

MEMO# 22552

May 23, 2008

FINRA Issues Four Proposals on Rulebook Consolidation; Comments due to FINRA by June 13

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TO: BROKER/DEALER ADVISORY COMMITTEE No. 15-08
EQUITY MARKETS ADVISORY COMMITTEE No. 24-08
SEC RULES MEMBERS No. 47-08
SMALL FUNDS MEMBERS No. 36-08 RE: FINRA ISSUES FOUR PROPOSALS ON RULEBOOK CONSOLIDATION; COMMENTS DUE TO FINRA BY JUNE 13

FINRA has recently issued four proposals to consolidate existing NASD and NYSE rules into a new FINRA rulebook. [\[1\]](#) The proposals, which still must be filed with and approved by the Securities and Exchange Commission before they can take effect, cover the following areas: financial responsibility; supervision and supervisory controls; books and records requirements; and investor education and protection. The most significant aspects of the proposals are summarized below. Comments are due to FINRA by June 13.

Financial Responsibility

Currently, both NASD and NYSE rules contain provisions governing financial responsibility. The proposed rules would incorporate many of these provisions but would streamline and reorganize the provisions. The scope of the rules generally would be limited to clearing firms, meaning that NYSE firms that are not clearing members would no longer be subject to these requirements.

- Authority to Increase Capital Requirements (based primarily on NYSE Rule 325(d)):

Under the proposal, FINRA would be able to impose greater net capital requirements on a clearing firm or require a clearing firm to restore or increase its net capital or net worth, when deemed necessary for the protection of investors or in the public interest.

- **Suspension of Business Operations** (based in part on NASD Rule 3130(e)): Unless otherwise permitted by FINRA, the proposal would require a firm to suspend all business operations during any period of time in which it is not in compliance with Rule 15c3-1 under the Securities Exchange Act of 1934.
- **Withdrawal of Equity Capital** (based in part on NYSE Rule 312(h)): A clearing firm would be prohibited under the proposal, without FINRA's prior written approval, from withdrawing equity capital for a period of one year or from withdrawing capital, paying a dividend, or effecting a similar distribution over a rolling 35-calendar-day period that would exceed 10 percent of the clearing firm's excess net capital.
- **Regulatory Notification** (based on NYSE Rule 325(b)): The proposal would require a clearing firm to notify FINRA within 24 hours when certain specified financial triggers are reached.

Supervision and Supervisory Controls

The proposals would incorporate existing NASD and NYSE supervision and supervisory control rules and rewrite certain provisions of the rules in a manner that provides firms with greater flexibility to tailor their supervisory and supervisory control procedures to reflect their business, size, and organizational structure.

- **Supervisory System**: The proposal would require a firm to designate an appropriately registered principal(s) with authority to supervise each type of business in which the firm engages, regardless of whether registration as a broker-dealer is required for that activity.
- **Review of Member's Investment Banking and Securities Business**: The proposal would require that a principal review all transactions relating to a firm's investment banking and securities business. The proposal also would add new supplementary material clarifying that the review may be risk-based.
- **Supervision of Outside Securities Activities**: The proposal would require an associated person to obtain a firm's prior written approval before engaging in any outside business, but would add an exception for bank-related securities activities of a dual employee.
- **Review of Customer Complaints**: The proposal would incorporate existing NASD and NYSE requirements regarding customer complaints, but would be limited to written (including electronic) customer complaints.
- **Documentation and Supervision of Supervisory Personnel**: The proposal would eliminate the prescriptive provisions in the existing rules concerning the supervision of a producing manager's customer account activity, including the requirement to impose heightened supervision when any producing manager's revenues rise above a specific threshold, and replace them with a new provision that would address potential abuses in connection with the supervision of supervisors.
- **Supervisory Control Systems**: The proposal would retain the NASD testing and verification requirements, including the requirement to prepare and submit to a firm's senior management a report at least annually summarizing the test results and any necessary amendments. The proposal also would apply certain content requirements in NYSE Rule 342.30 to firms that reported \$150 million or more in gross revenue on

their FOCUS reports in the prior calendar year.

Books and Records Requirements

Based in large part on the current NASD and NYSE recordkeeping rules, the proposed rules would rewrite the books and records provisions with three goals in view: to streamline the rules to make them as clear as possible; to group the requirements along similar subject matter lines to make finding them a more intuitive process and to provide firms with a better understanding of the regulatory scheme; and to eliminate the requirements contained in the current NASD and NYSE rules that have become obsolete or otherwise duplicative.

- **Customer Account Information:** The proposal would incorporate the current requirement under NASD rules that a firm maintain certain information relating to customer accounts, but would simplify the requirement by requiring the firm to maintain the name of the associated person, if any, responsible for the account rather than the signature of the registered representative introducing the account.
- **Discretionary Accounts:** The proposal would simplify and clarify current requirements relating to discretionary accounts, including that a firm must maintain discretionary accounts and exercise discretion in the accounts to the extent permitted under the federal securities laws.

Investor Education and Protection

- The proposal, which is based on NASD Rule 2280, would require a firm, with certain exceptions, to provide customers with FINRA's website address and information regarding FINRA's BrokerCheck program at least once every calendar year. The proposed rule also would clarify that the information required under the rule may be provided electronically to customers.

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endnotes

[1] See Proposed Consolidated FINRA Rules Governing: Financial Responsibility, FINRA Regulatory Notice 08-23 (May 2008); Supervision and Supervisory Controls, FINRA Regulatory Notice 08-24 (May 2008); Books and Records Requirements, FINRA Regulatory Notice 08-25 (May 2008); and Investor Education and Protection, FINRA Regulatory Notice 08-26 (May 2008). FINRA's press release and a link to the proposals can be found at <http://www.finra.org/PressRoom/NewsReleases/2008NewsReleases/P038499>.

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