Exhibit 2b.²⁹

(A) Proposed FINRA Rule 4150 (Guarantees by, or Flow Through Benefits for, Members)

One commenter sought clarification as to whether the scope of the term “obligations” as used in proposed FINRA Rule 4150 is limited to financial obligations as opposed to other types of contractual obligations.³⁰ In response, FINRA has clarified that the term “obligations” includes financial obligations, as well as other obligations that may have a financial impact on a member, such as performance obligations.³¹ The same commenter sought clarification regarding the proposed rule’s impact on expense sharing agreements. The commenter inquired whether, if a firm files or has already filed such an agreement with FINRA, the rule imposes a separate

²⁷ Letter from Claire Santaniello, Managing Director and Chief Compliance Officer, Pershing LLC (“Pershing”), dated April 27, 2009; Letter from Holly H. Smith and Eric A. Arnold, Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers (“CAI”), dated February 20, 2009; Letter from Sarah McCafferty, Vice President, Chief Compliance Officer, T. Rowe Price Investment Services, Inc. (“TRP”), dated February 19, 2009; and E-mail from Terry Nickels, Chief Financial Officer, Vice President, Wedge Securities, LLC (“Wedge”), dated February 19, 2009.

²⁸ The Commission notes that while provided in Exhibit 2a to FINRA's filing with the Commission, the Notice is not attached hereto. The Notice can be accessed online at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117679.pdf>.

²⁹ The Commission notes that while provided in Exhibit 2b to the filing, the list of the commenters and comment letters received by FINRA are not attached hereto. Those comment letters can be accessed online at <http://www.finra.org/Industry/Regulation/Notices/2009/P117680>. As stated previously, all references to "commenters" are to the commenters to the Notice, which are listed in Exhibit 2b.

³⁰ CAI.

³¹ See note 7.

obligation to provide written notice to FINRA. The commenter further suggested that the rule should exempt guarantees that are already subject to review by another regulator (for instance, federal bank regulators). In response, FINRA believes that, in view of the importance of this regulatory area, FINRA should be notified in accordance with the proposed rule's provisions of any agreement or arrangement that, falling within the subject matter covered by the rule, is already in existence when the rule goes into effect, in addition to any such new agreement or arrangement going forward. Accordingly, FINRA has revised the proposed rule to provide that, within 30 days of the implementation date of the rule, each member must advise FINRA, in writing, of any guarantees, endorsements, assumptions of obligations/liabilities, or flow through capital benefits, in effect as of the implementation date of the rule, not having otherwise been reported, in writing, to the appropriate Regulatory Coordinator.³² With respect to the commenter's last point, FINRA does not believe that guarantees subject to review by other regulatory authorities should be exempt from the proposed FINRA requirement. It is FINRA's responsibility to exercise supervision over its members in accordance with FINRA's standards. In this regard, FINRA notes that proposed FINRA Rule 4150.05 excludes from the rule's coverage guarantees executed routinely in the normal course of business, which should serve to reduce associated burdens on members.³³

(B) Proposed FINRA Rule 4311 (Carrying Agreements)

(1) Introducing Firms

As proposed in the Notice, proposed FINRA Rules 4311(a)(1) and (i) set forth certain requirements with respect to the identification of introducing firms and their accounts ("clear

³² See proposed FINRA Rule 4150.06.

³³ FINRA also has made minor clarifying revisions to proposed FINRA Rule 4150.05.

thru” or piggyback requirements). Proposed FINRA Rule 4311(a)(2) permits carrying firms to enter into carrying agreements for the carrying of the customer accounts of a person other than a U.S.-registered broker or dealer, subject to the rule’s requirements.³⁴ One commenter sought clarification as to whether under the proposed rule the so-called “clear thru” requirements would be applied to foreign introducing firms in the same way as they would to members, and, if so, what reporting information would be appropriate.³⁵ The commenter further inquired whether the term “introducing firm,” as used in the proposed rules generally, includes a bank or broker-dealer, or foreign equivalent. In response, FINRA notes that the term “introducing firm” includes a bank or broker-dealer, or the foreign equivalent. With respect to reporting information, FINRA notes that FINRA would expect requirements as to foreign introducing firms to be applied in the same fashion as they do with respect to members.

(2) Due Diligence

One commenter suggested that the proposed rule should not set forth specific review requirements with respect to due diligence obligations and that firms should be allowed to craft their own due diligence review based on a prudential approach according to the business model of the introducing firm.³⁶ The commenter suggested that due diligence should be limited to confirming that a prospective introducing firm relationship is appropriate from a commercial perspective and does not pose undue credit risk or liability to the carrying firm, and that the rule should not imply a responsibility on the part of the carrying firm to take further steps to proactively determine the appropriateness of the introducing firm’s activities or compliance

³⁴ FINRA also has made minor clarifying revisions to proposed FINRA Rules 4311(a)(1) and (2). See note 13.

³⁵ Pershing.

³⁶ Pershing.

profile, which, the commenter suggested, is the responsibility of regulatory authorities. The commenter further suggested that, in place of the proposed rule's due diligence requirement, the new rule should instead incorporate language from current NYSE Rule Interpretation 384/04, to the effect that members "should carefully weigh the capital and other regulatory and practical consequences" of assuming the responsibilities required under the rule.

In response, FINRA notes that the purpose of the proposed rule is to set a standard as to the due diligence that carrying firms must exercise. The staff believes such a standard is important as a matter of investor protection. However, in response to the commenter's suggestion, FINRA has revised proposed FINRA Rule 4311(b)(4) to provide that the carrying firm must conduct appropriate due diligence with respect to any new introducing firm relationship to assess the financial, operational, credit and reputational risk that such arrangement will have upon the carrying firm. Supplementary Material to the revised rule (proposed FINRA Rule 4311.03) provides that, for purposes of FINRA Rule 4311(b)(4), the due diligence may include, without limitation, inquiry by the carrying firm into the introducing firm's business model and product mix, proprietary and customer positions, FOCUS and similar reports, audited financial statements and complaint and disciplinary history. Further, the revised rule provides that FINRA, in its review of any arrangement, may in its discretion require specific items to be addressed by the carrying firm as part of the due diligence requirement under the rule.

One commenter suggested that FINRA should make clear that the carrying firm's due diligence obligation extends only to pertinent information regarding the introducing firm that receives clearing services, and not the introducing firm's affiliates.³⁷ The commenter also suggested that FINRA should make clear that any information provided by the introducing firm

³⁷ CAI.

as part of the due diligence review must be kept confidential by the carrying firm. In response, FINRA notes that the due diligence obligation is with respect to the introducing firm *relationship*; information about affiliates is not expressly required but should be considered if necessary to make an informed decision about entering into a carrying agreement with the introducing firm. FINRA believes that the confidentiality of due diligence information generally is a matter between the carrying firm and the introducing firm, subject to applicable laws and rules.³⁸

(3) Notification of Termination of Carrying Agreements

One commenter sought clarification as to whether, for purposes of proposed FINRA Rule 4311(b)(1), it is a “material change” to an agreement if a party chooses to exercise its right to terminate the agreement, in which case FINRA’s prior approval would be required.³⁹ The commenter suggested that construing the proposed rules in such fashion would burden the parties to the agreement. The commenter further suggested that the rules should delete any proposed requirement to notify customers of such termination because there are existing mechanisms designed to provide customers of such changes, such as communications pursuant to Notice to Members 02-57 (addressing the use of negative response letters for the bulk transfer of customer accounts) as well as customers’ affirmative consent to open and transfer their accounts to another firm. The commenter cited concern that a further notification requirement could confuse customers and suggested that the proposed rule should require the introducing firm, not the carrying firm, to be responsible for any such notifications. The commenter further suggested the

³⁸ For clarification, FINRA notes that the carrying firm and the introducing firm are not permitted to agree to keep due diligence information confidential from FINRA.

³⁹ Pershing.

carrying firm should only be required to communicate directly with customers in circumstances when it provides services to the customer through contract.

In response, FINRA has revised proposed FINRA Rule 4311.01 to clarify that certain changes to the parties to the agreement – including the addition of a new party to the agreement, such as a “piggyback” arrangement, a new carrying firm or a new introducing firm – are material and thus require FINRA’s prior approval, but that a termination of the agreement is not material for purposes of the provision. (FINRA has noted, however, that – as explained in Regulatory Notice 08-76 – under NYSE Rule 416A, carrying firms that are Dual Members are required to update their Firm Clearing Arrangement Form information on an ongoing basis no later than 30 days after the information has changed; FINRA expects to extend this requirement to all carrying firms later as part of the rulebook consolidation process.⁴⁰) With respect to notification to customers, FINRA has added proposed FINRA Rule 4311.04 to clarify that notification to customers of a change in the parties to the agreement is not required under FINRA Rule 4311(d) in instances where, consistent with applicable FINRA rules and the federal securities laws, such customers’ accounts are being transferred pursuant to: (a) ACATS using an authorized Transfer Instruction Form (TIF); or (b) a process outside of ACATS where notification to customers is provided by means of an alternative mechanism such as affirmative or negative response letters. As a result, customers would need to be notified of changes in parties under proposed FINRA Rule 4311 when, for example, any party to the agreement undergoes a reorganization that results in a name change or a carrying firm requires an introducing firm to clear via a piggybacking arrangement rather than directly with the carrying firm.

(4) Furnishing of Customer Complaints and Reports

⁴⁰ See note 14.

As proposed in the Notice, proposed FINRA Rule 4311(g)(1)(A) provides that each carrying agreement must authorize and direct the carrying firm to furnish promptly to the introducing firm and introducing firm's DEA, or, if none, its appropriate regulatory body, any written customer complaint regarding the introducing firm and its associated persons. Proposed FINRA Rule 4311(h)(2) provides that no later than July 1 of each year the carrying firm must notify certain officers of the introducing firm of a list of reports supplied to the introducing firm, and that a copy of such notification must be provided to the same authorities as specified under Rule 4311(g)(1)(A). One commenter suggested that, if the proposed requirements apply to non-U.S. introducing firms, they could present difficulties for members because some non-U.S. regulatory authorities are not accustomed to or prepared for the receipt of such information.⁴¹ The commenter suggested that FINRA should engage in additional international coordination efforts and industry discussions.

In response, FINRA notes that the proposed rule does extend to non-U.S. introducing firms and, accordingly, the requirement to provide information to foreign regulators may apply. FINRA believes that the proposed requirement is consistent with the goal of strengthening international regulatory coordination and is conducive to investor protection, and further notes that the requirement exists under current rules. Though FINRA has not revised the proposed rule with respect to this issue, FINRA notes that it plans to engage in coordination and education efforts with such bodies as IOSCO, and will consider whether any future changes are necessary based on such discussions.

(C) Proposed FINRA Rule 4522 (Periodic Security Counts, Verifications and Comparisons)

⁴¹ Pershing.

As proposed in the Notice, proposed FINRA Rule 4522 imposes certain requirements on members that are subject to SEA Rule 17a-13. One commenter requested clarification as to whether members that are exempt from Rule 17a-13 would also be exempt from the proposed rule, notwithstanding that such members may be carrying or clearing firms.⁴² In response, FINRA has clarified that the proposed rule, by its terms, does not apply to members that are exempt from SEA Rule 17a-13.⁴³

(D) Proposed FINRA Rule 4523 (Assignment of Responsibility for General Ledger Accounts and Identification of Suspense Accounts)

One commenter sought clarification as to whether the proposed rule is intended only to cover general ledger accounts used by the member and not the general ledger accounts of the corporate complex to which the member belongs.⁴⁴ Two commenters suggested that the proposed rule should be revised so as to permit flexibility with respect to members' supervisory obligations.⁴⁵ One of the two suggested the proposed rule should incorporate a concept of reasonable supervision and policies and procedures reasonably designed to achieve compliance; the commenter further suggested that FINRA should strike from the proposed rule the requirement that the person responsible for the account must determine "at all times" that the account is current and accurate.⁴⁶ The second of the two commenters suggested that there should be an exemption for small firms so that the person assigned responsibility for general

⁴² CAI.

⁴³ See note 22.

⁴⁴ TRP.

⁴⁵ CAI and Wedge.

⁴⁶ CAI.

ledger bookkeeping would also be the person exercising the supervisory functions that the proposed rule sets forth.⁴⁷ The same commenter also sought clarification as to what evidentiary proof of review of the account would be required under the rule.

In response, FINRA appreciates the concerns that small firms may have with respect to supervision of general ledger accounts. As a general matter FINRA does not believe it is appropriate, from the standpoint of investor protection, that the same person assigned responsibility for the accounts also be the person exercising the supervisory functions set forth in the rule. However, in view of the circumstances of small firms, FINRA has revised the proposed rule to allow each member with only one associated person to assign primary and supervisory responsibility for each account to that associated person; members of limited size and resources would be able to seek FINRA's prior written approval to assign primary and supervisory responsibility for each account to the same associated person.⁴⁸

With respect to the requirement, as set forth in the rule as proposed in the Notice, to ensure such accounts are current and accurate "at all times," FINRA notes the particular importance of this subject matter. FINRA believes that requiring the accounts be accurate "at all times" is consistent with SEA Rule 15c3-1(a), which governs net capital requirements, and requires a broker-dealer to maintain its required net capital continuously and demonstrate moment-to-moment compliance.⁴⁹ However, in response to commenter suggestion, FINRA has revised proposed FINRA Rule 4523(a) to clarify that the obligation imposed by the rule is to ensure that the general ledger account is current and accurate as necessary to comply with all

⁴⁷ Wedge.

⁴⁸ FINRA has also amended proposed Rule 4523 to require members to designate an "associated person" to perform the specified functions, rather than an "individual."

⁴⁹ See Notice to Members 07-16 (Frequently Asked Financial and Operational Questions) (April 2007), Question A-1.

applicable FINRA rules and federal securities laws governing books and records and financial responsibility requirements. Further, FINRA notes that the rule's requirements only apply to the general ledger account of the member, as opposed to the corporate complex to which the member belongs. Lastly, with respect to maintaining records that give evidence of the supervisory review, FINRA notes that FINRA expects members to keep such records as would reasonably demonstrate that the supervision required by the proposed rule is being carried out. (In the interest of clarity with respect to record-retention requirements, FINRA notes that it has revised proposed FINRA Rules 4523(b) and (c) to require that all records made pursuant to each of those rules must be preserved for a period of not less than six years, the period set forth in SEA Rule 17a-4(a)).

(E) Miscellaneous Comments

In FINRA's separate rule filing regarding the proposed consolidated financial responsibility rules, FINRA has proposed certain regulatory treatment of firms that operate pursuant to the exemptive provisions of SEA Rule 15c3-3(k)(2)(i).⁵⁰ Regarding such treatment, one commenter on the Notice raised concerns that the commenter expressed in virtually identical language in a letter submitted to the SEC on SR-FINRA-2008-067.⁵¹ Because FINRA has already responded to the commenter's concerns in a separate letter that is available on the SEC website,⁵² FINRA will not re-address them in connection with this filing.

⁵⁰ See note 6.

⁵¹ CAI.

⁵² See letter to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, from Adam H. Arkel, Assistant General Counsel, FINRA, dated April 14, 2009. See also Partial Amendment No. 2 to SR-FINRA-2008-067 (June 30, 2009).

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. Please include File Number SR-FINRA-2010-061 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-2010-061. 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 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 10:00 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-2010-061 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.⁵³

Elizabeth M. Murphy
Secretary

⁵³ 17 CFR 200.30-3(a)(12).